# Table of Contents

**Executive Summary** .................................................................................................................. 4

**Section 1** .................................................................................................................................... 7

**Introduction** .................................................................................................................................. 7

1.1 Background .................................................................................................................................. 7
   Economy and poverty .................................................................................................................. 7
   Socio-economic development .................................................................................................... 8

1.2 Context ......................................................................................................................................... 9

1.3 Study Methodology ..................................................................................................................... 9

1.3. Study Limitations ...................................................................................................................... 10

**Section 2** ....................................................................................................................................... 11

**Key Findings** ............................................................................................................................... 11

2.1 Overview of the tax system in Nepal ...................................................................................... 11

2.2 Distributions of tax burden and progressivity ........................................................................ 12
   2.2.1 Personal Income Tax ........................................................................................................... 12
   2.2.2 Property Tax ....................................................................................................................... 12
   2.2.3 Presumptive tax .................................................................................................................. 13
   2.2.4 Corporate income tax ......................................................................................................... 14
   2.2.5 Value Added Tax (VAT) ..................................................................................................... 15

2.3 Gender sensitivity of tax system .............................................................................................. 15

2.4 Revenue sufficiency and tax leakages ..................................................................................... 16
   2.4.1 Sufficiency ........................................................................................................................ 16
   2.4.2 Illicit financial flows .......................................................................................................... 16
   2.4.3 Tax balance among three units of governments ................................................................ 17

2.5 Revenues .................................................................................................................................... 18
   2.5.1 Tax Revenues ..................................................................................................................... 18
   2.5.2 Non- Tax revenues .......................................................................................................... 20
   2.5.3 Taxpayers ........................................................................................................................ 20
   2.5.4 Tax competition ................................................................................................................. 20

2.6 Tax Administration in Nepal ................................................................................................... 20
   2.6.1 Organization of the administration .................................................................................. 20
   2.6.2 Staffing, Capacity & Oversight ....................................................................................... 21

2.7 Tax incentives and tax evasion ................................................................................................. 22
   2.7.1 Tax Incentives .................................................................................................................... 22
   2.7.2 Tax evasion ....................................................................................................................... 25
   2.7.3 Tax dues, non-payment of taxes & other forms of tax losses ........................................ 27

2.7 Government Spending ............................................................................................................. 28
   2.7.1 Education ........................................................................................................................ 28
   2.7.2 Health .............................................................................................................................. 29
   2.7.3 Agriculture ....................................................................................................................... 31
   2.7.4 Social protection .............................................................................................................. 31
   2.7.5 Gender Equity and Social Inclusion (GESI) ...................................................................... 32

2.8 Transparency and Accountability of the Tax System ............................................................ 32
Executive Summary

Context:
Tax is becoming an increasingly prominent part of the global agenda around poverty reduction; well-functioning domestic tax systems are now frequently championed as a means towards sustained economic growth and national self-sufficiency. Taxation is also the cornerstone of the social contract between state and citizens – quality gender responsive public services provided by the state in exchange for taxes paid – and therefore, a vital path to build legitimacy and a sense of fairness. This is predicated on a tax system that is based on principles of transparency, accountability and participation.

The goal of the Fair Tax Monitor (FTM) is to strengthen advocacy activities on equitable and fair taxation at local and global levels. It provides an overview of national tax systems, identifies the main challenges within these systems and charts new courses of action that will lead to fair tax systems.

Methodology:
This study utilized FTM’s methodology for the uniform data collection and analyses in different countries. For this study a combination of both primary and secondary sources were adapted for the information. A desk review of secondary data/information was performed to acquire in-depth insights into the taxation mechanism. The primary qualitative interviews were conducted with various stakeholders supplemented and triangulated the overall observations from the secondary data.

Key findings:
Nepal has achieved strong tax performance despite policies that contributed to the proliferation of costly tax incentives. A total revenue of NPR. 267.30 billion was collected from including divisible VAT and excise duty from domestic production during FY 2017-18 and a total of 29.41 billion has been distributed to provinces from the revenue collected till Mid-March 2018. In addition, government’s income has been increased to 19.6 percent as compared to FY 2017-18 and revenue growth has been 21.7 percent. Nepal, a predominantly agricultural country, derives one-third of its GDP from agriculture. Remittances are equal to one-third of the GDP. In the past few years, there is a larger structural change occurring in the economy; contribution of agriculture and industry is declining while that of service sector is increasing. In FY 2015/16, the contribution of agriculture sector to GDP was 35 percent while that of non-agriculture sector was 65 percent.

The tax to GDP ratio is on the higher side for Nepal, largely due to the undervaluation of the GDP, inflated due to remittance influx. The increase in the tax to GDP ratio led to increase in the overall GDP, subsequently increasing the total budget on education, health and social protection. However, the share of budget allocated on education, health and social protection has not increased. Nepal does not suffer from chronically high debt/dependence on international aid. Nepal recorded a total external debt equivalent to 30 percent of the country’s GDP in 2019. Although Nepalese economy has observed wide fluctuation in GDP growth rates (plummeting to 0.6% in 2016) during the last decade, Nepal has not adopted any austerity measures, thanks to a sizable amount of remittance received every year.

Government of Nepal introduced gender responsive budgeting and started to track the amount across all sectors since 2012. In FY 2018/19, 14 percent of the total government budget was categorized as gender responsive. In a broader outlook, there is a positive gender discrimination in PIT. A rebate of 10% of tax liability is provided to women (not with couple status) on their income from employment.
However, the tax rebates are outweighed by unscientific and gender biased thresholds. The government has provided 50 percent discounts in such sales tax of land if the land is being purchased by women. The provision has significantly boosted the women’s ownership over land and house, though the effect is yet to be visible at the national scale.

However the IFF issues in Nepal seen prominently with several fund mismanagement issues can be found in The Auditor General’s report FY 2017/18. Transparency International (TI) has repeatedly flagged issues related to illegal appropriation of public funds. Latest studies show that the Illicit Financial Flows (IFF) drained from Nepal on an average far exceeds the Official Development Assistance (ODA) the country receives as grants from the donor community. The major reasons for IFFs include the decade-long internal conflict and political instability, prevalence of corruption in the bureaucracy and business community, tax evasion, lack of accountability and transparency in the private sector, low confidence of investors, and challenges with safeguarding the right to private property.

Nepal has been successful to steadily increase the inland revenue during the last decade. The country has nearly doubled the size of its fiscal budget within the last five years. By managing the swift transition from unitary to federal structure of government amidst widespread skepticism on whether the country would have enough financial resources to shoulder the transition, Nepal has already shown the potential to increase the inland revenue. The increase, however, comes from the tightening and administrative sharpening of the tax collection process rather than the switch to the progressive taxation mode.

The key challenge for the tax administration mechanism in Nepal is its complete disconnect from the evidence. The tax related decisions are made arbitrarily without any solid reference to the key source variables such as purchasing power of taxpayers, their income distribution, and tax accountability/justice. The taxation system in Nepal is clearly from being transparent and accountable to the public. It is evident from the fact that government does not disclose the purpose of collecting tax, utilizing it for the stated purpose, and returning it to the public in case of meeting the resources. For example: the tax baskets such as social security tax fund and education service tax fund have remain obsolete, and the tax rates, though the total collection amount is small, can be ranked among the worst – an individual with income as small as USD 1,200 is liable to pay a minimum tax of 20 percent on the annual income. The concept of tax return does not exist in theory let alone in the practice. Tax is considered all but the liability of the people to pay to government. In such a situation, there is a natural incentive for people and businesses to find tricks to avoid paying taxes. Nepal is losing large sum of tax revenue in the form of tax incentives and tax non-payments, disproportionately favoring large businesses.

While this report does not deny a fact that there is a huge potential and a need to increase the overall tax revenue of the country, particularly through proper valuation of the GDP, expansive tax coverage with the reduced tax rates, and progressive tax reforms. The tax system in Nepal clearly requires a transformation guided by a policy commitment to make it equitable and just.

**Recommendations**

The study findings call for wide and comprehensive advocacy initiated centered on tax fairness and justice. The taxation should be progressive enough to allow government to fetch much needed revenue to support its growing demand for capital expenditure. The following are the study recommendations:
✓ Advocacy on people centered tax administration that is transparent and accountable to the taxpayers
  o Increase the minimum tax threshold and reduce the income tax rates for lower income groups
  o Make tax collection and utilization route transparent and report to public regularly on tax collection and utilization
  o Expand the number of taxpayers by increasing the coverage of PAN and other forms of tax identifiers
  o Specific tax amount introduced and kept in separate basket fund to finance specific priorities so that people find a motive to submit tax
Section 1
Introduction

1.1 Background

Nepal is set to maintain a much-needed political stability after decades of political fragility and uncertainty. After promulgation of Constitution of Nepal, 2015 through constituent assembly, the transition from unitary to federal mode of governance is ongoing amidst plethora of challenges and plenty of opportunities in the hindsight. The country has been restructured in 753 local governments and 7 provincial governments. The constitution assumes coordination, collaboration, and co-existence among the three levels of government. After a long period of internal conflict and uncertainty there is a degree of cautious optimism as the country moves towards the full-fledged implementation of the constitutional commitments and provisions that underlie state restructuring. As of June, 2018, the newly elected governments have assumed office in all three layers of governments, and are currently in the process of unveiling their annual work plan and budget for the fiscal year 2018/19 after the budget speech made by federal government in early June, 2018. Governments at all three levels are prioritizing the goal of peace, stability, and economic prosperity. The expectations of public are high with all three governments at a time when provincial and local governments struggle in terms of capacity, technical know-how, resources, and clear guidelines and authorities. The tug of power, authorities and resources among the governments has already surfaced.

Economy and poverty

Nepal's economy is steady for three consecutive years thanks to a stable government after a long hiatus amid a long process of transition in governance mechanism. As per the projections made by ADB and World Bank Nepal had an impressive growth of economy of 7.5 percent in 2016-17 after 20 years reversing the meagre figures (0.75 percent) in 2015. However more than 8.1 million Nepalese live in poverty. Women and girls are more likely to be poor, despite the significant contribution they make to the economy, especially through unpaid care and household work. The income of the richest 10 percent of Nepali is more than three times that of the poorest 40 percent. In Nepal, top bank executives earn more than 100 times the salary of an average worker. The wealthiest seven percent of households own around 31 percent of agricultural land. More than half of Nepali farmers own less than 0.5 hectares of land, and 29 percent of the population do not own any land at all. Women work long hours on agricultural land, yet 81 percent are landless. Gross Domestic Product of Nepal1 grew 6.7 percent in 2018 compared to last year. This rate is 15 -tenths of one percent less than the figure of 8.2 percent published in 2017. According to their GDP per capita, Nepal is in 166th position. Nepal mainly exports carpets, beverage, textile, tea and plastic. Its main export partners include India, the US, Bangladesh and Germany. According to the World Bank, Nepal is 19th largest receiver of remittances with $8.1 billion.

The Economic Survey 2018/19 published by Nepal Rastra Bank reported that the Per Capita Income for FY 2018/19 is expected to be around Rs 1,17,455 (US $ 1034).2 According to the National Living Standard Survey 2014, that uses consumption quintile as a basis to poverty considering a person living with less than $1.5 per day as poor, around 25 percent of the population is below the poverty line. The multi-dimensional poverty index also indicate towards the figure of same proportion. Based on the study on multi-dimensional poverty index conducted by National Planning Commission in

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1 https://countryeconomy.com/countries/nepal
technical collaboration with Oxford University, close to 29 percent of Nepal's population is multidimensionally poor. Based on the report, the indicators that contribute most to multidimensional poverty in Nepal are under-nutrition and households that lack any member who has completed five years of schooling. The distribution of poverty incidence is wide across the country with large proportion of poor living in province 2, 6 & 7. Human Development Index (HDI), which is an average measure of life expectancy, adult literacy rate and gross domestic product per capita, measured wider disparities based on caste and ethnicity than by geographic region. In 2006, three caste groups comprising of Madhesi Brahmin and Chettri, Newar and hill Brahmin had a higher HDI value of (0.6 and above) than that of Dalits and Janjatis both of the hills and tarai. Madhesi Dalits had the lowest HDI value of 0.383 followed by Muslims at 0.401 (ADB, 2017).

**Socio-economic development**

Nepal society is governed by patriarchal norms that limit women's opportunities for self-determination and empowerment. True especially for rural areas, discrimination against women exists at the household, workplace, and also in the law in issues pertaining to land ownership, and citizenship acquirement. The discrimination also exists based on caste and ethnicity. Dalits and some minority ethnic groups lag behind heavily in terms of human development, and access to various services. Similar to figures from rest of the world, the rich have access to and control largest portion of the national wealth. Based on national figures, 20 percent of rich people have access to 56 percent of the total national wealth. Gender Development Index (GDI) adjusts the average achievement of each region in terms of life expectancy, educational attainment, and income in accordance with disparity in achievement between men and women. Nepali women fall way below their male counterparts with regards to GDI. Based on figures from National Living Standard Survey 2011/12, the life expectancy rate is 67.9 for female and 65.5 for male population, the average age of marriage was close to 24 for Male compared to 20 for female, the adult literacy rate is 71.6 percent for male compared to 44.5 percent for female, and the estimated earned income of $949 in PPP in purchasing power parity as against $1,868 for men. In terms of access to resources, importantly land, women's access is very limited. Here, it will be worthy to note that majority of land in Nepal get transferred from one to another generation through patriarchal lineage. Around 19.7 percent had land in ownership of female compared to 11.7 percent during 2004. During last two decades, the urban areas have expanded heavily. The urban rural divide is also clearly visible in Nepal. In terms of poverty rate, in urban areas, 15.5 percent lived below poverty line compared to 27.4 percent for urban area, and 25.2 percent for entire country (NLSS, 2011/12). For Nepal, the gini-coefficient was 0.328 which was 0.353 for urban area, and 0.311 for rural areas (CBS, 2014). This is the reduced figure from 2004 (0.414).

Despite meager outlook, there have also been some impressive changes during last two decades. The final status report on Millennium Development Goals (MDGs) published by National Planning Commission (NPC) in 2016 indicated that Nepal was successful to achieve nearly all goals and targets set for 2015. The number of schools and students has expanded over the years and infant and maternal mortality rates have decreased. The net enrolment rate for primary school has increased to 98 percent (DOE, 2016). Gender parity has been achieved at primary and secondary education levels with gender parity index (GPI) scores of 1.09 in primary and 1.0 in secondary education in 2015. The improvements have come amidst multiple socio-economic challenges.

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3 Nepal_MPI.pdf (npc.gov.np)
5 National Living Standard Survey (NLSS 2011-12)
1.2 Context

Tax is becoming an increasingly prominent part of the global agenda around poverty reduction; well-functioning domestic tax systems are now frequently championed as a means towards sustained economic growth and national self-sufficiency. But most of the policy discourse centers on a rather technical set of questions concerning system design at the macro level, driven by the a priori assumption that domestic revenue generation is necessary for national development (and that the most important question, therefore, is how to build better tax regimes). Taxation is also the cornerstone of the social contract between state and citizens – quality gender responsive public services provided by the state in exchange for taxes paid – and therefore, a vital path to build legitimacy and a sense of fairness. This is predicated on a tax system that is based on principles of transparency, accountability and participation. Generally, governments tend to focus more on the revenue raising objective of taxation whilst prioritizing the roles of redistribution, representation and repricing, which are important in addressing poverty and inequality.

The Fair Tax Monitor (FTM) project started in December 2014 as part of the CRAFT (Capacity for Research and Advocacy for Fair Taxation) program. It was developed by Oxfam Novib (ON) in collaboration with Tax Justice Network-Africa (TJNA) and other partner organizations in the pilot countries: Bangladesh (SUPRO), Pakistan (Indus Consortium), Senegal (Forum Civil) and Uganda (SEATINI). It was initiated as a pilot project to develop a common research framework and an online advocacy tool, and to subsequently test them in practice in the selected focus countries. The project foresees regular updating and becoming a reliable source of information and analyses on fiscal policies and practices, especially related to equitable and fair taxation.

Purpose of the research. The Fair Tax Monitor’s overall goal is to strengthen the advocacy activities at the local and global levels on equitable and fair taxation which was initiated as a pilot project to develop a common research framework and an online advocacy tools. It provides an overview of national tax system; identifies the main challenges they face and charts a new cause of actions that will lead to fair tax systems. The tool provides reliable evidence for the advocacy and lobby work for the partners which will strengthen their position and increase credibility. Furthermore, the FTM compares key elements of tax systems and thus complements the activities of Oxfam's global 'Even it Up!' campaign as well as the Tax system standing in the context of Nepal.

1.3 Study Methodology

The FTM is an evidence-based advocacy tool that provides an overview of national tax systems and identifies the main bottlenecks and opportunities for making tax systems fairer and raising sufficient revenues to finance quality gender responsive public services. The tool evaluates the performance of national tax systems and creates a strong foundation for programming to influence tax policy at the national level. The FTM Working Group has defined a fair tax system as: (1) progressive and serves as a mechanism to redistribute income in a gender responsive way; (2) allows to raise sufficient revenue to perform government functions and provide high-quality essential public services; (3) refrains from and eliminates tax exemptions and incentives to the elite (individuals and corporate); and (4) tackles causes of illicit capital flight and tax evasion & avoidance by multinational companies and the wealthy.

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The FTM uses the country’s data reports and the methodology initiated by Oxfam Novib and her sister-organizations. The structure of the methodology used to analyze the data is rooted in the Common Research Framework (CRF) and is divided into six thematic categories used for evaluation. These categories are meant to cover the main issues that tax systems in developing countries face today, and to reflect the idea of a fair tax system. The categories included in the FTM’s methodology to evaluate the tax systems are:

i. Progressive Tax System
ii. Sufficient Revenues
iii. Well Governed Tax Exemptions
iv. Effective Tax Administration
v. Pro-Poor Government Spending
vi. Accountable Public Finances

The country reports collect information uniformly and provide analyses of the same issues across countries. Therefore, the methodology is equally applied in the analysis of data collected in the different country reports, which subsequently allows for a comparison between different aspects of national tax systems. The methodology is based on the experience of both local and international organizations, and simultaneously builds on the knowledge of experts in global tax policies. (key questions as per the CRF is attached in the Annex)

Along with the FTM, the study has a combination of both primary and secondary sources for the information. A desk review of secondary data/information was performed to acquire in-depth insights into the taxation mechanism. The primary qualitative interviews conducted with various stakeholder supplemented and triangulated the overall observations from the secondary data.

1.3. Study Limitations

The study faced plenty of challenges with the global pandemic COVID-19, which caused the government and local government officials working for the containment of the number of cases in their Palika and province. This delayed and limited the participation for the information about the tax system.
Section 2
Key Findings

2.1 Overview of the tax system in Nepal

Nepal has achieved strong tax performance despite policies that contributed to the proliferation of costly tax incentives. A total revenue of NPR. 267.30 billion was collected from including divisible VAT and excise duty from domestic production during FY 2017-18 and a total of 29.41 billion has been distributed to provinces from the revenue collected till Mid-March 2018. In addition, government's income has been increased to 19.6 percent as compared to FY 2017-18 and revenue growth has been 21.7 percent. Nepal, a predominantly agricultural country, derives one-third of its GDP from agriculture. Remittances are equal to one-third of the GDP. In the past few years, there is a larger structural change occurring in the economy; contribution of agriculture and industry is declining while that of service sector is increasing. In FY 2015/16, the contribution of agriculture sector to GDP was 35 percent while that of non-agriculture sector was 65 percent.

Table 1. Basic economic details

<table>
<thead>
<tr>
<th></th>
<th>2013/14</th>
<th>2014/15</th>
<th>2015/16</th>
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<tr>
<td>GDP (In Billion Rupees)</td>
<td>1965</td>
<td>2120</td>
<td>2249</td>
</tr>
<tr>
<td>GDP (In Billion Dollars) Approx.</td>
<td>19.6</td>
<td>21.2</td>
<td>22.5</td>
</tr>
<tr>
<td>Per Capita Income (In USD, Approx.)</td>
<td>724.1</td>
<td>770.8</td>
<td>809.2</td>
</tr>
<tr>
<td>% of growth in real GDP</td>
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<td>2.73</td>
<td>0.6</td>
</tr>
<tr>
<td>% of contribution of agriculture in GDP</td>
<td>35.2</td>
<td>34.7</td>
<td>34.8</td>
</tr>
<tr>
<td>% of contribution of remittance in GDP</td>
<td>27.6</td>
<td>29.1</td>
<td>32.1</td>
</tr>
</tbody>
</table>

Source: NRB, Economic Survey, 2015/16

The size of GDP (at current price) of Nepal was USD 22.5 Billion during FY 2015/16 equivalent to NPR 2249 billion. In 2016/17, GDP grew at a rate of 6.94 percent reaching a record 9-year high primarily due to low base rate at 0.6 percent in the previous year marred by earthquake and economic blockade (World Bank, 2017). The growth rate of GDP - lowest during FY 2015/16 (0.6%) - is set to increase by 7.5 percent during FY 2017/18. But good monsoon and sustained electric supply both boosted growth in agriculture and non-agriculture sectors.

Chart 1. GDP of Nepal (In billion Nepali Rupees - NPR)

Source: NRB, Economic Survey, 2015/16

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10 Ministry of Finance 2016
2.2 Distributions of tax burden and progressivity

2.2.1 Personal Income Tax

Personal income tax (PIT) is a constituent of the direct tax and includes the three heads of income (i.e., business – sole proprietor, employment and investment), which emerge through factors of production like labor plus capital, labor and capital respectively of economics. However, according to the income tax of Nepal, it does not include the exempted income and income of final withholding payments. There is a threshold for paying personal income tax as per the standard of living based on the income per annum. For income less than NPR 400,000 for an individual or NPR 450,000 for a couple, the applicable income tax is one percent. For any additional income of NPR 100,000, the applicable income tax rate is 10 percent. And, for the additional NPR 200,000, the applicable income tax rate is 20 percent. For an aggregate individual income beyond 600,000, the applicable income tax rate is 30 percent. Additional Tax remaining above NPR 2,000,000 is at 36 percent.11

The personal income tax is applicable to everyone. Taxpayers registered as sole proprietorships (or income from businesses and investments) or receiving pension income are exempt of paying 1% tax social security tax on the first slab of income. Similarly, the employees catered at rural workstations are subject to pay lower amount of tax. The locations have been categorized in the order of A-E from difficult to convenient duty stations. The taxpayers in difficult working locations are subject to higher income tax threshold. Non-Residents or foreigners have to pay 25 percent of their income per annum.12

The tax rates are updated almost every year which shows modest increase. The tax-slab in FY 2017/18 has been updated from the slab rate of FY 2016/1713. However, the increase is based on discretion and does not reflect inflation and rising cost of living. Also, even though there are effective tax rates for higher income groups, but with their modest income range of NPR 2,000,000 tax distribution doesn't match as per the income distribution which is not adequately fare. The highest income quintiles pay as much as those of lower middle-income group.

2.2.2 Property Tax

House and Land Tax Act, 2019 has laid out the details on property tax. The tax rate differs based on years of ownership. If the land and building is owned for period less than 5 years, one requires to pay at five percent of the value. If the ownership of land and building is for more than 5 years, the tax rate is 2.5 percent14. It is worthy to note that the tax collection through the land and building tax is way below its potential. The formal land valuation set by the government, that government bases to collect tax, is way less (often 10 times less) than the actual value (i.e., the unit rate used in the most recent purchases). There is also a tax applicable during the selling/buying of the land. At sales, the tax rate applied is 4.5 percent in Municipal areas and two percent in non-municipal areas, and women get 50% discount in the tax if they are buying a land.15 As unconventional as it is, the buyers are required to pay sales tax, and there are no mandatory requirements for the sellers (who make huge profit out of land business) to pay tax in any form.

12 IRD- Personal Income Tax , 2076-77, Income tax Act 2058
13 Budget 2075/76 (amendment to Income Tax 2058)
The Municipal tax office, on the basis of the prescribed principles, valuate the house and land of their area and determine the taxes. The valuations are often based on the relative prices of the area and types of houses. The local governments are entitled to collect land and house tax and are required to report to the federal government on their collections and shared revenues.

If the land is used for agriculture, any income derived by an individual through agriculture is not subject to a tax. However, if a business or a firm makes income out of agriculture or any other business that involves land as a capital, the taxes are equivalent to other sectors (25% on the profit). There are some other exceptions to it. The informal sector businesses and person-to-person businesses that utilize land are also not subject to tax. However, a modest rate of tax is application in income obtained by selling land (paid by the buyer). The government has provided 50 percent discounts in such sales tax of land if the land is being purchased by women.

Financial assets like shares, bonds, mutual funds and bank deposits incur tax. On the gains from disposal of interest held in a resident entity listed in stock exchange, there are two types of taxes: (i) five percent if received by a resident natural person (10% in case of financial assets not listed with Nepal Stock Exchange - NSE), and (ii) 10 percent if it is received by others (15% in case of non-listed in NSE). The net gains derived from the shares listed in NSE are subject to tax at the rates of five percent, 10 percent and 25 percent respectively for resident natural person, resident entity and others. For the gains made from assets not listed in NSE, tax rates are 10 percent higher than the listed ones. The dividends are taxed at five percent of the total amount, except for mutual funds that are exempt from tax. The interest income made by individuals is subject to five percent tax while that by bank and financial institutions is subject to 15 percent tax.

The wealth taxes are not progressive. The tax rates are same regardless of the taxable amount. There are, however, some distinct rates and exemptions. For example: women are provided with 50% discount in the new land registration tax. Since 2001, capital gains taxes apply to all economic sectors. There are, however, some exceptions to it. If a building is owned and resided for a period more than 10 years, a business is not liable to pay capital gains tax of that particular building. There is no information available to verify whether the aggregate wealth tax has increased or decreased in recent years. The wealth tax rates remain unchanged in recent years. IRD does not report aggregate wealth tax because it is not considered a significant tax envelope. For example: rent tax, covering a bulk of wealth tax, accounts to only 1.5 percent of the total internal tax revenue.

2.2.3 Presumptive tax

The presumptive tax is applicable to all types of businesses, be it formal or informal. However, it is non-existent in reality since the informal sector is out of the tax ecosystem. The presumptive tax is not charged based on the size of the turnover but rather based on the tax bracket. A single person with an income of NPR 200,000 or an annual turnover less than two million NPR have to pay a lumpsum tax amount depending on where they live. If it is in Metropolitan then they have to pay a tax of NPR 7,500, if it is in Municipality, then have to pay tax of NPR 4,000 and if in other area then have to pay NPR 2,500. In Nepal, formal businesses are required to pay advance tax in three tranches: 14 Jan, 13 April & 15 July. However, the presumptive tax system is not based on feasibility assessment and are entirely based on discretion. For example, the Government of Nepal recently increased the
presumptive tax by 50% compared to the last year (from 2018/19 - 2019/20). Needless to say, there was no evidence used in determining the rates of tax. The presumptive tax, however, struggles in terms of actual collection.

The presumptive tax rules are fairly clear. The section 96 of the Income Tax Act also clearly mentions that there will be a penalty of NPR. 100 per month applicable for the non-payment. IRD provides clear directives to calculate the tax amount. Small enterprises with annual turnovers of less than NPR 2 million will be eligible for a tax exemption of 75 percent while those whose turnover is between NPR 2 million and NPR 50 million will be eligible for 50 percent tax exemption. Enterprises with an annual turnover between NPR 5 million and NPR 10 million will receive an exemption of 25 percent, Cooperatives that operate in rural municipalities will no longer have to pay income tax, according to the new budgetary announcement. However, cooperatives operating in municipalities, sub-metropolitan cities and metropolitan cities will be required to pay five, seven and 10 percent income tax, respectively.19 A small business with an annual transaction of less than 2 Million NPR a year is not subject to pay business tax. However, there is no difference in applicability of presumptive tax.

2.2.4 Corporate income tax

A company in respect of an income year is resident in Nepal and fulfills any criteria i.e. is incorporated under the law of Nepal or, the management of which is effective in Nepal in an income year or within the law of Government of Nepal or Provincial government have to pay corporate income tax. Resident Company are taxed on the income generated by them regardless of the source of the income and non-resident Company are taxed on the income generated by them within the extent that the sources of income is in Nepal20.

The minimum CIT rate is 25 percent and maximum rate is 30 percent. The tax rates differ by type of entities: (a) in case of Special industries (mainly manufacturing other than alcoholic & tobacco producing industry) the normal rate of tax will be 20 percent, and some rebates are provided based on the number of people employed by the industry, and (b) in case of Industry established in ‘Special Economic Zone’ recognized in mountain areas or hill areas by the government, there will be 100% tax exemption for 10 years followed by 50 percent tax rebate after that. However, the CIT rate in Nepal has remained constant for last five years21.

However, the tax rates are not different by the levels of profits but are different by sectors. Small businesses have to pay 25 percent tax on their profits. Banks, telecommunications, internet service providers, money transfer services, merchant traders, brokerage service, liquor and tobacco companies, and petroleum companies have to pay 30 percent of their profits. Cooperatives have to pay 20 percent along and additional amount depending on whether they are located in urban municipality (5%) or metropolitan city (10%)22.

There are lower tax rates for Mini Small and Micro Enterprises (MSMEs). The MSMEs23 with an annual income less than NPR 2 Million are provided with 75 percent discount on their profit tax. The MSMEs
with an income between 2 Million to 5 Million NPR are entitled to 50 percent tax. The MSMEs with an annual income between 5 Million to 10 Million are provided with 25 percent discount. If an industry is set up in a very underdeveloped area or underdeveloped area (as defined in Industrial Enterprise Act), the applicable profit tax rate will be 10 percent and 20 percent respectively of the normal rate for 10 years from the year of establishment) regardless of their volume of business. As per Section 117(1)(b) of Income Tax Rules\textsuperscript{24}, penalties will be imposed if not paid on time. For delays, the taxpayers will need to pay 0.1 percent of assessable income without deducting any amount or Rs. 100 per month of delay whichever is higher. However, startups receive a discount of tax for seven years and the ones led by women and MSMEs in underdeveloped areas get discounts for 10 years. The micro-industries (as defined in the Industrial Enterprise Act) receive entire tax exemption for the first five years. If such industries are run by women, they receive 100 percent tax exemption for two additional years.

There is also a transfer pricing regulation though it is not entirely clear. Nepal provides relief against international double taxation to residents by granting foreign tax credits. This is restricted to an amount calculated by multiplying the Nepal income tax rate to the income subjected to foreign tax. Double tax reliefs can be claimed under the provisions of existing Double Tax Agreements that are negotiated with 11 countries\textsuperscript{25,26}.

2.2.5 Value Added Tax (VAT)

VAT is levied at a flat rate of 13 percent, which is applied to the invoice value. There are certain goods that are exempt from VAT. All exports, agricultural produce, small businesses of annual sales less than NPR 2 Million, and non-profit making non-governmental agencies registered within Social Welfare Council are exempt from paying VAT. The exemption, however, does not encompass essential female products.\textsuperscript{27} Based on the data published by the IRD\textsuperscript{28} the share of VAT has increasing trend. This is largely due to expansion of the sectors/businesses responsible to pay a VAT and increase in the number of new businesses registered with VAT. The VAT rate is a flat 13 percent for all VAT applicable items. A blanket approach was chosen to avoid confusion in billing. It contravenes with the agenda of progressive taxation. Some products/sectors such as agricultural products and non-profit making agencies are exempt from paying VAT. The luxury goods, imported from abroad, are subject to a high import tax rate. Such items include petroleum products (except aviation fuel and LP gas), motor vehicles, gold and jewelries etc.\textsuperscript{29}

2.3 Gender sensitivity of the tax system

The United Nations Development Program's (UNDP) Gender Inequality Index gave Nepal a score of 0.497 in 2015 with zero representing equality. In this index, which measures reproductive health, empowerment and economic status, Nepal ranks 115\textsuperscript{th} out of 188 countries for gender equality. Government of Nepal introduced gender responsive budgeting and started to track the amount across all sectors since 2012. In FY 2018/19, 14 percent of the total government budget was categorized as gender responsive.

\textsuperscript{24} Income tax Act 2058
\textsuperscript{25} Income Tax Act 2058, amendment 2063 Section 71
\textsuperscript{26} http://pkf.trunco.com.np/uploads/publication/file/Taxation%20Nepal%202019_20190805043400.pdf pg10
\textsuperscript{28} IRD-Value added tax
\textsuperscript{29} Budget, FY 2020/21, VAT Act 2052
In a broader outlook, there is a positive gender discrimination in PIT. A rebate of 10% of tax liability is provided to women (not with couple status) on their income from employment. However, the tax rebates are outweighed by unscientific and gender biased thresholds. An income threshold of 400,000 for a single individual and 450,000 for a couple only provides a tax threshold of 50,000 for either of spouses. The tax system, indirectly, assumes that one of the spouses, especially women, will make low level of income. In an ideal environment, the thresholds would be balanced.

The government has provided 50 percent discounts in such sales tax of land if the land is being purchased by women. These measures, depending on the geographical location, include a 25 per cent to 50 per cent tax exemption on registration when land is owned by a woman; a 35 per cent tax exemption for single women (Financial Bill 2072, Ministry of Finance); and joint registration of land in the names of husbands and wives with a fee of Rs. 100 (or less than $1)\(^{30}\). The provision has significantly boosted the women’s ownership over land and house, though the effect is yet to be visible at the national scale. There is a long way to go. Only 19.7 per cent of women own around five per cent of land throughout Nepal, and only around 11 per cent have effective control over their property\(^{31}\).

The startups receive a discount of tax for seven years and the ones led by women and MSMEs in underdeveloped areas get discounted for 10 years. The micro-industries (as defined in the Industrial Enterprise Act) receive 100% tax exemption for the first five years. If such industries are run by women, they receive 100% tax exemption for two additional years.

### 2.4 Revenue sufficiency and tax leakages

#### 2.4.1 Sufficiency

Tax revenue (as percentage of GDP) in Nepal was reported at 20.71 in 2017. In previous years, the ratio has fluctuated slightly and have remained between 15 - 20 percent. The tax to GDP ratio is on the higher side for Nepal, largely due to the undervaluation of the GDP, inflated due to remittance influx. The increase in the tax to GDP ratio led to increase in the overall GDP, subsequently increasing the total budget on education, health and social protection. However, the share of budget allocated on education, health and social protection has not increased. Nepal does not suffer from chronically high debt/dependence on international aid. In the current fiscal budget, only 23 percent of the development budget is expected to be financed through international aid/loan. However, the rate has steadily increased over the last two decades. Nepal recorded a total external debt equivalent to 30 percent of the country's GDP in 2019. Although Nepalese economy has observed wide fluctuation in GDP growth rates (plummeting to 0.6% in in 2016) during the last decade, Nepal has not adopted any austerity measures, thanks to a sizable amount of remittance received every year. In the budget for FY 2019/20, Government, however, is in the direction to cut down administrative structure and continue increasing funds to education, health and social work, at least in the papers.

#### 2.4.2 Illicit financial flows

The Auditor General’s report FY 2017/18 flagged several fund mismanagements issues in its report. Transparency International (TI) has repeatedly flagged issues related to illegal appropriation of public funds. Latest studies show that the Illicit Financial Flows (IFF) drained from Nepal on an average far exceeds the Official Development Assistance (ODA) the country receives as grants from the donor


community. A report published by the Global Financial Integrity (GFI), a US longtime authority on financial crimes, reveals Rs 62 billion has been drained from Nepal annually during the period of 2002 to 2011 in the form of IFF. On the other hand, the statistics maintained by the Ministry of Finance (MoF) shows that Nepal has received Rs 37 billion as grants annually during the same period. In recent years, Government of Nepal, in an effort to comply with donor requirements, have initiated some financial control mechanisms including the need to make certain documents/information transparent.

The major reasons for IFFs include the decade-long internal conflict and political instability, prevalence of corruption in the bureaucracy and business community, tax evasion, lack of accountability and transparency in the private sector, low confidence of investors, and challenges with safeguarding the right to private property. While some of these issues are related to domestic challenges such as tax administration and enforcement, governance issues and business climate, others require international cooperation to promote transparency in transactions across countries (such as transfer pricing and non-disclosure of deposits in overseas accounts). Other than some financial control mechanisms, largely ineffective, there were no concrete measures taken during the last five years.

### 2.4.3 Tax balance among three units of governments

There is clear demarcation in the constitution of Nepal 2015, on what the three-tier government can do when it comes to taxation. The major sources of revenue custom duty, Value added tax (VAT), excise duty, corporate income tax and personal income tax which is more than 80 percent of total tax revenue are assigned to be collected by the federal government. The province governments are assigned to collect entertainment tax, advertisement tax and registration charge of land and house concurrently. While property tax, land revenue, vehicle tax, business tax and house rent tax is assigned to be collected by the local level. However, the service charges, punishment and fine and tourism charge is concurrently collected by all three tiers of government. Also, the non-tax revenues derived from the corporate debt servicing is collected by federal government and non-tax revenues collected from user charges are assigned to local government in federal Nepal.

The natural resources revenues are shared by the province and local level with 40 percent provided to Province, two percent given to District Coordination Committee (DDC) and the rest is kept at the local level. Similar, private natural resources revenues are kept by the local level, but 13 percent VAT is sent to the federal government. However, in practice, the demarcations are not as clear between the three tiers of the government. This has led to double taxation, especially with the VAT and excise duty. Currently, a large chunk (80%) of the total tax is directly collected the federal government. This has affected the income of the province which have very small pool of resources and income sources to work with. Since VAT and Income Tax are collected by the central government, the excise duty even being demarcated by constitution to be collected by the federal government, are also being collected by province which is their prime source of income. Also, the tax rates amongst the local levels are not uniform for the same services. This has created the imbalance and conflict for tax collection within three tiers and people are getting the brunt of the issue.

In recent years, there is a public outcry that local governments have increased the tax rates as well as the tax base. In consultation with local government officials, it was noted that the federal government has left them with a lot of responsibilities and fewer number of resources. As a result, they have to come up with local level taxation. Since there are some limitations on what the local government can collect and maintain on their own, they are pressed to increase the tax rates wherever possible, as

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32 Constitution of Nepal, 2015
most of the tax collected in local levels have been utilized for administrative purpose rather than in social or development sector. Also limited knowledge and capacity of the revenue collectors in the local level (i.e ward and Palika) have also hindered and created loopholes for tax collection.

2.5 Revenues

In FY 2016/2017\(^{34}\), the total revenue of the country was around 4.5 billion US Dollars (498 billion NPR). The amount was big increment (of around 21 percent) from 4.1 billion USD in FY 2015/16 that increased with around 14 percent from 3.6 billion USD during FY 2014/15. Direct tax revenue makes up more than half of total national revenue. Compared to previous year, the direct tax revenue increased by 19 percent; indirect tax increased by 16 percent, non-tax revenue increased by 22 percent, and revenue from other sources increased by 110 percent.

Table 2. Revenue Details (In Million Rupees)

<table>
<thead>
<tr>
<th></th>
<th>FY 2014/15</th>
<th>FY 2015/16</th>
<th>% change</th>
<th>FY 2016/17</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct tax</td>
<td>227,710</td>
<td>243,500</td>
<td>6.9</td>
<td>290,540</td>
<td>19.3</td>
</tr>
<tr>
<td>Indirect tax</td>
<td>84,730</td>
<td>112,460</td>
<td>32.7</td>
<td>130,560</td>
<td>16.1</td>
</tr>
<tr>
<td>Non-tax revenue</td>
<td>44,180</td>
<td>49,910</td>
<td>13.0</td>
<td>60,870</td>
<td>22.0</td>
</tr>
<tr>
<td>Others</td>
<td>6,300</td>
<td>8,060</td>
<td>27.9</td>
<td>16,950</td>
<td>110.3</td>
</tr>
<tr>
<td>Total Revenue</td>
<td>362,920</td>
<td>413,930</td>
<td>14.1</td>
<td>498,920</td>
<td>20.5</td>
</tr>
</tbody>
</table>

Source: IRD Annual Report, 2017

2.5.1 Tax Revenues

Taxes on goods and services contribute to 41.36% of the total revenue. Taxes on income, profits and capital gains, and taxes on international trade and transactions comprise 25.68%. Based on the total revenue collected during the FY 2018/19, a total of NPR 499.58 billion has been collected from the custom, excise VAT, and taxes on private health and education providers out of total revenue of NPR 732.22 billion. The share of direct taxes in total revenue has increased compared to the last five years. In fact, the proportion of tax in total revenue has gradually increased during the last four years - 87.7 (2014/15), 87.4 (2015/16), 90.7 (2016/17), 90.8 (2017/18).

In the last decade the proportion of tax in comparison to GDP has improved. For the FY 2015/16 percentage of tax revenue vis-a-vis GDP was around 19 percent. However, Nepal has still one of the lowest tax-to-GDP ratios in South Asia. Low tax-to-GDP ratio indicates towards poor domestic revenue collection and underestimated gross domestic product. The ratio of revenue to GDP is slightly higher. In FY 2015/16, ratio of total revenue to GDP was 21.4 percent.

Chart 2 : Tax to revenue and tax to GDP ratio

\(^{34}\)IRD Annual Report 2018/19
Compared to countries with same income level, Nepal has higher tax/GDP ratio. Nepal maintains GDP to tax ratio of over 21 percent. The evidence showed that total tax revenue to gross domestic product (GDP) ratio of Nepal is the highest in the SAARC region. It means that either Nepal produces only a small amount of goods and services or it imposes a high rate of tax to its citizens. The former is more likely to be true given that there are plenty of evidence to suggest tax loss and poor tax collection (due to presence of a large informal sector). One plausible reason for such a high ratio might be a large dependence of the country's GDP on remittance. In Nepal, there is not a clear plan to improve Tax to GDP ratio. In fact, none of the government expenditure projections are based on gradual change in Tax to GDP ratio. The tax rates are decided on discretion evident from the fact that some taxes are introduced or entirely removed during the annual budget. However, there has been gradual increase over the last five years. the main mission as enlisted in Strategic plan is to ensure appropriate tax policies and better services for improved tax compliance.

**Sources of revenues**

Inland Revenue Department’s collection makes up 42.43 percent of total revenue as of FY 2016/17. In FY 2019/20, income tax (57%) and VAT (25%) were the biggest contributors to revenue. Custom duty and excise contributed to nearly one sixth to the revenue. But the tax collection from health and education services is nominal. Only one percent of the tax revenue comes from health service fee while the tax revenue from education service fees is close to zero. Overall, taxes levied on goods and services such as value added tax and sales tax were the major source of tax revenue in Nepal.

**Chart 3: Sources of tax revenue**

*Source: IRD Annual Report, 2020*
2.5.2 Non-Tax revenues

A licensee of the excavation shall have to pay royalty for each time of export of the minerals from the mining gate on the basis of the quantity of such exported minerals. There are no specific provisions related to windfall taxes on royalty gains or at least the documents/information are not available to verify it. No ring fencing is allowed for extractive companies.

2.5.3 Taxpayers

There are two types of tax identification numbers – Permanent Account Number (PAN) and Value Added Tax Registration Number (VAT). All taxpayers are required to have a PAN number and the taxpayers, required to pay VAT, have to obtain a VAT number. However, tax identification is not mandatory to obtain certification or licenses for businesses. Moreover, it is not essential for an individual to have a PAN number to own a business nor to open a bank account. For a formal business, the business, not the owner, can have a PAN number. The proportion of population who maintains an active PAN account is very small. PAN has long way to be an universal tax identifier.

The number of taxpayers is ever increasing. Between 2018 to 2019, the total number of taxpayers increased by 800,000 and reached 2.9 Million. The percentage of registered businesses accountable to pay taxes has increased every year. Between 2017-2018, more than 110,000 businesses obtained permanent account number for tax purposes from IRD.

The Inland Revenue Department (IRD) has always used push model to expand the coverage of tax ecosystem. The informal businesses, likely to have transactions less than NPR 2 Million, are entitled to lower tax rates compared to other businesses. However, there are no schemes to encourage or incentives for them to come under the tax bracket. The current fiscal budget made some changes in Income Tax Act and declared some tax exempts for agriculture and forest-based cooperatives and small-scale cottage industries.

2.5.4 Tax competition

The Office of the Auditor General (OAG) monitors the tax incentives every year. However, there are no reports/information available on how the monitoring reports were utilized, particularly to correct flaws and challenges within the tax administration. The log of similar issues and challenges in the reports every year infer that the tax system is yet to get rid of the shortcomings. There are no mandatory requirements for the government to take immediate actions on the OAG findings. The decisions related to tax administration related reforms are often discretionary.

2.6 Tax Administration in Nepal

2.6.1 Organization of the administration

Central Inland Revenue Department (IRD), under the umbrella of Ministry of Finance, is the tax administration authority of the country. The department is entirely managed by the government. The department collects taxes from multiple tax centers - provincial governments, districts, and local governments. The Constitution of Nepal provides authority to the Federation, State and Local level to impose taxes on matters falling within their respective jurisdiction and collect revenue from these

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35 https://ird.gov.np/
sources. The distribution of collected revenue, however, is discretionary and is controlled by the federal government.

The IRD has four tiers of tax administration (Higher, Middle, Inland Revenue Offices and Taxpayer Service Offices as field offices). The tax administration is directly under the control of the political administration and is directly influenced by government decisions. The large-taxpayer section of the Inland Revenue Department was converted into a fully-fledged Large Taxpayer Office in 2004 to deal with large taxpayers who provide the bulk of tax revenue. The Large Taxpayer Office deals with taxpayers who maintain an annual transaction of volume more than NPR 800 million. However, IRD does not differentiate the nature of service by businesses or individuals among the large taxpayers. There is no specific service unit to deal with large individual taxpayers. The middle-taxpayer office deals with taxpayers who have 400-800 million transactions in a year and banking, manufacturing and construction companies with transaction above 250 million. The Tax Reform Unit/Tax Administration within the IRD is dedicated for transfer pricing. Also, there is an international Tax section under the Policy Management and Analysis Division of IRD.

*Digitization of the tax administration system.* In recent years, the tax administration has taken steps to digitalize the tax system. There is registration of taxpayers in bio-metric system along with the system of submitting all types of documents in electronic form to custom office for efficient custom clearance mechanism. Similarly, the tax can be paid through an online site (*connectips.com*). Taxpayers will get provision of 10% of VAT amount refund directly in their account if the VAT is paid using electronic payment system as well. However, one can choose any among both modes available. The digital mode was introduced recently and requires individuals to scan and upload the documents. The traditional filing mode, i.e., filing in the tax office, remains the main mode.

2.6.2 Staffing, Capacity & Oversight

*Staffing.* The IRD officials are deputed from the Ministry of Finance, recruited through Public Service Commission (PSC) under the financial sector cadre. Although there are no records available on the distribution of IRD staff, the entire IRD staffing is dominated by men though some women hold senior positions in the IRD revenue administration.

*Capacity building.* There is a Revenue Administration Training Centre responsible for capacity building of revenue and account cadres. The center runs several capacity building events including trainings targeted to tax officials. IRD, in its monthly bulletin, updates information on trainings conducted by the center. There is no publicly available information on whether tax officials received training on GESI. The trainings, based on the contents provided in the bulletins, appeared to focus on financial aspects and barely touched on gender equity and inclusion. The tax office is very poor in engaging with citizens. Neither there is a structure to engage citizens and educate taxpayers nor there are effective communication campaigns, other than a few television and radio advertisements.

*Oversight & supervision.* There are three tiers of the oversight mechanism for the revenue authority. The revenue department within the Ministry of Finance, led by a revenue secretary, supervises the

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37 IRD-Reform Plan 2015-16
38 IRD-Reform Plan 2015-16
40 [https://connectips.com/](https://connectips.com/)
41 [https://ird.gov.np/Content/ContentAttachment/1011/TaxbulletinJestha_2076final-iv730201910941PM.pdf](https://ird.gov.np/Content/ContentAttachment/1011/TaxbulletinJestha_2076final-iv730201910941PM.pdf)
IRD. There is a parliamentary committee on financial affairs that takes public complaints, raises concerns, discusses on the complaints, and directs the Ministry or the IRD accordingly. An official agency - Office of Auditor General Financial Comptroller General office- carries out a detailed audit of the IRD and flag irregularities. In addition, there are 4 revenue tribunal courts that address any complaints received against the tax collectors.

**Code of conduct for Tax collectors.** The tax collectors have to follow wide public service worker protocols\(^{43}\). In addition, they need to strictly adhere the rules and regulations of IRDA. The courts under the Revenue Tribunal Act 1974 hear appeals of decisions of district level customs, income tax, and value added tax offices. There are four tribunals, in Biratnagar, Kathmandu, Pokhara, and Nepalgunj. Each three-member tribunal comprises members from three different disciplines: law, taxation, and accounts. The legal representative chairs the tribunal and is chosen on the recommendation of the Judicial Council from among currently serving judges on the Court of Appeals. The tribunals reversed or partly reversed a large number of cases in 2008 and 2009, possibly due in part to the failure of revenue officers to follow norms or standards when calculating taxable income. The revenue officials levy taxes to meet annual revenue targets irrespective of whether their decisions stand on appeal. The revenue tribunal courts offer a mechanism to submit grievances and seek legal solutions.

**Protection of Whistleblowers**\(^{44}\). As per the Nepal Law commission Chapter 4, point 29, it shall be a responsibility of an employee of a Public Body to provide information on any ongoing or probable corruption or irregularities or any deed taken as offence under the prevailing laws, and it shall be the duty of the information receiver to make the identity of whistleblower confidential.

### 2.7 Tax incentives and tax evasion

The GON has regularly granted ad hoc exemptions, rebates, and tax holidays to promote industrial development goals. There have also been partial tax amnesties in several years. The Inland Revenue Department (IRD), the GON’s national tax administration, estimates that the revenue loss from tax incentives may be as large as five percent of the GDP. These incentives distort investment decisions, complicate tax administration, and have not generally resulted in strong growth for favored sectors.\(^{45}\) In recent years, the issues of tax evasion and tax incentives have been brought to national level attentions and discussions, particularly after the debates and confusion about the tax returns of one of the foreign telecommunication company. The tax incentives as well as tax evasion has been part of the Nepalese economy since very long and are believed to have reduced in recent years (in terms of proportion of total revenue). The Financial Act, 2014 sets the Government of Nepal's jurisdiction to increase, decrease the tax rates or give partial or complete relief on taxes as provisioned by the.

#### 2.7.1 Tax Incentives

At present the government provides tax incentives in the form of tax exemption, tax rebate and holidays, depreciation allowance, income repatriation and reduced rates on income and dividends.

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\(^{43}\) [https://asiafoundation.org/resources/pdfs/AGuidetoGovernmentinNepal.pdf](https://asiafoundation.org/resources/pdfs/AGuidetoGovernmentinNepal.pdf)


\(^{45}\) [DOMESTIC RESOURCE MOBILIZATION, Case Study of Nepal, 1997-2016 by USAID](https://www사업자등록.com)
1. **Tax exemption**: Tax exemption is provided to farm income except registered farm business or companies related to organized farming; to agro based co-operatives, saving and credit organization located in rural areas and to dividends distributed by savings and credit organizations.

2. **Depreciation allowance**: It is given as accelerated depreciation on manufacturing industries and infrastructure and utility projects. Similarly, production oriented industry is entitled to claim 50 percent depreciation in the same income year on the capital amount that has been capitalized as an asset to generate power required for its own use.

3. **Reduced Rate**: Following are the areas where tax rate is reduced.
   - Reduced rate on dividends
   - 20 percent income tax rate for special industries (manufacturing industries except tobacco and liquor related industries)
   - 20 percent income tax limit is set for road, bridge, tunnel, ropeway and sky bridge projects. The same rate applies for trolleybus and tram development.
   - 20 percent income tax limit is applicable for power development and transmission
   - 20 percent tax rate is applicable for export income

<table>
<thead>
<tr>
<th>Box 1. Tax rebates</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ 10 percent rebate on special manufacturing industries providing direct employment to 300 and more Nepali citizens throughout the year</td>
</tr>
<tr>
<td>✓ 20 percent rebate on special manufacturing industries providing direct employment to 1200 and more Nepali citizens throughout the year.</td>
</tr>
<tr>
<td>✓ CIT, dividend tax exemption for 5 years from the commencement of the business and 50 percent tax rebate thereafter for next three years</td>
</tr>
<tr>
<td>✓ 50 percent income tax concession for foreign invested companies in SEZ</td>
</tr>
<tr>
<td>✓ 50 percent tax rebate on income for software processing, cyber café and digital mapping located in technology parks and biotech parks</td>
</tr>
<tr>
<td>✓ 70-90 percent rebate on income tax for 10 years for special manufacturing industries in far underdeveloped, underdeveloped and least developed areas.</td>
</tr>
<tr>
<td>✓ Full income tax holiday for the first five years and 50 percent tax rebate for next years from the date of commencing business to special manufacturing industries with capital investment of more than 1 billion and providing direct employment to more than 500 people throughout the year.</td>
</tr>
<tr>
<td>✓ Full income tax holiday for first five years and 50 percent tax rebate for next three years for tourism related industry or an airplane company operating international flights with more than 2 million capital investment.</td>
</tr>
<tr>
<td>✓ 25 percent tax rebate on royalty income from the export of intellectual property right.</td>
</tr>
<tr>
<td>✓ 7 -10 years of full income tax holiday and 50 percent rebate for the next 3-5 years for energy projects.</td>
</tr>
</tbody>
</table>

4. **Tax rebate and holiday**: Tax rebate is given to particular sector of manufacturing and businesses to promote their competitiveness and growth. The following are the tax rebates:

5. **VAT exemption**: VAT threshold has been set at two million Nepali Rupees. The small vendors that operate with the scale of funds less than two million are exempted from the tax. The agencies registered under social welfare council, mostly non-governmental agencies involved in development sector are also exempted from the VAT. VAT refund is provided in
inputs for regular export items from the country. There is no VAT applicable for hydropower projects, and also for the machinery imports.

6. **Other tax incentives:** Custom duty is charged at only one percent to technology and machinery imports. There is also duty draw back facility for importing raw materials and ancillary goods.

From FY 2070/71 to 2073/74, the Government provided NPR 138 billion as tax incentive in different headings. This amount is close to 11 percent of the total tax collected those years. **Tax incentive increased by 34 percent in the span of three years.** In FY 2016/17, a tax incentive of NPR 51.3 billion was provided by the government for sectors spanning agriculture, electric equipment and program/projects with foreign aid. Incentives were also provided to garment and publication. While a large share of the incentive is enjoyed by agriculture, livestock and related industries, luxury items like gold and silver also benefited from the provisions (see chart below).

**Chart 4. Percentage of tax incentives by cluster**

<table>
<thead>
<tr>
<th>Cluster</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>44%</td>
</tr>
<tr>
<td>Mills, machinery and raw materials</td>
<td>9%</td>
</tr>
<tr>
<td>Energy production and equipments</td>
<td>6%</td>
</tr>
<tr>
<td>Airplanes, vehicles and parts</td>
<td>3%</td>
</tr>
<tr>
<td>Government and other organizations</td>
<td>12%</td>
</tr>
<tr>
<td>Gold, silver</td>
<td>5%</td>
</tr>
<tr>
<td>SAFTA discount</td>
<td>3%</td>
</tr>
<tr>
<td>Others</td>
<td>18%</td>
</tr>
</tbody>
</table>

**Source:** IRD, Annual Report, 2016/17

A closer analysis of tax exemptions and the beneficiaries of these incentives reveals a gross misinterpretation and misuse of the Financial Act. Incentives being provided not only to primary sector but also to luxury goods is ever increasing. For example: there is a provision of tax incentives to raw materials of gold and golden jewelries. For jewelries, tax incentive of NPR 2.5 billion was given in the fiscal year 2072/73 which is an increase of 26 percent from 1.94 billion in FY 2071/72. Even for the discounts provided to items of agricultural nature, it is hard to justify the rebates given in the absence of analysis and evaluation of their economic impacts on local agricultural products. The 54th report of the Auditor General reports that unbridled discount on taxes may be harmful to the national economy and recommends a study on its impacts on the overall economy to be presented to the legislative during budget announcement.

47 NRB Annual Report 2014/15
Table 3. Tax incentives provided in 2017 (in lakhs)

<table>
<thead>
<tr>
<th>Sector of Incentive</th>
<th>Amount</th>
<th>Sector of Incentive</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and livestock related, hatchery and tea industry</td>
<td>117724</td>
<td>Chemical fertilizer</td>
<td>55178</td>
</tr>
<tr>
<td>Medicines, pesticides and raw materials for medicines</td>
<td>53618</td>
<td>Raw materials for feed industry</td>
<td>41852</td>
</tr>
<tr>
<td>Mill machinery</td>
<td>34324</td>
<td>Gold, silver</td>
<td>25230</td>
</tr>
<tr>
<td>Nepali army, police, government and other agencies</td>
<td>34181</td>
<td>Electricity production equipment and parts</td>
<td>24065</td>
</tr>
<tr>
<td>LPG gas, salt, cotton</td>
<td>22036</td>
<td>Hospital and social organizations</td>
<td>21585</td>
</tr>
<tr>
<td>SAFTA discount</td>
<td>16164</td>
<td>Generator, thresher, harrow, pump and other agricultural equipment</td>
<td>12865</td>
</tr>
<tr>
<td>Airplane and parts</td>
<td>10382</td>
<td>Solar battery and others</td>
<td>7995</td>
</tr>
<tr>
<td>Programmes funded by foreign support</td>
<td>6539</td>
<td>Cotton sari, dhoti, sindoor, tika</td>
<td>6394</td>
</tr>
<tr>
<td>Electric and other vehicles, fire truck, ambulance,</td>
<td>5323</td>
<td>Raw material for oil mills</td>
<td>5111</td>
</tr>
<tr>
<td>Book and print material, new print paper and bank note</td>
<td>4493</td>
<td>Raw jute and spare parts for jute mill</td>
<td>3838</td>
</tr>
<tr>
<td>Fiber for garment factory, manmade fiber, Kashmiri yarn and cotton yarn</td>
<td>3313</td>
<td>PVC film, BOPP film, filler master batch</td>
<td>660</td>
</tr>
<tr>
<td>Export of items for hotel upgrading, export of items imported by cinema industry</td>
<td>210</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>513080</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: 54th report of the Auditor General, 2017*

Although the amount of tax incentives has increased over the years, the proportion of tax incentives against the tax revenue has remained around 11 percent (fluctuating between 10-12 percent).

Table 4. Total revenue, tax incentives, and proportion

<table>
<thead>
<tr>
<th>Year</th>
<th>Total tax revenue (NPR)</th>
<th>Tax Incentives (NPR)</th>
<th>% of Incentive / tax revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2014/15</td>
<td>362920</td>
<td>38270</td>
<td>10.5</td>
</tr>
<tr>
<td>FY 2015/16</td>
<td>413930</td>
<td>49010</td>
<td>11.8</td>
</tr>
<tr>
<td>FY 2016/17</td>
<td>498920</td>
<td>51308</td>
<td>10.3</td>
</tr>
</tbody>
</table>

*Source: 54th report of the Auditor General, 2017*

2.7.2 Tax evasion

Tax evasion is a criminal activity which has large economic implications to a country’s economy. It reduces the amount of funds available for socio-economic development of the country thus depriving the country to devote resources to ensure social, cultural and economic rights of the citizens. Nepal is no exception to tax evasion and have a major compliance issue with:

- Low registration in both income tax and VAT,
- Low return of filing (high percent of non-filers),
- Under invoicing and a huge percent of non-invoicing,
- Existence of large percent of the mismatch (difference in reporting among the transacted parties),
- Tax fraud (a large percentage exist in VAT with fake bill), and
- Huge pending cases with Revenue Tribunal

Tax evasion in Nepal is a complex issue interlinked with large scale bribery and corruption. Large taxpayers in the country are known to evade various types of taxes with support from the authorities. Tax Justice Network estimates that every year approximately USD 599 million is lost to tax evasion from the shadow economy in Nepal. 49 Rather than being regulated, tax evasion is increasing every

49 Tax Justice Network, 2011
year. In FY 2014/15 the Revenue Tribunal cleared 714 cases of tax evasion which is almost double compared to previous fiscal year\(^{50}\). Most of the cases in tax evasion filed in the Tribunal are income tax related and VAT related. Customs and other taxes make up smaller proportion of tax evasion cases. One of the high-profile cases of tax evasion in recent history of Nepal was the attempt to evade corporate gains taxes in the sale of a telecommunication company. The foreign company paid only 15 percent of the profit as taxes although according to Nepalese tax laws the country should receive 25 percent of the profit made in the sales deal of USD 1.03 billion. The tax evasion in Nepal roots into legal ambiguity and authorities. Tax settlement committee (TSC) guided by TSC Act, 2032\(^{51}\) has been utilized as a mechanism to evade tax that has not been paid or underpaid. The most recent tax settlement committee report published in December 2015 provided huge tax waivers to large companies. Sometimes, the amount settled was larger than what the companies had applied for. One of the two journalists from Nepal who unmasked the tax evasion issue was awarded Barbara Adams Investigative Journalism Award 2016 on July 29, 2017 \(^{52}\).

The claims made by the journalists were, later, confirmed by the report of auditor general. According to the 54th report of the Office of the Auditor General in April, 2017 reported that the commission whittled down tax liabilities amounting to Rs 30.52 billion to just Rs 9.54 billion, resulting into a loss of around 70 percent tax dues which amounts to around five percent of the annual tax revenue of the country. While the primary purpose of the settlement committee was to look after the pending cases and legal confusions, most of the cases filed and decided upon were linked to tax dues. According to the report, there were 1,726 applications involving 1,037 about tax dues. Interestingly, most of the companies provided with waivers in their dues were not in any position to be insolvent.

### Chart 5. Types of cases entertained by the TSC

<table>
<thead>
<tr>
<th>Type of Case</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax dues</td>
<td>60%</td>
</tr>
<tr>
<td>Cases in court</td>
<td>8%</td>
</tr>
<tr>
<td>Revenue jurisdiction</td>
<td>14%</td>
</tr>
<tr>
<td>Administrative review</td>
<td>14%</td>
</tr>
<tr>
<td>Change in tax headings</td>
<td>4%</td>
</tr>
</tbody>
</table>

*Source: 54th report of the Auditor General, 2017.*

The report strongly pointed out that several straightforward and recent tax liabilities were also unnecessarily handled by the commission. Based on the discrepancies noticed in the work of TSC, Commission for Investigation of Abuse of Authority (CIAA) recently arrested and filed cases against the TSC members including the Director General of Inland Revenue Department. The tax settlement committee is backed up by Tax Settlement Act, 2032 which has provided very strong mandate and authorities to TSC not allowing any other agency to question their decisions. According to one tax officer, before the Income Tax Act 2058 BS [where taxes are paid on self-declared income] TSC was

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50 https://glocalkhabar.com/cases-of-tax-evasion-rises/
51 Tax Settlement Act 2032
supposed to settle taxes for companies that had no means to pay. However, TSC was utilized to evade tax payments. Around 650 organizations (out of the 1069) whose taxes were settled neither paid their taxes nor used the legal recourses available to appeal their case. TSC was formed by Finance Minister comprising of chartered accountants, tax experts, and a representative from Inland Revenue Department (IRD). Although it was 11th TSC formed after the promulgation of Act, the committees were never out of criticisms. The large as well as small business firms have tried to evade tax, utilizing the obscure legal provisions related to tax. The abuse of authority by tax officials was also another key reason behind tax evasion. The first issue of tax evasion through VAT surfaced during 2011. Thirty-one out of 52 companies under investigation from Inland Revenue Department (IRD) have been found to evade tax using fake VAT bills. Among those, twenty-four companies had evaded 2.7 billion Nepalese Rupees in VAT and income tax through transactions in fake bills while they had taken back VAT amount of 890 million Nepalese Rupees by submitting fraudulent certification of payments. The auditor general’s report identified that in one case for the sale of land worth NPR 860 Million, the tax adjudged by the tax office and paid by the company was only NPR 40 Million.

2.7.3 Tax dues, non-payment of taxes & other forms of tax losses

One of the major tax compliance issues is non-payment of dues. In last FY 2016/17, there were 1,723 applications in various agencies with 40.8 billion worth of taxes. Of this, 31.86 percent was dues not paid intentionally. More than half of these dues were cleared by the tax settlement commission as incentives. There are also evidences of gross violation of VAT rules. VAT collected from the consumers and declared in audit reports is not surrendered to the government. The 54th report of the Auditor’s General listed down various instances of VAT non-payments by construction companies and breweries. In some cases, such dues have been settled through tax exemption/incentives by the TSC.

In FY 2069/70, the Inland Revenue decided to waive tax of around 210 Million NPR with various construction companies. The tax amount waived included those mentioned and included in the contracts the construction companies had with government and other agencies including the amount that the agencies pre-reported as an estimated amount of VAT payment for the year. In the same year, one liquor company was provided with waiver of more than 99.6 percent on its formerly adjudged tax dues that perpetuated loss of around 370 Million in the form of VAT and 20 Million in the form of income tax. While these were only a few examples, the tax evasion and waivers were found to be gigantic.

In addition to the areas of tax losses described above, there are also other forms of tax losses that often remain overlooked, and possibly entail amount much larger than those described above. One key source of tax loss is unrecorded cash transactions, particularly among small vendors and service sectors. Large share of transactions that happen are done in rarely recorded cash transactions involving bills. In many cases, the vendors do not issue formal bills that make them responsible to pay tax, and deal with cash-based transactions which are not formally recorded to be taxed. There is limited awareness among public on need to take bills to ensure that the tax they paid is deposited in the inland revenue. Although taxes are charged based on the ceiling of family income, there is no practice of declaring individual and family level income. The payment of tax based on actual declared income remains non-existent. The current tax structure does not cover all sectors. There are many small vendors that are not registered in VAT/PAN, thus, do not report or pay any taxes. The remittance income and outsourcing companies that are not registered but in operation are often not covered by

tax radar. While it is increasingly being evident that individuals are engaged in business related to purchase and sale of land and other forms of realty properties, the current tax system does not record them as ‘business’ unless it is done forming a company. The charge on such income (5%) for companies and nominal transfer charges for individuals overlooks the volume of transactions currently involved in such businesses.

In discussion with Inland Revenue Department officials, they agreed that the existing collection of tax revenue far too less than what it should be, and recognized capacity and policy related weaknesses as a major source of tax loss. In their opinion, Ministry of Finance and Inland Revenue Department does not have adequate technical resources and capacity to respond to changing macroeconomic context and ensure that all businesses are paying taxes based on the set provisions. They also agreed that in absence of any form of research priorities within IRD, there is very limited information available on possible source of tax loss, its estimated amount, and ways to recover the losses. The tax related legal provisions and policies are also obscure. The formation and operation of tax settlement committee is an example of possible policy loophole.

Box 2. What is the size of estimated tax loss?

Tax incentives contribute to around 11 percent of the total tax revenue. The inability of TSC to settle tax non-payment issues as per the expectation has already resulted to a tax loss of around 5 percent every year. It is pretty clear that there are many sectors which are unrecorded and uncovered. In discussion with IRD, the growth in the size of tax revenue over the years is more of the result of expansion of the sectors and coverage than productivity of the businesses. Since every year, the revenue size increases by around 20 percent, and if assumed that half of the increase is due to addition of transactions that were not covered during previous years, there is a loss of at least around 10 percent in the form of non-coverage of certain sectors. Remittance, not entirely contributing to the tax revenue, contributes to more than 35 percent to the GDP. If it is anticipated that they will pay around five percent income tax on total remittance, the tax loss from remittance can be estimated around 8 percent. In simple calculation, there is an aggregate loss of around one third of the current tax revenue (34%). The tentative amount is around 170 Billion Nepali rupees (around 1.7 Billion US Dollars). The estimated loss amount could have been sufficient to increase the current size of capital expenditure of government by around 50 percent (i.e. current capital expenditure (FY 2074/75) is 335.17 billion).

2.7 Government Spending

Government Spending are based on the budget allocations and allocations are path dependent. The amount and proportion of budget allocations largely follow the trend and figure in previous years. While there might be some allocations targeting certain regions such as Karnali Employment Project, those allocations are project-based and time bound. The budget in bundle does not respond to the population, regional needs or the amount of tax collected from the region. The government spending are on education, health, agriculture and social protection. The debt to GDP ratio has increased during the last five years. Between 2014 to 2018, the ratio increased from 10.28 to 11.69.56

2.7.1 Education

Prior to the federal structure (2015), the budget allocated on the education sector was consistently more than 15 percent for several years. However, after the federal structure, the proportion decreased

56 Worldbank 2018

substantially, largely due to increased administrative expenses to run the federal structure. For FY 2020/21, the allocation on education was 11.64 percent of the total budget. Although the total amount allocated on education has increased every year (5 percent increase in FY 2020/21 compared to the last year), the share of education in the total budget is slightly decreasing. The ratio of education to GDP is slightly better. For FY 2020/21, the estimated size of the education budget is 7.1 percent of the GDP. The share of education budget in the total government budget can be observed in continuous decrease trend from 2014/15 to 2018/18 only to see a slight increase in FY 2020/21.

Chart 6. Share of Education in the Federal Budget (% of budget)

![Chart showing share of education in the federal budget over years]

Source: Ministry of Finance, Budget 2020/21

In principle, the public education system is entirely managed by the government. The Constitution of Nepal and the Education Act/Regulation has mandated free and universal basic education (till grade 8). However, there are several exceptions. First, there are many partially funded public schools where the community or school management committee is responsible to finance teacher salaries or top up to the amount provided by the government. Second, several studies have shown that the out-of-pocket expenses burned by parents outweigh the investment made by the government. Broadly, there are no significant allocations in the education budget to benefit women and girls. However, there are some piecemeal schemes that tend to benefit girls/women. For example, all girls enrolled in community schools (below Grade 8) are entitled to a petty amount of scholarship every year. Girls, children of marginalized community, vulnerable groups are provided with the pro-poor targeted scholarships have been initiated for secondary level, and scholarships to encourage students to pursue science in grade 11 and 12 have also been arranged. Similar, distribution of Free sanitary pads for female students attending public schools is also done.

2.7.2 Health

Between FY 2015/16 and FY 2019/20, the allocations on the health sector as proportion of the budget has stagnated to five percent. Similar to the education sector, the share of health in the total budget

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57 Economic Survey 2019-20, Page 139, Budget of FY 2020/21
58 Economic Survey 2019-20, Page 139, Budget of FY 2020/21
59 https://unesdoc.unesco.org/ark:/48223/pf0000232769 - Education for all National review report
decreased nearly by half (from around 10 percent) following the transition to the federal structure of governance. The share of the health sector reached to record low values during FY 2016/17 and FY 2017/18 with 4.6 percent and 4.4 percent respectively. Although the number of allocations on the health sector has increased over the years, the proportion of the health sector budget against the total budget has remain stagnant. For example, the share of budget on health decreased to the record low of 4.4 percent during 2017/18 to climb back to around five percent in FY 2019/20. In numbers, the budget allocated for health sector has increased by 32 percent in FY 2020/21 compared to the last fiscal year (i.e. NPR 90.69 billion from NPR 68.78 billion), largely due to COVID-19 related allocations.

Chart 7. Share of health section in the federal budget

Source: Share of Health Sector budget as percentage of National Budget (http://www.nhssp.org.np/Resources/PPFM/Budget%20Analysis%20of%20MoHP-%202019.pdf)

Almost all public primary health service providers are managed by the government. However, there are some exceptions. Government opened up public-private-partnership modality to encourage collaboration between private sector, government and local communities. There are also a few health facilities operated in the public-private or community mode. When it comes to tertiary health facilities, all large medical colleges and some regional hospitals are managed in public-private mode.

The health sector in Nepal has a thematic focus on Gender Equity and Social Inclusion (GESI). MOHP has a Health sector GESI Department that oversees women/girls related programs such safe motherhood program and safe abortion program etc. The GESI focal persons of all divisions and centers need to ensure that activities for reaching underserved areas and unreached groups are identified and costed. It is also to be noted that GESI became a priority of the health sector largely because the large majority of public health service users are women. There is an adolescent and sexual reproductive health program run by the government. The program aimed to improve the sexual and reproductive health status among adolescents in Nepal had a target to make health facilities adolescent-friendly. The Nepal Health Sector Strategy has envisioned that all the services provided through the public health facilities will be friendly in all the districts. Through improving access to family planning information and devices, the program aims to reduce the Adolescent Fertility Rate (AFR) which is the outcome indicator of Nepal Health Sector strategy. As of 2016, 1534 health facilities were declared adolescent friendly.

61 Budget Analysis of Ministry of Health and Population FY 2018/19
62 National Health Sector Strategy 2015-2020
2.7.3 Agriculture

The contribution of agriculture sector (agriculture, forest and fisheries) to GDP was 37.1 percent in FY 2019/20 and is expected to be 27.7 percent. Agriculture, however, is a least prioritized sector in terms of public spending. For FY 2020/21, the allocation to the agriculture sector was round 2.7 percent though the allocation increased from NPR 34.8 Billion in FY 2020/21 to NPR 40.4 Billion. The budget on agriculture has increased, to some extent, during the last five years. There was a 7 percent increase in the amount allocated in FY 2020/21 compared to FY 2019/20.

![Chart 8. Allocations in the agriculture sector](chart.png)

Source: Ministry of Finance, Budget Speeches, 2016-2020

Government of Nepal prioritizes access to water, land and credit. For FY 2020/21, the government has a plan to promote the agriculture sector and make the country self-sufficient with the products. One of the targets is to establish 300 land banks, promotion of cooperative farming, set up 78 wholesale agriculture markets in all states, expand irrigation facilities to additional 22,000 hectares of land, establishing 5,000 small and medium irrigation systems in 25 districts, and production of more than 5 million units of fruit saplings in the next fiscal year.

Although the Government of Nepal identifies small holder farmers as one of the target groups, there are no concrete programs/interventions. The provisions such as land banks and community farming are yet be scaled up to benefit small holder farmers. However, at the broader level, there are no women specific programs/investment in agriculture.

2.7.4 Social protection

Government of Nepal have scanty social protection schemes which is mostly limited to the formal sector. There is a government food aid program to the food-insecure regions through Nepal Food Corporation. In those areas, there are also specific government program to arrange mid-day meal for all children. Although there is no social security pension that covers the entire population, the pensions are provided to retired government-funded employees upon their retirement. There is a social security scheme that targets elderlies (above 65 years) and provides them with NPR 2,000 per month.

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63 Economic Survey 2018/19
64 MOALD, Statistical Data 2017/18
65 National Budget 2020/21 (Pg 28-29,31
66 Budget 2020/21 page 30
There is a Labor Act and Regulation\textsuperscript{67} that governs labor engagements and requirements, including foreign employment. For example, the labor legislations have prescribed minimum wage and minimum age to be employed. However, there is no mechanism to enforce and monitor implementation of such rules. As a result, many people are being paid less than the minimum wage.

However, there are no any social protection schemes for non-formal sector unpaid care work or subsistence economy. In 2019, Government made it mandatory for all formal companies to follow certain payment and benefit regulations. The formal sector is mandated to set up some social protection mechanism. The actual situation of implementation is yet to be known.\textsuperscript{68}

2.7.5 Gender Equity and Social Inclusion (GESI)

Nepal is signatory to CEDAW and has also set up gender responsive budget related regulations and other GESI measures.\textsuperscript{69} For women and girls\textsuperscript{70}, there are two key regulations of importance. First, the government mandates equal pay for equal work, and bars differential payments for men and women. Although the equal pay provision is not enforced in the informal sector, the formal sector is required to follow the provision. For single women above 50 years, GON has a scheme to provide NPR 2,000 per month. There is a gender responsive budget committee within the Ministry of Finance that monitors the allocations of budget specific to gender equity. It is a mandatory requirement for all government cost centers to allocate gender responsive budget, keep track of the amount, and report it to the Ministry of Finance.

\textit{Unpaid care work}. Beginning 2018, Nepal Labor Force Survey has started to collect information on unpaid care work (childcare and elderly care). However, the questions are indirect, and will not be useful in estimating the time spent in unpaid care and domestic work.

Elderly and disabled are provided with regular allowance to support their livelihood. There are no provisions to finance childcare responsibilities, except for the government workers based in the central government plaza - Singhadurbar\textsuperscript{71}. There are also no incentives or payments to compensate elderly care.

2.8 Transparency and Accountability of the Tax System

Every Nepali citizen is guaranteed with right to information as provided by Article 27 of the Interim Constitution of Nepal, 2007 and section 3 (1) of Right to Information Act, 2007. Act has provided every Nepali citizen right to request and obtain information held in public agencies.

The tax rates as well as the total revenue and tax collections are made public by IRD through their annual report. However, the tax reports are not available immediately after the end of the fiscal year. They are often publicized after a couple of years. The public limited companies are required to make their financial statements transparent to their shareholders, not necessarily to public. However, the practice to make the information public differs by agencies as they are not mandated by the law to do

\textsuperscript{67} Labour act 2074, page 12
\textsuperscript{68} contribution based social security act 2074, page 2
\textsuperscript{69} OHCHR.org
\textsuperscript{70} contribution based social security act 2074, page 2
so. The private companies can choose to not make their records public\textsuperscript{72}. The public limited companies make the details public to their shareholders but are not required to make it available to the general public. However, the ownership details are rarely publicized.

The concept of tax return does not exist, hence, tax expenditure is not disclosed. Moreover, the tax baskets are very few, and are rarely transparent in terms of the amount within. Also, any sort of cost benefit analysis does not exist. Tax mechanisms and rules are entirely discretionary.

2.8.1 Audit

The Office of Auditor General conducts the financial audit\textsuperscript{73} of Inland Revenue Department and the Ministry of Finance every year, and submits a publicly available report to the President. However, the procedure takes very long time, and the reports are not readily available. As of now, the latest audit report is available for Fiscal Year 2015/16.\textsuperscript{74} The Office of Auditor General is an independent entity, though the officials are nominated by the government. In practice, the office has the history of providing neutral and candid impressions on the financial transactions made by the government entities including IRD. The companies that benefit from tax exemptions are disclosed. The OAG report clearly mentions the list of companies that received tax incentives. The audit reports are submitted to the President. Although some of the issues from the audit report are brought into the discussions of parliamentary committee on financial management, the discussions are not timely given that the reports are submitted with a long delay. The audit reports are publicly available, but after a few years. The audit reports examine whether the expenses or income are made based on the existing financial rules and regulations but do not evaluate whether the taxation is fair and just.

2.8.2 Budget

There is a practice of budget speech covering the revenue sources, not only their expected contribution/collection but also if there are any proposed changes in the tax rates. For example: the budget speech of FY 20/21\textsuperscript{75} expects to collect 8.4 Billion NPR through IRD, 74 percent lower than the internal revenue during FY 19/20. There is a detailed account of income sources included in the budget document. For example, in the 2019/20 budget document, the budget sources were laid out as follows: NPR 981.13 billion will be financed through revenue mobilization. NPR 57.99 billion from foreign grants, and NPR 298.83 will be arranged from foreign loan. Any changes in the tax rates and sources are also clearly pronounced. In the latest budget document FY 2019/20, there was no mention of extra-budgetary funds.

The budget does not specify how taxes collected in the different headings are allocated across different priorities. In fact, this is a major weakness with taxation and budgeting in Nepal. Some of the budget baskets including private education tax and social protection tax has not been utilized so far and have only served as a financial cushion in case of liquidity crisis or fund shortages.

There is no practice of conducting impact assessment of tax. There are no units/sections assigned with impact assessment responsibilities. Moreover, during the consultation with the tax office, it was noted that the tax office does not consider that as a priority. The priority of the government is increase the tax base and sharpen the tax administration to meet the goal of increased revenue collection.


\textsuperscript{73} https://oagnep.gov.np/en/report/annual-report-2073/

\textsuperscript{74} https://oagnep.gov.np/en/report/annual-report-2073/

\textsuperscript{75} National Budget 2020/21
2.8.3 Citizen's engagement

At the provincial and federal level, there is scanty to no engagement of civil society in shaping revenue policies. At the local government level, however, the general assembly, also including local civil society groups, have say in deciding about local taxes. There are no mechanisms for including civil society to participate in shaping revenue policies at national and local level. The decisions are discretionary. Similarly, there are no such processes to facilitate participation of women’s rights organizations in the revenue policies at the national and local level. However, several women rights groups are active in advocating for tax incentives and other equitable measures. The tax related policy changes are mostly taken by Ministry of Finance without sufficient consultation with civil society groups. There are some tax incentives available for women. These incentives may or may not be attributed to the women right’s campaign/movement.
Section 3
Conclusion & Recommendations

3.1 Conclusion

Nepal has been successful to steadily increase the inland revenue during the last decade. The country has nearly doubled the size of its fiscal budget within the last five years. By managing the swift transition from unitary to federal structure of government amidst widespread skepticism on whether the country would have enough financial resources to shoulder the transition, Nepal has already shown the potential to increase the inland revenue. The increase, however, comes from the tightening and administrative sharpening of the tax collection process rather than the switch to the progressive taxation mode. The key challenge for the tax administration mechanism in Nepal is its complete disconnect from the evidence. The tax related decisions are made arbitrarily without any solid reference to the key source variables such as purchasing power of taxpayers, their income distribution, and tax accountability/justice. The taxation system in Nepal is clearly from being transparent and accountable to the public. It is evident from the fact that government does not disclose the purpose of collecting tax, utilizing it for the stated purpose, and returning it to the public in case of meeting the resources. For example: the tax baskets such as social security tax fund and education service tax fund have remain obsolete, and the tax rates, though the total collection amount is small, can be ranked among the worst – an individual with income as small as USD 1,200 is liable to pay a minimum tax of 20 percent on the annual income. The concept of tax return does not exist in theory let alone in the practice. Tax is considered all but the liability of the people to pay to government. In such a situation, there is a natural incentive for people and businesses to find tricks to avoid paying taxes. Nepal is losing large sum of tax revenue in the form of tax incentives and tax non-payments, disproportionately favoring large businesses.

While this report does not deny a fact that there is a huge potential and a need to increase the overall tax revenue of the country, particularly through proper valuation of the GDP, expansive tax coverage with the reduced tax rates, and progressive tax reforms. The tax system in Nepal clearly requires a transformation guided by a policy commitment to make it equitable and just.

3.2 Recommendations

The study findings call for wide and comprehensive advocacy initiated centered on tax fairness and justice. The taxation should be progressive enough to allow government to fetch much needed revenue to support its growing demand for capital expenditure. The following are the study recommendations:

✓ Advocacy on people centered tax administration that is transparent and accountable to the taxpayers
  o Increase the minimum tax threshold and reduce the income tax rates for lower income groups
  o Make tax collection and utilization route transparent and report to public regularly on tax collection and utilization
  o Expand the number of taxpayers by increasing the coverage of PAN and other forms of tax identifiers
Specific tax amount introduced and kept in separate basket fund to finance specific priorities so that people find a motive to submit tax

- Advocacy to prevent tax losses (especially targeting reduction in tax incentives and tax evasion along with expansion of tax bases) and also focus on proper utilization of collected revenue (e.g., education service tax).
- Advocacy on tax justice and fair distribution of revenue between three layers of governments
  - Capacitating local government in collecting and utilizing tax to finance priorities for excluded and marginalized groups, including education for girls.
References


### Annex 1. Key FTM Questions

#### 1. Brief description of the tax system

<table>
<thead>
<tr>
<th>Topic</th>
<th>Research Analysis Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax and social security system</td>
<td>Describe the overall tax system. What types of taxes does the country collect at local and national level? Do the tax policies focus more on equity and progressivity or on more “efficient” collection? What is the tax collection procedure? Who is responsible for collecting taxes at both local and national levels?</td>
</tr>
<tr>
<td></td>
<td>What benefits are covered by the social security system? Are social security contributions collected separately from tax payments?</td>
</tr>
<tr>
<td></td>
<td>What important reforms in the tax system and tax policies have been made in the last 10 years? Are there any reforms of the tax system planned for the near future? Focus on the most essential reforms and those that have had (will have) an important impact on the current tax system.</td>
</tr>
<tr>
<td></td>
<td>Provide a brief historical evolution of the country tax system indicating the reasons behind particular tax reforms which were implemented. Has the country intended to/succeeded in combating tax evasion/avoidance, eliminating inefficient tax incentives and in broadening the tax base?</td>
</tr>
</tbody>
</table>

#### 2. Distribution of the tax burden and progressivity

<table>
<thead>
<tr>
<th>Topic</th>
<th>Research Analysis Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cross cutting progressivity</td>
<td>Provide a trend analysis of the share of direct and indirect taxes in total tax revenue taking into consideration the last year available, 5 years ago and 10 years ago. Has there been an increase in the reliance on indirect taxes over this period?</td>
</tr>
<tr>
<td></td>
<td>What is the ratio of PIT &amp; CIT as a share of total tax revenue?</td>
</tr>
<tr>
<td>Personal Income Tax (PIT)</td>
<td>Provide distinct ways of assessment/collection (e.g. withhold taxation at source for salaries and self-assessment for non-salary income).</td>
</tr>
<tr>
<td></td>
<td>Is there any distinction of rates based on gender, marriage status (single/married) or size of family (e.g. number of children)? Are married couples taxed differently? If yes, do couples have the option to file PIT returns as a single unit or are actually required to do so? What is the impact on women’s income?</td>
</tr>
<tr>
<td></td>
<td>Are tax allowances/exemptions equally accessible for men and women? Are women eligible to be recognized as head of household/family and receive the related fiscal incentives for herself and for dependents?</td>
</tr>
<tr>
<td></td>
<td>In what way do the PIT policies, rates and exemptions address income &amp; gender inequality? Do such policies contribute to a fair tax system? What policies could be designed to increase its fairness? Draw main policy recommendations based on this analysis.</td>
</tr>
<tr>
<td>Corporate Income Tax (CIT)</td>
<td>Provide a trend analysis of the share of CIT in total tax revenue taking into consideration the last year available, 5 years ago and 10 years ago. Please reflect on the overall revenue trend in this period.</td>
</tr>
<tr>
<td></td>
<td>Provide the current rates of CIT and its development over the past 5 years. If a CIT rate changed recently, what was the actual impact on revenues? Who does the CIT apply to? Do the rates vary for different sectors and activities (e.g. extractive industry or export oriented) or levels of profit? What are the exemptions to CIT and who do they apply to? Are there penalties applied for failure to file returns or pay tax on due date? Which tax revenue authority is responsible for CIT?</td>
</tr>
<tr>
<td></td>
<td>Are there different tax rates for Micro, Small and Medium Enterprises (MSMEs)? Is there a simplified general framework for MSMEs? This might include no registration fees, or simplified tax returns, regulations and accounting requirements.</td>
</tr>
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<td></td>
<td>Are there transfer pricing rules in place? If yes, do these rules follow the OECD arm’s length standard or alternative guidelines (e.g. safe harbours)?</td>
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<tr>
<td></td>
<td>How do the CIT policies affect income &amp; gender inequality? Do the policies contribute to a fair tax system? Draw main policy recommendations based on this analysis.</td>
</tr>
</tbody>
</table>
| Wealth taxes (property/land tax, capital gains tax, inheritance/gift tax) | - Is data on property tax, land tax, taxes on financial assets and derived income published? If yes, provide a trend analysis of their share in total tax revenue taking into consideration the last year available, 5 years ago and 10 years ago.  
- Have inheritance & gift taxes been enacted in your country? How about net wealth tax? If yes, is data on these taxes published? If yes, provide a trend analysis of their share in total tax revenue taking into consideration the last year available, 5 years ago and 10 years ago.  
- Provide the current rates for these taxes and their development over the past 5 years. Which tax revenue authority is responsible for collection of the distinct wealth taxes (local/national)?  
Do wealth taxes vary for different sectors and different levels of wealth? Are there exemptions which are applied to wealth taxes? If yes, do they favor the wealthy or the poorest in society? Do wealth taxes sufficiently take into account the position of poor people? Do minimum threshold levels or brackets apply to exempt the poorest from wealth taxation (e.g. inheritance tax only above a certain level of income, exemption of primary residences & subsistence lands)? Is inheritance taxation systematically avoided by the imposition of intermediary companies?  
- Do capital gains taxes apply to all economic sectors, forms of corporations and individuals? Are there specific provisions concerning offshore indirect transfers?  
- How do the property and wealth tax policies affect income & gender inequality? Do the policies contribute to a fair tax system? Draw main policy recommendations based on this analysis. |
| Sales tax/VAT | - Provide a trend analysis of the share of sales tax/VAT in total tax revenue taking into consideration the last year available, 5 years ago and 10 years ago. What are the rates of sales tax/VAT? Do they differ for different goods/services?  
- What goods/services are exempted from sales tax/VAT or are zero rated? If an official list of essential and basic goods exists, are these goods taxed at a reduced rate? Are luxury goods taxed at an increased rate? Which tax revenue authority is responsible for sales tax/VAT?  
- Is there a lower rate, exemption or zero sale tax/VAT rate for essential products traditionally purchased by women for the household (e.g. female hygiene products, cooking fuel, cleaning material, education material, clothes)?  
- How do sales tax/VAT and its specific rates/exemptions affect income & gender inequality? Do they contribute to a fair tax system? Draw main policy recommendations based on this analysis. |
| Excise taxes (OPTIONAL) | - Are excise taxes levied on socially harmful activities (e.g. tobacco, alcohol or gambling)? If yes, is the revenue collected directed to prevention or relief of negative effects of these activities?  
- Are excise taxes levied on luxury goods (e.g. jewelry, perfume or flight tickets)? Is fuel subject to excise tax? What are the most significant & basic goods and services that are subject to excise taxes? How does it affect the poor?  
- Are impact assessment studies carried out before the levying of excise taxes, taking into account the impact on women and the poorest in society?  
- How do excise tax policies affect income & gender inequality? Do the policies contribute to a fair tax system? Draw main policy recommendations based on this analysis. |
| **Trade taxes (OPTIONAL)** | - What was the share of import/export taxes in total tax revenue and GDP in the past year? Has import/export tax revenue been reduced due to recent international trade agreements?  
- What are the rates of import/export taxes? Do they differ for different goods or sectors (e.g. for basic/luxurious goods)? Are any goods/sectors exempted from import/export taxes? Which tax revenue authority is responsible for trade tax?  
- Are essential goods predominantly consumed by women, the household and vulnerable groups subject to trade taxes? Are sectors that traditionally employ women subject to export taxes?  
- How do trade tax policies affect income & gender inequality? Do the policies contribute to a fair tax system? Draw main policy recommendations based on this analysis. |
| **Presumptive/Turnover taxes (Informal economy taxes)** | - Is there a presumptive tax system for the informal sector in place? This might include local taxes (e.g. market access taxes).  
- Provide a trend analysis of the share of presumptive taxes in total tax revenue taking into consideration the last year available, 5 years ago and 10 years ago.  
- Is the presumptive tax system based on a feasibility assessment? Are there clear rules for calculating the tax? Is there a threshold level for low-income informal businesses?  
- When individuals or informal businesses receive a tax presumption, is there a legal objection procedure available? Which tax revenue authority is responsible for presumptive tax?  
- Are there specific government policies (fiscal and others) designed to attract informal businesses into registration? This might include reduced tax rates for an adaptation period, reduced regulatory burden and others. Are such policies well-received or instead seen as harmful incentives for profitable informal businesses?  
- Do presumptive tax rates differ by economic sectors in an unfavorable way for women and other vulnerable groups?  
- How do these tax policies affect income & gender inequality? Do they contribute towards a fair tax system? Draw main policy recommendations based on this analysis. |
| **Gender analysis** | - Are the sectors that traditionally employ women taxed distinctly?  
- Is there any government policy (fiscal and others) focused on unpaid care work? This might include tax allowances, free childcare, elderly facilities and others.  
- Are there specific aspects of the tax system (rates, policies or laws) which have a discriminatory effect towards women? How about gender-responsive policies?  
- Having in mind that gender discrimination is often implicit, draw main policy recommendations based on this analysis. |
| **Public perception of the tax system** | - Search for the following information in existing national surveys: What is the public perception of fairness and transparency of the tax system? How about the public perception of revenue authorities? |
### Sufficient revenues and Illicit Financial Flows (IFFs)

<table>
<thead>
<tr>
<th>Topic</th>
<th>Research Analysis Questions</th>
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</thead>
<tbody>
<tr>
<td>Sufficiency</td>
<td>- Based on national development plans or budgets, provide an overview of what would be considered ‘sufficient revenue’ taking into consideration the last year available, 5 years ago and 10 years ago.</td>
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<tr>
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<td>- Is an increasing proportion of revenue coming from tax? Has the changing proportion of tax revenue affected the budget allocation to public services, infrastructure or social protection?</td>
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<td>- What additional revenue would be required for expenditure to achieve spending targets on healthcare, education &amp; agriculture? How about to alleviate poverty or similar measure? How do these gaps compare with neighbouring countries?</td>
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<td>- Are there public policies designed to address gender inequality (also in public services where gender equality is not the primary objective)? Do these policies have adequate resources allocated within the budget? Does the government track and report on resource allocation for gender equality? What has been the trend related to total budget expenditure?</td>
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<td>- Does the government have benchmarks for financing gender equality? Is there a financing gap on gender equality public commitments? What additional revenue would be required to achieve targets?</td>
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<td>- If the revenue is not sufficient, how is the fiscal debt gap met (debt, aid, private sector)? Does the country face chronically high levels of debt? Has the country undertaken a UN Development Finance Assessment?</td>
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<td>- Have austerity measures been taken/planned, and did/would these include cutbacks on spending on pro poor and gender-responsive public services, infrastructure or social protection? What was/is the timeframe for these? Has the impact of these on gender equality been assessed?</td>
</tr>
<tr>
<td>Illicit Financial Flows (IFFs)</td>
<td>- What are the main causes of Illicit Financial Flows (IFFs) including tax evasion and avoidance - in the country? What steps has the government taken to combat IFFs? Do the tax authorities have the authority and means to investigate possible cases of tax evasion and avoidance?</td>
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<td></td>
<td>- Are there IFF data estimates? Do they include tax avoidance and evasion?</td>
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<tr>
<td>Tax revenues</td>
<td>- Provide a trend analysis of the share of tax revenues to GDP taking into consideration the last year available, 5 years ago and 10 years ago. Analyze the tax/GDP ratio based on GDP per capita over time.</td>
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<td></td>
<td>- How does the tax/GDP ratio compares to neighbours and countries of the same income level?</td>
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<td>- Are there government objectives to reach targets? Does the government set a long-term goal for the tax/GDP ratio? What is it? Are they on track?</td>
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<td>- Is tax revenue collection also carried out at sub-national level? If yes, is it a relevant share of total tax revenue collection? Are there links between regional integration and national tax policies?</td>
</tr>
<tr>
<td>Non-tax revenues</td>
<td>- Provide a trend analysis of the share of non-tax revenues to GDP taking into consideration the last year available, 5 years ago and 10 years ago.</td>
</tr>
<tr>
<td></td>
<td>- Provide a pie-chart of the share of non-tax revenues (extractive royalties, profits from public enterprises, sales of government’s assets) in the total non-tax revenues for the latest available year. How is the non-tax revenue utilized? Is it included in the budget or is it managed separately?</td>
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<td>- How are public-based royalties calculated (e.g. profit, volume or other)?</td>
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<td>- Are there windfall taxes, variable royalty rates or variable profit taxes for extractive industries? How about ring fencing rules?</td>
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<tr>
<td></td>
<td>- Is non-tax revenue collection also carried out at sub-national level? If yes, is it a relevant share of total non-tax revenue collection? Are there links between regional integration and national tax policies?</td>
</tr>
</tbody>
</table>
| Taxpayers | - What is the rate of PIT taxpayers to the economically active population and to total population? Provide an overview taking into consideration the last year available, 5 years ago and 10 years ago. If possible, provide disaggregation by gender, age, income and other relevant groups.

- Is there a tax registration system for individuals? What is the proportion of PIT taxpayers in each income bracket? What is this breakdown by gender and income quintiles?

- Is there a corporate tax registration system (Tax Identification Numbers)? How many entities have been registered? And how many businesses have been registered for VAT? Provide an overview over the past 5 years.

- How does the trend in company and individual taxpayers compare to the PIT and CIT collected revenue? Is there data on the amount of profit and revenue generated by registered businesses? Is there the same data for informal businesses? Is there an estimation of the number of formal and informal businesses in the country?

- Are there any reports (e.g. in media) of significant pending taxes owed from large corporations? Are there well-known litigation cases involving large corporations with large amounts of taxes owed?

- Provide a trend analysis of the ratio of tax revenues from public and private sectors taking into consideration the last year available, 5 years ago and 10 years ago. |
## 4. Tax competition and corporate incentives

<table>
<thead>
<tr>
<th>Topic</th>
<th>Research Analysis Questions</th>
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</thead>
<tbody>
<tr>
<td>Governance</td>
<td>- How high is the statutory CIT rate compared to neighbouring countries?</td>
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<tr>
<td></td>
<td>- Are there indications of the average effective tax rates for companies? If possible, analyze the data for both domestic and foreign companies.</td>
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<tr>
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<td>- Does your country have any corporate tax incentives? Are these incentives enshrined in legislation? If yes, are the incentives enshrined in a single legislation or in several different laws? Is there a requirement for companies to have a minimum level of investment, employment, core activities or assets in the country to have access to incentives?</td>
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<td>- If special zones have been created with corporate incentives (free trade zones, special economic zones, export processing zones, development zones), has there been any impact on labour conditions, labour rights and labour unions? Any specific impact on women or marginalized groups?</td>
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<td></td>
<td>- Are there corporate incentive tax policies supported by the IMF or World Bank (e.g. World Bank consultation, Art IV)?</td>
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<tr>
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<td>- Is your country a member of a community or union of countries? Are there any rules within this community or union on tax incentives (e.g. code of conduct on harmful tax competition)? If yes, is there a screening by this community or region of tax incentives in its member countries?</td>
</tr>
<tr>
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<td>- Are there tax reductions provided at the discretion of tax officials or government ministries? If yes, how does this happen (e.g. is there a clear procedure, who is responsible, is there parliamentary oversight)?</td>
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<td>- Are there withholding taxes applicable to companies on specific payments (e.g. royalties, interest, management fees)? If yes, what are the rates?</td>
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<td>- Does your country have specific anti-abuse rules (e.g. interest limitation or thin capitalisation rules, minimum tax rate, exit taxes, general anti-tax abuse rules)?</td>
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<tr>
<td></td>
<td>- Are there permanent establishment rules in your country? Are they based on UN or OECD standards?</td>
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<td>- Are there Double Tax Treaties in place? If yes, with which countries? Are the treaties based on the UN or OECD model? Are there LOB (limitation of benefits) rules or similar measures to prevent treaty abuse?</td>
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<tr>
<td></td>
<td>- How do companies perceive the tax system? This could include national surveys, World Bank Ease of Doing Business report or the World Economic Forum competitiveness index.</td>
</tr>
</tbody>
</table>

| Transparency | - Are corporate incentives and their impact monitored on a yearly basis by the government? Is the total revenue foregone published?               |
|             | - Does the government publish on a yearly basis the disaggregated tax expenditures data linked to each specific tax or individual tax incentive? Are companies that benefit from tax incentives disclosed? |
|             | - Are cost-benefit analyses (or other similar economic studies around tax incentives) made publicly available?                                   |

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2 Detailed list available on FTM Guidance document.
5. Effectiveness of the tax administration

<table>
<thead>
<tr>
<th>Topic</th>
<th>Research Analysis Questions</th>
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</thead>
</table>
| **Organization** | - Is there a centralized revenue authority? Is it responsible for all revenues, or is there a separate customs administration or extractive industry agency?  
  - Are local governments empowered to collect their own revenues? Are regions rich in natural resource authorized to collect related revenues?  
  - Does the centralized revenue authority work with local governments in revenue collection? Is part of the centrally collected revenue transferred to the local level authorities?  
  - What is the level of autonomy of the tax administration? Are senior staff members of the tax administration independent from political interference or strongly reliant on the current political administration? Are there reports of abuse by the tax administration against politicians or media?  
  - What is the gender composition of tax administration staff? What is the percentage of women in senior positions?  
  - Is there a unit dedicated to Large Corporate Taxpayers?  
  - Is there an international tax unit? Is there a specific transfer pricing unit established? If not, what is the transfer pricing expertise level in the tax authority?  
  - Is there an issue with staff retention (specifically for highly qualified)?  
  - Is there a unit dedicated to High Net-Worth Individuals (HNWI)? Is there a specific strategy for monitoring and assessing HNWI?  
  - Does the revenue authority have a taxpayer education/civic engagement unit or strategy? How accessible is taxpayer education for low income earners, individuals operating in the informal economy for subsistence and illiterate/low literacy populations? |
| **Resources for the tax administration** | - Provide a trend analysis of funding provided to tax authorities to GDP, taking into consideration the last year available, 5 years ago and 10 years ago. Is most of the allocated funding used for running costs or are there also capital investments in capacity development, IT and other technologies?  
  - Provide a trend analysis of number of tax officers compared to registered taxpayers/total population taking into consideration the last year available, 5 years ago and 10 years ago. Are there any reports (e.g. in media) on serious understaffing?  
  - Is any part of the tax administration funding based on taxes collected or results achieved (e.g. increased funding dependent on reaching a minimum collection amount)? Has any department or function of the tax administration been privatized? This might include tax collection.  
  - Are the local and national authorities well equipped (financial resources, human resources and expertise) to effectively collect taxes? This should include financial resources, human resources and expertise. If available, provide an analysis of the availability and quality of training programs for tax officials.  
  - Provide a description of how the tax administration has been modernizing tax collection. Is the tax administration digitized and automatically processed or have there been any steps taken in recent years to do so? Are Tax Identification Numbers in place and is it required for certification or licenses for businesses?  
  - Is it possible to file tax returns online? If yes, are taxpayers still able to file returns through analogue ways or are they exclusively required to utilize digital platforms? Provide an analysis of possible negative impacts on illiterate people and digital exclusion based in the national context. |
| Revenue shortfall | - Provide a trend analysis of revenue shortfall taking into consideration the last year available, 5 years ago and 10 years ago (amount of actual tax collected compared to official forecasts). How is the revenue forecast calculated?  
- What is the tax effort or productivity (actually taxes collected compared to potential taxes, based on the tax base)? If the tax effort is low, why is collection underperforming? What could explain the revenue gap/shortfall? Does this gap appear to be related to weakness in tax administration or overall tax policy?  
- Has the tax administration undertaken and published a TADAT assessment (Tax Administration Diagnostic Assessment Tool)? If yes, what are the weakest Performance Outcome Areas? |
| Effective Capacity | - Provide an assessment of tax administration effectiveness for each tax policy area (PIT, CIT, Wealth Taxes, VAT/Sales Tax, Presumptive Tax) by looking at tax effort/productivity, cost of collection and staff expertise.  
- Are administrative reforms currently under consideration? Please describe those and provide a progressiveness/effectiveness assessment.  
- Are international (aid) donors providing any external support to the tax administration? If so, is it through funding or knowledge/experience sharing? What are the main priorities of donors? |
| Conventions | - Is the country signatory to the OECD Convention on Mutual Administrative Assistance in Tax Matters? How about specific bilateral conventions for administrative assistance (or other similar alternatives)? Is the country actively involved in Automatic Exchange of Information?  
- If the international conventions are often utilized, does the tax administration receive/share information with similar authorities from other countries? Has this information helped improve tax collection?  
- If the international conventions are not often utilized, why is the tax administration not exchanging information? Has the government actively pursued information? Is there an issue complying with the Common Reporting Standard (CRS)? Is this information available to civil society organizations?  
- Is the country part of the IF (Inclusive Framework) & MLI (Multilateral Convention to implement tax treaty related measures to prevent BEPS)?  
- Is the country signatory to regional or international conventions related to gender fiscal policies (e.g. CEDAW)? Have there been any changes on how the government sets criteria for gender equality in fiscal policy and practice due to being part of such conventions? |
| Oversight | - Provide an analysis of oversight mechanisms for the revenue authorities. Is there a code of conduct (including sexual misconduct) and is it effectively enforced? Is there protection for whistleblowers?  
- What is the policy and practice regarding complaints about tax officers? Is there a grievance mechanism and does it work in practice?  
- Is the government willing to effectively investigate tax evasion?  
- Is there capacity/political will to effectively prosecute individuals/corporations utilizing offshore tax structures?  
- How much was spent on taxpayer audits last year? What percentage was spent on multinational companies, HNWI, MSMEs and regular taxpayers? |
| Gender | - Does the tax administration allocate resources to collect and update sex-disaggregated data?  
- Do tax officials receive training on gender equality & inclusion? Do tax collectors receive training on engaging with marginalized groups? |
6. **Government spending**

<table>
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<tr>
<th>Topic</th>
<th>Research Analysis Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>General</td>
<td>- Is there data collection on poverty-reducing spending? Is such data disaggregated by gender &amp; age? Are there specific pro-poor policies?</td>
</tr>
</tbody>
</table>
| Overview       | - What is the proportion of development & investment spending compared to recurrent expenditure for public spending?  
- Provide a trend analysis of debt/GDP ratio compared taking into consideration the last year available, 5 years ago and 10 years ago. How is debt affecting the fiscal space and investments in social sectors? What is the budget share spent on debt payment?  
- What are the sources of finance? Does the country relies heavily on aid for development & investment expenditure?  
- What is the rural/urban/regional distribution of the budget?  
- How does the country compare on public expenditure to neighbouring countries and development recommendations from international organizations and commitments? |
| Education      | - Provide a trend analysis of education expenditure taking into consideration the last year available, 5 years ago and 10 years ago. Has the government expenditure reached 4% of GDP or 15% of total public expenditure on education in the last year?  
- Does the government promote and practice the principles of universal free access to quality education? This might be evidenced in national development plans, policies, strategies and budgets.  
- Is government expenditure on education gender responsive? Does it promote gender parity in school enrolment/graduation? What are the enrolment and graduation statistics of girls in primary, secondary and higher education?  
- Does the government undertake measures to prevent absences of both students and teachers? Is primary and secondary education free and accessible?  
- Has there been any recent movement from government towards the privatization of public education (including Public Private Partnerships)?  
- Does the education department promote and practice gender responsive budgeting? This might be evidenced in sectoral development plans, policies, strategies and budgets.  
- Does the government expenditure on education take into account the needs of vulnerable groups of society? Does the government provide schooling for those with special needs and disabilities? |
| Healthcare     | - Provide a trend analysis of healthcare expenditure taking into consideration the last year available, 5 years ago and 10 years ago. Has the government health expenditure reached 15% of total public expenditures in the last year?  
- Does the government promote and practice the principles of universal free access to quality health care? This might be evidenced in national development plans, policies, strategies and budgets.  
- Is government expenditure on health gender responsive? Does it provide SGBV (Sexual and Gender Based Violence) and SRHR (Sexual and Reproductive Health and Rights) programmes? Does it make provisions for same-sex physicians? Does it make provisions to promote primary care?  
- Does the health department promote and practice gender responsive budgeting? This might be evidenced in sectoral development plans, policies, strategies and budgets.  
- Does the government expenditure on health take into account the needs of vulnerable groups? Does it make provisions for people who are not able to afford transportation and/or are not mobile (mobile clinics, transport reimbursement, delivery of medicine, home visits)? Does it provide free or subsidized drugs, medical equipment and services? |
### Agriculture
- Provide a trend analysis of agriculture expenditure taking into consideration the last year available, 5 years ago and 10 years ago. Has the government agriculture expenditure reached 10% of its total expenditure of the previous year? Does agriculture spending cover access to water, land, credit and technologies? Does spending on agriculture address the needs of small holder farmers?
- Overall, is government expenditure on agriculture gender responsive? Does the government collect gender disaggregated data on agriculture? Does it secure women’s rights over resources, such as land and water? Does it create and ensure entitlements over agricultural services (credit, insurance, technologies) on par with male farmers? Does it provide social protection cover in the form of better working conditions, equal wages, pensions, child care support or maternity entitlements? Does it guarantee equal space for woman farmers in all decision-making bodies related to agriculture? Does the government expenditure on agriculture take into account the needs of vulnerable groups?
- Does the agriculture department promote and practice gender responsive budgeting? This might be evidenced in sectoral development plans, policies, strategies and budgets.

### Social Protection
- Does the government have a social protection policy aimed at reducing risk exposure and enhancing public capacity to manage economic and social risks (unemployment, exclusion, sickness, disability and old age)? Does the government provide cash or in-kind transfers?
- Does the government promote and practice the principles of universal free access to social protection? This might be evidenced in national development plans, policies, strategies and budgets.
- Does the government provide food transfers? How about measures to address food insecurity? Does it provide school feeding?
- Does it provide contributory pension schemes? How about insurance schemes for informal sector workers?
- Does the department responsible for social protection promote and practice gender responsive budgeting? This might be evidenced in sectoral development plans, policies, strategies and budgets.
- Is there legislation to improve labour regulations and minimum standards focused on improving earnings opportunities, promoting workers’ rights and safety, and protecting against discrimination?

### Unpaid Care Work
- Are tax revenues invested in public services to reduce unpaid care work, increasing available time for education and employment? This may include public spending, tax breaks or subsidies for child/elderly care.
- Does the government recognize unpaid care and domestic work through the provision of public services, infrastructure and social protection policies? Within the national context, does the government promote shared responsibility within the household and the family?
- Does the government support or provide childcare services? Does the government support or provide services for the care of elderly or disabled dependents? Are these of good quality and universally accessible?
### 7. Transparency and accountability

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<tr>
<th>Topic</th>
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<tbody>
<tr>
<td>Information availability</td>
<td>- Is there a legislation regulating access to information/data of public interest? Is it effective in practice or does the government place barriers to avoid sharing information/data?</td>
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<td>- What is the policy regarding publishing information &amp; informing the public on the tax system (rates, revenue and overall collection system)?</td>
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<td>- What is the policy regarding the management of non-tax revenues? Are all revenues managed as part of the budget?</td>
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<td>- Are companies’ financial statements available at national business registries or other publicly accessible places?</td>
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<td>- Is the information about companies’ direct shareholders and ultimate beneficial owners public? Is this information effectively public or are there obstacles for effective access?</td>
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<tr>
<td>Audit</td>
<td>- How often do tax authorities undergo audits? Who is responsible for it? Are the results debated in parliament within a reasonable period of time? Are the audit results publicly available?</td>
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</tbody>
</table>
| OBI questions (Open Budget Index) | - Do budget proposals (or any supporting budget documentation):  
  - Identify the different sources of tax revenue (such as income tax or VAT) for the budget year?                                                                                          |
|                            | - Identify the different sources of non-tax revenue (such as grants, property income, extractive royalties, and sales of government- produced goods and services) for the budget year?                |
|                            | - Present information on extra-budgetary funds for the budget year?                                                                                                                                                        |
|                            | - Present information on tax expenditures for the budget year?                                                                                                                                                              |
| Impact assessment          | - Does the government conduct impact assessments by gender, income and other groups, to identify the direct and indirect effects of taxes/budget choices, paying particular attention to the impacts of both taxes and public spending on the poor, women and vulnerable groups? How extensive is this impact assessment? How is the assessment process? |
|                            | - Does the government make a prominent effort to promote and implement Gender Responsive Budgeting (GRB)?                                                                                                               |
| Citizens’ engagement       | - Has the government established processes to facilitate civil society participation in shaping fiscal/budget policies at the national and local levels? What is the practice? Is civil society given the opportunity to participate? How does participation work at the national and local levels? |
|                            | - Is there any policy/practice that is promoting or supporting the participation of women and women’s organizations in the development of revenue policies in particular?                                                    |
|                            | - Has there been a policy change in response to a campaign/movement on tax or budget priorities?                                                                                                                         |
| Corruption (OPTIONAL)      | - Provide an analysis of corruption practices in the tax administration or the collection of illegitimate taxes based on independent/external information, if available.                                                    |
|                            | - Are there studies that demonstrate the impact of corruption on tax morale and general voluntary compliance?                                                                                                           |