TAXATION AND DEMOCRACY IN NEPAL

Taxing Land, Labour and Capital for Achieving Rights for Everyone

Uddhab Pyakurel
Binay Kumar Kushiyait
Indra Adhikari

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This report is meant to be a starting point for developing local advocacy campaigns around issues of taxation, equity and public accountability under the auspices of the South Asian Tax Justice Network. The report itself draws on a month of research conducted in February-March 2011 by Uddhab P. Pyakurel and Indra K. Adhikari, and the economic analysis skills of Binay K. Kushiyait. We owe a debt of gratitude to all of those who contributed their time and knowledge to this report during interviews in Kathmandu and Kushma ofPrabat District of Nepal. Also we are thankful to Dr. Mahesh Chaulagai (for his help in accessing research related data), Indra Bahadur Adhikari, Basanta Jung Thakuri and SK Nepal for their help in identifying potential respondents during the fieldwork.

The Tax Justice Network is a civil society organisation based in the United Kingdom that promotes transparency in international finance and opposes secrecy. TJN was initiated at the European Social Forum in Florence in 2002, and officially launched at the British Houses of Parliament in 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. We work to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. Our objective is to encourage reform at the global and national levels. We support a level playing field on tax and we oppose loopholes and distortions in tax practices and regulation, and the abuses that flow from them.

South Asian Dialogues on Ecological Democracy, Nepal (SADED-Nepal), a non-profit/non-governmental organisation registered at District Administrative Office, Kathmandu on January 10, 2011, has been born out of work wider collaborative and creative involvement by many individuals and organizations forming a network or web of efforts, which does not have one epicentre. SADED-Nepal encompasses democratic control of natural resources and looks upon it as integral to the deepening and expansion of democracy and to the survival of humankind. The concept of 'Ecological Democracy' is central to the work undertaken in the SADED (India) framework. All the dimensions of life, also of democracy within them, are inter-linked and so focusing on any one leads to the others. Since the ecological crisis is a special one for our times, and yet is inadequately recognized, SADED-Nepal envisages strengthening the idea of comprehensive democracy through 'Ecological Democracy'. The notion of Ecological Democracy incorporates a democratic relationship between human beings and nature as well as an equitable distribution of nature's resources among human being within a nation and between nations.

This *series* is edited by:
Matti Kohonen,
Tax Justice Network, 38 Stanley Avenue, Chesham Bucks HP5 2JG, United Kingdom,
Email: matti@taxjustice.net,

Report Design and Layout:
Mr Shekhar KC
Email: kushekharkc@gmail.com,

To contact the authors of this report please get in touch with:

Indra Adhikari, PhD.
SADED-Nepal, Kathmandu.
Phone**: 01-5535628**; Cell phone: 9851068392;
Email: indrajnu@gmail.com. sadednepal@gmail.com.

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Glossary

BC: Before Christ

BEPZ: Bhairahawa Export Processing Zone

BOP: Balance of Payment

CBCR: Country-by-Country Reporting

CBS: Central Bureau of Statistics

CCI: Chamber of Commerce and Industry

GEFONT: General Federation of Nepalese Trade Unions

CIAA: Commission for the Investigation of Abuse of Authority

DRI: Department of Revenue Investigation

FDI: Foreign Direct Investment

GDP: Gross Domestic Product

ICAN: Institute of Chartered Accountants of Nepal

IRD: Inland Revenue Department

LTO: Large Taxpayer Office

MoF: Ministry of Finance and Economy

MoJ: Ministry of Justice

MoI: Ministry of Industry

MoICS: Ministry of Industry, Commerce and Supply

NBA: Nepal Bar Association

NIC: National Information Commission

NRS: Nepalese Rupees

OECD: Organisation for Economic Cooperation and Development

PAC: Public Accounts Committee

PAN: Permanent Account Numbers

PPP: Public-Private Partnership

RTI: Right to Information

SEZ: Special Economic Zones

SEZP: Special Economic Zone Project

TIEA: Tax Information Exchange Agreements

UNDP: United Nations Development Programme

VAT: Value-added Tax

VDC: Village Development Committee

1. Rights-based approach to taxation

> *Under* wise *and constitutional legislation, every citizen should contribute his proportion, however small the sum, to the support of government, and it is no kindness to urge any of our citizens to escape this obligation.*
>
> Stephen J. Field

Tax is the sum of money to be paid by the citizens to the government for public purposes, according to the income or value of purchases. It is a compulsory payment levied by a government for its support and services to the taxpayers. It can be regarded as a compulsory transfer of resources from the private to the public sector on the basis of pre-determined criteria. The large majority of Nepal's budget resources come from domestic tax and non-tax revenues. The share of domestic revenues was 10.9 percent of GDP in 2005/06 and is expected to increase to 16.4 percent[1] of GDP in 2012/13[2], and grants have also increased from 2.4 percent of GDP in 2005/06[3] to expected 4.9 percent of GDP in 2012/13[4]. Most domestic resources come from tax revenue, which in 2012/13 is expected to account for 86.5 percent of total revenues, while the non-tax revenue from extractive industry royalties, and revenue from state-owned companies, sales of state assets, fines, and user fees, is projected to account for 13.5 percent.

The fact is, then, that the vast majority of taxes are being levied as indirect taxes that are paid at equally high rates by the rich and the poor. Instead, the criteria of taxation should be determined by the

[1] MoF, 2012
[2] IMF, 2012
[3] IMF, 2007
[4] IMF, 2012

people through democratic governance. Common criteria include:

- *Raising revenue equitably and efficiently;*
- *Regulation of economic flows via transparent taxation;*
- *Redistribution of income and wealth via fair taxation;*
- *Reallocation of revenue to fund public services especially in health and education;*
- *Re-pricing of good and services to balance social and environmental costs and benefits;*
- *Representation of taxpayers as citizens and via collective interest groups*[5].

Through these principles a link can be drawn between human rights and tax and broader fiscal systems[6]. It is already the case that poverty is considered as a violation of human rights. Human rights should be understood as encompassing not just socio-political but also economic and cultural rights. Economic human rights include the right to food, education, health, security and other basic rights. Achieving these rights is conditional on the availability of financial resources to fund them. Tax abuses prevent governments from fulfilling these obligations towards their citizens. Tax is therefore key to ensuring that the state can fulfil its human rights obligations. In fact, fair and efficient tax systems can play an essential role in ensuring a level playing field for economic relations, trade and investment, while tax exemptions favour one group of citizens and businesses over another. Therefore any tax exemptions should also be evaluated on the basis of efficiency, equity and fairness. Taxes also provide the financial basis for most public spending, alongside with non-tax revenue from extractive industries, foreign aid grants, central bank money, and loans. Of these revenue categories, the different types of taxes far outweigh any other type of public finance. Together public services and fair tax systems also reduce economic inequalities in society.

Monarchy, by its nature, is evidently an institution with less transparency and more immunities and privileges in Nepal, in comparison with any form of democracy – either parliamentary democracy or social democracy. As far as tax is concerned, the royal house members receiving a stipend were exempt from income tax over that stipend. They were not only exempt from all personal taxes over assets and possessions that they use or need in carrying out their functions for the kingdom, but also from inheritance tax on inheritances received from the members of

[5] TJN-Africa, 2011
[6] International Bar Association, 2013

the royal house. Reports by the sub-committee of Parliament's Natural Resources Committee indicate that Nepali monarchy had grossly misused such tax exemption in making money out of that provision. It is said in the report that the former king Gyanendra and his family members had an ownership of 18 big companies, big hotels, cigarette and biscuit factories, tea estates, travel companies and hydropower projects since he was the crown prince. Likewise, according to the report the King owns over 40,000 ropanis[7] of land in different parts of the country, and other members of the royal family have an additional 4,000 ropanis[8]. This is why political parties have raised the issue of tax leakage and tax evasion by Nepali monarchy as part of their struggle for democracy in Nepal. As an inherent part of the aspiration towards democracy and commitment to good governance, taxation has been a major agenda for almost all the political parties.

The goal of the study is to increase the awareness of the following major objectives among civil society, media and stakeholders:

- *Introducing taxation for a civil society audience;*
- *Providing an insight into Nepal's tax system;*
- *Assessing recent domestic, regional and international initiatives as they relate to Nepal.*

This report gives a historical overview of Nepal's tax system and the process of on-going tax code reform, along with the citizen participation in this process. The tax collection areas and tax incentives provided by Tax Laws of Nepal have also been discussed at length. Further, the issue of tax and representation has been surveyed among ordinary Nepalese with regard to their impressions and attitudes towards paying taxes, and their feeling about the tax contract.

Public Debate on Taxation in Nepal

Tax leakage and tax evasion have become common phenomena in today's Nepal even though Nepal has turned into democratic governance only with the ouster of monarchy in 2006. At present, there are 507 big taxpayers who are dealt at the Large Taxpayer Unit (LTU) among the total of 800,000 taxpayers in the country, which is less than 3 percent of the country's population, according to the government[9]. More than 600,000

[7] Ropani is a Nepalese measurement of area corresponding to 74 feet × 74 feet or 22.6 metres x 22.6 metres.
[8] *The Kathmandu Post,* 2006.
[9] Nepal News, May 12, 2012

taxpayers out of the total are small taxpayers. Almost all the business houses may be evading taxes in one way or another.

Tax evasion has become ever more common in Nepal, as exemplified by the number of cases both in the media and in government publications in the recent years. A recent report by the Department of Revenue Investigation of Nepal indicates a revenue leakage of Rs. 3.44 billion[10] during the first four months of the current fiscal year[11]. This unpaid VAT would be enough to pay for the cost of the country's financing gap for scaling up maternal health services by investing in infrastructure and training more skilled birth attendants are between Rs. 1.26 billion to R.s 2.91 billion[12].According to another report, 385 firms were engaged in producing counterfeit VAT bills in order to evade taxes[13]. However, the number of companies rose later to 518[14]. Interestingly, most of these firms that produced counterfeit VAT bills are big corporate houses in Nepal. A total of 4402 tax payer firms are under the scanner of Inland Revenue Department (IRD) for VAT/Tax evasion in Nepal in 2012[15]. Similarly, there are around 3200 business enterprises, mainly small and medium-sized ones, having annual transaction of more than 2 millions, which were found to have been VAT evaders over the past two years[16]. These firms allegedly inflicted the loss of Rs. 4 billion on state income either by evading VAT or not registering for VAT[17]. Also, only around 248 out of some 1053 brick kilns operating across the country are registered with VAT. As a result Nepal is losing more than five billion rupees per year[18]. This unpaid VAT could pay, for instance, the expansion in the coverage of health services.

Part of the problem is the unwillingness of taxpayers to cooperate in paying taxes. The IRD officials said that the factories have been refusing to pay VAT despite conducting transactions worth millions of rupees. It is reported that the owners of brick kilns begin to collect money to bribe tax officials once the IRD starts compelling the factories to register with VAT. "They collect and mobilize almost 10 million rupees per year not only to avoid registering to VAT but also to

[10] The Nepalese currency unit is the Nepalese Rupee (NPR), and one Nepalese Rupee is 0.62644 Indian Rupees (INR) or 0.01006 US Dollars (USD)
[11] The Kathmandu Post *Report, April 16, 2012*
[12] Ministerial Leadership Initiative 2012, sums converted from USD.
[13] *The Telegraph*, April 9, 2012
[14] *The Kathmandu Post* Report, April 16, 2012

[15] *Kantipur*, May 25, 2012
[16] R*epublica*, May 25, 2012
[17] ibid.
[18] *Kantipur*, February 6, 2013

escape tax amount of billions [...] it has become a common phenomenon for years", the report states[19]. If a brick factory registers with VAT, it needs to pay 13% of its income as VAT. For example, if a company sells more than 70 million bricks a year, it has to pay around Rs. 5.2 million, provided it is registered with VAT. If not, it pays only Rs. 0.15 million. It is said that there are dozens of such factories selling more than 200 million bricks per year.

Interestingly, instead of settling their outstanding dues, it is reported that the firms under the IRD scanner are exerting pressure on revenue officials for waivers through local Chambers of Commerce and Industries (CCIs). "We are facing pressures from VAT defaulters for dues waiver. We've also been getting memorandums from local CCIs for such waivers", says Ghimire, quoting Tanka Mani Sharma, Director General of IRD in Nepal. According to government officials, they are helpless in bringing firms under VAT threshold[20]. The IRD officials said that the factories have been refusing to pay VAT in spite of conducting transactions worth millions of rupees. "We have waited for them to come under the VAT net for a long period, and the government had also formed a dialogue committee," said Sharma. "The dialogue committee has recommended that VAT should be imposed on the brick factories," he further states[21]. And, once one reads the statement of Director General of IRD of Nepal regarding the issue, he/she understands the government's helplessness in bringing them under VAT threshold. "Our effort to get them registered for VAT is not paying dividend", he states[22].

Taxpayers often evade tax with the help and connivance of the tax officers concerned. Chapter 23 of the Income Tax Act, section 29 of the VAT Act and section 16 of the Excise Duty, deal with the provisions of penalties for the violation of tax laws and rules. Despite all these mechanisms, corruption is rampant in the country. It pervades all levels – from top to bottom. According to the official data only about 10 percent of the house owners have been paying taxes[23], and among them many have been undervaluing the rental contract and paying less than what is due[24]. Generally, anyone who makes earning by renting their house, land, and other properties will come under the rental tax net, according to the IRD. However, more than 90 percent people are considered to evade paying it. By their

[19] *Kantipur*, February 6, 2013
[20] *Republica*, May 25, 2012
[21] *Kantipur*, June 12, 2013
[22] *Republica*, May 25, 2012
[23] *The Kathmandu Post*, April 9, 2012
[24] *The Kathmandu Post*, May 1, 2012

social status, they are above the middle classes, and thus they should be above the minimum tax bracket.

The IRD states that it has also been facing difficulties in bringing high earning professionals under the tax net as their associations have been unwilling to provide details of their members. It is reported that the IRD had written to the Nepal Bar Association (NBA), Medical Council, Veterinary Council, Institute of Chartered Accountants of Nepal (ICAN) and the Department of Cooperatives, among others, in May 2012, asking for particulars of their members. *The Kathmandu Post* quotes a senior IRD official, who did not want to be identified, as saying: "Our aim is to compare the number of professionals who are registered with the tax office and those who are not," he states, to able to identify professionals who are not in the tax net. Elsewhere, good practice with associational taxation or presumptive taxation has shown signs of increasing taxpayer compliance through existing institutional structures.[25] However, the IRD said they have not fulfilled the request. "We are really shocked with the unprofessional behaviour of most of the professional organisations from whom we have asked for details of their members." Therefore, both the taxpayers and tax officers are equally responsible for not tackling tax evasion seriously enough.

In fact, the type of tax-dodging creates problems for not only the poor but also for the wealthy nations. It forces low-income countries like Nepal to struggle even more to be able to provide basic needs for their citizens. When large corporations avoid paying their fair share of taxes, it forces everyday people to shoulder the majority of the tax burden, while public services remain underfunded. In that situation, the genuine taxpayers face and uneven playing field, and may have no option other than follow other defaulters or shut down the business. Eventually, this contributes to economic, political and social crises. Thus it is an unfortunate reality for Nepal that there is still a large section of population which see that taxing and tax related issues are not their primary concern. As a result, they remain quiet, while a handful of people manipulate huge sums of state revenue with little accountability to the people.

There are no credible estimates of the scale of the problem of tax dodging in Nepal, but according to some international estimates the annual illicit financial flows out of Nepal for the years 2000-2008 were

[25] Joshi and Ayee, 2008

around the scale of US$565.6 million per year[26]. This is more than the average annual amount of official development assistance in the same years, which measured at US$485.4 million.[27] The UNDP ranked Nepal among the most affected low-income countries regarding Illicit Financial Flows and recommended improving financial transparency and regulation.[28] In this respect the Ministry of Finance is in the process of drafting a law regarding transfer pricing, in order to curb commercial sources of illicit financial flows.[29]

Here, the question arises if there is any way out to overcome the problem. Since rampant corruption, at all levels of government, is becoming the definitive characteristic of the country's rocky transition to peace, after a decade-long civil war between Maoist rebels and the state between 1996 and 2006, the tax system alone cannot be seen as an exceptional case, but rather as an integral part of this transition.[30] To many observers these problems seem to share a common cause: politicians enjoy freedom to plunder with impunity. It has been shown in many other countries that taxpayers continue to resist paying taxes as long as there is little or no accountability for the use of public funds[31]. The similar scenario of corruption can be found in local government. Each year local authorities including Village Development Committees (VDCs) and municipalities receive funds designated for development. But reports state that as much as 60 to 90 percent of all funds are misused in the southern plains, an area called the Terai, whereas in the hill districts such a misuse is between 25 and 50 percent. The following quote shows the level of corruption at the local level:

> *[...] local officials, politicians, journalists and activists told a series of remarkably consistent stories. Each was marked by systematic fraud, the financing of political networks to benefit powerful local figures and, indirectly, criminal gangs. The accounts the storytellers gave of individual scams became repetitive: buildings paid for but never built, or simply repainted and passed off as new. The same roads were supposedly rebuilt—as if from scratch—every year. A commonly reported trick is to record as one item the construction of a road from A to B and then again, on a separate line, the road from B to A*[32].

Corruption has been recognized even by senior officials of the government. "If I take action against corruption," said the Chief District Officer in one Terai district, "there will be a mob outside and inside my

[26] Kar and Curcio, 2011
[27] World Bank, 2012
[28] UNDP, 2011
[29] *Himalayan News Service* 2012
[30] *The Economist*, May 31, 2011
[31] Fjeldstad 2008; Cheeseman 2013
[32] *The Economist*, May 31, 2011

office[33]." He is, in fact, true in his statement.

The Chitwan incident proves him true. It was an incident where unrest reported at the Narayangadh market (Chitwan district) remained tense on June 6, 2012 after merchants set on fire vehicles used by officials of the Department of Revenue Investigation (DRI) and locked up members of an inspection team. It is said that all hell broke loose after the seven-member rapid inspection squad led by DRI director Bharat Raj Subedi stormed into the Laxmi Narayan Bastralaya (shop) in Sahidchok, Narayan Chowk in the early hours and sealed the store on charges of evading tax. According to the officials, they suspected a significant amount of tax evasion in the store. DRI Director General Janma Jaya Regmi said they raided the store after they received information that it was involved in illegal transaction of imported readymade clothes. "The squad was sent only after we received an authentic report that smuggled apparels were dumped in large quantities in the four-storey warehouse", he says. He also accused the Chitwan Chamber of Commerce for not helping the government in tackling the tax evasion. Once the shop was raided, the mob of the locals forced the DRI officials to break the government seal that had pounded the shop and its goods due to the tax evasion charges.

It seems that the trend of growing protest to evade tax is increasing. After a month of Chitwan incident, locals from Dharan Municipality called for Bandha (general strike) in protesting the increase in property tax imposed by the Dharan municipality[34]. Here, a serious question arises whether the general public is either reluctant or supportive to the defaulters and if there is a tax related case? In the context described above, this study looks at key topics, both domestic and international, regarding Nepal's tax system, and its historical development.

Most domestic resources come from tax revenue in Nepal. The share of tax revenue was expected to account for 86.5 percent of total revenues in 2012/13, whereas it was only 13.5 per cent of the non-tax revenue.

[33] ibid.

[34] *Republica*, September 22, 2012.

2. Historical Overview of the Nepalese Tax System

The king employs a considerable part of the tribute in grants of largesse, bestowed by way of banquets or presents, to those whose support consolidates his authority, whereas their defection would endanger it. Do we not see modern governments as well using the public funds to endow social groups or classes, whose votes they are anxious to secure? Today the name is different, and it is called the redistribution of incomes by taxation.

Bertrand de Jouvenel

The political history of Nepal shows the existence of various forms of tax since the ancient period[35]. "Taxes were imposed as per the *Shastras*, *Kautilya Nitee*, *Manu Smriti*, *Yagyavalkya Smriti*, during the ancient period. Kautilya, Yagyavalkya and Manu were great philosophers of Eastern civilization during ancient time. The principles and philosophy propounded by them were known as Kautilyaniti, Yagyavalkya Smriti and Manu Smriti. Kautilya was also popularly known as Chanakya and his principle as Chanakyaniti. Chanakya was an advisor of the first Maurya Emperor Chandragupta Maurya, who is said to have ruled in India during 320 BC to 298 BC. The main principle of taxation at that time was to impose tax without hampering the taxpayers.[36] According to the *Shastras*,

[35] Dahal, 2004

[36] Kandel, 2011

taxes were to be imposed in a manner one would collect honey from the beehives or get milk from the udder of a milk cow."[37] Tax was collected at that time to launch various government programmes. According to Kautilya, "The launching of all programmes depends first and foremost on the treasury."[38]

The Licchhavi rulers entered Nepal around the middle of the fifth century B.C. from the Republic of Vaisali (presently northern part of the state of Bihar of India)[39] and ruled Kathmandu Valley till 750 B.C. They imposed three forms of *Karas* (taxes): *Bhaga*, tax on agriculture, *Bhoga*, tax on livestock and *Kara*, tax on trade. *Matsya Kara* (imposed on fishing), *Palabdu Kara* (imposed on onion and garlic), *Malla Kara* (imposed on wrestling), *Goyuddha Kara* (imposed on bull fighting), and *Sin Kara* (imposed on firewood), were some of the taxes of that time. Ansubarma, one of the Lichchavi kings, imposed water tax and religious monument repair tax. At that time, a tax on the income of the farmers from agriculture was imposed at the rate of 1/6, 1/8 and 1/12 shares of crop production depending on the land quality[40]. Equity in taxation was established through capacity to pay.

[37] ibid. p.3
[38] Ibid. p.1.
[39] Pyakurel, 2009, p. 29
[40] Dahal, 2004.

The Mallas replaced Licchhavi rulers and ruled Kathmandu Valley for almost three centuries from 1200 to 1484 B.C. They seem to be the first rulers who started imposing taxes on land. King Jayasthiti Malla (1381-1395) imposed taxes not only on *Daha Sanskar* (cremation) but also for the purpose of Hindu caste and purity related issues. Regmi[41] has mentioned that tax provisions were introduced to maintain Hindu cast hierarchy during that time. According to him, taxes were imposed for transgression of caste laws or violating commensality or co-habitation norms. There was also tax on every male buffalo, boar, and pig killed in public places, either at a public lawn or side of a thoroughfare. Regmi further informs that there were taxes on land property and on imports of commodities till 15th century. According to him, the Nepal government started taxing foreigners, especially the Tibetans, on their entry into Nepal since 15th century. Tributes from the feudatories formed another source of revenue[42]. He states:

> *"Although we have no means to know if there were taxes on commodities, but considering the materials of the ancient period it can be presumed that the state levied excise on certain articles of consumption, both necessaries and luxuries. The gleaming from the ancient taxes also lead us to presume that there*

[41] Regmi,1965, pp.527-528.
[42] Ibid.

was a tax on oil, fishes, flows and pigs, and on woods and leaves."

The subsequent Shah regime also continued the tax system of the Mallas, which was based on land and trade. After the unification of the country, different types of taxes i.e. land tax, transit tax, forest product tax, mining tax, and market duties were levied. There were different types of taxes like *Walak* (collected from each family to celebrate national festivals), *Gaddimudarak* (collected for financing coronation ceremony of the new King), *Chumawan* and *Goddhwa* (collected in the time of ceremony of conferring ranks to the royals and the wedding ceremonies of Princes and Princesses). *Godan* was another form of tax which was collected for funeral ceremony of the reigning king. King Prithivi Narayan Shah (1722-1774) introduced *Pota* tax in 1772. This system of tax was based on a flat rate system and was limited to small *Birta* owners. *Birta* was the land that generally enjoyed tax exemption. However, the birta system was abolished after 1951. Excise duty was introduced during the reign of Surendra Bikram Shah (1829-1881).[43]

The Ranas ruled the Kingdom of Nepal from 1846 until 1953, reducing the Shah monarch to a figurehead and making the Prime Minister and other government positions hereditary. For Ranas, the main source of government revenue was land tax, customs duty and excise duty. The tax system was based on a contract and *Amanat*. *Jimmal*, *Mukhiya*, *Dittha* etc. were the persons who used to collect taxes. *Sanads* and *Sawals* were the laws guiding the tax system. *Lagati* (based on *lagat* record) and *Hasawali* (not based on record) were the two types of revenues. *Jamma Najodnu, Kachcha Nachhodnu* (not to get total and not to leave even a single penny) was the principle of revenue collection in the Rana period[44]. This principle was arbitrary and discretionary, and reflected the predatory nature of tax collection at the time.

Colonialism had a minimal influence on Nepal's tax system in the past as it was among the few countries in the region that was never colonized by a foreign country. The modern tax system, however, began only with the advent of democracy in the 1950s, with an overhaul of the tax system in 1951 as one of the first steps. From the ancient period till date, tax remains one of the major sources of revenues for the government.

[43] Kandel, 2011.

[44] Ibid

3. The Tax System in Nepal

> *People want just taxes more than they want lower taxes. They want to know that every man is paying his proportionate share according to his wealth.*
>
> Will Rogers

Today, the Inland Revenue Department (IRD) oversees the enforcement of tax laws and administration and also monitors the non-tax revenue such as dividends, royalties etc. The IRD carries out the following functions[45]:

- *Tax Administration (Income Tax and Value Added Tax, VAT)*
- *Tax policy*
- *Tax paying services*
- *Registration, revenue collection*
- *Tax audit*
- *Tax enforcement and investigation*
- *Review and appeal*
- *Tax refund*
- *Advance ruling*
- *Tax treaty and international taxation*
- *Excises and liquor administration*
- *Monitoring of non-tax revenues*

Income tax, VAT, customs duty and excise duty are the major sources of government revenue in Nepal. Besides, the IRD taxes are also collected at the local level by the local bodies as per the Local Self-Government Act 1999. According to this Act, these bodies are permitted to levy taxes and charges such as land revenue and house tax, rent tax, enterprise tax, vehicle tax, property tax, entertainment tax, commercial video tax, advertisement tax, and parking and service charges among others, to meet their administrative and other expenditures.[46] It is to be noted here that the government amends tax laws and regulations through the financial acts and ordinances if it deems necessary to do so.

To facilitate mutual international cooperation, the government has concluded Avoidance of Double Taxation and Prevention of Fiscal Evasion Agreements with China, Austria, India, Korea, Mauritius, Norway, Pakistan, Sri Lanka and Thailand.[47] The agreement

[45] Inland Revenue Department, 2013

[46] IMF, 2007, p. 6

[47] Inland Revenue Department, 2013

with India has been recently renegotiated to allow for tax information exchange to take place on the basis of "foreseeable relevant" grounds, as mentioned in the Article 26 of the Organisation for Economic Cooperation and Development (OECD) model tax treaty[48]. In the light of recent research, these treaties may also provide loopholes for companies to engage in tax planning[49]. Nepal has not signed any Tax Information Exchange Agreements (TIEAs), which would in addition provide the possibility of bilateral tax information exchange; nor has it signed to the Mutual Convention on Tax Matters, launched in 2011, which provides the possibility of automatic information exchange. In July, 2013, the G8 summit in Lough Erne, United Kingdom,[50] agreed to further automatic information exchange between tax authorities and public registries of company owners. If implemented, this would mean an automatic knowledge of Nepali accounts in the notorious tax havens such as Mauritius and Switzerland.

Income Tax

The concept of income tax was introduced only lately in the country's tax history. The concept was first dealt in the fiscal budget of 1951. However, it got implemented only in 1959 when the first democratically elected government introduced Finance Act and Business Profits and Remuneration Tax Act in the same year[51].

The Income Tax Act 1962 replaced Business, Profit and Remuneration Tax Act of 1959. In 1974, the Income Tax Act 1962 was replaced by Income Tax Act, which was amended eight times and existed for a period of 28 years. The Income Tax Act 1974 and all the income tax related provisions made under other special enactments have been repealed, and the existing Income Tax Act 2002 became effective on April 1, 2002. This Act governs all income tax matters and is applicable to the persons not only within the country, but also to those who live outside the country[52]. In fact, the income tax act imposes tax on income or wealth created by a person either in the country or outside the country. There are basically three sources that generate income i.e. labour, capital, and labour together with capital. Correspondingly, the Act imposes tax on income earned from employment - which is labour; income earned from investment - which is capital, and income earned from business - which is labour plus capital. This means that the income

[48] *The Hindu,* 2013
[49] Eurodad, 2013
[50] United Kingdom Government, 2013

[51] Kadel, 2013
[52] Inland Revenue Department, 2013

created from outside these sources is not taxable[53]. As per section 3 of Income Tax Act, 2002, tax is imposed on the following persons and is collected in three instalments. The Act imposes income taxes on the following individuals for each income-year:

- *Person, who has taxable income for the year;*
- *Foreign permanent establishment of a non-resident person situated in Nepal that has repatriated income for the year as mentioned;*
- *Person, who receives a final withholding payment during the year.*

Taxes can be paid in three instalments in a year. Seen from the administrative point of view, the Income Tax Act is based on a self-assessment system. That requires taxpayers to calculate their tax by using income tax forms prescribed by the tax administration. The tax authorities should accept taxpayers' declarations unless there are reasons for amending their statements[54]. This raises issues connecting to taxpayer consent, concerning the willingness in declaring the correct amount of income, and on the other hand, the tax authority's capacity to assess whether the amount the taxpayer has declared is correct[55]. Assessment efficiency also depends on the availability of information concerning businesses operations on a country-by-country basis as well as automatic access to information concerning private wealth in all possible jurisdictions where they can be held.

[53] Inland Revenue Department, 2002
[54] Ibid.
[55] Bräutigam, Moore and Fjeldstad, 2008

Personal Income Tax Rate

Nepalese Income Tax Act makes a distinction between the natural person and the entities in the case of levying income tax. In the case of a natural person, a distinction is again made between an individual and a couple. Basically, there are four slabs of income taxes that are applicable to the taxable income of any resident individual or a couple, as stipulated in the schedule 1 of the Income Tax Act.

Presently, the structure of tax rates on the taxable income of any resident individual in any income year[56] is as follows:

a) *If the taxable income on employment does not exceed Rs. 1,60,000 the tax is levied at the rate of one percent.*
b) *If the taxable income is more than Rs. 1,60,000 but less than 2,60,000, Rs. 1,600 for up to Rs.1,60,000, and at the rate of 15 percent for the remaining amount.*
c) *If the taxable income is more than Rs. 2,60,000, then he/she needs to pay Rs. 16,600 for up to Rs. 2,60,000, and the rate of 25*

[56] Income Tax Act, 2002

percent applies for the exceeding amount, and

d) *If the taxable income is more than Rs. 25,00,000, additional 40 percent tax is levied to the amount derived from "c" above.*

e) *Nonetheless, in the case of the taxpayer being a sole registered firm, the one percent tax, pursuant to "a" is not levied.*

However, in the case of couples, tax is levied by the following rate on the taxable income in any income year:

- *If the taxable income on employment does not exceed Rs. 2,00,000, one percent tax is levied.*
- *If the taxable income is more than Rs. 2,00,000 but less than Rs. 3,00,000, the tax is levied at the rate of Rs. 2,000 for up to Rs. 2,00,000, and then 15 percent for the exceeding amount.*
- *If the taxable income is more than Rs. 3,00,000, Rs. 17,000 for up to Rs. 3,00,000, and at the rate of 25 percent for the exceeding amount.*
- *If the taxable income is more than Rs. 25,00,000, additional 40 percent tax is levied to the amount derived from "c" above.*
- *Nonetheless, in the case of the taxpayer being a sole registered firm, the one percent tax, pursuant to "a", is not levied.*

According to the schedule (1) of the Act, the following amount of tax is applicable for those who run businesses.

- In the case of a natural person running a business in the municipal corporation or sub-municipal corporation area: Rs. 3,500;
- A natural person running a business in the municipality area: Rs. 2000;
- A natural person carrying out a business in any other places: Rs. 1,250.

However, the Tax Act also provides a tax relaxation to the pensioners (in pension income, tax is computed only on the amount of the balance remaining after subtracting an additional 25 percent of the amount from the taxable income); differently-able people (additional 50 percent of the amount is deducted from the taxable income, and tax is then calculated on the remaining amount only); women (concerning a woman's income from labour, 10 percent of the taxable amount is exempted). Similarly, when a resident individual procures an insurance business, the amount to be set by investment insurance or Rs. 20,000, whichever is lesser, out of the premium paid for the same, is allowed to be deducted from the taxable income, and tax is then calculated on the remaining amount only.

There are also a number of special tax regimes in Nepal. As far as the owners of vehicles on hire are concerned, the Act has categorized vehicles into four categories and fixed annual tax as per the categories. Also, if an individual is fully engaged in the operation of a "special industry" as mentioned throughout any year, tax is charged by 20 percent of the taxable income and 15 percent on the taxable income, if it is earned by a natural person from exports in any income year.

In the case of non-resident persons, tax is levied by five percent on the taxable income. However, in the case of a non-resident person providing telecommunication, air transport or water transport services, tax is levied by two percent. These three sectors therefore receive a tax incentive to attract foreign investment in these areas.

In the case of **entities**, the income tax seems to be discriminatory in nature as it is different for different entities "based on their importance and need in the course of the country's development". It is more liberal to those who are considered by the government to contribute to the development of the country. The structure of income tax as stipulated in the Act is as follows:

- *20 percent on the taxable income earned by any entity (cigarette, Bidi, cigar, chewing tobacco, liquors and beer), through its source in Nepal, from exports in any income year.*
- *30 percent on the taxable income of any bank, financial institution, an entity carrying out general insurance business or petroleum works pursuant to the Nepal Petroleum Act, 2040 (1983), in any income year.*
- *20 percent on the taxable income of any entity that carries out projects such as building, operating any public infrastructure project and transferring it to Government of Nepal and building power-house, generation and transmission of electricity.*
- *Similarly, 20 percent income tax is levied on the taxable income of the industries that are involved in the operation of special industries or construction companies involved in the building and operating of any roads, bridges, tunnels, ropeways, sky-bridges, trolley bus, trams or any cooperatives (except for the cooperatives which are registered pursuant to Co-operative Act, 2048 and enjoy tax exemption in their transactions).*

The same rate of income tax is applicable to the taxable income earned by any entity from exports through its source in Nepal. While it is levied by five percent on the income sent abroad by any non-resident person's foreign permanent establishment situated in Nepal, it is levied at the rate of two percent in the case of such a non-resident person who has been providing services like telecommunication, air transport and water transport services under some specified circumstances. The differential rates of corporate income tax mean that the tax system is used as an economic development tool in Nepal, through incentives and exemptions.

Informant regime on tax evasion

The Nepalese government has established a system known as Tax Rewards, whereby those who act as informants to the government concerning tax evasion receive a part of the income resulting from a tax inspection as a Tax Reward. The system has been established because tax evasion remains a major problem in Nepal. The tendency to evade tax is rampant not only among the individuals but also among the big business houses. This has thus adversely impacted the mobilization of government resources for development projects as well as public services. Therefore, in order to discourage tax evasion, the Income Tax Act has made a provision whereby 20 percent of tax amount out of the total evaded tax that has been recovered from an evader is given as a reward to the individuals who inform with evidences of the occurrence of such evasion. The success of the system is unknown, as no official evaluation of the regime exists.

Value Added Tax (VAT)

VAT was introduced in Nepal after the restoration of democracy in 1990 with the aim of reforming the taxation system and making it more uniform, transparent and efficient. The VAT largely replaced previous sales taxes, and in terms of the revenue it has covered the loss of revenue from decreasing customs revenues since Nepal signed up to the World Trade Organisation. The VAT was expected to increase tax base and remove the cascading effect that existed under sales taxes, where in each step of value-added a new tax burden would be applied on the product, making it unfair for industries that had several levels of manufacturing. The VAT was also thought to encourage exports, increase transparency and minimize tax evasion in the country. Economists in Nepal believe that the VAT adds less cost to the economy than customs duties, domestic trade taxes and other taxes except retail sales tax. Consequently, it is widely accepted as "an effective way of generating revenue[57]".

[57] Khadka, 2004

The Value Added Tax Act 1996 got the Royal Seal on 20 March 1996 and came into effect on 16 November 1997. However, the government failed to implement it fully until the fiscal year 1998/99, due to political instability and strong opposition from the business community. The VAT Act 1996 has repealed the Sales Tax Act 1967, Hotel Tax Act 1962, Contract Tax Act 1967 and Entertainment Tax Act 1960. The VAT Act has been amended from time to time through the financial acts/ordinances. After the introduction of the VAT, the Tax Department and the VAT Department were merged to form the Inland Revenue Department (IRD) in 2002. Prior to the merger, income tax was under the jurisdiction of the Tax Department, whereas the excise duty and VAT were under the jurisdiction of the VAT Department. Since the merger, the IRD is solely responsible for the formulation and implementation of tax policy and the administration of various taxes such as income tax, value added tax, house rent tax, interest tax and excise duty and the other taxes as specified.

In fact, the VAT is a broad-based tax that covers the value added to each commodity by a firm during all stages of production and distribution. According to section 5 (1) of the Value Added Tax Act 1996, VAT is levied on the transactions of goods and services supplied within Nepal, goods and services imported into Nepal, and goods and services exported outside of Nepal.

The rate of VAT to be levied in any fiscal year shall be in a single rate as prescribed in the financial Act made for that fiscal year[58]. It is now in a single rate of 13 percent. However, no VAT is levied on the transactions of goods or services mentioned in schedule-1 of the VAT Act, under prescribed condition and it is at zero rates in the case of the transaction of goods and services as mentioned in schedule-2 of the Act. The current threshold for the purpose of VAT registration is Rs. 2,000000. It means that the registration is not compulsory for vendors whose annual turnover is below the threshold. This reduces the administrative burden on the very poorest, who have low trading volumes in village markets. Moreover, taxpayers who fall below this limit are required to register themselves at the VAT Department within 30 days of their annual transaction reaching or crossing Rs 2,000,000. However, it is compulsory for all vendors to register with the VAT office "if a tax payer’s stock exceeds the specified amount when the tax officer inspects the stock or if the monthly sales

[58] Government of Nepal, 1996

exceed Rs. 200,000 or more during a month; if the annual expenses of the tax payer on the telephone and the rent exceeds Rs 100,000 or if the premises of the taxpayer lies within the specified area of the market or the street as specified by the IRD."[59] In practice these other provisions are used as ways of estimating the taxpayers who are likely to have monthly sales in excess of the established minimum threshold.

This Act mandates registered persons to use their VAT registration numbers for all transactions related to value added tax, excise customs and other transactions as prescribed under sec. 10(6) of the Act. However, taxpayers are often found evading taxes despite this anti-evasion measure. One common tactic is that evaders maintain double accounts in most of the cases: one for their own use, which shows their actual transactions and the other for the tax purposes. This covers a very insignificant part of their total transactions, so the tax liability is minimized. In other cases, they do not issue authentic receipts of their transactions, as it is only authentic receipts that they need to give account for the tax authority. Therefore, the conditions mentioned in the above paragraph, which are also known as the proxy criteria, are imposed for discouraging tax evasion. In order to discourage malpractices, VAT laws have given tax officers the authority to inspect and audit business houses and check irregularities, if any. These random checks should deter tax evasion, since it raises the risk of being caught and having to pay fines.

Many newspaper articles have been covering the news of tax evasion by the business houses and individuals from time to time, raising the issue of risk to company reputation as a result of tax evasion. Among all such news coverage by print media, one of the news articles has been reproduced here in the box (Box–1) given below.

The modern tax system in Nepal, however, began only with the advent of democracy in the 1950s, with an overhaul of the tax system in 1951 as one of the first steps.

[59] Inland Revenue Department, 2013

Box-1

VAT Scam: Government makes public companies, firms under scanner Kathmandu, Oct 30, 2011

The government has made public names of some firms that are being probed in the much-talked-about Value Added Tax (VAT) evasion scam. The Finance Ministry's decision to make public a report of its investigation into the multi-billion rupees VAT Evasion scandal follows directives from the National Information Commission (NIC).

The ministry has handed over the report to Freedom Forum, a non-government organisation that had filed an appeal with the NIC in line with the Right to Information (RTI) Regulation.

The ministry had been hesitating to make public the names. It had also told the Public Accounts Committee (PAC) that it was unable to furnish the details as the VAT and Income Tax Act required it to maintain secrecy and disclose such details only to designated officials. The PAC had asked the ministry to submit the details of the tax evaders. The Acts allow only the finance minister, officials related to tax collection and courts to view such information. The Freedom Forum had appealed to the NIC and said it was not satisfied with the Finance Ministry's decision to not disclose the information. The NIC had asked the government to submit the photocopy of the VAT evasion study report-2067 BS, including its annexes 1, 4 and 7.

"We submitted the report as per the direction of the NIC," Finance Secretary Krishna Hari Baskota said.

The report reveals involvement of some of the country's leading business houses and firms under them in the VAT scam. The report forwarded to the Freedom Forum was prepared on March 4, 2011.

The report has listed names of 385 firms that issued fake VAT bills, their Permanent Account Numbers (PAN) and names of companies that used the bills issued by such firms.

The report has also disclosed 35 companies that used fake bills and their PAN numbers. The report has included names of 10 companies that were referred to the authorities concerned for investigation. It, however, does not mention the amount of tax evaded as investigations were on when the report was prepared.

However, it has included names of seven firms that received money from the state coffers under the tax return facility. The Inland Revenue Department (IRD) had directed the Inland Revenue Offices concerned to probe 518 companies, including 52 mentioned in the report, terming their transactions suspicious as of mid-April 2011. Of them, probe on 365 firms has already been completed, according to the IRD. The department has slapped tax bills of Rs 3.45 billion on them.

As many as 65 taxpayers have applied to the administrative review committee headed by the IRD Director General for a review of the tax bills. As per existing provisions, firms that are not satisfied with the tax amount slapped on them can ask for an administrative review within 60 days of the determination of the fine.

They can apply for the review after putting up one third of the total amount that the tax office sought to recover from them. The taxpayers can further apply to the Revenue Tribunal by putting 50 percent bail amount of the total amount of the fine.

Firms that got tax returns on the basis of fake VAT bills

Sarita Enterprises	Rs 5.04 m
Sarita International Business	Rs 5.31 m
Ashutos Impex	Rs 17.22m
Shivashakti Impex	Rs 16.95m
Digambar Trade House	Rs 11.26m
Digambar Trade International	Rs 45.60 m
Bhimeshwor Trade House	Rs 14.33 m

Source: *The Kathmandu Post*, Posted on: 2011-10-31 07:41[60]

[60] *The Kathmandu Post,* October 31, 2011.

The tax law is quite clear on the duties of taxpayers. According to section 19 of the Act, a taxpayer has to pay tax for each month within twenty-five days from the closing of the month. Failure to do so results in the imposition of an extra 10 percent charge on due tax amount until the end of the first full month. Another 10 percent is imposed on the tax due at that time if the tax is not paid even within the second deadline. However, such fines may be exempted if a taxpayer is unable to make timely payment for reasons beyond his/her control.

Generally, the VAT is applicable only to the consumption of goods and services in Nepal, and the value for the duty of the goods is determined in accordance with the valuation provisions contained in the Customs Act. As far as imported goods are concerned, they are taxable at the customs point. Once these goods are taxed at customs points, they are treated as domestically produced goods. However, Nepal-made export goods are taxable at zero percent. Exporters are allowed to claim input tax credits for the VAT paid or payable on purchase of goods and services relating to their commercial activities. Exports taxed at zero percent include exports of both goods and services[61].

Excise Duty

Excise duties are taxes payable on a specific list of items, often due to their specific characters as luxuries that should be taxed more heavily, or goods that have a negative impact on health such as tobacco and alcohol. Excise Act 2002, which received the Royal Seal on January 2002 and came into effect the same year, repealed the old Excise Act of 1958. The main objective of the new Excise Act is to make the process of revenue collection effective and increase revenue mobilisation for the country's economic development.

According to this Act, one cannot undertake production, import, sales or storage of excisable goods or provide excisable services without obtaining the license for the same. The Act has also identified the persons liable to pay excise duties. According the section 4(A) of the Act, the following persons are liable to pay the excise duty:

- *If a product or service to be produced within the country, the producer thereof;*

[61] Inland Revenue Department, 2013

- *If a product to be imported, the person receiving the product as mentioned in the bill of lading, airway bill, invoice or application made for examination and clearance;*
- *In the case of auction of a product subject to excise duty, the person taking over that product;*
- *In the event of resale of any goods, other than liquors and cigarette sold by a duty-free shop or the use of such goods in other purpose, the person reselling or reusing them;*
- *In the event of the conversion of goods from a condition of being exempted from excise duty into a condition of being subject to excise duty, the person who has ownership of such product;*
- *In the circumstances other than mentioned above, the person as specified by the Department.*

Except as otherwise provided, the excise duty is to be collected on the goods and services as follows:[62]

- In the case of goods produced by an industry, subject to the physical control system, at the time of production and discharge from the enterprise for sale;
- In the case of any product and service to be sold under the automatic discharge system, at the time of the issuance of invoice;
- In the case of goods to be imported, at the time of entering of such goods into Nepal;
- In the case of services to be imported, as prescribed by the IRD.

However, in the case of any goods or services, the Department has the authority to collect excise duty at the time of production of such goods or delivery of such services. Collecting excise taxes at the point of production, for instance with cigarette package or alcohol bottle labelling or seals is an efficient manner to collect these taxes, and they have among the lowest rates of tax evasion due to the visible proof of payment of the excise seal or stamp.

The excise duty collected on the goods and services as per section 4 of the Excise Act is paid to the government as follows Section 4(B):

- *In the case of goods subject to the physical control system, at the time of discharge of such goods;*
- *In the case of any goods or services to discharge system, within 25 days after the invoice is issued;*
- *In the case of goods to be imported, at the time of entering of such goods into Nepal; and*
- *In the case of services to be imported, as prescribed by the Department.*
- *be sold under the automatic*

Furthermore, it is to be noted that in the event of failure to pay excise duty within the time limit as specified above, a delay fee equal to 0.05 percent is charged on the due and payable amount per day. On imported goods, the proof is therefore a document, which is required for legal import of the goods into Nepal. If goods that are liable for payment of excise taxes are not declared, an individual commits a customs fraud. The legal provision is that without obtaining a license as per the

[62] Inland Revenue Department, 2002, Excise Act, Sec. 4

Excise Duty Act, nobody is allowed to undertake production, import, sales or storage of excisable goods or provide excisable services.

However, the excise duty paid on the raw materials used in the making of a product subject to excise duty is allowed to be deducted from the excise duty to be paid while exporting the finished product under some circumstances. This is to reduce the cascading effect of the excise duty, where the intent is to have excise payable on the final user of the product rather than the different phases of manufacturing. Similarly, the excise duty paid on the purchase or import of any goods or services subject to excise duty for commercial purposes may be deducted from the excise duty payable while selling such goods or services. This provision is applicable for entrepreneurs, for instance, when they buy a computer for their professional use. On the same ground, the excise duty that is paid on the goods damaged due to arson, theft, accident, disruptive acts or expiry of date, is also allowed to be deducted as specified by the Department. There are exemptions of excise taxes for duty-free shops found in the international airport, border crossings and in diplomatic shops. Also diplomatic missions are exempted from the payment of excise taxes upon proof of diplomatic immunity.

Customs Duty

Customs duties are applied on both imports and exports, and are calculated on the value of the goods. In order to consolidate customs laws and to facilitate international trade by making customs administration more systematic, transparent and accountable, the government of Nepal has amended the Customs Act in 2007 by repealing the Customs Act 1962. The Customs Act 2007 came into effect on 31 August 2007.

According to the Act, the customs duty is chargeable on all goods to be exported or imported except those goods, which enjoy customs duty exemption pursuant to the Customs Act or the prevailing laws. As per the Act, the invoice value declared by an exporter is taken as the customs value of the goods to be exported while fixing the customs value of the goods to be exported. However, the Government of Nepal may, if it considers necessary, determine separate customs value for any goods of specific nature to be exported, by notification in the Nepal Gazette. Where separate customs value is so determined, the customs value of such goods shall be the invoice value declared by an exporter or the customs value so determined by the

Government of Nepal, whichever is higher.

Moreover, the Act states that any person who exports or imports any goods has to fill up the declaration form, accompanied by the documents as prescribed, and submit it to the Customs Officer of the area concerned. However, it is not necessary to fill up the declaration form in the case of those goods that have been exempted from customs duty by the Government of Nepal by notification in the Nepal Gazette, out of the goods contained in the luggage and baggage of passengers going out from Nepal and coming into the country from foreign countries. If a person, owing to circumstances beyond control or any other justifiable reason, is not able to submit any document along with the declaration form as prescribed in the law, such person may make an application, showing such circumstance or reason, to the Customs Officer for permission to submit such document later. Where, upon examination of the application, such circumstance or reason appears to be reasonable, the concerned Customs Officer may prescribe the period within which such document has to be submitted. While prescribing the period for the submission of such documents, the Customs Officer may prescribe any terms or ask for a reasonable deposit for security.

The provision made in section 18 of the Customs Act is quite cumbersome from the traders' viewpoint. The difficulties and delays arising out of the burdensome legal provision of this section may encourage some extra-judiciary and under-the-table deals at the customs points. All these activities add up to the cost of transaction, which may discourage national and formal international trade. Similarly, the provision made in Section 16 of this act may create possibilities of under-invoicing of the imported goods for the purpose of evading tax.

International Taxation

All of the above taxes are also related to taxpayers who may reside abroad when doing business in Nepal, or in the case of businesses who may have a permanent establishment in several countries at the same time. To facilitate mutual international cooperation, the government has concluded Avoidance of Double Taxation and Prevention of Fiscal Evasion Agreements with China, Austria, India, Korea, Mauritius, Norway, Pakistan, Sri

Lanka and Thailand.[63] The agreement with India has been recently renegotiated to allow for tax information exchange to take place on the basis of "foreseeable relevant" grounds, as mentioned in the Article 26 of the Organisation for Economic Cooperation and Development (OECD) model tax treaty[64]. In the light of recent research, these treaties may also provide loopholes for companies to engage in tax planning[65]. Nepal has not signed any Tax Information Exchange Agreements (TIEAs), which would in addition provide the possibility of bilateral tax information exchange; nor has it signed to the Mutual Convention on Tax Matters, launched in 2011, which provides the possibility of automatic information exchange.

In July 2013, the G8 summit in Lough Erne, United Kingdom,[66] agreed to further automatic information exchange between tax authorities and public registries of company owners. If implemented, this would mean an automatic knowledge of Nepali accounts in the notorious tax havens such as Mauritius and Switzerland. Various international agencies have accepted that international tax avoidance is a serious problem to public finances, most recently in October 2013 by the IMF[67] who is taking a greater role in international tax co-operation, and the OECD who has since its creation led the efforts for coordinating international tax matters. In February 2013 it launched a report called Base Erosion and Profit Shifting (BEPS)[68]. Civil society is concerned of the lack of ambition in dealing with tax evasion and avoidance, and is concerned of the lack of developing country representation in these proposals.[69]

Nepalese tax system has not been able to bring people's property fully under the tax net. It is still in its infancy and many areas to be improved, to broaden the tax coverage.

[63] Inland Revenue Department, 2013
[64] *The Hindu,* 2013
[65] EURODAD, 2013
[66] United Kingdom Government, 2013

[67] IMF 2013, p. 47
[68] OECD, 2013
[69] TJN, 2013

4. Tax Collection in Nepal

A tax system, to be workable in a democratic country, must in general appeal to the sense of fairness of the people.

Roy Blough and Carl Shoup

In the present time, the Internal Revenue Department (IRD) is the sole authority responsible for the enforcement of tax laws and administration of the following taxes: income tax, value added tax, excise duty, health tax, vehicle tax and certain fees and duties like educational fees, entertainment fees (film development fee), special fees, etc. Likewise, the Department is also responsible for monitoring the non-tax revenue such as dividends, royalties, etc.[70] The head office of IRD is located in Kathmandu. There are 22 field offices throughout the country including a Large Taxpayers Office, which is located in Kathmandu.

The major functions of the IRD and its district offices include taxpayer's service, audit and collection[71]. The IRD field offices are based in Bhadrapur, Biratnagar, Dharan, Janakpur, Lahan, Simara, Birgunj, Hetauda, Bharatpur, Dhangadhi, Mahendranagar, Pokhara, Lalitpur, Bhairahawa, Nepalgunj, Kathmandu-1, Kathmandu-2, Kathmandu-3, Bhaktapur, Krishnanagar, Dang, Large Taxpayer Office (LTO). The IRD has set a target to open a tax office or a taxpayers' service centre in all the 75 districts of the country, so that taxpayers need not travel out of the district to file taxes and settle tax liability[72]. The proximity of tax authorities is considered an important step in extending the reach of the tax system to all regions, and to the universal application of tax laws in the national territory. Proximity also reduces the compliance cost to the taxpayers, as they need not travel far to settle their tax matters.

In addition to these offices, Nepalese customs administration collects customs duty, value added tax, excise and other taxes at the border points. These taxes and duties account for 42 percent of the total

[70] Inland Revenue Department and German Development Cooperation (GTZ), 2010

[71] Inland Revenue Department, 2013

[72] *Republica, 2013*

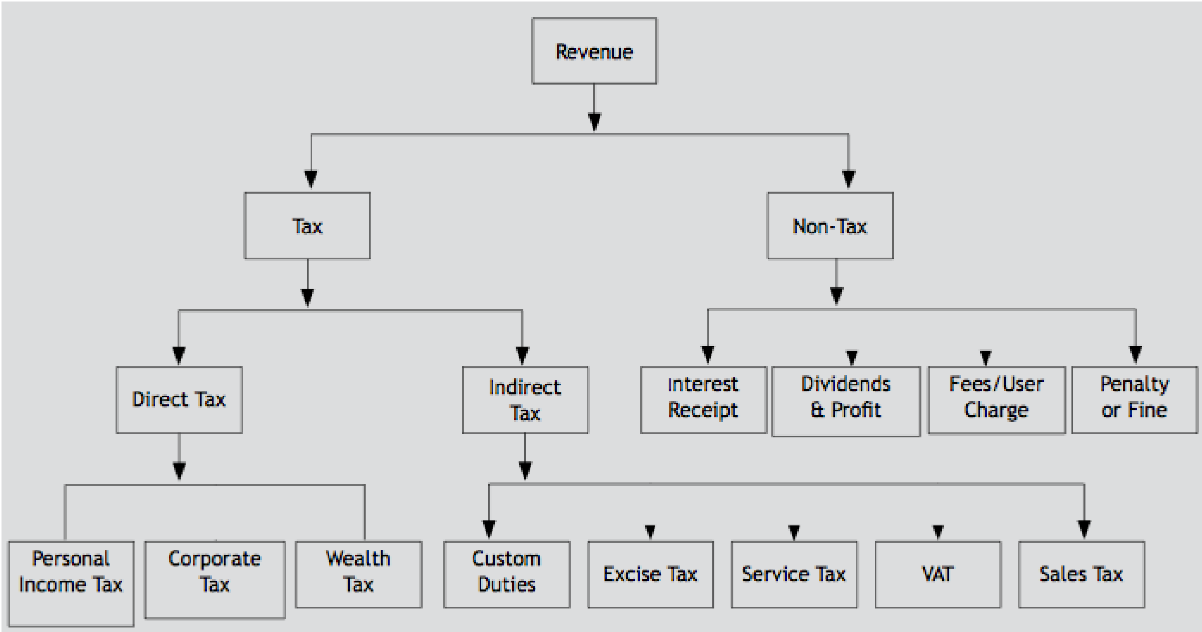
revenue and 50 percent of the total tax revenue. Customs duty alone contributes to 22 percent of the total tax revenue. Customs administration plays a major role in the mobilisation of internal revenue.[73] This is high in an international comparison, which may be due to high nominal rates, or more likely due to a high evasion of VAT as mentioned earlier. In most other Asian countries it is VAT that provides the bulk of the revenue.

Based on certain features, taxes can broadly be divided into two headings: direct tax and indirect tax. Direct tax is levied on the income and/or property of an income earner and/or property holder and is paid directly to the government by the person on whom it is imposed. There is no possibility of shifting the burden of taxes to others in the case of direct tax. On the other hand, indirect tax is levied in the production and consumption of goods and services, and its burden is finally shifted to the ultimate consumer. Direct taxes can be adjusted to the capacity to pay of taxpayers while indirect taxes as the final consumer is not known to tax authorities cannot be individually adjusted according to their conditions. One can only exempt entire categories of goods and services from indirect taxation, or give an exemption based on region, industry or sector in case of businesses. Due to limited adjustability according to capacity, indirect taxes are considered less equitable, and can contribute to equity manly through how the taxes raised are spent. While the income tax, corporate tax, land and building registration tax, property tax and vehicle tax etc. are the examples of direct tax, customs duty, the VAT and excise duty are the foremost examples of indirect tax. The following Chart shows the classification of revenue (tax and non-tax).

Nepalese tax structure is heavily dominated by indirect taxes as share of indirect tax (in total tax revenue) is very high compared to direct tax. Such a higher value of indirect tax may lead to cost-push inflation and thereby gross losses of welfare.

[73] Inland Revenue Department, 2013

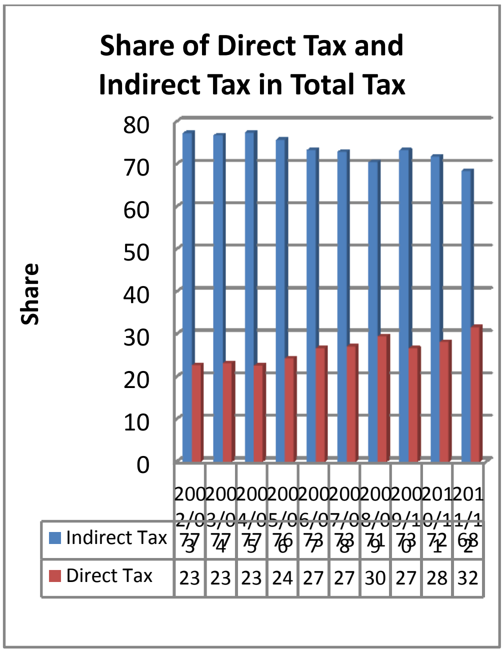
Chart 1: Classification of Revenue



Source: CBGA 2011

If examined carefully, it can be observed that Nepalese tax structure is heavily dominated by indirect taxes. Out of the total tax revenue, the share of indirect tax is about 70 percent in an average. While the share of indirect tax was 77.3 percent in 2002/2003, it decreased to 73.3 percent in 2009/10, and 68.4 percent in 2011/12 The share of direct tax and indirect tax in the total tax is shown in the chart 2 (see Table 1. A.in annex 1).

Chart 2



The chart (Chart 2) shows that in 2002/03, the share of indirect tax in the total tax was 77.3 percent. The higher share of the indirect tax compared to direct tax indicates that the Nepalese tax system is lacking efficiency. Indirect taxes are regressive by nature.[74] A higher value of indirect tax may lead to cost-push inflation and thereby a gross loss of welfare. Nevertheless, on the contrary, a higher amount of taxes on imports is supposed to discourage the consumption of imported

[74] Dahal, 2006.

goods, making a shift to the domestically produced goods, if available. This may lead to the generation of more employment and income in the home country, which ultimately contributes to the goal of alleviating poverty.

However, as Nepalese economy is entirely an import dependent economy, a higher value of taxes on import may lead to a higher inflation of prices as well as an adverse balance of payment (BOP) situation in the country, at least in the short-run. The chart (Chart 2) clearly shows that even if the share of indirect tax in total tax is declining, its share in total revenue has always remained more than 68 percent in the period between 2002/03 and 2011/12. As they cannot be adjusted according to the income or specific circumstances of taxpayers, the indirect taxes are considered to be less fair than direct taxes, which can be higher for those earning a larger income.

The Table 1.B. (*see in annex 1*) shows that in the context of direct tax, the share of income tax is the highest among all, followed by land and building registration tax. While the share of the income tax in the total direct tax was 85.2 percent in 2002/03, it stood at 79.5 percent in 2008/09, 81.0 percent in 2009/10 and 86.5 percent in 2010/11. During 2002/03 to 2010/11, the share of income tax in the total direct tax was the highest in 2010/11 followed by 2004/05 and then by 2002/03. In the context of the land and building registration tax, the share of it in total direct tax was the highest in 2005/6 followed by 2003/04 and 2008/09. However, the share of property tax in the total direct tax is very insignificant. This shows that Nepalese tax system has not been able to bring people's property fully under the tax net. All these factors mean that the Nepalese tax system is still in its infancy and that there are many areas to be improved, to broaden the tax coverage.

Charts 3

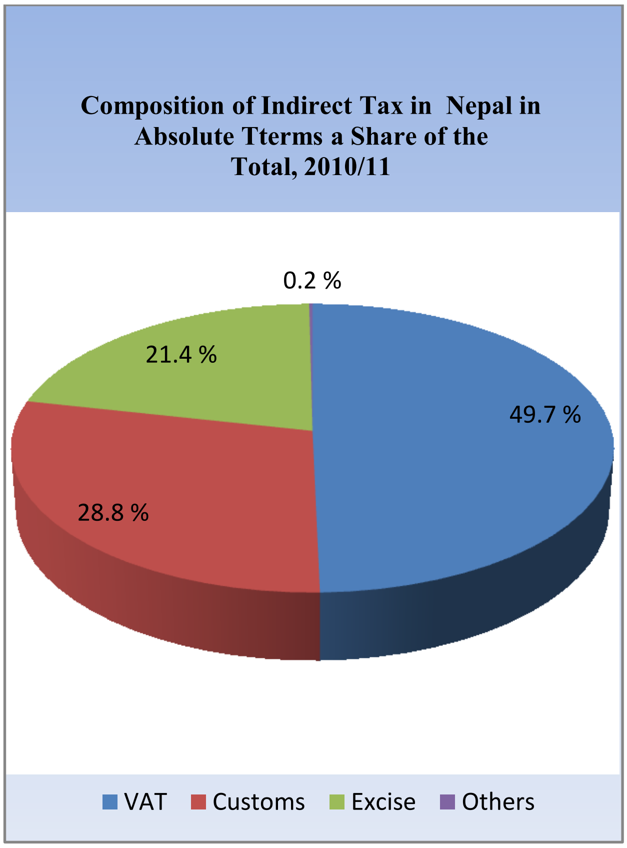


Chart 4

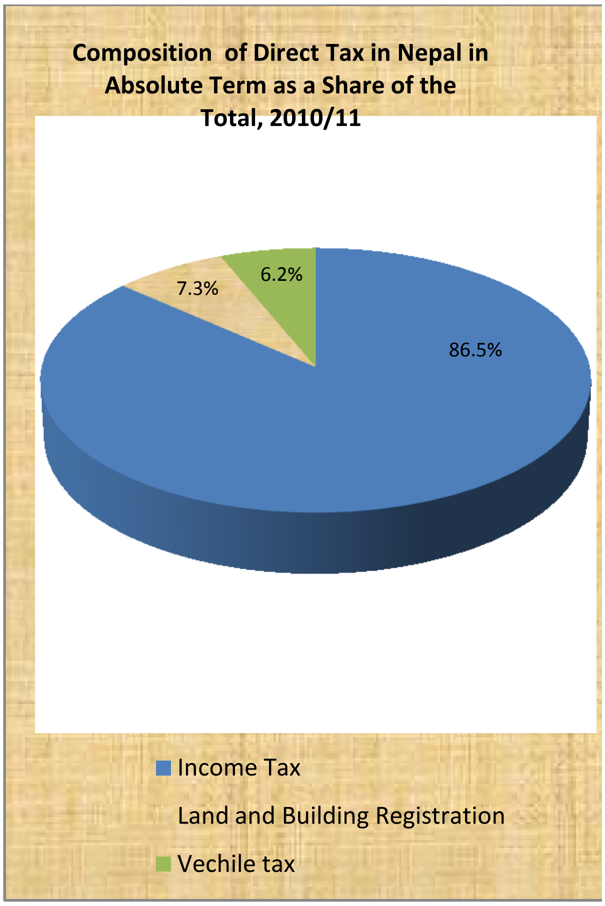
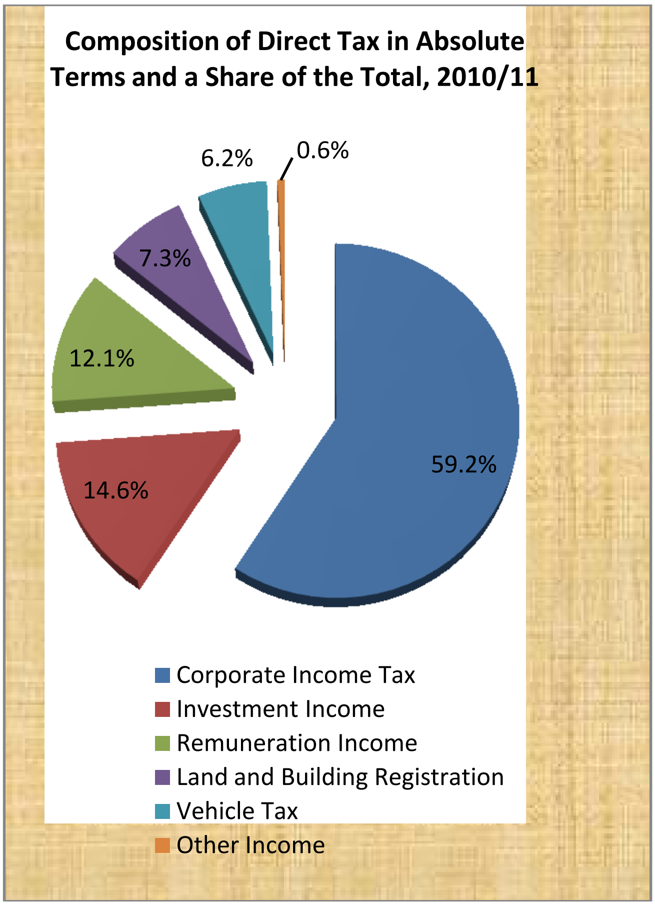


Chart 5

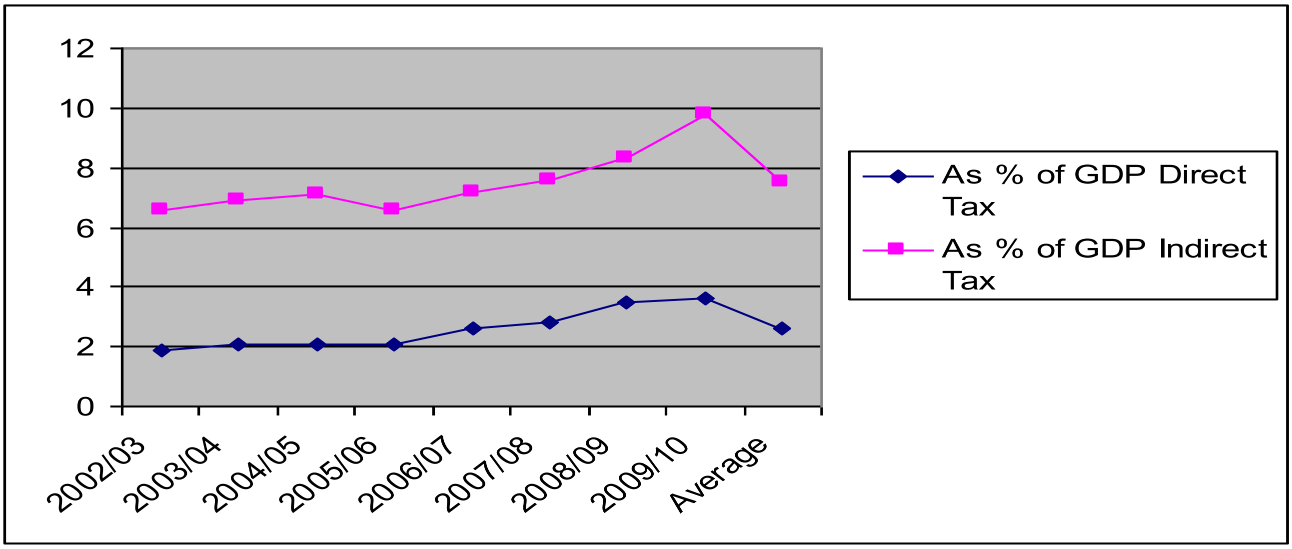


The Chart 3 (Table 1.C. in annex 1) shows the structure of indirect taxes in Nepal. The chart clearly shows that the share of the VAT in the total value of indirect tax is the highest, followed by customs duty. While the share of the VAT in total indirect tax accounted for 41.5 percent in 2002/03, it was at 47.9 percent in 2009/10 and 49.7 percent in 2010/11(see table 1.C. in annex 1). Under the VAT heading, VAT from import stands at the top position. This clearly indicates that the Nepalese tax system is highly dependent on the import of goods and services from other countries.

Furthermore, the table clearly shows that the share of the VAT from the production and sales and distribution to the total indirect tax is not remarkable. The major reasons for this situation are inefficient tax administration, and the lack of good vision and enthusiasm of the concerned entities.

The following chart (Chart 6, see table 1.D. in annex 1) shows the ratio of direct tax and indirect tax as percentage of the GDP and as percentage of the total governmental expenditure from 2002/03 to 2009/10.

Chart 6
Direct Tax and Indirect Tax (As % of the GDP)



The chart clearly shows that the average ratio of indirect taxes to the GDP for the entire period is 7.5 percent, while it is 2.6 percent in the case of the direct tax. On the similar grounds, when the average ratio of indirect tax to total government expenditure is 45.7 percent, it is 15.8 percent in the case of direct tax (see table 1.D. in annex 1). It also shows that the ratio of direct tax to the GDP is comparatively much lower than the ratio of indirect tax to the GDP. According to general literature on tax systems in developing countries, the main reasons appear to be as follows:

- *Indirect taxes are easier to collect;*
- *Direct taxes require formal business registration, which is difficult for an informal economy like Nepal;*
- *Possible existence of simplified methods of collecting direct taxes as a result, e.g. market stall fees, taxes for small businesses based on annual levies;*
- *Existence of tax evasion in the formal business sector*[75].

The same is applicable in the case of the ratio of direct and indirect taxes with the total governmental expenditure. This shows that the efforts to mobilise direct tax have not yet yielded the desired results. We discuss remedies to these problems in the final section concerning conclusions and recommendations.

[75] *The Kathmandu Post*, October 30, 2011.

5. Tax and Representation

> *People want just taxes more than they want lower taxes. They want to know that every man is paying his proportionate share according to his wealth.* Will Rogers

This study has also attempted to find out awareness and perceptions of the general public about tax. A survey was conducted as a field study by distributing specially designed semi-structured questionnaires. The questionnaires incorporated tax related issues such as people's awareness on the different forms of tax, their estimated amount of paying tax, their assessments regarding its usefulness, and their relationship with tax authorities (local / district / national).

It is worth mentioning here that Nepal, though a small country in South Asia, is a homeland of 103 ethnic/caste groups (including two unidentified groups) that speak 92 different languages and dialects.[76] As per the official definition, "Janajati" or "indigenous nationalities" means a tribe or community that is mentioned in the schedule as having its own mother language and traditional rites and customs, distinct cultural identity, distinct social structure and written or unwritten history. The 'Janajatis' in Nepal alone comprise 59 groups. Janajatis are the largest ethnic groups with 37.2 percent of the total population, followed by Brahmin/Chhetri 32.8 percent, Dalits 11.8 percent, Muslim 4.3 percent and other 1.0 percent.[77] The term Madhesi refers to people of Nepal who reside in the southern plains region called the *Tarai*, and they are ethnically, culturally and linguistically similar to people of Bihar and eastern Uttar Pradesh states of India. The 'Madhesis' make up 31.2 percent of the total population[78]. Poverty rates vary between ethnic and caste groups, and it is among the Dalit that poverty rates are the highest.

[76] UNDP 2009, p.18.

[77] Ibid. p. 15.

[78] Nepali Times 2011

Composition of the respondents

In order to avoid bias and to make the study more inclusive, the researchers posed questions to both the male and female respondents from different social classes, including owners of small enterprises, businessmen, job holders, farmers and housewives. Data was collected from urban area (from capital city of Kathmandu) and a semi-urban area (Kushma from Parbat District) of Nepal. The respondents are here classified according to their caste status, which according to chart 5 below widely indicates the income status as well. The social composition of the respondents interviewed for this study is as follows:

People from Parbat/Kushma like seems to have more knowledge on the local tax system than the residents of Kathmandu. One of the main reasons behind this may be because in a small town people knows each other very well and they tend to do things in a more transparent manner.

Chart 7

Social Composition of the Respondents (Kathmandu and Kushma, Parbat) by Caste/Ethnicity

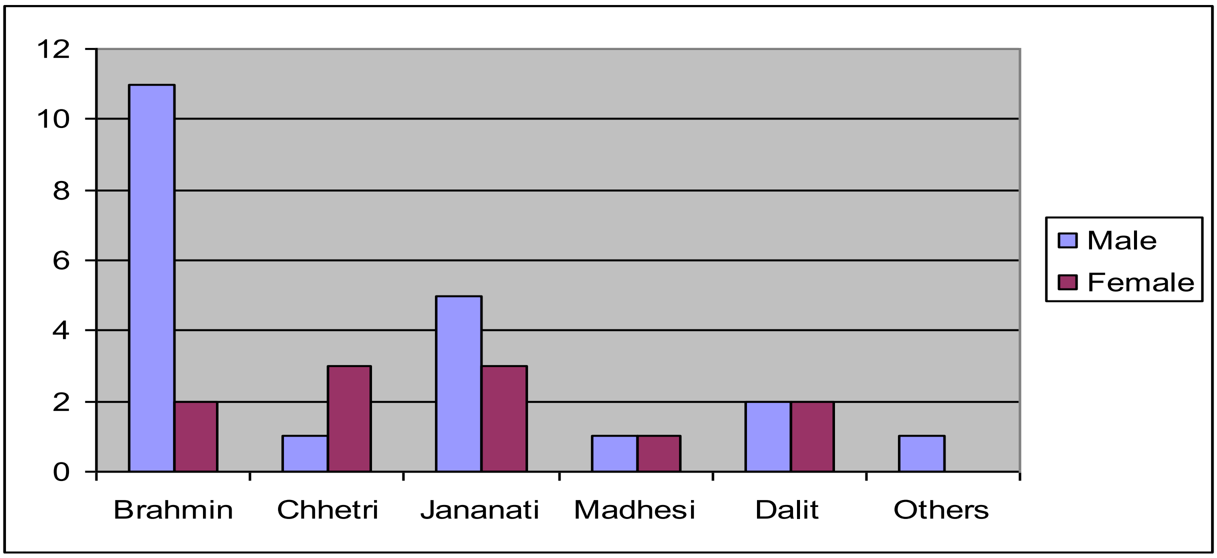


Chart 8

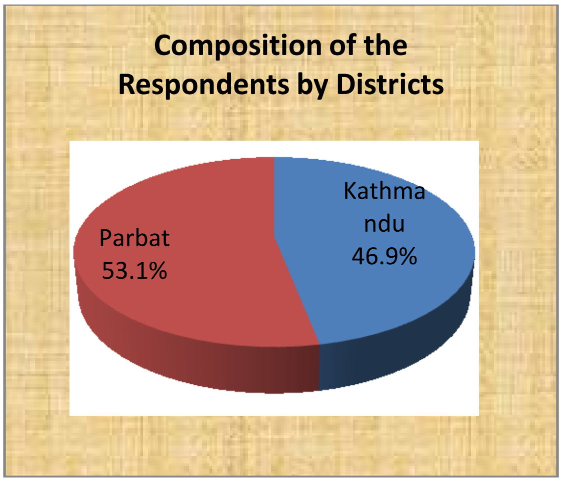
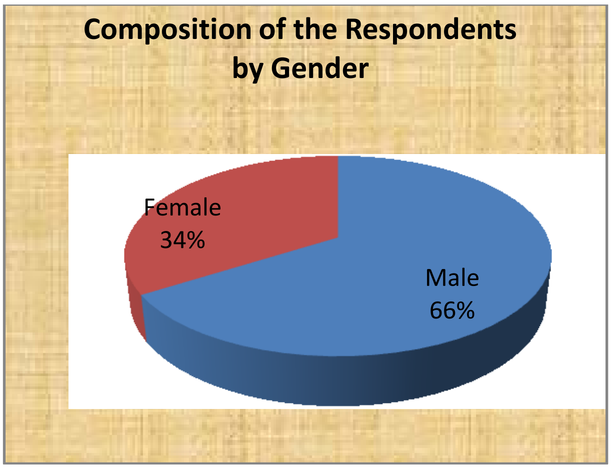


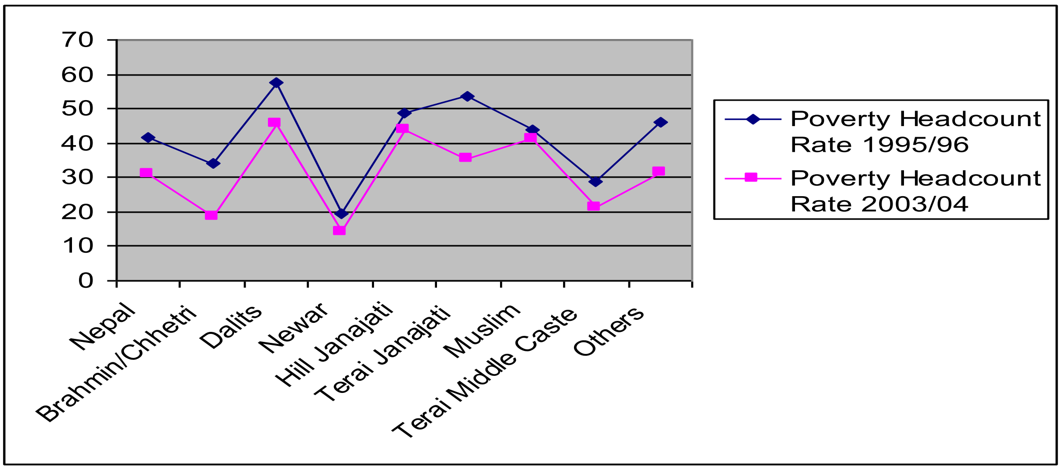
Chart 9



In order to examine the awareness and perception of the general people about tax, this field study was carried out as a survey of different castes and ethnic groups. For this purpose, 32 randomly selected respondents were surveyed including 15 (49.9 percent) respondents in Kathmandu and 17 (53.1 percent) respondents in Parbat district (see in table 2.A. in annex 2). Among these, 21 (65.6 percent) were males and 11 (34.4 percent) were females.

The Chart 9 (see table 1.E. in annex 1) shows the comparative study of poverty rate by caste and ethnicity in Nepal in 1995/96 and 2003/04. It demonstrates that caste is a reasonably good generalisation for poverty levels, and respondents all know their caste status but estimating their income status would be much harder through household income and expenditure studies.

Chart: 9
Poverty Incidence by Caste and Ethnicity, Nepal, 1995/96 and 2003/04



The above chart (9) shows that while the rate of poverty is the highest in Dalit community, it is lowest in Newar community. However, the poverty rate has declined remarkably in all the caste and ethnic groups between 1995/96 and 2003/04 (see in table 1.E. in annex 1).

Important Reflections of the Field Work

The rich aren't like us; they pay less taxes.

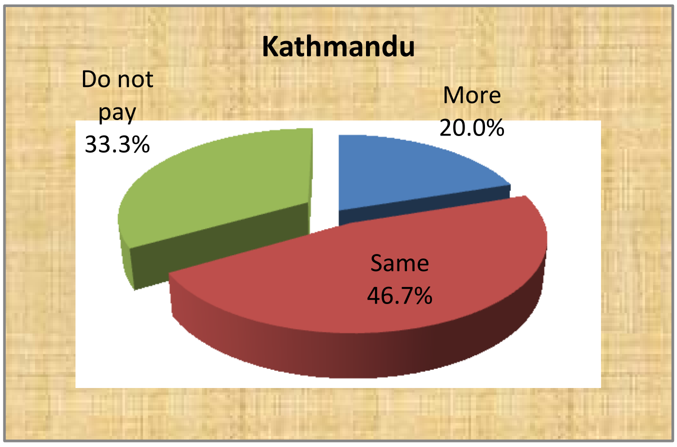
Peter De Vries

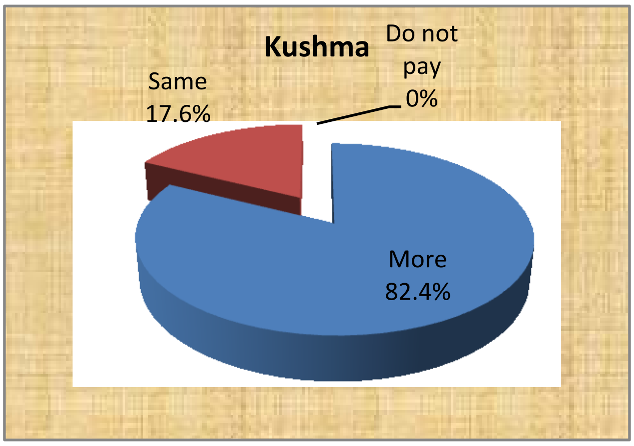
As the major objective of the study is to gauge people's perceptions on tax system, the first question that was asked everybody was about their basic understandings of tax. Of the total respondents, 86.7 percent (13 out of 15 respondents) from Kathmandu fieldwork indicated that they had a basic understandings of tax, and one respondent each form Chhetri and Dalit groups said they had no idea about tax at all. All the respondents from the different social classes, excluding one female from both Janajati and Dalit groups, answered that they had some basic understanding about tax. A female respondent stated "I do not know about the types of taxes. The sources of tax implacable in the locality are house tax, land tax, tax on drinking water, tax on electricity, tax on telephone, tax for rubbish management, etc."

Mentioning the sources of tax implacable in the locality, three respondents, including one from the unspecified group from Parbat/Kushma, mentioned that taxes had been imposed on more items such as tax on stone, tax on pebble and sand, tax on vehicles, employment tax, etc. Some of them went on relating fees on event registration, such as birth, death, marriage, and migration.

When asked about the tax they paid before and after 2006, the answer was as follows:

Chart: 10
Tax paid before and after 2006

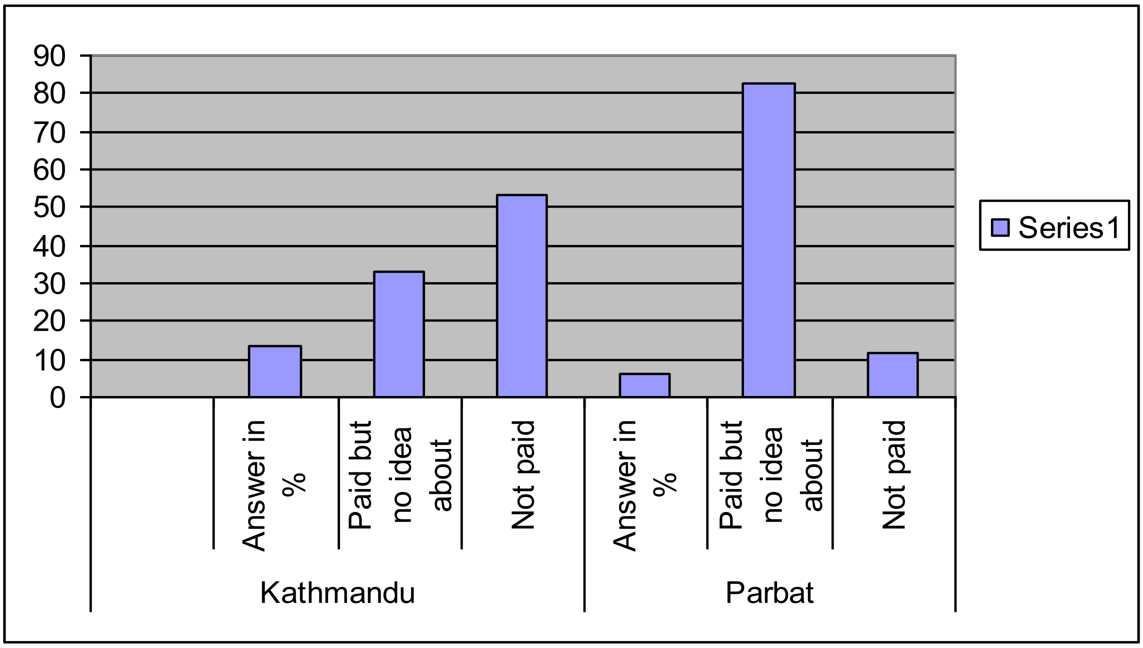




As per the Chart 10 (see Table 2.B. in annex 2) 46.7 percent of the respondents in Kathmandu valley paid the same amount of tax before and after 2006, and only 20 percent of respondents paid more tax after 2006 in Kathmandu valley. But in Parbat/Kushma, 82.4 percent respondents paid more tax after 2006.

The answer of the next question about "the amount of the VAT the respondents paid" is given below in Chart 11.

Chart: 11
Volume of the VAT Paid by the Respondents

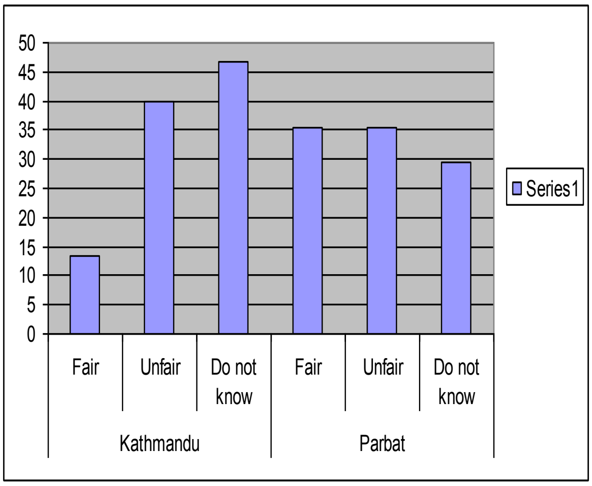


Interestingly, 53 percent of the respondents from Kathmandu valley did not pay VAT while 33.3 percent paid it but without knowing what it was. Only about 13 percent of the respondents answered the right percentage of VAT that is levied on goods. Those who mentioned the amount of VAT in percentage stated that they had been paying 12 to 15 percent of VAT. However, a female respondent from Kathmandu was categorical in saying that she is "paying 15 percent VAT". But in Parbat/Kushma 82.4 percent of respondents seemed to have paid VAT but without knowing about it. Only about six percent of respondents gave the percentage of the VAT amount.

Those who seem to be aware of tax system, are unaware of the actual percentage of the VAT they pay. A majority of the respondents (two from Brahmin male, one from Brahmin female, one female respondent from Kathmandu field, and four males and a female Brahmin, a male and female Chhetri, two Janajati males, a Janajati female, a Madhesi female, two male Dalits, and one unspecified respondent from Kushma) answered that they had paid VAT but were unaware about the amount they had paid as VAT. "I have not paid VAT directly, but I am paying it indirectly while buying daily consumer goods," was the answer of most of the respondents. The remaining respondents from Kathmandu and Kushma answered that they had not been paying any VAT. They replied, "I have heard about the VAT but have not paid it as yet". Therefore, it can be said that a lot of people do not know much about the VAT.

When asked whether the collection of VAT was fair or unfair, 40 percent of the respondents (two males and one female from Brahmin caste, one female from Chhetri caste, one male and one female from Janajati groups) from Kathmandu, and 35 percent (one Brahmin male and two Janajati males along with a Janajati female, two Dalit males and a male from unspecified group) from Kushma said it was unfair to collect VAT (see in Chart below, and also in Table 2.D. in annex 2).

Chart: 12
Respondent's perception towards VAT (Fair/Unfair)

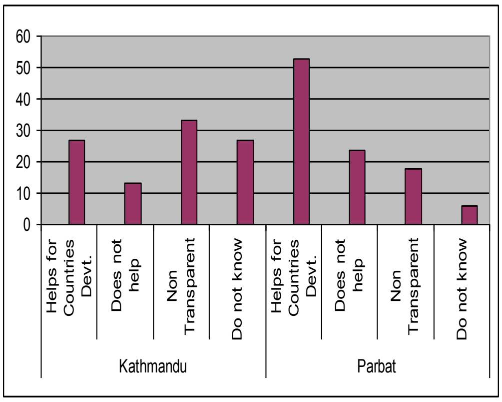


Those who said that it was fair to collect VAT, proposed a condition that both the processes of tax collection and utilisation should be done in a transparent manner.

When asked whether VAT is harmful or helpful, a majority of the Kathmandu respondents said they "had no idea about the harmfulness or helpfulness o VAT." Those who responded positively on the issue of VAT also raised the question of its possible malpractice. "We pay VAT but many merchants cheat us by issuing fake bills", as replied by most of the respondents. Quite a big number of Kathmandu respondents (27 percent) responded directly that "VAT does help in the development of the country", whereas 33 percent of the respondents from Kathmandu, and 18 percent respondents from Kushma, argued that "VAT collection and utilization system is not transparent" (see in Chart 13).

Chart: 13

Respondent's perception towards VAT (helpful/harmful)



As the subsequent sections of the questionnaire were related to land taxes, respondents were asked about the amount of land tax paid, and whether the tax is fair or not. Their answers were as follows.

The data presented in annex (table 2.F. in annex 2) indicate two different scenarios in the two fields. The first one is that the land revenue in Kathmandu valley is more than in Parbat/Kushma, and the second scenario is that fewer people staying in Kathmandu valley have their own land properties in comparison to the residents of other semi-urban and rural areas. According to the data collected in Parbat/Kushma, 70.6 percent of the respondents (except one each woman respondent from Madhesi and Dalit community) have been paying land tax, and all of them, except a Brahmin respondent, pay Rs. 10 to Rs. 150 as land tax. However, in Kathmandu, almost one third of the respondents answered that they had no idea about the amount and even whether they were paying land tax, and 40 percent seemed to have not possessed any land property as they answered that they had not paid any land tax.

Table 2.G. (see in annex 2) provides responses of the question asked whether land tax was fair or unfair, according to which a little less than a half of the

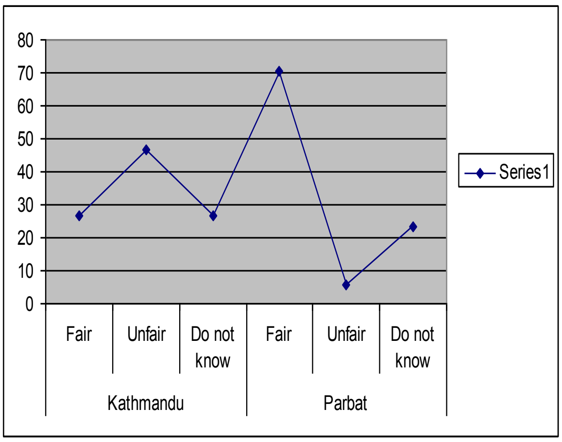
respondents (46.7 percent) from Kathmandu, and above 76 percent of the respondents from Parbat/Kushma considered the land revenue system fair.

On the question of whether land tax is helpful or harmful (see in table 2.H. in annex 2), only four respondents (two Brahmin males and two Janajati females) from Kathmandu answered that land tax helps in the development of the country, whereas more than 76 percent (13 out of the total 17) respondents from Kushma replied that "land tax helps in the development of the country". These issues are discussed in the next section in more detail in terms of the transparency of the land tax. Those who replied in the negative were categorical in saying that "it does not help in the country's development as it is not transparent".

When asked about the amount of income tax paid, about 47 percent (see in table 2.I. in annex 2) of the respondents from Kathmandu valley could clearly mention the amount of income tax they were paying, whereas about 20 percent said that they did not have any idea about the exact amount of income tax they paid. Also, 33 percent of the respondents said that they did not pay income tax. In Parbat/Kushma about 59 percent mentioned the amount they paid as income tax, but about 24 percent had no idea about it. Almost 50 percent of the respondents clearly answered the tentative amount of income tax they paid.

Chart 14 (see table 2.J. in annex 2) gives the answers on whether the income tax collected by the authority was seen as fair or unfair. Data states that Income tax collection has become unfair for most of Brahmins respondents in Kathmandu. However, most of the respondents from same social category (Brahmin) state that income tax collection in Parbat is fair. This contraction could be because little income taxes are collected in the rural areas of Parbat/Kushma, while income taxes collected in Kathmandu are especially from the Brahmin caste. Members of the Brahmin caste in the rural areas find income tax as being fair, which could relate to the lesser tax burden that they have.

Chart: 14
Whether the Income Tax Collected by Authority is Fair or Unfair

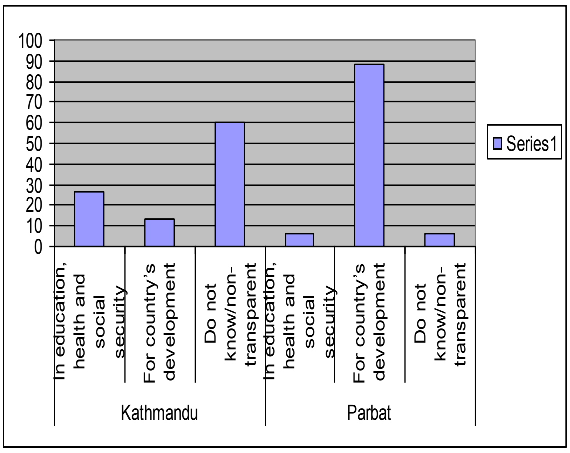


The answer of the respondents to the question about the reasons of collecting the tax is available in table 2.K. (in annex 2). There is a striking difference between Kathmandu and Parbat/Kushma in the reasons to collect taxes. This could be because persons living in rural and semi-urban areas feel that there should be more emphasis on developing the country more equally, whereas in Kathmandu, as it is the capital, the perception is that taxes are needed to run the administration situated there.

Chart 15 (see in Table 2.L. in annex 2) gives answers about how the government should utilise taxes.

Chart: 15

How Government Uses Taxes



It (the above chart) indicates that the respondents from Kushma of Parbat District seemed to be more positive towards and aware of the tax system than the Kathmandu respondents. This is evident in that about 94 percent of the respondents from ParbatKushma stated that the tax collected by the government was being used in social security and overall development of the country, whereas nine respondents (60 percent) in Kathmandu replied that the use of tax collected by the government was not transparent. The difference in the perceptions seems to be due to the fact that the Kathmandu respondents have been paying taxes for a long time and they know how and where the taxes are utilised. That is why the response from Parbat/Kushma is comparatively more positive than from the Kathmandu respondents, who are new to the system and do not yet know how the utilisation works.

On the question of how the authorities collected taxes, almost all the respondents in both the fields answered that they had to go to the offices to pay their taxes. On the question of what changes they expected in the tax system, they suggested that the system of collecting tax should be fast and there should be a single criterion of imposing tax. They suggested reforms to the tax system but did not categorically say what types of reform they wanted to see in place. Some of the respondents from Parbat/Kushma said that they wanted a strong law against the tax evaders. When asked if they would be willing to pay more taxes if they saw expected changes, two thirds of the respondents from Kathmandu and most of the respondents from Parbat/Kushma answered "yes”.

After analysing all the information gathered from both Kathmandu and Parbat/Kushma, it can be said that the majority of the population have a basic understandings of taxation. However, people from Parbat/Kushma (semi-urban area) seemed to have more knowledge on the local tax system than the residents of Kathmandu, the capital city. Why is this so? There is no single answer to this question. However, people seemed to be more aware on the issue of tax in Parbat/Kushma also because these taxes were only recently introduced in those areas. New taxes always generate debate and discussion that ultimately increase awareness in the society, and some public awareness campaigns by the tax authorities may also have taken place. Kathmanduites knew very little about these taxes possibly because they had been paying them for a long time and the issues were no longer topical for them.

Another reason why Parbat/Kushma residents may be more aware of the matter was because in this small town people know each other very well and they tend to do things in a more transparent manner. In fact, none of them can remain immune from paying garbage management tax and other forms of municipal taxes. But in the city like Kathmandu, only landlords or owners of the house pay most of the local taxes. Interestingly, a few respondents of Parbat/Kushma suggested making tax payment compulsory. They raised this issue because the existing Income Tax Act is based on a self-assessment system. This requires taxpayers themselves to calculate the taxes by using the income tax forms prescribed by the tax administration. The tax authorities have to accept the taxpayers’ declarations. Only if the tax administrators find reasons for suspecting what a taxpayer has declared can they amend his/her statement.

The results of the field survey also showed that the tax rate should be as minimal as possible and the process of paying tax should not be cumbersome. According to them, tax should be used for the overall development of the country. The major issue raised was that taxes had not been utilized properly and were not transparent. Key suggestions made by the respondents were that the process of paying tax should be eased, the practice of levying double or multiple taxes should be lifted immediately, and that the government should encourage the taxpayers to come forward by providing more facilities where taxes can be paid.

The respondents further suggested making the tax rate fair for all and ensuring a proper mechanism of tax collection at the local level. The study shows that people are willing to pay taxes if timely reforms are introduced in the existing tax system, and if the money is properly used for development of the country and towards the social sector. The provision of social services, therefore, increases citizens' willingness of to pay taxes. The study further shows that a lot of efforts are still necessary for enhancing the awareness of the general public on various issues of tax. Tax education would thus be welcome in the light of the low awareness of taxation especially in big cities including Kathmandu.

6. Tax Exemptions in Nepal

In the matter of taxation, every privilege is an injustice.

Voltaire

The structure of tax rate may have a substantial influence on the business activities. Business tax exemption is supposed to work as a stimulator for augmenting the business activities in the country. It is also seen as an indispensable factor, among others, for attracting foreign investment in the country. In this connection, tax exemption is supposed to be helpful in reducing poverty by providing more opportunities for employment and availability of low price goods and services. Although exemption in tax may tend to reduce government revenue thereby retarding the economic growth in the short run, it is thought to augment government revenue in the long run by broadening the tax base. While tax is neither the unique nor the most important factor in attracting businesses, business tax exemption is important from the viewpoint of augmenting business activities. Businesses also consider factors such as the presence of a local market for the goods produced, quality and quantity of local inputs of raw materials, availability of skilled labour and possibility to use land, as well as the infrastructure and transport linkages to their ultimate final consumers among other factors.

This study has attempted to examine the existing business tax exemption systems and their effectiveness in the country. This chapter has been divided into three sections. The first section provides the latest updates about Nepal's effort in establishing Special Economic Zones (SEZ), and the last section makes an assessment of the effect of the tax exemption, whereas the general tax exemption provisions of Nepali Tax Laws are made available in the annex 3.

Special Economic Zone (SEZ) policy in Nepal: An Overview

The Special Economic Zone (SEZ) policy is a recent development in Nepal, which currently generates a substantial degree of public debate. It is studied here from the perspective of Nepalese public debate, and it shows the different opinions in Nepali society concerning tax exemptions.

Nepal is an "underdeveloped" country. This is a known narrative to the world, and for this reason, there is an interest in the concept Special Economic Zone (SEZ) among the educated people of Nepal, which is translated as *visesh arthik kshetra* in Nepali. It is not unnatural for them to see the SEZ system as crucial or even an alternative for their country's economy. The SEZ is a geographical region that has economic laws that are more liberal than a country's typical economic laws. A SEZ is considered a trade capacity development tool, with the goal to promote rapid economic growth by using tax and business incentives to attract foreign investment and technology. In fact, the SEZ system defines certain regions as under SEZs by providing them special tax subsidies, physical infrastructures with all necessary services, providing necessary procedural service systems through a one window system, establishing an export-oriented industry and attracting Foreign Direct Investment (FDI) and modern appropriate production technology. Therefore, what we read the bottom-line of SEZ system according to the government are to: - (a) increase export and FDI; (b) enable the increase use of Public-Private Partnership (PPP); and (c) bring an ultimate result of a development of world class infrastructure, boost economic growth, exports and employment.

It is said that Spain was the first country to introduce special economic zone in 1929[79], while Puerto Rico has experimented them since the 1960s. However, the concept of Special Economic Zones was largely pioneered by China in 1980s according to the Chinese Government's decision to reform the national economic setup in 1978[80]. The establishment of SEZs during this period was of great help in attracting FDI and in kickstarting the economy. Many SEZs were established in Guangdong, Fujian and Shanghai coastal areas of China following Deng Xiaoping's decision to open up the economy in 1978. This was also the time when Taiwan and

[79] National Centre for Advocacy Studies, 2007

[80] Government of the Peoples Republic of China, 20122

Hong Kong were looking for the prospect of transforming their industries from low-tech to high-tech and from manufacturing to the services sector. So once they found that the SEZs were opened up in China, they dismantled their low-cost industries and transferred them to the SEZs[81]. Historically, the most prominent SEZs in the country are Shenzhen, Xiamen, Shantou, and Zhuhai, which are located in Guangdong province, and all are on the southern coast of China where sea is very accessible for transportation of goods. Today as labour costs in the Guangdong province have risen and transport network through railways has extended to the interior of China, SEZs are being established in the interior provinces of the country.

After almost a two-decade "successful" experience in China, Nepal's southern neighbour, India, also adopted the SEZ policy in April 2000, as a part of the Export-Import ("EXIM") policy of India. In fact SEZ, in India was introduced to achieve the following objectives[82]:

- Generation of additional economic activity,
- Promotion of exports of goods and services,
- Promotion of investment from domestic and foreign sources,
- Creation of employment opportunities,
- Development of infrastructure facilities.

Special Economic Zone Act 2005 came into force with effect from 10th February 2006, with SEZ rules legally vetted and approved for notification. In India, SEZ is defined as "a specifically delineated duty free enclave and shall be deemed to be a foreign territory for the purposes of trade operations and duties and tariffs". SEZs are an acknowledgement of the potential of export-led development strategy in accelerating economic growth[83].

The Indian SEZ policy provides for the development of these zones in the Government, private or joint sector offering opportunity to both Indian and international private developers. The Government has converted eight Export Processing Zones located at Kandla and Surat (Gujarat), Cochin (Kerala), Santa Cruz (Mumbai-Maharashtra), Falta (West Bengal), Madras (Tamil Nadu), Visakhapatnam (Andhra Pradesh) and Noida (Uttar Pradesh) into Special Economic Zones and all are functional now. In addition, three new Special Economic Zones approved for establishment at Indore (Madhya Pradesh),

[81] Bansh Jha, 2012
[82] Government of India, 2012
[83] Government of India, 2012

Manikanchan - Salt Lake (Kolkata) and Jaipur have commenced operations[84].

Nepal sees SEZ as an alternative policy to help overcome the problem of trade deficit and decrease in export-oriented products in Nepal. It is said that Nepal witnessed a trade deficit of Rs. 317 billion in the fiscal year 2009-2010. For this reason, it is argued that setting up of SEZs is crucial for the country's economy. Enterprises in SEZs in mountain and hilly areas would see their corporate tax reduced to a 0 percent rate for 10 years, and continue to benefit from a reduction of 50 percent thereafter, while enterprises in SEZs elsewhere would have a 0 percent rate for 5 years, and 50 percent reduction thereafter.

With significant decrease in export-oriented products due to a host of problems – loss of competitiveness and manufacturing base among the private sector, labour dispute, lack of investment due to political instability and policies – the country's trade deficit is growing[85]. The advocates of SEZ policy in Nepal refer to the problems of poor planning, low industrial base, poor infrastructure, lack of appropriate legislation, limited foreign direct investment, and unfavourable investment climate. Due to these reasons the private sector is failing to perform competitively like its neighbour countries. They argue that the effective establishment of SEZs in Nepal could provide "a leeway to the private sector to contribute in the country's economy[86]". It is reported that around 60 million jobs have been created by 3,000 SEZs across the globe. They have $200 billion investment[87]. How many of these jobs and investments can be directly attributed to SEZ, however, cannot be said without comparing with countries who at the same time did not implement SEZ policies but still managed to attract FDI or grow their economies through domestic savings and investment.

Those who see the economic gap between the developed districts like Kathmandu, Biratnagar and Birgunj measured against the undeveloped districts like Jumla, Baitadi and Bardiya, once they read about such exciting results by SEZs they think that Nepal needs a SEZ system to maximize creation of new jobs, start economic development through investment by foreign and domestic investors, maximize foreign exchange earnings and return on investment to economy. The public debate brings up the view that it is a problem that the rich Nepalese do not

[84] Ibid.
[85] Shahi, 2012
[86] Rawal quoted in Shahi, 2012
[87] *The Himalayan Times*, June 21, 2012

know how and where to invest their money, so in the absence of such an alternative, they end up buying lands, jewelleries, and keeping the money for their future generations. Through the SEZ system, they think that they would have the option to invest in shopping malls, restaurants, amusement parks, etc, as SEZs are townships of their own that attract people, thereby contributing in economic development of the region. Another problem facing Nepal is how to transfer the extra population excessively dependent from agriculture to more productive non-agriculture sector by creating employment opportunities and thereby reducing poverty. It is thought that setting up of SEZs creates a lot of indirect employment in terms of labour required, and then after the completion, it enables employment in the relevant industries operating in the SEZ. Again there are a lot of indirect employments generated wherein people start investing around SEZ.

Current status of SEZ policy in Nepal

Though the government of Nepal has been putting SEZs in its priority list in the annual budget programme since 2003, the SEZ Act has been put on the back-burner[88] due to the lack of political support. In fact, it is almost nine years now since the Nepal government mooted the idea of introducing SEZs in the country with an objective to boost "its sagging exports and attract foreign investment". Initially, the then government tried to bring it into existence through Special Economic Zone Ordinance 2004. Along with that initiative the Government of Nepal formed the SEZ Project under the Ministry of Industry, Commerce and Supply (MOICS) on January 29, 2004 in order to formulate the laws, rules and regulations, and to implement the planning, design and construction of Special Economic Zones throughout Nepal and to carry out the relevant work. Presently the SEZ Project office is engaged in the following measures:

- *Formulation of Special Economic Zone Ordinance-2012 and related rules;*
- *Feasibility Study for the Identification of Sites, Infrastructure Development and Design and Cost Estimates of the establishment of SEZ at Birgunj, Panchkhal of Kabhre and Ratmate-Devighat Areas of Nuwakot Districts, and land acquisition in those areas;*
- *Detailed Engineering Survey and Design of Facilities to be*

[88] Shahi, 2012

established inside Export Processing Zone at Bhairahawa;
- *Infrastructure Development of Bhairahawa Export Processing Zone (BEPZ).*

Then onwards, the SEZP kept trying to have a law in the name of Special Economic Zone Act in order to implement the project. The cabinet had endorsed the SEZ Bill in January 2009 and it was registered at the Parliament Secretariat on March 31, 2009 and presented at the full house of parliament on April 19, 2009. But it failed to get endorsed in the Parliament as some of the UCPN (Maoist) leaders and almost all trade unions in Nepal criticized the bill for not having provisions to protect the rights of labourers. A faction of the UCPN (Maoist) is still against the enactment of the bill. Instead of facing opposition voice, the Maoist-led government stopped the discussion in the Parliament and endorsed ordinances on SEZ in January 2009[89] by "sidelining the Parliament", which was termed by the opposition as "totalitarian attitude" of the Maoist Party.

It is said that Maoist leader Krishna Bahadur Mahara tried to table the bill when he was given the charge of the ministry. “However, it seems that he stepped back due to objections from within his party[90].” An officer of SEZP shares his experience about the politics on the SEZ Bill: "It was supposed to be tabled by the Minister at around 11.00 o'clock in the morning. We reached there in the parliament early in the morning around 8.00 that day. But we got a call from Ministry at around 10.00 and came to know that the Bill would not be tabled as Minister had to be busy in other works". According to him, Minister Mahara must have briefed about the Bill to his party leaders, and once the party people knew Mahara's program to table the Bill in the parliament, the party must have suggested him to put it in withhold[91].

Dr. Pitambar Rawal[92], who was involved in doing a feasibility study of the proposed SEZs recalls a saying and notes that though there is a political consensus to introduce the SEZ, leaders often oppose the idea without providing any substantive reasons. Since an ordinance has to be approved by parliament within six months to make a law of the country, the ordinance became defunct by June 2009. Again Madhav Kumar Nepal Government tabled the SEZ Bill at the full house of parliament. Once it was tabled the bill was

[89] Thaindian, June 21, 2012

[90] *Kantipur*, June 21, 2012

[91] As per discussion with SEZ Project Official, October 7, 2011

[92] As per discussion with Professor Rawal, October 7, 2011

sent to the Bill Committee. But it is said that the Committee did not take the initiative to clear these bills as the Committee “was not serious about the bill related to the economy".[93] Once Prime Minister Madhav Kumar Nepal resigned and the government lost authority to take decision on policy issues as it was converted into a caretaker government, no attempt was made to clear the bill. Then onwards also the subsequent governments repeated saying that the SEZ Bill would be presented to the Bill Committee of the Parliament, but no one could do it. As a result, SEZs remain a concept on paper.

Once the parliament was dissolved along with the completion of its tenure in May 27, 2012, the Ministry of Industry once again tried to endorse the SEZ Bill through an ordinance. It is said that Minister for Industry Anil Kumar Jha had said the government was holding talks with major political parties to put in place SEZ Act through ordinance[94]. Sources said that Industry Minister Anil Kumar Jha and Secretary Umakant Jha recently met President Ram Baran Yadav and urged him to pass the bill through ordinance. “The minister and the secretary briefed the President about the need for having a SEZ Act".[95] But it seems that he could not convince President Yadav who has been saying that he wouldn´t endorse any ordinance proposed by the caretaker government in the absence of parliament unless the opposition parties support it. It is reported that the government, of late, has decided to run SEZ through a SEZ Development Committee after its attempt to introduce an ordinance failed. According to a report[96], the Cabinet has approved the order to form the development committee, and its first meeting is scheduled to be held on February 6, 2013. “Our several attempts to get the SEZ Act passed through ordinance bore no results [...]“. “Forming the SEZ through a development committee is the only option” the media quotes Industry Minister Anil Kumar Jha as saying.

However, the industrial community has shown their unenthusiastic poster with the proposed model saying that the legal provision under the development committee would not be strong enough. According to them, the committee will only be able to recommend what facilities should be provided to the factories located in SEZs. But the Ministry tries to convince them saying that "even if SEZs come into operation under the development

[93] *Kantipur*, June 21, 2012
[94] *My Republika*, June 21, 2012
[95] *Kantipur*, June 21, 2012
[96] *The Kathmandu Post*, February 6, 2012

committee, all necessary facilities promised to be provided to the industries would be ensured[97]". It is said that the government's first move would be to bring SEZs into operation and later ensure the necessary facilities by introducing an SEZ Act through the Parliament in the future. Ministry officials said that the development committee would be automatically replaced by the SEZ Act after the proposed act is endorsed by the Parliament and then the industrial sector would receive all the facilities accordingly.

As far as work in progress is concerned, the government has proposed SEZs in eight districts in the country. Work on developing SEZ infrastructure, such as roads, water supply and electricity lines, is nearly complete in Bhairahawa. It is said that a feasibility study for two SEZs in Panchkhal and Dhangadhi and a pre-feasibility study of other five remaining SEZs in Jhapa, Kapilvastu, Biratnagar, Simara and Jumla are in progress. But the delay in the approval of the SEZ Bill has, however, led to uncertainty about the future of these zones. It is also reported that the bill protects the interests of residents near SEZs in stating that any private national and international company interested in investing in different industries in SEZs, must provide for 30 percent domestic value addition (rules of origin) in order to avail 'zero-tariff facility' (customs duty exemption) on exports[98]. Another report[99] says that land has already been acquired in Paanchkhal, initial studies to establish SEZ in Kakadvitta and Dhangadi have already been carried out, and extensive surveys have already been conducted in Trishuli, Jumla, and Biratnagar.

But there is a lack of political commitment. "SEZ is directly related to the international market. There should be proper coordination regarding workers rights and facilities and services for investors. There are provisions allowing the private sector to be involved in the infrastructure development of SEZ, its management and operation"[100], report states. As there are many of the provisions related to ad-hoc management, the government is likely to have more control leading to misbalance, and this must be reduced. Bhoj Raj Poudel writes that the lack of full-fledged budget for 2012/13 has affected multiple high priority programs such as constructions of strategic bridges and feasibility study of special economic zones (SEZ) in different districts, as

97 Ibid.

98 Shahi, 2012

99 Nepal News, June 21, 2012

100 Government of Nepal, Ministry of Finance, 2012

concerned ministries are facing difficulties in starting the tender process. According to him, the officials at the Ministry of Industry (MoI) said that they have faced a problem in awarding the tender for the feasibility study of the SEZ in three districts due to lack of full-fledged budget for the fiscal year. The ministry had selected three contractors to carry out the feasibility study of the SEZ in the three districts – Dhanusha, Siraha and Rauthat – at the end of the last fiscal year. But it had failed to strike agreements with them then. The lack of full-fledged budget has also affected the construction of SEZ in other places such as Bharatpur, Jumla and Kapilbastu where a feasibility study is going on[101]. However, the government budget in 2011/12 has allocated just Rs 140 million for the purpose, and according to the officials the amount was too little to execute its plan to build such zones in different parts of the country including Panchkhaal, Simara, Jhapa, Kapilvastu, Jumla and Biratnagar, among others.

Problems faced by SEZ today in Nepal

As mentioned earlier, rights activists, some of the UCPN (Maoist) leaders and almost all trade unions in Nepal criticized the bill for not having provisions to protect the rights of labourers. It is said that one faction of the Maoist party opposed the SEZ bill arguing that it was against the national interest and would exploit natural resources and labour rights. Also, the SEZ bill has run aground after the Finance and Labour ministries as they could not agree on the incentives to be provided to companies[102].

According to media reports, the Ministry of Finance was opposed to the provision of tax exemption and the Ministry of Labour and Employment rejected the provision of annulment of labour laws in the SEZ. Once the Ministry of Industry had planned to introduce the bill through an ordinance and sent it to the Ministry of Law and Justice for its approval, the Ministry of Law and Justice in turn forwarded the draft to the Finance and Labour ministries for their feedback. The Ministry of Industry officials said the two ministries weren't enthusiastic about the proposed law. The media report quotes Ministry of Industry officials and states that the Ministry of Finance was emphatic that no additional tax exemptions or similar facilities could be granted other than those provided in the existing Income Tax Act and Value Added

[101] Poudel, 2012

[102] *The Kathmandu Post*, 2012

Tax (VAT) Act. Similarly, the Labour Ministry has stated that the SEZ law should not go against the existing labour laws.

To mention the major clauses of the bill, it mainly upholds three broader principles: incentives to industries, one-spot service and labour flexibility in the zones, which are being developed to give impetus to the country´s export trade. According to the bill, SEZ will be treated as a land wherein other domestic laws related to labour and industries would not be applicable. The bill allows workers to unite and practice collective bargaining, but prohibits them from undertaking activities that affect production and normal operations of industries. "The workers of industries established in SEZ are not allowed to carry out any activities that would have a negative impact on the industry and its production," reads the draft of the bill. Rather, the bill provides for better facilities, in order to address workers´ concerns, for workers in SEZ than what workers receive outside of the zone. The Bill also allows entrepreneurs to hire workers on a contract basis. "Autonomous SEZ Authority that will be formed to oversee the zone´s operations and SEZ regulations will determine the extent of workers pay-scale, medical and insurance facilities, among others," reads the bill.

As far as incentives to industries are concerned, the bill promises the investors in SEZ facilities such as duty-free import of raw materials, value added tax (VAT) exemption and waiver of excise duty and other local taxes. The industries in SEZ have also been offered income tax holiday for five years. And it is said that they will continue to enjoy a 50 percent discount on income tax even after five years. More so, the industries established at present would continue to enjoy all the facilities, even if later amendments would change the structure and extent of facilities. It is said that the Maoists had reservations on clause 37 of the proposed Act that restricts workers and staffers of a SEZ from conducting activities that would have a negative impact on industry and production. The trade union activists also have similar concerns over it. However, the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) has not only welcomed the proposed SEZ Bill, but also has been pushing each and every government to endorse it. "Any issue that is related to economic development should not be blocked for political interests," *Kantipur*[103] quotes Vice President Pashupati Murarka as saying. The private sector's lobby for the Act is

[103] *Kantipur*, June 25, 2012.

understandable as they would get more facilities from the government.

One of the major reasons for the private sector eagerly waiting for the Act is that the labour law will not be applicable in industries inside SEZs. As per the provision in the SEZ Act, workers' wage in industries inside SEZs would be set on the basis of agreement between workers and management and the management alone would determine other social security facilities. As per the proposed Act, no other laws would be imposed on transactions carried out from SEZs. The Act also mentions special treatment to industries inside SEZs. "The business transaction carried out in the Special Economic Zone, the tariff, fee and tax on goods or services produced in the Special Economic Zone shall be given special treatment similar to that of outside scope of taxes," states the proposed Act. Also, it is provisioned that no industry established and operated in SEZs will be nationalized. Industries in SEZs will be exempted from income tax for five years from the date of commencement and a 50 percent exemption on the tax will be given for the next five years. If an industry uses 60 percent domestic raw materials, the fifty percent discount on income tax will be extended for 10 years. Also, no income tax will be levied on dividend distributed by industries inside SEZs for the first five years. The Act also says that industries will get a VAT exemption on the import of machinery, equipment, spare parts, raw materials, and up to three vehicles for transporting goods.

Though the onus is on the government to convince its citizen about why we need special economic zones, the government body seems to be unclear about it. It is said that the opposition of Finance and Labour ministries regarding the incentives offered for SEZs goes against the very purpose of the SEZ. It is said that the government has envisioned the SEZ to promote export-oriented industries. In a bid to allow factories inside the SEZ to operate without disturbances, the proposed SEZ Act has banned labour movements and heavy tax exemptions. "Investors were attracted to the SEZ only because it had promised special treatment for the promotion of the industrial sector. If the very basic facilities are not provided, the SEZ will not be different from any other industrial hub. What's the use of setting up an SEZ if it is no different than the existing industrial estates?" said Vice President of FICCI Pashupathi Murarka. He added that industrialists would not be induced to establish factories in the SEZ if there is no special arrangement to protect their investment. Without these arrangements "[i]t would be useless to introduce the SEZ Act or develop SEZ projects." It seems that the concerned ministries, including the Ministry of Industry, are convinced to provide the proposed incentives to SEZ. That is why they have asked that all the existing laws be kept intact in the bill and have it passed through an ordinance," media quotes Law Ministry official as saying[104].

Having gone through the above debate among the stakeholders, it becomes easier to understand the major problems faced by each new initiative, including SEZ in Nepal. One finds that Nepal initiated SEZ haphazardly without any preparation[105]; neither was there any dialogue among the stakeholders, i.e. the trade unions and labour activists, before the government decided to bring the concept[106]. According to Rajkarnikar, "it would not be worth to tell that SEZ would help develop the country if it comes into existence after a decade it was thought of". It seems that political instability has proved to be the greatest hindrance in the implementation of SEZ in Nepal. "If there is political stability, SEZ would be implemented soon. Otherwise, I am not sure when the project will be materialized", Netra Bhattarai[107], an officer of SEZ project states. "I had to deal with eight different governments in the past six years while I was there in the SEZP office. And I found that each government set its own priority," Jagadiswar Nath Shrestha[108], a retired officer of SEZP project who led the office for six years remarks. Along with such political instability, the issue of 'who gets credit' for such new initiatives seems to have remained another concern of those Ministers and government officials. "Every political party is found very much interested to introduce SEZs in Nepal. They are, in fact, cautious about whether they get credit or not. Each Minister had his/her eagerness to introduce the project within his/her tenure so that the credit would come to them. Once they are not sure about how long they will be in power, they linger on it," Krishna Prasad Parajuli[109], a SEZ Project official states.

Actually, a committed political leadership is a must for the development of a country in any political system, be it parliamentary democracy (India), communist system (China), presidential form of democracy (USA), or constitutional monarchy with

[104] *Kantipur*, 2012
[105] Rajkarnikar, July 14, 2012.
[106] As per discussion with CSOs and Trade Unions, October 5, 2011
[107] As per discussion with Bhattarai on October 27, 2011
[108] As per discussion with Shrestha on October 27, 2011
[109] As per discussion with Parajuli on October 27, 2011

parliamentary democracy (Japan). However, this is lacking in case of Nepal. If any leader or party in power takes up the issue thinking that it is better for the development of the country, another leader or party tries its best to hamper the work, which can be seen in the case of the SEZ system. Non-cooperation has become a norm in the political discourse of the country, which is only the replica of Nepali society.

Apart from the political instability, there are certain points on the basis of which the implementation of the SEZ system has been delayed[110]. Firstly, the bill circulated by the government was either silent or deliberately unclear on three basic points: the environmental guidelines for the proposed SEZ, the rights of the workers in the SEZ and the compliance measures for multi-national investors. It has been argued that the proposed bill gives enormous power to the autonomous corporation to be established under the Act that would be responsible for managing and monitoring the SEZ. However, the Act does not have regulations to guide the functioning of the corporation. For instance, Clause 3 of the proposed bill gives the corporation enormous power to select and recommend any part of the country as a SEZ. Clause 4 of the proposed Bill specifies that the corporation must ensure that the proposed area is economically and logistically viable but does not require the project to conduct an Environment Impact Assessment or Social Impact Assessment. Similarly, Clause 6 gives the corporation the power to transfer the establishment and administrative role of the SEZ to the private sector. All these arguments can lead to the private management turning indifferent to possible threats to local livelihood and biodiversity posed by future industries. Again, Clause 36 gives the corporations a complete authority to decide on minimum wages and Clause 37 of the proposed Bill states that any issue of worker's social security will be as per the individual contracts.

This clearly means that the industries will have no obligation to abide by the national minimum wage or standard working conditions and social security package including medical and life insurance. The points raised above need to be given a serious thought and efforts should be made to establish SEZs in locations that do not harm environment and people, and moreover, the needs and wages of workers should be taken care of. Otherwise, SEZ won't be implemented in Nepal even if the parliament endorses the SEZ Bill, and it becomes a full-phased law. "We are

[110] Acharya, 2012

complaining today saying that we don't have a SEZ law. Once it has become a law, we will complain saying that the law is not being implemented. Unless the Bill addresses labour issues, I see no possibility for it to be implemented in Nepal" Ramesh Badal[111], a lawyer who is closely monitoring the SEZ debate in Nepal states. If we go by the ideas of Bishnu Rimal,[112] Chairperson of General Federation of Nepalese Trade Unions (GEFONT), industry with foreign investment and foreign raw materials cannot help the country like Nepal. "If we compromise national labour laws in the name of inviting foreign investment, it will be beneficial to investors only, neither country will be benefited nor the people," Rimal states[113]. "Though the parliament endorses the SEZ Bill without any changes, I don't think that it will help installing industries in the SEZ areas", states Baburam Gautam[114], Vice President of Nepal Trade Union (revolutionary). According to him, they are not against the objectives of SEZs but against the provisions in the SEZ Bills. "If an investor is provided incentives on tax and VAT along with the exemption of the country's labour laws, what Nepal would get as no one can guarantee that the investor invest the profit inside Nepal," Gautam[115] further says. But his view was that if the government assures labourers' collective rights in the SEZs, they are not willing to disturb the projects.

It seems that the concerned Ministry is well aware of the trade union's demand, and that is why Clause 38 of the SEZ Bill mentions about a different mechanism in order to deal with labour issues. The proposed Bill talks about Grievance Management committee which needs to be formed in order to manage the grievances of the workers and employees working in industries in those Zones. However, GEFONT seems to be in a no compromise mood. "We won't accept any compromise on our national labour laws,"[116] Chairperson of GEFONT Bishnu Rimal states. Regarding incentives on tax, VAT and other duties, neither the ministry of Finance nor trade unionists and other stakeholders seem to be convinced to offer such huge subsidies to the investors inside SEZ regions. It seems that the major anxiety is whether a real investor gets benefited out of that provision. "We oppose SEZ as it is a plan introduced by

111 As per discussion with researchers on October 10, 2011.

112 As per discussion with researchers on October 8, 2011.

113 *Abhiyan* Daliy, July 13, 2011.

114 As per discussion with researchers on October 13, 2011.

115 As per discussion with researchers on October 13, 2011.

116 As per discussion with researchers on October 8, 2011.

the expansionists of the world where there will be exemption of national laws, labourers will have no rights, and state cannot impose taxes," CP Gajurel[117], the then Secretary of the United Communist Party of Maoist says. "Who will guarantee us that only genuine companies come to invest in SEZs and get tax benefits?" Baburam Gautam[118], Vice President of Nepal Trade Union (Revolutionary), puts forward a counter-question. According to him, many Indians are likely to register their firms in SEZs in Nepal as if they are real investors, and start demanding incentives and compensations without contributing anything here in Nepal. "Why should we offer tax incentives to those who are not willing to invest their profit in Nepal", he states. The SEZ may amount to nothing else by so-called “round-tripping” where investors create capital flows into a territory for the purpose of minimising taxes or escaping regulation, and the capital flows back to its origin having escaped these duties. Also, questions have been raised about the intentions of investors in SEZs. "Since the foreign investors regenerate capital from inside the country by borrowing loans, from our banks, why we need SEZ in order to invite foreigners? If they run away in-between without paying bank loans, our banks will go for bankruptcy[119]" Ramesh Badal states.

The anxiety the stakeholders expressed in Nepal seems to be valid; following a similar case in Ghana[120], it is widely held that tax incentive regimes are the cause of major revenue losses and abuse. Another anxiety reported from various such initiatives is that the use of time-limited tax holidays will lead firms to invest only as long as the incentive remains in force, or that they will use questionable ownership transfers or modest new investments to seek to renew the tax holiday indefinitely[121]. Also, the question of raw materials to be used in the SEZs has been another debatable issue in Nepal. "Even if we invite foreign investment, we need to use raw material and labour of our country. Also, we won't accept any compromise on our national labour laws,"[122] Rimal states.

Though Nepal is late to introduce a SEZ policy, it has the benefit of being able to examine weaknesses and strengths of similar practices experienced by other countries all over the world. Since both the

[117] As per discussion with Gajurel, Reporter's Club, July 14, 2011.
[118] As per discussion with researchers on October 13, 2011.
[119] As per discussion with researchers on October 10, 2011.
[120] Prichard and Bentum, 2012
[121] Ibid.
[122] As per discussion with researchers on October 8, 2011.

neighbours – India and China – are major countries to implement the SEZ policies, Nepal not only can learn many things but also can avoid demerits faced by them while introducing SEZ. In order to do so, Nepal needs intensive discussion on it, and such dialogue should be high in national priority. While talking about SEZs in India, it is not without problems. Despite the fact that more than a quarter of the country's exports still come from them, SEZs are grappling with a sharp slowdown in growth. The number of new SEZs too has dropped drastically in recent years[123]. The recent move by the Maharashtra government to scrap four SEZ projects only emphasizes the point. The private companies face difficulty to acquire land for the SEZs. For instance, in September 2008, the Maharashtra government had scrapped Reliance Industries' grand plans for the Maha Mumbai SEZ in Raigad as 22 villages opposed the land acquisition for the project[124]. Data from the ministry of commerce shows that SEZs have been losing ground over the past couple of years. Export growth of SEZs has declined from over 120 percent in 2009/10 to just 15 percent in 2011/12. At the end of 2009/10, of the 364 SEZs that had been approved by the government, only 153 had become operational[125].

Since India has a large population, the regions are densely populated, so there is always the problem of land to be provided for SEZs. The farmers are being paid disproportionate money, which is not in line with the current land prices. The best example could be seen in the case of farmers from Kalinganagar in Orissa, where the money given was disproportionate to as little as 1:10 with respect to the market rates. Moreover, another big problem that seems to be emerging is that arable land is used for non-agricultural purpose, which can lead to a food crisis and loss of self-sustenance in future. India has already entered into "the era of importing food grains regularly in order to ensure food security for all citizens, not merely the people living below the poverty line and those who depend upon the Public Distribution System[126]." It is said that the Indian Government is yet to go the whole hog for undertaking massive agricultural reforms in order to quickly raise the productivity of the main cereals such as rice, wheat, bajra (pearl millet) and jowar (sorghum) besides pulses[127].

[123] Sebasttian, 2012
[124] Ibid.
[125] Ibid.
[126] Ghose, 2012
[127] Ibid.

In China, earlier there was a scarcity of food grains, especially during the period of 1959-61 when there was a great famine in the country. After that, the government launched an effort to maintain grain self-sufficiency by adopting production-boosting measures, such as 40 percent rise in the grain support price paid to farmers, an increase in agricultural credit, and a heavy investment in developing higher yielding strains of wheat, rice, and corn[128]. China overcame the losses of croplands in coastal provinces owing to industrialization by ploughing grasslands in north-western provinces. Moreover, the Chinese also expanded their irrigation by over-pumping aquifers. Lastly, China made a conscious effort in self-sufficiency of its main food grains by sacrificing its self-sufficiency in soybean. It is said that China is importing four- fifths of its soybean[129]. In the light of this discussion, Nepal should learn from the SEZ experience of India that SEZs should be established at locations that do not harm the agricultural production. To enter into the international trade regime, a country should at least be self-sufficient in the production of foodstuff and mass consumable items. It, according to Shrestha, is considered the primary base for forward activities[130].

More than 74.0 percent of the total population of Nepal still derive their livelihood directly from agriculture, which involves a staggering amount of disguised unemployment, mounting to rural indebtedness, and a high rate of poverty. Investment in agriculture, the biggest and priority sector has been minimal, being confined to 3.2 percent of total resource allocations, and the share of manufacturing sector remains below 6 percent of GDP.[131] Dahal suggests a scientific land reforms system to be introduced with a view to increase productivity of agriculture. Individuals must have the right to create wealth to overcome livelihood problems, while paying taxes to government according to existing rules and regulations. Also, the dual ownership on land should be abolished by offering reasonable incentives to absentee landlords to increase their willingness to give up land ownership and transfer entitlement to the actual tillers. Among other measures to be taken to increase food production, a constitutional guarantee is needed to ensure “food security” as a fundamental right[132]. Otherwise, Nepal would soon be

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128 Brown, 2012
129 Ibid.
130 Shrestha, 2010
131 Dahal, 2012
132 Ibid.

forced to import food grains to feed its growing population.

Therefore, any policy such as SEZ would fail in Nepal in absence of self-sufficiency in food grains as “SEZs are not the panacea to be used to solve all problems, many have also failed," said Lead Investment Policy Officer of International Finance Cooperation, Gokhan Akinci[133]. "But with better physical features, development approach supported by policy framework, it could work miracle"[134] in developing countries like Nepal. Nepal should think of increasing agricultural production along with the adoption of SEZ system. "Agriculture, hydropower and tourism are major three areas to be developed today in Nepal. But SEZ seems to have gone beyond the government's priority as it tried to establish manufacturing industries under the various SEZs. That is where SEZ has been facing problems in Nepal", says Ramesh Badal[135], a lawyer who is closely monitoring the SEZ debate in Nepal.

Nevertheless as China benefited from the development of SEZs in its coastal regions, Nepal could also benefit from SEZs if they are established at suitable locations. The flat land of Terai region of Nepal is best suited for developing SEZs because of the proximity factor in trade with the bordering Indian states[136]. Of India’s population of 1.21 billion, more than 361 million people live in Nepal’s bordering states of Sikkim, West Bengal, Bihar, Uttar Pradesh and Uttarakhand in India. By developing SEZs in this region, Nepal could easily export goods right across the border in the bordering states, with which there is similarity in tastes and preferences, and purchasing power[137].

Even if the Government has done well in extending incentives for the infrastructure sector to zone developers and the units as well, with a purpose to attract foreign direct investment for providing an internationally competitive infrastructure[138], Indian experience on SEZ is not that much exciting on the matter. Considering the mammoth sops that industry will be getting in terms of 100 percent Foreign Direct Investment, 100 percent exemption from stamp-duty and registration charges, customs, service tax, income tax for five years, substantial subsidies on electricity and water, it is still obvious that SEZs are a little more than another tax-dodge. If the primary

[133] Businessjournalist,blogspot,com 2012
[134] Ibid.
[135] As per discussion with researchers on October 10, 2011.

[136] Jha, 2012
[137] Ibid.
[138] Soundrapandian, 2012.

attraction of an SEZ is tax benefits, the investments there are definitely going to be a diversion from the domestic tariff areas. For instance, Posco Steel Plant in Orissa has been given the approval to classify itself as an SEZ despite the promoters only wanting land to set up their plant and a captive iron ore mine. When the SEZ scheme got unfurled, Posco decided there was no harm if it also got some additional tax benefits, and so applied for a SEZ, which will provide it an effective subsidy of more than Rs. 98,000 crores in the next 15 years. These kinds of "development goals" will not only render lakhs of farmers landless, but also destroy the livelihoods of many more lakhs. Eventually it will allow the free and open exploitation of labour and cause huge chunks of resources, private and otherwise, to pass on into private hands. The continuation of this trajectory of development has already compelled people to rename SEZs to "Special Exploitation Zones".

While several arguments have been given for the creation of SEZs, ranging from the pressing needs of the developed nations for cheaper labour and resources, to the need to increase employment, increase the GDP, etc.[139], what is often missed out is the fact that none of these can happen unless there is a political will to execute these SEZs. "If Nepal controls political anarchism, foreign investment would come even without SEZs," Ramesh Badal[140] says. This is not to say that the implementation of the New Economic Policies, the opening up of Nepal to the free flow of foreign capital, and the so-called regime of "liberalisation" are not the contributory factors. There is, as Das stated in the context of India, an ever-increasing crisis in the developed nations, faced with depleting natural resources, high costs of labour, increased spending on state welfare, and over-production. These and various other reasons are compelling these nations to seek captive markets and captive cheap resources in the developing nations. Our political leaders have traditionally been more aligned to serving the interests of the powerful ever since the Rana Regime. This is yet another attempt of foreign rule to benefit the developed nations through the newly established Democratic Republic of Nepal, including powerful neighbours, and save their countries from the vagaries of wrong economic policies.

Also, if once we critically examine the "willingness" to develop SEZs in Nepal, it can be found in a large section of the large Nepalese landowners who have a vested

[139] Das, 2010

[140] *Kantipur*, 2012

interest in setting up of these SEZs. Though the budget for the current fiscal year has allocated Rs 12 million for developing the infrastructure and arranging security for mega industries, it is said that the Ministry of Industry is using the funds to conduct feasibility study of SEZs in new places, including Gorkha, Rautahat, Dhanusa and Siraha. Ministry sources said the new SEZs were announced haphazardly without any concrete plans and initiation of feasibility studies for SEZs in Gorkha and Rautahat, as a 'politically motivated' move. "The Prime Minister and the Industry Minister are from Gorkha and Rautahat districts, respectively," a ministry source said[141]. The private sector has criticised the government's move. "It is unfortunate that the government is transferring the budget meant for us to other headings," said Manish Agrawal[142], Director of Lumbini Sugar Mill. However, Ministry of Industry Secretary Umakant Jha said that the funds for the said projects remained unspent for a long time, so they were transferred to new projects. "It is better to spend the budget than to freeze," *Kantipur*[143] quotes the Minister as saying.

As the bulk of Nepal's political and bureaucratic elites belong to the landed gentry, it is this section in whose hands rests the control over the reins of political power. With the huge tax and duty sops, and effective subsidies being provided to industry under the SEZ rules, the scramble for setting up SEZs is bound to increase. Here, Das's argument based on Indian experience seems to be worth mentioning:

> This mad scramble has led to a spiralling increase in the premium over those lands earmarked for SEZ projects. The very fact that in the future, industry will not have to pay any taxes or custom duties means that it is willing to invest in a one-time higher cost in acquiring land, keeping in mind that in the long run this cost will be more than offset by the subsidies it will gain through no taxes and no custom duties. It is exactly this section of the Indian ruling elite which is greedily eying a huge windfall in marked-up costs and premiums over land sale and is desperate to set up SEZs and also sell their land. It is this landed ruling elite which is using the armed might of the Indian state to force the other unwilling and not so greedy members of the peasantry to forcibly part with their land for upcoming SEZ projects[144].

On the other side, the larger majority of the middle and marginal peasantry see this one-time payment as a threat to their single, most secure form of livelihood, which is farming. Neither are they

141 As per discussion with researchers on October 10, 2011
142 *Kantipur*, 2012
143 *Kantipur*, 2012

144 Das, 2012

enamoured by the cash compensation being offered. These farmers know that their skills are in farming and fishing - not in managing loose cash. Numerous interviews by the affected people in Raigarh have clearly put this point across that they have seen the disastrous consequences within those families who have wasted their entire compensation money in conspicuous consumption. As Das mentions:

> *For the landless and the sharecroppers, the issue becomes even more threatening since they will be completely excluded from the process of both compensation and employment, while losing their sole means of livelihood. It is the open fact of the reality of their lives which has compelled these peasants to take up resistance against these SEZ projects. It is also their determination which is forcing party workers of the ruling political parties to take a stand, which is often antagonistic to the overall policies of the party itself*[145].

There is a proverb that where there is a will, there is a way. The government can make a law that only genuine companies should be allowed to establish industries in SEZ. Regarding the issue of environment there is not much discussion. According to government officials at SEZP office, they have not heard any voice against SEZs on the environmental grounds. They state that people don't know the real impact of SEZ at the local level, as it is yet to be implemented[146]. Even the civil society member like Ramesh Badal, who has been following the SEZ debate, knows no one who is raising concern about SEZ and its impacts on environment and public health. It may be because of the fact that Nepalese are yet to test the benefits of the development. Unless they have real taste of it, it is difficult for them to think of the negative things that come along with the 'development'. The debate on SEZs is being led by those favouring development over environment. That is why one finds quite many scholars who see environment is a non-issue. We have to leave the nature to take its own course as humans are creations of nature, life finds its own way", Neel Kumar Chetri[147] states. He further says:

> *"We can say that environment changes owing to human activities for production and to make their life comfortable. We learn from history that environment changes and humans have always adapted to such changes. For instance, in the past, Nepalese used to clear forest by cutting or burning for pursuing agriculture. Driving vehicles or establishing a factory always emits smoke, this, however, has not stopped the people from industrialization in other countries or driving the vehicles. Raising the issue of environment is just the way of some people who do not want industrialization in Nepal to*

[145] ibid.

[146] As per researchers' discussion with officers of SEZP office, 16 October, 2012

[147] As per discussion with Neel Kumar Chetri, January 16, 2012

happen. For their sake, the country cannot always remain underdeveloped, and people cannot return to bullock carts and palanquins. Not to accept this view would be to negate human endeavour, and the human efforts to adapt to changes. If we look at China then one would find that coastal areas, which are industrialized owing to SEZ system have undergone environment changes, however, this has not hindered Chinese economy and life from developing. This seems to be the reason why in Nepal there is not much discussion."

Also, many see problems in implementing SEZ due to its vagueness with regard to tax and VAT and other relaxations offered to the investors. Many suggested to be cautious about the possibility of misuse of such a provision at the time of implementation. It is due to the fact that neither the international nor the Indian experience with SEZs has been particularly happy. Globally, only a handful of SEZs, of the hundreds that exist, have generated substantial exports, along with significant domestic spin-offs in demand or upgrading technology. For each successful Shannon (Ireland) or Shenzhen (China), there are 10 failures – in the Philippines, Malaysia, Brazil, Mexico, Colombia, Sri Lanka, Bangladesh, and even India. A 1998 report by the Comptroller and Auditor General (CAG) of India on export processing zones (EPZs) says: "Customs duty amounting to Rs. 7,500 crores was forgone for achieving net foreign exchange earnings of Rs.4,700 crores. The Reserve Bank of India says that large tax incentives can be justified only if SEZ units establish strong "backward and forward linkages with the domestic economy" which is a doubtful proposition[148]. Even the International Monetary Fund's (IMF) Chief Economist Raghuram Rajan has warned: "Not only will [the SEZs] make the government forgo revenue, it can ill afford to lose, they also offer firms an incentive to shift existing production to the new zones at substantial cost to society." A UNCTAD study quoted the case of Malaysia, where foregone tax revenues due to SEZs are estimated at 1.7% of GDP and some incentives were considered as over generous[149]. The OECD has also raised concern over the lost tax revenues in Indian SEZs, and concludes that it may not be cost-efficient as a way of attracting FDI[150]. In Nepal, however, the foregone tax revenue due to the SEZs legislation has not been estimated. The thinking of the World Bank on SEZs has also shifted to caution Nepal to calculate actual cost-benefits of its SEZ policy stating that "Increasing transparency of the costs and

[148] Bidwai, 2006
[149] UNCTAD, 2002
[150] OECD, 2008b

benefits of tax incentives would help in the long run in framing future policy"[151].

The thinking of the World Bank on SEZs has also shifted to caution Nepal to calculate actual cost-benefits of its SEZ policy[152]. In Nepal, however, the foregone tax revenue due to the SEZs legislation has not been estimated. As there was no any study to calculate the cost of a new infrastructure needed by new companies might actually amount to more than the benefits. In India, it is stated that the foregone revenue is found higher as compared with the SEZ attracted export revenues.[153]

Coming back once again to Nepal, the major critical constraints to growth include the following circumstances in Nepal[154]: high-cost economy, subsistence agriculture, alarmingly increasing dependency, extremely poor infrastructures, low investment in priority sectors, acute and pervasive poverty, limited items for exports, lack of employment opportunities at home, fragile industrial relations, lack of pragmatic industrial and foreign investment policy, persistent stagflation, huge subsidies to public enterprises, frequent disruption in the supply of petroleum products, poor capacity to spending capital expenditures, as revenues are inadequate to supplement the counterpart funding; relatively high tax burden, tumultuous financial sector, poor implementation of reform programs, growing inefficiency, rampant corruption and poor governance, and prolonged transition. Further, transferring excessively agriculture-dependent extra population to more productive non-agriculture sector by creating employment opportunities and thereby reducing the extent of poverty along with integrating domestic economy with neighbourhood, regional and global economies to maximize benefits from globalization, and liberalization and market economy in order to achieve a sustainable, high and inclusive economic growth, are considered the crucial issues[155] faced by the Nepali economy today.

The introduction of SEZ could be one of the options to address many constraints mentioned above that eventually drastically improve the economic activity in the country, and make the country's export competitive and globally noticeable by being net foreign exchange earner and provide immense employment opportunity. But this should not be done at the cost of bringing down the agricultural activities, and Land grabbing and real

[151] World Bank, 2008, p. 51
[152] World Bank, 2008
[153] OECD, 2008a
[154] Dahal, 2012
[155] Ibid.

estate mafia should be properly regulated so that the common man is not the net sufferer, to get the net foreign exchange earner up and running. Along with the introduction of SEZ, Nepal needs to realize that it has to have a dialogue among political parties and their sister organizations about how to make an investment-friendly environment inside the country. This is essential because the major political parties and their sister organizations have been instrumental in disturbing industrialization process in Nepal since 1990s. The real question is about industrial policy, and how the SEZ question relates to designing an industrial policy for Nepal. The OECD has studied Export-Processing Zones across the world, and concluded: "EPZs are always a suboptimal policy from an economic point of view. They can provide an interim solution to countries with poor business environments where bridging deficiencies at a national level is temporarily impossible."156 If SEZs are an interim policy, then having evaluation mechanisms is important to know when benefits of the policy no longer compare with the costs.

The situation has become the worst along with beginning of the Maoist Movement in 1996. For this and that reason, many industries were closed and many investors were chased away by the UCPN-Maoist party during the 10-year long insurgency. One finds many such examples by the Maoist even today after they signed Comprehensive Peace Accord in 2007 and became part of the government. It is reported that the Maoists are yet to return property seized during the insurgency to the rightful owners. That is why many Nepalese still have a speculation on Maoist leaders' promise about protecting foreign investment in the country, and ask the Maoist leaders to answer "whether they are ready to protect the property of Nepali citizens[157]."

This is not the first time that Nepalese, especially the non-Maoists, raise the question about Maoist party's position in protecting foreign and domestic investment. A similar argument came when the then Prime Minister Baburam Bhattarai decided to sign the Bilateral Investment Promotion and Protection Agreement (BIPPA) with India in 2011. The main opposition party Nepali Congress (NC) had welcomed the Prime Minister's move saying that the UCPN (Maoist) has finally come around to the economic policy the NC had been advocating for the last 20 years. NC leader and former finance minister Dr Ram

[156] OECD 2008a, p. 48

[157] *Republica*, October 24, 2012

Sharan Mahat argued, however, that "just signing the bilateral agreement was not enough if the Maoists did not mend their ways, but it would really be a welcome development if the Maoists had undergone ideological transformation in a true sense. But the main concern is whether or not the Maoists are truly transformed[158]". According to him, there is nothing to rejoice over the signing if the Prime Minister reached the agreement just to please somebody else. Maoist cadres must stop attacking projects "being developed under foreign direct investment."[159] "We want the Maoists to translate it into action," he states [160].

If we recall clause six of the 40-point demand that Bhattarai submitted to the NC government led by Sher Bahadur Deuba in 1996, before announcing an armed insurgency against the state and going underground, it was mentioned that "the domination of foreign capital in Nepali industry, business and finance should be stopped". That is why people still recall saying that it was none other than Dr Baburam Bhattarai who launched nationwide protests some 20 years ago when the then NC-led government adopted the policy of promoting foreign investment in the country, and seek answer from Maoist party and leadership about their real position today. However, it seems that the situation has become more complicated in Nepal now; even if the UCPN-Maoist convinces its cadres to play a positive role towards business community, many other such groups can be seen in the field to disturb/harass the investors as others have already learned the modus operandi from Maoist party. That is why a political consensus among the political parties at the central level seems to be the first and foremost steps before introducing SEZ policies in Nepal, along with a wide range of discussions and dialogue with the stakeholders to inform the importance of introducing SEZ at the local level. Secondly, as discussed earlier, there is not much discussion about sustainability of industries and the possible environmental problems that the locals will face in the course of the implementation of SEZs. It seems that such issues are not in priority as Nepal is yet to taste the outcomes. But it will soon be late if the government doesn't start thinking about strategies to minimize environmental damage so that public health issue won't be undermined. The meaning of SEZ itself is that certain areas are identified and given for industrialization. We cannot expect all the country to become industrialized as a result of SEZ. Increasing exports, job

158 Ibid.
159 *The Himalayan Times, 2012*
160 As per discussion with researchers on October 20, 2011.

availability, and investment opportunities for rich people or companies in Nepal are only main benefits of SEZ system for Nepal, if it is carefully implemented. As it is not likely to increase tax revenues, the provision of public services that help the poor is unlikely to improve as a result of SEZ policies.

An Assessment of the Effect of the Tax Exemption

The government has introduced the concept of SEZs in its bid to put the country on the path of industrialization. The government has sought tax exemption as one of the major factors for encouraging foreign direct investment and augmenting industrialization and business activities in the country. A review of the tax facility that the government has provided to different kinds of businesses has already been done above.

Now, it is imperative to judge whether such exemptions are really fair and helpful in achieving the objective of overall growth and development of the country. There is no doubt that tax facilities can encourage foreign investment and the other business activities in the country. However, tax facility is not the sole determinant of a conducive business environment; the profitability of investment is the key to attract domestic and foreign direct investment. Profitability depends on various factors including tax facilities, market size, purchasing power of the consumers, existence of an investment-friendly environment, availability of required infrastructures, adequacy of cheap labour, the culture of the general public, industrial security and cheap credit facilities, and so on.

Nepal is passing through a transition. Although the Maoists have joined the political mainstream, a lasting peace is yet a distant dream as the major stakeholders of the peace process continue to differ on key issues of peace process, and some other armed groups continue to wreak havoc in various parts of the country. Political instability had plagued Nepal for long. Racial discontents, which erupted after the declaration of federalism in the aftermath 2006 popular movement, seem to have shattered social harmony in the country. The industrial sector has been suffering from long hour power cuts, labour problems, frequent *bandhs* and closure of the industries, and the interest rate on the industries bank credit is also going up. Capital market is on the verge of collapse. Underground economic activities are thriving. All these factors are adversely affecting the country's economy.

Nepal has not yet made its capital account convertible, due to which the possibility of portfolio investment in the country, by the foreign investors, is very slim. Due to the lack of adequate market, infrastructure, good labour relation, industrial security, skilled manpower and stable government, Nepal cannot be an attracting destination for the foreign direct investment even if tax facilities of different kinds are offered. Nepal, however, has the potential of becoming an attracting foreign direct investment in the future as the country is situated between the two most populous countries of the world, China and India. Although there has been significant rise in the FDI in terms of percentage after the commencement of the peace process, the volume of the FDI is still far from satisfactory. Though the amount of the FDI grew from $23.8 million in 2008/09 to 38.3 million in 2009/10 with an increment of 60.8 percent[161], its inflows in 2012 were 2.85 percent lower than the figure of 2011. According to the latest World Investment Report - 2013 prepared by the United Nations Conference on Trade and Development (UNTCTAD), Nepal attracted FDI worth $92 million in 2012, against $95 million in 2011[162]. The increment in the foreign direct investment cannot be attributed solely to the tax facilities provided by the government. In fact, the commencement of the peace process in the country may have played a positive role in attracting foreign direct investment in recent years. Therefore, in order to encourage more foreign direct investment, the government has to create favourable environment for the same through various measures. Tax facilities alone are not enough to attract foreign direct investment.

Broader Tax Exemptions in Nepal Tax Legislation

Tax exemptions exist across the board, and are not limited to corporate income tax as is sometimes assumed. Tax exemptions are a manner in which the government gives incentives for individual or corporate residents in the territory for different reasons. They can be economic where the objective is to grow the economy and certain sectors in particular, or they can relate to social policy objectives of

[161] The data on foreign direct investment can be derived from the balance of payments sheet published by the Nepal Rastra bank in the Current Macroeconomic Situation, Quarterly Economic Bulletin and other publications. One can visit the URL: www.nrb.org.np for this data.

[162] *The Kathmandu Post*, June 29, 2013.

favouring marginalised sections of the population due to profession, caste, gender or geographic criteria. As policy tools, tax exemptions have a similar effect as government subsidies, and tax exemptions should be counted as revenue foregone from the budget in a transparent manner. Exemptions are harder to target on the individual level than subsidies, but they are simpler to administer. For instance, tax exemptions have been used also to increase investment in the energy, information technology and agricultural sectors.

In terms of Value Added Tax (VAT), under the zero rating provision, an exporter is not required to pay VAT for his/her exports, but if the items are taxable the seller can claim tax deduction of all VAT incurred in purchasing the item that was exported or in purchasing the input that was used in the production of that item or in the services used.[163]A registered person can deduct the amount of tax he/she has collected against the tax he/she had paid or due in importing or receiving goods or services related to his own taxable transactions. However, the tax refund facility is provided only when a claim is substantiated by the documents as prescribed (sec. 17). This is called the issue of cascading, where VAT is supposed to be levied only at the final consumer, and it can be claimed back on different levels of the supply chain.

The tax paid by a registrant on purchase/imports of goods or services for the purpose of his/her taxable business is called an 'input tax.' This comprises tax paid on raw materials, machinery, equipment, services etc. used for the purpose of taxable business.[164] A taxpayer can deduct the tax paid on purchase/import from the tax collected from sales. If the tax collected from sales exceeds the tax incurred on the purchase/import, the excess amount is required to be paid by the sellers to the government. However, on the contrary, if the tax paid on purchase/import exceeds the amount collected on sales, then one can credit the amount and deduct this from the amount to be paid in the following month. But if the amount cannot be adjusted for six consecutive months, there is a provision for that amount to be refunded to the taxpayer in a single transaction by the government. If the amount is not refunded within 60 days after the application has been received, there is a provision for the amount to be refunded with interest.[165]

[163]IRD, 2002a

[164]IRD, 2002b

[165]IRD, 2002c

In terms of the excise tax and customs taxation, long lists of exemptions exist which reveal the power of special interest groups as much as sectoral prioritise by the government. Certain exemptions seem to be motivated by social policy goals such as increasing investment in education and health sectors, but most are motivated by business elites in various sectors. Finally some, such as the detailed taxes on LCD-televisions, are motivated by luxury taxes on high-end consumer goods. Such additional taxes can be progressive for raising more revenue.

7. Conclusion and Recommendations

It seems that Nepalese still live with their past hangover of considering tax as a resource collected for the survival of the institution of monarchy. In other words, it seems that a majority of the people have not realised the fact that the government collects tax so that it can introduce and implement various new welfare programs for the people. For Nepalese, government service was regarded as *RAJAKO SINDUR* (the grace of the favour of the king), and the salary earned by the government servant was considered *RAJAKO NUN* (the salt and grain given by the king). That is why, a prominent saying in Nepali--*RAJA KO KAM KAHILE JALA GHAM* (while doing the king's work, the only concern is when the sun will set) - becomes a worthy statement to be analysed. In fact, the above-mentioned saying was categorical to point out lack of working attitudes of those who were in the government service in Nepal. What we meant to say here is that the civil servants never thought that they were taking salary from the public exchequer[166]. Once there is such an impression, the general public do not bother about the kind of problem the country's tax system has been facing. A more disappointing part was that the majority of the people seem to have seen no difference even after the institution of monarchy was gone. The genuine cause behind this is that the governments formed also after the end of the monarchical rule have not performed differently as far as tax collection and distribution is concerned. Democratizing financial governance along with the tax system is the only way out towards achieving rights for everyone.

Tax Policy and Administration

Strengthening Oversight of Government Revenue and Expenditure

There are anti-graft bodies and laws to deal with corruption, but they have not been effective in controlling corruption. There is Commission for the Investigation of Abuse of Authority (CIAA), an apex

[166] Dangal, R. 2005 p. 76

constitutional body established to curb corruption and investigate the abuse of authorities. There is a Special Court to deal with the cases of corruption. On the other hand, there is the Public Accounts Committee in the Parliament, which also deals with financial irregularities. This Committee also interrogates and investigates the issues of corruption. All these institutions should be provided a role in promoting public awareness of the importance of tax for the country's development so that people start watching not only the system of collecting and spending taxes, but also the connection between tax avoidance, corruption and economic crisis. Civil society, media and academia can play a significant role in citizen accountability beyond the formal parliamentary channels of scrutiny.

Tackling Corruption and Improving Transparency

Taxation is determined by arbitration between taxpayers and tax authorities, which generates a huge sum of kickbacks that go into the pockets of politicians and power-groups. Delinquency and manipulations in taxation are rampant, and are often protected by the politicians.[167] Moreover, the rampant political patronage of tax evaders, lack of strong legal action against the tax evaders and their associates, and the lack of bureaucratic action against corrupt tax officers have all compounded the problems of tax evasion. Watchdog agencies such as the mass media, civil society, judiciary and so on should be empowered to publicize the irregularities of public officials and their collusive relationships with the powerful interests in the society. In order to get rid of corruption and spread the fruits of economic growth and development in Nepal, it is necessary to introduce a culture of discipline rather than mere political idealism. Some problems relate to the international tax laws, such as transfer pricing, double tax treaties, tax havens, as well as tax information exchange between countries concerning individual accounts and corporate tax payers (black money), etc.

Increasing the Tax Base

Without increasing transparency and ensuring accountability on the part of both the taxpayers and tax-receivers, the tax base and the tax performance cannot be widened. Nepal's tax system faces various challenges. The system is circumscribed by the lack of transparency and simplicity. Besides, narrow base, over concentration

[167] Dahal, 2006

on the indirect tax, low tax performance and the lack of the enthusiasm among concerned entities are the by-products of an inefficient tax system. Therefore, a massive reform is needed in order to increase the overall performance of the tax system. Expansion of tax base, which increases the volume of tax, is badly needed to meet the government's development expenditure and to lessen its dependency on foreign assistance.

Modernising and Simplifying Tax Administration

It is necessary to strengthen the institutional framework and modernize and augment the overall efficiency of the tax administration by developing e-governance. If online tax-paying is introduced, a large number of taxpayers would be encouraged to pay their taxes. For this to happen, the government has to provide a user ID and password to each taxpayer with the help of which they can obtain their entire information including their tax dues. Online tax-paying would also help reduce under-the-table dealings. The tax administration needs to be made more efficient, transparent, cost-effective and user-friendly to taxpayers, and thus more accountable, by simplifying the tax system.

Improving Customer Service at Tax Administration

The government should establish special windows in all government offices to deal with the tax issues. When each government office deals with all kinds of tax-related issues, including tax information through their special windows, the ordinary taxpayers feel more comfortable in paying the taxes. Such a system would enhance the awareness of the general public and encourage them to pay their taxes on time. However, the government has to establish a wide area network for connecting all such windows with the central information system concerning all taxpayers.

Tax Exemptions and Special Economic Zones

Tax Exemptions

Tax exemptions are common in Nepal, and they have many different and sometimes overlapping objectives, such as encouraging inward investments, reducing taxes and customs rates of materials in educational and health-related facilities, encouraging investments in remote areas, and promoting national industries. These measures are either meant to achieve social policy objectives in the areas of education and health, or to improve the attractiveness of investment, which is different in all locations in Nepal. Whatever the reason of giving exemptions, they should be more transparent so that corruption could be reduced. Counting the annual “revenue foregone” due to tax exemptions is a priority for the Ministry of Finance. This would allow for making the tax exemptions cost-effective, and for parliamentarians and media to act as watchdogs, raising questions of their relevance. It would also ensure that tax exemptions are only temporary measures, rather than permanent sources of revenue leakage.

Special Economic Zones

The government announced in 2009 its policy on Special Economic Zones (SEZ) with the intention to attract foreign direct investments with tax breaks, lesser worker protection and less stable employment contracts. The policy of SEZs was inspired by the good results in China, and the current experiences with SEZs in India. However the government has since then faced with resistance both from the political parties and social groups who consider especially the importance of workers’ rights. The policy was supposed to lead to the opening of the first SEZs in 2013, but the opening has since then been delayed as none of the three first SEZs are yet open. All of the proposed SEZs require a considerable government-built infrastructure including roads, electricity, clearing the site, and rehousing local populations. A clear cost-benefit study should be conducted as to whether the policy is sensible, and whether the funds used for infrastructure improvements could be better used somewhere else.

Discretion in Tax Exemptions

The power to grant tax exemptions rests with the SEZ authorities that approve new companies. This authority is under the Ministry of Industry and Commerce, but when the activities lead to revenue losses, these are resolved under the auspices of the Ministry of Finance. This process should be more coherent, and the Ministry of Finance together with the Parliament should establish a ceiling on tax exemptions. This ceiling could be approved by the Ministry of Commerce and Industry each calendar year, to reduce the revenue erosion due to SEZs and other tax incentives to an agreed level. If local level officials can grant tax exemptions without the approval of the national government, an open door is provided for corruption and abuses of the system.

Tax Advocacy and Social Rights

Taxpayer Representation

What ways are there ways to handle the problem of abuse, which is not only a complication but also a very necessary thing to do in order to institutionalise the democratic process? Generally, anticorruption campaigns cannot succeed without involving the people and making them aware that they are the real masters of the national resources, and politicians and governmental officials are public servants. If the poor and currently ignorant people are not aware of their own position, and the role of the public officials, they may at least not be able to ask questions when they encounter a situation of tax evasion, tax avoidance, bribery and corruption. Budget tracking activities by CSOs and media have paved the way for citizen scrutiny of public expenditure, and it should be extended to the revenue side of the budget as well. Active citizenship plays a critical role in making taxpayers more mobilised and able to use their rights in challenging government policies on both raising tax revenue and spending it in public services.

Taxpayer Education

Taxpayer education should take place in all workplaces, universities and schools by way of linking taxpayers' awareness with their citizen rights and the government services. This is mandatory because more than 90 percent of the people who live in villages, being poor and ignorant, become the victims of corruption cheated by the government officials, politicians and development planners, who take advantage of their ignorance. Clearly, the question is how to bring about a public awareness of the grievous impacts of corruption, tax evasion and tax avoidance. When the public are made aware of the evils of society, officials cannot manipulate and intimidate them. Furthermore, a strong political commitment is essential for making people aware of the costs of corruption, and involving them in an effort to combat corruption in Nepal. A social boycott of corrupt businesses and officials, along with the institutional reforms discussed above, will discourage corruption and work towards increasing the economic, cultural and social rights of all Nepalese.

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Annex 1
Revenue Collection Tables

Table 1. B

Composition of Direct Tax in Nepal in Absolute Terms and as a Share of the Total

Heads	Mid-July (Rs. in millions)								
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
DIRECT TAXES	**9,546.5 (100.0)**	**11,201.5 (100.0)**	**12,255.2 (100.0)**	**13,961.5 (100.0)**	**18,979.6 (100.0)**	**23,070.8 (100.0)**	**34,552.6 (100.0)**	**41760.5 (100.0)**	**48,641.0 (100)**
A. Income Tax	**8,132.2 (85.2)**	**9,504.0 (84.8)**	**10,456.0 (85.3)**	**10,933.5 (78.3)**	**15,730.0 (82.9)**	**19,067.5 (82.6)**	**27,479.7 (79.5)**	**3,3832.1 (81.0)**	**42,066.3(86.5)**
i. Corporate Income Tax	**5,554.0 (58.2)**	**6,805.0 (60.8)**	**7,331.3 (59.8)**	**7,576.5 (54.3)**	**11,604.9 (61.1)**	**13,263.2 (57.5)**	**19,646.4 (56.9)**	**24054.3 (57.6)**	**28,807.2(59.2)**
Govt. Corporation	1,251.0 (13.1	2,056.6 (18.4)	1,331.5 (10.9)	195.8 (1.4)	1,019.5 (5.4)	183.4 (0.8)	959.7 (2.8)	1132.5 (2.7)	1282.0(2.6)
Public Ltd. Corporation	1,235.1 (12.9)	1,531.3 (13.7)	2,467.6 (20.1)	3,405.6 (24.4)	5,716.4 (30.1)	7,207.3 (31.2)	9,428.2 (27.3)	12023.5 (28.8)	13,967.2(28.7)
Private Ltd. Corporation	1,166.7 (12.2)	1,239.8 (11.1)	1,527.3 (12.5)	1,703.0 (12.2)	2,310.0 (12.2)	3,135.2 (13.6)	4,200.5 (12.2)	6268.8 (15.0)	7,232.9(14.9)
Individual & sole Trading Firm	1,801.7 (18.9)	1,869.7 (16.7)	1,876.8 (15.3)	1,958.8 (14.0)	2,303.4 (12.1)	2,452.2 (10.6)	4,481.6 (13.0)	3842.3 (9.2)	4,895.7 (10.1)
Income from Other Institutions	99.5 (1.0)	107.6 (1.0)	128.1 (1.0)	313.4 (2.2)	255.6 (1.3)	285.1 (1.2)	576.4 (1.7)	787.1 (1.9)	1,429.5(2.9)
ii. Remuneration Income	**1,249.0 (13.1)**	**1,392.9 (12.4)**	**1,678.2 (13.7)**	**1,771.1 (12.7)**	**2,006.8 (10.6)**	**2,452.0 (10.6)**	**3,398.5 (9.8)**	**4420.0 (10.6)**	**5,863.8(12.1)**
iii. Investment Income	**1,321.5 (13.8)**	**1,291.9 (11.5)**	**1,425.9 (1.6)**	**1,546.6 (11.1)**	**2,080.1 911.0)**	**3,271.7 (14.2)**	**4,169.7 (12.1)**	**5087.8 (12.2)**	**7,108.9(14.6)**
iv. Other Income	**7.7 (0.1)**	**14.2 (0.1)**	**20.6 (0.2)**	**39.3 (0.3)**	**38.2 (0.2)**	**80.7 (0.3)**	**265.1 (0.8)**	**270.0 (0.6)**	**286.5(0.6)**
B. Land & Building Regist.	**1,414.2 (14.8)**	**1,697.5 (15.2)**	**1,799.2 (14.7)**	**2,180.3 (15.6)**	**2,238.7 (11.8)**	**2,933.0 (12.7)**	**5,248.4 (15.2)**	**5510.8 (13.2)**	**2,552.0(7.3)**
. property Tax	**0.1 (0.0)**	**0.0 (0.0)**	**0.0 (0.0)**	**0.0 (0.0)**	**0.0 (0.0)**	**0.0 (0.0)**	**0.0 (0.0)**	**0.0 (0.0)**	**0.0(0.0)**
D. Vehicle Tax	**559.3 (5.9)**	**700.4 (6.3)**	**806.1 (6.6)**	**847.6 (6.1)**	**1,011.0 (5.3)**	**1,070.2 (4.6)**	**1824.5 (5.3)**	**2417.6 (5.8)**	**3022.6(6.2)**

Source: *Quarterly Economic Bulletin* (various issues), Nepal Rastra Bank.
Note: Values in the parentheses represent the share in total direct tax.

Table 1. C
Composition of Indirect Tax in Nepal in Absolute Terms and a Share of the Total

Heads	Mid-July (Rs. in million)								
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
INDIRECT TAXES	**32,481.2 (100)**	**36,974.2 (100.0)**	**41,851.8 (100.0)**	**43,465.5 (100.0)**	**52,188.3 (100.0)**	**62,076.3 (100.0)**	**82,499.2 (100.0)**	**114530.2 (100.0)**	**124,114.3 (100.0)**
A. Customs	**14,236.4 (43.8)**	**15,554.2 (42.1)**	**15,701.5 (37.5)**	**15,343.7 (35.3)**	**16,699.3 (32.0)**	**21,062.6 (33.9)**	**26,622.5 (32.3)**	**35151.6 (30.7)**	**35,708.6(28.8)**
i. Export	855.2 (2.6)	527.4 (1.4)	736.3 (1.8)	625.3 (1.4)	708.6 (1.4)	445.7 (0.7)	796.4 (1.0)	908.9 (0.8)	357.7(0.3)
ii. Import	10,567.7 (32.5)	11,439.1 (30.9)	12,302.9 (29.4)	11,744.5 (27.0)	13,623.9 (26.1)	17,128.3 (27.6)	21,886.3 (26.5)	29964.8 (26.2)	31,477.3(25.4)
iii. Indian Excise Refund	2,370.6 (7.3)	3,110.1 (8.4)	2,188.3 (5.2)	2,314.4 (5.3)	1,896.6 (3.6)	2,997.1 (4.8)	3,211.2 (3.9)	3521.0 (3.1)	2,831.8(2.3)
iv. Agriculture Reform Duties	426.2 (1.3)	404.7 (1.1)	400.9 (1.0)	538.8 (1.2)	406.0 (0.8)	390.1 (0.6)	497.2 (0.6)	497.3 (0.4)	751.6(0.6)
v. Miscellaneous	16.7 **(0.1)**	72.9 **(0.2)**	73.1 **(0.2)**	120.7 **(0.3)**	64.2 (0.1)	101.4 (0.2)	231.4 (0.3)	259.5 (0.2)	290.2(0.2)
B. Value Added Tax	**13,467.3 (41.5)**	**14,498.2 (39.2)**	**18,897.9 (45.2)**	**21,615.4 (49.7)**	**26,145.4 (50.1)**	**29,784.6 (48.0)**	**39,604.2 (48.0)**	**54896.5 (47.9)**	**61659.1(49.7)**
i. Production	1,904.1 (5.9)	1,964.1 (5.3)	2,460.9 (5.9)	2,899.9 (6.7)	3,278.5 (6.3)	3,456.4 (5.6)	4,140.5 (5.0)	5999.2 (5.2)	6,720.0(5.4)
ii. Import	8,629.2 (26.6)	8,874.7 (24.0)	12,270.2 (29.3)	13,462.5 (31.0)	16,508.0 (31.6)	18,951.9 (30.5)	25,579.2 (31.0)	34555.2 (30.2)	39.379.3(31.7)
iii. Sales and Distribution	676.3 (2.1)	851.4 (2.3)	1,164.2 (2.8)	1,357.4 (3.1)	1,645.9 (3.2)	2,296.2 (3.7)	2,379.3 (2.9)	3286.6 (2.9)	4,233.3(3.4)
iv. Services	2,257.7 (7.0)	2,808.0 (7.6)	3,002.6 (7.2)	3,895.6 (9.0)	4,713.1 (9.0)	5,080.1 (8.2)	7,505.2 (9.1)	11055.5 (9.7)	11,326.5(9.1)
C. Excise	**4,777.5 (14.7)**	**6,221.4 (16.8)**	**6,446.3 (15.4)**	**6,506.5 (15.0)**	**9,343.6 (17.9)**	**11,229.2 (18.1)**	**16,272.5 (19.7)**	**24315.1 (21.2)**	**26,542.2(21.4)**
i. Cigarettes & Bidi	2,049.6 (6.3)	2,394.2 (6.5)	2,477.0 (5.9)	2,409.1 (5.5)	2,854.3 (5.5)	3,117.6 (5.0)	3,740.3 (4.5)	4511.5 (3.9)	5,142.8(4.1)
ii. Liquor & Beer	2,212.4 (6.8)	2,244.5 (6.1)	2,559.1 (6.1)	2,677.3 (6.2)	3,436.5 (6.6)	3,672.6 (5.9)	5,131.2 (6.2)	6584.0 (5.7)	8,438.9(6.8)
iii. Other Industrial Production	332.0 (1.0)	296.1 (0.8)	326.2 (0.8)	330.2 (0.8)	973.6 (1.9)	1,522.1 (2.5)	2,139.6 (2.6)	2514.0 (2.2)	2,191.7(1.8)
iv. Excise on Imports	183.5 (0.6)	1,286.6 (3.5)	1,084.0 (2.6)	1,089.8 (2.5)	1,970.3 (3.8)	2,847.2 (4.6)	5,129.0 (6.2)	10546.9 (9.2)	10,564.1(8.5)
v. Other Taxes	0.0	0.0	0.0	0.0	109.0 (0.2)	69.8 (0.1)	132.4 (0.2)	158.6 (0.1)	204.8(0.2)
D. Others	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**167.0 (0.1)**	**204.4(0.2)**

Source: *Quarterly Economic Bulletin* (various issues) Nepal Rastra Bank.
Note: Values in the parentheses represent the share in total direct tax.

Table 1. D
Direct Tax and Indirect Tax (As % of the GDP and the Total Government Expenditure)

FY	As % of the GDP		As % of Total Expenditure	
	Direct Tax	Indirect Tax	Direct Tax	Indirect Tax
2002/03	1.9	6.6	11.4	38.7
2003/04	2.1	6.9	12.5	41.3
2004/05	2.1	7.1	13.7	46.8
2005/06	2.1	6.6	13.6	42.4
2006/07	2.6	7.2	17.1	47.1
2007/08	2.8	7.6	17.3	46.5
2008/09	3.5	8.3	21.4	51.1
2009/10	3.6	9.8	19.0	52.1
Average	2.6	7.5	15.8	45.7

Note: The data on the GDP is derived from the Central Bureau of Statistics (CBS) and then the ratio is calculated.

Table 1.E.
Poverty Incidence by Caste and Ethnicity, Nepal, 1995/96 and 2003/04

Social Category of Population of Nepal	Poverty Headcount Rate	
	1995/96	2003/04
Nepal (average)	41.8	30.8
Brahmin/Chhetri	34.1	18.4
Dalits (formerly untouchables)	57.8	45.5
Newar	19.3	14.0
Hill Janajati	48.7	44.0
Tarai Janajati	53.4	35.4
Muslim	43.7	41.3
Tarai Middle Caste	28.7	21.3
Others	46.1	31.3

Source: UNDP (2009), Nepal Human Development Report, 2009, p. 46

Table 1.A
Amount of Tax and the Share of Direct and Indirect Taxes in the Total Tax in Nepal

Fiscal Year	Total Tax (Rs. in million)	Direct Tax (Rs. in million)	Share of Direct Tax in Total Tax	Indirect Tax (Rs. in million)	Share of Indirect Tax in Total Tax
2002/03	42,027.7	9,546.5	22.7	32,481.2	77.3
2003/04	48,175.7	11,201.5	23.2	36,974.2	76.8
2004/05	54,104.9	12,255.2	22.6	41,851.8	77.4
2005/06	57,427.0	13,961.5	24.3	43,465.5	75.7
2006/07	71,168.0	18,979.6	26.7	52,188.3	73.3
2007/08	85,147.1	23,070.8	27.1	62,076.3	72.9
2008/09	117,051.8	34,552.6	29.5	82,499.2	70.5
2009/10	156,290.7	41,760.5	26.7	114530.2	73.3
2010/11	172,755.3	48,641.0	28.2	124,114.3	71.8
2011/12	211,718.3	66,906.7	31.6	144,811.6	68.4

Source: *Quarterly Economic Bulletin* (Various issues) Nepal Rastra Bank

Annex 2

Tables related to Tax and Representation

Table 2.A
Social Composition of the Respondents

Social Composition	Kathmandu			Parbat (Kushma)			Kathmandu & Parbat		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Brahmin	5	1	6	6	1	7	11	2	13
Chhetri	0	2	2	1	1	2	1	3	4
Jananati	3	2	5	2	1	3	5	3	8
Madhesi	1	0	1	0	1	1	1	1	2
Dalit	0	1	1	2	1	3	2	2	4
Other Unspecified	0	0	0	1	0	1	1	0	1
Total	9	6	15	12	5	17	21	11	32

Source: Field survey
*Here, we categorised one respondent as other unspecified group as he refused to mention his caste.

Table 2.B.
Tax paid before and after 2006

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	More	2	0	0	0	0	0	1	0	0	0	0	0	3	20.0
	Same	3	1	0	1	2	0	0	0	0	0	0	0	7	46.7
	Do not Pay	0	0	0	1	1	2	0	0	0	1	0	0	5	33.3
Parbat/ Kushma	More	5	0	1	1	2	1	0	1	1	1	1	0	14	82.4
	Same	1	1	0	0	0	0	0	0	1	0	0	0	3	17.6
	Do not Pay	0	0	0	0	0	0	0	0	0	0	0	0	0	0.0

Source: Field survey

Table 2.C.
Volume of VAT Paid by the Respondents

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Answered in %	0	0	0	0	0	2	0	0	0	0	0	0	2	13.3
	Paid but no Idea about Amount	3	0	0	1	1	0	0	0	0	0	0	0	5	33.3
	Not Paid	2	1	0	1	2	0	1	0	0	1	0	0	8	53.3
Parbat/ Kushma	Answered in %	1	0	0	0	0	0	0	0	0	0	0	0	1	5.9
	Paid but no Idea about Amount	4	1	1	1	2	1	0	1	2	0	1	0	14	82.4
	Not Paid	1	0	0	0	0	0	0	0	0	1	0	0	2	11.8

Source: Field survey

Table 2.D.
Respondent's perception towards VAT (Fair/Unfair)

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Fair	1	0	0	0	0	1	0	0	0	0	0	0	2	13.33
	Unfair	2	1	0	1	1	1	0	0	0	0	0	0	6	40.00
	Do not know	2	0	0	1	2	0	1	0	0	1	0	0	7	46.66
Parbat/ Kushma	Fair	4	0	1	0	0	0	0	0	1	0	0	0	6	35.29
	Unfair	1	0	0	0	2	1	0	0	1	0	1	0	6	35.29
	Do not know	1	1	0	1	0	0	0	1	0	1	0	0	5	29.41

Source: Field survey 2011

Table 2.E.
Respondent's perception towards VAT (helpful/harmful)

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Helps for Country's Dev	2	0	0	1	0	1	0	0	0	0	0	0	4	26.67
	Does not help	1	0	0	0	0	1	0	0	0	0	0	0	2	13.33
	Non Transparent	1	0	0	1	1	0	1	0	0	1	0	0	5	33.33
	Do not know	1	1	0	0	2	0	0	0	0	0	0	0	4	26.67
Parbat/ Kushma	Helps for Country's Dev	4	0	1	0	2	0	0	0	1	0	1	0	9	52.94
	Does not help	1	0	0	1	0	1	0	0	1	0	0	0	4	23.53
	Non Transparent	0	1	0	0	0	0	0	1	0	1	0	0	3	17.65
	Do not know	1	0	0	0	0	0	0	0	0	0	0	0	1	5.88

Source: Field survey 2011

Table 2.F.
The Amount of Land Tax Paid by Respondents

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Answered in amount (Rs 20-150)	3	0	0	1	0	0	0	0	0	0	0	0	4	26.7
	Paid but no Idea about Amount	2	1	0	1	0	1	0	0	0	0	0	0	5	33.3
	not Paid	0	0	0	0	3	1	1	0		1	0	0	6	40.0
Parbat/ Kushma	Answered in amount (Rs 10-150)	5	0	1	0	2	1	0	0	2	0	1	0	12	70.6
	Paid but no Idea about Amount	1	1	0	1	0	0	0	0	0	0	0	0	3	17.6
	not Paid	0	0	0	0	0	0	0	1	0	1	0	0	2	11.8

Source: Field survey 2011

Table 2.G.
Whether the Land Tax is Fair or Unfair.

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Fair	4	0	0	0	0	2	1	0	0	0	0	0	7	46.7
	Unfair	1	1	0	1	1	0	0	0	0	0	0	0	4	26.7
	Do not know	0	0	0	1	2	0	0	0	0	1	0	0	4	26.7
Parbat/ Kushma	Fair	6	0	1	0	2	1	0	0	2	0	1	0	13	76.5
	Unfair	0	0	0	0	0	0	0	0	0	0	0	0	0	0.0
	Do not know	0	1	0	1	0	0	0	1	0	1	0	0	4	23.5

Source: Field survey

Table 2.H.
Respondent's perception towards Land Tax (helpful/harmful)

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Helps for Country's Dev	2	0	0	0	0	2	0	0	0	0	0	0	4	26.66
	Does not help	1	0	0	0	0	0	0	0	0	0	0	0	2	13.33
	Non Transparent	1	0	0	1	1	0	1	0	0	1	0	0	5	33.33
	Do not know	1	1	0	0	2	0	0	0	0	0	0	0	4	26.66
Parbat/ Kushma	Helps for Country's Dev	5	1	1	0	2	1	0	1	0	1	1	0	13	76.46
	Does not help	1	0	0	1	0	0	0	0	0	0	0	0	2	11.76
	Non Transparent	0	0	0	0	0	0	0	0	2	0	0	0	2	11.76
	Do not know	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Source: Field survey 2011

Table 2.I..
The Amount of Income Tax Paid by Respondents

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Answered in amount (Rs 100-150)	4	1	0	1	0	1	0	0	0	0	0	0	7	46.7
	Paid but no Idea about Amount	1	0	0	0	0	1	1	0	0	0	0	0	3	20.0
	not Paid	0	0	0	1	3	0	0	0	0	1	0	0	5	33.3
Parbat/ Kushma	Answered in amount (Rs 10-130)	5	0	1	0	1	1	0	0	2	0	0	0	10	58.8
	Paid but no Idea about Amount	1	1	0	1	0	0	0	1	0	0	0	0	4	23.5
	not Paid	0	0	0	0	1	0	0	0	0	1	1	0	3	17.7

Source: Field survey 2011

Table 2.J.
Whether the Income Tax Collected by Authority is Fair of Unfair

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	Fair	1	0	0	0	0	2	1	0	0	0	0	0	4	26.7
	Unfair	4	1	0	1	1	0	0	0	0	0	0	0	7	46.7
	Do not know	0	0	0	1	2	0	0	0	0	1	0	0	4	26.7
Parbat/ Kushma	Fair	6	1	1	0	1	1	0	0	2	0	0	0	12	70.6
	Unfair	0	0	0	0	0	0	0	1	0	0	0	0	1	5.9
	Do not know	0	0	0	1	1	0	0	0	0	1	1	0	4	23.5

Source: Field survey 2011

Table 2.K..
Reasons of Collecting Taxes

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F	M&F	M&F
Kathmandu	To run the country	4	1	0	1	2	2	1	0	0	0	0	0	11	73.3
	For Country's development	0	0	0	0	0	0	0	0	0	0	0	0	0	0.0
	Do not know	1	0	0	1	1	0	0	0	0	1	0	0	4	26.7
Parbat/ Kushma	To run the country	4	0	0	0	1	1	0	0	0	0	0	0	6	35.3
	For Country's development	1	1	1	1	0	0	0	1	2	1	1	0	9	52.9
	Do not know	1	0	0	0	1	0	0	0	0	0	0	0	2	11.8

Source: Field survey 2011

Table 2.L..
How Government Utilises Taxes

Field	Social Composition	Brahmin		Chhetri		Jananati		Madhesi		Dalit		Unspecified		Total	% of Total
	Gender	M	F	M	F	M	F	M	F	M	F	M	F		
Kathmandu	In education, health and social security	3	0	0	1	0	0	0	0	0	0	0	0	4	26.7
	For country's development	0	1	0	0	0	1	0	0	0	0	0	0	2	13.3
	Do not know/non-transparent	2	0	0	1	3	1	1	0	0	1	0	0	9	60.0
Parbat/ Kushma	In education, health and social security	1	0	0	0	0	0	0	0	0	0	0	0	1	5.9
	For country's development	5	0	1	1	2	1	0	1	2	1	1	0	15	88.2
	Do not know/non-transparent	0	1	0	0	0	0	0	0	0	0	0	0	1	5.9

Source: Field survey 2011

Annex 3
General Tax Exemptions

Table 3.A.: Examples of Income Tax Exemptions

Industry Specific Concessions	Rate of Tax
Agriculture and by any cooperatives (which have been registered and operated under the Cooperatives Act 1991 and based in rural communities) from agriculture and forest-based industries	No tax levied
Income tax earned through special industries and information technology industries employing women, Dalits and differently able people in the country.	Special arrangements
Income earned from sources in Nepal during an income year by person from a special and information technology industries, which provide direct employment to 300 or more Nepalese citizens throughout the year.	Tax levied at 90% of standard rate
Income earned through special and information technology industries which give direct employment to 1200 or more Nepalese citizens throughout the year,	Tax levied at 80% of standard rate
Income earned through special and information technology industries which provide employment includingat least 33 percent women, Dalit or disabled persons and employ 100 or more Nepalese citizens throughout the year.	Tax levied at 80% of standard rate
Industries that are established in the least developed areas and produce fruit-based brandy, cider as well as wine	Tax levied at 40% of standard rate.
Industries established in SEZs which are situated in Himalayan districts	Full exemption of income tax for 10 years from the commencement of the business, and 50 percent exemption thereafter.
Other industries that are established in SEZs, but are not in Himalayan districts.	Fully exempted for five years from the commencement of the business, and 50 percent of income tax is exempted thereafter.
SEZ industries	a full tax exemption is granted to any industries established at any SEZ for five years from the commencement of the business. However, after the expiry of the five years, 50 percent tax exemption is provided for a maximum period of three years. Furthermore, concession of 50 percent is provided on income generated as service charge or royalty for technology transfer or management services provided by a foreign investor for the industries established at any SE
Industries in remote areas	100 percent tax exemption to the industries for up to 10 years from the date of operation of the industries

Information technology industries established in the Information Technology Park as prescribed by the government.	An exemption of 25% of Income Tax.
Agencies (body corporate), that produce, transmit and distribute hydro-electricity up to Chaitra 2075 B.S. (mid-April 2019 in Roman calendar). The same facilities have been granted to the producer of solar power, wind power as well as bio-fuel.	Full income tax remission for the first seven years; and 50 percent income tax remission up to three years thereafter
investors who build roads, bridges, airports, tunnel roads and operate tram and trolley buses.	25 % of tax rebate is granted.
Manufacturing industry that exports goods.	25 % of tax rebate is granted.
manufacturing, tourism service, and hydro-power generation and distribution industries enlisted in the stock exchange	10% tax exemption is granted
Royalty earned from the export of intellectual property right is granted to concerned persons	25% of the standard rate.
Royalty income earned from the transfer of intellectual property right is granted to the person entitled to tax rebate.	50% of the standard rate.
Interests paid by controlled entity to the parent entity in the course of conducting a business or investment.	Deductible with some limitations, categorized in five classes.
Costs such as cost of trading stock, repair and improvement cost of owned and used depreciable asset, pollution control, research and development.	Deductible with some limitations, categorized in five classes.

Table 3.B.: Examples of VAT Exemptions

Item	**Description**
Goods and services	**Goods and services are either taxed at the standard rate of 13 percent**
Basic Agricultural Products	(a) paddy, rice, wheat, maize, barley, millet, pulses, flour, and similar unprocessed food materials. (b) green and fresh vegetable, fresh fruits, fresh eggs and similar products (except used in hotels, restaurants, bars, guest houses, cafeteria and other similar organizations) (c) unprocessed cereals, (such as sugarcane, tea leaf, tobacco, cotton, cardamom, jute, oil seeds, soybean) (d) herbs
Goods of Basic Needs	(a) Unprocessed edible oil (b) Piped water, including water supplied by tankers (c) Fuel wood and coal (d) Kerosene (e) Salt
Live Animals and animal products	(a) he goat, sheep, yak, he buffalo, bore, pigs, rabbit, and similar other animals; their fresh milk, and uncooked/unprocessed verities (b) cows, she buffalo and she goat (c) ducks, hens, cocks, turkey and similar other birds, and their fresh meat, eggs, and similar, Uncooked varieties. (d) fresh or dried fish (other than packed)
Agricultural inputs	(a) seeds of any plants listed in Group 1 (b) manure, fertilizer and soil conditioners (c) agriculture hand implements,

	(d) pesticides, made mainly for use of crops (e) agriculture equipment, including tractors, (f) Birds and Animal feed
Medicine, Medical and Similar Health services	(a) medical or surgical services provided by Government Institutions (b) human blood and products derived from human blood (c) human or animal organs or tissue for medical research (d) the supply of services by persons on the regisere of veterinary surgeons and veterinary doctors (e) the supply of goods made for, and suitable only for the use of, disabled persons. (f) X-ray film and oxygen gas to be used for treatment (g) Raw materials purchased or imported by the drug industries to the extent approved by the Department of Drug Management
Education	(a) The provision of research in a school or university (b) The provision, otherwise than for profit, of professional or vocational training or refresher training (c) The provision of education in a school or university and supply of goods made in connection with such services
Books, Newspapers etc.	(a) Books, newspapers, newsletters and periodicals (b) Newsprint
Artistic and cultural goods and services, carving services	(a) Painting, handicrafts, carving and related services. (b) cultural programme (c) Admission to libraries, archaeology, museums, zoos and botanical gardens.
Passengers and goods transportation services	Air transport, non-tourist passenger transportation (except cabal car) and goods carrier (except transportation related to supply)
Personal or Professional service	Personal services rendered by artists, sportsmen, authors, writers, designers, translators and interpreters Institutionally or individually.
Other goods or services	Postal services (provided by HMG only) (a) The service of conveyance of letters, money and postal packets by the Post office (b) The supply by the post office of any service in connection with the conveyance of letters, money and portals packets (c) Postage stamps, 2. Financial and insurance services. 3. Bank notes, and cheque books. (a) The printing and issue of bank notes (b) The supply of bank notes from outside the Nepal to the Nepal. (c) Cheque book 4. Gold and silver (a) Gold, gold coins and gold ornaments (b) Silver and silver coins (other than ornaments and goods made of silver) 5. Electricity, 6. Aluminium, copper, scrape, circle, plate and utensils 7. Raw wool, 8. Battery operated tempo, their chassis and battery

	9. Bio-gas, solar power and wind power operated power generation plant and their main parts on the recommendation of the Alternative Energy Centre. 10 Aeroplane, Helicopter, Fire Brigade and Ambulance 11. Jute goods 12. Industrial machinery included in section 84 of customs tariff and subject to 5% tariff 13. Woolen carpet & woolen carpet weaving, dying, washing, knitting 14. Cotton and other synthetic sadi, Lungi, Dhoti, Gamcha 15. Cotton yarn 16. Woolen yarn to be used in hand knitting sweater (except artificial & acrylic) domestically 17. Donated goods received for calamities or philan thropic purpose approved by Ministry of Finance
Land and Building	Purchase and rent of land and buildings (except the rental service provided by hotels, guest houses or similar organization)
Betting, casinos, lotteries	(a) The provision of any facilities for the placing of bets or the playing of games of chance (b) Lottery

Table 3.C.: Goods or Services payable at zero rate

Item	Description
2. Export of goods	(a) goods exported outside the Nepal; or, (b) goods shipped for use as stores on a flight to an eventual destination outside the Nepal; or, (c) goods loaded for use as stores on aircraft to a destination outside the Nepal or as Merchandise for sale by retail or supplied to persons in the course of such a flight.
3. Export of services	(a) A supply of services by a person resident in the Nepal to a person outside the Nepal and having no business establishment, agent, or legal representative acting on his behalf in the Nepal (b) Where goods are supplied on a hire or loan basis by a registered person resident in Nepal to a person resident outside the Nepal
4. Imports of goods and services by accredited diplomats	

Table 3.D: Examples of Excise Duty Rates

Item	Description
UN charter is those belonging to diplomatic missions	Exempted.
chassis of ambulances, corpse carrying vehicles, electric vehicles and battery tempos, local production of marble.	exempted
goods imported under the Luggage and Baggage Order Facility	Exempted.
the local production of motorcycles	50% exemption of standard rate.
local production of other motor vehicles	25% exemption of standard rate.
brandy produced by the local fruits-based industries established in	80% exemption of standard

the least developed regions	rate.
motor vehicles that were imported in the name of any project having full or partial tariff facility (except those imported on inventory or bank guarantee) to any local body, community school, community hospital or governmental body after the completion of the project, in scrapping or cancelling of the registration of any motor vehicle that has been imported under tariff facility and which is more than 15 years old and, in transferring the vehicle imported for personal use with the enjoyment of partial customs tariff facility to his spouse after the death of the owner	Exempted from customs duty.
any industry producing goods by using 90 percent or more native worn and torn or unusable goods	Exempted.
Against the bank guarantee on the export and import of the raw materials, subsidiary raw materials which are required for the manufacturing of finished products to be exported, packing materials and other materials to be used in manufacturing, plants, machines, equipment, tools and spare parts and motor vehicles (based on the size and nature of industry), required for the industries situated in SEZs	Government may grant partial or full customs duty exemption.

Table 3.E: Examples of Customs Duty Rates

Item	Description
customs duty is applicable to the import of goods	20% to 30% standard rate
import of alcoholic beverages	Rs. 125 to Rs. 600 per litre depending on their quality and concentration
cigar and cigarettes made of tobacco	Rs. 2000 per thousand sticks
Goods to be imported in the name of any project to be operated under foreign loan or grant assistance or in the name of the contractor of such project	Government may grant partial or full customs duty exemption.
Fuel to be consumed during international flight, engine of aircraft, spare parts, machine, equipment thereof, food, liquors, beer and light drinks consumed in flight by an international air service company	Government may grant partial or full customs duty exemption.
The provisions for according the duty facility to any goods to be sent again to a foreign country from the foreign country via Nepal shall be as prescribed	Duty shall be as prescribed.
import of industrial raw materials as well as agricultural inputs	Government may grant partial or full customs duty exemption.
import of generator having capacity of 10 kilowatt or more, aeroplane, helicopter and their parts (gear box, engine, tyre, battery, nut, bolts, rivet)	Government may grant partial or full customs duty exemption.
imported by the feed industries for the purpose of producing and exporting the cattle feed, seed of mustard, linseed, and rapeseed, the raw materials or subsidiary raw materials imported for own purpose by the tyre industries	Government may grant partial or full customs duty exemption.
Straw cutting machine for feeding cattle, thresher for threshing paddy and wheat, cultivators used in agriculture and horticulture, leveller, plough, seeders, planters, transplanters, manure spreaders, fertilizers distributors and harvesting machines used in agriculture, pumping set, along with engine and hosepipe (of power ranging from 2 horsepower to 8 horsepower), milk separator, milk chilling	Government may grant partial or full customs duty exemption.

vat, liquid nitrogen	
Industrial refrigerator, container and incubator, feeding plant for poultry and all equipments necessary for poultry farming, inputs (coffee perforator, seed screening and sorting machine) used in coffee farming, juice machine, egg cleaning machine, machineries, tools and parts, sprinkle, etc. used in drip irrigation, tea chest imported by the tea industries for tea packing fishing nets, nylon thread used for making fishing nets, fish keeping readymade cages, pump set, incubator for hatching duck eggs etc imported by the registered fish firms, greenhouse, irrigation equipments and other similar equipments imported by agriculture, horticulture and floriculture firms	Government may grant partial or full customs duty exemption.
man-made staple fibre imported by the carpet industries	90% exemption on standard rate.
mill, machineries and equipments	5% duty is applicable, excluding those which are used for household purpose and for which five percent customs duty is applicable
import of tin cans and tank respectively, which are used for transporting milk by dairy industries	50 and 80 percent tax exemption on standard rate
chemicals imported by the ink industries. Fifty percent exemption in customs duty is granted on the imports of machineries, parts, block, sheet, graphic art, film, vertical camera and chemicals, five percent exemption in the customs duty is granted on the import of ink by domestic press industries	50 percent exemption.
imports of tent, ice axe, piton, climbing rope, goods used only in climbing, special types of camping crockery and cutlery and rucksack, by the trekking agencies, imports of rubber boat and motor (10/10 numbers), helmet (100 pieces), paddle (100 pairs) and waterproof camera container (10 numbers) by the rafting agencies	5 percent customs duty is levied.
import of communication equipments by trekking agencies, imports of luxury coach, microbus and minibus, under some conditions, by the travel agencies, trekking agencies and star and resort hotels on the recommendation of the concerned government entities.	50 percent exemption on standard rate.
Export of speciality herbal products such as Yarchagumba (CordycepsSinesis)	Rs. 1000 per kilogram
Export of Catechu Extract	Rs. 25 per kilogram
Export of slate and natural sand, crushed stone of more than 2.5 inch in size	Rs. 400 per cubic meter
Export of timber / wood depending upon the types and qualities of the wood	70 percent to 200 percent of the value of timber / wood

Annex 4

A. In-depth Interview Checklist

Part I: personal Details

1. Background of respondent (ethnicity, family, residence, education, occupation, etc.)
2. Marriage
3. Economic well-being (household, family and person)
4. - weekly income

Part II: Tax related Questions

1. Knowledge about Tax and Tax System in Nepal (types of tax, kind/sources of taxes implacable in locality, utilisation of taxes in locality, etc.)
2. Do you pay more or less tax since 2006?
3. His/her own involvement as tax payer.
   - Volume of VAT he or she is paying?
   - - is it fair or unfair?
   - - is it helpful or harmful? (if so how)
   - -Volume of land revenue tax he or she is paying?
   - - is it fair or unfair?
   - - is it helpful or harmful? (if so how)
   - -Volume of income tax he or she is paying?
   - - is it fair or unfair?
   - - is it helpful or harmful? (if so how)

Part III: Perception towards Tax

1. What is the reason the Government is collecting taxes?
2. How much tax should everybody pay in Nepal?

How much tax you are actually paying?

Part IV: Local tax authorities and relationship

1. Who is collecting tax in your locality?
2. How customer friendly are they?

Part V: Suggestions

1. What change in the tax system would you like to see?
2. If the change has been done as per your suggestion, would you like to pay more tax?
3. Any other suggestions?

B. Check List Administered to Analysis of the Government's SEZ Policy

Respondents:

1. Government Officials who are Responsible for Administering SEZ Process i.e. preparing laws and regulations, issuing licences (SEZ Authority), tax administration, (6-10 interviews)
2. NGOs which are working on trade issues, (3-5 interviews)
3. NGOs that work on rights based issues (labour rights, education rights, health rights), (3-5 interviews)

Questions

1. Rational of SEZ policy
   a. What is the rational behind bringing SEZ policies in Nepal (GVT Respondents)?
   b. Are you aware of SEZ policies and their implications in Nepal (NGO Respondents)?

2. Current Status
   a. What is the current status of SEZ project in Nepal (GVT)?
   b. What is the current awareness of SEZ project in Nepal (NGO)?

3. What motives are there for investors to use SEZ?

4. Are you aware of tax exemption in SEZ policies in Nepal (NGO)?
   a. Can you tell about the tax exemption in SEZ policies in Nepal (GVT)?
   b. Are you aware of tax exemption in SEZ policies in Nepal (NGO)?

(If needed, explain to respondent about SEZ tax exemptions unless already aware, or give correct information)

5. Are tax exemptions in SEZ essential (GVT & NGO)?
6. Are other special laws / regulation in SEZ essential (GVT & NGO)?
7. What expected effect are SEZ likely to have for NEPAL (GVT & NGO Respondents)?
8. In your view, how easily Nepal can implement SEZ policies in the given circumstances?
   (circumstances can be defined by respondent)
9. Are these policies beneficial for Nepal (GVT & NGO)?
10. Indicators
    a. What are the indicators /criteria that assure the fulfilment of SEZ project (GVT)?
    b. What indicators / criteria would you use assuring the fulfilment of SEZ (NGO)?

11. Any suggestions, regarding SEZ policies?

About the Authors

Uddhab Pyakurel, a Ph.D. from Jawaharlal Nehru University, New Delhi, is teaching Political Sociology as Assistant Professor in School of Arts, Kathmandu University, Nepal. He is also associated with various democracy forums i.e., South Asian Dialogues on Ecological Democracy (SADED), Vasudhaiva Kutumbakam (VK), and Network Institute for Global Democratization (NIGD). He often contributes articles to journals and local newspapers on poverty, people's participation, social inclusion/exclusion, state restructuring, micro-credit, gender, conflict, identity, democracy, election, Indo-Nepal relations and other socio-political issues. In addition, he is the author of a book *Maoist Movement in Nepal: A Sociological Perspective* (New Delhi: Adroit Publishers, 2007), and co-author of two books--*Dalit Representation in National Politics of Nepal* (Kathmandu: NNDSWO 2012) and *State of Conflict and Democratic Movement in Nepal* (New Delhi: Vij Books, 2013).

Binay Kumar Kushiyait, a PhD from Panjab University, Chandigarh, India has been working as Professor of Economics Education in Tribhuvan University, Nepal since 1989. He was Social Inclusion Research Fund (SIRF) Fellow in 2007 and has served as an expert on development economics and education planning in various Governmental and Non-governmental organization in Nepal. He has published many books, articles, and research reports in Nepal and outside. He is the author of books including *Teaching of Economics: Methods and Application* (Kathmandu: Ratna Pustak Bhandar, 2011); *International Economics* (Kathmandu: Sunlight Publication. 2011), and co-author of *Economics of Development and Education* (Kathmandu: M.K. Publishers. 2010). He is also associated with various organizations i.e., Nepal Center for Contemporary Studies (NCCS), South Asian Dialogues on Ecological Democracy (SADED-Nepal).

Indra Adhikari, a Ph.D. from Jawaharlal Nehru University, New Delhi, is Executive Chairperson of South Asian Dialogues on Ecological Democracy, Nepal (SADED-Nepal). She has been a visiting faculty at the Central Dept. of Political Science since 2011 and was SAARC Visiting Fellow at Institute of Defense Studies and Analyses, New Delhi (2011-2012); Harka Gurung Research Fellow (2011-2013); and Project Coordinator at Nepal Center for Contemporary Studies (NCCS). She regularly contributes articles to journals and local newspapers on gender, conflict, security, military affairs, democracy and other socio-political issues. In addition, she is co-author of *State of Conflict and Democratic Movement in Nepal* (New Delhi: Vij Books, 2013), and 'Military and Democracy in Nepal: A Study of Democratization of Nepal Army' {New Delhi: Rutledge (Forthcoming)}.

"Evidence suggests that income redistribution, via taxes and transfers, the latter of which are key to social protection, are more efficient for poverty reduction than economic growth per se."

— World Health Organization
(Commission on Social Determinants of Health 2008: 87).

"The fundamental class division in any society is not between rich and poor, or between farmers and city dwellers, but between taxpayers and tax consumers".

— David Boaz

"When a rich man is taxed, he need only retrench his superfluities, but when a poor man is taxed that can only increase his miseries".

— George Mason

"*It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion*".

— Adam Smith

"The tax system has become the vehicle of choice for influencing economic policy, the distribution of the tax burden, the state of the economy, the social welfare of families, and almost anything else you want to mention".

— Gene Steuerle

"Corporations don't pay taxes, they collect them".

— Paul H. O'Neill

tax justice network

Tax Justice Network, (TJN)
38 Stanley Avenue, Chesham Bucks HP5 2JG, United Kingdom,
Email: matti@taxjustice.net,
Website: http://taxjustice.net,
Blog: http://taxjustice.blogspot.com

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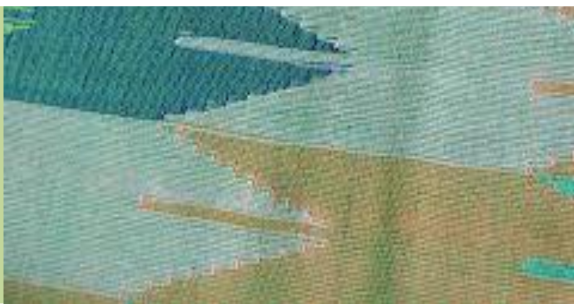
South Asian Dialogues on Ecological Democracy, Nepal (SADED-Nepal), Sanepa, Lalitpur Nepal
Email: sadednepal@gmail.com
Phone: 01-5535628



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