An Overview of Nepalese Tax Structure

Historical Background

The history of taxation in Nepal dates back to antiquity. Nevertheless, the modern tax system gained its momentum with the establishment of democracy and implementation of the first consolidated budget took place in 1951. Until the late 1950s, the two major sources of revenues were land tax and tariff on foreign trade.

Income Tax was firstly adopted through the Finance Act 1959 and implemented under the business Profits and Salaries Tax Ordinance 1959. Later on, the ordinance was replaced by the Business Profits and Salaries Act 1960. After about three years of experiences, the government replaced the prevailing tax Act by Income Tax Act 1962. By which sales, property taxes as well as several other minor taxes were introduced.

The income tax Act 1962 was substituted by the Income Tax Act 1974 which incorporated the different sources of income chargeable to Agricultural means, income of Remuneration, income from Industry, Trade, profession or Occupation and Rental Income from Land and Building.

To enhance revenue mobilization by making the process of collecting revenue effective for the economic development of the country and to amend and consolidate the laws relating to income, the Parliament of Nepal enacted income Tax Act 2002, which substantially reform the income tax system. The government of Nepal framed income Tax rules 2059 to clarifying the provision of act.

Tax Administration was established in 1959 in order to administer Income Tax and other minor taxes. This administration was also responsible for administering Sales Tax until 1992 when a separate Sales Tax Department was created to govern Sales Tax. In 1993, Excise Department and Sales Tax Department were merged to form the Sales Tax and Excise Department. This Department was replaced by the Value Added Tax (VAT) Department in 1996. This was the milestone of tax reform in Nepal. VAT Administration and Tax Administration were merged in 2001 to form a newly functioned organized Administration by the name of Inland Revenue Department.

Working system of Inland Revenue Department

This department drafts tax policies and laws, implements laws and policies related to Value Added tax, Income tax, Excise and other tax. It has been working to expand the scope of taxes, implement necessary procedures and programs to increase the voluntary tax participation of taxpayers, monitor and evaluate the compliance of tax laws and implement tax laws based on tax risk.

In this regard, department is implementing programs and work plans to manage internal revenue, provide taxpayer services using information technology, issue permanent account numbers identifying all taxpayers, conduct self-assessment system, test and research limited taxpayers, reduce direct contact between taxpayers and tax administration through information technology. It has been implementing strategies and programs such as increasing tax participation by increasing taxpayer participation, reducing tax compliance costs, and bringing the informal economy under the tax net. Functional working procedures have been adopted in the operation process of the department and its subordinate offices.

Institutional management

The role of this department has been important in mobilizing tax revenue through internal revenue sources. About half of the total revenue of the Government of Nepal is collected from this department. Under this department, a total of 84 operational level offices (1 Large taxpayer's office, 1 Medium level taxpayer's office, 43 Inland Revenue offices and 39 Taxpayer service offices) and organization structure of about 1700 manpower have been approved.

VISION

An efficient institution to support the process of development through broad based transparent and fair tax system.

MISSION

Ensuring appropriate tax policies and better services for improved tax compliance.

OVERALL OBJECTIVE

Ensure equitable, progressive, transparent and predictable tax system.

MANDATE

- Tax administration and reform,
- Initiating and carrying on tax policies,
- Taxpayer service and education
- Information and communication technology (ICT) management
- Research and development

Taxation System of Nepal: Direct and Indirect Taxes in Nepal

Direct **tax:** It is collected directly by the government from the person who bears the tax burden. The impact and the incident are on the same person. Direct taxes are **Income** tax, Property tax, Interest tax, Capital gain tax, Vehicle tax, Death tax, windfall gain tax, Etc.

Indirect tax: It is imposed on one person but partly or wholly paid by another. In these taxes, the imposed and incident of tax are on different persons. Indirect taxes are **Value Added Tax (VAT), Excise duty**, Import and export duties, Entertainment tax, Hotel tax etc.

VAT as Indirect Tax
An indirect form of tax, Value-added tax (VAT) is a Consumption tax on goods and services that is levied at each stage of the supply chain where value is added, from initial production to the point

of sale. value is added designed to be a multi- stage tax system as the tax is collected by all sellers in each stage of the supply chain. The amount of VAT the user pays is based on the cost of the product minus any costs of materials in the product that have already been taxed at a previous stage.

Excise Duty as Indirect Tax

Excise is an indirect tax, a tax levied on goods imported from another country as well as goods manufactured in the country. Excise duty is levied primarily on alcoholic beverages, mineral oils, and tobacco products, as well as in the import of all types of vehicles in Nepal. This duty is levied on the products which are harmful to one's health and excise duties help to reduce consumption. Environmental concerns have played a growing role in determining the nature and application of excise duties to, in particular, road fuel over the last decade.

Following Nepal's accession to the World Trade Organization (WTO) in 2003, the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) in 2004, and implementation of the South Asian Free Trade Area (SAFTA) in 2006, the Government of Nepal has continued to adopt a policy of mobilizing excise taxes. The purpose of the policy is to compensate for the revenue losses resulting from the reduction and abolition of customs tariff rates and other obligations of WTO membership. It also affects a wide variety of social conditions.

Income Tax as Direct Tax

As it is Direct tax, The term "income tax" refers to a type of tax governments impose on income businesses and individuals within their jurisdiction. Income taxes are a major source of revenue for the government in Nepal. Income tax includes income from employment, business and investment.

Types of Income tax:

- **The Individual or Personal Income Tax:** A personal or individual income tax is levied on the total income of the individual. It is often collected on a pay-as-you-earn basis, with small corrections made soon after the end of the tax year. Income tax systems will often have deductions available that lessen the total tax liability by reducing total taxable income. As a direct tax, individual income tax is highly elastic.

- **Corporation/ Business income tax:** Refers to a direct tax levied by various jurisdictions on the profits made by companies or associations and often includes capital gains of a company. It is the tax on capital income that occurs in the form of profit and originates in the corporate sector (company.)

Tax structure of Nepal is administered by the Inland Revenue Department (IRD) which is under the Ministry of Finance. The IRD is advancing its technology for the improvement of total tax administration which is the need of the present time. The information and data that the tax authorities play with must be clear and concise assisting for the better administration of revenue generation. The IRD operates mainly the structure of Income tax, VAT and excise Duty according to the provision made by the legal statutes.

An Overview of E-Taxation in Nepal

E-governance is the process of transforming the governance system into ICT enabled governance system. This helps to reduce distance, cost, and high availability as well as some threats of misuse of data/information, maintain the digital divide, need to increase digital literacy. World bank defines “e-Government” refers to the use by government agencies of information technologies (such as Wide Area Networks, the Internet, and mobile computing) that have the ability to transform relations with citizens, businesses, and other arms of government. It is the shift from the traditional method of carrying out government activities which is mainly hierarchical, linear, and one-way to the use of internet which enables the public to seek information at their own convenience and not really having to visit the office in person or when government office is open e-governance is the ICT-enabled route to achieving good governance.

E-taxation

Taxation is the necessary avenue for government revenue generation. In The Wealth of Nations (1776), Adam Smith argued that taxation should follow the four principles of fairness, certainty, convenience, and efficiency. Digital/electronic taxation refers the electronic eco-system of tax registration, tax compliance, tax enforcement, tax collection/ payment. Interconnection of data with various government agencies such as custom data, business registration data, share purchase agreement data, share transfer data, land registration, and transfer data. Maintain electronic data repository and analysis of various prospective use of artificial intelligence to minimize tax evasion risk, transfer pricing risk and so on which help to create a conducive environment of investment.

Digital transformation of tax administrations

Digitalization and emerging technologies have opened the doors to new opportunities not just for businesses, but for tax administrators as well to transform their day-to-day operations. Tax authorities are harnessing the power of new technologies such as big data and advanced analytics to improve tax administration, counter fraud and facilitate taxpayer compliance. As countries move toward digitizing their tax administration, their efforts can often follow a similar pattern, aligning with different levels of digitization. The move to digitization is not necessarily linear, nor should higher levels of digitization be viewed as the ultimate goal of either taxpayers or tax authorities. Currently, certain technology trends, including Big Data, analytics, Artificial Intelligence (AI), machine learning, the Internet of Things (IoT), mobility, and cloud computing have huge impact on tax administrations. These trends have power to increase taxpayer satisfaction, empower tax administrators, optimize operations and modernize services.

Nepalese scenario of e-Taxation

The Nepalese tax authorities have been adopting digital technology (IT). The IT systems implemented so far have helped direct taxpayers applying for tax registrations online, e-payment of taxes, e-filing of tax returns, for indirect tax as well, with the implementation of the Value Added Tax (VAT), computerized vat return, and Audit Trail Report (ATR) were implemented.

Major Tools can be summarized as follows.

- E-Filing: In Nepal, Electronic form is developed for filing tax returns for VAT, Income tax, and Excise. It is compulsory to file electronically. Nepal was a pioneer in the implementation of the Value-Added System and from the beginning return used to be entered in computerized systems. Nowadays, taxpayers can easily file returns from their workplaces.

- Online Tax Payment: Nepal implemented online tax payment using ConnectIPS since 2018.

- Integrated Tax System (ITS): Nepal is using an Integrated Tax System for Taxpayer record management. Since Income Tax, Value Added Tax, and Excise are regulated by a single department that is Inland Revenue Department (IRD), taxpayers' records are unified within a single platform. It allows cross-validation of data provided by taxpayers.

- Revenue Management Information System (RMIS): The RMIS is a web-based software that keeps track of the government's revenue collection implemented by Financial Comptroller General Office (FCGO).

- Centralized Billing Monitoring System (CBMS): In this system, real-time billing information is extracted by tax authorities. Initially, Big taxpayers are kept in monitoring using this system, the department is planning to bring all taxpayers registered in VAT under this system.

- Mismatch Report: Inland Revenue Department has made it mandatory to report the name of taxpayers for the transactions greater than one lakh. Using data from the reporting system, the department generates mismatch reports, and use in the amended assessment.

- ASYCUDA World: The Automated System for Customs Data (ASYCUDA World) is a computerized system designed by the United Nations Conference on Trade and Development (UNCTAD) to administer a country's customs. Nepal is currently using ASYCUDA World to administer customs.