

STRATEGIC PLAN

2012/13 – 2016/17



Government of Nepal
Ministry of Finance
Inland Revenue Department (IRD)

आन्तरिक राजस्व विभाग
करदाताको सेवामा समर्पित

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Message from the Finance Minister

I am very pleased that the Inland Revenue department's Strategic Plan for next five years has been developed at a time when there is enormous resource requirement for our quest for building a new Nepal. This resource requirement can be met through enhancing our own sources. One of the crucial areas could be from a robust level of tax collection.. Broadening the tax net is necessary to mobilize more revenue and to equally distribute the tax burden among the citizens.

The objectives of the Strategic Plan: "improving efficiency and effectiveness in the tax system" enables IRD to enhance its services while realizing the potential revenue growth. Even though the current tendencies in revenue collection and a growing Tax-to- GDP ratio are encouraging, the large informal sector and a tendency to avoid taxes have obstructed attempts to establish an efficient tax system in the past.

IRD has succeeded to set a comprehensive five year Strategic Plan for the first time. This Plan will help improve services and institutional capacities for the implementation of policies and the administration of revenue. Overall, the four development objectives have been defined and translated into activities for the term towards 2016/17.

In line with the reform efforts of the Government of Nepal, IRD's Strategic Plan contributes to our aspirations for a modernized, dynamic, and credible revenue system. With this plan, IRD has established a frame for potential future developments. Together with its motivation, willingness to improve and innovative approaches, I am confident that IRD will be able to achieve its pursuit for reform.

A handwritten signature in black ink that reads "Barsha Man Pun".

Barsha Man Pun
Finance Minister



Message from the Finance Secretary

The Ministry of Finance is committed to continue reform in tax administration. The present Strategic Plan of the IRD is the latest example of our commitment for change and reform in this area. The Strategic Plan of the IRD is also in line with the current efforts to modernize public institutions in Nepal. I am very pleased that IRD understands its role not only in the revenue administration, but also in the contribution to the socio-economic development for enhancing reform and revenue collection. It is self evident that taxation is crucial for sustainable governance systems. The Strategic Plan thus points out the importance to create an efficient organization and a predictable, taxpayer-friendly environment to ease compliance and broaden the tax net. Equally, the private sector will benefit from quality services, better access to information and transparent processes.

The Strategic Plan is a key document for the revenue system which will guide IRD and its employees in the upcoming years. The expected results for each development objective reflect IRD's motivation for innovative, sustainable reform steps for the period ahead. I wish IRD success to meet its objectives.

A handwritten signature in black ink that reads "K. H. Baskota". The signature is written in a cursive style and is positioned above a horizontal line.

Krishna Hari Baskota
Finance Secretary



Message from the Director General

The vision of the Inland Revenue Department (IRD) is to establish an efficient organization with sufficient domestic revenue mobilization, professionalism in service to its clients, innovation and research in tax policy. This vision states IRD's idea for a long-term plan in Nepal's constantly changing environment. A stable and predictable fiscal environment is the precondition to finance public goods, to promote economic growth and the national development. In its attempt to mobilize domestic revenue, the country is dealing with numerous challenges, including reduction of the informal sector, mitigating tax evasion, broadening the tax net and unlocking more resources for the investment in economic and social programs as well as poverty reduction.

The success of IRD's reform efforts depends largely on the effectiveness of the public administration and the promotion of a transparent and accountable government that works in partnership with all stakeholders. The public service is the connecting link between the state and citizens, and as such, it influences the public trust in state institutions. Other factors, such as the delivery of quality services, a conducive environment for law enforcement as well as the demonstration of integrity and responsiveness of civil servants affect taxpayers' behavior to follow obligations.

Derived from a review of the compliance environment, internal and external determining factors as well as identified challenges on tax mobilization in Nepal, IRD has succeeded to formulate a result-oriented five year Strategic Plan for the period 2012-2017. Reforms require efficient management and administration, as well as technical capacities supporting tax legislation. The following four development objectives will contribute to achieve our vision:

- **Policy Reform and Enhancement of Enforcement** will focus on the support to reduce complexities and foster the consistency of tax legislation by applying scientific based approaches for revenue forecasting, risk management, the enhancement of enforcement capabilities and the provision of advice to the government.
- IRD is committed to **Improving Taxpayer Service and Education** aiming to create a citizen-friendly environment, the reduction of compliance cost, assistance by and promotion of quality services in order to promote voluntary tax compliance.
- The **Optimal Use of Modern Technology** ties in with the progress IRD has achieved in the past. Outlining a comprehensive and integrated

ICT network as well as IT-assisted services are in line with the focus on e-governance and support an effective administration.

- In order to realize reform efforts, the *Revitalization of IRD's Organization Structure and the Mobilization of competent Human Resources* has been identified as essential.

I am confident that this Strategic Plan will increase our capability to act and give guidance to all employees within the tax administration, taxpayers and concerned stakeholders. It will serve as a basis for further directions and interventions in the process of planning, implementation, monitoring and evaluation. In addition, the plan provides valuable input to deal with current challenges and prepares IRD to influence change processes in line with our vision and mission. The organization's values express how we want to work with and treat others.

I would like to thank the Revenue Administration Support (RAS) Project, jointly implemented by GIZ and IRD, for providing financial and valuable technical support. The efforts of the consultants from Alliance for Social Mobilization's are highly appreciated. I would like to express my sincere thanks to Mr. Krishna Prasad Devkota, Deputy Director General of Inland Revenue Department for his hardworking to providing pragmatic input and suggestions to GIZ and the Strategic Plan formulating team. Moreover, I would like to thank other officials for their contributions to this document.

I firmly believe that this Strategic Plan can help achieving objectives and rebuilding the trust of taxpayer in the tax administration.

A handwritten signature in black ink, reading "T.M. Sharma", written over a horizontal line.

Tanka Mani Sharma
Director General

Strategic Plan at a Glance

VISION

An efficient organization for internal revenue mobilization, professional services, innovation and economic growth.

MANDATE

Tax Administration
Revenue Mobilization
Tax Reform
Advice on Tax Policies
Taxpayer Service and Education
Research & Development
ICT Management
Organizational & Human Resource Management
Logistic Management

VALUES

Equity
Valuing People
Integrity & Commitment
Collaboration
Innovation

MISSION

Ensuring quality service for voluntary tax compliance and applying enforcement with fairness

OVERALL OBJECTIVE

Improving Efficiency and Effectiveness in the Tax System

DEVELOPMENT OBJECTIVES

2. Improving Taxpayer Service and Education

- 2.1 Empowering taxpayers on related laws and tax issues through education, counseling and other outreach programs.
- 2.2 Increasing voluntary compliance and reduction of compliance cost.
- 2.3 Identify and reduce non-compliance.
- 2.4 Promote timely reporting and payment of taxes.

3. Optimal Uses of Modern Technology

- 3.1 Enhancement of ICT network.
- 3.2 Operationalization of full-scale e-governance system.
- 3.3 Regular auditing and management of ICT system to international standards.
- 3.4 Establishment of professional forward linkage with national and international agencies.

4. Revitalization of the Organization System and Mobilization of Competent Human Resources

- 4.1 Transformation of IRD and its associated offices into a segment and functional organization.
- 4.2 Increase coverage and access of service for potential tax payers with low administrative cost.
- 4.3 Application of tax cadre-based professional and compatible HRM policy and plan.
- 4.4 Revitalization of human resource development system to increase knowledge, skills and abilities of employees.

STRATEGIC OBJECTIVES

1. Policy Reform and Enhancement of Enforcement

- 1.1 Tax policy reform.
- 1.2 Harmonization of tax laws and procedural framework on par with international standards.
- 1.3 Operationalization of research and forecasting for maximization of revenue collection.
- 1.4 Application of tax information network, enhancement of tax enforcement and risk management system.

Overview of the Strategic Plan

VISION

An efficient organization for internal revenue mobilization, professional services, innovation and economic growth.

MISSION

Ensuring quality service for voluntary tax compliance and applying enforcement with fairness.

GUIDING PRINCIPLES

- To broaden tax base and tax net for the sustainability of the tax system,
- To create an environment for promoting voluntary compliance,
- To streamline and simplify tax processes in line with legal provisions,
- To foster neutrality in decision-making and implementation,
- To improve administrative capabilities through strengthening of in-house competences, dynamics and professionalism,
- To establish a stable and predictable tax environment to encourage investment and trade,
- To support growth friendly tax policies.

VALUES

Equity

IRD is committed to right taxation. Employees will treat all citizens equally, fairly and professionally in the implementation of tax laws, and thus contribute to a better perception of the tax administration.

Valuing People

IRD will create a respectful relationship among the employees within the administration, with taxpayers as well as stakeholders.

Integrity & Commitment

IRD will foster public confidence in the tax administration by fulfilling duties with a strong work ethic dedicated to responsibility, integrity, diligence and accountability.

Collaboration	IRD will strengthen the communication and cooperation with national and international stakeholders to exchange experiences and create a better understanding for tax legislation. Improved interaction will contribute to the achievement of common goals and to create support to anchor reform efforts.
Innovation	IRD will strive for continuous learning to improve knowledge, skills and behavior of the employees in order to assure the fulfillment of IRD's functions. The administration aims to identify innovative ways to manage challenges, improve quality services for taxpayers, promote ICT and create ideas to progress as a role model for public administration in Nepal.

MANDATE	<ul style="list-style-type: none"> Tax Administration Revenue Mobilization Tax Reform Advice on Tax Policies Taxpayer Service and Education Management of ICT System Organizational and Human Resource Management Research and Development Logistic Management
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OVERALL OBJECTIVE	Improving Efficiency and Effectiveness in the Tax System
DEVELOPMENT OBJECTIVES	<ul style="list-style-type: none"> DO - 1. Policy Reform and Enhancement of Enforcement DO - 2. Improving Taxpayer Service and Education DO - 3. Optimal Uses of Modern Technology DO - 4. Revitalization of the Organization System and Mobilization of Competent Human Resources

List of Abbreviations and Acronyms

ABBS	Any Branch Banking System
ADB	Asian Development Bank
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical & Economic Cooperation
CIT	Corporate Income Tax
DO	Development Objectives
DTO	District Treasury Office
EU	European Union
FDI	Foreign Direct Investment
FY	Fiscal Year
GDP	Gross Domestic Product
GNP	Gross National Product
GoN	Government of Nepal
HR	Human Resource
HRM	Human Resource Management
ICT	Information and Communication Technology
IFC	International Finance Corporation
IMF	International Monetary Fund
IRD	Inland Revenue Department
IRO	Inland Revenue Offices
IT	Income Tax
LAN	Local Area Network
LTO	Large Taxpayer Office
MDG	Millennium Development Goal
PI	Program Interventions
PIT	Personal Income Tax
SAFTA	South Asia Free Trade Agreement
SME	Small and Medium Enterprises
SO	Strategic Objectives
SP	Strategic Plan
TDS	Tax Deduction at Source
TPIN	Tax Payers' Identification Number
TSO	Taxpayers' Service Office
VAT	Value Added Tax
WTO	World Trade Organization

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Executive Summary

The generation of domestic revenue and the efficient management of public finances play an essential role in the functioning of government systems. Revenue authorities are responsible for policy implementation and tax administration as well as to obtain resources to finance public goods, such as infrastructure, health, education and security. The fulfillment of tax obligations is necessary to invest in development programs to the benefit of all citizens. However different factors, such as the large informal economy, tax fraud and evasion, insufficient information about the tax system, as well as limited organizational capacities have an impact on the mobilization of revenue.

In the past decades, both the Nepalese tax system and the revenue authority have been modernized through various reform steps. The direction has been on improving revenue productivity while minimizing costs and deficiencies in processes. With this backdrop, the Government of Nepal's tax reform agenda has been oriented towards increasing voluntary tax compliance, broadening the tax base by reducing compliance costs, promoting taxpayer-friendly services, encouraging investment and increasing the confidence of taxpayers in the abilities of state institutions to manage public finances.

Especially efforts of the Inland Revenue Department (IRD) for efficient services and a transparent, fair application of tax laws have improved its perception by taxpayers. Moreover, increasing tax revenue in the past has encouraged IRD to continue reforms in major areas of the organization.

The proposed Strategic Plan reviews determinants and considers upcoming trends and opportunities in the tax system. Following the identification of the core challenges, the plan has adopted a number of development and strategic objectives. These objectives will be translated into activities designed to reduce deficiencies, close unintended loopholes, and address areas of non-compliance. The Strategic Plan seeks voluntary compliance management through quality service and enforcement by improving the following areas:

- Policy Reform and Enhancement of Enforcement
- Improving Taxpayer Service and Education
- Optimal Use of Modern Technology
- Revitalization of the Organization System and Mobilization of Competent Human Resource

“The major challenges in the revenue mobilization are major share of revenue based on import trade, small contribution of direct tax in revenue, lack of information technology, unfriendly revenue administration, lack of desired amount of revenue collection even at broadening tax base, lack of effective control in revenue leakage, lack of adequate exercise to make tax policy stable and predictable, lack of adequate probe and actions taken to bring all under tax net or showing less participation not complying with tax liability, and also not providing effective encouragement to the people to participate in the tax net”.

Three Year Plan (2010/11-2012/13)

The Strategic Plan supports the improvement of legal, procedural and administrative aspects. Some of the proposed activities require the revision or establishment of new compliance processes and reporting initiatives, while others enhance consistency of tax laws that have proven to be a source for non-compliance. Furthermore, the Strategic Plan focuses on tackling frauds, improving the quality of audit and accounting system and payment procedures. Among others, the plan recommends the establishment of a Data Analyzing Networking System, dispute settlement mechanisms, a Research and Revenue Forecasting Unit and a separate Investigation Wing within IRD. The administrative response to focus on increasing efficiency, transparency and better communication within and outside IRD has also been suggested by pointing out the importance of e-governance and establishing an integrated information network system.

Emerging tax trends in South and South East Asia, global cooperation agreements, its impacts on the Nepal's tax composition as well as major findings of international research and practices were taken into account for the review. The development of the Strategic Plan was foremost based on domestic determinants and the compliance environment of Nepal. In this regard various institutional aspects such as organizational structure, capacities and working modalities, measures to curb evasion and frauds, the context of Information and Communication Technology (ICT), the service approach to taxpayers as well as revenue potentiality and collection, have led to a comprehensive review of the current situation of IRD and approaches to address deficiencies in line with the achievement of the development objectives.

In order to successfully achieve the stated objectives, the Strategic Plan concludes that prioritized interventions will be incorporated in annual plans for the operationalization. The annual plan will serve as basis for a precise implementation, taking into account the prevailing policies and resources needed.

In IRD's understanding it is essential to:

- Articulate the Strategic Plan among the administration / employees in order to ensure that the strategic direction of IRD is known, understood and internalized. This should also be included in orientation training to incoming staff.
- Follow an integrated approach to explain efforts to the public and the growing number of stakeholders in order to gain support and better anchor the Strategic Plan and its measures.
- Establish an appropriate monitoring system to follow up on the achievements of interventions, potential hurdles and impacts of activities and strategic interventions.



Introduction

1.1. Country Context

Following a long political conflict, Nepal is in a transition period facing several challenges, its landlocked geographic location, limited resources and its susceptibility to natural disasters. The government has reiterated the need to generate more funds through internal sources to fulfill its core functions in providing public services and to promote socio-economic development. Especially in view of future changes, internal revenues will be required to cover increasing demands of a growing population: The estimated annual growth rate of almost two percent will cause the need to bring in more taxpayers under the tax net in order to mobilize distinctively more revenue and distribute the tax burden. Due to the large informal sector and a tendency to avoid taxes, revenues are currently dependent on a small share of registered taxpayers. Out of nearly 30 million and a per capita income of less than US\$ 650¹, around 80 percent of the tax revenue is currently collected by the LTO, which serves about 700 taxpayers. However, Nepal has made some encouraging progress in the past years by reducing the percentage of people living below the international poverty line (people earning less than US\$1.25 per day) to almost half in seven years (from 53.1 percent in 2003/2004 to 24.8 percent in 2010/2011) ².

Political instability has hampered creating an enabling environment for economic growth, investment and trade as well as revenue collection. Moreover, the adoption of the budget and the implementation of policies were delayed in the past due to unresolved disputes and demonstrations. In recent years, reforms have been initiated by the Ministry of Finance to enhance the country's development. Supported by an Investment Board, the Fiscal Year 2012/2013 has been declared as Nepal Investment Year to promote economic initiative against declining foreign direct investment commitments.

The economic development is influenced by an inflation rate remaining of eight percent (June, 2012), the large informal sector estimated to be around 38.4 percent of the GDP and a high unemployment rate. The **economic growth rate** of Nepal is still one of the lowest among its neighboring countries with a modest four percent growth rate of the Gross Domestic Product (GDP)³ :

1 Op.cit.

2 Nepal Country Overview 2012, World Bank, <http://www.worldbank.org.np>

3 Economic Growth Rates (annual percentage change), World Economic Outlook, 2011, IMF: <http://www.imf.org>

Country	2008	2009	2010	Forecast	
				2011	2012
Afghanistan	3.6	20.9	8.2	8.0	7.5
Bangladesh	6.0	5.8	6.0	6.3	6.6
Bhutan	3.0	8.7	6.7	6.5	6.0
China	9.6	9.2	10.3	9.6	9.5
India	6.2	6.8	10.4	8.2	7.8
Maldives	12.8	-4.8	8.0	6.0	5.0
Nepal	6.1	4.4	4.6	4.5	3.8
Pakistan	1.6	3.4	4.8	2.8	4.0
Sri Lanka	6.0	3.8	9.1	6.9	6.5

Unresolved political conflicts have slowed down industrial processes, trade and investment as well as limited confidence of the business sector. In addition, the tourism sector has been disrupted in the past. Meanwhile, economic conditions have gradually changed and resulted in the restructuring of sector-wise contribution to the GDP ⁴:

Agriculture remains the major contributor to the GDP with a growth rate of 4.9 percent. Though highly vulnerable to environmental influences, the agricultural sector which is the livelihood especially for rural areas, still has one of the highest development potentials in Nepal. Besides, it is estimated that the country's topography entails advantageous conditions for the use of water power, thus leading to an estimated **hydropower** potential accounting of more than 80,000 MW. This leads not only to a domestic interest to cover energy deficits, but also meets the economic interest of the private sector and the growing energy demand of the South Asian region. However, the contribution of agriculture, as well as the industrial sector to the GDP has declined in the latest observation. The **industrial sector** has been plagued with limited resources, rigid labor law, socio-political conflicts and instability, high transaction cost and a slowly developing export/import ratio. Current numbers have been promising, accounting for 16.3 percent growth in export, and 16.8 percent in import respectively. The positive development of this macro-economic factor has led to an increase of revenue collection of about 22 percent (FY 2011/2012) compared to the previous Fiscal Year. The **service sector**, including tourism and foreign employment, has improved steadily, resulting in the highest growth rate of 4.3 percent in the last years and an increase in the contribution to the GDP. Following the Nepal Tourism Year 2011, the Visit Lumbini Year 2012 was recently announced to further support the expanding tourism. The service sector has encouraged significant inflow of remittance and foreign income, eventually resulting in favorable current account balance.

Remittances are estimated to be equivalent to 25-30 percent of the GDP and thus of major importance to mobilize revenue⁵. The emerging Nepalese Diaspora has resulted in about three million non-resident Nepalese following foreign employment mostly in the Gulf States and India. It is estimated that remittances accounting for US\$3 billion are generated every year, having potential to contribute to the socio-economic development of the country. One third of Nepalese households are estimated to be beneficiaries of remittances.

⁴ Economic Survey 2010/2011, Ministry of Finance, GoN, Budget Speech, 2012, Ministry of Finance

⁵ Op.cit.

1.2. Inland Revenue in Nepal: Compliance Environment

Different aspects are influencing the implementation of tax policies in Nepal. The large informal economy, tax fraud and evasion, insufficient information about the tax system, as well as limited organizational capacities have been identified to impede progress of the tax system and change processes within IRD.

At the core of the improvement of tax compliance is the context or the 'environments' in which the tax administration operates. A variety of **environmental and organizational factors** needs to be considered: Over the years, tax policy in Nepal has evolved in response to the development strategy and its changes. From 1951, land revenue, custom duties and excise duties were in existence in Nepal. The Excise Act, 1958 and the Customs Act 1962 consolidated respective laws and improved both the excise and customs systems throughout the country. However, the foundation of the modern tax system was initiated in 1959/60 (**Byapar Munafa Ra Parisramik Kar Ain, 2017**) after the introduction of income tax, urban house and land tax, and foreign investment tax, followed by sales in 1965. In 1969/70, the foreign investment tax was merged with income tax. Furthermore, the corporate income tax was separated from the individual income tax in 1986/87 when public corporation and public limited companies listed on the Nepal Stock Exchange were subjected to a flat corporate tax rate. This tax was extended to private limited companies in 1993/94.

Significant reform progress was recognized with the implementation of initiated reform processes starting in 1974: the self-assessment system, changes in accounting system, and introduction of a presumptive tax payment system assured the GoN steady and predictable revenue. In the process of tax reforms, Value Added Tax (VAT) was introduced in the Fiscal Year (FY) 1997/98, replacing the Sales Tax, Entertainment Tax, Hotel Tax, and Contract Tax. In line with the introduction of an internationally compatible Income Tax Act 2002, the Inland Revenue Department (IRD) was established by merging the Tax Department and the VAT Department. IRD with a mandate to levy tax in accordance with the law, to collect centrally levied taxes⁶, to administer the tax system, and advise the Government of Nepal on tax policies. IRD currently has 22 Inland Revenue Offices (IROs), one Large Tax Office (LTO), and 13 Taxpayers Service Offices (TSOs) inside Kathmandu valley and 13 outside Kathmandu. Two more TSOs are yet to be established. IRD's mandate can be summarized as follows:

- Tax Administration
- Tax Collection
- Tax Reform
- Advice on Tax Policies
- Taxpayer Service and Education
- Management of ICT system
- Organizational and Human Resource Development
- Research and Development
- Logistic Management

The growing importance of new technology is focused on e-governance. IRD has become a role model introducing web-based applications and a comprehensive ICT architecture connecting all Inland Revenue Offices (IRO). E-filing has been used by more than 90 percent of VAT returns, simplifying compliance processes, providing information and reducing costs. IT-assisted services will be of further relevance in the development of customer-friendly approaches to enhance voluntary tax compliance.

⁶ IRD annual report 2067-68.

In order to anchor support for future reforms and investments, a continuous stakeholder dialogue is needed to initiate target-oriented measures, enhance understanding of concerns of the business sector and make processes transparent. Hence, considering taxation from the citizen's viewpoint is essential. The taxpayers' satisfaction level survey conducted in 2003 and 2010 reflect the perception of taxation and tax administration. Among others, success depends on perceived fairness of the tax structure, its stability, value attached to government activities and the legitimacy of governments. In the past, IRD initiated a dialogue with stakeholders on particular tax issues, i.e. with the **Federation of Nepalese Chambers of Commerce and Industry (FNCCI)**, the **Law Society** and the **Institute of Chartered Accountants of Nepal (ICAN)**. The **Non Resident Nepali Association (NRNA)** and civil society organizations promoting accountability and transparency might be potential cooperation partners in the future.

While reforming the tax system, it is critical to achieve fiscal consolidation, minimize distortion in the economy, and create a stable and predictable environment for the markets to function. The wave of internationalization of economic activities across the world in the 1990s necessitated the alignment of tax policy to Nepal's development strategy, which required a wide range of tax reforms. With past initiatives, the government has aimed for more efficiency in the management of public finances and to achieve defined objectives linked to taxation.

The Four "R's" of Taxation

Taxation has four main purposes

Revenue – to raise money for direct and indirect government functions

Redistribution – to reduce inequality

Representation – to stimulate accountability among citizens and better governance

Re-pricing – to address externalities in order to reflect social costs and benefits

Evolution of Inland Revenue and Opportunities in Nepal

Global Influences on Domestic Taxation Policies

Nepal not only acceded to the WTO regime in 2004/05 but is also a member of SAFTA and BIMSTEC. International exchange entails potential benefits from trade with neighboring countries, but especially from Nepal's transit position between two emerging countries, with India and China estimated to have economic growth rates of 8 percent and 9.5 percent respectively. Regional and international cooperation agreements further require measures to compete on global markets, manage cross-border businesses and transactions. International commitments necessitate promoting modernized public financial management systems. A **Five Year Strategy and Action Plan** has been recently announced to take action against anti-money laundering and counter-terrorism. Those measures can further contribute to develop an investment-friendly environment. Cooperation efforts, such as the WTO membership, on the other hand have also had an impact on the revenue compilation of the country:

The WTO membership made it obligatory for the Nepalese government to reduce tariff rates on imported goods and services. The share of customs tariff is on a declining trend and the contribution of VAT has increased; a marginal rise in the share of direct taxes has been noticed⁷. VAT has been a major source

⁷ Source: http://www.mof.gov.np/economic_policy/pdf/Revenue_Implications.pdf

of tax revenue followed by income tax. The share of VAT in total tax revenue stands at 35.92 percent in FY 2010/11 with a propensity of further rise, together with the rise in consumption level, and has been established as the major source of revenue.

After accession to the WTO, the share of customs in the revenue collection has declined. Excise duty has become more significant in raising government revenue currently comprising a number of around 22,800 registered taxpayers.

Table 1: Trend of various types of revenue collection in different Fiscal Years⁸ (Rs in billion)

Fiscal Year	1997/98	2002/03	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Custom Duty	8.5	12.78	15.34	16.71	21.06	26.79	35.15	35.66
VAT	8.35	13.46	21.61	26.09	29.82	39.72	55.09	61.67
Income Tax	4.9	9.84	10.94	15.73	19.08	27.25	33.82	41.71
Excise	2.9	3.77	6.51	9.34	11.19	16.22	24.31	26.39
Land Duty and Registration	1.29	1.04	3.03	3.25	4.01	7.07	7.93	6.22
Tax Revenue	25.94	40.89	57.43	71.12	85.16	117.05	156.3	171.65
Non-tax Revenue	7	13.64	14.85	16.59	22.47	26.42	23.65	29.18
Total Revenue	32.94	54.53	72.28	87.71	107.63	143.47	179.95	200.83
Ratio of Custom Duty to GDP	2.83	2.60	2.35	2.30	2.58	2.71	3.00	2.65
Ratio of VAT to GDP	2.78	2.73	3.30	3.58	3.66	4.02	4.70	4.58
Ratio of IT to GDP	1.63	2.00	1.67	2.16	2.34	2.76	2.89	3.10
Ratio of Excise to GDP	0.96	0.77	1.00	1.28	1.37	1.64	2.07	1.96
Ratio of Tax Revenue to GDP	8.62	8.31	8.78	9.77	10.44	11.85	13.34	12.74
Ratio of Non-tax to GDP	2.33	2.77	2.27	2.28	2.75	2.67	2.02	2.17
Ratio of Total Revenue to GDP	10.95	11.08	11.05	12.05	13.20	14.52	15.36	14.91

Table 1 shows the trend of various types of revenue collection in different fiscal years. The shares of VAT, income tax and excise duties to GDP have increased to 4.58, 3.10 and 1.96 percent in FY 2010/11 from 2.78, 1.63 and 0.96 percent in FY 1997/98 respectively. Because of the slowly declining share of customs, Inland Revenue will foremost finance public expenditure (**Figure 1**).

Figure 1: Trend of share of tax revenue from FY 2006/07 to FY 2011/12⁹



⁸ Source: Economic Survey 2011

⁹ Source: IRD

Remittances have enhanced the consumption level and thus increased the VAT revenue substantially. A stronger investment of remittances in productive sectors could create revenue in the long-term. The growing importance of global businesses, international trade and foreign employment changes the economic climate in Nepal. The recently concluded bilateral Investment Promotion and Protection Agreement (BIPPA) with India is one example for future cooperation with neighboring countries.

Managing liabilities without double taxation but also by preventing tax avoidance requires better information exchange. This need is currently covered by 10 Double Taxation Agreements of the Nepalese state with Thailand, Sri Lanka, Pakistan, Norway, Mauritius, Korea, India, Austria, China and Qatar. The treaties are expected to become more relevant in the future and require the fulfillment of specific obligations by the tax administration.

Domestic Tax Development

Government expenditures are financed foremost by domestic revenue. Reform initiatives undertaken by the tax administration over the past years have resulted in an encouraging volume of revenue collection. The contribution of revenue to the annual budget oscillated from 64 to 69 percent during the last three years. The share of tax revenue has increased to 85 percent of total revenue and share of non-tax revenue is getting lower day by day. In the FY 2011/2012 the government could increase revenue collection by 21 percent compared to the previous year.

Tax revenue, the most reliable and non-debt creating resource to finance government spending, is preferred to external resources because of unpredictable nature and strings associated with the latter.

- IRD has maintained fiscal stability by keeping the fiscal deficit down to 3.5 percent of GDP in FY 2009/10. **Tax revenue to GDP ratio** has increased from 8.62 percent in FY 1997/98 to 12.74 in FY 2010/11, whereas non-tax revenue hovered around less than 3 percent of the GDP during the last decade.
- In 1997/98 the **ratio of total revenue to GDP** was 10.95, maintaining a steady growth, it reached 13.34 in 2009/10. However, it declined slightly to 14.9 percent in 2010/11.
- The total public expenditure to GDP ratio stands at 22.16 percent (FY 2010/2011), which caused a budget deficit of 6.8 percent of GDP. The collected tax also hasn't reached the expected target of the Three Year Plan (2010/11–2012/13), which states: **"During the Plan period, it is estimated to raise total revenue amounting to Rs 677.99 billion at 2009/10 prices. While projecting revenues, it is estimated that the revenue will increase on an annual average by 8.7 percent at constant prices and the ratio of revenue to GDP which is estimated to be 16.1 percent in the FY 2009/10 is projected to reach 17.3 percent at the final year 2012/13 of the Plan."**

So far, there has not been a comprehensive strategic program plan that guides the IRD to deal with the national, regional and international complex business environment.

Taking developments in different areas, external influences and the understanding of the tax composition as a starting point for the review, the following **determining factors** have become decisive for the compliance environment:

TAX BASE

The last budget introduced measures to extend the revenue base by imposing registration of some new sectors, mainly those in service sectors. However, there is a need to improve consistency of

The **Tax Net** refers to all PAN-registered taxpayers as well as withholding taxes paid to the Revenue Department in Nepal. The **Tax Base** refers to expansion of taxable sectors.

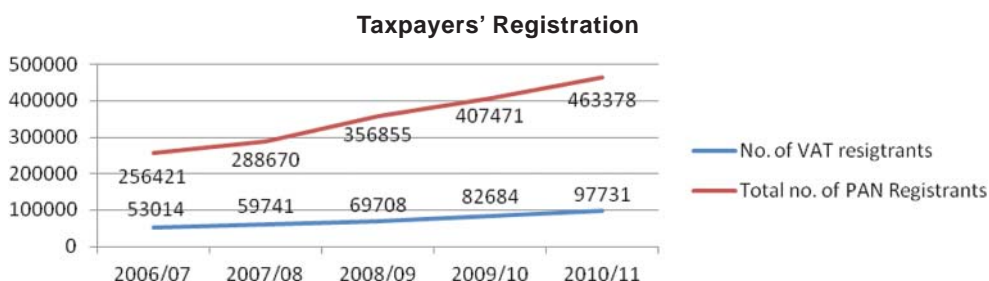
tax laws and exemptions as well as incentives. Efficient mechanisms are necessary to take action against fraudsters and non-filers. At the same time, investigation and audit processes has to be redefined and streamlined.

The taxpayers’ registration trend has been positive over the years. In case of income tax, the trend shows that taxpayers’ registration has been increasing at an average rate of 20.17 percent, whereas in case of VAT, the average growth rate has been 21.09 percent over

the last four years. Moreover, by the end of April 2012, 263,250 Personal Income Tax (PIT) registered taxpayers were noted who are not required to submit annual tax return provided they have only final withholding income. There are 34,923 Tax Deduction at Source (TDS) with-holders who reported a TDS amount of Rs 8.61 billion to IRD in FY 2010/11.

Figure 2 shows the trend of taxpayers’ registration for the last five fiscal years. At the same time, the ratio of non-filers is also increasing.

Figure 2: Trend of taxpayers’ registration in last five fiscal years¹⁰



TAX COMPLIANCE

The primary goal of a revenue authority is to collect payable taxes and duties in accordance with

Tax Compliance describes the extent to which taxpayers obey to tax laws and regulations, by reporting their income and duly file tax returns. **Noncompliance** refers to attempts not to pay taxes. Among others, it includes both tax evasion and tax avoidance.

the law. This needs to be done in such a manner that it will sustain the confidence of the taxpayers in the tax system and administration. Noncompliant behavior is based on various reasons. According to the traditional Fischer model on tax compliance (1992), the key determinants can be categorized as followed: (a) tax system structure (taxrate, penalty, and probability of detection, complexity of tax system); (b) attitude and perception (fairness, ethics, and peer influence); (c) non-compliance opportunity (income level, income sources and occupation) and (d) demographic factors (age, gender and

¹⁰ Source: IRD

education). However, other researchers have added factors such as perceived tax service quality, public governance quality, as well as moderating effect of personal financial condition and risk preference on tax compliance behavior. The compliance level in income tax indicates that 58.36 percent of taxpayers have not reported to the tax offices. Those who have not reported are generally presumptive taxpayers. **Table 2** reflects the total number of PAN registrants, the percentage of non-filers, and the number of returns in the last five fiscal years.

Table 2: Total number of PAN registrants, percentage of non-filers and number of returns in last five fiscal years¹¹

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
Total No. of PAN Registrants	256,421	288,670	356,855	407,471	463,378
Non-filer (%)	82.65	58.74	55.51	57.93	58.36
Filer (%)	17.35	41.26	44.49	42.07	41.64
D. 01 Returns (No.)	20,463	66,704	93,078	105,173	120,280
D. 02 Returns (No.)	7750	19324	22613	29	4
D. 03 Returns(No.)	16,287	33,091	43,080	66,202	72,659
No. of Returns collected	44,500	119,119	158,771	171,404	192,943
% of D.01 Returns	45.98	56	58.62	61.36	62.34
% of D.02 Returns	17.42	16.22	14.24	0.02	0
% of D.03 Returns	36.6	27.78	27.13	38.62	37.66

The compliance activity for VAT has not been significantly different from income tax. Around 21 percent taxpayers were non-filers in FY 2010/11. A decreasing trend of debit returns has been observed in last five years, whereas the volume of credit and zero returns have been gradually increasing. **Table 3** shows the total number of VAT registrants, the percentage of monthly, trimester and bimonthly return-based taxpayers, the share of non-filers, and the ratio of credit amount to debit amount.

Table 3: Total number of VAT registrants, percentage of monthly, trimester and bimonthly return based taxpayers, percentage of non-filers¹²

Fiscal Year	2006/07	2007/08	2008/09	2009/10	2010/11
No. of VAT Registrants	53,014	59,741	69,708	82,684	97,731
Monthly Return-based TP (%)	52.3	57	56	54.1	55.04
Trimester Return-based TPs (%)	47.4	42.8	43.8	45.8	44.8
Bimonthly Return-based TPs (%)	0.3	0.2	0.2	0.2	0.16
Non-filers (%)	14.58	16.66	19	27	21.25
Filer (%)	85.42	83.34	81	73	78.75
Debit Returns (%)	31.43	30.6	18.8	17.3	18
Credit Returns (%)	37.29	38.5	53.6	49.9	49
Zero Returns (%)	30.29	29.1	27.5	32.8	33
Debit Amounts (billions)	NA	NA	8.92	14.72	19.03
Credit Amounts (billions)	NA	NA	26.36	63.46	106.96
Ratio of Credit Amount to Debit Amount (times)	NA	NA	2.96 x	4.31 x	5.62 x

¹¹ Source: IRD

¹² Source: IRD

TAX EVASION & TAX FRAUD

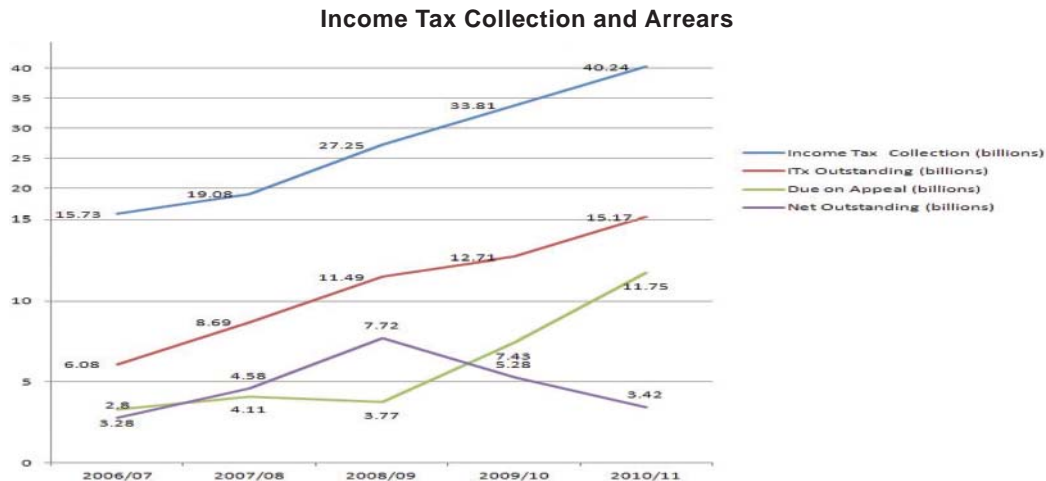
In 2012, 518 suspected VAT fraud cases were assessed worth Rs. 6.6 billion, especially caused by the informal economy. Currently 495 new fraud cases and around 4,400 cases of mismatch data are under investigation. These numbers indicate a tendency of using fake and false bills and invoices to evade tax, concerning vulnerable aspects of VAT non-compliance. Nepal’s VAT design is based on the principle of neutrality, applicability and proportionality with the basic characteristics of deductible input taxes, single standard rate, zero rate and exemptions. The level of VAT evasion and fraud is influenced by the complexity of processes within the tax administration, government regulations, and systemic default in VAT design and implementation weaknesses. Various types of VAT evasion and fraud are prevailing in practice and the scale is increasing. Beside conventional methods of evasion and fraud, new methods such as ‘Carousel’ fraud, ‘Bogus Traders’ ‘invoice milling’ and ‘cloning’ types of frauds are increasing. A report presented to the Public Accounts Committee revealed that VAT frauds are dominated by the use of fake and forged invoices.

The experience of the European Union (EU) single market in tackling with ‘Carousel’ and ‘Missing Trader’ fraud postulate that the future federal structure of the country should carefully determine VAT jurisdiction. Fraud in tradable services is rather difficult to detect. Improvement in the quality of audit and investigation, as well as application of available legal provisions, is needed to tackle fraud. For example, VAT evasion and fraud control cases are dealt with through general laws (civil codes, i.e. **Muluki Ain**) and also through specific laws on the basis of gravity of offence. **Muluki Ain** has the provision of criminal prosecution on fake and forged documents.

TAX COLLECTION & ARREARS

Income Tax: Income tax collection has been increasing at an average rate of 38.95 percent during the last five years. Income tax collection in FY 2010/11 reached Rs.40.24 billion from Rs.15.73 billion in FY 2006/07. Similarly, income tax arrears have increased to Rs.15.17 billion from Rs.6.08 billion during the same period. The income tax demand stuck in appeal has reached the peak of Rs.11.75 billion, leaving net arrears at Rs.3.42 billion. **Figure 3** shows income tax collection and arrears during the last five fiscal years.

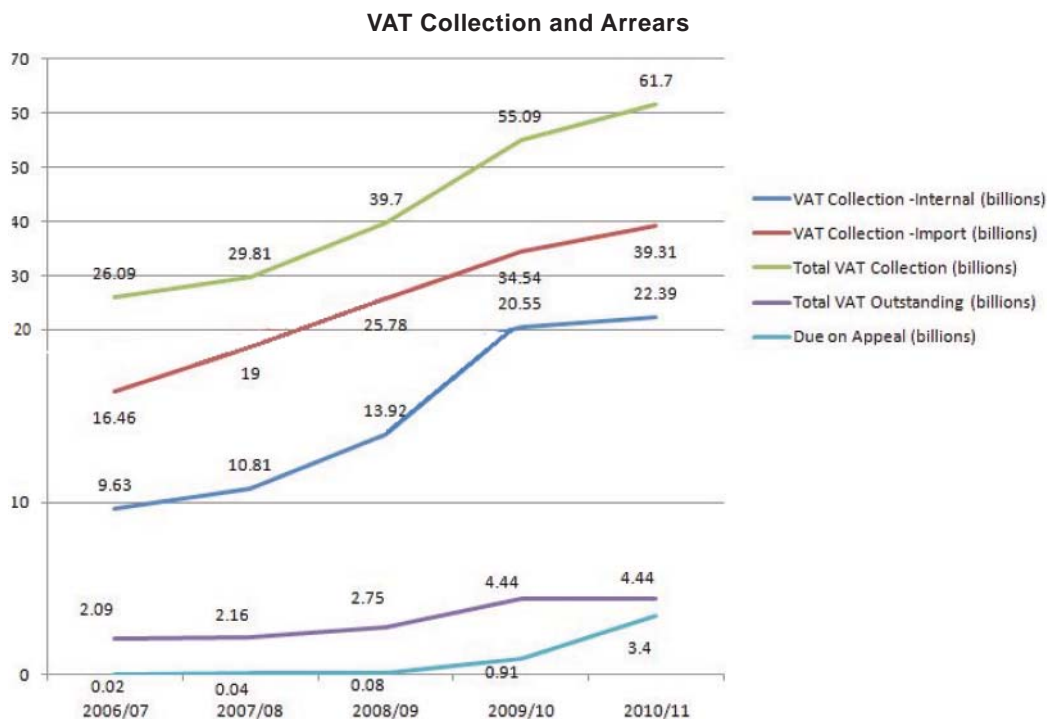
Figure 3: Income tax collection and arrears for the last five FY¹³



13 Source: IRD

VAT: VAT collection has been increasing at an average rate of 34.12 percent during the last five years. VAT collection in FY 2010/11 reached Rs.71.7 billion from Rs.26.09 billion in FY 2006/07. VAT collection from domestic source has been increasing at an average rate of 33.12 percent, whereas collection from import has been increasing at an average of 27.46 percent. However, VAT arrears have increased to Rs.4.44 billion from Rs.2.09 billion during the period. Around Rs.3.4 billion VAT assessments have been held up in appeal. **Figure 4** shows VAT collection and arrears during the last five fiscal years.

Figure 4: VAT collection and arrears for last five FY¹⁴



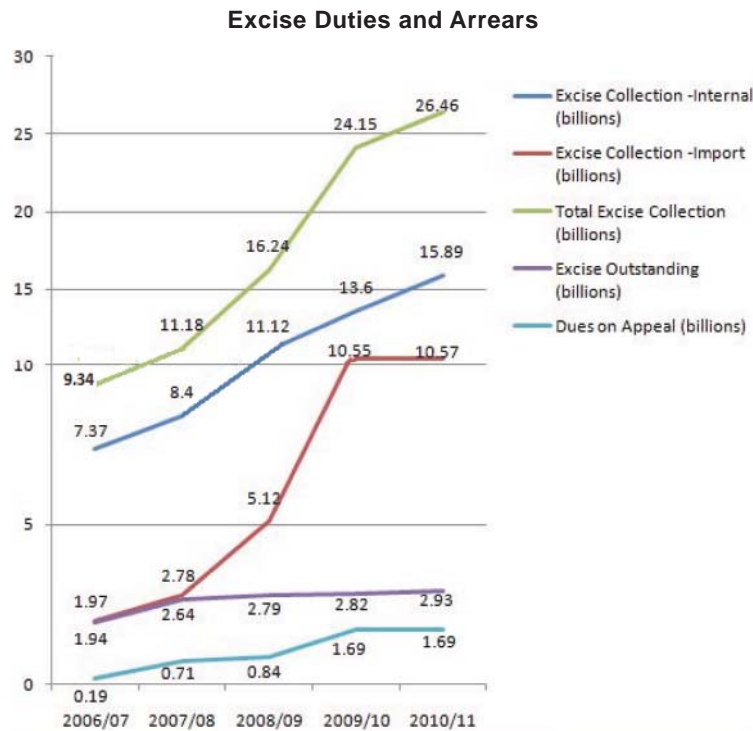
Excise: The collection of excise duties has been increasing at an average rate of 45.82 percent during the last five years. Excise collection from domestic as well as from import of excisable goods and services in FY 2010/11 has reached Rs.26.46 billion from Rs.9.34 billion in FY 2006/07. The average annual growth rate of excise collection from the domestic source has been 28.9 percent, whereas collection from import has been recorded as 111.2 percent due to widening base of excise in imported goods.

However, excise arrears have increased to Rs.2.93 billion from Rs.1.94 billion during the same period. Beside, around Rs.1.69 billion excise duties have been held up in appeal.

Figure 5 shows the excise duty collected from internal and import, and arrears in the last five fiscal years. A number of cases are pending for a long time at the Revenue Tribunal, waiting for final verdict. A legal system that delays the application of penalties tends to contribute towards the blockage of government revenue, and as a result diminishes the system's effectiveness.

¹⁴ Source: IRD

Figure 5: Excise duty collected from internal and import, and arrears in the last five fiscal years¹⁵



Audit: The audit performance of IRD has been improving over the years. Around 5.21 percent taxpayers are partially verified, 2.09 percent (of total 508,806) taxpayers are fully audited, and around 18.77 tax returns (out of total tax returns filed) were audited in FY 2010/11. Audit yield from an assessment order in terms of tax demand has increased from Rs.750,000 in FY 2008/09 to Rs.1,200,000 in March 2012. However significant amounts of tax assessment are being held up in appeal. **Table 4** shows the audit performance during the last four Fiscal Years.

Table 4: Audit performance in last four years¹⁶

Fiscal Year	2008/09	2009/10	2010/11	Up to March 2012
Rapid Verification of Tax Returns (No.)	24,361	27,876	23,348	8,720
Full Audit (No.)	7,213	9,438	9,350	2,712
Total Assessment (including tax from loss recovery) (billions)	5.41	6.7	14.37	3.3
Full Audit Yield (000)	750	709	1,537	1,200
Assessment - Revenue collection Ratio (%)	10.31	10.06	18	5.9
Person Involved in Audit (No)	154	154	154	154
Per Capita Audit Yield (millions)	35.11	43.48	93.33	21.42
% of taxpayer verified	6.88	7.07	5.21	1.95
% of Taxpayer audited	2.04	2.40	2.09	0.61
% of Returns Audited	16.44	18.04	18.77	6.73

¹⁵ Source: IRD

¹⁶ Source: IRD

Conducting regular audit on the principles of risk management and selection of criteria on input/output analysis is vital for successful compliance. Regular audit of taxpayers gives the IRD a high and fair chance of detection of fraud and thereafter strict application of penalties. Therefore, a good and effective system of audit is important for tax administrations.

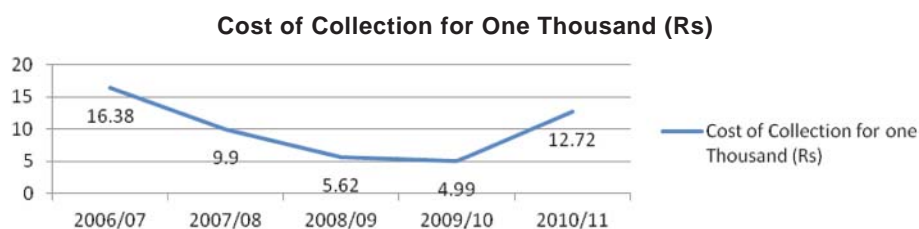
It provides an effective paper trail of the input and output activities of a registered taxpayer to tax administrators. With the execution of a regular and investigative audit program, potential fraudsters are deterred by the belief that they see a reasonably high chance of detection and punishment.

COLLECTION COST

The collection cost of IRD substantially increased in FY 2010/11 due to costly collection processes (e.g. of excise stamp cost) and infrastructure measures. 13 TSOs were newly established in the Kathmandu Valley. The cost of collection for one thousand rupees tax has been recorded to be Rs.16.38 in FY 2006/07 and gradually plummeted to Rs.4.99 in FY 2009/10, but shot up to Rs.12.72 in FY 2010/11.

Figure 6 shows the cost of collection for one thousand rupees until 2010/2011. Collection cost shows the efficiency in collection. A further cost reduction requires respective measures.

Figure 6: Cost of collection for one thousand rupees in the last five fiscal years¹⁷



COMPLIANCE COST

A fair and simple taxation system reduces complexity, costs to fulfill obligations and legal requirements as well as non-compliance. The complexity in the Nepalese tax system on the contrary has further accelerated with the perennial amendments in the tax legislation and influenced tax compliance. Together with the constant changes in the tax laws, limited administrative capacities and inadequate responsiveness towards taxpayers contribute to creating higher tax compliance cost. The compliance cost referred here includes the accounting cost for taxpayers.

In 2012, the International Finance Corporation (IFC) had conducted a compliance cost survey for a sample of 990 businesses in Nepal. The survey focused especially on smaller and medium sized enterprises taking into account the Corporate Income Tax (CIT), VAT, and withholding tax. According to the results of the survey, the overall average compliance cost (accounting cost) for taxpayers amounts

All direct and indirect costs associated to obey requirements of the law, are summarized as **Compliance Cost**, which include expenditures of money and time, e.g. for planning, administration, information, paperwork, research, etc.

¹⁷ Source: IRD

Rs. 9,382 across business with various turnover groups, whereas the highest cost arises for time-consuming VAT compliance with Rs. 14,756. In addition, the survey indicates that an average Nepali enterprise spends over 300 hours on tax compliance related matters per year. Higher compliance cost implies a disincentive to small and large entrepreneurs. The simplification of processes, prompt response and responsiveness is needed to reduce compliance cost.

ICT CONTEXT

In line with the initiation of an electronic Information and Communication Technology (ICT) system, web-based applications for the registration of taxpayers and their tax returns and assessment have been developed. More and more taxpayers have started using e-taxation platforms and submitting tax returns online. Although the online revenue reporting system is yet to be developed, a centralized networking system has been established resulting in an increase of tax revenue collection. All IROs and the LTO are connected to the web-based revenue collection system.

At present, IRD maintains over 600,000 tax files, and the number is increasing. Given the huge amount of tax data involved and to meet the demands from the public, IRD has to strategically maintain and upgrade its ICT system to enhance the efficiency of its day-to-day operations and to provide a wide range of electronic services to the public. The major components of IRD's existing ICT infrastructure (comprising mainframe, midrange, personal computer (PC) and local area network (LAN) platforms) were implemented in 2000/01. Technological advancements can support a secure and reliable ICT platform to meet its operational requirements. It is anticipated that IT-assisted services will be of growing relevance in the future.

ORGANIZATION & HR MANAGEMENT

Reforms require efficient management and administration, as well as technical capacities supporting tax legislation. According to the Income Tax Act, the superior role of the Inland Revenue Department comprises responsibilities in the implementation and administration of tax laws as well as the establishment of tax offices as part of the department in order to facilitate the fulfillment of delegated responsibilities¹⁸. The further structure comprises one LTO, 22 IROs, and 28 TSOs.

In order to manage a functional division of labor and the organization's work-force, human resource development and improvement is an on-going process within IRD. Skilled employees are required to assure quality performance based on job descriptions. Measures have been taken in the past to strengthen knowledge, skills and positive behavior. Further tailor-made training measures will be based on a thorough review of the current Human Resource Management in order to support the positive process. Following the encouraging results from the established Performance Based Incentive Scheme on the overall organization's performance, a review of internal mechanisms based on a sufficient monitoring allows a critical reflection for further improvement.

¹⁸ Source: Income Tax Act

TAXPAYER SERVICE

Especially since the introduction of the self-assessment system in 1993, the tax administration has identified the need to empower citizens by providing improved information access and assistance in 23 IROs as well as educating taxpayers to comply with tax laws. Attempts for effective communication strategies and initiatives to provide assistance to individuals and businesses have been undertaken in the past to strengthen the capabilities of citizens to manage own tax liabilities:

- Information campaigns were conducted using different channels, such as newspapers, radio, TV, microphone, brochures and direct interactions.
- Manuals on income tax, VAT and excise have been developed and published, in order to provide a clear reference and interpretation of tax laws.
- Online applications were introduced and demonstrated, such as the opportunity for registration and filing. Further applications are yet to be developed.
- The Personal Account Number System, introduced in 2009, has been further developed as an internet based system allowing online access by all taxpayers (e-PAN)

Taxpayer service has become essential in providing quality assistance to taxpayers, improving the perception of IRD and enhancing voluntary tax compliance. Services provided to citizens have resulted in progress of taxpayer-friendly services throughout the country. By enhancing the communication between taxpayers and the revenue authority, IRD is directly contributing to create confidence in state institutions.

1.3. Challenges

By considering the different organizational, technical and social factors in the reform environment of IRD, future challenges can be summarized as follows:

1. The informal economy prevents IRD to a large extent to obtain sufficient revenue to finance public services, and increases the tax burden for those following the tax obligations. In order to bring the informal sector into the tax net and enhance voluntary tax compliance, compliance costs need to be reduced through different approaches and mechanisms.
2. A complex, unpredictable tax system and inconsistent laws increase the probability for non-compliance. IRD therefore needs to establish a taxpayer-friendly environment by providing accessible information and services in order to create a better understanding on tax legislation and administrative processes.
3. Tax systems with a low risk of detection motivate citizens to avoid the registration to pay taxes. In order to effectively mitigate noncompliance and to take efficient action against tax fraud and evasion, enforcement mechanisms of IRD need to be strengthened.
4. Limited resources, technical capacities and infrastructure impede quality services throughout the country. A competent Human Resource System is the prerequisite to initiate change processes. In order to build on the progress achieved by IRD so far and to be prepared for future challenges, the enhancement of organizational capacities is an on-going process.
5. Change processes within an organization require new ideas and team-play to progress and succeed with reform efforts. IRD wants to create an atmosphere for on-going learning and the development of innovative input.

In line with the code of conduct and the values defined in the Strategic Plan, IRD promotes transparency, participation, accountability and responsiveness. Adherence can not only improve the organization's performance, but also contribute to a positive image of the tax administration and support creating confidence in state institutions.

6. The purpose of the integration of IT-assisted systems is multi-functional. It simplifies administrative operations, empowers taxpayers and enhances independency. It reduces compliance costs and fosters transparency through standardized processes. IRD is committed to creating an effective IT architecture and improve the technical capacities of a comprehensive network together with relevant stakeholders in order to serve customers' needs.

The Strategic Plan contributes to achieving IRD's objectives and shows measures of how to address the challenges summarized above.

1.4. Rationale for Strategic Plan

The identified challenges necessitate change processes in order to improve the described environment for enhanced voluntary tax compliance. Improving the environment demands reform efforts to broaden the tax net, including income tax, VAT and excise with its growing relevance. In this regard the institutionalization of compliance approaches and measures will be crucial and influential also for other areas, such as collection and enforcement. To address discrepancies and potential opportunities as mentioned in the previous chapter, IRD has identified the need to develop a Strategic Plan and translate Strategic Objectives into specific interventions in particular areas. The plan provides guidance in the achievement of its overall objective to improve efficiency and effectiveness in the tax system.

Since the implementation of the Strategic Plan is taking place in a dynamic environment, it is necessary to regularly monitor internal and external change processes, and to evaluate consequences for the Strategic Plan. With an appropriate M&E system, the achievements of tasks can be verified and the Strategic Plan can be adjusted if needed.

However, policy reform and enforcement, taxpayer service and education, organization and human resource management as well as ICT are interlinked and influencing each other. A coherent understanding and internalization for the measures taken is essential for a successful implementation of the Strategic Plan. Hence, the plan will be articulated among the administration / employees, e.g. as part of orientation training to incoming staff. Moreover, an integrated approach can support explaining efforts to the public and the growing number of stakeholders in order to gain support and better anchor the Strategic Plan. Detailed measures have been explained in the following chapter and will serve as a reference for IRD, the government and the public.

STRATEGIC DIRECTION

Considering the challenges enumerated in the previous chapter, four major Development Objectives (DO) were formulated. A vision was developed for IRD to become accepted by the public through its professional and fair services to the taxpayers, innovation and research as well as for contributing to economic growth. A mission statement is a commitment of IRD and its employees for which dissemination of the intent, explanation and intensive mentoring (individually and/or in groups) for adherence is needed. Values set the culture of an institution. Hence, monitoring and actions for non-adherence are also necessary. Similarly the DOs are supported by the corresponding Strategic Objectives (SO) for which numerous reformative programs and activities have been proposed.

Development Objectives (DO)

One of the challenges that the IRD is currently facing is the poor voluntary compliance. Furthermore, it has also been challenged with high compliance cost, narrow tax base and an unpredictable tax environment. Thus, in order to make the taxpayers compliant to the tax laws, IRD needs to eliminate these obstacles by being efficient and effective. This could be achieved through faster dispute resolution and integration of taxpayer-friendly tax administration system, proper audit mechanism, harmonizing legal system and procedures, enforcing the law in a timely manner, improving advance ruling, administrative review and appeal system, educating taxpayers, being responsive to taxpayers and meeting taxpayers' aspirations and honoring taxpayers' rights.

Considering these features, the following four development objectives have been set for a period of five years starting with the FY 2012/13. A sincere implementation of these DOs (with the help of each strategic objective) will lead to the **overall objective to improve efficiency and effectiveness in the tax system**. By executing the development objectives, policy reforms will be supported and enforcement mechanisms will be strengthened. IRD is committed to anchor quality taxpayer services and education programs. Measures will be taken for the revitalization of the organization and an effective management of competent human resources. The department will upgrade and enhance its ICT equipment and facilities to serve its customers.

- DO - 1. Policy Reform and Enhancement of Enforcement
- DO - 2. Improving Taxpayer Service and Education
- DO - 3. Optimal Uses of Modern Technology
- DO - 4. Revitalization of the Organization System and Mobilization of Competent Human Resources

Development Objective I

Policy Reform and Enhancement of Enforcement

Reforms require efficient management and administration, as well as technical capacities supporting tax legislation. Simplified processes and tax laws contribute to a better understanding but also to an enhanced enforcement. IRD has initiated processes to improve audit, investigation, and thus its overall performance. In addition, manuals have been developed in the past to create transparency on decisions and a reference for taxpayers. IRD is committed to advise the government to reduce complexities and foster consistency of tax legislation. IRD has identified the relevance to create a predictable, taxpayer-friendly environment that encourages investment and trade in order to contribute to the national development of Nepal. The following activities have been planned under four strategic objectives to achieve this DO by 2017:

Strategic Objective 1.1

Tax policy reform

- Strengthen the Policy Section of IRD as a focal division for policy analysis and reform
- Analyze existing tax policies in view of implementation and implementation deficiencies
- Regularly exchange with stakeholders on concerns and potential amendments
- Provide advice on potential future tax policies in order to promote investment and mitigate tax avoidance
- Initiate negotiations with other governments to conclude Double Taxation Avoidance agreements which would be helpful in sharing information on taxpayers

Strategic Objective 1.2

Harmonization of tax laws and procedural framework on par with international standards

- Initiate the establishment of dispute settlement mechanisms so that taxpayers are assured for having an institutionalized and permanent entity for efficient service delivery on matters of tax demands, long outstanding tax disputes and arrears
- Revisit and study the legal system to amend laws and/or propose new laws and official directives
- Revisit and amend regularly tax manuals, SOPs in line with the tax policies and laws to avoid ambiguity in the application of laws and procedures
- Strengthen system of advance ruling and administrative directives to reduce the propensity of litigations
- Integrate registration, filing, payment, reporting and assessment system of Income Tax, VAT and Excise to ensure harmonization and ease of working
- Improve records and reporting system of Administrative Review and Appeal System so that the taxpayers do not have to spent more time and cost
- Support the government to amend Revenue Tribunal Act and Regulations and strengthen Revenue Tribunal for effectiveness, efficiency and promptness to increase the higher rate of success and early recovery of revenue

Strategic Objective 1.3

Operationalization of research and forecasting for maximization of revenue collection

- Institutionalize a revenue intelligence system to receive proper information on taxpayers
- Rationalize tax exemptions and incentives regularly so as to provide appropriate incentives to the investors with fairness.
- Analyze tax gap and forecast using tax forecasting models for quantifying the gap between potential revenue and actual collection to help IRD to optimize its revenue mobilization
- Undertake a feasibility study to introduce simple taxation for SMEs

Strategic Objective 1.4

Enhancement of risk management and enforcement capability

- Establish and regularly update a comprehensive and integrated data banking system in informing and rectifying any deviations and/or shortcomings immediately
- Devise and use risk engine based on taxpayer segments and sectors to make the processes easy
- Revise existing risk based indicators to become vigilant on issues and to become proactive to manage the risks on time
- Revisit existing audit policies by segmenting revenue risks, nature of taxpayers and businesses, turnover, and time lag
- Revise existing selection criteria for internal review
- Reorient enforcement against non-filers so as to increase compliance
- Clean up data and files of nonexistent taxpayers due to closure of businesses, bankruptcy, international migration and not-in-operation for many years
- Develop and apply harmonized arrears collection guidelines
- Create and mobilize competent legal panel within IRD so that it can win cases against non-compliant tax payers and fraudsters
- Develop and apply harmonized litigation guidelines so that the working of IRD and all the IROs would be in harmony

Expected Results

- Regular exchange of information with stakeholders
- Systematized analysis of existing and potential tax policies
- Full use of streamlined tax policies, tax manuals and standard operational procedures
- Systematized annual tax gap analysis and revenue forecasting
- Tax Revenue-to-GDP ratio will be increased to approx. 18 % by the end of FY 2016/17
- Income Tax to-GDP ratio will be increased to 5.46 % by the end of FY 2016/17
- VAT-to-GDP ratio will be increased to 5.64 % by the end of FY 2016/17
- Excise Duty-to-GDP ratio will be increased to 3.17 % by the end of FY 2016/17
- 2 % taxpayers (including cent percent of large taxpayers) will be brought into full audit annually
- 15 % LTO audited files and 10 % other IROs audited files will be reviewed by IRD

Development Objective II

Improving Taxpayer Service and Education

IRD is facing challenges such as reducing compliance cost, educating taxpayers about their rights and obligations, transformation of IRD and its offices into a functional, taxpayer friendly environment, which are essential to enhance voluntary compliance. Hence, providing efficient service is not only an obligation but is a pre-condition to raise the level of voluntary compliance. Considering these factors, the following program activities have been proposed under four strategic objectives to achieve this DO by 2017:

Strategic Objective 2.1

Empowering taxpayers on related laws and tax issues through education, counseling and other Outreach programs

- Draw up and operationalize an innovative and taxpayer-friendly service toolkits, approaches and methods
- Outsource potential taxpayers education programs
- Publish monthly Tax Bulletin to disseminate information and circulars/public notifications
- Recognize and award Prizes to Good Taxpayer on National Tax-day function to make them feel proud for their contributions (from each IRO)
- Create and operationalize consultative collegiums of taxpayers & contributors for making them aware of the programs of IRD, results and seeking suggestions for improvement including collaboration to increase tax-base and tax-net
- Prepare and update need-based manuals and brochures on tax issues and procedures

Strategic Objective 2.2

Increasing voluntary compliance and reduction of compliance cost

- Coordinate with Ministry of Education to integrate basic course on taxation system in higher secondary level curricula to make them aware of the liabilities and rights of a citizen vis-à-vis inland taxes
- Make standard operating procedures easier for the entry to and exit from the tax system to deal with non-filers
- Simplify operational manuals and guidelines for easy compliance with tax laws and processes
- Collaborate and integrate registration and deregistration system with other government agencies
- Strengthen e-governance (in registration, e-return, and e-payment)
- Educate taxpayers on e-governance system which will provide educational materials with meaningful messages that will ultimately help to create voluntary mind-set among the taxpayers for ultimate increase in the compliance rate
- Devise and provide pragmatic incentive system to taxpayers such as investment bonus, investment tax credits, accelerated depreciation to investors (smart incentives), etc. as one of the strong but softer means to attract investment

- Operate call centers and use SMS/emails for reminders and further support for improving compliance and decreasing non-filers
- Intensify use of regular media to educate and empower taxpayers to improve compliance
- Improve services in providing payment options so that compliance is increased while compliance costs are reduced

Strategic Objective 2.3

Identify and reduce non-compliance

- Use of the reporting of an effective ICT System to identify non-compliance
- Regularly follow up with non-compliant taxpayers by providing information about tax obligations, and take legal action if necessary
- Develop legal and administrative measures to make non-compliance more costly and risky

Strategic Objective 2.4

Promote timely reporting and payment of taxes

- Use of the reporting of an effective ICT System to identify non-payment
- Regularly follow up with taxpayers by providing information about payment options, and take legal action if necessary
- Revisit and simplify legal provisions of Income Tax, VAT, and Social Security Tax to reduce time and costs

Expected Results

- Development of ICT system to effectively follow up on non-compliance and non-payment
- Implementation of ICT system offering appropriate and IT assisted payment options
- Need-based taxpayer awareness programs
- Positive perception towards the tax administration
- Operationalization of taxpayer education manual
- Maintain non-filer rate at 10 % in VAT and 40 % in Income Tax
- 50 % Decrease in compliance cost

Development Objective III

Optimal Uses of Modern Technology

IRD has progressed in the use of IT-assisted systems but still faces certain challenges to deal with the changing business environment and complexity. Besides this, compatibility is a concern regarding how much, to what extent and level. ICT has changed the perception and ambition of the taxpayers to be served quickly, fairly and efficiently which needs continuity, effectiveness and uninterrupted services. This can be accomplished through outlining a comprehensive and integrated ICT networking that includes all the functional areas of IRD. For this purpose the following activities have been planned under four strategic objectives to achieve this DO by 2017:

Strategic Objective 3.1

Enhancement of ICT network

- Organize required soft and hardware for ICT networking to make it compatible to modern standard and national and international needs
- Outsource for specialized services and maintenance for effective ICT system
- Integrate different software being used into an integrated ICT system so that a compatible national system with international standards is maintained
- Prepare software for taxpayers to access own online accounts

Strategic Objective 3.2

Operationalization of full-scale e-governance system

- Revisit, update and implement ongoing five year e-governance master plan
- Strengthen ABBS to facilitate tax collection
- Support the government to amend tax laws to apply digitally registered and verified documents.
- Introduce e-banking systems for tax payment
- Work-out to launch e-payment system and develop capabilities of different stakeholders
- Install all required amenities for getting into full-fledged e-governance
- Monitor and supervise the system regularly

Strategic Objective 3.3

Regular auditing and management of ICT system to international standards

- Conduct ICT audit with the help of experts, which is a must activity for being secured that the system is working and safe
- Maintain and improve ICT software and hardware regularly for making taxpayer-friendly and making it internationally compatible
- Establish Disaster Recovery Centers in a secured place

Strategic Objective 3.4

Establishment of professional forward linkage with national and international agencies

- Interlink the ICT system with other government agencies to share information for quicker action on relevant data
- Apply petals (web-based network) to expand the networking of the likeminded individuals and professionals in the country and abroad

Expected Results

- Full Integration and full automation of VAT, IT and excise system
- Full implementation of an accessible, simplified and taxpayer-friendly ICT system
- Establishment of transaction-based taxpayer categories
- Implementation of e-banking systems
- Operationalization of Functional Data Analyzing Networking
- Full operationalization by ABBS System for tax collection
- 100 % Taxpayer Registration by online system
- 100 % Collection of tax returns through e-filing

Development Objective IV

Revitalization of Organization Structure and Mobilization of competent Human Resources

At present IRD is exposed to a high mobility of competent personnel and an absence of a human resource management plan. It also faces other challenges such as ways to motivate staff including career development opportunities to its staff members. These are the pre-conditions for encouraging the commitment of staff, and to effectively cater to the needs of the taxpayers. For this purpose, it is crucial to develop a comprehensive and visionary human resources development strategy covering all aspects of human resources management. Ultimately, it is the human resources that are at the core of the tax administration that realizes the vision. Considering these facts, the following activities have been specified under four strategic objectives to achieve this DO by 2017:

Strategic Objective 4.1

Transformation of IRD and its associated offices into segment and functional organization

- Expedite internal monitoring plans.
- Reengineering of tax administration by assessing scope of work of the organization and the workload of tax officers.
- Refurbish/renovate offices to ensure function-based and quality service delivery to become efficient
- Provide required logistics (vehicles, computer, fax, internet access, sufficient amount of information materials...) that is essential for quality of works and efficiency
- Maintain the premises and logistics regularly so that the environment is maintained to a professionally acceptable standards

Strategic Objective 4.2

Increase coverage and access to service for potential tax payers with low administrative cost

- Expand IRD's presence throughout the country and set up an appropriate service structure (i.e. through regional offices, mobile offices, etc.)
- Categorize taxpayers to better coordinate functions and implement target-oriented services
- Use other government agencies to implement administrative activities

Strategic Objective 4.3

Application of a tax cadre-based professional and compatible HRM policy and plan

- Support the government to amend laws to create a tax group within the revenue service
- Develop and operationalize function based core groups in areas such as taxpayer services, arrears collection, audit and investigation
- Activate Quality Circles in IRD
- Update staff profile in e-IMS so as to have up-dated information for motivation, deployment and support
- Attract and retain staff within IRD system by introducing performance-based incentives and promotion

- Recognize and reward good tax officials to motivate and highlight exemplary works once a year attached with a common function such as National Tax Day. Committed employees who are valued and treated fairly are more likely to be reasonable and professional in their dealings with taxpayers
- Enforce code of conduct and align it with reward and punishment practices
- Review staff performances based on Job Description vis-à-vis outputs

Strategic Objective 4.4

Revitalization of Human Resource Development system to increase knowledge, skills and abilities of employees

- Re-define and apply the approaches for entry-level, specialized, issue based and career development oriented training approaches that become compatible for institutionalization of quality circle and cadre-based team system
- Collaborate with Revenue Administration Training Centre (RATC) for training and workshops while identifying specific needs and output-based training programs
- Conduct on-the-job and off-the-job training for different issues and jobs
- Organize in-house seminars and conferences on issue-based themes so that contemporary tax issues are dealt efficiently and in-house competence is developed for institutionalizing “knowledge management” practices
- Develop capability to investigate and enforce high-tech national and cross-border tax frauds

Expected Results

- Establishment of a functional, segment based organization
- Full application of HRM policy
- Review of IRD's performance
- Operationalization of Quality Circles in IRD
- Assessments on physical presence, accessibility of services and workload of IROs/TSOs
- Conduct a study on the potential reorganization of the administration as per future requirements
- Reallocation of offices and service-units for accessibility to taxpayers
- Renovation and refined set-up of the office layout with essential equipment and modern amenities

Risks and Mitigating Strategies

Some risks have been identified in relation to the implementation of this SP. Relative mitigating strategies are also proposed.

Risks	Probability	Impact	Mitigating Strategies
Policy inconsistency	Medium	High	<ul style="list-style-type: none"> Comprehensive review and documentation of inconsistent policies, followed by steps to revise the policies so as to address the inconsistencies Separation of authority to raise tax between various levels of government under federal structure is yet to be finalized. This aspect of inter-jurisdictional taxation rights under federal structure needs further study.
IRD with ample authority to function effectively	Medium	High	<ul style="list-style-type: none"> Obtain political support Retain and mobilize competent human resources
Absence of coherent team work and high turnover	High	High	<ul style="list-style-type: none"> Form revenue services group and sub-groups under the revenue service for IRD staffs Establish and mobilize various thematic groups in IRD
Inadequate back-up and maintenance of ICT system	High	High	<ul style="list-style-type: none"> Carry periodic audit of the system Obtain international standard certification
Code of conduct: low level of compliance	High	High	<ul style="list-style-type: none"> Strictly comply to code of conduct in staff appraisal and reward and punishment system
Insufficient growth in national economy and international trade	Medium	High	<ul style="list-style-type: none"> Monitor national and international economy and develop preparedness for any unpredicted development impacting the economy of the country
Coordination between various government agencies	Medium	High	<ul style="list-style-type: none"> Form a coordination committee consisting of key government agencies and conduct monthly coordination meetings



Conclusion

This Strategic Plan supports IRD in becoming a capable, efficient revenue administration influencing change processes to the benefit of the organization, the taxpayer and the public. Within the upcoming five years, IRD is committed to follow four development objectives, strategic objectives and activities to achieve expected results given the described challenges as well as internal and external influences.

The IRD's mandate to collect taxes denotes a remarkable responsibility to maintain a high level of integrity, fairness and competence. IIRD strives for transparency to craft an environment of trust and cooperation between IRD and taxpayers. This Strategic Plan is developed to create such an environment. IRD will use it as the basis for the preparation of the following operationalization and as a reference for decision-making. The vision must be internalized primarily by the IRD system and explained to stakeholders. This plan will guide IRD to improve its services, educate the public on their rights and obligations as well as to promote and enforce compliance with the tax laws following a defined approach comprising:

1. Voluntary compliance based tax administration
2. Research based tax policy reform
3. Need based taxpayers education and awareness programs
4. IT based taxpayers services
5. Scientific forecasting based revenue collection
6. Information and intelligence based enforcement
7. Indicator based risk management and audit
8. Evidence based tax fraud and evasion investigation
9. Functional and segment based organization
10. Taxpayer friendly and cadre-based tax administration
11. Justice based administrative review system

IRD will define and create appropriate activities in its yearly plan of operation with a view to achieving the strategic objectives. Since the timeframe amounts to five years, it is recommended to monitor the plan regularly and review it through a mid-term evaluation process. The Strategic Plan should also be reviewed and refined by the end of the term.



Government of Nepal
Ministry of Finance
Inland Revenue Department (IRD)
Lazimpat, Kathmandu

Phone 01-44 15 802, 44 10 340,
44 15 967, 44 15 969
Fax 01-44 11 788

E-mail admin@ird.gov.np
Website www.ird.gov.np