

# Nepal: Country's Experience on Tax Gap on PIT



- Area: 147,181 Sq. Km
- Population: 30 million
- Boarder: North-China, Rest-India
- GDP: NRs 5381 bn.
- Currency: NRs (1\$=132 NRs)
- Multiparty Democratic Republic Country
- PCI: NRs 200000
- Religion: 81% Hindu, 9% Buddhists, 4% Muslim, 2% Christian
- Language: Nepali
- Foods: Traditional Nepali Food (Less Spicy): Rice, Cereals, Vegetables, milk etc.
- Major Highlights: Mt Everest (8848 MT.), Birth Place of Lord Buddha, Ethnic diversity, Climate diversity, Cultural diversity, Remained sovereign since the history.

# Outline

- **Number of Taxpayer Registration**
- **Revenue Effort Ratio**
- **Major Highlights in PIT**
- **Challenges in Compliance Gap**
- **Challenges in Policy Gap**
- **taxpayers compliance in Strategic Plan**
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# Taxpayer Registration

Taxpayer Categories	No. of Registration (FY 2022/23)
Business PAN (B-PAN)	18,68,691
Withholder PAN Number (W-PAN)	28,107
Personal PAN (P-PAN)	36,43,458
Digital Service Tax (DST)	13
Total PAN	55,40,266
Value Added Tax	3,06,901
Excise	1,15,279
Source: Inland Revenue Department, Nepal	

## Revenue Effort Ratio

F/Y	2018.19	2019/20	2020/21	2021/22	2022/23
GDP (bn. Rs.)	3858.93	3888.70	4352.55	4933.70	5381.34
Total Revenue (bn Rs.)	829.63	793.75	938.32	1067.96	957.15
GDP/Revenue Ratio	21.50	20.41	21.56	21.65	17.79
Tax Revenue (bn. Rs.)	738.60	700.05	870.11	984.16	865.62
GDP/Tax Revenue Ratio	19.14	18.00	19.99	19.95	16.09
PIT (bn. Rs.)	59.61	62.90	87.51	97.62	86.30
GDP/PIT Ratio	1.54	1.61	2.01	1.97	1.04

## Major Highlights in PIT

- In PIT, It is assumed that Compliance gap is much higher than policy gap
- In PIT, It contain Personal Income Tax & Proprietorship, Remuneration, Social Security Tax, Individual Capital Gain Tax and Individual Windfall Gain Tax.
- Except Proprietorship business, PIT is collected as TDS methods. But income having above NRs 40,00,000.00 must filling returns.
- Payroll audit is widely used in Inland Revenue Offices.
- In this current year, we set the target of doing Tax Expenditure and Tax Gap Study. Tax Expenditure report is completed recently. And Tax Gap study is going on through the expert consultant. The consultant is in close contact to the IRD. IRD is coordinating in order to collecting the data. The final report will get within few months.

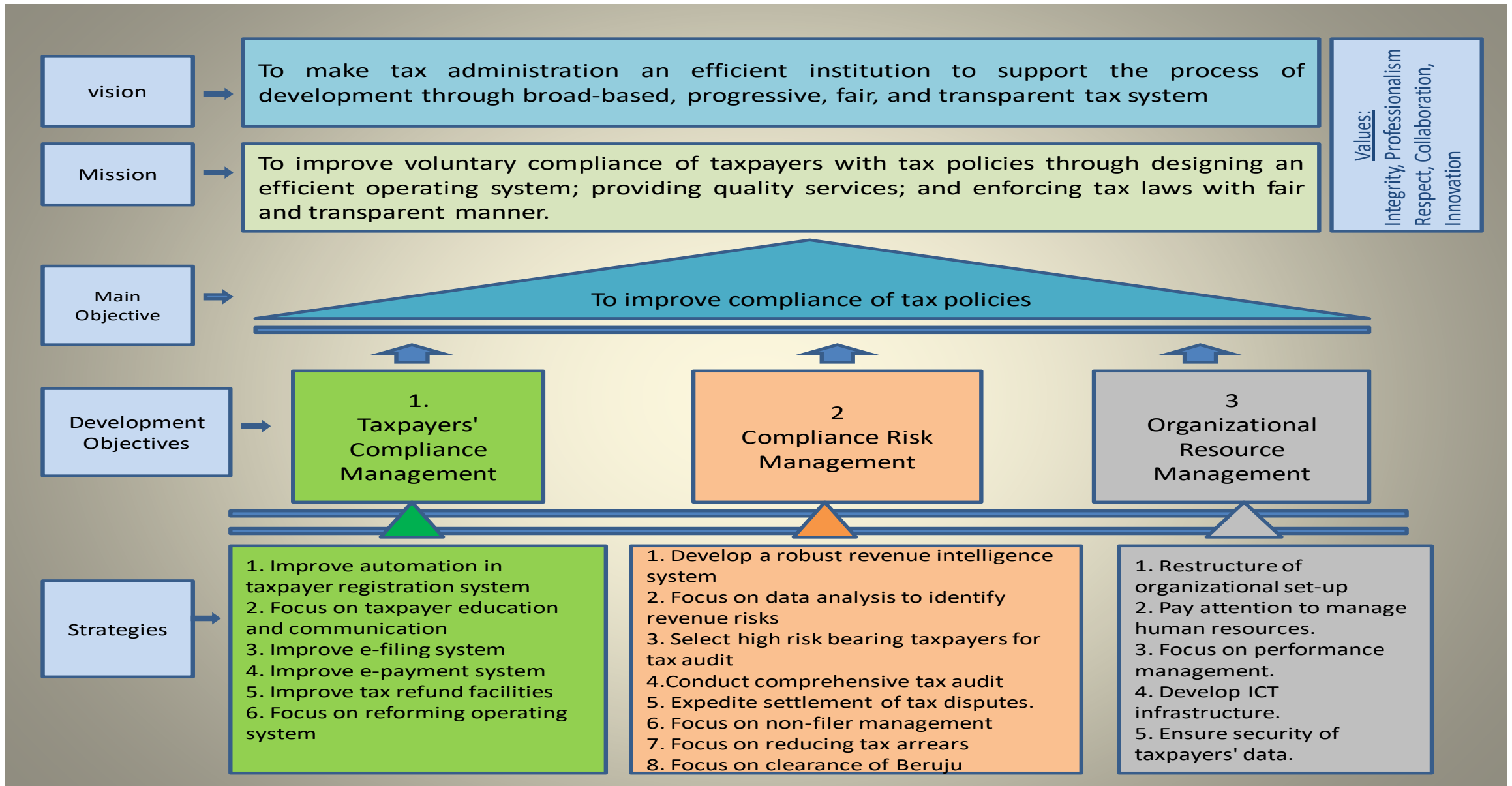
## Challenges in Compliance Gap

- Informal sector still exists in high volume.
- Intermediary business like many kinds of brokers are mostly out of tax coverage.
- Informal sector labor, daily wages, small service business like hair cutting, plumber, electrician etc. are still out of tax coverage.
- Many rural areas are outside of banking coverage.
- Still there exists high cash transaction in market.
- No invoicing, Under Invoicing, sometimes fake invoicing found in the market.
- Exchange of information with other government sector is not fully automated.
- Non filler is increasing day by day.
- Registration gap, Reporting gap, Compliance gap and Payment gap etc.

## Challenges in Policy Gap

- Primary Agricultural Sector (25% of GDP) is tax exempted. An exemption of agricultural income keeps many potential taxpayers out of the PIT net.
- Many kinds of tax exemption existed in Income Tax Act.
- Most of the Daily wages labors and informal sector labors are outside the tax coverage.
- Amount received as gift, Inheritance, or scholarships are exempted.
- First slab (NRs 500000 for single and 600000 for Couple) is tax exempted. Lower PIT rates are applied for wide range.
- Seems to be elite influence in tax policies.
- Frequent change in tax policies.

# Tax Compliance in Strategic Plan





## PIT Rates as Slab Basis

S.N.	Slab		Tax Rate
	Single	Couple	
1	NRs. 500,000	NRs. 600,000	1 % (SST)
2	Next NRs. 200,000	Next NRs. 200,000	10 %
3	Next NRs. 300,000	Next NRs. 300,000	20 %
4	Next NRs. 10,00,000	Next NRs. 10,00,000	30 %
5	Next NRs. 30,00,000	Next NRs. 30,00,000	36 %
6	NRs. 50,00,000 and above	NRs. 50,00,000 and above	39 %

Moral: Progressive, Multi slabs and Compactible with other many countries.

# Methodology

- Tax Gap= Compliance Gap+ Policy Gap  
= Economic Potential of Revenue – Legal Potential of Revenue
- In order to calculating the Tax Gap, Top-Down approach is using being difficulty in the collection of individual taxpayers data. National Accounts data and household survey data are available easily.
- Calculation of Revenue Foregone;
  - Determine the Total Taxable Income,
  - Estimate the Effective Tax Rate,
  - Calculate the Expected Tax Revenue,
  - Compare Expected vs. Actual Tax Revenue,
  - Adjustments and Sensitivity Analysis,
  - Refinement and Validation
- This report adopts a methodology in which the benchmark tax gap is defined by focusing solely on the core elements of the tax system. The objective of the Study includes to measure of the amount of tax revenues lost or foregone through both non-compliance and policy decisions.

# Challenges Encountered During Study

During the data collection phase, various challenges were encountered. The challenges associated with using top down approach have been mentioned below:

- 1. Informal Economy:** Nepal has a significant informal economy, with a large portion of economic activities conducted outside the formal tax system. Estimating the tax base and liabilities from informal economic activities is challenging, as such transactions may not be captured in official data sources used for top-down approach.
- 2. Limited Data Availability:** Even some macroeconomic surveys like Living standard survey, Labor force survey, Household consumption survey etc. are available. But Nepal may have limited data availability and reliability, particularly regarding income distribution, taxpayer compliance, and economic indicators.
- 3. Absence of a data collection mechanism:** The absence of a data recording system has resulted in data being predominantly stored at local levels without subsequent communication to the federal government.
- 4. Underreporting and Non-Compliance:** Non-compliance with tax obligations, including underreporting of income and evasion of taxes are also challenging. The extent of non-compliance may vary across different taxpayer segments and economic sectors, complicating efforts to estimate the tax gap using top-down methods.

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5. **Absence of comprehensive records and data aggregation issues:** Aggregating data at the national level is very poor. Significant variations in income levels, economic development, and infrastructure across different regions can affect the accuracy of top-down estimates.
6. **Absence of required and structured data:** In various cases, the structured data could not be found in required format. In few cases, there were customized data without detail or root to the detail data. For instances, the data related to agriculture published by the Ministry of Labor is customized for the purpose of the Ministry itself.
7. **Informal Cross-Border Trade:** Nepal shares borders with India and China, and informal cross-border trade is prevalent. Transactions occurring through informal channels may not be captured in official data sources, leading to underestimation of the tax base and liabilities in top-down analyses.
8. **Institutional Capacity:** Nepal's tax administration and statistical agencies may face challenges in collecting, managing, and analyzing data necessary for top-down tax gap studies.
9. **Complex Tax System:** Nepal's tax system is characterized by multiple taxes, exemptions, and incentives, which can complicate the estimation of tax liabilities and the identification of non-compliance. Interactions between different taxes and regulations may not be fully captured in top-down analyses.

Addressing these challenges requires a comprehensive understanding of tax system, economic structure, and institutional framework. We may need to employ bottom-up approaches as an alternative methodologies in the future.

# Data Sources

- National Statistics Office: <https://nsonepal.gov.np>
- Nepal Rastra Bank( Central Bank of Nepal): <https://www.nrb.org.np>
- Inland Revenue Department: <https://www.ird.gov.np>
- Ministry of Finance : <https://www.mof.gov.np>
- Pension Management Office: <https://pension.gov.np>
- Department of Consular Services: <https://nepalconsular.gov.np>
- Department of Foreign Employment: <https://dofe.gov.np>
- University Grant Commission <https://www.ugcnepal.edu.np>
- Land Management and Archive Department <https://dolma.gov.np/>
- Department of Foreign Employment: <https://dofe.gov.np>
- Reports:
  - Annual Report 2021.22 CE – Nepal Rastra Bank
  - Annual Report 2022.23 CE – University Grants Commission
  - Annual Report 2078.79 CE – Inland Revenue Department
  - Annual Report 2079 (2023 CE) – Office of Auditor General
  - Nepal Living Standard Survey IV- National Statistics Office
  - Annual Household Survey- National Statistics Office
  - Nepal Labor Force Survey- National Statistics Office
  - Economic Survey 2020.21 CE – Ministry of Finance
  - Finance Act 2078 (2021 CE) and 2079 (2022 CE)
  - Industrial Statistics FY 2078.79 (2021.22 CE) – Department of Industry

Thank You!