आन्तरिक राजस्व विभाग

Inland Revenue Department

Estimating Tax Expenditure: Experiences and Challenges

Dinesh Panday

Inland Revenue Department, Nepal

May 8, 2024

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BACKGROUND

- Nepal has initiated a Tax Expenditure Study marking the first of its kind in the country.
- The presentation is based on the preliminary Tax Expenditure study reports.
- The calculation of Tax Expenditure aligns with the guidelines issued by IMF and OECD.
- Calculation period: From 16.07.2021 to 16.07.2022
- The GDP for FY 2021.22 was NPR 4,933.70 billion.
- Federal budget of NPR 1,647.57 billion for the FY 2021.22.
- Revenue to federal budget ratio was 62.21%
- The Foreign Exchange rate was 1 US$= 127.51 NPR at the period of study

METHODOLOGY

Tax Expenditure = Benchmark – Actual Tax Liability

"Revenue Foregone" methodology to estimate Tax Expenditure associated with Income Tax, Value Added Tax, & Customs duties comparing it against benchmark rates.

Calculation Categories

Tax Expenditures are categorized into:

- Tax Exemptions
- Tax Credits
- Tax Concessions – in rates
- Tax Concessions – non-taxation
- Tax Rebates

Data Source:

Income Tax:

Mostly Internal sources (Income Tax Returns submitted by individuals/entities) & other external sources.

Value Added Tax:

VAT returns and External sources (other bodies and organizations

BASES AND ASSUMPTIONS: VAT

- **Focus Areas**

  Highlight sector-specific consumption patterns of VAT exempted items.

  Determine proportion of final consumption relative to total consumption.

  Provide comprehensive view of consumption dynamics impacting VAT landscape.

- **Data Source**

  Current Macroeconomics and Financial Tables published by the Central Bank of Nepal (NRB).

- **Assumption**

  Consumption pattern used for VAT Expenditure calculations.

- **Final consumption**

  Final consumption includes goods and services for individual or collective needs.

SECTORS CONSIDERED: VAT

Calculation

- Value Added Tax operates under the Final Consumption principle, where the final consumption is measured to determine the tax liability.
- Various sectors (as shown beside) are classified and analyzed based on their consumption patterns.
- Sector-wise consumption data for FY 2020.21 and 2021.22 is derived from Statistical Tables published by the NRB, sourced from the UN Trade Statistics Broad Economic Categories Rev.5.

Agriculture, forestry, fishing, food, beverages, tobacco
Mining quarrying, refinery, fuels, chemicals, electricity, water, waste treatment
Construction, wood, glass, stone, basic metals, housing, electrical appliances, furniture
Textile, apparel, shoes, jewelry, leather
Transport equipment and services, travel, postal services
ICT, media, computers, business and financial services
Health, pharmaceuticals, education, cultural, sport
Government military and others

SECTORS AND WEIGHTED AVERAGE

S.N.	Sectors	Weighted Average Final Consumption (%)
1	Agriculture, forestry, fishing, food, beverages, tobacco	34%
2	Mining, quarrying, refinery, fuels, chemicals, electricity, water, waste treatment	61%
3	Construction, wood, glass, stone, basic metals, housing, electrical appliances, furniture	16%
4	Textile, apparel, shoes, jewelry, leather	31%
5	Transport equipment and services, travel, postal services	19%
6	ICT, media, computers, business and financial services	51%
7	Health, pharmaceuticals, education, cultural, sport	37%
8	Government, military and other	9%

Source: NRB Current Macroeconomics and Financial Situation Tables (Based on Annual data of 2022.23 CE)

BENCHMARKS

INDIVIDUAL INCOME TAX	FINAL WITHHOLDING TAX	VALUE ADDED TAX	VARIANCE
Individual Income Tax benchmarks are set by the rates outlined in Section 1 of Schedule 1, while entity taxes are determined by rates in Section 2 of the Income Tax Act 2002.	Final withholding tax heads use their withholding tax rate as the benchmark.	Value Added Tax adopts a single tax rate of 13% as its benchmark.	Any variance from these benchmark tax systems is regarded as revenue foregone, constituting Tax Expenditure.

Total Federal Tax Expenditure estimated **NPR 296.76 billion** represents 27.79% of Total Tax Revenue and 6.01% of GDP

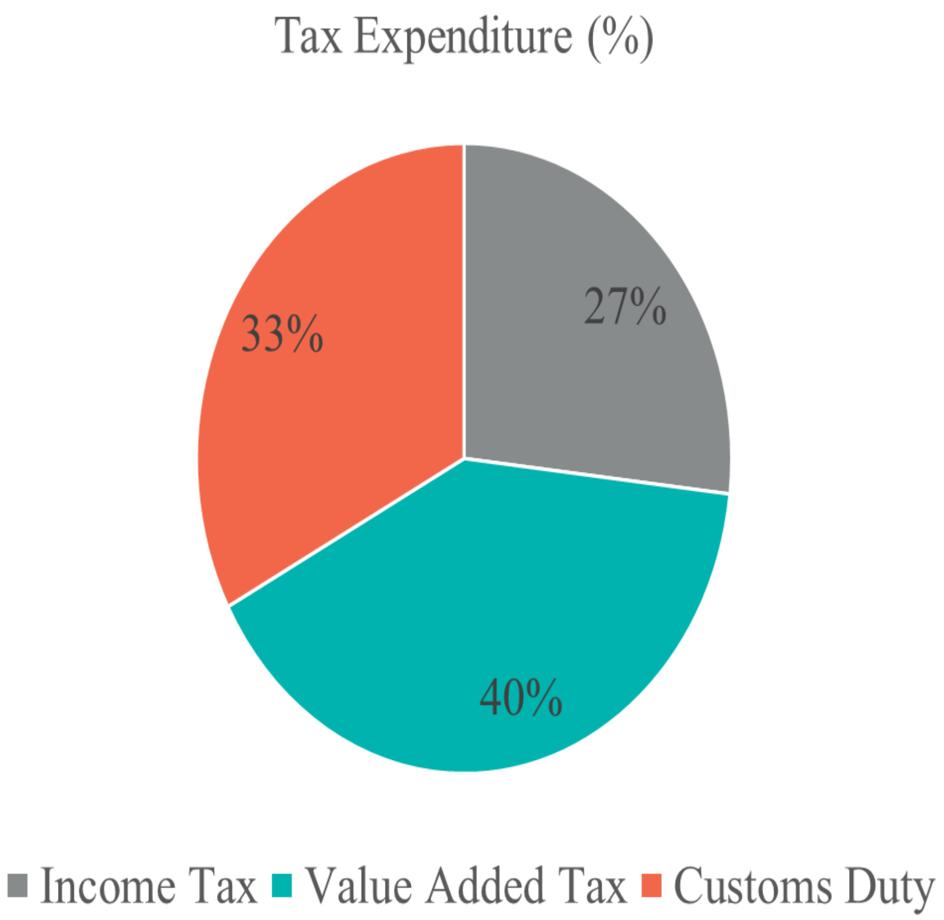
Income Tax Expenditure **NPR 76.34 billion** accounts for 25.72% of Total Tax Expenditure and 1.55% of GDP

VAT Expenditure **NPR 119.91 Billion** constitutes 40.41% of Total Tax Expenditure and 2.43% of GDP

Tax Expenditure under Customs Duty: **NPR 97.31 Billion** represents 32.79% of Total Tax Expenditure and 1.97% of GDP

Tax Expenditure under Finance Act 2022: **NPR 3.2 Billion** represents 1.08% of Total Tax Expenditure and 0.06% of GDP

TAX EXPENDITURE CONT…



- Economy is depended on agriculture which consists around 25-26% of GDP
- On top of that, Agriculture is largely sustenance based due to the lack of commercialization of agriculture
- VAT is exempted on Agriculture as a basic need
- Also, exempted in health, education, electricity & transportation sector which contributes a significant portion of GDP

CHALLENGES & WAY FORWARD

Tax expenditure ceiling to be set in comparison with GDP and Revenue

Developing a centralized database and automated reporting mechanism for comprehensive tax expenditure records.

Data sharing and consolidation between IRD and other relevant bodies or ministries in the case of tax concessions and expenditures

Reports prepared by government bodies must align with taxation perspectives to support national financial policy.

Revision of tax returns forms and schedules for capturing the total tax expenditure amount

Thank You

Inland Revenue Department, Nepal

नेपाल सरकार
अर्थ मन्त्रालय
आन्तरिक राजस्व विभाग

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