

**A STUDY OF TAX AUDITING SYSTEM
IN NEPAL**

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I hereby declare that the work reported in this thesis entitled **Tax Auditing System in Nepal** have submitted to Faculty of Management, Tribhuvan University is my Original work. It is done in the form of partial fulfillment for the Master's of Business Studies (M.B.S) under the supervision and guidance of Mr. Shiva Prasad Poudel, Research Department of Balkumari Kumari College.

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ABBREVIATIONS

CBS	Central Bureau of Statistics
DT	Direct Tax
DTR	Direct Tax Revenue
FY	Fiscal Year
GDP	Gross Domestic Product
GON	Government of Nepal
Govt.	Government
ICAI	Institute of Chartered Accountants of India
ICAN	Institute of Chartered Accountants of Nepal
IDT	Indirect Tax
IRD	Inland Revenue Department
IRO	Inland Revenue Office
IT	Income Tax
ITA	Income Tax Act
MOF	Ministry of Finance
NRB	Nepal Rastra Bank
OAG/N	Office of Auditor General/Nepal
OECD	Organization for Economic Development and Cooperation
PAN	Permanent Accounts Number
SAARC	South Asian Association of Regional Cooperation
T.U.	Tribhuvan University
VAT	Value Added Tax
W.T.O.	World Trade Organization

INTRODUCTION

1.1 Background of the Study

The tendency of welfare state in the present day world of twenty- first century is increasing rapidly. A welfare state has many duties and responsibilities towards its sovereign principal. The government tries to maximize the welfare of the people through Development and efficient allocation of resources. Till 1960's the economic development was focused on Economic growth. But afterwards social issues such as Poverty alleviation and equitable distribution of income and wealth replaced the issue of growth. In the 1980's, the concept of sustainable development, reflecting increasing concern about environment, has emerged.

Economic growth and stabilization are the main objectives of any economy. Economic growth is still the first priority of developing countries. They have to accelerate their economic growth rates, eradicate absolute poverty, reduce inequality in income distribution and create more employment opportunities.

In the context of Nepal, the Nepalese economy growth rate is about 5.5 percent last year, whereas economy of our close neighbors China and India grew by 9.5 and 8 percent respectively during last year. Our GDP growth rate (approximately 3 percent) was lowest in the SAARC region.

1.2 Statement of the Problem

In every country, the government collects its revenues through different sources. Out of which, taxes contribute a significant amount in the public revenues. The government mobilizes its revenues through budget in development activities for the public welfare and interests. Nepal is an underdeveloped and one of the poorest countries in the world. It has low per capita income and more than one third people of the nation are living under the poverty line. The economic development and prosperity is very low. Foreign dependency and internal leakages have made government think for another option which is expected to increase the revenue. Moreover, fiscal deficit has been increasing due to the continuously growing expenditure and the low revenue performance in Nepal. In addition, the country has also been facing the increasing burden of foreign loan.

1.3 Objectives of the Study

The study focus to evaluate the present performance of audit program of IRD and to propose recommendations for reform. The objectives of the study were:

- a. To examine the self assessment function as per VAT and Income Tax act and rules.
- b. To evaluate the status of management assessment system as per VAT and Income Tax act and rules.
- c. To analyze the problems and challenges faced by tax officials and taxpayers during the audit.

1.4 Research Question

In this fragile Nepalese economic environment, how is Tax faring is the main concern here. There are several research questions which are given below:

- a) Is present administration system of Tax sufficient to satisfy the need of the nation?
- b) Is there any significant change being observed in the revenue collection after implementation of VAT and Income Tax?
- c) How can tax auditing system should be fair?
- d) How many people known the Tax auditing?
- e) How to control tax leakage and elusion?
- f) What is the practicing scenario of Taxation in Nepal and what are the key problems of taxation implementation and possible correction measures?

1.5 Significance of the Study

Significance of the study is mainly covering overall review of tax assessment in Nepal and controlling tax evasion and corruption in Nepal. Mainly focus on highly how to coverage on tax assessment in Nepal. Most of people are hesitate to pay their tax obligation in Nepal so there need to make some new policy for encouraging taxpayers to pay tax with dignity.

1.6 Scope of the Study

The study didn't look into every aspect of tax auditing as this concept covers audit programs of Department of Customs and other institutions; it was concentrated on the audit program of IRD only. But it has tried to examine the effectiveness of tax audit and impact of audit program on taxpayer compliance.

1.7 Limitations of the Study

The study has very limited area of investigation. It is only a part and partial analysis of the corpus of Tax auditing system. The comprehensive study of the tax system is not possible in this research work due to its certain deadline for completion. The history of Tax auditing is not so long in Nepal. When talking about Tax Auditing, it implicitly concerns the corpus of the taxation like income tax and others, but this study would not go that far. The information and data were collected from the IRD office, MOF and other concerned offices. Most of the data were taken from Economic Survey: 2010/12 and Annual report of IRD. Due to time and resource limitation mainly secondary date were used in this study. So, it is largely dependent on the reliability of secondary data. These all constraints have limited the boundary of the study. Despite such limitations, the attempt has been made to make it profitable.

1.8 Organization of the Study

This thesis has organized in five chapters. The first chapter is about introduction. It includes General Background, Statement of Problem, Importance of Study, Objectives of Study, Scope of study, Research methodology, Limitations of the study, Organization of Study.

The second chapter is about Conceptual Framework and Review of Literature. In Literature Review, review of thesis, books, research reports and articles are done which are used as guideline for preparing this thesis.

CHAPTER- II

REVIEW OF LITERATURE

Review of literatures on this research consists of two parts, i.e. firstly describes theoretical aspect of tax audit and later effectiveness of tax auditing.

2.6. Theoretical Framework

2.1.1 Meaning of Audit

Auditing is a systematic examination of financial statements, records and related operations to determine adherence to generally accepted accounting principle, management principles or stated requirements.

2.2 Taxation Concept

Taxation is the biggest source of public revenue of the modern governments. In a democratic setup taxation is responsible for shaping the political activities of the government that are aimed at equity growth and stabilization. The term 'tax' has been used since a very long time.

2.3 Tax auditing scope

Basically taxes can be classified as direct taxes and indirect taxes. The basic distinction between Direct taxes and Indirect taxes is that whereas former is meant to be borne by the person on whom it is levied, the latter is expected to be passed on to the buyer and thus an Indirect levy on the person paying the tax.

tax.

2.3.1 Income Taxation

2.3.1.2 Income Tax Act 1974 (2031)

2.3.1.3 Income Tax Act 2002 (2058)

2.3.2 VAT in Nepal

2.3.2.1 Basic Provision on VAT

1 Registration

2 Scope of VAT

3 How is it charged?

4 Input Tax Credit Systems

5 Treatments of Exports and Imports

6 Tax invoice and other records are fundamental to obtain credit

7 VAT Rate

8 Tax Refund

9 Tax Assessment Systems

2.4 Effectiveness Concept

2.5 Auditing Policy and the Tax Auditing Process in Nepal

2.5.1 Organization of Tax Audit Operations

2.5.2 Legal Guidelines in Tax Auditing

2.5.3 Auditing Competences in General

2.5.4 Taxpayers' Record-keeping Obligations

2.5.5 Obligation to Provide Information & Access to Information

2.5.6 Rights of Inspection & Examination (Section 23 of VAT Act)

2.5.7 Right of Search & Seizure

2.5.8 Giving Tax Official Access to Third Party Information Sources

2.5.9 Management Assessment in VAT Act

2.5.10 Amended Assessment in Income Tax Act, 2058

2.6 Selecting Taxpayers to be audited

Audits are a critical and significant component of the compliance activities of revenue bodies in all countries. Faced with limited resources and relatively large numbers of taxpayers to administer, revenue bodies require a systematic risk-based approach for identifying which taxpayers to audit and effective examination techniques to ensure that each audit arrives at a reasonably accurate assessment of each taxpayer's correct tax liability.

2.7 Preparation and Planning

2.7.1 Audit - Visit Program

2.7.2 Appointment for Visit

2.7.3 Visit - Cancellations

2.7.4 Audit Teams Building

2.7.5 Preparation for Visit

2.7.6 General Review of Past Report

2.7.7 Study the Audited Financial Statement (Trading & P/L Accounts)

2.7.8 Analysis of the Balance Sheet

2.7.9 Analysis of Business Ratio

2.7.10 Other Related Information

2.7.11 Necessary Items for Auditing Works

2.8 Implementing the Audit - Plan

It is the important for the implemented audit plan to reflect reflects the overall function of the so and organization. The following steps help to make the audit function more effecting.

2.9 Completing and Reporting

2.10 Management Assessment & Amended Assessment

In the course of visit, if an officer discovers irregularities, which proves that the taxpayer has paid lesser amount of income tax and/or value added tax than is due, or has incurred penalties or interest charges; an assessment order is issued.

2.11 Computer Assessment

Especially in value added tax, there is the provision to assess by computer-program known as computer assessment. When a taxpayer fails to submit the tax return then the computer itself makes an assessment on the basis of the transaction of the previous periods. Such assessment is

being dispatched to the taxpayer's address offer being signed by tax official. If the taxpayer files the self-assessed return, the system itself replaces the previous computer assessment

2.12 Common Errors

The following common errors were found during the courses of auditing. They are:

- J PAN not found in tax invoice
- J Purchase/sales/VAT account/invoices not in prescribed format.
- J Invoice date instead of customs declaration date.
- J Improper filing of VAT related documents/Scattered in many places.
- J No tax invoice printed in the first copy of the invoices.
- J Tax invoice printed in all copies of the invoice.
- J Misuse of debit note and credit note.
- J Claim of Zero rate in the sales in foreign currency
- J Posting of many invoices in a lot.
- J Return filling and total of debit/credit
- J Excess credit in return than in purchase account.
- J Lack of original purchase bill.
- J Export document (e/c, customs declaration form, bank draft)
- J No serial number on invoice/hand-written serial number
- J Full credit claim of partial creditable goods. (e.g. Vehicles)
- J Credit claims the telephone bill of other individual instead of the taxpayer.
- J Posting of export in exempted column instead of Zero-rated.
- J Direct posing in tax return without account keeping
- J Claim of the credit of entertainment bill
- J Credit claim of the Customs deposit amount.
- J All purchase invoice of which input tax has been claimed are not related to actual tax period (related to future/past tax periods)
- J Sales invoice from actual tax period accounted for future tax periods.

2.13 International Aspects of Tax Auditing

As per Double Taxation Treaty Agreement, the competent authorities of the States under double taxation treaty shall exchange information as is necessary for carrying out the provisions the Agreement or of the domestic laws of the Contracting State concerning taxes covered by the

Agreement, insofar as the taxation there under is not contrary to the Agreement, in particular for the prevention of evasion of such taxes. Nepal has done Double Taxation Treaty Agreement with 10 countries. So, it can also be used for audit& investigation purposes.

A study by **doing Business 2011** showed paying taxes indicator of south Asian nations as follows:

Table 2.1
Paying Taxes Indicator of South Asian

Countries	Tax payment period	Average tax rate	Tax payment frequency	Relative status
Nepal	326	31.5	34	86
India	254	61.8	33	147
Maldives	0	9.3	3	1
Bhutan	274	40.8	6	67
Bangladesh	302	35	21	100
Pakistan	560	35.3	47	158
Sri Lanka	256	105.2	71	173
Afghanistan	275	36.4	8	63

Cited from Annual report of IRD

2.14 Review of Previous Researches and Dissertations

There are quite a few dissertations relating to Tax auditing in Nepal undertaken by various individuals and some institutions. Some of them are reviewed below:

“Audits are a critical and significant component of the compliance activities of revenue bodies in all OECD countries. Faced with limited resources and relatively large numbers of taxpayers to administer (especially in the SME sector), revenue bodies require a systematic risk-based approach for identifying which taxpayers to audit and effective examination techniques to ensure that each audit arrives at a reasonably accurate assessment of each taxpayer’s correct tax liability.” (Strengthening Tax Audit Capabilities: Innovative Approaches to Improve the Efficiency and Effectiveness of Indirect Income Measurement Methods, 2003:362)

“Good revenue authorities identify and assess compliance risks and develop strategies targeted at addressing those risks. These strategies include education, service, and

marketing, profiling risk, auditing, general anti avoidance efforts, prosecution and proposals for legislative change.”(OECD Practice note-Principles of Good Tax Administration, 2001:211)

2.15 Research Gap

Since the above mentioned studies offer limited finding more extensive testing and adjustment about taxation. Previous studies were find out the income tax system in Nepal, tax structure in Nepal, Tax administration and its effectiveness etc, all studies are unable to find the tax auditing system in Nepal.

Now, this study mainly focus the Tax auditing system in Nepal, related to Tax payer, Tax officer and Tax auditor and its behavior while tax auditing Nepal. Similarly this study covered the tax auditing in Nepal, composition of revenue to tax. Mention studies were failed to study the fair behavior mention parties while tax auditing system conduct. They are mainly focused their studies rules and regulation of Income tax and Vat, leakage of tax in Nepal, awareness of taxation etc.

The current study is a supplement to overcome the weakness and limitation of previous studies.

CHAPTER – III

RESEARCH METHODOLOGY

This chapter is concerned with detail discussion of the methodology used in this study by covering the procedure of getting research problems answers as per the objectives. There are four parts as Research Design, Nature and source of data, Data collection procedure and Data processing and Analysis procedures.

3.1 Research Design

This study is to measure the effectiveness of tax auditing system of IRD. It was qualitative in nature and based on survey as well as secondary data. The data was descriptive and explorative in nature. The analysis was done on basis of available data, views of stakeholders and associated personnel so as to bring in rating scale to evaluate or measure the effectiveness of tax audit. Some quantitative secondary data were also taken so as to analyze the effectiveness of tax auditing in Nepal.

3.2 Source of Data

The study was qualitative and subjective in nature. The study was basically depending upon secondary data. However, primary data, collected from different field of taxation as stated above, were used to reach in conclusion.

3.3 Population and Sample of the Study

All tax officers, business firms (taxpayers) and tax auditors (include both registered business auditors and revenue auditors from OAG/N) are population of the study. Therefore, sample research was carried out in this study. The sample size was taken 70 number of population and it was divided into three different groups, i.e. tax officials, business firms(taxpayers) and tax auditors (include both registered business auditors and revenue auditors from OAG/N) and equal

chances of being selected heterogeneously. Three sets of structured and close-ended questionnaire (Annex-I) were prepared with sufficient coverage of audit works to reach to the conclusion.

3.4 Method of Analysis

The data were properly organized and presented in appropriate tables, charts and graphs. The percentage and trend analysis were used to analyze the data. The conclusions, recommendations are based on study findings and various reference materials.

3.5 Data Processing and Analysis Procedures

For the analysis, all collected data and information of various aspects of income tax was arranged in order and processed. Then, the descriptive tools and statistical tools such as simple percentage, simple average, graphs, charts, diagrams, Table time series analysis, have been applied in the way of analysis so that the findings could be presented and interpreted precisely and properly in order.

CHAPTER – IV

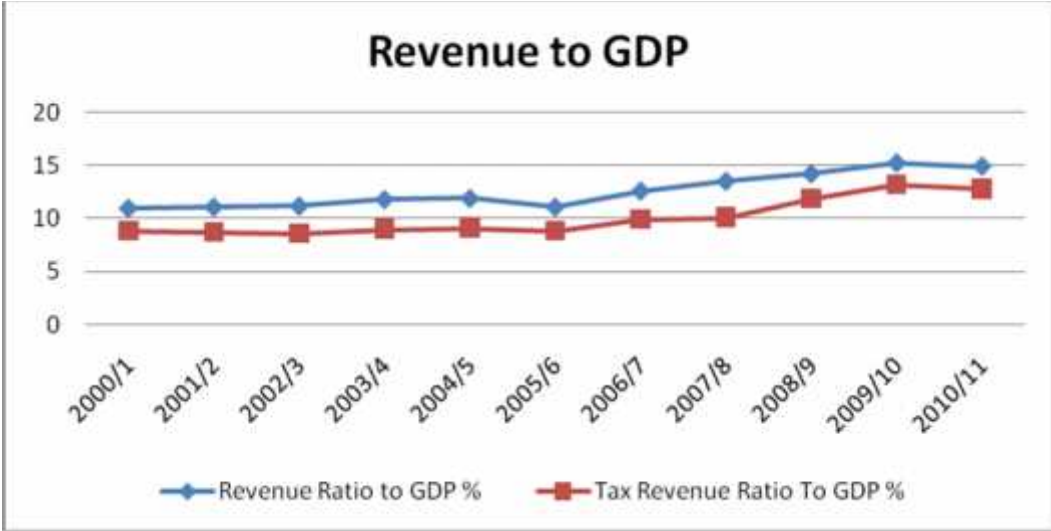
PRESENTATION AND ANALYSIS OF DATA

This chapter deals with the present status of tax audit through secondary data. Secondary data derived from the authorized agency’s publication were used to examine the present status of tax administration.

4.1. Secondary Data Analysis

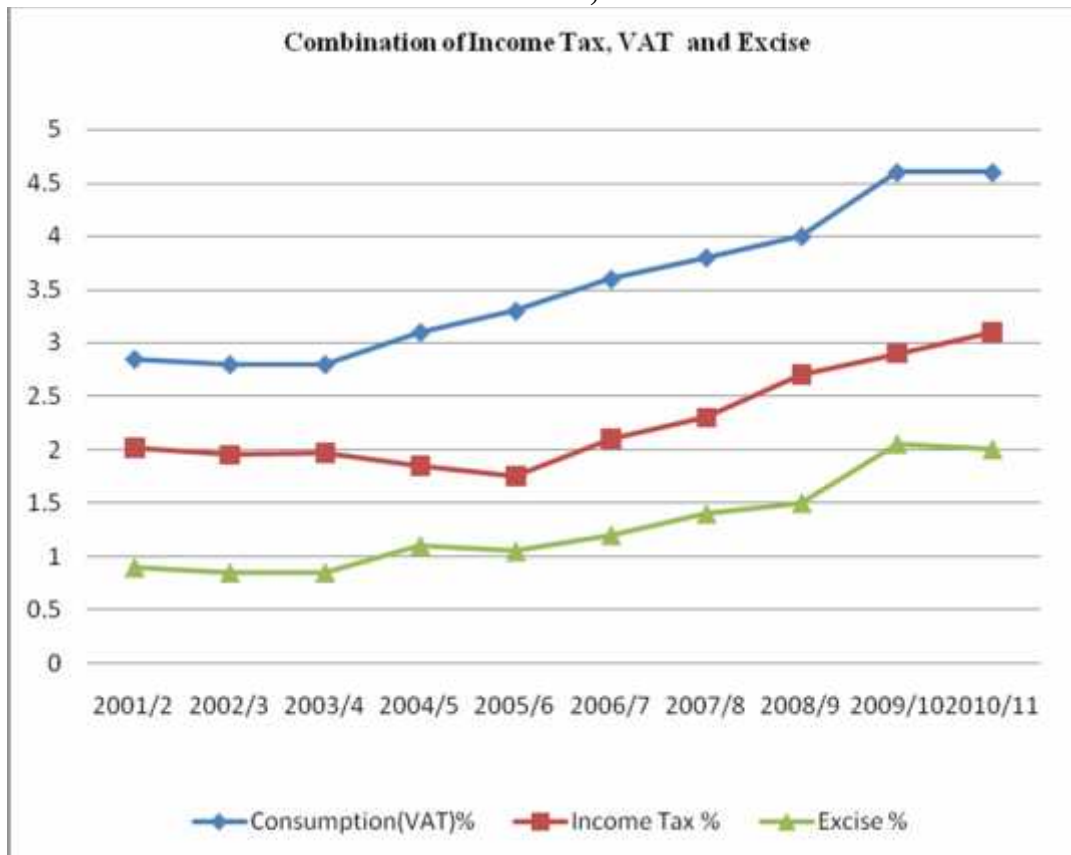
4.1.1. Tax Revenue Contribution to Treasury

4.1 Figure



Source: - Economic Survey 2010/11 Government of Nepal, Ministry of finance

4.1.2 Combination Ratio of Income Tax, VAT and Excise to GDP

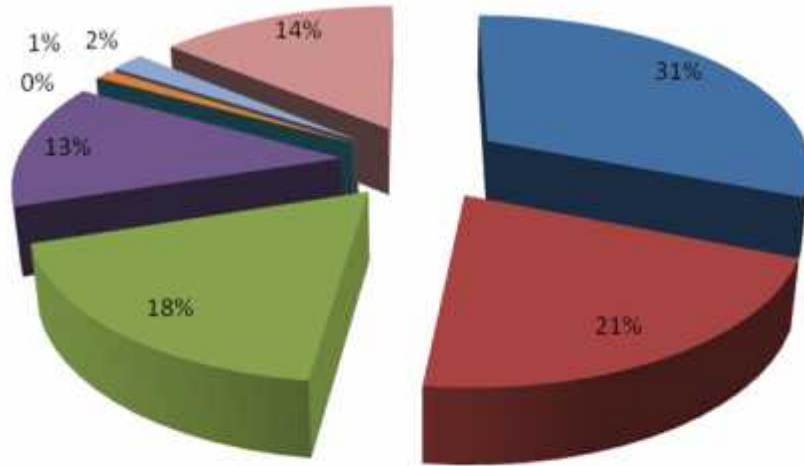


4.1.3 Structure of Revenue Contribution

4.3 Figure

Structural Revenue Contribution (FY 2010/11)

■ VAT ■ Income Tax ■ Custom ■ Excise
■ Education Fee ■ Registration Fee ■ Vehicle Tax ■ Non-Tax Revenue

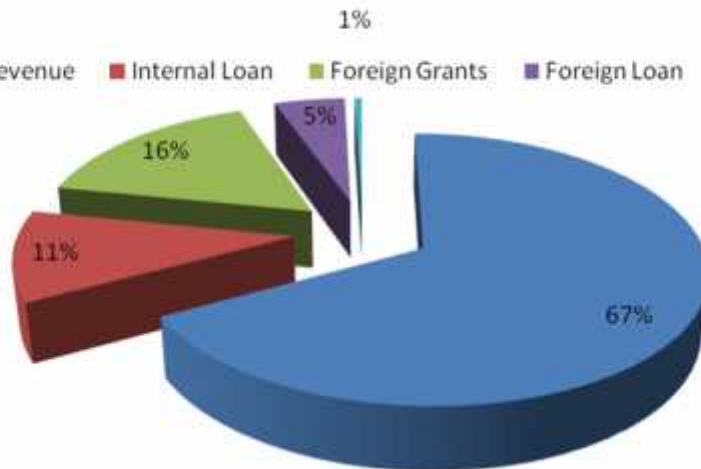


4.1.4 Government Expenditure & Source of Finance

4.4Figure

Government Expenditure & Sources of Finance %

■ Revenue ■ Internal Loan ■ Foreign Grants ■ Foreign Loan ■ Cash(+){-}



4.1.5 Revenue Target and Achievement

Table 4.1

NPR '000'

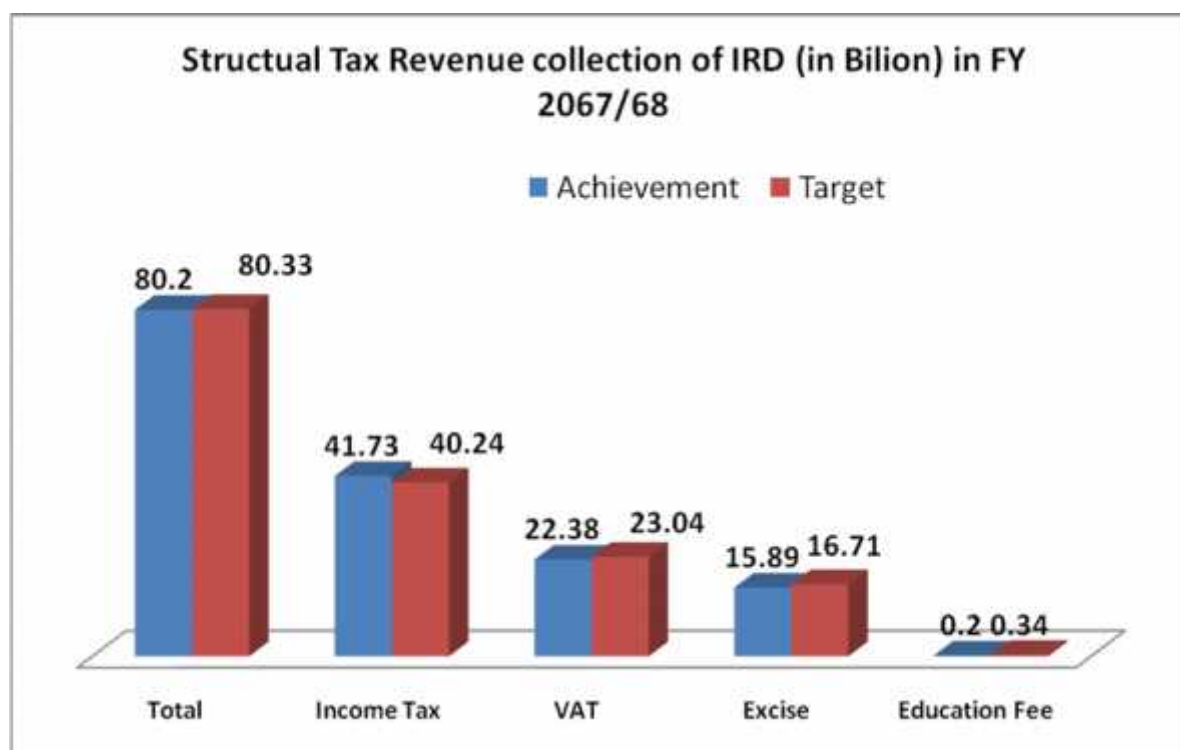
Fiscal year	2063/64	2064/65	2065/66	2066/67	2067/68
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Target					
Tax Revenue	48,81,70,00	58,12,68,00	85,66,00,00	1,06,49,99,00	1,3722,53,37
VAT	26,46,30,00	29,65,19,00	41,00,00,00	51,56,00,00	67,37,16,28
Income Tax	12,71,05,00	16,86,92,00	27,08,70,00	36,29,80,00	40,24,23,32
Excise	8,63,75,00	10,52,32,00	14,07,30,00	18,64,19,00	29,61,13,77
Achievement					
Tax Revenue	51,85,25,86	61,15,22,97	83,18,57,06	1,13,04,82,90	1,29,87,69,68
VAT	26,09,55,99	29,81,57,02	39,70,09,21	54,92,08,56	61,69,28,48
Income Tax	15,73,18,04	19,07,78,13	27,24,73,86	33,82,13,27	41,72,57,31
Excise	9,34,31,87	11,18,95,75	16,23,73,98	24,60,61,07	26,45,83,89
Annual Growth Rate%	30	18.64	39	36	15

Source: Tax collection Department of IRD **Note: Note mention the Export VAT and Excise in above table.**

Total tax revenue was collected as per are in the year 2063/64, 202064/65 and 2066/67 and failed to achieve target in the year 2065/66 and 2067/68, however these year IRD close to the target.

4.5 Figure



During FY 2067/68, IRD achieve almost all tax revenue as per estimation the target. Total Tax Revenue collection to IT, VAT and Excise is 52%, 28% & 20% respectively.

4.1.6 Revenue Collection Costs

The following table 4.2 shows the tax collection costs from F/Y 2063/64 to 2067/68. The revenue collection cost is considered as significant indicator for the measurement of the organization's effectiveness. The cost of collection has gone down when excise tax was included and such cost is mainly borne by the enterprise selling the goods. The cost of collection as compared to the European countries is low. When cost of collection is less than 0.5 percentages, it is considered good. It should, however, be remembered that European tax authorities collect value added tax and tax from all businesses including the small business where the cost of collection is higher.

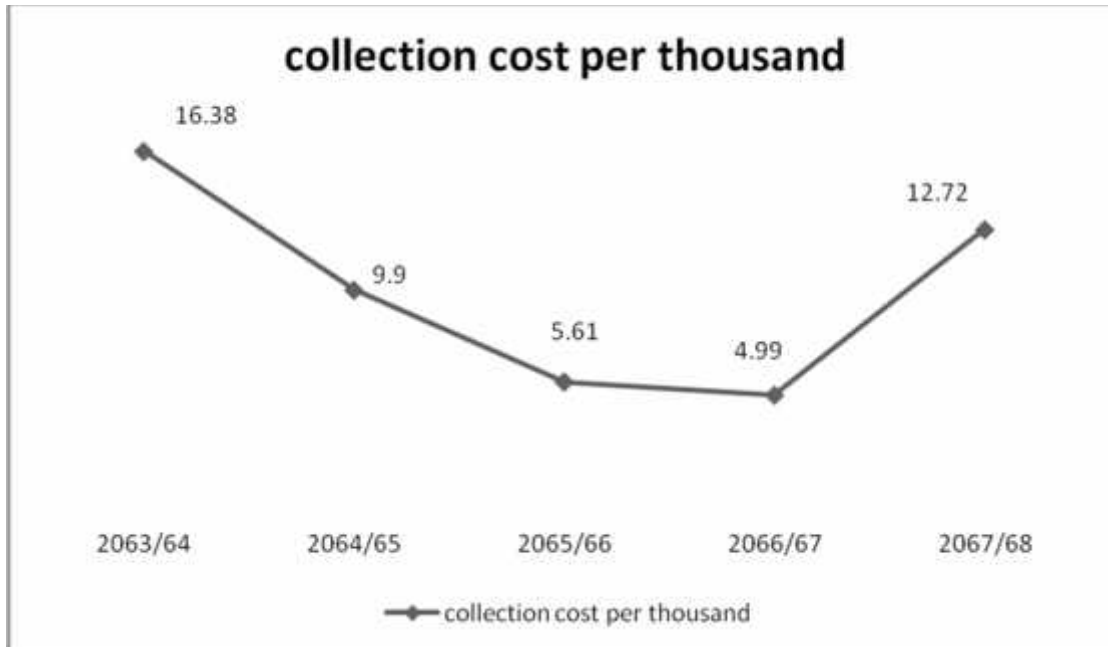
Revenue Collection Cost

Table 4.2

Particular	Fiscal year 2063/64	Fiscal year 2064/65	Fiscal year 2065/66	Fiscal year 2066/67	Fiscal year 2067/68
Inland Revenue Expenditure (Rs in '000')	5,32,174	3,82,301	2,94,448	3,32,099	10,20,360
Total Collection (Rs in '000')	3,24,88,609	3,86,14,074	5,24,23,097	6,66,09,402	8,02,06,262
Collection cost for per thousands in Rs	16.38	9.90	5.61	4.99	12.72

Source: Tax collection Department of IRD

Figure 4.6 Revenue Collection Cost

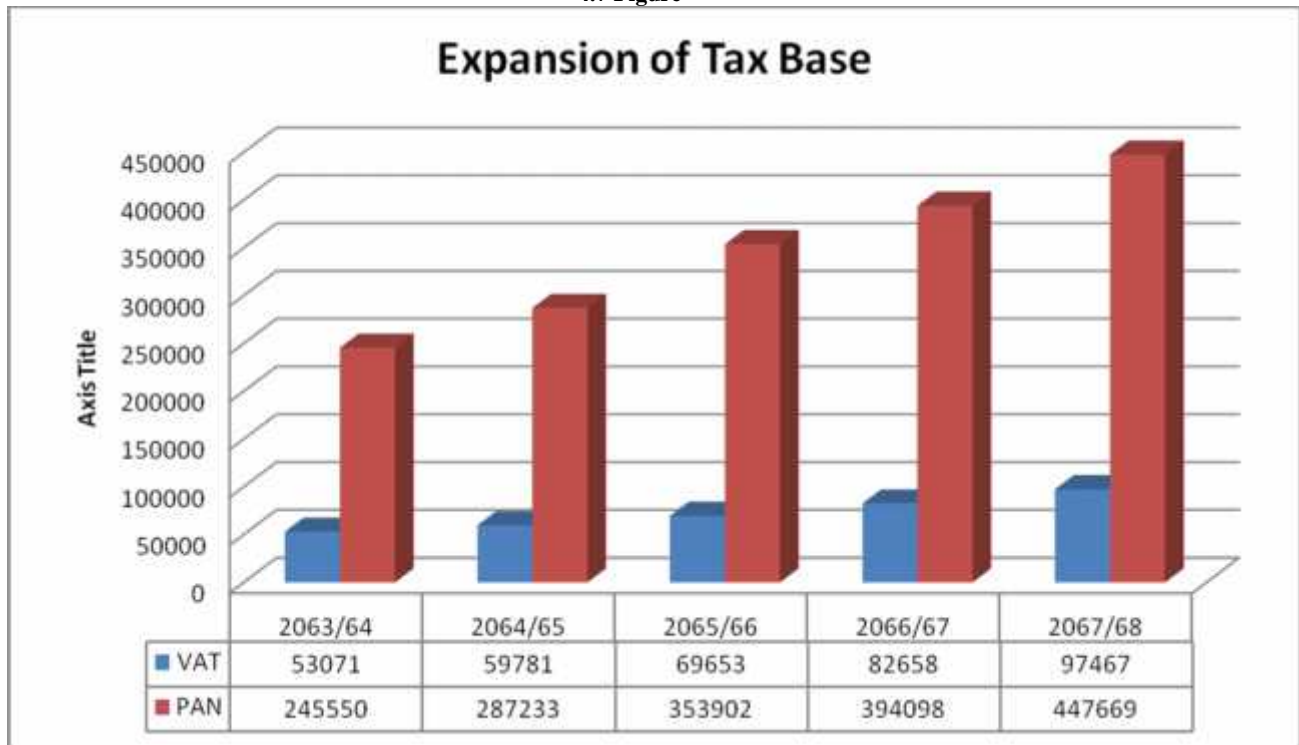


According to the report of IRD, revenue collection cost per thousand was Rs. 4.99 in 2066/67 but it was highly increased i.e. 12.72 in 2067/68 that is mainly due to increase in capital expenditure.

4.1.7 Tax Coverage and expansion of Tax Base

As per the IRD stretched the tax policy the registration in PAN and VAT is increased dramatically and achieved higher than target. The PAN registration is 55,563 person where as target is only 44,325 only. Similarly Registration in VAT is 14,797 person where as target is 12,660 Person. This is improved by 117% during last fiscal year 2067/68. Likewise Excise license renewal is 23,994 where as target is 22,140 only.

4.7 Figure



Source: Tax collection Department of IRD

4.1.8 Composition of Income Tax return

The Tax payer categories three parts Day1, Day 2, and Day 3 in basis of income transaction of tax payer. But the categories are changed only two type Day1 and day 3 since FY 2067/68 and reduce the Day 2 category. The pre forecasting of income transaction up to 2 million entity lies on day 1 category and other taxpayer lies on day 3 category.

4.8 Figure



During FY 2067/68 total income tax payer who lies on D3 is about 39% of total payer and 69% of D1 taxpayer. 2065/66 2066/67 2067/68

4.1.9 Composition of VAT

The registration in VAT taxpayer submitted their transaction timely on nearby IRD office. Generally, Taxpayer Debit VAT returns, Credit VAT returns and Zero VAT returns data are submitted in Tax office. Debit VAT returns show the VAT paid to Government and Credit VAT returns show VAT returns from Government and Zero VAT returns indicates no transaction of Taxpayers.

4.3 Table

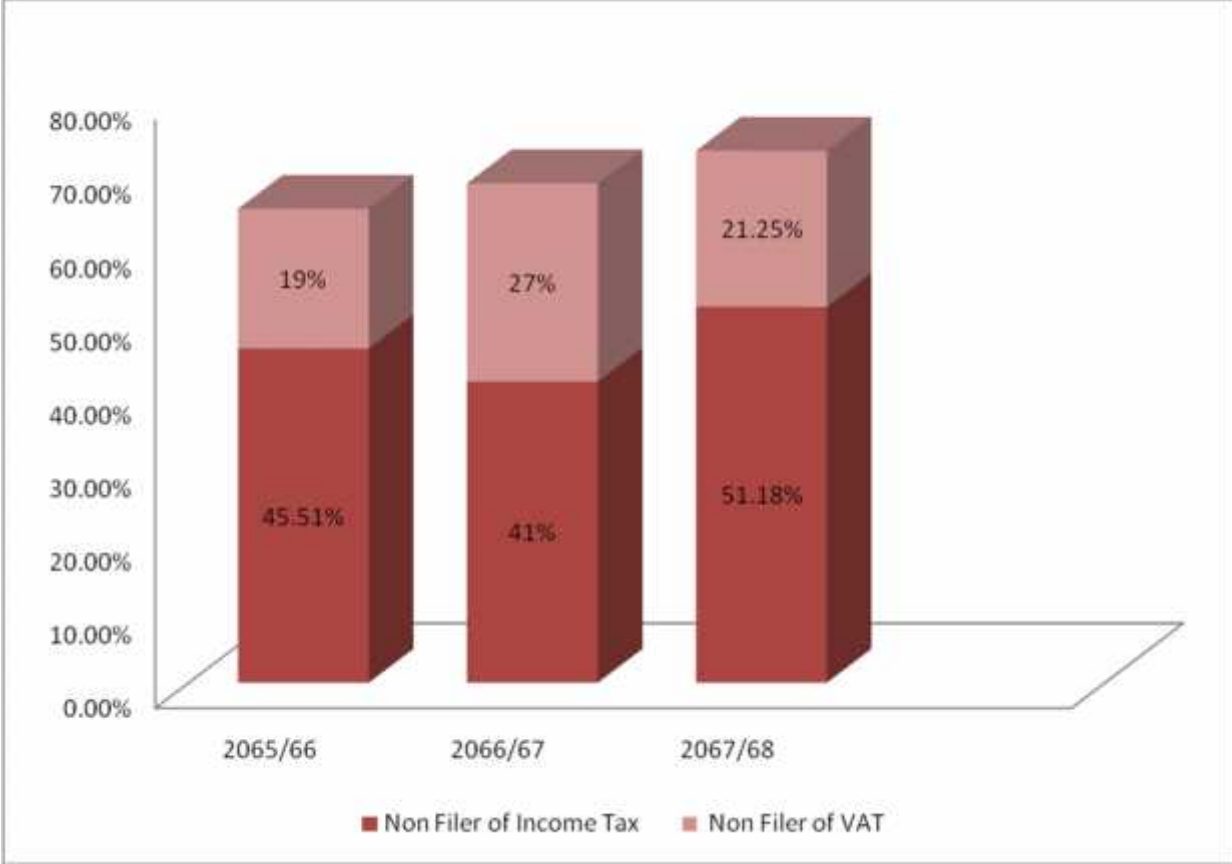
	2065/66	2066/67	2067/68
% of Debit VAT Returns	18.8%	17.3%	18%
% of Credit VAT returns	53.60%	49.90%	49%
% of Zero VAT returns	27.5%	32.80%	33%
Total Debit amount (in Billion)	Rs.8.92	Rs. 14.72	Rs. 19.03
Total Credit amount (in Billion)	Rs.26.36	Rs. 63.46	Rs. 106.96
Ratio of Credit AMT to Debit AMT(in times)	2.96 times	4.31 Times	5.62 Times

Source: information and Technology Department of IRD

4.1.10 Compliance of Taxpayer

Registered Taxpayer should pay the Income tax and VAT timely in the basis of their transaction as per the Tax Act; it is legal provision in Nepal. The transaction is not clean who not submitted Tax timely to Government as per Act.

4.9 Figure Compliance Chart



In above chart mention, the high no of Registered Taxpayer who are Non filer the Tax as per tax Act. There are found Non filer of Income tax is more than Non filer of VAT. During FY 2067/68, non filer of income tax is about 51.18% and Non filer of VAT is about 21.25%, only about 20% of registered Taxpayer paid tax on time. The data shows highly evasion of Tax in Nepal. It should be control by the Nepal Government in coming days.

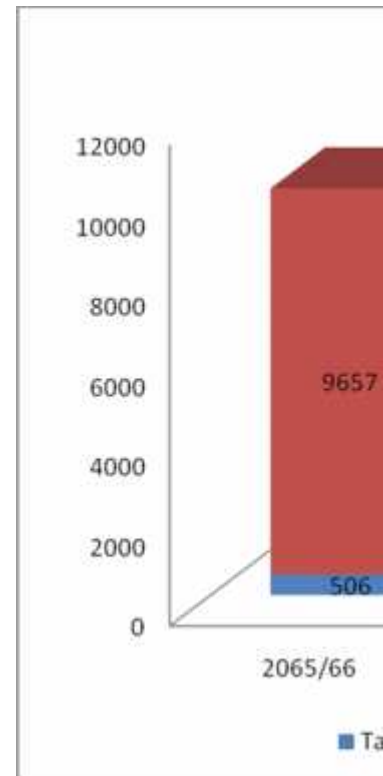
4.1.11 Tax Payer education

Registered Taxpayer should be obliged as per legal provision in Act and all taxpayer known their obligation towards government but all taxpayer not known their duties as per the Act. So the government aware and provide the information about provision in Tax Act.

4.10 figure Tax education

Table 4.4
Selection of Taxpayer for Audit and Investigation

Fiscal year	Total registration of taxpayer	Selection for audit and investigation	Percentage of selection for audit
2066/67	4,76,756	6,277	1.31
2067/68	5,45,136	5,920	1.08



4.1.12

The table 4.4 shows the **Taxpayer for Audit and Investigation** in the fiscal year 2066/67 and 2067/68. The above data indicates that IRD is using different type of auditing system so that tax evasion will be reduced as desired and efficiency on self-assessment is increased. It seems that performance in-group audit is poor whereas TDS audit is performing well and increasing. It's also observed from the above table that most of the functions of VAT were displayed in functional target than income tax functions. IRD organization has been administrating functional line in VAT than income tax even after merging both the existing organization into IRD.

Source: Annual report of IRD.

Table 4.5
Statement of Tax audit and Investigation NPR in thousands

S.N	Work Statement	No. of Audit and Investigation		Due Amount	
		2066/67	2067/68	2066/67	2067/68
1.	Full Audit	3566	2571	62,51,295	58,88,159
2.	Detail Investigation	386	513	1,91,191	9,76,888
3.	EDP audit	37	67	31,764	41,519
4.	Stock Verification	392	285	77,126	98,466
5.	Link Audit	120	177	42,607	1,08,390
6.	Registration Cancel	1,361	1,853	3,215	
7.	Tax determination not tax payer	415	454	98,005	2,69,323
Total		6,277	5,920	66,95,167	73,82,745

Source: Annual report of IRD.

4.1.13 Human Resources in Audit

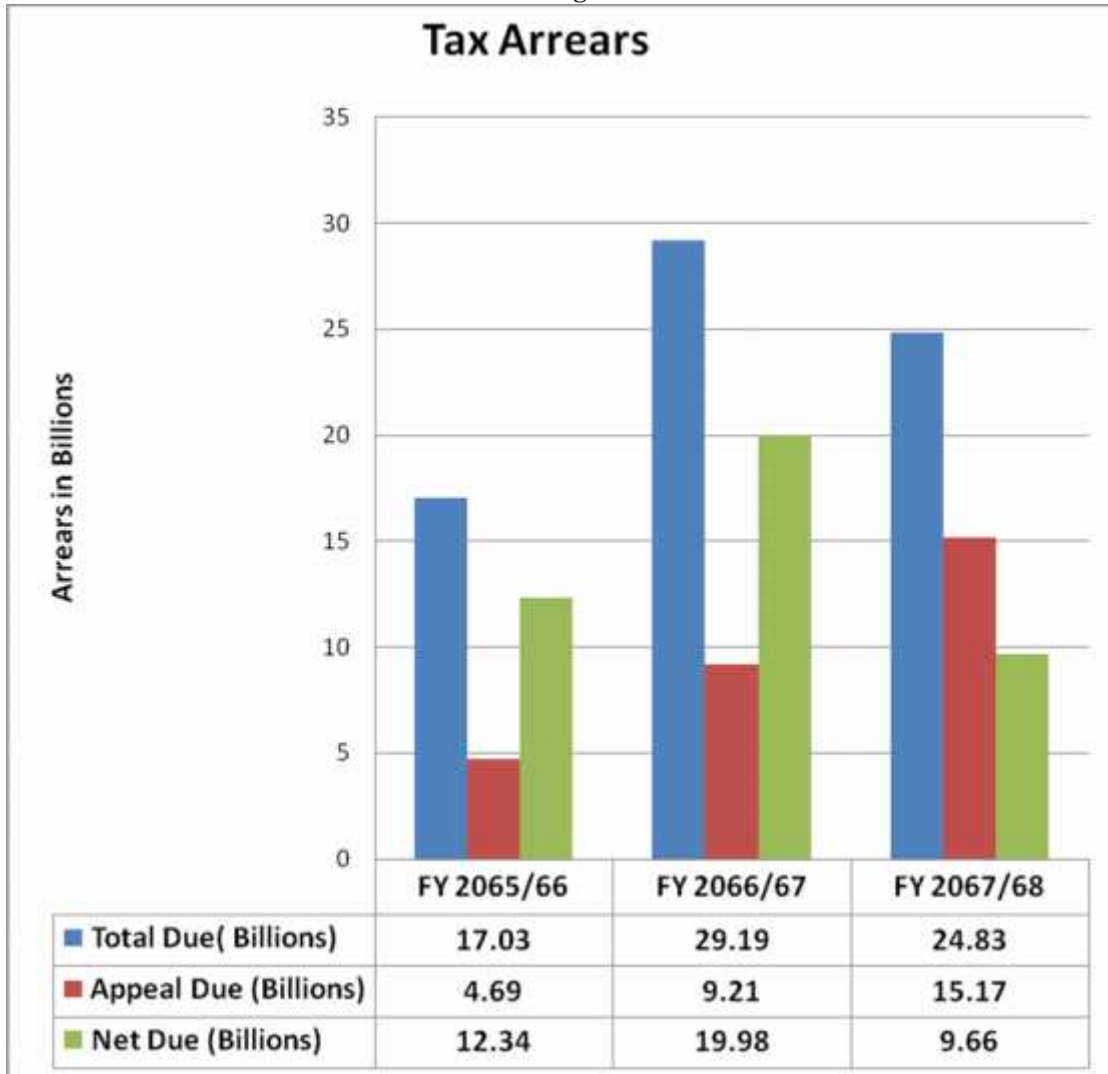
Table 4.6
Auditing Staffs

Fiscal year	Audit staff	Total staff in department	Audit staffs in total staff percentages
2006/7	165	924	17.8
2007/8	165	924	17.8
2008/9	170	924	18.83
2009/10	195	882	22.10
2010/11	195	882	22.10

Source: - Annual Report of IRD

4.1.14 Tax Arrears

4.11 Figure



Source: - Annual Report of IRD

4.2. Primary Data Analysis (Survey Data)

4.2.1. Analysis and Interpretation of Survey Data

The finding of survey data were tabulated and classified to make the use of statistical tools easy. Such data were categorized so as to meet the purpose. The findings of objective questions are as follow:

Table 4.7
Respondents

Name	Frequency	Percent
Tax officials	15	100
Business firms	27	90
Auditors	23	92
Total	65	92.85

Source: Field Survey, 2012

Table 4.7 shows that out of total 75 questionnaires, tax officials have cent percent and all together 70 had responded. Out of 23 respondent auditors 4 were revenue auditors from OAG/N.

Table 4.8

Qualities of IROs Service

Indicator	Frequency
Worse	10
Average	30
Good	9
Best	1

Source: Field Survey, 2012

Table 4.9

Improvement of Service Quality of IROs

Indicator	Frequency
Yes	25
No	21
Don't know	-
Don't response	-

Source: Field Survey, 2012

Table 4.10

Do You Know Audit

Indicator	Frequency	Percent
Yes	25	92.5
No	2	7.5
Total	27	100

Source: Field Survey, 2012

Table 4.10 shows that 92.5% know what is audit and 7.5% do not have knowledge about audit.

Table 4.11

Overall Qualities of Tax Audit

Indicator	Frequency	Percent
Very good	15	23
Fair	35	54
Worse	10	15
Don't know	5	8
No answer	-	-
Total	65	100

Source: Field Survey, 2012

Table 4.11 shows that 54 percent respondents' rated overall qualities of tax audit fair and very good have go t23 percent only that are most of tax officers. No views has revealed by 8 percent.

Table 4.12

Tax Officers' Behavior during Audit

Indicator	Frequency	Percent
Friendly & Cooperative	31	67.4
Suspicious	10	21.7
Rude	5	10.9
Total	46	100

Source: Field Survey, 2012

The table shows that majority of respondents favored for tax officials' behavior during audit.

Table 4.13

Tax Officer's Honesty and Transparent in Tax Auditing Procedure

Indicator	Frequency	Percent
Yes	21	42
No	11	22
No answer	18	36
Total	50	100

Source: Field Survey, 2012

Table 4.13 shows that 36 percent did not response about the honesty of officers and transparency in work while 42 percent favored tax officials.

Table 4.14**Present Tax Audit Targets**

Indicator	Frequency	Percent
Sufficient	9	60
More than expectation	5	33.33
Less than expectation	1	6.67
Total	15	100

Source: Field Survey, 2012

The above table shows that 60% officials are satisfied with present audit target.

Table 4.15**Achievement of Tax Audit Targets**

Indicator	Frequency	Percent
Yes	13	86.67
No	2	13.33
Total	15	100

Source: Field Survey, 2012

The above table shows that 86.67 percent officials have finished their audit job in time; and 13.3 percent did not achieve their audit target.

Table 4.16**Monthly Performance of Audit Target**

Indicator	Frequency	Percent
One	2	13.33
Two	4	24
Three	7	52
More	2	16
Total	15	100

Source: Field Survey, 2012

Table 4.16 shows that 16% performed tax audit of more than three taxpayers per month and 52 per cent has performed tax audit of three and 24 percent has completed tax audit of two only.

Table 4.17**How Many Taxpayers should be audited in a Year?**

Indicator	Frequency	Percent
All	18	27.6

5% of total	37	56.9
10% of total	10	16.1
Total	65	100

Source: Field Survey, 2012

Table shows that 56.9% percent respondents favored for 5% of total taxpayers should be audited. 16.1 percent are in favor of 10% and 27.6 percent are in favor of 100%.

Table 4.18

Taxpayer's Co-operation for Audit

Indicator	Frequency	Percent
Yes	6	40
No	9	60
Total	15	100

Source: Field Survey, 2012

Table 4.19

Need of Competencies of Tax Auditors for Effectiveness of Audit

Indicators	Frequency	Percent
Yes	46	92
No	-	-
Don't know	4	8
Total	50	100

Source: Field Survey, 2012

Table 4.20

Competencies of Tax Auditors

Indicators	Frequency	Percent
Inadequate	31	62
Fair	18	36
Enough	1	2
Total	50	100

Source: Field Survey, 2012

Table 4.21
Effectiveness of Audit

Indicators	Frequency	Percent
Yes	11	22
Less effective	7	14
No	28	56
Don't know	4	8
Total	50	100

Source: Field Survey, 2012

56 percent respondents had negative answer towards effectiveness of audit whereas 22 per cent had positive attitude on this.

Causes for Ineffectiveness of Audit

Out of 28 respondents, who believe audit is ineffective, 16(57%) people consider poor selection criteria is the main reason for it whereas 12(43%) people consider lack of competencies of tax auditors.

Table 4.22
Need of Separate Audit Policy

Indicators	Frequency	Percent
Yes	23	60.5
No	7	18.4
Don't know	8	21.1
Total	38	100

Source: Field Survey, 2012

Out of 23 respondents who favored for separate audit policy, 17(74%) respondents gave emphasis on both audit techniques and competencies of tax auditors.

Table 4.23

Adequacy and Objectiveness of Selection Techniques

Indicators	Frequency	Percent
Yes	27	71
No	6	15.8
Don't know	5	13.2
Total	38	100

4.3. Major Findings of the Study

4.3.1 Major Findings from Secondary Data

- **Total tax revenue collected / GDP:**
- **Total Revenue Estimation/Total Revenue Collection:**
- **Number and types of tax returns/Number of registered tax payer**
- **Composition of Income Tax and VAT:**

- **Tax Arrears:**
- **The taxpayer's selection for audit:**
- **Audit target and achievement:**
- **Staff Engagement:**
- **Compliance through registration:**
- **Revenue collection cost:**
- **4.3.2 Major Finding from Questionnaire Survey**

The summaries of survey findings are as follows:

- **Qualities of IROs service:**
- **Overall qualities of tax audit and tax auditors' behavior:**
- **Tax officer's honesty and transparent in tax auditing procedure:**
- **Present tax audit targets and Achievement**
 - **Competencies of tax auditors and effectiveness of audit:**

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

This research work entitled, “Tax Auditing system in Nepal, A Study of Nepalese Tax Auditing System”, has been carried out to ponder into the theoretical knowledge of Tax auditing and to examine the tax system of Nepal. The study has been divided into five broad chapters. The contents of those chapters are as follows Chapter:

I: Introduction Chapter

II: Review of Literature Chapter

III: Research Methodology Chapter

IV: Presentation and Analysis of Data Chapter

V: Summary, Conclusion and Recommendations

The first chapter begins with the brief background of the study, i.e., the introduction to Taxation and Tax auditing itself, its types and all relevant information about Taxation which is essential for having some understanding about VAT and Income tax the main topic. The chapter also goes on to discuss the main focus of the study, research questions, and objective of the study, significance, limitations and organization of the study.

In the second chapter, theoretical framework of Tax Auditing has been discussed. This chapter includes introduction to Audit, Income tax, Vat in Nepal, Effectiveness of Taxation, Auditing policy and the Tax auditing Process In Nepal, Basic Provision of VAT, Income Tax Act, Legal guidelines in Tax auditing.

5.2 Conclusion

The contribution of total revenue to GDP reached to 12.8 percentages in the year 2010/11. The tax revenue and Inland Revenue to GDP ratio is increasing trend. GON succeeded to collect total revenue as per estimation in the fiscal last two year 2009/10 and 2010/11 respectively. It is also increasing trends, in future obviously total revenue to be collected as per the estimation.

5.3 Recommendations

Audit policies and procedures should be based on principles of accuracy, efficiency, fairness,

objectivity, transparency, completeness, consistency, and defensibility.

1. IRD should improve understanding of taxpayers' compliance and the effectiveness of compliance improvement programs **by developing a compliance-monitoring framework**. Such a framework, which can be progressively enhanced over time, should embody a range of measures and indicators for each of the major risk types for the major taxes administered by the IRD.

2. The IRD's strategy for taxpayer audit needs to be further developed to provide information and proposals to address the issues– in particular:

- Improving the focus and conduct of audits;
- Strengthening capability; and

Recommendation on MIS

1. The IRD should review its technology strategy – including the range of tools required so that the principles identified in the audit strategy are implemented as a priority. The review should clarify the inter-relationships between MIS (Pro-Tax) technology and audit strategies, and ensure that they are implemented and monitored in a co-coordinated way.

Recommendation on Audit Technique

Presently tax auditors focus their effort on prohibited expense part of the income report. It should be changed to supervision of income part.

1. There is no proper segmentation of taxpayers before selecting them for the audit purpose. Keeping all taxpayers in the same basket and adopting it breaking line for each one to measure their compliance level is also not appropriate. Therefore, taxpayer rating system should be introduced for segmentation of taxpayers based on past audit performance and profile.

Recommendation on Human Resource Management

Retention of competent staff is crucial. Without retention of competent staff tax audit activities will not achieve their objectives. Therefore, IRD should focus on its HR strategies.

1. IRD should identify and develop a system of capability / competency models in place that describes formal specification of the skills (including knowledge) that are required to perform audit work in a competent (i.e. efficient and effective) manner. The qualifications for

recruitment of new tax officers need to be revised. Greater emphasis should be given to accounting training in an academic setting as opposed to obtaining candidates with economics or law degrees.

Other Recommendations

1. Audit and investigation working manual should be updated with the help of the team of experts. Working manual should be developed with international standard.
2. Specific segments of non-compliance should be targeted as per compliance model. For example a taxpayer belongs to upper half of compliance model should be addressed by audit & investigation functions whereas taxpayer belongs to lower half need taxpayer services.
3. The IRD should identify the case management requirements of taxpayer audit, and purchase and/or create tools to meet these requirements.
4. IRD should not have responsibility for tax cases. It should focus exclusively on prescribing policies and procedures for audit and monitoring audit in the field to ensure conformity and consistency.

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Questionnaire for Research work

Dear sir/Madam

I am a student of Master's Degree of Business Studies (M.B.S.) of Trivhuvan University and conducting a research entitled **Tax Auditing System in Nepal** to complete the Masters' Degree, as thesis is one part of the course. I would be grateful if you cooperate in responding thesis questions.

The information that you provide will be strictly and exclusively used for the purpose of this research only.

Yours,

Sachindra Hari Subedi

Balkumari College, Narayangarh

Personal Details:

Name

Sex: Male Female

Age.....Year

Permanent address:

Residence (District):

Designation:

Place of work:

Set – A (For businessman/taxpayer):

Questionnaire

1. How long have you been paying taxes? Please tick (✓)

Year	1	2	3	4	5	More

2. Do you have business contact with tax officer/tax personnel?

Month	Tick (✓)
Every Month	<input type="checkbox"/>
Three Months	<input type="checkbox"/>
Six Months	<input type="checkbox"/>
Never	<input type="checkbox"/>

3. What purpose have you visited to the tax office/tax officials for?

- Filing tax returns & paying taxes
- Receiving tax clearance & receiving information
- Tax refund
- Tax audit
- Others

4. How would you get information relating to tax?

- Newspaper
- Radio Television
- Internet
- Tax official
- Tax consultants

5. How would you rate quality of services of Inland Revenue Offices?

- Worse
- Average
- Good
- Best

6. Do you feel, the qualities of services in IROs are improving in recent years? Please Tick (✓)

- Yes
- No
- Don't know

7. If Not, Which services are poor?

- Taxpayer service
- Tax collection
- Tax audit

8. Do you know tax audit?

- Yes
- No

9. How do you differentiate business audit to tax audit?

- Both are same
- One audit by tax officials and other by business auditor

10. Do you know the tax auditing procedure?

- Yes
- No

11. Do you present during your tax audit?

- Yes
- No

12. If not, who will coordinate your tax audit programme?

- Manager/accountant
- tax consultant
- business auditor

13. Do tax official help you during tax audit?

- Yes
- No

14. How do think about tax official behaviour during the audit?

- They are friendly and cooperative and try to educate us.
- They are suspicious and always observe us as a tax evader.
- They are rude and always think how to assess additional tax

15. How do you feel when tax officials assess additional tax after tax audit?

- That's not fair.
- Its' ok, as we have had mistake.

- It'll help us to make correction.
- Do not know

16. How do you rate overall quality of tax audit?

- Very good
- Fair
- Worse
- Do not know

17. Do you feel tax officials are honest and transparent in the process?

- Yes
- No
- Don't know

18. Would you please make some suggestions to make audit function more effective and to improve overall performance level of tax administration?

.....

.....

Thank you for your effort and time.

Set 2 (For Tax officials):

Questionnaire

1. How many taxpayers should be audited a year?

- All
- 5 % of total
- 10 % of total

2. Does taxpayer cooperate during the tax audit?

- Yes
- No

3. If not, what might be the cause?

- Tax audit is painful to them.
- It adds the tax burden.
- Ignorance
- Noncompliance

4. Do you feel audit selection techniques are satisfactory and objective?

- Yes
- No
- Don't know

5. If not, what are the reasons?

- Majority is selected by IRD.
- Poor selection criteria
- Lack of consistency in selection criteria
- Others

6. Do you think IRD should delegate its power of selecting taxpayers to IROs.

- Yes
- No

7. How many audits do you perform per month?

- One
- Two
- Three
- More than that

8. How do you take audit target set by IRD?

- Sufficient
- More than expectation
- Less than expectation

9. Do you achieve your target?

- Yes
- No

10. If not, what are the causes for it?

- Ambitious target set by IRD.
- Engage in other function.
- Taxpayers do not cooperate in this matter.
- Weak execution of law

11. How do you rate your competencies to perform the audit?

- Inadequate
- Fair
- Enough

12. Do you think your skill may play vital role for the effectiveness of audit?

- Yes
- No
- Don't know

13. Do you think audit are effective?

- Yes
- Less effective
- No
- Don't know

14. If not, what are the causes? Please rank more important to less.1 to

- Poor selection criteria
- Lack of competencies
- Selection based on subjective forces
- Lack of transparency
- Other

15. Have you felt any changes in taxpayer attitude and other behaviour after the tax audit?

- Yes
- No
- Don't know

16. Do you feel tax audit may have effect on taxpayer's compliance?

- Yes
- Not yet all

17. Do you feel IRD should have separate audit policy?

- Yes
- No
- Don't know

18. If yes, which part should be focused in the policy?

- Audit technique
- Competencies of tax auditors
- Both
- Don't know

19. How do you rate overall quality of tax audit?

- Very good
- Fair
- Worse
- Do not know

20. Would you please make some suggestions to make audit function more effective and to improve overall performance level of tax administration?

----- Thank you for your
effort and time.

Set 3 (for Business/Revenue auditors)

Questionnaire

1. Do you have any experience of tax audit?

- Yes
- No

2. If yes, how?

- I'm a taxpayer also.
- I assist and represent my client during the tax audit.
- I'm a revenue auditor from OAG/N.

3. How would you rate quality of services of Inland Revenue Offices?

- Worse
- Average
- Good
- Best

4. Do you feel, the qualities of services in IROs are improving in recent years? Please Tick

(✓)

- Yes
- No
- Don't know

5. If Not, Which services are poor?

- Taxpayer service
- Tax collection
- Tax audit

6. How do think about tax official behaviour during the audit?

- They are friendly and cooperative.
- They are suspicious and always observe taxpayer as a tax evader.
- They are rude and always think how to assess additional tax

7. Do you think competencies of tax officers may play vital role for the effectiveness of audit?

- Yes
- No
- Don't know

8. How do you rate competencies of tax officers to perform the audit?

- Inadequate
- Fair
- Enough
- Don't know

9. Do you feel tax officials are honest and transparent in the process?

- Yes
- No
- Don't know

10. Have you felt any changes in taxpayer attitude and other behaviour after the tax audit?

- Yes
- No
- Don't know

11. Do you think audit are effective?

- Yes
- Less effective
- No
- Don't know

12. If not, what are the causes? Please rank more important to less.1 to

- Poor selection criteria
- Lack of competencies
- Selection based on subjective forces
- Lack of transparency
- Other

13. Do you feel IRD should have separate audit policy? (For revenue auditor only)

- Yes
- No
- Don't know

14. If yes, which part should be focused in the policy? (For revenue auditor only)

- Audit technique
- Competencies of tax auditors
- Don't know

15. How many taxpayers should be audited a year? (For revenue auditor only)

- All
- 5 % of total
- 10 % of total

16. Do you feel audit selection techniques are satisfactory and objective? (For revenue auditor only)

- Yes
- No
- Don't know

17. How do you rate overall quality of tax audit?

- Very good
- Fair
- Worse
- Do not know

18. Would you please make some suggestions to make audit function more effective and to improve overall performance level of tax administration?

Thank you for your effort and time.

The End