

**A STUDY ON
"OVERVIEW OF TAX AUDITING SYSTEM
IN NEPAL"**

A Thesis

Submitted to:

Office of the Dean

Faculty of Management

Tribhuvan University

By:

Iswari Khadka

Tribhuvan Multiple Campus

T.U. Regd. No. 7-2-49-621-2003

**In Partial Fulfillment of the Requirements for the
Master's Degree of Business Studies (M.B.S.)**

Palpa

August, 2011



त्रिभुवन विश्वविद्यालय
Tribhuvan University
त्रिभुवन बहुमुखी क्याम्पस
Tribhuvan Multiple Campus

तानसेन, पाल्पा, नेपाल
Tansen, Palpa, Nepal
☎ 075-520030, 520114, 520116
Fax : 075-520114
क्याम्पस प्रमुखको कार्यालय
Office of the Campus Chief

प.सं./Ref No. :-

च.नं. :-

मिति/Date:-

RECOMMENDATION

This is to certify that **Mr. Iswari Khadka** has prepared the thesis entitled A Study on "**Overview of Tax Auditing System in Nepal**" under my supervision and guidance. It embodies his original and independent work. I am satisfied with the work in terms of its research, methodology, presentation and description of data.

This thesis has been prepared in the form as required by the Faculty of Management for the partial fulfillment of the degree of Master of Business Studies (M.B.S).

It is forwarded for examination. I recommend this thesis for the approval and acceptance.

.....
SantoshLal Shrestha
Thesis Supervisor



त्रिभुवन विश्वविद्यालय
Tribhuvan University
त्रिभुवन बहुमुखी क्याम्पस
Tribhuvan Multiple Campus

तानसेन, पाल्पा, नेपाल
Tansen, Palpa, Nepal
☎ 075-520030, 520114, 520116
Fax : 075-520114
क्याम्पस प्रमुखको कार्यालय
Office of the Campus Chief

प.सं./Ref No. :-

च.नं. :-

मिति/Date:-

Approval Sheet

This is to certify that the thesis submitted by MR. Iswari Khadka entitled A Study on "**Overview of Tax Auditing System in Nepal**" has been prepared as approved by this department in the prescribed format of faculty of management. This thesis is forwarded for examination.

.....
Santosh Lal Shrestha
Thesis Supervisor

.....
Keshav Raj Sharma
Chairman, Research Department

.....
Yubraj Paudel
Campus Chief



त्रिभुवन विश्वविद्यालय
Tribhuvan University
त्रिभुवन बहुमुखी क्याम्पस
Tribhuvan Multiple Campus

तानसेन, पाल्पा, नेपाल
Tansen, Palpa, Nepal
☎ 075-520030, 520114, 520116
Fax : 075-520114
क्याम्पस प्रमुखको कार्यालय
Office of the Campus Chief

प.सं./Ref No. :-

च.नं. :-

मिति/Date:-

VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis presented by

Iswari Khadka
TU Reg. No. 7-2-49-621-2003

Entitled

A Study on "**Overview of Tax Auditing System in Nepal**" is found to be the original work of the student and written according to the prescribed format. We recommend the dissertation to be accepted as partial fulfillment of the requirement for Master's Degree in Business Studies (M.B.S)

Viva-Voce Committee

Chairman, Research Committee

Member (Thesis Supervisor)

Member (External Expert)

ACKNOWLEDGEMENT

As the partial fulfilment of the M.B.S. degree, I have prepared this report. During the course, I worked with sincerity, honesty and diligently, as far as possible. Beside my continual efforts, I also got unforgettable support from different people.

I would like to express my deep gratitude to the Tribhuvan Multiple Campus, Tansen Palpa for providing me to carry out this thesis.

I am extremely grateful and indebted to my thesis supervisor **Mr. Santosh Lal Shrestha, Lecturer**, Tribhuvan Multiple Campus, Tansen, for his constant encouragement, guidance, valuable supervision and suggestions in all aspects of the research study.

I would also like to express my gratitude to Campus Chief Mr. Yubaraj Poudel, Chairman, Research Department Mr. Keshav Raj Sharma, for their warmly support and valuable advice and suggestions.

I am indebted and grateful to my Gurus Mr. Rajeshwor Udaya, Lilaballav Dhakal of TMC Palpa and all other members of Tribhuvan Multiple Campus, especially, all fellow, and other people who supported as well inspired me to shape up the thesis.

I would like to pay homage to my father and mother as well as my sister and brother who headed me towards the light of education and path of truth. I am here because of them; therefore I would like to share the credit of my success with them.

I would like to express my cordial thanks and gratitude to my all teachers for their incomparable contribution especially in academic excellence.

Last but not least, my sincere thanks go to my friends, Govinda Acharya, Dipendra Khanal, Man bahadur Rana, Tukraj Thapa and so on for their help in my thesis and valuable suggestion.

Iswari Khadka
Tribhuvan Multiple Campus
Tansen, Palpa

TABLE OF CONTENTS

<u>Contents</u>	<u>Page No.</u>
Recommendation	
Approval Sheet	
Viva Voce Sheet	
Acknowledgment	
Table of Contents	
List of Tables	
List of Figures	
Abbreviations	
CHAPTER-I	
INTRODUCTION	1-7
1.1 Background of the Study	1
1.2 Statement of the Problem	4
1.3 Objectives of the Study	5
1.4 Significance of the Study	5
1.5 Scope of the Study	6
1.6 Limitations of the Study	6
1.7 Organization of the Study	7
CHAPTER- II	
REVIEW OF LITERATURE	8-55
2.1. Theoretical Framework	8
2.1.1 Meaning of Audit	8
2.2. Taxation Concept	9

2.2.1	Income Taxation	10
2.2.2	VAT in Nepal	17
2.3	Effectiveness Concept	22
2.4	Auditing Policy and the Tax Auditing Process in Nepal	25
2.4.1	Organization of Tax Audit Operations	25
2.4.2	Legal Guidelines in Tax Auditing	26
2.4.3	Auditing Competences in General	27
2.4.4	Taxpayers Record-keeping Obligations	28
2.4.5	Obligation to Provide Information & Access to Information	28
2.4.6	Rights of Inspection & Examination	29
2.4.7	Right of Search & Seizure	29
2.4.8	Giving Tax Official Access to Third Party Information Sources	30
2.4.9	Management Assessment in VAT Act	30
2.4.10	Amended Assessment in Income Tax Act, 2058	31
2.5	Types of Audit	33
2.5.1	Full Audit	33
2.5.2	Partial Audit	33
2.5.3	Verification Visit	34
2.5.4	Link Audit	34
2.5.5	Joint Audit	34
2.5.6	Pay Roll Audit	34
2.5.7	Investigation	35
2.5.8	VAT-Refund Visit	35
2.5.9	De-registration Audit	35
2.6	Selecting Taxpayers to be Audited	35
2.6.1	Audit Core Group	36
2.6.2	Audit Case Selection Criteria	37
2.6.3	Data Used in Audit Case Selection	37
2.6.4	Data Analyzing System	37
2.6.5	Number of Audit Case Selection	38
2.6.6	Feedback	38
2.6.7	Location of Audit	39
2.7	Preparation and Planning	39

2.7.1	Audit - Visit Program	39
2.7.2	Appointment for Visit	39
2.7.3	Visit - Cancellations	40
2.7.4	Audit Teams Building	40
2.7.5	Preparation for Visit	40
2.7.6	General Review of Past Report	40
2.7.7	Study the audited financial statement (Trading & P/L accounts)	40
2.7.8	Analysis of the Balance Sheet	41
2.7.9	Analysis of Business Ratio	41
2.7.10	Other Related Information	41
2.7.11	Necessary Items for Auditing Works	41
2.8	Implementing the Audit - Plan	42
2.8.1	Initial Action	42
2.8.2	Officer's Behavior	42
2.8.3	Examining the Business premises	42
2.8.4	Types of Audit Checking	42
2.8.5	General Review	43
2.9	Completing and Reporting	44
2.9.1	Contents in Audit Report	44
2.9.2	Writing Audit Report	44
2.9.3	Audit-Result	45
2.9.4	Execution and Forming a Judgment (Findings)	45
2.9.5	VAT Visit Report (VVR) Entry	45
2.10	Management Assessment & Amended Assessment	45
2.11	Computer Assessment	46
2.12	Common Errors	46
2.13	International Aspects of Tax Auditing	47
2.14	Other related Researches	47

CHAPTER – III

RESEARCH METHODOLOGY	56-58
3.1 Research Design	56
3.2 Nature, Source and Collection of Data	56
3.3 Population and Sample of the Study	57
3.4 Method of Analysis	57
3.5 Data Processing and Analysis Procedures	57

CHAPTER – IV

DATA PRESENTATION AND ANALYSIS	58-79
4.1 Secondary Data Analysis	58
4.1.1 Tax revenue Contribution to Treasury	58
4.1.2 VAT & Income Tax on Revenue, Tax Revenue & GDP	59
4.1.3 Total Revenue, Tax revenue & Non - tax revenue on GDP	60
4.1.4 Revenue Target & Achievement	61
4.1.5 Revenue Collection Costs	62
4.1.6 Tax Assessment Amount	63
4.1.7 Management Assessment & Appeal	64
4.1.8 Tax Audit Achievement	65
4.1.9 Human Resources in Audit	68
4.1.10 Compliance Measurement through Registration	69
4.1.11 VAT Comparative Statistics and Composition of Returns	69
4.1.12 Tax Dues Status	71
4.2 Primary Data Analysis (Survey Data)	72
4.2.1 Analysis and Interpretation of Survey Data	72
4.3 Major Findings of the Study	77
4.3.1 Major Findings from Secondary Data	77
4.3.2 Major Finding from Questionnaire Survey	79

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS	80-87
5.1 Summary	80
5.2 Conclusion	82
5.3 Recommendations	83

APPENDIX

BIBLIOGRAPHY

LIST OF TABLES

Table No.	Title	Page No.
2.1	Paying Taxes Indicator of South Asian	55
4.1	Revenue Collection Statement	58
4.2	Combination of Revenue	59
4.3	VAT & Income Tax on Revenue, Tax Revenue and GDP	60
4.4	Economic Indicators	61
4.5	Revenue Target Achievement	61
4.6	Revenue Collection Cost	62
4.7	Tax Assessment Amount	63
4.8	Management Assessment & Appeal	64
4.9	Tax Audit Achievement	66
4.10	Selection of Taxpayer for Audit and Investigation	67
4.11	Audit and Investigation Performing During the Years	67
4.12	Level wise Auditing Staffs	68
4.13	Auditing Staffs	68
4.14	Compliance Measurement through Registration	69
4.15	VAT Comparative Statistics on Return	70
4.16	Tax Dues Statement	71
4.17	Respondents	72
4.18	Qualities of IROs Service	72
4.19	Improvement of Service Quality of IROs	72
4.20	Do You Know Audit	73
4.21	Overall Qualities of Tax Audit	73
4.22	Tax Officers' Behavior during Audit	73
4.23	Tax Officer's Honesty and Transparent in Tax Auditing Procedure	74
4.24	Present Tax Audit Targets	74
4.25	Achievement of Tax Audit Targets	74
4.26	Monthly Performance of Audit Target	74
4.27	How Many Taxpayers Should be Audited in a Year?	75

4.28	Taxpayer's Co-operation for Audit	75
4.29	Need of Competencies of Tax Auditors for Effectiveness of Audit	75
4.30	Competencies of Tax Auditors	76
4.31	Effectiveness of Audit	76
4.32	Need of Separate Audit Policy	76
4.33	Adequacy and Objectiveness of Selection Techniques	77

LIST OF FIGURES

Figure No.	Title	Page No.
4.1	Contribution of Income Tax, VAT and Other upon the Total Revenue	60
4.2	The Revenue Share of GDP	61
4.3(A)	Revenue Target	62
4.3(B)	Revenue Target	62
4.4	Revenue Collection Cost	63
4.5	Tax Assessment Amount	64
4.6	Compliance Measurement through Registration	69
4.7	VAT Compliance Statistic of Return	70
4.8	Tax Dues Statement	71

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
LAN	Local Area Network
MA	Management Assessment
MOF	Ministry of Finance
NRB	Nepal Rastra Bank
OAG/N	Office of Auditor General/Nepal
OECD	Organization for Economic Development and Cooperation
PAN	Permanent Account Number
SAARC	South Asian Association of Regional Cooperation
T.U.	Tribhuvan University
VAT	Value Added Tax
WAN	Wide Area Network
W.T.O.	World Trade Organization