FISCAL FEDERALISM IN NEPAL:

Revenue Potential of Provincial and Local Governments and Recommendations to Enhance Own-Source Revenue Generation

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Acronyms

CIT	Corporate Income Tax
DDC	District Development Committee
FGD	Focused Group Discussion
FY	Fiscal Year
GDP	Gross Domestic Product
HDI	Human Development Index
HPI	Human Poverty Index
IGFM	Inter-governmental Financial Management
IRD	Internal Revenue Department
KII	Key Informant Interview
MoF	Ministry of Finance
NEA	Nepal Electricity Authority
NNRFC	National Natural Resource and Fiscal Commission
NPR	Nepali Rupee
PIT	Personal Income Tax
PLG	Provincial and Local Government
RCC	Reinforced Cement Concrete
VAT	Value Added Tax
VDC	Village Development Committee

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Executive Summary

Transition into current system of federal structure of governance from unitary structure in Nepal began with promulgation of the constitution in 2015. The constitution has laid the foundation for fiscal federalism and has assigned expenditure responsibilities and revenue sources to central, provincial, and local governments. All three levels of government have the constitutional power to enact laws, prepare budget, and mobilize their own resources.

The transition to and practice of fiscal federalism is fairly new and has gone through only couple of fiscal years under this new system. Sub-national governments are still in the process of formulation of sub-national legislations, determining the tax rates specific to their areas, study of revenue potential, and building institutional and human capacity to fully reap the benefit of the new revenue mobilization rights provided to them by the constitution. These processes are in the early stages of development as a result of which, there is a significant room to increase own source revenue generation. In this context this study explores the current legal provisions of tax assignments, assesses the revenue collection and gap, and recommends strategies to enhance own source revenue (OSR) in selected six sub-national governments. The sample of selected sub-national governments in this study consists of two provinces— Province 5 and Gandaki Province and two local governments from each of the provinces namely: Pokhara Metropolitan City, Kligandaki Rural Municipality; Butwal Sub-metropolitan City, and Chhatradev Rural Municipality respectively.

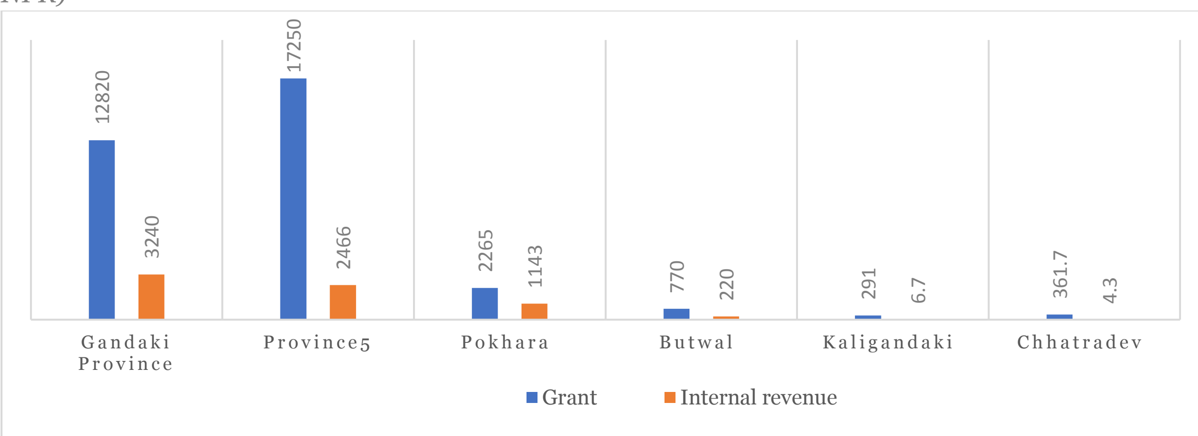
In principle, under a federalized structure sub-national governments can and should be able to generate OSR through imposition of hosts of local taxes and fees as provisioned by the Constitution of Nepal (2015), Local Governance Operation Act (2017), National Natural Resource and Fiscal Commission Act (2017), and Intergovernmental Financial Management Act (2017). These acts also have provisions for fiscal transfer, and revenue sharing. Thus, sub-national revenue consists of fiscal transfers, revenue sharing, and revenue from local taxes and service fees. Local Government Operations Act (2017) and Intergovernmental Financial Management Act (2017) have provisions of both exclusive and concurrent tax rights among provincial and local government. The taxes with concurrent rights are— motor vehicle tax, house and land registration fee, advertisement tax, and entertainment tax. Provincial government keeps the 60 percent of collected tax and remaining 40 percent is shared with local governments within the province[1]. Rate for house and land registration fee and entertainment tax is determined by provincial government but tax is administered at local level. Rate for advertisement tax is determined by local government and tax is also administered at local level. Of the total tax collected from house and land registration, entertainment tax, and advertisement tax local government keeps 60 percent of total tax collected and shares remaining 40 percent with provincial government. Property tax, house rental tax,

[1] Provincial government uses indicators such as population, length of road, and area covered by forest to determine the share of vehicle tax for local governments. The weight assigned to these indicators are— 45%, 50% and five percent respectively.

business tax, and natural resource tax is administered by local governments. Agriculture income tax is administered solely by provincial governments. Royalties from natural resources, tourism fee, service fee, and penalties are concurrent rights among central, provincial and local governments.

The most important source of revenue for sub-national government has been fiscal transfers (fiscal equalization grant, conditional grant, etc.) and revenue sharing (VAT and excise duty on domestic production) from the central government. Contribution of local taxes to provincial revenue is less than one to two percent of total revenue for both provinces and both rural municipalities. This is different from central government, where revenue from custom duties, excise duties, VAT, corporate and personal income tax makes up higher share in composition of total revenue. These taxes contributed to 87 percent of total revenue for central government in FY 2018/19. Figure E1 summarizes grants and internal revenue of selected sub-national governments.

Figure E1. Summary of grant and internal revenue for selected sub-national governments (in million NPR)[2]



The size of internal revenue[3] is minimal compared to the size of the grants from central government. Internal revenue is 25 percent and 14 percent of grant for Gandaki Province and Province 5 respectively. Whereas internal revenue is 50 percent and 28 percent of grant for Pokhara and Butwal. Similarly internal revenue is 2.30 percent and 1.19 percent of grant for Kaligandaki and Chhatradev. Long term sustainability and development of sub-national governments requires them to utilize the tax and fees under their jurisdiction to increase OSR. However, sub-national governments are not effectively utilizing the taxes assigned to them to generate sufficient revenue thus all selected sub-national governments have revenue collection gap on local taxes assigned to them. These collection gap are attributed to challenges faced by sub-national governments such as: lack of awareness, lack of detailed revenue potential study,

[2] The data is from FY 74/75 (2017/18) for Pokhara and Butwal and rest of the data is from FY 2075/76 (2018/19). Pokhara has all the information required to calculate the tax gap from both the methods. Some selected sub-national governments have missing data.

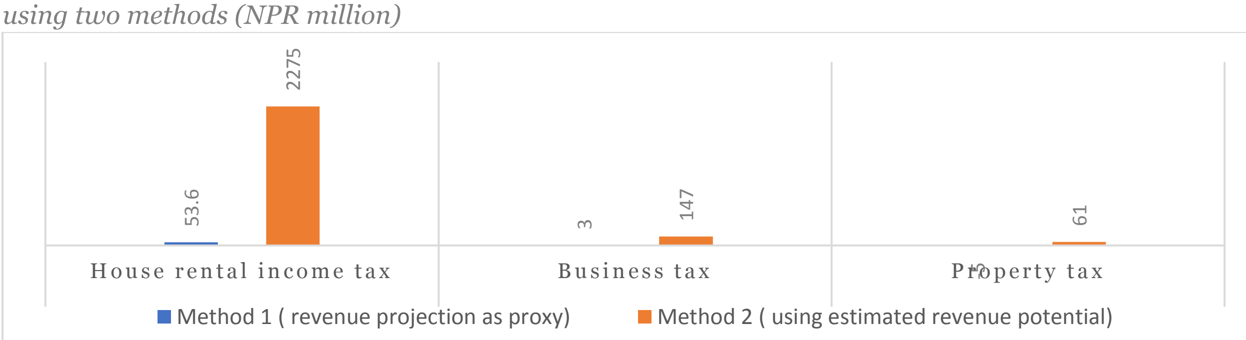
[3] Internal revenue excludes revenue sharing, grant, and royalty sharing from central government. Sub-national taxes with concurrent rights are also considered OSR/internal revenue for provincial and local governments.

poor tax administration due to insufficiently developed human and institutional capacity, lack of proper databases and tax mapping, ineffective registration of tax bases and tax payers, poor information sharing among government agencies, overreliance on high tax rates rather than on increased tax coverage and effective administration etc.

The revenue collection gap is calculated as: ***Revenue collection gap for FY = Potential revenue in FY- Actual revenue in FY***

This study uses two methods to calculate the revenue collection gap at the sub-national level. The first methods uses revenue projection available from budget documents as a proxy for revenue potential and the second method estimates the revenue potential for business tax, property tax, and house rental income tax using data from the National Population and Housing Census (2011) and the National Economic Census (2018). To the best of our knowledge this is the first study to estimate revenue potential for the sub-national level governments using these data. The revenue projection available on budget speeches and documents (used in the first method) is based on revenue collection trend of previous years and not on rigorous study of revenue potential. Thus the revenue collection gap calculated from first method does not provide true picture of sub-national revenue mobilization. To address this challenge, the study estimates revenue potential (used in the second method) for business tax, property tax, and house rental income tax and then calculates the revenue collection gap. These taxes are sole rights of local governments. For the first method there is both revenue collection gap and revenue collection surplus. Collection surplus indicates the revenue collection that is meeting the target, however for the second method there is only the revenue collection gap. Also, the revenue collection gap is higher for the second method. This indicates that the revenue projection available in the budget speeches might be lower than the actual revenue potential of tax revenue in respective sub-national governments. Figure E2 and E3 summarizes the revenue collection gap and surplus from two methods for Pokhara Municipality[4] and Butwal Sub-metropolitan respectively. The revenue collection gap from house rental income tax from the second method is significant relative to other taxes with gap of NPR 2275 million and 691 million respectively.

Figure E2. Summary of revenue collection gap in selected revenue sources for Pokhara Municipality using two methods (NPR million)



[4] Pokhara Municipality has surplus of NPR 5 million instead of collection gap for property tax.

For Gandaki Province the collection gap for house and land registration and vehicle tax is NPR 664 million and 1494 million respectively for FY 2018/19. These gap represent 20.49 percent and 46.11 percent of internal revenue of the province. For Province 5 there is collection surplus of NPR 136 million and collection gap of NPR 142 million. These surplus and gap represent 5.51 percent and 5.75 percent of internal revenue of the province.

Figure E3. Summary of revenue collection gap in selected revenue sources for Butwal Sub- Metropolitan using two methods (NPR million)

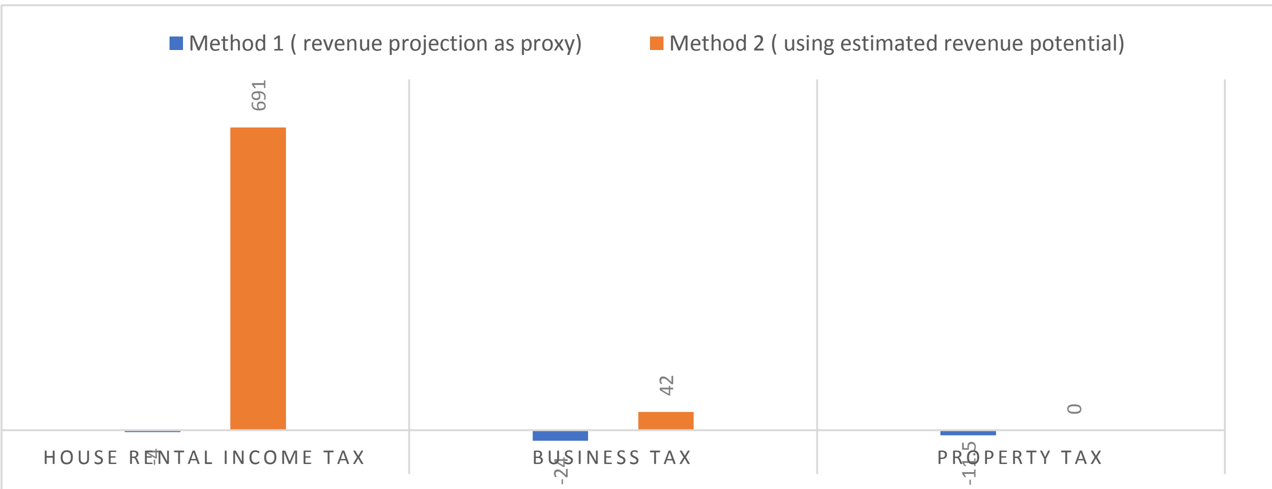
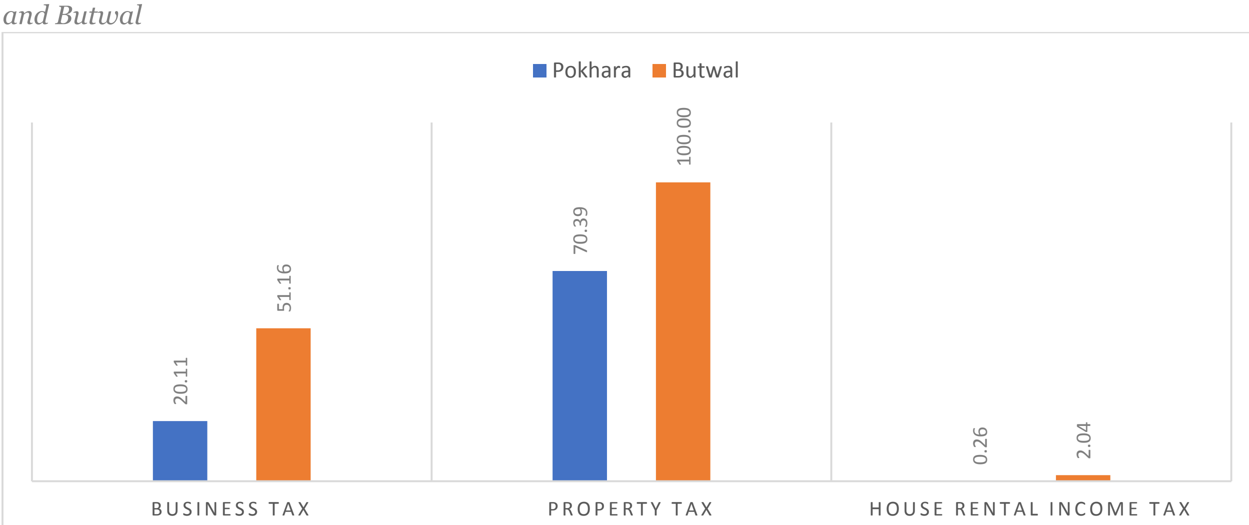


Figure E4. Summary of revenue collection as percentage of estimated revenue potential for Pokhara and Butwal



Both of methods used to calculate revenue collection gap help evidently conclude that house rental income tax, business tax, vehicle tax, house and land registration, among others have revenue collection gap for each of selected sub-national governments. For selected sub-national governments house rental income tax has highest revenue collection gap among other taxes. This is due to the informal nature of house rental income. There is no formal contract and hence no proper records of rental income with sub-national governments. The tenant pays rent to landlords in cash and as of now there is no system in place to properly tax this income. Sub-national governments have higher utilization of the property tax relative to other taxes. Figure E4 summarizes actual revenue collection as a percentage of estimated revenue collection for Pokhara and Butwal. In terms of percentage of estimated revenue, Pokhara collected only 0.2 percent of estimated house rental income tax whereas Butwal collected 2 percent of the estimated house rental income tax. The collection of property tax is relatively impressive when compared to house rental income tax, Pokhara collected 70 percent of estimated property tax whereas Butwal collected 100 percent of estimated property tax.

The causes for such gap at sub-national level is summarized broadly in terms of tax rate, tax base, and tax administration. This implies that the revenue collection gap can be caused by lack of proper assessment of revenue potential, lack of assessment of capacity of taxpayers (i.e. income and ownership of income generating properties), underutilization or non-utilization of assigned taxes (i.e. entertainment tax, advertisement tax in rural municipality and house rental income tax in municipality), setting the tax rate either too high (where it creates disincentive to pay taxes) or too low (where it is not sufficient to generate sufficient revenue), low coverage of tax base due to lack of proper database, existence of informal/unregistered economic activities, and ineffective tax administration that cannot curve the issue of underreporting, underpayment and non-payment of taxes. Even if the tax administration is efficient due to capacity development, there still can be a challenge for OSR generation if assigned taxes to sub-national government inherently do not have enough potential to generate sufficient revenue (also known as tax buoyancy). Furthermore, the assigned taxes (with high tax buoyancy) can generate sufficient revenue only if there economic growth at sub-national level. These challenges should be addressed with appropriate strategies. The study recommends short-term, medium- term and long-term strategies to address the challenges faced by sub-national governments to close the revenue collection gap and to increase OSR. These strategies, discussed below, also addresses other challenges that are discussed in chapter 2 and chapter 3 of the report.

- Short term strategies focuses on strengthening the capacity and tax administration such as: detailed revenue potential study, creation of databases to increase tax-base coverage, strengthening of human and institutional capacity, digitization of transactions, exploring potential new tax base within assigned taxes, effective allocation and administration of expenditures.
- Medium term strategy concentrates on reassignment of tax rights to sub-national governments. This strategy stems from the issue raised during KII and FGDs that current tax assignment do not have the potential to raise enough revenue to sustain expenditure of sub-national governments. It is important to take into account the disparity in revenue potential in rural and urban municipalities while reassigning the taxes. One potential solution is to introduce piggyback

taxation on either VAT or excise tax or some other taxes with higher revenue potential with reasonable rate assigned to sub-national governments. For example: two percent piggy back taxation on existing VAT would make the total rate to be 15 percent where central government keeps 13 percent and respective sub-national governments keep 2 percent of collection from their jurisdiction. This provision has potential to generate revenue significantly for local governments as compared to current provision of 15 percent of VAT and excise revenue shared (under 70-15-15 revenue sharing rule) among 753 local governments. Another solution is to have separate set of tax rights for rural and urban municipalities instead of current provision of blanketed tax assignment. For example rural municipalities cannot generate revenue from entertainment tax, advertisement tax, business tax, and house rental income tax. The study team is aware of strong political will needed to bring changes in legal provisions including the amendment in the constitution to adapt such changes in tax assignments.

- Long term strategy discusses formulation of policies and strategic investments for economic growth at sub-national level. The policies should make it easier for businesses to register and operate in the area. Other policies needed are provisions of special economic zones and business districts. These policies should be supported with investment in infrastructures such as roads, bridges, internet and communications, energy etc. Sub-national governments should also invest heavily in human capital to create skilled individuals to match the skills in demand.

Chapter 1. Introduction

1.1. Background

The current fiscal decentralization process in Nepal began in 2015 with promulgation of the new constitution and deceleration of the country as a Federal Democratic Republic by the second Constituent Assembly. Under the federal structure, the country has three tiers of government: central, provincial, and local governments. The country has seven provinces and 753 local governments. Under the new governance system in the country, sub-national government (provincial and local governments) are assigned various authorities and responsibilities such as planning, delivery of public services at local level, active participation of citizens at governance, and fiscal autonomy through fiscal decentralization by the constitution of the country.

As Nepal continues its transition towards a federalized state, sub-national governments take on a variety of responsibilities that include managing their own administrative and fiscal affairs including the sub-national revenue mobilization. Sub-national revenue mobilization is important for sustainability of the economic growth of the country and of sub-national governments. Also, the sound revenue system, especially own source revenue (OSR) at sub-national government is critical prerequisite for the success of fiscal federalism in Nepal. OSR here refers to the revenue generated by sub-national governments from taxes assigned to them by the Constitution, service charges, and fees.

Mobilization of OSR is important for sub-national government's improved ability to provide public goods and services, lower poverty, capacity development at local level, and economic development. Improving OSR by sub-national government can also reduce the pressure of central government in the face of rising public debt and recurrent expenditure. In addition, strengthening OSR generation can also help improve fiscal autonomy, increase source of revenue, and achieve control over development agenda of sub-national government. In principle, the most important benefit from fiscal decentralization is the increased efficiency and increase in welfare gain resulting from moving governance closer to the people as local government has best interest of its constituents (Oates, 1972). Sub-national governments being closer to the people they are governing can respond to the preferences of the people in their area with tailored policies and budgets to achieve locale specific goals. This can also help foster political and administrative accountability of by empowering local governments (Oates, 1999). In addition to efficiency and accountability, fiscal decentralization can also help in efficient allocation of resources whereby sub-national governments can play pivotal role as they have better information regarding local level demand, needs, and expectations (Sewell, 1996). People’s propensity to pay taxes is also higher in a decentralized structured, where taxes collected in one region are spent exclusively on that region’s public goods, than in a centralized tax structure, in which taxes paid in all jurisdictions are pooled and redistributed[5] (Güth et al. (2005). Finally, fiscal decentralization can also help increase revenue and reach greater share of

[5] For other reviews literature on Proximity Principle see Vincent (2017).

country's GDP by the tax system when sub-national governments are directly involved in taxation (Bahl and Bird, 2008). For further discussion on fiscal federalism see Shah (2007). For discussion of fiscal federalism in context of Nepal, its legal provisions, its challenges, and its prospects see (Adhikari, 2019; Thapaliya et. al., 2018).

The benefits of fiscal decentralization depend on factors such as autonomy to make independent fiscal decision, however this degree of autonomy depends on the level of resources owned by sub-national governments. Thus, sub-national revenue mobilization and more specifically OSR mobilization is of vital importance for success of fiscal federalism in the country.

1.2. Rationale of the study

One of the critical components for the successful implementation of the federalism is good fiscal framework with equitable distribution of resources across three tiers of government and building capacity of sub-national governments to generate and mobilize their own revenue. Major sources of sub-national governments are revenue from taxes assigned to them by the constitution, non-tax sources, revenue and royalty sharing, and fiscal transfers from the federal government as prescribed by formulae and criteria developed by the National Natural Resource and Fiscal Commission (NNRFC).

OSR generation under federal structure is a relatively new undertaking for sub-national governments in Nepal and this requires assessing current revenue collection and gap, identifying and exploring revenue potential, and developing basic capacities to increase own source revenue at sub-national level. In principle, under a federalized structure, sub-national governments can and should be able to generate their own revenue through imposition of hosts of taxes and fees. Sub-national governments in the country can levy hosts of taxes such as business tax, vehicle tax, entertainment tax, agriculture income tax, tax on house rental income, and fees such as tourism fee and house and land registration fee. As of now the most important source of revenue for sub-national government has been fiscal transfers and revenue sharing from the central government. Long-term sustainability and development of sub-national governments require effective utilization of the tax and fees under their jurisdiction to increase own source revenue. Thus, there is a need to assess the current legal provisions and tax gap. The tax gap (or revenue collection gap) is generally defined as difference between own source revenue potential[6] and actual own source revenue collection. Revenue potential can be economic and legal. Economic revenue potential depends on inherent economic capacity of the country whereas legal revenue potential depends on regulatory framework of the country. The difference between legal revenue potential and actual revenue collection is tax gap and difference between economic revenue potential and actual revenue collection is called tax space[7]. For discussion of revenue potential and tax gap see Khwaja and Iyer (2014). Tax gap is also

[6] This study uses projected revenue from budget of sub-national governments and estimated revenue potential of business tax, property tax, and house rental income tax to calculate the tax gap.
[7] Study of tax space is beyond the scope of this study.

defined as difference between amount of tax owed by the tax payers under tax code and amount that is actually paid[8] (Mazur et.al 2007). And some of the causes of this gap are: non-compliance from tax payers, lack of buoyant sources of revenue, and poor administrative capacity. The strategy for sub-national governments to enhance OSR is to close the gap by fully utilizing the revenue potential in their respective jurisdiction.

As of now, the body of research on sub-national revenue mobilization in Nepal is very limited, which makes it difficult for concerned stakeholders, including administrative bodies of sub-national governments, the GoN, and different development partners to assess the situation and devise plans to support the enhancement of domestic resource mobilization at the sub-national level. The study intends to fill this gap and provide scientific and thorough analyses and assessment. The study also intends to serve as a foundation for future planning and policy decisions by the GoN, sub-national governments, and concerned development partners. The study is also timely and relevant as the transition from unitary to a federal system is in progress with several laws yet to be formulated and enacted, institutional arrangements at three tiers of governments yet to be finalized, and policies and guidelines yet to be proposed.

1.3. Objective of the study

The main objective of the study is to conduct a thematic research on revenue collection gap and revenue potential at the sub national level. Other specific objectives are:

- To assess the current situation of taxation powers (rights/overlaps) at provincial and local level.
- To analyze current tax gap (or revenue collection gap) at provincial and local level.
- To provide set of strategies and recommendations in short-term, medium-term and long-term to narrow down the revenue gap and make sub-national governments fiscally sustainable.

1.4. Methodology

The study uses the combination of desk review of literature on federalism and sub-national revenue mobilization, government policy documents and international best practices, secondary data on sub-national taxation and revenue, and qualitative information from field visits. Secondary data used in this study are revenue, expenditure, and fiscal transfer and it is collected from budget document, local expenditure and revenue ledgers, and reports and plans from selected provincial and local governments (PLGs).

[8] Estimation of tax gap between tax owed and amount actually paid involves some combination of survey and audit of taxpayers. This approach is beyond the scope of this study.

Qualitative data on sub-national revenue mobilization is obtained from dialogues Key Informant Interview (KII) and Focused Group Discussion (FGD) with concerned elected officials, civil servants, and other relevant stakeholders such as businesses and individual taxpayers from selected PLGs. Field visit for the study started on January 18 and lasted till February 4. Structured tools were developed and used for the field study to collect relevant secondary data and qualitative information. List of individuals consulted for the study are enlisted in Annex A and the tool used for KII and FGD are detailed in Annex B. Qualitative information obtained from KII and FGD is used to discuss the current state of sub-national revenue mobilization and challenges faced and to recommend strategies to increase own source revenue to close the revenue gap. There is no analysis of qualitative data in the study.

Secondary data collected is used for descriptive analysis to assess the current state of revenue collection and gap at sub-national level. Using secondary data from the National Population and Housing Census (2011) and the National Economic Census (2018), the study also estimates the revenue potential for business tax, property tax, and house rental income tax for selected provincial and local governments. The choice of these taxes to estimate revenue potential is driven by two main causes— (i) availability of the data and (ii) their revenue potential which can be utilized by sub-national governments to increase OSR.

The sample of sub-national government consists of two provinces— Province 5 and Gandaki Province and two local governments from each of the provinces. Local governments in the study consists of one urban (metropolitan or sub-metropolitan) and one rural municipality from each of the province. The selection of rural municipalities is based on its population, its potential for growth, and its potential to be urban municipality in the near future. The list of selected sub-national governments is presented in Table 1.

Table 1. Summary of provincial and local governments considered in the study

Province	*Local governments*
Province 5	Butwal Sub-Metropolitan and Chattradev Rural Municipality
Gandaki Province	Pokhara-Lekhnath Metropolitan and Kaligandaki Rural Municipality

1.5. Limitations of the study

- As the transition into the federal structure is fairly new the data on sub-national revenue and expenditure is limited to one or two fiscal years. Thus, the study uses these data to describe the current state of revenue collection and the composition of total revenue of sub-national governments. The data used were obtained from selected sub-national governments during the field visit (January 18 to February 4, 2020).
- The study does not provide comparative analysis of revenue composition, revenue collection, and revenue collection gap of selected sub-national governments.
- The calculation of tax gap involves data on revenue potential at sub-national level, however sub-national governments are in the process of conducting studies and estimating their revenue potential. Thus, the study relies on projected revenue from annual budgets of and data on industries and

economic activities (from the National Population and Housing Census (2011) and the National Economic Census (2018)) to get some assessment of revenue potential of business tax, property tax, and house rental income tax at sub-national level. These estimates are sensitive to the choice of tax rate and projection of tax base. Though this estimate gives some indication of revenue potential, this is no substitute for detailed study of revenue potential at sub-national level. Lack of detailed revenue potential study for all taxes is huge setback to assess the true tax gap for the study.

- The study relies heavily on the qualitative information obtained from KIIs and FGDs with relevant stakeholders during the field visit to assess current situation and to recommend strategies
- Due to time and budget constraints, the study covers only two province and two local governments from each of the provinces. Small sample is also one of the limitations of the study; however, the insight and recommendations that stems from interactions with stakeholders should be applicable to all sub-national governments in the country to improve revenue mobilization.

1.6. Organization of the report

Following the introduction laid in the first chapter, the second chapter describes the legal and policy framework in context of fiscal federalism for OSR mobilization. Chapter three discusses current state of expenditure, revenue collection, and collection gap. Chapter four presents short-term, medium-term and long-term strategies and policies to address revenue gap and other challenges faced by sub-national governments.

Chapter 2. Legal and Policy framework for OSR mobilization of sub-national governments (or PLGs) in Nepal

This chapter reviews and discusses the legal and policy framework for OSR mobilization in the country after transition into federal structure of governance. The chapter also discusses pillars of fiscal federalism in context of current legal and policy framework. The pillars of fiscal federalism discussed in this chapter are— expenditure assignment, revenue assignment, and fiscal transfer. The chapter then discusses the potential overlap of taxation rights and tax bases among three tiers of government and other challenges of sub-national taxation in the country.

2.1. General overview of legal and policy framework

Nepal has developed legal and policy frame works to determine the jurisdiction expenditure assignment and tax rights, sharing of revenue, and management of inter-governmental fiscal transfers. Prominent among the legal and policy frameworks is the Constitution of Nepal. The constitution has clearly laid out the expenditure assignments and revenue mobilization framework for central, provincial, and local governments. The constitution also has authorized sub-national governments to enact law, to formulate policies, and to prepare annual budget. In terms of preparation of budget, they are however required to follow the guidelines prepared by the central government.

Apart from the constitution other legal and policy frameworks are: Local Governance Operation Act (2017), National Natural Recourse and Fiscal Commission (NNRFC) Act (2017), and Intergovernmental Financial Management (IGFM) Act (2017). Local Governance Operations Act (2017) defines the distribution of authority for policy formulation, determination of tax rate, collection of taxes, and local borrowing. NNRFC Act, 2017 elaborates the functions of NNRFC and lays out the guidelines for the management of inter-governmental fiscal transfers to address vertical and horizontal imbalances. IGFM Act (2017) specifies sharing of VAT, domestic excise duty, and royalties among three tiers of government. The act also has provisions of process of presentation of budget by sub-national government and has dates specified for submission of budget at State Assembly and Local council.

These frameworks provide basis for revenue mobilization for sub-national governments. Based on these frameworks, sub-national governments prepare their own legal and policy framework such as provincial and local economic acts/policies to determine the tax-base, tax-rate, and revenue mobilization in their respective governments.

2.2. Expenditure assignment

Expenditure responsibility[9] of three tier of government is assigned by the constitution in Article 57; Schedule 6 to 9. According to the expenditure assignments, the role of the central government are— national defense, central police and national intelligence, central planning, foreign affairs, international treaties, telecommunications, federal civil service, water and natural resources, electricity transmission lines, central universities and its standard and regulations, health policies and health services, international trade, civil aviation, national highways, citizenship and passport and visa, central statistics, intellectual property, criminal and civil laws etc.

The role of the provincial government as per the expenditure assignment are— state police, state civil service, state statistics, intra-state trade, state highways, state universities, health services, state level electricity and irrigation, use of forest and water and environment within a state, agriculture and livestock development, industrialization and business in the province etc.

And the role of the local government are— local police, cooperatives, management of local services, local statistics and records, basic and secondary education, basic health and sanitation, local market management, local roads and rural roads, management of senior citizens and person with disabilities records, small hydropower projects etc.

2.3. Revenue assignment

The constitution of Nepal has assigned tax rights to three tiers of the government in Article 57; Schedules 5 to 9. As per the assignment custom duty, VAT, excise duty, corporate income tax (CIT), and personal income tax (PIT) are exclusive right of central government. Entertainment tax, advertisement tax, vehicle tax, house and land registration fee are concurrent right of provincial and local governments. Property/land tax, business tax, house rental tax (except rental income of entities[10]), and local natural resource taxes are assigned to the local government exclusively. And agriculture income tax are solely assigned to provincial government. The detail of the provision of revenue assignment is presented in table 2.

Tax assignments among central, provincial and local governments to some degree follows the tax assignment principles and models developed in fiscal decentralization literature. Standard literature suggests that central government should collect custom duties, excise duties VAT, CIT, PIT, taxes on unevenly distributed natural resources etc. (for review see Bird, 2010). The rationale is that the taxes with direct impact on macroeconomic stability of the country and taxes that can achieve greater redistribution goals should fall under central government. These principles and models also suggest that local level governments should not collect tax on mobile tax bases such as consumption, trade, labor and capital as it

[9] This is brief summary of expenditure assignment
[10] The Federal government collect rental income of entities as House Rent Income

will be economically distorting and will reduce the overall well-being. Taxes appropriate for local level are the ones on immobile bases, imposed on local residents, and easily administered locally (Musgrave, 1983). Most popular tax assigned to local level governments, globally is property tax. This is also the case in Nepal. In principle the perfect sub-national taxes should have following conditions— (i) ability to decide whether or not to levy the taxes; (ii) ability to determine the tax base and tax rate; (iii) authority to administer the tax, and (iv) ability to keep all the revenue generated (Bird, 2010). Generally sub-national taxes do not fulfill of these above mentioned conditions.

Table 2. Constitutional provision of revenue assignment among three tiers of government in Nepal

Central	*Provincial*	*Local*
	Tax Revenue Sources	
Custom duties	Vehicle tax	Vehicle tax
Excise duties	Entertainment tax	Entertainment tax
Value added tax (VAT)	Advertisement tax	Advertisement tax
Corporate income tax	-	Property tax
Personal income tax	-	House rental tax
Remuneration tax	-	Business tax
-	-	Land revenue/land tax
-	Agricultural Income tax	Local natural resource tax (gravel stone, lime stone, clay etc.)
-	-	Local tax on wool, medicinal herbs, salvaged item (Kaabadi)
	Non- Tax Revenue Source	
Tourism fee	Tourism fee	Tourism fee
Visa fee	House and land registration fee	House and land registration fee
Passport fee	-	
Service charge	Service charge	Service charge
Fines/penalties	Fines/penalties	Fines/penalties

Source: The Constitution of Nepal (2015).

Local Government Operations Act (2017) and IGFM Act (2017) have provisions of both exclusive and concurrent tax rights among provincial and local governments. The taxes with concurrent rights are— motor vehicle tax, house and land registration fee, advertisement tax, and entertainment tax. Motor vehicle tax rate is determined by the provincial government and tax is also administered by the provincial government. Provincial government keeps the 60 percent of collected tax and remaining 40 percent is shared with local governments within the province. Provincial government uses indicators such as population, length of road, and area covered by forest to determine the share of vehicle tax for local governments. The weight assigned to these indicators are— 45%, 50% and five percent respectively. Rate for house and land registration fee and entertainment tax is determined by provincial government but tax is administered at local level. Rate for advertisement tax is determined by local government and tax is also administered at local level. Of the total tax collected from house and land registration, entertainment tax, and advertisement tax local government keeps 60 percent of total tax collected and shares remaining 40 percent with provincial government. Property tax, house rental tax, business tax, and natural resource tax is administered by local governments. Agriculture income tax is administered solely by provincial governments. Royalties from natural resources, tourism fee, service fee, and penalties are concurrent rights among central, provincial and local governments. The details of tax administration at sub-national level are presented in Table 3.

Table 3. Tax and non-tax revenue administration at sub-national level

Tax type	*Rate determination by*	*Collected by*	*Revenue share in percentage*	*Additional remark*
Motor Vehicle tax	Province	Province	Province 60% Local 40%	In case of tanga, rickshaw, auto rickshaw etc. local level will determine the tax rate and collect tax accordingly.
House and land registration fee	Province	Local	Province 40% Local 60%	-
Advertisement tax	Local	Local	Province 40% Local 60%	-
Entertainment tax	Province	Local	Province 40% Local 60%	-
Natural resource tax (limestone, gravel, clay etc.)	Local	Local		At the time of writing of this report, provincial governments argue that revenue from this tax should be shared among provincial and local governments.
Wealth tax/property tax	Local	Local		-
House rental tax	Province	Local		-
Business tax	Local	Local		-

Agriculture Income tax	Province	Province	-
Tourism fee[11]	Trekking fee determined and collected by Province	Park, zoo, historical sites, museum fee to be determined and collected by Local government	-

Source: Local Governance Operations Act (2017) and Intergovernmental Financial Management Act (2017)

2.4. Sharing of revenue and royalty

As per the IGFT Act (2017) the revenue collected from VAT and excise duty (on domestic production) and royalty from natural resources is shared among central, provincial, and local governments. The proportion of sharing of revenue from VAT and excise duty is 70 percent, 15 percent and 15 percent for central, provincial and local government, respectively. The distribution of these funds among the provincial and local governments are made by taking population, total area of the respective jurisdiction, Human Development Index (HDI), and low development indicators as the parameters. The weights assigned to these parameters are 70 percent, 15 percent, 5 percent, and 10 percent respectively. The method used to determine the share puts more weight on population and thus favors populated sub-national governments which tend to be municipalities. Representative from rural municipalities, the study team visited, expressed the concern that this method puts rural municipalities at a disadvantage as they do not have higher number of population relative to municipalities. It was suggested that other indicators such as low development indicators and human development index should be given more weight to determine the share of revenue for sub-national governments.

The royalty amount is shared in proportion of 50 percent, 25 percent, and 25 percent for central, provincial, and local government. The central government can review the provision of royalty sharing and alter the proportion every five years based on the recommendations from the National Natural Resource Finance Commission (NNRFC).

Table 4. Summary of revenue and royalty sharing

Source of revenue	*Proportion of distribution*	*Deposited in*
VAT	70% to the central government 15% to the province 15% to the local governments	Federal divisible fund State divisible fund Local divisible fund
Excise duty (on domestic production).	70% to the central government 15% to the province 15% to the local governments	Federal divisible fund State divisible fund Local divisible fund
Royalty of natural resources		

[11] Mountaineering fee is collected by central government.

Mountaineering, electricity, forest, mines and minerals, water and other natural resources	50% to central government 25% to provincial government 25% to local government	Federal divisible fund State divisible fund Local divisible fund

Source: *Intergovernmental Financial Management Act (2017)*

2.5. Fiscal transfer

There are provisions for four categories of fiscal transfer in the country, namely –fiscal equalization grants, conditional grants, complementary grants, and special grants. Fiscal equalization grants are transfer of funds to provincial and local governments based on population, development status, and the gap between expenditure needs and revenue potential. The grant is distributed from federal consolidated fund based on the recommendation of NNRFC and the aim of the grant is to reduce horizontal fiscal imbalances. The grant are distributed by the federal government to the sub-national governments on the basis of weights assigned to gap between need of expenses and capacity to generate revenue, Human Poverty Index (HPI), social and economic discrimination indicators, and indicators of infrastructure availability. The weights assigned to these parameters are 60 percent, 15 percent, 15 percent, and 10 percent, respectively. Conditional grants are transfer of funds to provincial and local government to implement projects. Complementary grants are transfer of funds to provincial and local governments to match the resources of local and provincial government from consolidated federal fund. They are used for physical infrastructure. Lastly, special grants are transfer of funds to provincial and local governments to support any special project related to supply of services, emergency needs, and projects and programs related to national development priorities.

2.6. Overlap in tax rights and tax bases

The issue of whether tax rights and tax bases overlap, which can be defined as practice of two or more governments levying taxes on same subject or object, in federal structure of governance is of great importance as it has direct implication on whether taxpayers are paying double taxes or not. The tax assignment structure of the country follows both principle of 'separation' and of 'concurrence'. Which is to say there are taxes that are exclusively assigned to each level of governments and there are certain taxes with shared rights between provincial and local governments. The taxes assigned are as follows:

- Custom duties, excise duties, VAT, corporate and personal income tax is exclusive right of central government.
- Agriculture income tax is exclusive right of provincial government.
- Property tax, house rental tax (except of entities), business tax, land revenue/land tax, local natural resource tax is exclusive right of local governments.

- Vehicle tax, entertainment tax, advertisement tax, and house and land registration are taxes with concurrent rights shared between provincial and local governments. The share of revenue is assigned 60-40 where the government administering the taxes keeps the 60 percent of revenue generated and shares the remaining 40 percent.

The provision of taxation rights among the three tiers of governments under the federal structure is clearly laid out by the constitution and the Local Governance Operation Act (2017). There is no issue of tax overlaps as provided by these legal provisions. For taxation rights that overlap with province and local government such as house and land registration fee, motor vehicle tax, advertisement tax, and entertainment tax, the legal basis is clear on rate determination and sharing of collected revenue among province and local governments. In addition, the provincial and local governments cannot introduce new taxes on their own, this also limits the possibility of overlapping of tax rights and tax bases.

Though the legal provisions are clear there are instances of local governments levying taxes which are contrary to their legal rights. This is result from lack of effective awareness campaign regarding taxation rights. Some of the example of such taxations at sub-national level are— tax on cement and clinker, tax on production of cement based on transaction, scrap iron and materials made from scrap, pollution tax on petroleum products, and district export tax on mineral products and agricultural products[12] (Thapaliya et. al., 2018). Also, local governments can collect tourism fee as per the constitution and Local Level Governance Act (2017), however they cannot collect entrance fee for entering their boundary. Khumbu Pasang Rural Municipality of Solukhumbu levied NPR 2,000, against the prevailing law, on every tourist entering its boundary.[13]

Generally taxes on income, sales, and imports such as individual and corporate income, taxes on fuels, alcoholic beverages and tobacco are the ones with chances of overlapping of tax rights and tax bases if they are shared among more than one government (for example: USA). But here in the country these taxes are exclusive rights of the central government. The taxes and fees that requires further examination and discussion of whether there is case of overlapping tax rights are: tourism fee, advertisement tax, and business tax.

- The right of tourism fee is assigned to all three tiers of the government. But there is clear distinction on type of fee that can be collected by each these tier. Tourism fee from mountaineering is collected by central government. Tourism fee from trekking is collected by provincial government. Tourism fee collected from park, zoo, historical sites etc. is collected by local government.
- Business tax, which is exclusive right of local government, shares the tax base with federal government. The tax collected by local governments would be the case of overlapping of tax

[12]https://kathmandupost.com/valley/2018/08/15/three-tier-government-at-loggerheads-over-tax
[13]https://www.tourismmail.com/nepals-ministry-of-federal-affairs-and-local-development-issues-circular-to-the-local-bodies-to-stop-levying-fee-from-tourists

rights/base and of double taxation (taxing twice on same source) if business tax were levied on the basis of transaction as this clearly overlaps with VAT. There were some instances of such taxes levied by the local governments (for example on per transaction of production of cement). But the provincial and local government considered in this study levy yearly lump sum tax determined on the basis of capital and type and category of businesses.

- Entertainment tax levied by provincial and local government has rate of five percent of per unit of ticket sold. This tax shares the tax base with central government as they also pay VAT on the price of ticket to the central government. Thus, movie theaters, play theaters, among others pay both VAT (13 percent) and entertainment tax (five percent) on same unit of ticket sold.

2.7. Other challenges in sub-national taxation

There are several other challenges related to sub-national taxation besides overlapping tax bases and tax rights. These challenges related to sub-national revenue rights were encountered during desk review and during KIIs and FGDs[14]. It is important to note that these challenges are not limited only to the sub-national governments considered for the study. They are summarized as follows:

- Taxpayers are not fully aware of sub-national taxes under the federal system;
- Fiscal grants and revenue sharing from central government are major sources of revenue for sub-national governments in the country;
- Currently, provincial governments can only know the revenue amount that is shared by the local governments, but they do not have any mechanism to assess or evaluate the actual revenue collection, revenue potential, and tax gap of local governments;
- Local government has hiked the service fees and other charges such as citizenship application, registration of personal records (for example the infamous NPR 1000 charged for birth registration), divorce application, registration of businesses, among others. There are disparities on service charges among local governments belonging to same provinces. The charges are not reflective of the service provided and might not reflect ability to pay by the users of these services;
- Sub-national governments are dealing with ineffective revenue administration due to lack of skilled personal to do a detailed study and assess the revenue potential, determine effective tax rate, and project future revenue generation. There is a lack of infrastructure such as computers and necessary software to make tax collection and revenue sharing efficient, lack of proper database/tax mapping due to poor infrastructure, ineffective registration, and poor information sharing among government agencies, lower frequency of digital transaction and digital billing, registration of houses, businesses etc., collusion and co-ordination between tax officer and tax payers, and avoidance and leakages of taxes;

[14] Except for the challenges with citation of other sources, all other are result of ideas derived from KII and FGD with stakeholders during the field visit.

- Sub-national governments are relying on increasing rate to increase their revenue rather than increasing tax-base and tax coverage through effective data base and effective administration;
- Rural municipalities are not able to raise revenue from business tax, advertisement tax, house rental tax, entertainment tax as there is no economic activity in the rural areas to impose these taxes. Newly formed municipalities are also facing such problems. Even revenue from these taxes in older municipalities is not significant compared to the total revenue collected. It is due to lack of sufficient economic activities to levy taxes on them;
- There is great discrepancy in tax rates and valuation of land and house for property tax among neighboring local governments. These differences in tax rates and valuations create confusion and dissatisfaction among taxpayers. This is due to lack of proper guideline and method of valuation of property. High valuation of property does create a scenario where taxpayers may appear to be rich due to inflation in property prices, but they might not receive any return from that property but end up paying high property taxes;
- Due to lack of proper awareness, taxpayers perceive property tax, rental taxes from house owned in that property, and business taxes from business owned on that space/property as triple taxation of the same property. Such lack of clarity also feeds onto already growing dissatisfaction that local taxes are unfair and high;
- Agriculture income tax, which is exclusive right of provincial government, is not able to generate any revenue as it is difficult to impose such tax on small farmers or farmers engaged in subsistence farming. On the other hand, commercial agriculture does generate higher income and thus has potential for higher tax revenue, but it comes under jurisdiction of CIT, which is levied by central government;
- There are instances of vehicle tax of one local/provincial government being collected by other local/provincial government. For example: Province 3 collects most of vehicle tax of vehicle owned by people residing in other provinces. This occurs mainly because while most of these vehicles are purchased in Province 3, they are subsequently registered in this province itself. There is no legal restriction that vehicle registered and person purchasing the vehicle should be residing in the same area. For example: person residing in Province 5 can register vehicle in Bagmati Province and the person can end up paying the vehicle tax in Bagmati Province. Some rural municipalities (for example Kaligandaki) are also facing same problem where nearby municipality for example Pokhara, is collecting the vehicle tax on the vehicle owned by people who although reside in Kaligandaki got their vehicles registered in Pokhara. As of now revenue from such vehicle taxes are not returned to the respective local government where the taxpayer resides;
- Sub-national governments are relying more on natural resource taxes such as sand, gravel and stone tax, and royalty from natural resources such as forest and rivers as potential for increasing revenue. Over reliance on taxes from natural resource and haphazard extraction of natural

resource to generate revenue can result in severe negative environmental consequences in the long run;

- The local taxes in general, are perceived as levied on basis of ease of collecting them rather than on economic activity generated and ability of payment by the tax payers;
- Lack of efficient review system to address the complaint from taxpayers;
- Lack of support from tax offices to pay taxes in installments;
- Lack of visible linkage between tax collected and service delivered at sub-national level which in turn reduces incentive to pay those taxes;
- There is potential for increased collusion and corruption between tax administration officials and taxpayers as each of the local level government is given tax rights as compared to unitary system of governance. This is further complicated due to weak tax administration system at sub-national level. Also, the tax administration officers, locally elected officials, and taxpayers closely know each other which further exacerbate such problems;
- Overall sub-national government lacks adequate capacity for revenue assessment and preparation of plans and policy guidelines to streamline the tax administration at sub-national level.

Are these sub-national taxation rights new rights provided by the constitution?

Before the country transitioned into the federal structure in 2015, Local Self Governance Act (LSGA) (1999) and Rules (2000) and Local Bodies Financial Administration Rules (2007) were the legal and institutional basis for governance of local bodies in Nepal. Local bodies constituted of Village Development Committee (VDC), municipalities, and District Development Committee (DDC). This act gave a financial authority to mobilize local revenues, laid out mechanisms for inter-governmental fiscal transfers, revenue sharing, and borrowings. The act also provided autonomy to local bodies to invest their resources in prioritized projects.

- Tax rights assigned to DDC were: Vehicle tax, natural resource use tax, sales, and agriculture production tax.
- Tax rights assigned to VDC and municipality were: House and land tax, integrated property tax, vehicle tax, entertainment tax, house rent tax, advertisement tax, natural resources use tax etc. ,

These sub-national tax rights assigned by the constitution are not different than that assigned by the LSGA (1999). The constitution has assigned or recycled those same taxes to sub-national governments with added rights which allows them to set their own rate.

Chapter 3. Current state of revenue collection at central and sub-national level

This chapter summarizes and discusses the current revenue (tax and non-tax) collection and expenditure of selected provinces and respective local governments from those provinces. The discussion also consists of general tax revenue collection under different tax headings. Following this, the chapter also discusses revenue collection gap using projection of revenue collection target as proxy for revenue potential. The chapter also presents the estimate of revenue potential for business tax, property tax, and house rental income tax for selected provincial and local government and discusses the revenue collection gap.

The operation of fiscal federalism began partially in FY 2017/18 (B.S. 2074/75). The beginning of the process was with fiscal transfers from central government to the newly-established sub-national governments. In FY 2018/19 (B.S. 2075/76) with establishment of provincial governments and formulation of acts, policies, and budget the process of fiscal federalism came into full operation. The process of acquiring income and expenditure details from provincial and local government is still a work in progress, which limits the scope of descriptive analysis using those data.

3.1. Overview of central revenue and expenditure

As per the provision of the constitution, the central government generates revenue from VAT, excise, income tax, and custom duties. According to the Economic Survey 2018/19, the tax revenue collected by the government was NPR 395.58 billion for the same fiscal year. The tax collection in the survey are reported up to mid-March for all fiscal years. The revenue collected is 73.11 percent of total government expenditure. The revenue collected by the government in previous fiscal year was NPR 367.65 billion which is 69.48 percent of total government expenditure. The central government more or less has been collecting close to 70 percent of its total expenditure based on data from past three fiscal years. VAT has the highest proportion of contribution to the central revenue followed by income tax and custom duties. The break-down description of various taxes levied by the central government shows that VAT contributed NPR 107.17 billion to the tax revenue in the fiscal year. This is 24.49 percent of total revenue collected by the central government. Whereas income tax, excise duty, and custom duties contributed 24.11 percent, 14.82 percent and 23.69 percent of total revenue collected, respectively for the FY 2018/19. These four major taxes in the fiscal year contributed 87 percent to total revenue collected by the central government. The detail of revenue, expenditure, and tax wise break down is presented in Table 5 and Table 6.

Table 5. Summary of revenue and expenditure of central government (NPR, in billions)

Up to mid-March for each of the fiscal years[15]			
Particulars	2016/17	2017/18	2018/19
Tax revenue	305.70	367.65	395.58
Non-tax revenue	24.15	41.08	43.76
Total government revenue	329.85	410.82	437.66
Total government expenditure	400.16	529.07	540.89
Share of tax revenue to total government expenditure	76.39	69.48	73.11
Share of total revenue to total government expenditure	82.43	77.65	80.91

Source: Economic survey (2018/19)

Table 6. Break down of federal tax revenue by tax types (NPR, in billions)

Up to mid-March for each of the fiscal years			
Particulars	2016/17	2017/18	2018/19
VAT	100.4	126.16	107.17
Share of VAT in total revenue	30.45	30.71	24.49
Excise duties	55.11	61.41	64.87
Share of excise in total revenue	16.71	14.95	14.82
Income tax	73.14	86.04	105.52
Share of income tax in total revenue	22.18	20.95	24.11
Custom duties	73.17	84.16	103.67
Share of custom duties in total revenue	22.18	20.49	23.69

Source: Economic survey (2018/19)

Until mid-March for the FY 2018/19, the total revenue mobilization of the central government has been NPR 437.66 billion of which NPR 395.58 is tax revenue. The revenue belonging to the provincial and local level including VAT, excise duties, and other revenue in Federal Reserve Fund but belongs to the sub-national governments is NPR 59.66 billion. The ratio of provincial and local tax revenue to central tax revenue is 0.15 for FY 2018/19. The detail of sub-national revenue from local taxes is discussed in section 3.2 to 3.4.

Table 7. Revenue up to mid-march FY 2018/19 (NPR, in billions)

Particulars	*Amount*
Central total revenue	437.66
Central tax revenue	395.58
Revenue belonging to provincial and local government	59.65
Ratio of provincial and local tax revenue to central tax revenue	0.15

Source: Economic survey (2018/19)

[15] Total revenue for FY 2016/17 is NPR 609.18 billion and for FY 2017/18 is NPR 732 billion. The tax revenue are NPR 547 and NPR 659.49 billion respectively (IRD, 2018). The tax revenue for up to mid-march is reported in the table to make it similar to the revenue for provincial and local governments, which has revenue and expenditure data of first seven months of FY.

The proportion of central and local revenue before country transitioned into federal structure also follows similar pattern. For instance, in FY 2015/16 (B.S. 2072/73) the central government collected NPR 517.71 billion whereas local revenue (of VDC, DDC, and municipalities) collected NPR 33.93 billion. The ratio of local revenue to central revenue was 0.065. The details of central and local revenue is summarized in Table 8. This description of data in this section indicates that proportion of tax revenue for the central government is higher relative to local governments both before and after transition into federal structure of governance.

Table 8. Comparison of central and local level revenue and expenditure (NPR, in billions)

Fiscal Year	*Central revenue*	*Local revenue*	*Ratio of local revenue to central revenue*	*Central expenditure*	*Local expenditure*
2014/15	448.33	30.79	0.068	531	28.57
2015/16	517.71	33.93	0.065	610	31.71

Source: Local Body Fiscal Commission (2017)

3.2. Overview of provincial revenue

For the FY 2018/19,[16] total tax revenue for Gandaki Province was NPR 6.48 billion. The tax revenue for the province consists of both—(i) revenue sharing (VAT and excise) and fiscal transfer from central government and (ii) revenue generated and shared (both are considered internal revenue/OSR) from local taxes such as vehicle tax, advertisement tax, entertainment tax, business registration fee, among others. Revenue sharing from central government is NPR 6.08 billion which is 93 percent of total tax revenue collected and 69 percent of total revenue collected in the province. Similarly, for the FY 2018/19, Province 5 collected NPR 8.67 billion of tax revenue and tax revenue sharing from central government worth NPR 7.01 billion, which is 80 percent of total tax revenue collected and 68 percent of total revenue collected in the province. It is evident from the description of tax revenue, federal grants, budget, expenditure that majority of sources of funds to the provincial government do come from central government in the form of tax revenue sharing and fiscal grants.

Non-tax revenue which consists of registration fees, administrative fees, and other service charges have significant contribution to the provincial revenue. For Gandaki province the contribution of non-tax revenue is NPR 1.31 billion, which is 15 percent of total revenue of the province. For Province 5 contribution of non-tax revenue is NPR 1.20 billion, which is 11 percent of total revenue of the province.

Table 9. Provincial tax and non-tax revenue FY 2018/19 (NPR, in billions)

Particulars	*Gandaki Province*	*Province 5*
Provincial share of VAT	4.90	5.41
Provincial share of Excise	1.18	1.60
Internal revenue	3.24	2.46

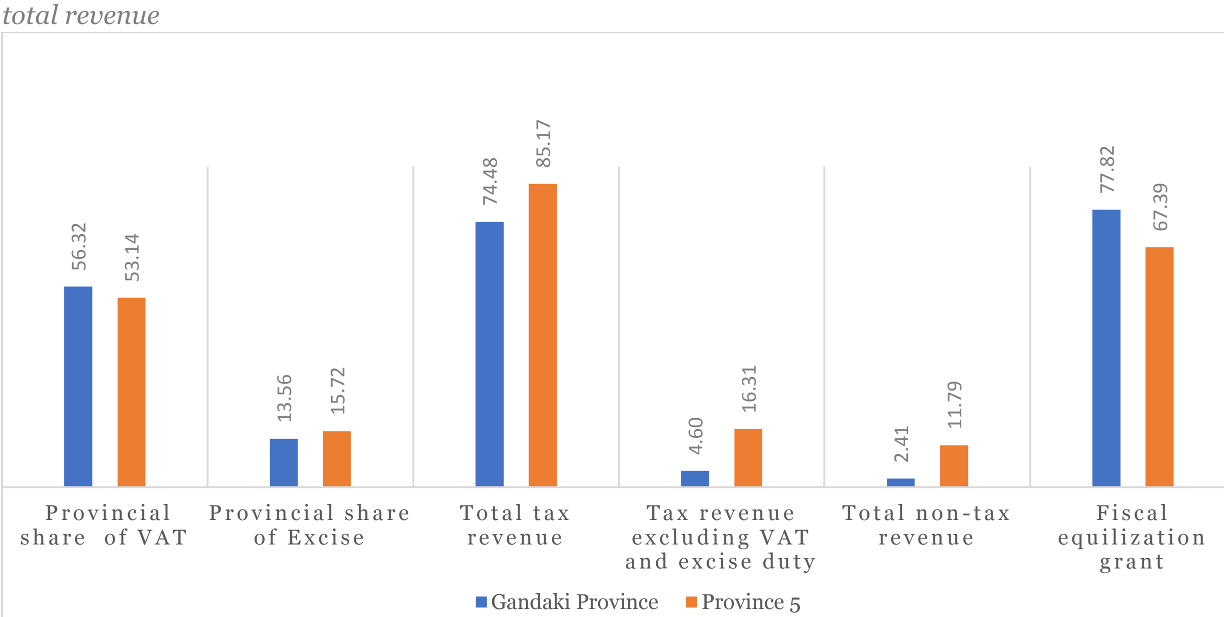
[16] The data of revenue covers around seven months of the fiscal year.

Total tax revenue	**6.48**	**8.67**
Total non-tax revenue	**0.21**	**1.20**
Total revenue	**8.70**	**10.18**
Fiscal equalization grant	6.77	6.86
Conditional grant	6.04	9.69
Total Grant	**12.82**	**17.25**
Allocated budget expenditure	**16.13**	**23.09**

Source: Report from Provincial Comptroller General Office on Sanchit kosh and budget speech, 2075/76

Current composition of the sources of revenue for Gandaki Province and Province 5 indicates that provincial governments are relying heavily on central government for their source of revenue. Figure 1 summarizes the proportion of revenue sharing from central government, proportion of tax excluding VAT and excise, proportion of non-tax revenue calculated as percentage of total revenue for the provinces. Proportion of VAT ranges from 56 to 53 percent of total revenue of Gandaki Province and Province 5 respectively. In contrast, the percentage of tax revenue collected excluding the revenue transfer is four percent and 16 percent for Gandaki Province and Province 5, respectively. Proportion of tax revenue is 74 percent and 85 percent of total revenue for Gandaki Province and Province 5 respectively.

Figure 1. Summary of proportion of taxes, fees, and grants from central government as percentage of total revenue



Source: Author's calculation using the revenue data provided in Table 9.

Table 10 summarizes the breakdown of some provincial tax and non-tax revenues of two provinces. Both the provinces have not collected any agriculture income tax, which is the tax right solely provided to provincial government by the constitution.

Provincial government sets the rate and administers the vehicle tax and keeps 60 percent of total collection. Province 5 has better collection of vehicle tax compared to Gandaki province and hence has better share in total collection. Contribution of vehicle tax to revenue of Gandaki province is NPR 5.6 million as compared to NPR 998 million for Province 5. There is no further detail on vehicle tax collected apart from the total amount, hence it limits further analysis of the causes of difference in revenue collection.

Other taxes such as advertisement tax and entertainment tax are administered by local government and provincial government receives 40 percent of the collection. These taxes are not well utilized and hence the collection and sharing of these taxes do not contribute significantly to total revenue collection. For example, Gandaki province received NPR 3.9million from advertisement tax whereas Province 5 received only NPR 0.06 million. Gandaki province received NPR 1.1 million from entertainment tax whereas Province 5 does not have any revenue from entertainment tax. Contribution of local level taxes such as vehicle tax, advertisement tax, entertainment tax, and agriculture income tax to total revenue of province is minuscule compared to the total revenue and expenditure of provinces. Contribution of these local taxes to total revenue of Gandaki province is .0001 percent whereas contribution for Province 5 is 0.009 percent.

Apart from these taxes house and land registration does have higher contribution relative to local taxes in Gandaki Province. The contribution is NPR 436 million. For Province 5, the contribution of house and land registration is NPR 816 million.

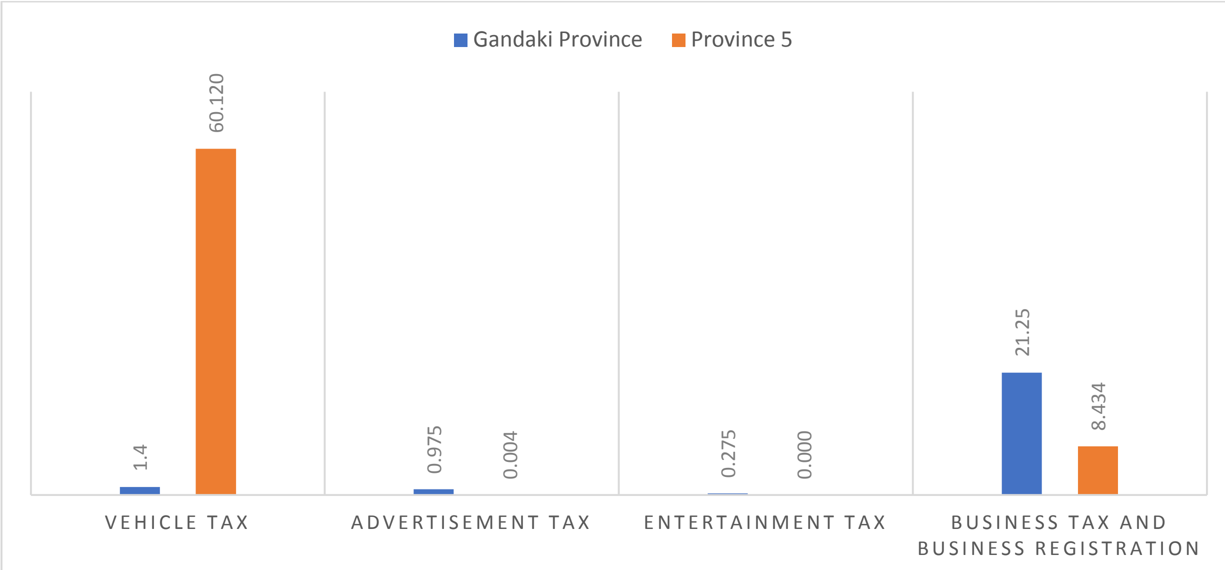
Table 10. Break down of some provincial own source revenues for FY 2018/19 (NPR, in millions)

Particulars	*Gandaki Province*	*Province 5*
	Tax Revenue	
Vehicle tax	5.6	998
Advertisement tax	3.9	0.06
Entertainment tax	1.1	
Business tax and business registration	85	140
Agriculture income tax	No collection	No collection
	Non-tax revenue	
House land registration	436	816
Royalty	NA	250.9

Source: Report from Provincial Comptroller General Office on Sanchit kosh and budget speech, 2075/76

Figure 2 illustrated the proportion of taxes calculated as percentage of provincial tax revenue excluding the revenue transfer from the central government. The present condition of utilization of taxes assigned is minimal. Contribution of vehicle tax, advertisement tax, entertainment tax is minimal. Most of the proportion is less than one percent of tax revenue generated excluding the revenue transfer from the central government. Exception to this is the vehicle tax collected in Province 5. Business tax and business registration for both the provinces have higher proportion relative to other taxes. The proportion are 21 percent and 8.4 percent of tax revenue excluding the revenue transfer.

Figure 2. Tax collected as percentage of provincial tax revenue excluding revenue transfer



Source: Author's calculation using the revenue data provided on Table 10.

3.3. Overview of municipal revenue

Table 11 summarizes revenue and expenditure for Pokhara metropolitan and Butwal sub-metropolitan. External revenue, which consists of grant from central government and revenue sharing, makes up greater proportion of revenue collected by these local governments. Grants from central government makes up 47 percent of total revenue collected by Butwal and 60 percent of total revenue collected by Pokhara.

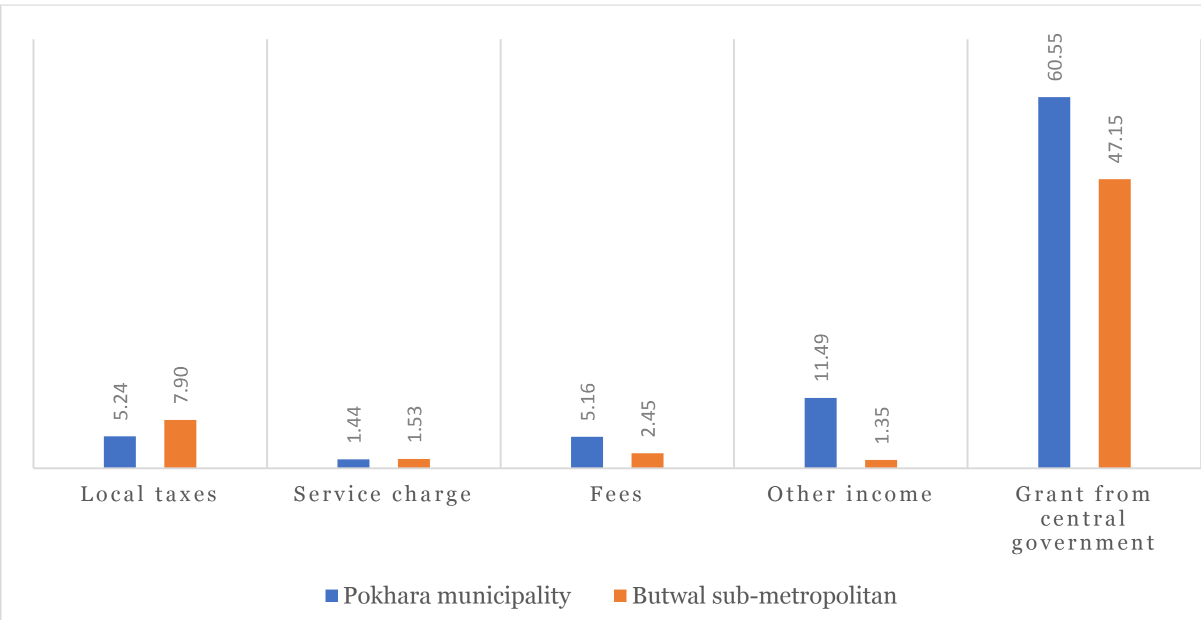
Local taxes (sole rights and concurrent rights) constitute higher proportion of internal revenue in both municipalities. Butwal collected NPR 129 million from local taxes of which higher contribution was from property tax. It contributed NPR 64 million. Pokhara collected NPR 196 million from local taxes with highest share of property taxes. It contributed NPR 145 million. Overall contribution of local taxes to the total revenue is seven percent for Butwal and five percent for Pokhara. Whereas the contribution of grant from central government is 60 percent and 47 percent of total revenue for Pokhara and Butwal, respectively. At municipal level, the contribution of grant from central government is higher relative to the contribution of OSR. The breakdown of local own source revenue is presented in Table 12 and the percentage of taxes, fees, and grants is displayed in Figure 3.

Table 11. Municipal Revenue and Expenditure 2017/18 (NPR, in millions)

Particulars	*Pokhara municipality*	*Butwal sub-metropolitan*
Internal Revenue		
Local taxes	196	129
Service charge	54	25
Fees	193	40
Sales		.96
Other income	430	22
Total internal revenue	1143	220
External revenue/other sources		
Grant from central government	2265	770
Total Revenue	**3766**	**1135**
Total Expenditure	**3592**	**1062**

Source: Revenue report from respective municipalities

Figure 3. Summary of proportion of taxes, fees, and grants from central government as percentage of total revenue



Source: Author's calculation using the revenue data provided on Table 11.

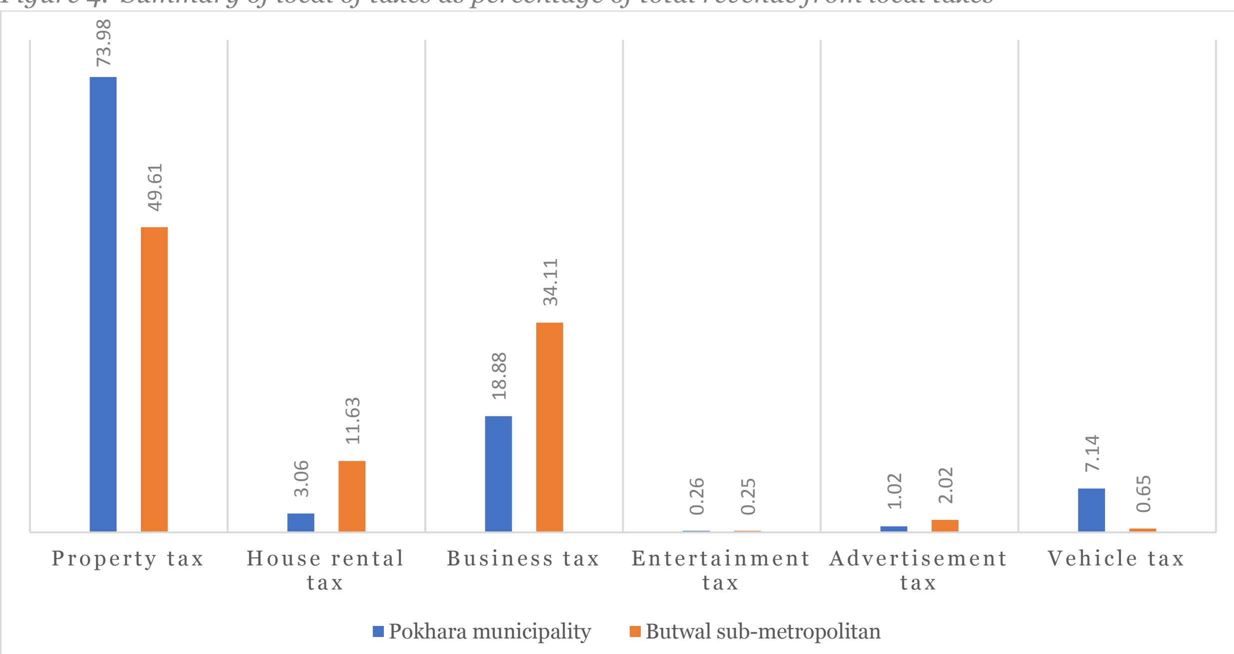
Further breakdown of local taxes as percentage of total revenue from local taxes (Table 12 and Figure 4) indicates that property tax and business tax have been utilized more, relative to other taxes. The share of property tax is 73 percent and 49 percent of total local taxes for Pokhara and Butwal, respectively. Whereas share of business tax is 18 percent and 34 percent for them. The contribution of advertisement tax and entertainment tax is minimal to the total revenue from local taxes.

Table 12. Breakdown of some municipal own source revenues for FY 2017/18 (NPR, in millions)

Particulars	*Pokhara municipality*	*Butwal sub-metropolitan*
Property tax	145	64
House rental tax	6	15
Business tax	37	44
Entertainment tax	0.5	0.32
Advertisement tax	2	2.6
Vehicle tax	14	0.84
Bahalbituari	No collection	
House and land registration	2.1	0.3
Tourism fee	5	1.05
Local tax on wool, leather, bones, medicinal herbs	18	-

Source: Revenue report from respective municipalities

Figure 4. Summary of local of taxes as percentage of total revenue from local taxes



Source: Author's calculation using the revenue data provided on Table 12.

3.4. Overview of rural-municipal revenue

Table 13 summarizes revenue and expenditure for Kaligandaki and Chhatradev rural municipality. External revenue, which consists of grant from central government and revenue sharing, makes up higher proportion of revenue collected by these local governments relative to OSR. For Kaligandaki, grant from central government denotes 60 percent of total revenue collected. Similarly, for Chhatradev, grant from central government represents 82 percent of total revenue collected.

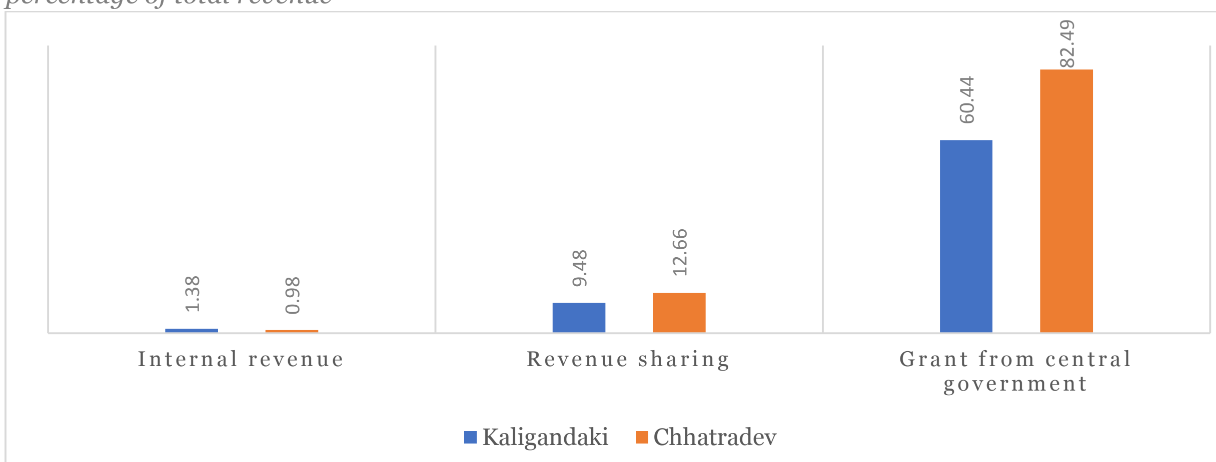
Internal revenue collected by Kaligandaki for FY 2018/19 is NPR 6.7 million whereas for Chhatradev it is NPR 4.3 million. For Kaligandaki, internal revenue makes up 1.38 percent of total revenue collected and for Chhatradev contribution of internal revenue is 0.98 percent of total revenue collected.

Table 13. Rural municipality revenue and expenditure FY 2018/19 (NPR, in millions)

Particulars	*Kaligandaki*	*Chhatradev*
Internal revenue	6.7	4.3
Revenue sharing	45.9	55.5
Fiscal equalization grant	80.9	91.6
Conditional grant	176.6	260.9
Complementary grant	15.09	9.2
Special grant	20	
Total revenue	**484.1**	**438.5**
Total expenditure	**414**	**415.1**

Source: Revenue report from respective rural- municipalities

Figure 5. Summary of proportion of taxes, revenue sharing, and grants from central government as percentage of total revenue



Source: Author's calculation using the revenue data provided on table 13.

Table 14. Breakdown of some rural municipality own source revenue for FY 2018/19 (NPR, in millions)

Particulars	*Kaligandaki*	*Chhatradev*
Integrated property tax		0.49
Land tax (Malpot)	0.41	0.6

House and land registration	0.42	1.16
House rental tax	0.35	0.04
Vehicle tax	No collection	No collection
Advertisement fee	No collection	No collection
Entertainment tax	No collection	No collection
Tourism fee	No collection	No collection
Local tax on medicinal herbs, wool, etc.	No collection	No collection
*Recommendation fees (*Sifaris dastur*)*	1.5	1.62
Business registration	0.18	0.31

Source: Revenue report from respective rural- municipalities

For Kaligandaki and Chhatradev rural municipality recommendation fees (*sifaris dastur*) contributes more to the own source revenue. Kaligandaki collected NPR 1.5 million and Chattaradev collected NPR 1.62 million in recommendation fees. This is followed by house and land registration with NPR 0.42 million and 1.16 million, respectively. Land tax is six percent and 13 percent of internal revenue for Kaligandaki and Chhatradeve respectively. Whereas house and land registration is six percent and 26 percent of internal revenue for them. Breakdown of some of the OSR is presented in Table 14. These rural municipalities do not have revenue collection from advertisement tax, entertainment tax, business tax, vehicle tax, tourism fee, etc.

3.5. Discussion of revenue collection and gap at sub-national level

This section discusses the revenue collection and gap using projected revenue from budget speeches from respective selected sub-national governments, and factors associated with revenue collection gap such as tax administration, tax rate, and tax base.

3.5.1. Share of tax revenue in total revenue collection

For central government the share of tax-revenue (composed of VAT, excise tax, custom duty, income tax, corporate income tax etc.) ranges between 79 percent and 85.7 percent of total revenue collected for FY 2015/16 to FY 2017/18 (see Table 15), whereas the share of tax revenue of total revenue collected is minimal for sub-national governments. The share of tax revenue is four and 16 percent for selected provincial governments (Figure 1). The share is five and seven percent of total revenue collected for selected municipal and local government (Figure 3). For selected rural municipal governments, the share of tax revenue is 0.9 to 1.3 percent of total revenue collected (Figure 5). For sub-national government larger share of total revenue comprise of revenue sharing (from VAT and excise on domestic production) from central government, royalty sharing, and fiscal transfers and grants etc. Stakeholders consulted at sub-national governments raised the concern that all the important taxes with potential to generate substantial revenue (i.e. VAT, excise, income tax, corporate income tax etc.) are assigned to central government and the tax assigned to sub-national government does not have potential to generate significant revenue. This might be valid point but there could also be other factors such as underutilization of assigned taxes, ineffective tax administration, leakages in revenue collection etc. These factors need to be addressed with appropriate institutional and policy reforms.

Table 15. Structure of central government income (in percentage)

Particulars	FY 2015/16	FY 2016/17	FY 2017/18
Tax revenue as percentage of total revenue collection	79.2	85.5	85.7
Non-tax revenue as percentage of total revenue collection	11.5	8.5	9.5
Tax revenue as percentage of GDP	18.69	20.71	21.76

Source: Economic Survey (2017/18) and (2018/19)

3.5.2. Revenue collection gap

Revenue collection gap is defined as:

Revenue collection gap for fiscal year= Potential revenue in FY- Actual revenue in FY

Due to lack of data and information on revenue potential from local taxes for selected sub-national government, projection of expected revenue from the budgets of selected provincial and local governments are used as proxy for the potential revenue. Thus, the revenue gap using projected revenue from the budget is calculated as:

Revenue collection gap for fiscal year= Expected revenue in FY- Actual revenue in FY

In this calculation, positive number indicates gap in revenue collection and negative number indicates surplus collection, which means actual collection exceeds the expected revenue collection. The data on expected/projected and actual revenue are obtained from budget speeches and revenue collection reports from each of the selected provincial and local governments. Table 16 to 18 provides summary of expected revenue and revenue collection gap. Actual collection for Provincial governments (Gandaki Province and Province 5) and rural municipalities uses actual collection for first seven months of the fiscal year. This was the data available to the study team during the field visit. The collection gap would be different if the actual collection for whole of the fiscal year is used. The section following this one (*Section 3.6*), presents the estimates of the revenue potential for business tax, property tax, and house rental income tax and discusses the revenue collection gap in relation to estimated revenue potential.

Gandaki province has revenue collection gap under some major tax and non-tax revenue headings for FY 2018/19. The collection gap for house and land registration is NPR 664 million (20.49 percent of internal revenue) while that for vehicle tax is NPR 1,494 million (46.11 percent of internal revenue). The collection for advertisement and entertainment tax exceeds the expected revenue collection for Gandaki province. Province 5 has collection gap of NPR 142 million (5.75 percent of internal revenue) for vehicle tax but has collection surplus of NPR 136 million (5.51 percent of internal revenue) for house and land registration.

Table 16. Summary of provincial expected Own source Revenue collection and collection gap (NPR, in millions)

Particulars	*Gandaki Province*			*Province 5*		
	Expected revenue for FY 18/19	Collection gap (expected-actual collection) for FY 18/19	Collection gap/surplus as percentage of internal revenue	Expected revenue for FY 18/19	Collection gap (expected-actual collection) for FY 18/19	Collection gap/surplus as percentage of internal revenue
House and land registration	1100	664	20.49	680	-136	5.51
Vehicle tax	1500	1494	46.11	1140	142	5.75
Entertainment tax	1	-.01	0.00	0	NA	NA
Advertisement tax	1.5	-2.4	0.00	0		
Agriculture income tax	0	No collection		0	No collection	NA
Dahattar Bahattar	150			0		
Tourism fee	1			NA	NA	NA
Royalty	2.5			110	-140.9	5.67
Total tax revenue	**9178.5**	**2698**		**1820**	**-6850**	
Other revenue	**203.5**			**8300.6**		
Total revenue and grant	**21408**			**28090**		

Source: Compiled from Budget Speech 2076/77 of respective provinces.

Pokhara municipality has revenue collection gap under various tax and non-tax heading in FY 17/18. The revenue collection gap for house rental tax is NPR 53.6 million (4.68 percent of internal revenue) and for vehicle tax is NPR 23.5 million (2.05 percent of internal revenue). Revenue collection gap for house and land registration is NPR 647.6 million (56.6 percent of internal revenue) and for tourism fee is NPR 145 million (12.68 percent of internal revenue).

Table 17. Summary of municipality expected own source revenue collection and gap (NPR, in millions)

Particulars	*Pokhara*			*Butwal*		
	Expected revenue for FY 17/18	Collection gap (expected-actual collection) for FY 17/18	Collection gap/surplus as percentage of internal revenue	Expected revenue for FY 17/18	Collection gap (expected-actual collection) for FY 17/18	Collection gap/surplus as percentage of internal revenue
Property tax	130	-5	0.00	52.5	-11.5	5.22

House rental tax	60	53.6	4.68	11	-4	1.81
Business tax	40	3	0.00	20	-24	10.90
Entertainment tax	10	9.5	0.00	0.5	0.18	0.00
Advertisement tax	10	7.7	0.00	3	0.4	0.00
Vehicle tax	37.5	23.5	2.05	2.5	1.66	0.00
House land registration	650	647.9	56.6	20	19.7	8.95
Bahal Betauri	30	No collection	NA	4	-	-
Tourism fee	150	145	12.68	1.9	0.85	0.00
Local tax on wool, leather, bones, medicinal herbs,	20	2	0.00	-	-	-
Other revenue	123	-	155	-	-	-
Services charges	40.5	-	10	26.5	-	-
Total revenue	**4291**	**-**	**-**	**1633.5**	**498**	**-**
Internal Revenue	**1384**	**241**	**-**	**107.5**	**-112.5**	**-**

Source: Compiled from budget speech 2018/19 and 2019/20 of respective municipality

Butwal Sub-metropolitan city has surplus of NPR 11.5, 4, and 24 million for property tax, house rental income tax, and business tax respectively. This translates to 5.22, 1.81, and 10.90 percent of internal revenue respectively. The city has collection gap of NPR 0.18, 0.4, 1.66, and 19.7 for entertainment tax, advertisement tax, vehicle tax, and house and land registration respectively. Collection gap for entertainment tax, advertisement tax, and vehicle tax is minimal as percentage of internal revenue for the city. The collection gap for house and land registration is 8.95 percent of internal revenue.

Kaligandaki Rural Municipality also has revenue collection gap for the FY 18/19. Revenue collection gap for land tax is NPR 0.09 million (1.34 percent of internal revenue), for rental tax is NPR 0.15 (2.23 percent of internal revenue) million while that for other services and fees is NPR 1 million (14.92 percent of internal revenue). Chhatradev Rural Municipality does not have data for expected revenue collection for FY 18/19 in their budget documents. Rural municipalities are not fully able to utilize tax rights assigned to them, for example advertisement tax, entertainment tax, business tax etc. due to lack of relevant economic activities in the area.

Table 18. Summary of rural municipality expected own source revenue collection and gap (NPR, in millions)

Particulars	*Kaligandaki*			*Chhatradev*		
	Expected revenue for FY 18/19	Collection gap (expected-actual collection) for FY 18/19	Collection gap/surplus as percentage of internal revenue	Expected revenue for FY 18/19	Collection gap (expected-actual collection) for FY 18/19	Collection gap/surplus as percentage of internal revenue
Land tax/malpot	0.5	0.09	1.34	NA	-	
House land registration	0.42	0	-	-	-	
Rental tax	0.5	0.15	2.23	-	-	
Business tax	0.5	-	-	-	-	
Service fees and other registration charges	2.5	1	14.92	NA	-	
Other income	1	-	-	NA	-	
Vehicle tax	NA	-	-	NA	-	
Local tax on wool, medicinal herbs	-	-	-	-	-	
Water resource royalty	NA	-	-	NA	-	
Total internal source	**NA**	**-**	**-**	**NA**	**-**	

Source: Compiled from Budget Speech 2019/20 of respective rural municipality

3.5.3. Tax administration as the factor for revenue collection gap

The revenue collection gap discussed previously is based on the expected revenue and actual revenue collection. However, this projection of expected revenue, provided in budget speeches, is based on revenue collection trend of past years, and is not based on detailed study of revenue potential in the area. The expected revenue projection is set on ad-hoc basis according to some of stakeholders consulted by the study team during the field visits. In this context, the revenue collection gap does not provide true picture as the target set is not based on detailed revenue potential in provincial and local governments. Thus, detailed research on revenue potential is urgent to get the true picture. Next section presents estimates of revenue potential for business tax, property tax, and house rental income tax, while this estimate gives some idea of revenue potential from these taxes for selected sub-national governments, it should not be considered a substitute for detailed revenue potential study. Such research will also help sub-national governments to set and revise the tax rates and tax base to suit the economic activities in the area as well as willingness and ability to pay taxes of taxpayers. This in turn will help increase revenue of sub-national governments and reduce the revenue collection gap by focusing on tax and non-tax sources with greater potential. Thus, lack of detailed study of the revenue potential is one of the major reasons for revenue collection gap.

Underutilization of current tax rights due to weak tax administrative capacity at sub-national level is also another factor for revenue gap. Tax administrative capacity ranges from infrastructures to skilled personnel, ability to enforce taxes, among others. Tax administration does cover two aspects of tax enforcement and collection namely: ability of government to enforce the taxes and compliance of taxpayers. In general compliance from taxpayers depends on efficiency of tax-administration and services (i.e. ease of payment, friendly attitude of tax officers, ease in paperwork, digital options to pay taxes etc.) provided by sub-national governments using those taxes. These two combined affects revenue collection and utilization of tax rights. Some of the administrative challenges are detailed in Table 19. It is also important to note that the administrative readiness to administer (impose and collect) taxes requires backing of strong political will. In addition, it is also important to link local services such as education, water and sanitation, sewage, roads etc. be funded and supported by local taxes for effective tax administration.

Table 19. Summary of results from field study on administrative capacity

Particulars	*Present condition*
Infrastructure (buildings/furniture/computers etc.) of revenue department	• Present infrastructure is enough just to get by daily functions; most offices do not have their own building
Knowledge of staffs of revenue administration	• Lack of skilled personnel trained in taxation and revenue administration • Most staffs related to tax and revenue are sent to sub-national governments are from central government and are assigned there for short duration which affects the capacity development • Needs capacity development
Records/database of tax bases (land, property, businesses, income, transactions etc.)and tax payers	• Lack of proper database • Current level of information is not sufficient
Information/database necessary to determine tax in the area	• Data collection work is in progress
Possibility of leakages on tax collection and its prevention	• Serious leakage problem
Compliance from taxpayers (individuals, businesses etc.)	• Lack of timely payment and lack of incentive to pay actual amount of taxes

	• Issues of double balance sheet, fake invoices, and less reporting of incomes • Collusion among tax administrators and taxpayers which results in leakages
Ability to identify, reward, and punish the taxpayers	• Recognition and rewarding of best taxpayer in the area
Information and awareness programs for taxpayers	• Through phone, newspapers, website
Involvement of stakeholders in determination of tax rates	• Stakeholders are involved especially through *Rajasow Paramarsha Samiti* in some areas whereas in some areas involvement is minimal
Co-ordination with other departments and other tiers of government	• Co-ordination is minimal
Transparency of revenue/expenditure records	• Transparency is not complete

3.5.4. Tax base and tax rate as the sources of revenue collection gap

Tax base and tax rate on those bases could also be one of the reasons for revenue collection gap. For rural municipality most of the tax rights assigned, no matter how the tax base is defined, is underutilized due to lack of economic activities in the area. The taxes that are underutilized are: advertisement tax, rental tax, entertainment tax, business tax, local natural resources taxes etc. For municipalities, the tax base of property/house land taxes, though it is a major source of revenue, is not based on scientific assessment of economic activities generated from the property. Rather the tax base and tax rates are set based on market value of land (which suffers from high inflation itself) and such valuation is mostly subjective and does not follow any proper valuation standards or guidelines and hence differ according to areas. House rental taxes, which can be source of significant revenue, also suffers from issues such as flat rate of 10 percent of rental income regardless of volume of transaction. For provincial government it is difficult to generate the tax revenue from agricultural income tax regardless of how the tax rate is defined.

Overall, sub-national government also faces challenges of linking the services provided to the tax rates and tax bases. Taxpayers are not seeing the direct connection between tax paid and services received and hence they do not have any incentive to pay those taxes. The general overview tax and non-tax sources of sub-national government and their rates is presented below in Table 20.

Table 20. Brief summary of tax and non-tax rates of sub-national government

Tax heading	Tax base	Gandaki Province/Pokhara/ Kaligandaki	Province 5/Butwal Municipality/ Chhatradev	Remarks
House and land	All house and land	`		

registration fee				
Vehicle tax	Private vehicles in the province	Tax rate depends on type of vehicle and engine capacity. For example: car, van up to 100cc NPR 20k, motorcycle up to 125cc pays NPR 2.6K whereas 401 cc or higher pays NPR 16K.	Tax rate depends on type of vehicle and engine capacity. For example: car, van up to 1000 cc pays NPR 20K, motorcycle up to 125 cc pays NPR 2.5 K whereas 401 cc or higher pays NPR 20K, Excavator pays NPR 20 K.	Pokhara Municipality has decided not to register rickshaw, auto rickshaw, e-rickshaw. Butwal sub-metropolitan charges NPR1,500 for e-rickshaw and NPR 100 for manual rickshaw.
Entertainment tax	Movie theatre, play theatre, circus, sports, trade fare and exhibitions	Tax rate is 5 percent entry fee. For events (i.e. summit, concerts, circus etc.) the tax ranges from NPR 1K to NPR 20k based on the type and duration of events. For events lasting more than week additional 100 percent tax.	Tax rate is 5 percent of entry fee or ticket price. If there is no provision of ticket the lump sum tax amount ranges from NPR 2.5K to NPR 150 K depending on the duration of events (i.e. summit, concert) (in number of days) and location of events.	
Advertisement tax	Advertisement materials	Rates range from NPR 30 annually for wall paint, shutter paint to NPR 3,000 for advertisement events.	Rates ranges from NPR 50 to NPR 150 per sq/ft based on types of advertisement materials.	
Tourism fee	All tourist attractions inside province	Tax rate is 5 percent of entry fee. For paragliding, bungee jumping NPR 100K annually. For rock climbing NPR 20K annually.	Tax rate is 5 percent of entry fee.	
Agriculture Income tax	Income from agriculture excluding	Tax exempt up to NPR 1 million	Tax exempt up to NPR 450 K	

	commercial agriculture	1 percent tax on income up to NPR 2 million 2 percent tax on income above NPR 2 million	5 percent tax on income from 450k to 1050 K 10 percent tax on income from 1050 K to 2050 K 15 percent tax on income above 2050 K
Natural Resource Tax	Gravel stone, soil, clay, Dahattar bahattar	Gravel stone NPR 4/cubic ft, clay NPR 3/cubic ft., Soil NPR 2/cubic ft., limestone NPR 6/cubit ft. Dahattar bahattar—NPR 2/kg	Gravel stone and clay—NPR 6/ cubit ft in Tarai and NPR 3/cubit ft in hill region Soil—NPR 2/cubic ft in Tarai and NPR 1/cubic ft in hill region Dahattar bahattar—NPR 1/kg
Property tax/Land tax (malpot)	Land and building owned either by individual or an organization	Land tax rate ranges from .006 percent to .06 percent of valuation of land. Valuation ranges from NPR .1 million to NPR 60 million. Whereas property tax rate ranges from .01 percent to .11 percent of property valuation. For Kaligandaki rural municipality the property tax ranges from NPR 25 to NPR 100.	Property valuation ranges from NPR 0.5 million to 50 million and tax rate ranges from NPR 100 to NPR 55000. For Chhatradev rural municipality the property tax ranges from NPR 50 to NPR 200.
House rental tax	On rental income of the property either land, house, pond, factory, etc.	Whichever is higher: either 10 percent of rental income or tax on minimum rental rate determined by the municipality.	Whichever is higher: either 10 percent of rental income or tax on minimum rental rate determined by the municipality.

Business tax	All registered businesses	Tax ranges from NPR 1000 to NPR 45,000 based on capital and investment.	Lump sum amount based on type of business if any business does not fit into the category of municipality then the tax is levied based on capital and investment. For capital investment ranging from NPR .01 million to 2 million the tax rate ranges from NPR 1,000 to 20,000.
Bahalbetauri	Rental spaces for business established by municipality	Rate ranges from NPR 1,500 to NPR 2000 annually.	Rate ranges from NPR 25 to 100 per day.

Source: Compiled from economic act of respective provinces, municipality, and rural municipality.

3.6. Estimation of revenue potential (business tax, house rental income tax, and property tax)

This section presents the estimate for revenue potential for property tax, house rental tax, and business tax for the provincial and local governments. Though business tax, house rental income tax, and property are exclusive right of local governments, revenue potential is also estimated at province level to get an idea of revenue that can be generated from all local governments in the province from these taxes. The estimation of revenue potential at the provincial level is not relevant to calculate the revenue potential gap but this estimation can be useful for policy formulation and preparation of guidelines by provincial governments to help local governments to effectively administer these taxes. Data to estimate the revenue potential, related to number of houses, proportion of houses rented, types of houses, and number of businesses in Gandaki Province and Province 5 is obtained from the National Economic Census (2018) and the National Population and Housing Census (2011).

The data on number of businesses being recent does not require any projection and it is used as a tax base to estimate revenue potential for business tax. However, number of houses by ownership status and by types from population census are from 2011 and thus require some approximation, with appropriate growth rate, to get an assessment of these variables in 2019/20. The tax rates used are selected such that they are both representative and avoids extremities (close to the average tax rates). The tax rates used for revenue estimation are actual tax rates prevalent in selected sub-national governments as provided in economic act, budget and programs. Then the revenue potential is estimated as product of tax base and tax rate. These estimates of revenue potential are sensitive to changes in assumptions of growth rate of tax bases (i.e. number of houses and proportion of house rented) and tax rates used.

The assumptions regarding the tax base and tax rate used for revenue estimation are fairly conservative (tax rates, rate of rents, rates used for projection, and valuation of property are all selected to be on the lower end of prevalent rates) and the local governments should be able to generate estimated revenue provided strong tax enforcement and efficient administration, and full coverage of tax base.

3.6.1. Revenue potential of business tax

Local governments levy lump-sum annual business tax using either the capital of business or the type of business as base. For this estimation, due to lack of detailed data on businesses and startup capital, number of business with information on broad sectors and registration status are used. Number of business establishments by sectors is obtained from National Economic Census 2018 and is used as tax base to estimate revenue potential for business tax. Around 11 percent of total business establishments in the census are in Gandaki Province and 16 percent are in Province 5. Wholesale retail and trade and food and accommodation make up higher percentage of businesses compared to other sectors.

To keep the revenue potential estimation simple and comparable to each other, a common tax rate, a fairly representative tax rate is referred. Revenue potential for business tax is estimated using two methods. First method used number of business establishments in the area by registration status and second method uses number of business establishment in the area by sectors.

In the first method all businesses are treated as similar to each other and the variation in the revenue potential is generated from different tax rates. This is done to curve the requirement of intensive data on size, type, startup capital, and location of businesses. Because of which, the difference in revenue potential arises from difference in number of businesses in the area. First method also generates the revenue potential for registered and unregistered businesses. The tax rate used for the estimation are: NPR 500, NPR 1000, NPR 2500, NPR 5000, and NPR 7500 annually. These five tax rates are selected from tax rates prevalent in Pokhara and Butwal from nearly 420 different business tax rates covering various businesses and their categories. The selected tax rates cover most of the rates and businesses represented in the study area.

Under the second method, business establishment is categorized as: manufacturing, wholesale and retail, food and accommodation, and others. Second method does not make distinction between registered and unregistered businesses and treats them as same due to lack of data on sectors of businesses by its registration status. Then two group tax rates are used for these businesses to estimate the revenue potential. First group of tax rate is NPR 3,000 for others and NPR 5,000 annually for rest of the sectors. Second group of tax rate is NPR 5,000 for others and NPR 10,000 for wholesale and retail and food and accommodation, and NPR 12,000 annually for manufacturing. Second method allows to use specific tax rates per sectors due to availability of information of businesses by sectors, which was not possible in the first method.

Data available to the study team from National Economic Census does not have the data of businesses by municipality thus this estimation assumes that 80 percent of businesses in Kaski district are in Pokhara (as it is the only municipality in the district) and 30 percent of businesses in Rupendehi are in Butwal (as there are merely two other municipalities of similar size and economic activity).

The estimated revenue potential from (first method) business tax in Gandaki Province ranges between NPR 50 million and 755 million whereas for Pokhara Metropolitan the revenue potential ranges from NPR 12 million to 184 million. The revenue potential for Province 5 is between NPR 73 million and NPR 1,108 million whereas the revenue potential for Butwal sub-metropolitan ranges from NPR 5.5 million to 86 million. For business tax, the local governments are missing all the potential revenue from unregistered businesses. The revenue from unregistered businesses in Gandaki Province ranges from NPR 22 million to 336 million and for Province 5 from NPR 35 million to 527 million.

The estimated revenue potential from the second method is slightly higher than the first method as the tax rate used are slightly higher than the rates in the first method. For Gandaki province the revenue potential ranges between NPR 457 million and 912 million. For Pokhara Metropolitan the revenue ranges from NPR 113 million to 227 million. Similarly, for Province 5 the revenue potential is between NPR 680 million to 1,364 million and between NPR 54 million to 108 million for Butwal sub-metropolitian. The detail of revenue potential from business tax is presented in Figure 6 and Table 21 below.

Figure 6. Summary of revenue potential for different business tax rates from method 1 for Pokhara and Butwal (in NPR million).

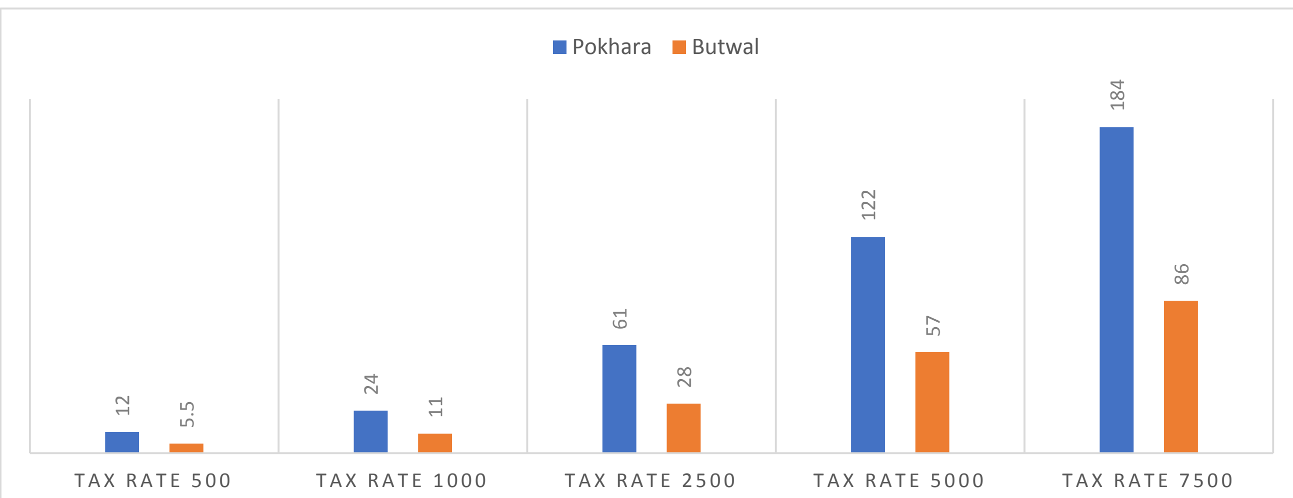


Table 21. Revenue potential for business tax

	Number of establishments	Revenue potential of all businesses from the first method (in NPR)	Registered businesses	Revenue potential of registered businesses from the first method (in NPR)	Unregistered businesses	Revenue potential of unregistered businesses from the first method (in NPR)	Number of businesses by category	Revenue potential from second method (in NPR)
Gandaki	100684	50 million	55872	27.5 million	44810	22 million	Manufacturing: 10928	
		100 million		55 million		44 million	Food and accommodation: 16011	
		251 million		135 million		112 million	Wholesale and retail: 50577	
		503 million		279 million		224 million	Others: 23168	
		755 million		419 million		336 million		Total revenue potential: 457 million to 912 million
Kaski District	30,745		18,754		12,170		Manufacturing: 2896	
							Food and accommodation: 6073	
							Wholesale and retail: 16197	
							Others: 5309	
Pokhara	24596	12 million	15003	7.5 million	9736	4.5 million	Manufacturing: 2316	Revenue from manufacturing: 11 to 27 million;
		24 million		15 million		9 million	Food and accommodation: 4858	
		61 million		37 million		24 million	Wholesale and retail: 12957	

		122 million 184 million		75 million 112 million		48 million 73 million	Others: 4247	Wholesale 64 to 129 million; Food and accommodation 24 to 48 million Total revenue potential: 1113 to 227 million
Province 5	147789	73.5 million 147 million 369 million 738 million 1108 million	77383	38.5 million 77 million 193 million 386 million 580 million	70392	35 million 70 million 175 million 351 million 527 million	Manufacturing: 16170 Food and accommodation: 18175 Wholesale and retail: 83672 Others: 29232	Total revenue potential: 680 to 1364 million
Rupendehi	38403		20,369		18,031		Manufacturing: 4022 Food and accommodation: 5277 Wholesale and retail: 23230 Others: 5784	
Butwal	11520	5.5 million 11 million	6110	3 million 6 million	5409	2.5 million 5 million	Manufacturing: 1206 Food and accommodation: 1583	Revenue from manufacturing 6 to 14

	28 million 57 million 86 million	15 million 30 million 45 million	13 million 27 million 40 million	Wholesale and retail: 6969 Others: 1762	million; wholesale 34 to 69 million; food and accommodation 7 to 15 million Total revenue potential: 54 to 108 million

Source: Data from the National Economic Census (2018), Revenue estimation: author's calculation

3.6.2. Revenue potential for house rental income tax

The revenue potential from house rental income tax is estimated only for the urban areas (municipalities only) of the provinces considered for the study as house rental income is prevalent only in urban areas for Gandaki Province and Province 5. The data on number of houses owned and rented is obtained from Population Census 2011. This requires projection of number of houses in 2019/2020. Number of houses grew by 30 percent between 2001 and 2011 according to the population census data. The number of houses between 2011 and 2019/20 is assumed to grow by following rates: growth by 30 percent, growth by 50 percent and growth by 100 percent.

The proportion of house rented for the areas ranges from 12 percent to 40 percent in 2011 according to the National Population and Housing Census (see detail in Table 22). Using the proportion of rented and owner occupied houses from the population census, the proportion of house rented in 2019/20 is assumed to be 40, 50, and 60 percent for Pokhara and Butwal. For all houses in urban areas of Gandaki Province is assumed to be 25, 30 and 35 percent while 15, 20 and 25 percent for Province 5. Once the tax base is calculated, which is number of houses that are rented under different growth rate and different proportion of house rented, the revenue potential from the rental tax is estimated using the following rents: NPR 5000, NPR 10,000, and NPR 15,000 (study team's educated guess of rents prevalent in urban areas of Gandaki Province and Province 5 including Pokhara and Butwal). Annual tax revenue generated for these rents at the rate of 10 percent of rental income is NPR 6000, NPR 12,000, and NPR 18,000 annually.

The estimated revenue potential from house rental income tax for urban areas of Gandaki Province ranges between NPR 704 million and 4551 million whereas that for Pokhara Municipality between NPR 329 million and 2,281 million. Revenue potential for urban areas of Province 5 ranges from NPR 560 million to 4313 million whereas that for Butwal sub-metropolitan ranges from NPR 106 million to 736 million. The details of revenue potential from house rental income tax is presented in Table 22 and Figure 7 below.

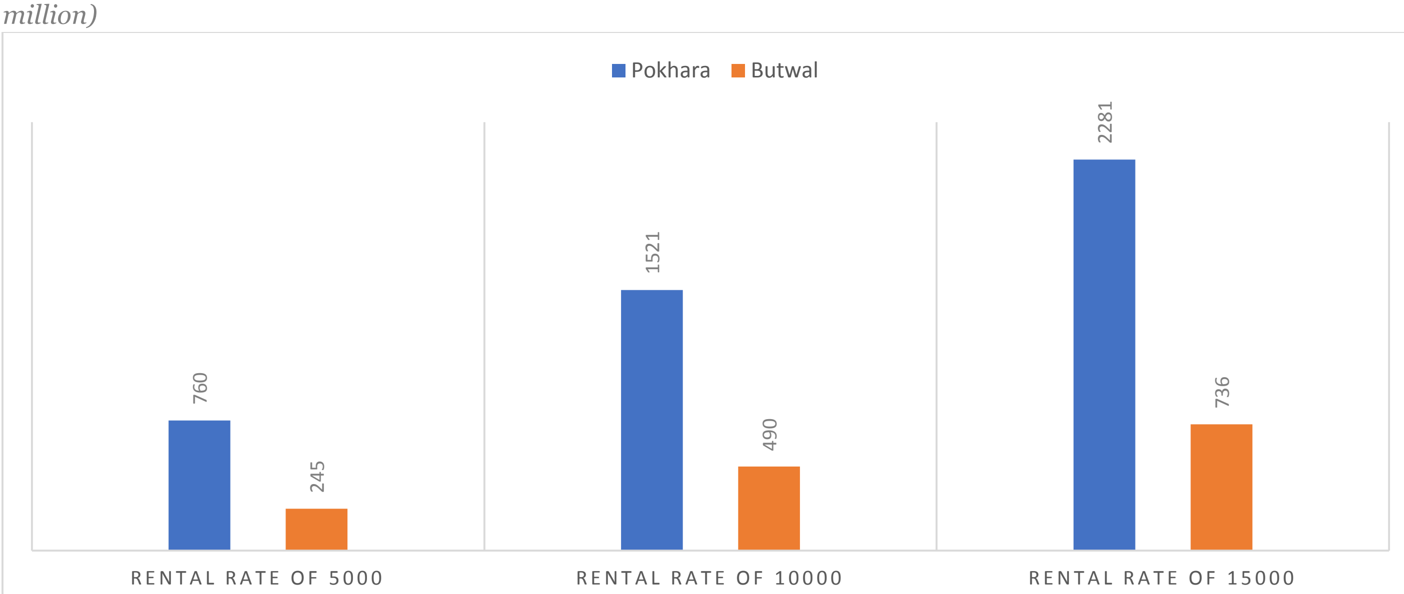
Table 22. Revenue potential for house rental tax

Province/local government	*Total in 2011*	*Rented in 2011*	*Proportion of rented in 2011*	*Number of houses in 2019/20 under three growth scenario*	*Number of houses rented under first proportion*	*Number of houses rented under second proportion*	*Number of houses rented under third proportion*	*Revenue potential under rent of 5,000 per month*	*Revenue potential under rent of 10,000 per month*	*Revenue potential under rent of 15,000 per month*
Houses in urban areas of Gandaki Province	361252	79638	22	469627.6 541878 722504	117406.9 135469.5 180626	140888.28 162563.4 216751.2	164369.66 189657.3 252876.4	NPR 704 million to NPR 1517 million	NPR 1408 million to NPR	NPR 2113 million to NPR 4551 million

									3034 million	
Pokhara-Lekhnath	10563 0	42991	40	137319 158445 211260	54927.6 63378 84504	68659.5 79222.5 105630	82391.4 95067 126756	NPR 329 million to NPR 760 million	NPR659 million to 1521 million	NPR 988 million to 2281 million
Houses in urban areas of Province 5	47927 0	61124	12	623051 718905 958540	93457.65 107835.75 143781	124610.2 143781 191708	155762.75 179726.25 239635	NPR 560 million to NPR 1078 million	NPR 1121 million to 2875 million	NPR 1682 million to 4313 million
Butwal	34097	13075	38	44326.1 51145.5 68194	17730.44 20458.2 27277.6	22163.05 25572.75 34097	26595.66 30687.3 40916.4	NPR 106 million to NPR 245 million	NPR 212 million to NPR 490 million	NPR 319 million to 736 million

Source: Data from the National Population and Housing Census (2011), Revenue estimation: author's calculation

Figure 7. Summary of revenue potential under different rental rates for Pokhara and Butwal (in NPR million)



3.6.3. Revenue potential for property tax

To estimate the revenue potential for property tax (tax on the valuation of house and land that the compound of house occupies), the study uses data on number of houses[17] by types of structure from the

[17] The data does not make distinction between commercial and residential property

Population Census (2011). The census has information on number of houses by types such as mud bonded with bricks/stones, cement bonded with bricks stones, RCC with pillars and wooden pillars. To estimate the revenue potential for this study the type of house is divided into RCC with pillars and all other types of houses are considered as similar hence this estimation has two categories of houses namely: RCC with pillars and mud/cement bonded/stone/bricks/wooden pillars.

Estimating the revenue potential of property tax requires projection of number of houses in 2019/2020. According to the census data number of houses grew by 30 percent between 2001 and 2011. The number of houses in 2019/20 is assumed to grow by following growth rates: growth by 30 percent, growth by 50 percent and growth by 100 percent for both houses in the urban areas (municipalities) and rural areas (rural municipalities) regardless of types of houses.

To calculate the revenue potential the tax rate used is as follows: in the rural areas, for mud/cement bound houses the rate is NPR 75, houses with RCC with pillar, the rate of NPR 100 is used. Likewise, in urban areas, for mud/cement bound houses the rate of NPR 500 is used and for houses with RCC pillar the rate of NPR 2000 (the property valuation of houses for this tax rate ranges from NPR 3 million to 4 million) is used. The tax rates used are prevalent in selected municipality and rural municipality.

The estimated revenue potential from property tax in Gandaki Province ranges between NPR 377 million and 581 million whereas in Pokhara sub-metropolitan ranges from NPR 184 million to 206 million. Revenue potential from property tax is low relative to urban areas, for Kaligandaki rural municipality the revenue potential ranges between NPR 0.4 million to 0.7 million. For Province 5, the revenue potential from property tax ranges from NPR 456 million to 705 million while for Butwal sub-metropolitan it ranges between NPR 42 million and 64 million. For Chhatradev rural municipality the revenue potential ranges from NPR 0.6 million to NPR 0.9 million. The summary of revenue potential is presented in Table 23 and Figure 8.

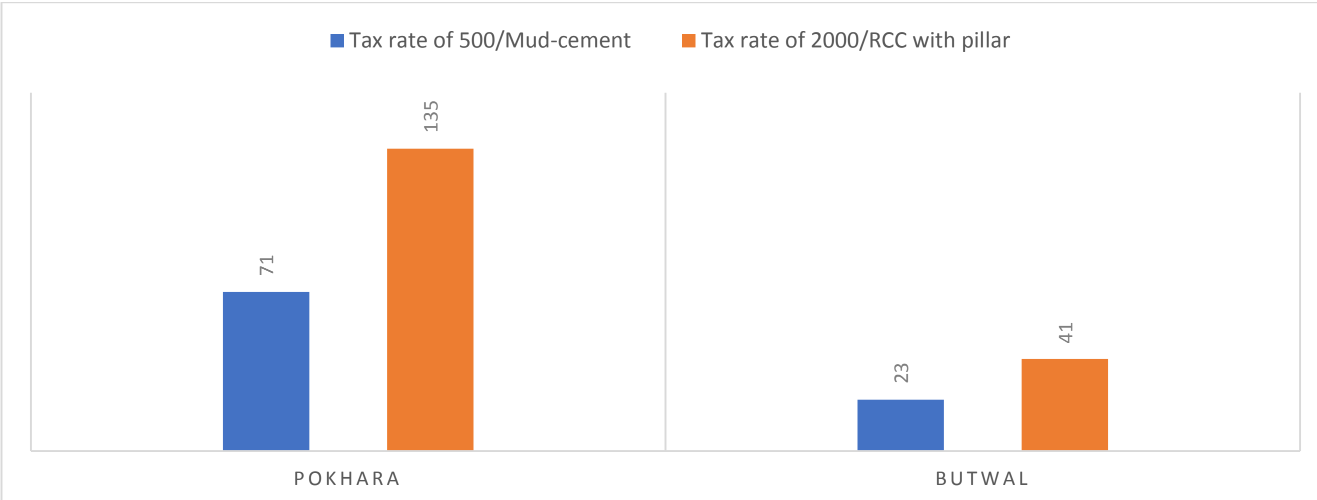
Table 23. Revenue potential from property tax

Province/Local government	*Mud/cement bonded Bricks/stone /wooden pillars in 2011*	*RCC with pillars In 2011*	*Mud/cement bonded /stone/wooden pillars in 2019/20 under three growth scenarios*	*RCC with pillars in 2019/20 under three growth scenarios*	*Revenue from mud/cement bonded/wooden pillars*	*Revenue from RCC with pillars*	*Revenue from property taxes*
Pokhara-Lekhath	71,753	33,877	93278.9 107629.5. 143506	44040.1 50815.5 67754	NPR 46 million to 71 million	NPR 88 to 135 million	NPR 184 million to 206 million

Gandaki Province Urban areas	299,010	62242	388713 448515 598020	80914.6 93363 124484	NPR 194 million to 299 million	NPR 161 million to 248 million	NPR 355 million to 547 million
Gandaki province rural areas	223,953	7017	291138.9 335929.5 447906	9122.1 10525.5 14034	NPR 21 million to 33 million	NPR 0.9 million to 1.4 million	NPR 22 to 34.4 million
Kaligandaki rural municapility	4,845	127	6298.5 7267.5 9690	165.1 190.5 254	NPR 0.4 million to 0.7 million	NPR 16 thousand to 25 thousand	NPR 0.4 to 0.7 million
Butwal	23,675	10,422	30777.5 35512.5 47350	13548.6 15633 20844	NPR 15 million to 23 million	NPR 27 million to 41 million	NPR 42 to 64 million
Province 5 urban areas	424,783	54487	552217.9 637174.5 849566	70833.1 81730.5 108974	NPR 276 million to 424million	NPR 141 million to 217 million	NPR 417 to 641 million
Province 5 rural areas	397,884	7603	517249.2 596826 795768	9883.9 11404.5 15206	NPR 38 million to 59 million	NPR 0.9 million to 1.5 million	NPR 39 to 60.5 million
Chhatradev rural municapility	6,326	15	8223.8 9489 12652	19.5 22.5 30	NPR 0.6 million to 0.9 million	NPR 1950 to 3000 thousand	NPR 0.6 to 0.9 million

Source: Data from the National Population and Housing Census (2011), Revenue estimation: author's calculation

Figure 8. Summary of revenue potential under different property tax rates for Pokhara and Butwal (in NPR million)



3.6.4. Revenue potential in context

As per the estimation, the significant revenue potential for both Gandaki Province and Province 5 is from the local taxes namely: business tax, house rental income tax, and property tax. The sum of maximum value of revenue in the ranges is more than NPR Five billion for both the provinces. This is the revenue that can potentially be generated from local governments (mostly urban areas). In terms of provincial GDP of 2018/19, it is 2.12 percent of GDP of Gandaki Province and 1.36 percent of GDP of Province 5.

Table 24. Summary of revenue potential in context of actual collections

Province	GDP contribution (percentage) in 2018/19	GDP 2018/19 (in billion NPR)	Estimated revenue potential of business, house rental income and property tax	Actual collection of these taxes
Province 3	41	1420.36	N/A	
Gandaki	8	277.14	Business tax NPR 50 to 755 million (method 1) and NPR 457 to 912 million (method 2) House rental tax NPR 704 to 4551 million Property tax NPR 377 to 581 million *Total of Max value of these revenue potential makes up 2.12 percent of Provincial GDP in 2018/19*	N/A

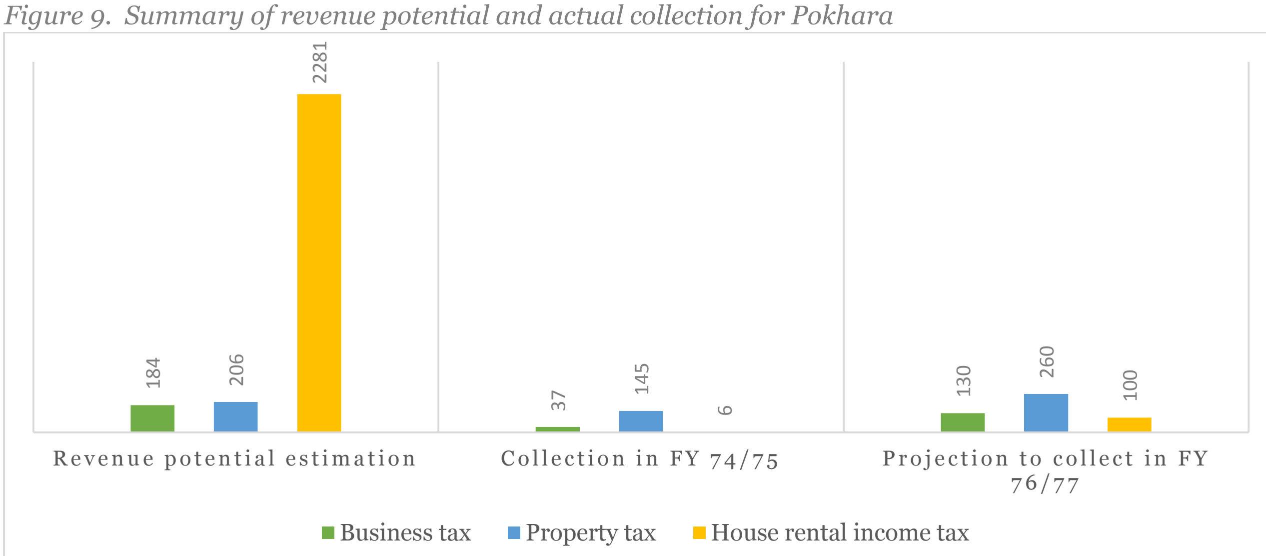
Pokhara	N/A	N/A	Business tax NPR 12 to 184 million (method 1) and NPR 113 to 227 million (method 2) House rental income tax NPR 329 to 2281 million Property tax NPR 184 to 206 million	Collection in FY 74/75 Business tax 37 million House rental income tax NPR 6 million Property tax 145 million *Projection to collect these taxes in FY 76/77* *Business tax 130 million* *House rental income tax 100 million* *Property tax 260 million*
Province 5	13	450.36	Business tax NPR 73 to 1108 million (method 1) and NPR 680 to 1364 million (method 2) House rental income tax NPR 560 to 4313 million Property tax NPR 456 to 705 million *Total of Max value of these revenue potential makes up 1.36 percent of Provincial GDP in 2018/19*	
Butwal			Business tax NPR 5.5 to 86 million (method 1) and NPR 54 to 108 million (method 2) House rental income tax NPR 106 to 736 million Property tax NPR 42 to 64 million	Collection in FY 74/75 Business tax 44 million House rental income tax 15 million Property tax 64 million *Projected revenue collection for FY 76/77* *Business tax NA* *House rental income tax 77 million* *Property tax 80 million*

Source: Economic Survey 2018/19, Budget speech of respective municipality, author's estimation

For Pokhara Metropolitan the estimated revenue potential is far higher than the actual revenue collected by the city. For example the estimation of maximum revenue potential from business tax is NPR 184 million (Method 1) and NPR 227 million whereas actual collection for the FY 17/18 was NPR 37 million, which is higher than the minimum estimated revenue potential of NPR 12 million (method 1). The city also projecting the expected revenue collection in FY 19/20 in the budget to be NPR 130 million, which is between the minimum and maximum estimated revenue potential. House rental income tax is one of the most underutilized taxes based on the estimation of revenue potential. The estimated revenue potential ranges from NPR 329 million to 2,281 million while the actual collection was merely NPR 15 million. The city also projects to collect only 100 million in FY 19/20. Property tax in Pokhara is among the most utilized compared to business and house rental income tax. The estimated revenue potential ranges from NPR 184 million to 206 million. The actual collection was NPR 145 million in FY 17/18 and is projected to collect 260 million in FY 19/20. This is summarized in Table 24 and Figure 9.

Estimated revenue potential is also far higher for Butwal sub-metropolitian. Maximum revenue potential from business tax is NPR 86 million and NPR 108 million. Actual business tax collection in the city is NPR 44 million in FY 17/18. Here too, the house rental income tax is the most underutilized. Based on the estimation of revenue potential, the house rental income tax ranges betwen NPR 106 million and 736 million whereas actual collection in FY 17/18 was NPR 15 million and projected collection for FY 19/20 is NPR 77 million. Property tax in Butwal is amongst the most utilized compared to business and house rental income tax. Estimated revenue potential from property tax is between NPR 42 million and NPR 64 million whereas actual collection is NPR 64 million and is projected to collect NPR 80 million in FY 19/20. This is summarized further in Table 24 and Figure 10.

Figure 9. Summary of revenue potential and actual collection for Pokhara

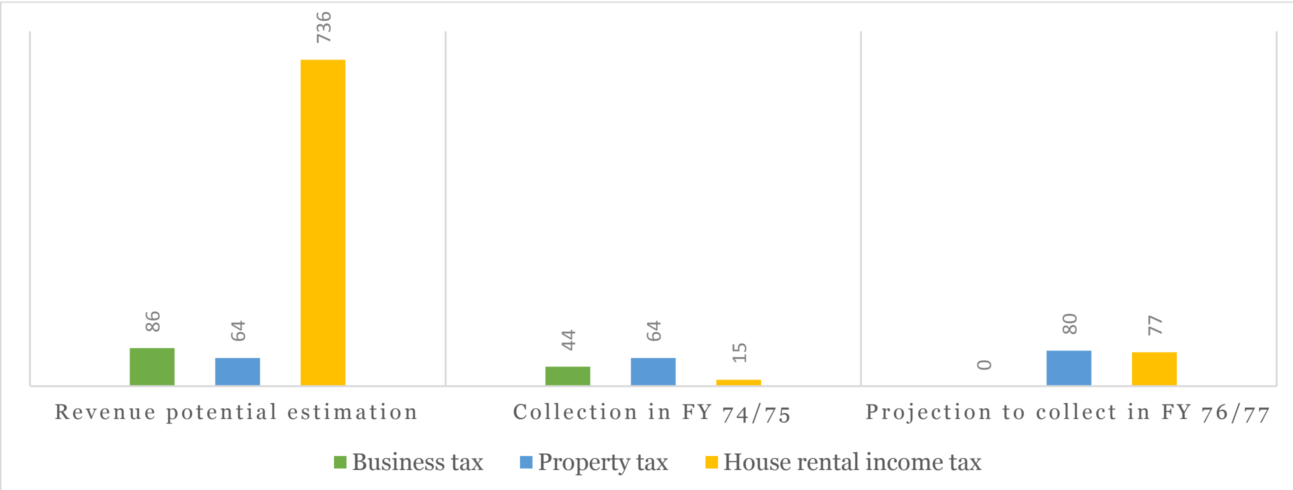


Source: Budget speech of respective municipality, author's estimation

The revenue collection gap (using maximum estimated revenue potential in the range) in Pokhara for business tax, property tax, and house rental income tax are NPR 147 million, NPR 61 million and NPR

2,275 million, respectively. Among these, house rental income tax is relatively underutilized as the collection gap is significantly higher than of other taxes. For Butwal the revenue collection gap is NPR 42 million, NPR 0 million, and NPR 691 million for business tax, property tax, and house rental income tax, respectively. Likewise, for Butwal house rental income tax is underutilized.

Figure 10. Summary of revenue potential and actual collection for Butwal



Source: *Budget speech of respective municipality, author's estimation*

3.7. Revisiting revenue collection gap

Using two methods to calculate the revenue collection gap namely: using revenue projection as proxy for revenue potential and using actual estimates of revenue potential for business tax, property tax, and house rental income tax, it is evident that there is significant revenue collection gap at sub-national level. The estimated revenue collection gap is higher for method two which uses estimated revenue potential. This indicates that the revenue projection available at budget speeches might be lower than actual revenue potential of tax revenue in respective sub-national governments. From both the methods it is evident that house rental income tax, business tax, vehicle tax, house and land registration etc. all have revenue collection gap. The reasons for collection gap at sub-national level can be summarized broadly in terms of ***tax rate, tax base, and tax administration***. These are further elaborated as following:

- Assigned taxes are underutilized (for example: house rental income tax, business tax) or not utilized at all (for example: entertainment tax at rural municipalities and agriculture income tax at provincial level).
- Tax rates for local taxes are high and does not take into account the ability and willingness to pay of taxpayers, thus creating disincentive for taxpayers to avoid paying taxes.

- Tax base is narrow due to lack of sufficient database and due to unregistered activities (informal economy).
- Weak tax administration which is unable to curve underreporting, under-payment and non-payment of taxes.
- Weak tax enforcement due to collusion among tax administrator, local politicians, and taxpayers. This can lead to weak political will for effective tax enforcement at sub-national level.
- Weak linkages between taxes and service delivery from sub-national governments.

Chapter 4. Strategies and policies to increase sub-national own source revenue

While the government is still struggling to ease the decentralization process, the sub-national governments are struggling through the process of formulation of sub-national legislation, formulation of tax-rates specific to their areas, and study of revenue potential. In addition they are facing challenges such as lack of awareness for both tax administrators and tax payers regarding sub-national taxes, weak institutional capacity, lack of skilled personnel, underutilization of tax rights assigned to them, revenue collection gap, over reliance on fiscal transfer and revenue sharing from central government and leakages in tax collection. As these processes are in early stages of development, there is significant room for improvement to address these challenges and to enable sub-national governments to utilize full potential of assigned revenue powers, to reduce dependency on transfer and grants from central government, to increase autonomy of sub-national government, and to sustain fiscal federalism in Nepal with appropriate strategies. The study recommends short-term, medium-term, and long-term strategies to address the challenges faced by sub-national governments in terms of OSR mobilization. The recommended strategies address the challenges and issues discussed in chapter two and chapter three. Short- term strategies focus on institutional and capacity development and fiscal responsibility, medium-term strategies on re-assignment of sub-national taxes through constitutional amendment, and finally the long-term strategy focuses on investment for economic development at sub-national level.

4.1. Short-term strategy: Institutional and administrative capacity development

Benefit from decentralization such as increased efficiency, increased in welfare gain resulting from moving governance closer to people can be offset by administrative weakness and the lack of capacity at sub-national level (Ter-Minassian, 1997). Thus, the short-term strategy to increase OSR and to sustain federalism should focus on capacity development at sub-national level. Following are the strategies:

- **Detailed study of revenue potential**: Sub-national governments as of now have not conducted detailed and rigorous revenue potential study. Such study, using scientific tools, is essential to help them formulate and prioritize taxes with higher potential for effective administration based on expected return. Such study also should incorporate the tax paying capacity (i.e. income and income generating properties) of tax payers in their respective jurisdiction.

- **Awareness campaign**: Since the local governance and local taxes are fairly new in the country, there is an urgent need of awareness campaign regarding sub-national taxes essentially to build capacity of tax administration officials at sub-national level, to make taxpayers aware of new local taxes after transition into federal system of governance, and to link local taxes with benefits local level services and governance. The campaign has chances of increasing compliance from taxpayers as they can see the benefit of paying local taxes. The campaign can also be used to change the current tendency/attitude of taxpayers from evading taxes to being responsible taxpayers.

- **Institutional capacity to enhance tax administration**: Strengthening the tax administration has always been underachieved. As the provincial and local governments are given more responsibilities to manage their fiscal affairs, there is an imperative need to increase the infrastructural, technical, administrative, and fiscal policy analysis, forecasting and revenue mobilization capacity of local officers, especially in light of the OSR potential. The tax structures, principles behind the taxes levied and payment mechanisms should be made lucid to the taxpayers through online portals where internet connectivity and usage is high and through awareness campaigns in areas lacking proper internet access. Taxpayer support desks, with taxpayer friendly staffs, should be established at each tax office and toll-free, dedicated helpline services should be activated across all provinces and local levels. Further resorting to mechanisms such as automatic payment reminders on the registered phone numbers, charging high penalties on evasion and missed due dates, among others are effective ways of increasing tax revenues.
  Provincial government should also strengthen mechanisms to check revenue collection at their respective local governments. As of now provincial governments can only know the revenue amount they receive (which can be either 60 percent or 40 percent of total revenue collected) from the local governments and there is no provision to check and verify the total tax collected on a regular basis. There is also a need of mechanisms to return tax on mobile unit such as vehicle tax to respective provinces where the owner resides if that tax is collected by other provincial government.

- **Registration, information sharing, and creating database**: One of the most significant challenges for the government would be to get the taxpayers registered in the system and formalize their existence. Simultaneously, sub-national governments can also work with central government, especially Ministry of Finance (MoF)/Internal Revenue Department (IRD), to gather information through information sharing schemes and build database that can help them with tax rate determination, increase coverage, and revenue collection. Sub-national government can also mobilize local resource in close co-ordination with the ward level office and local organizations.
  According to National Economic Census, 2018, almost 50 percent of the enterprises are yet to be registered which also means almost 50 percent of these enterprises might be evading taxes. As such, the technique of aligning incentives with registration might help decrease the population of unregistered individuals and firms and subsequently increase the government's revenue. Mechanisms such as implementation of policies that immensely favor digital transactions against cash transactions, incentivizing registrations by providing tax rebates to firms in its initial years of

formalization, among others can contribute towards enhancing government revenues. Sub-national governments can partner with IRD to further enhance business registration at the local level and to collaborate in information sharing regarding business registration.
Other tax that is heavily evaded besides business tax is house rental taxes. Sub-national governments can use two strategies: first lower the tax rate in the short run to provide incentive to get all houses registered in the system and increase the coverage and second use information from other agencies to collect other taxes and other information from databases such as: vaccination data, use sewerage/water sanitation information, meter data from NEA, cellphone data etc. to assess the number of houses that are generating rental income. Similar strategies can also be used to get household into tax coverage for house and land taxation. In general requirement of proof of tax payment for renewal and registration processes also helps to build database and help lower the case of tax evasion.

- **Digitization of transactions and taxation system**: Practiced in many parts of the world, digitalization of taxation system through standardized information technology will help collect more tax, more efficiently. It will seek to crack down on underreporting, evasion, fraud and corruption at central, provincial and local level. While automatic reporting, automatic update of tax rates and policies, elimination of laborious checking and calculation procedures, saving time and money are obvious advantages; easy data submission, enhanced data analysis and more routine sharing of data between tax authorities and amongst the tax payers and tax authorities are other significant benefits. The computerized system should focus on providing integrated core tax administration system. It should facilitate integrated connectivity and data sharing between central, provincial and local government, an integrated backup system, taxpayer identification through integrated recording, automated audit selection and introduction of return filing with automated error correction. Digitalization can consequently contribute towards shifting the compliance of the tax administration "upstream".

- **Monitoring, evaluation, and performance rating*:*** A notable concern raised during the study by some of the taxpayers was dearth of implementation of commitments by the government despite timely payment of taxes, fees and charges. Several issues making news about corruption by government officials, vivid lack of incentives from government's end, among others call for a dire need of government vetting which will evaluate development and implementation of government's programs and services as pledged. Moreover, as is being resorted by different governments globally, the central, provincial and local governments should get its performance quality evaluated on the basis of factors such as economic structure, government finances, administrative excellence, self-sufficiency, economic management, curving of corruptions through strengthening of monitoring system, leakages of taxes, transparency of tax collection and expenditure with practice of periodic sharing financial reports among others. This helps in relative comparison amongst seven provinces and 753 local governments and abets in identifying the faults for improvement.

- **Changes in revenue collection policies and principles**: This concern will be addressed in three fronts. First, lack of uniformity in defining and implementing taxation principles; second, shortcomings in defining parameters and allotting them weights; third, identifying appropriate tax sources for local levels.
  Amongst several issues noted, many taxpayers raised the need to standardize the basis of levying and calculating taxes, more specifically while valuing properties. The market prices of the properties might not depict the true intrinsic value hence the government officials should assess and update the value based on property's size, construction type, age, location, among others to standardize the mechanism. The principles and policies should be congruous and transparent across all the provinces and local levels, across all categories. This can be achieved through preparation of guidelines from the central government. Determination of tax rates also should consider the ability to pay of taxpayers. This determination can be achieved by involving stakeholders in the decisions.
  The Intergovernmental Financial Management Act, 2017, Local Governance Operations Act, 2017 and National Natural Resources and Fiscal Commission (NNRFC) Act, 2017 clearly stipulate the tax rate, share of central, provincial and local level, parameter to determine the distribution proportion and weights assigned to each of the parameters. These identified parameters however might not impartially justify several local levels which embody distinct geographical, social and economic features. Of course, it might not be possible to generate a consummate set of parameters appropriate across the nation but revisiting and revising the parameters and the weights assigned every five years might help in improvising the revenue stream within and across the sub-national governments. The revision should focus on assigning weights to parameters like per-capita GDP contribution, per unit cost of service delivery, progress of completion of projects/programs, weather local government is categorized as rural or urban etc. instead of putting more weight on population. Also, the proportion assigned for revenue sharing among three tiers of government can be changed. Office of Chief Minister, Gandaki Province, recommends revising formula of revenue sharing (of VAT and domestic excise tax) to 50-30-20[18] from current sharing proportion of 70-15-15. Similar adjustment can be made for parameters of fiscal transfer and royalty sharing. For parameters determining the fiscal transfer, especially the gap between revenue and expenditure it will help sub-national governments to receive higher share of fiscal transfer if revenue considered only covers revenue generated at sub-national level. These revisions in the short-term have potential to increase sub-national revenue. However, this strategy cannot be a long-term strategy for autonomy of sub-national governments.
  Finally, the mainstream tax principles explained in the legal provisions do not adequately contemplate key factors that influence local revenue generation. For instance, Kaligandaki and

[18] The office has prepared document with several recommendations aimed at NNRFC, this is one of the recommendations.

Chhatradev collected absolutely no revenue under advertisement fee, entertainment tax and tourism fee in the FY2018/19. As such, their source of revenue is slimmed. This calls for the local levels authority to explore the potential revenue sources, within their legal limit as taxes are assigned to them, specific to their geographical, social and economic attributes. For example, Gandaki Province can explore new areas to collect tourism fee.

- **Effective allocation and administration of expenditure**: Sub-national governments on one hand are facing the revenue collection gap and the subsequent pressure to generate enough revenue to sustain expenditure but at the same time have low budget absorption capacity. This can be addressed with effective allocation of expenditure and effective administration of that expenditure after allocation. To ensure effective allocation, first it is important to ensure that the functional responsibilities assigned to the three tiers of government do not overlap as this overlap results in inefficiency. Second, it is important to develop estimates of cost of delivering services for sub-national governments. This can help assess the estimate of expenditure needed. This estimation can also ensure accountability and efficiency of expenditure. This in turn helps to boost confidence in taxpayers at sub-national level about taxes being used effectively. Effective administration can be achieved with strengthening of administrative capacity and strong oversight of budget expenditure at sub-national level.

4.2. Medium term strategy: Reassignment of local taxes

It is necessary to revise the current assignment of local taxes to sustain sub-national governments through OSR. This strategy stems from the issue raised during KIIs and FGDs that current tax assignment do not have potential to raise enough revenue to sustain the expenditure of sub-national governments. Current taxes that are assigned to the sub-national level are not buoyant[19], meaning there is less chance of proportional increase in tax revenue in relation to increase in income and output of the sub-national governments. For example, taxes such as VAT, personal income tax, corporate income tax, etc. are highly buoyant taxes, which falls under the jurisdiction of central government in the country.

- **Re-assignment of taxes to sub-national governments**: Taxes assigned to sub-national governments are not new taxes that were introduced after transition into federal structure of the country. These taxes were in practice under Local Self Governance Act (1999). One update from past assignments to the current one is the authority to sub-national governments to set the tax rates. The taxes assigned such as: advertisement tax, entertainment tax, business tax, rental tax, etc. do not have great potential to generate enough revenue to sustain sub-national governments. The solution to this challenge is to revise current tax assignment. One of the possible solution is to scrap off existing taxes

[19] A tax is buoyant when revenues increase by more than, say, 1 per cent for a 1 per cent increase in GDP.

with less revenue potential and replace with taxes that have potential to generate enough revenue to sustain sub-national governments. This can be done with introduction of piggy-back taxation, with appropriate share for sub-national governments, on taxes like VAT, excise, income, and corporate income taxes. This concept government has the potential to increase revenue for sub-national governments significantly as compared to the current receipt from revenue sharing especially for local governments, which gets 15 percent of VAT and excise that is divided among 753 local governments. An equal share division of such taxes leads to local government receiving 0.019 percent of centrally collected VAT and excise on domestic production. Whereas, two percent piggy back taxation on existing VAT would make the total rate to be 15 percent where central government keeps 13 percent and respective sub-national governments keep 2 percent of collection from their jurisdiction. These taxes could also be administered by the IRD. This revision in addition to reducing the revenue gap also reduces vertical imbalance and reliance on transfers from central government.

Revision of current tax assignment is also necessary to address the disparity of revenue generating potential between rural municipality and municipality. Under the current tax assignments, only taxes that can generate revenue for rural municipality is property/land taxes due to absence of economic activities that allows rural municipality to raise revenue from vehicle tax, business tax, house rental tax, entertainment tax, advertisement tax, etc. Thus, instead of one blanked tax assignment, it is important to have separate sets of tax assignments for rural and urban sub-national governments. The study team is aware of strong political will needed to bring changes in legal provisions, including amendment in the constitution, to adapt such changes in tax assignment.

4.3. Long term strategy: Policies and investment for economic growth at sub-national level

Long term strategy to increase OSR and maintain autonomy of sub-national governments is to formulate policies (tax and other policies) and make strategic investments such that it helps to achieve high economic growth in the long run. The policies formulated should make it easier for businesses to register and operate in the area. Some other policies needed are provisions of special economic zones and business districts to attract businesses. In addition to the policies that creates conducive environment for businesses there should be investment in infrastructures that support businesses such as roads, bridges, tele-communication, internet, energy etc. Sub-national governments should also invest heavily in human capital that can create skilled individuals in the area that can meet the skills demand. This strategy is based on the principle that increased economic activity in the area will lead to increase in tax-base, tax-coverage, and thus increase in tax revenue at sub-national level. In addition, sub-national governments should also invest in projects/programs/infrastructures such that they can generate substantial revenue from service fees.

To make such strategic investment, sub-national government can use allocated capital expenditure and other sources as well. One of the sources can be municipal bond. As per Section 14, Sub-section (2) of Intergovernmental Fiscal Arrangement Act, 2074 (2017), "The Government of Nepal and the State may raise internal loans by issuing bonds subject to prevailing law." As such, the Province can access capitals through bonds and invest in developmental projects contributing towards increased economic activity in its vicinity. Although the interest earned on municipal bonds are tax free, the revenue generated through productive projects will not just increase the income stream but will subsequently enhance the tax base of the area directly contributing towards increased provincial and local revenue.

4.4. Strategic action plan

This section presents strategic action plan and responsible parties based on the strategies and policies discussed in the previous sections. This is summarized in the table 25.

Table 25. Summary of strategic action plan

Strategies	*Action*	*Responsibility*
	Short-term strategies	
Study of revenue capacity and utilization at sub national level	Commission detailed study of revenue potential at provincial and local level Detailed study of tax bases and tax rates Detailed study of current revenue collection	Provincial Planning Commission Revenue department of provincial and local government
Awareness campaign	Prepare guidelines for awareness campaign and training sessions regarding taxation rights, tax bases, and tax administration Conduct training sessions to tax officials Conduct training sessions to taxpayers	Central and Provincial government
Strengthening of institutional capacity of effective administration	Training and hiring programs to increase skilled personnel for tax administration Increase number of tax offices Build database of taxpayers Digitization of transactions Use of technology for tax payments and records keeping	Central government in close coordination with provincial and local governments
Monitoring and transparency	Transparency of tax collection Transparency of expenditure Updating and publishing of tax and expenditure records in a regular interval Formation of monitoring and evaluation committee	Provincial Planning Commission Office of chief Minister/Mayor/Chairperson Revenue department from provincial and local governments

Exploration of new tax sources	Detailed exploration of new areas to tax within the legal rights	Provincial and local governments
Medium-term strategies		
Reassignment of taxes	Scrap current local taxes and replace new one with higher revenue potential	Central government
Long-term strategies		
Plans and policies for economic growth	• Conducive environment and incentive for businesses • Investment in infrastructures	• Central government • Provincial Planning Commission and Office of Chief Minister • Office of Mayor and Chairperson of Local governments

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Annexes

Annex A. Consultations during the study

Gandaki Province, Pokhara Municapility, Kali Gandaki Rural Municapility	
Dr. Giridhari Sharma Poudel	Vice Chairman, Provincial Policy and Planning Commission, Gandaki Province
Dr. Bhima Dhungana	Member, Provincial Policy and Planning Commission, Gandaki Province
Dhurba Prasad Pandey	Under Secretary, Ministry of Economic Affairs and Planning, Gandaki Province
Tilak Dhakal	Officer, Ministry of Economic Affairs and Planning, Gandaki Province
Indra Prasad Paudel	Provincial Fiscal Comptroller Office, Gandaki Province
Sudeep Gautam	Officer, Provincial Fiscal Comptroller Office, Gandaki Province
Dhruba Kumar Pokheral	Chief Administrative Officer, Pokhara Municapility
Jaya Ram Poudel	Under Secretary, Economic Administration, Pokhara Municapility
Ganesh Pandey	Chief Officer, Revenue Administration, Pokhara Municapility
Dr. Dev Narayan Sutihar	Head of department, Prithvi Narayan Campus
Khim Bahadur Thapa	Chair Person, Kaligandaki Rural Municipality
Bhupati Pandey	Chief Officer, Planning Division
Prakas Khanal	Chief Officer, Economic Administration Division
Province 5, Butwal Municipality, Chhatradev Rural Municipality	
Dr. Ishwar Gautam	Vice Chairman, Provincial Planning Commission, Province 5.
Dr. Gopi Krishna Khanal	Secretary, Ministry of Social Development
Janardan Poudel	Under secretary, Ministry of Economic Affairs and Planning, Province 5
Tilak Bahadur Khadka	Under secretary, Ministry of Economic Affairs and Planning, Province 5
Deepak Gyawali	Provincial Treasury Comptroller Office, Province 5
Rabindra Aryal	Provincial Treasury Comptroller Office, Province 5
Dr. Baburam Gyawali	Economics Department, Butwal Multiple Campus
Dr. Pramshu Nepal	Economics Department, Butwal Multiple Campus
Leknath Pokheral	Chair Person, Chhatradev Rural Municipality

Annex B. Tools used (Data collection, KII, and FGD)

Key information:

- Objectives of the study: assess current taxation powers and revenue potential, analyze revenue gap and potential in medium term and long term, and provide set of recommendations to increase own source revenue generation and close the revenue gap.
- Four pillars of fiscal federalism: expenditure responsibilities, revenue assignments, inter-governmental transfers, and sub-national borrowings.
- Acts governing the taxation power and revenue sharing:(i) Local Governance Operations Act 2017, defines the distribution of authority for policy formulation, determination of tax rate, and collection of taxes; (ii) National Natural Resources and Fiscal Commission (NNRFC) Act 2017, which elaborates the functions of NNRFC-mainly to manage the inter-governmental fiscal transfers to address vertical and horizontal imbalances between federal and SNGs and (iii) Inter-governmental Financial Management (IGFM) Act 2017, which provisions for the sharing, and specifies sharing of SNGs in VAT, domestic excise duty, and royalties.
- Constitutional Provision of revenue power among three tires of government in Nepal

Central	**Provincial**	**Local**
Custom duties	House and land registration fee	House and land registration fee
Excise duties	Vehicle tax	Vehicle tax
Value added tax (VAT)	Entertainment tax	Entertainment tax
Corporate income tax	Advertisement tax	Advertisement tax
Personal income tax		Property tax

Remuneration tax		House rental tax
		Business tax
		Land revenue/land tax
	Agricultural Income tax	Local natural resource tax (gravel stone, lime stone, clay etc.)
Passport fee		Local tax on wool, medicinal herbs, salvaged item (Kaabadi)
Visa fee	Tourism fee	
Tourism fee	Service charge	Tourism fee
Service charge	Fines/penalties	Service charge
Fines/penalties		Fines/penalties

<u>Information collected from field visits at provincial and local levels</u>

Data collected from Provincial Government

Detail of provincial revenue (for two provinces Province 5 and Gandaki province)

	Internal Revenue (own source)		External Revenue			
Fiscal Year	Tax-revenue	Non-tax revenue	Transfer/grants received	Borrowing	Amount received from Revenue sharing	Amount received from Royalty sharing

2073/74					From central government: From local government:	
2074/75					From central government: From local government	
2075/76					From central government: From local government	

Revenue collection by types of taxes and fiscal year for provincial government (for Province 5 and Gandaki Province)

Types of taxes	**FY 2073/74**	**FY 2074/75**	**FY 2075/76**
House and land registration fee			
Vehicle tax			

Entertainment tax			
Advertisement tax			
Tourism fee			
Service charge			
Fines/penalties			
Agriculture Income tax			

Expenditure of provincial level government (for two Provinces):

Types of expenditure	**FY 2073/74**	**FY 2074/75**	**FY 2075/76**
Recurrent/Administrative expenditure			
Capital Expenditure			

Difference in revenue projection and collection (***provincial government***)

	FY 2073/74	**FY 2074/75**	**FY 2075/76**
Projected revenue			
Actual revenue collection			

Future revenue projection (for provincial government)

Projected revenue	**FY 2076/77**	**FY 2077/78**	**FY 2078/79**	**FY 2079/80**
Projected own source tax revenue				
Projected own source non-tax revenue				

Data collected from local government

Detail of local revenue (for each of local level governments from two provinces):

	Internal Revenue		External Revenue			
Fiscal Year	Tax-revenue	Non-tax revenue	Transfer/grants received	Borrowing	Amount received from Revenue sharing	Amount received from Royalty sharing
2073/74					From central government: From provincial government:	

2074/75					From central government: From provincial government	
2075/76					From central government: From provincial government:	

Revenue collection by types of taxes for fiscal year for local governments (for each of local governments from selected provinces):

Types of taxes	**FY 2073/74**	**FY 2074/75**	**FY 2075/76**
House and land registration fee			
Vehicle tax			
Entertainment tax			
Advertisement tax			
Tourism fee			

Service charge			
Fines/penalties			
Property tax			
House rental tax			
Business tax			
Land revenue/land tax			
Local natural resource tax (gravel stone, lime stone, clay etc.)			
Local tax on wool, medicinal herbs, salvaged item (Kaabadi)			

Expenditure of local governments (for each of local governments from selected provinces):

Types of expenditure	**FY 2073/74**	**FY 2074/75**	**FY 2075/76**
Recurrent/Administrative expenditure			
Capital Expenditure			

Difference in revenue projection and collection (***local government***)

	FY 2073/74	**FY 2074/75**	**FY 2075/76**
Projected revenue			

Actual revenue collection			

Future revenue projection (for provincial and local governments)

Projected revenue	**FY 2076/77**	**FY 2077/78**	**FY 2078/79**	**FY 2079/80**
Projected own source tax revenue				
Projected own source non-tax revenue				

<u>Information collected from provincial governments</u>

Detail of provincial taxation power:

Types of taxes	**Is this tax collected? (Yes/No)**	**Tax base**	**Tax rate**	**Is there any overlap issue with this tax? If yes, explain**	**Any compliance issues?**	**Any leakages in collection?**	**Any tax administration issues?**	**Any other issues**
House and land registration fee								
Vehicle tax								
Entertainment tax								

Advertisement tax								
Agriculture Income tax								
Tourism fee								
Service charge								
Fines/penalties								
Others								

Causes of success and failure in revenue collection by major taxes at provincial level:

Types of taxes	**Causes related to tax rates (high or low etc.)**	**Causes related to tax base (base not large enough, lack of proper data base/records etc.)**	**Causes related to administration/logistics and collection of taxes**	**Causes related to compliance (underreporting, underpayment, non-filing of taxes)**	**Any other causes?**
House and land registration fee					
Vehicle tax					
Entertainment tax					
Advertisement tax					

Agriculture Income tax					
Tourism fee					
Service charge					
Fines/penalties					
Others					

Method of revenue projection

Level of government	**Method of projection**	**Are you satisfied with the method of projection?**
Provincial Government		

What are the causes of gap between revenue projection and actual collection?

Level of government	**Causes related to tax rate, tax base (identification gap)**	**Causes related to projection of revenue (Assessment gap)**	**Causes related to compliance (actual tax collected vs. tax collection under full compliance)**	**Causes related to collection/administration (skilled manpower, office facilities, up-to-date technologies)**	**Other causes**
Provincial Government					

<u>Information to be collected from local governments</u>

Detail of local taxation power:

Types of taxes	Is this tax collected? (Yes/No)	Tax base	Tax rate	Is there any overlap issue with this tax? If yes, explain	Any compliance issues?	Any leakages in collection?	Any tax administration issues?	Other causes
House and land registration fee								
Vehicle tax								
Entertainment tax								
Advertisement tax								
Tourism fee								
Service charge								
Fines/penalties								
Property tax								
House rental tax								

Business tax								
Land revenue/land tax								
Local natural resource tax (gravel stone, lime stone, clay etc.)								
Local tax on wool, medicinal herbs, salvaged item (Kaabadi)								
Others								

Causes of success and failure in revenue collection by major taxes at local level:

Types of taxes	**Causes related to tax rates (high or low etc.)**	**Causes related to tax base (base not large enough, lack of proper data base/records etc.)**	**Causes related to administration/logistics and collection of taxes**	**Causes related to compliance (underreporting, underpayment, non-filing of taxes)**
House and land registration fee				
Vehicle tax				
Entertainment tax				
Advertisement tax				

Tourism fee				
Service charge				
Fines/penalties				
Property tax				
House rental tax				
Business tax				
Land revenue/land tax				
Local natural resource tax (gravel stone, lime stone, clay etc.)				
Local tax on wool, medicinal herbs, salvaged item (Kaabadi)				

Details of property tax:

Type of tax	Tax base	Methods of valuation	Other remarks
Integrated Property tax			
Property tax			
Land tax			

How are revenue projected for local government?

Level of government	Method of projection	Are you satisfied with the method of projection?
Local Government		

What are the causes of gap between revenue projection and actual collection?

Level of government	Causes related to projection of revenue (Assessment gap)	Causes related to tax rate, tax base (identification gap)	Causes related to compliance (actual tax collected vs. tax collection under full compliance)	Causes related to collection/administration (skilled manpower, office facilities, up-to-date technologies)	Other causes?
Local Government					

Information to be collected from both provincial and local government

Are there any potential new sources of taxes that can be levied to increase own-source revenue?

Types of taxes	Description of the tax base	Tax rate	Potential revenue to be collected	Which government sets the tax rate?	Which government collects this tax?	Is the government able to administer this tax?	Is there any overlap issue with this tax? If yes, explain

Are there any *new potential sources* of non-tax revenue to increase own-source revenue?

Types of non- taxes sources	Description of the base	Rate	Potential revenue to be collected	Which government sets the rate?	Which government collects this non-tax source of revenue?	Is the government able to administer this tax?	Is there any overlap issue with this tax? If yes, explain

Would changes in tax rate determination, new non-tax sources, changes in policies etc. help your government to increase its own source revenue? If yes, explain?

	Proposed changes	**Intended outcome**	**Potential impact on revenue collection**	**Potential impact on autonomy of federal and local governments**
Changes in tax, tax rate, tax base etc.				
1)				
2)				
3)				
Changes in non-tax sources				
1)				

2)				
3)				
Changes in policies				
1)				
2)				
3)				

Questions on revenue administration:

Particulars	**Present condition**	**Ways to improve**
Infrastructure (buildings/furniture/computers etc.) of revenue department		
Description of roles and responsibilities of revenue department		
Description of role and responsibilities of staffs of revenue department		
Knowledge of staffsof revenue administration		
Records/database of tax bases (land, property, businesses, income, transactions etc.)and tax payers		
Information/database necessary to determine tax in the area		

Possibility of leakages on tax collection and its prevention		
Compliance from tax payers (individuals, businesses etc.)		
Ability to iidentify, reward, and punish the tax payers		
Information and awareness programs for taxpayers		
Involvement of stakeholders in determination of tax rates		
Co-ordination with other departments and other tiers of government		
Transparency of revenue/expenditure records		

KII questions

1) Are the revenue collected (by provincial government and local government) enough to cover the expenditure assigned?
2) Are you clear on the jurisdiction of taxation power? And have you been properly oriented on this matter?
3) Are the taxes assigned to the provincial/local governments enough to generate revenue to cover their expenditure? If not, what could be the additional alternatives?
4) What is the status of compliance/management cost as the result of new taxation rights?
5) What is current situation of leakages in tax collection? Do you have any plan to minimize it?
6) Has the tax administration cost increased under sub-national/multilevel taxation system?
7) Are you able to effectively collect taxes from the tax bases? In other words do you have any compliance issue in tax collection?
8) Do you have any experience of success or failure story regarding the collection of tax or non tax revenue?
9) What types of help, assistance and facilitation ***Local level*** does need from the GoN and Provincial Government? And other Agencies?
10) What types of help, assistance and facilitation, ***Provincial Government*** does need from the GoN?
11) Is there incentive from central/provincial government to focus on own-source revenue generation?
12) Are there any medium-term and long-term strategy to increase own-source revenue?
13) Are provincial/local governments using capital expenditure to strengthen the tax base for future revenue collection? If yes, explain?
14) What reforms in tax administration will facilitate revenue collection?
15) Has there been any effort to provide tax-incentives to promote business/economic activity?
16) What is the rate of tax coverage regarding the major tax headings in your province/local government? Are you satisfied by that?
17) Are all the potential tax bases and viable tax rates utilized? If not,explain.

18) In your opinion, what are the major hurdles in your province/local level in revenue collection(legal, administrative, behavior of tax payer, etc.)?Explain.

19) What could be the major steps (both hardware and software) to be taken for potential revenue collection in your province/local level?

FGD Questions

1) Are you aware of tax bases/tax rates that need to be paid to the provincial/local governments?

2) Do you think that the taxes levied are justified? (Are the public services provided at sub-national level adequate?)

3) How have these new taxes at sub-national level affected your income/businesses etc.?

4) Are you willing to pay those taxes? Why?

5) Are you aware of reward and or punishment for paying/not-paying the taxes? How effective do you think it is?

6) Is the process of paying taxes easy? (i.e: forms to be filled, time taken to process the taxes, notice or information on timing of payment etc), if not, what are the hurdles?

7) Is there facilitation by the government in tax payment process?

8) Has the service provision of provincial and local government improved after transform of governance system into federal structure with separate taxation power?

9) Has there been any effort to provide tax-incentives to promote business/economic activity?

10) Has the cost of compliance for tax-payers increased under the new system?

11) Do you prefer current system of multi-level tax administration or single system of tax administration?

12) Does the government consult with the stakeholders before framing the tax policy?

13) Are you satisfied with the tax policy of the government? Why?

14) What are the potential taxes those could be utilized for increasing local revenue?

15) What could be the major steps to be taken to increase local revenue?

16) Are tax administrators friendly and supportive and friendly during the tax payment process?