



Revenue Audit Directives



**Office of the Auditor General
Anamnagar, Kathmandu, Nepal
2023**

REVENUE AUDIT DIRECTIVES

**OFFICE OF THE AUDITOR GENERAL
ANAMNAGAR, KATHMANDU, NEPAL
2023**

Foreword

It is my immense pleasure to release the Revenue Audit Directives of the Office of the Auditor General of Nepal. This directive will be applicable in undertaking respective financial, compliance, performance audits of the entities as per the Audit Act, 2075.

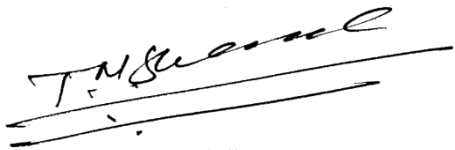
This directives provides a clear picture of methods and approaches to audit that the audit staff is required to comply with in imparting their duties. It has been built around the prevailing Audit Act, Nepal Government Auditing Standards (NGASs), and office policies that require conducting a high-quality audit. Since NGASs are based on INTOSAI framework for Professional Pronouncement (IFPP), this directives seeks to incorporate the Nepal audit practices at par with the international best practices.

This directives provides guidance and direction in all phases of the audit from pre-panning to follow-up including concept, preparation, institutional system, income tax, value added tax, custom duty, other tax revenue, non tax revenue with necessary annexures which encourages professional judgment where it requires. The directives does not override the legal requirements and conditions of NGASs. Likely, it shall not limit the professionalism of the officials entrusted with the responsibility of conducting audits.

Our knowledge, skill, and experience with auditing practices continue to evolve, and so will this directives. This directives is expected to be updated for the continuous improvement of audit practices to meet legal provisions, audit standards, and practices to address emerging risks.

My special thanks to all staffs who prepared the directives and provided their valuable feedback and comments to make this directives implementable which, I do hope, will be of use to conduct audits efficiently and effectively.

April 26, 2023


Tankamani Sharma, Dangal
Auditor General

List of Abbreviations

Abbreviation	Full form
ADR	Alternative Dispute Resolution
CA	Compliance Audit
CDA	Customs Duty Act, 2064
CDR	Custom Duty Regulation, 2064
CIC	Change in Control
DG	Director General
EDA	Excise Duty Act, 2058
EDR	Excise Duty Regulation, 2059
FA	Financial Audit
GATT	General Agreement on Tariffs and Trade
GoN	Government of Nepal
IA	Internal Audit
ITA	Income Tax Act, 2058
ITD	Income Tax Directives
ITR	Income Tax Regulation, 2059
IRD	Inland Revenue Department
LTC	Long Term Contract
LTO	Large Tax-payers Office
MLTO	Medium Level Tax-payers Office
NAMS	Nepal Audit Management System
NGAS	Nepal Government Auditing Standard
NRB	Nepal Rastra Bank
OAGN	Office of Auditor General Nepal
PA	Performance Audit
PAN	Permanent Account Number
PARF	Public Audit Restructuring Framework
QC	Quality Control
QA	Quality Assurance
RBA	Risk Based Approach
RBAF	Risk Based Auditing Framework
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Area
SEZ	Special Economic Zone
SOP	Standard Operating Procedure
TCS	Tax Collected at Source

Abbreviation	Full form
VAT	Value Added Tax
WHT	Withholding Tax

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Part - I

Introduction

A. Concept

Public audit has wider scope than being limited to the expression of audit opinion providing reasonable assurance. Being the audit of public money, public sector auditor's role covers the governance, regularity and propriety.

Audit Act, 2075 empowers the Auditor General to include revenue assessment within the audit scope. Based on legal provisions and standards on auditing, review of revenue assessment procedure is limited assurance activity. However, review of revenue as a part of the financial statement audit is a reasonable assurance engagement for auditor where auditor has to obtain sufficient and appropriate audit evidence to express an audit opinion. Auditor evaluates the revenue assessment procedures in accordance with the audit plan and issue audit report either as financial audit opinion on financial statements or report as direct reporting in form of conclusions. Therefore, for the purpose of the users the auditor need to explain the procedure performed, type of the assurance provided in the audit report.

According to Public Audit Restructuring Framework (PARF), auditor can cover the revenue audit in their financial audit (FA) or in compliance audit (CA). Therefore, this audit directives may be usable to both of the types of the audits.

1. Background

Audit Mandate

Constitutional provision related to Auditor General is the principal source of authority for public audit. Article 241 of the Constitution of Nepal mandates Auditor General to audit on the basis of regularity, economy, efficiency, effectiveness and propriety. According to Constitution of Nepal, Audit Act, 2075 and other legal provisions, Office of the Auditor General (OAGN) audits the financial transactions of entity and offices. Legal provisions cover the mandate and high-level audit procedures and reporting requirement. Details of audit principles, procedures, documentations, reporting and follow up has described in the auditing standards.

Auditing Standards and other documents

According to Nepal Government Auditing Standards, OAGN audits may be of three types namely Financial Audit (FA), Performance Audit (PA) or Compliance Audit (CA). Based on law and those standards, OAGN has developed:

- Public Audit Restructuring Framework (PARF) for identification of types of audit either FA, PA or CA on the basis of respective audit objectives;

- Risk Based Auditing Framework (RBAF) to capture the material audit risk during auditing process;
- Financial Audit Manual (FAM), Performance Audit Manual (PAM) or Compliance Audit Manual (CAM) for performing of audit procedure; and
- Audit Guide(s) as supporting audit tools to implement either FAM, PAM or CAM.

Audit Directives

According to RBAF, auditors plan their audit procedures to identify the audit risks and ways to respond to those risks. For the identification of audit risk and responses, specific Sectoral Audit Directives have been developed as audit tools as follows:

- a. Tools to evaluate the financial statements of entity or financial information of underlying offices as – Financial statement and financial information audit guide;
- b. Tools to evaluate the control system of auditee as – Financial accountability audit guide;
- c. Tools to evaluate the compliance of procurement law as –Procurement audit guide;
- d. Tools to evaluate the assessment of revenue as –Revenue audit guide;
- e. Tools to evaluate the entity-specific audit risk as –Entity- specific audit guide;
- f. Tools to evaluate the office-specific audit risk as – Office-specific audit checklist.

Document flow priority

Public audit covers various types of situations, institutions, transactions and scenarios. There may be differences in the prescribed audit tools depending with the particular circumstances or issues under audit. In such deviations, following documents are to be considered:

- a. Legal provisions
- b. OAGN audit standards – Nepal Government Auditing Standards [NGASS]
- c. Public Audit Restructuring Framework (PARF)
- d. Risk Based Audit Framework (RBAF)
- e. Audit Guide (FAG, PAG and CAG)
- f. Audit Directives

This audit directives provides the guidance and support for evaluation of revenue assessment procedures applied by the auditee.

How to use Audit Directives

Audit directives provides the checklist in the response of risk area. Following is the work-flow for the identification of risk-area and checklists:

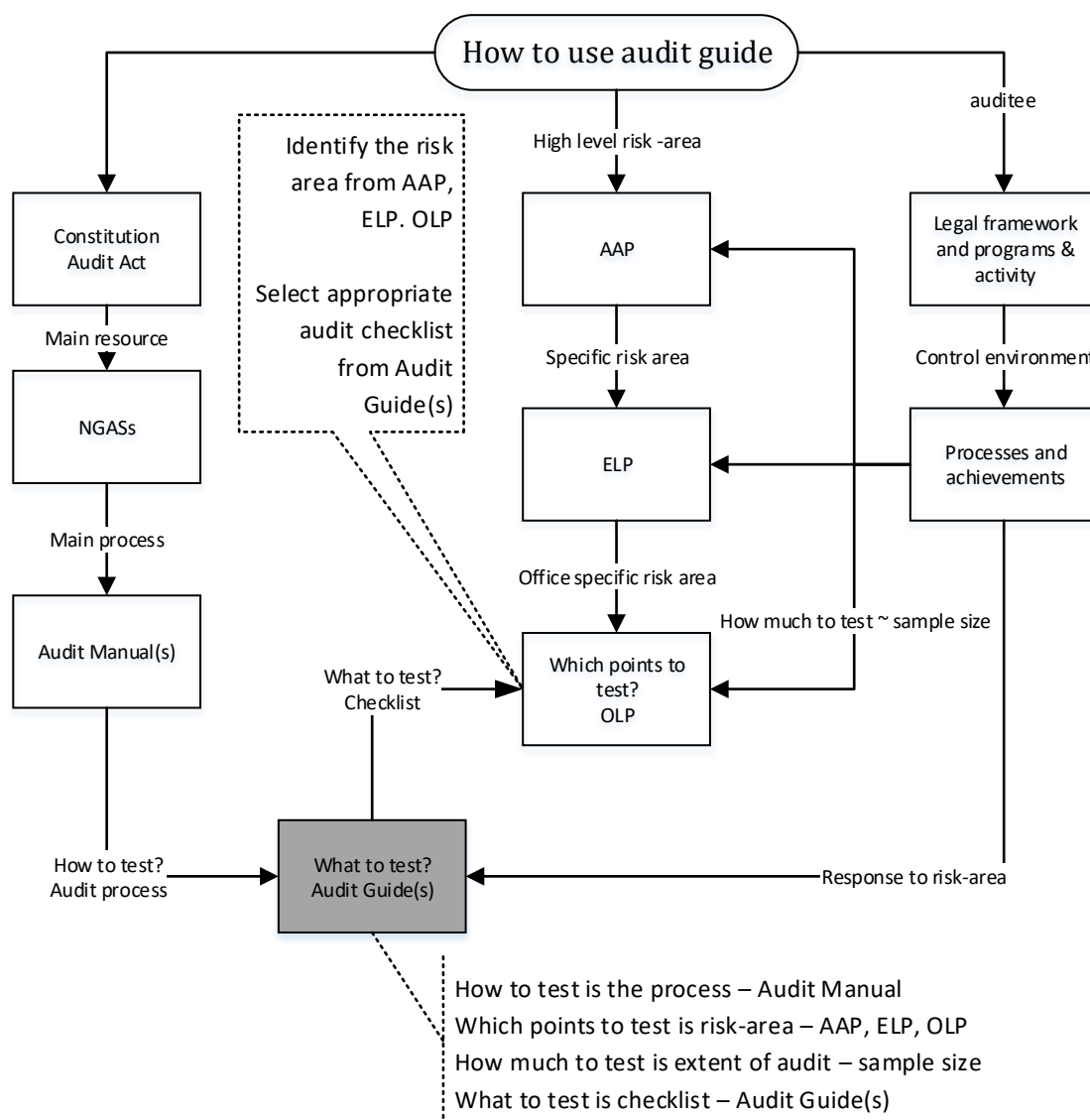
Step 01 – Auditor General approves the Annual Audit Plan (AAP) covering high-level identifiable risk areas relating to an entity under audit

Step 02 – Directorate includes the risk-areas identified in the AAP and adds additional risk-area as required in Entity Audit Plan (ELP).

Step 03 – Office level auditor includes the risk-areas applicable to the auditee from ELP and adds additional risk-area relating to that particular auditee in its Office Level Audit Plan (OLP)

Step 04 - Office level auditor selects (or develops, if requires) the appropriate and sufficient audit checklist in the response to the risk-areas from the respective audit guide.

Step 05 – Field auditor will test the risk-area in line with the audit checklist as approved in the OLP.



Updates

Based on the changed context on either legal provision, improvement by the auditee, experience and expertise of auditor(s), associated risk on the particular type of revenue or process of assessment, this Audit directives needs to review at least once in a year.

2. Objective of this audit directives

The objectives of this audit directives are:

- to support the auditor by way of grouping similar revenue issues applicable to those auditees;
- to collate revenue issues to be reviewed by using a single guide;
- to assist OAGN to audit the governance related issues by use of a single document;
- to assist OAGN to consolidate similar revenue audit information for its reporting;
- To support the auditor to conduct and manage revenue audit effectively
- To enhance the capacity of auditor to conduct revenue audit
- To direct the process of revenue audit and focus on the risk area of revenue sector,
- to simplify the provisions of laws, Acts and it's compliance

3. Coverage

This directives is one of the audit directives amongst other audit guides that can be applied on financial audits, performance audits or compliance audits. It can be used for audit of offices handling the taxation issues under general government.

As the circumstance requires, it can be used for concurrent audit as well.

The directives covers two major types of compliances – institutional compliance (i.e. compliance by the offices being audited) and taxpayer's compliance. Auditor needs to ascertain the applicability of specific audit issue either to institution or to the taxpayer.

This directives covers the revenue specific issues applicable to FA and CA. Revenue issues relating to the governance or institutional structure, relating to withholding during the payment, or generic service charges or levies etc. are described in Financial Accountability Audit Directives.

This directives covers federal revenue at the specific level and provincial revenue and local level revenue at the general level.

Though this audit directives specifically supports FA and CA auditor may use this audit directives for the performance audits with required modification.

4. Materiality consideration

Auditors should consider materiality throughout the audit process.¹ Therefore, revenue audit is subject to the materiality consideration². Every area of the audit has to be considered for associated risk of misstatements and its impact on the financial statements.

This revenue audit guide provides the guidance to conduct audit of the revenue. However, auditor needs to apply professional judgement in considering the materiality of each sub-category of the revenue and determine the nature extent and timing of the audit procedure. Process for identification of revenue risk-area and method of selecting the appropriate checklist in the response of risk-area has given in planning chapter.

This guide contains the guidance for possible audit procedures to be conducted related to revenue. It is up to the auditor to apply judgement in determining the nature and extent considering the risk and materiality.

5. Definitions

For the purpose of this audit directives, meaning of following terms are as follows:

Revenue – public recovery in form of direct taxes, indirect taxes and fees or service charges.

Direct reporting – direct reporting is the method of reporting on the assessment of planned issues without any reasonable assurance. In the direct reporting, auditor issues the report to the extent of risk-based audit plan.

Reasonable assurance – In order to obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion. Reasonable assurance is obtained when the auditor has thereby reduced audit risk to an acceptably low level.

Limited assurance – limitation assurance is the auditor's conclusion on the subject matter to the extent of audit plan.

Disclosure – disclosures are the information to the extent of minimum requirement of independent user of the financial statements, consolidated financial statements or financial information, as the case may be.

¹ ISSAI 100.41

² Para. 4.3.1 of Financial Audit Guide and Para. 3.3.1 of Compliance Audit Guide

Entity – entity is the legal body, which prepares financial statements or consolidated financial statements complying prevailing financial reporting framework as defined under financial procedures and financial accountability law.

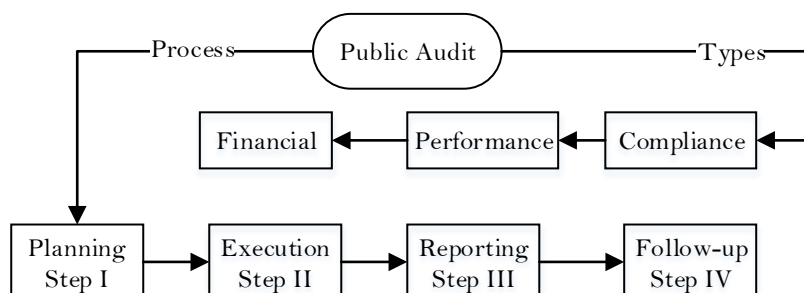
General government – general government is combined form of federal government, provincial governments, local authorities and their extra-budgetary institutions to discharge the governance activities of the government. General government does not include public corporation and government business enterprises.

Office – office is the legal body either in form of an entity, if it has single unit or underlying subordinates or branches under an entity.

Public corporation and government business enterprises – public corporation and government business enterprises are the independent/autonomous public institutions having business activities.

B. Preparation for revenue audit

Revenue audit is one of the activities of public audit by OAGN. Based on subject matter of auditing, revenue audit may be either financial audit or compliance audit or may take the form of the performance audit. Revenue audit itself is not an independent type of audit but a subset of public audit.



Financial audit

For the revenue audit as part of financial audit (FA), subject matter is the financial statements itself. Therefore, the process for revenue audit will be as class of transactions for the financial audit. All the processes applicable to FA need to be followed to express an audit opinion on the financial statement providing reasonable assurance. The process for audit will be as per financial audit manual.

Audit steps
Step I: Audit Plan
Step II: Audit Execution
Step III: Audit Report
Step IV: Audit Follow-up

Performance audit

Revenue audit as part of performance audit (PA), auditor needs to identify the subject matter based on nature, risk and materiality of the revenue activity. The process for audit will be as per Performance audit manual. In the case of identified subject matter permits, the checklists from this audit guide may be usable in PA too.

Compliance audit

For the revenue audit as part of compliance audit (CA), auditor needs to identify the subject matter based on nature, risk and materiality of the revenue law. The process for audit will be as per Compliance audit manual.

This audit directives deals the items of revenue audit that can be used during either FA, PA or CA. Auditor needs to follow procedures as defined in respective audit manuals while using this audit directives.

6. Planning³

For identification of potential risk area within the public revenue, auditor needs to analyse, based on the auditor's knowledge and experience, each type revenue sources, their weights in the total revenue, control mechanism, legal provisions and other indicators. For the legal provisions, auditor need to especially consider concessions and exemptions, to ensure that benefit is transferred to the public at large or special beneficiary group as intended. Based on the research and study reports, auditor needs to identify risk area in the audit plan.

Planning Steps

Step I-01: Identification of Risk area

- i) Risk area from AAP
- ii) Additional risk-area from ELP
- iii) Additional risk-area from OLP

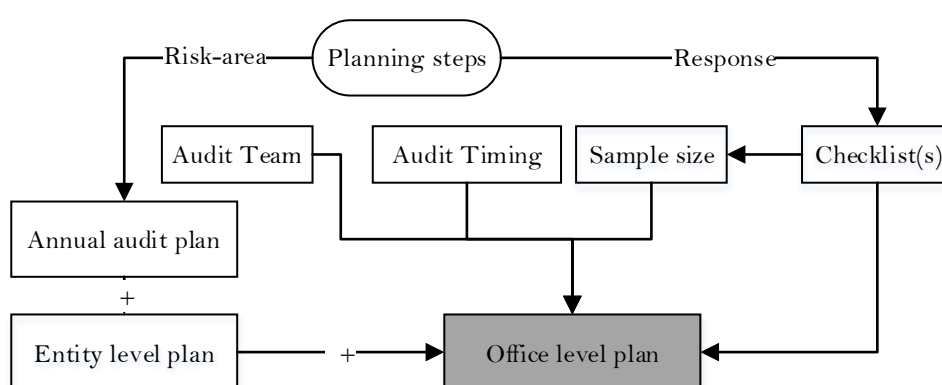
Step I-02: Response on risk-area

- i) Appropriate audit checklist
- ii) Appropriate extent of audit (sampling size)

Step I-03: Team-planning

Step I-04: Audit timing

Revenue audit is one of the subsets of financial audit or subject matter for performance audit or compliance audit. Based on subject matter, planning process as described in FAM, PAM or CAM will be applicable. Apart from audit planning as described in FAM, PAM or CAM, there is no separate audit planning for revenue audit. Revenue audit is one of the activities under either FA, PA or CA. Based on the type of audit, auditor needs to follow applicable auditing manual (FAM, PAM or CAM) for planning.



During the planning stage, auditor needs to select appropriate audit checklist or develop applicable checklists on the basis of associated risks and the audit type.

³ To be applied with Para 4.3 of Financial Audit Guide and Para 3.3 of Compliance Audit Guide Para

Revenue Risk-area examples	Indicators for the risk-area
1. Analysis of preparation of taxation authority to implement tax-policy	<ul style="list-style-type: none"> • Frequent changes in the tax policy. • There is indicative deviation on legal or institution with the tax policy.
2. Analysis of preparation of taxation authority to implement tax-policy	<ul style="list-style-type: none"> • There is indicative deviation on legal or institution setup with the tax policy. • Suggestions on prior years audit reports on implementation not implemented yet
3. Implementation of VAT law (or any tax revenue law) and VAT differences	<ul style="list-style-type: none"> • There are examples of unused or partially used legal provisions. • Study report on revenue analysis
4. Excise duty return reconciliation and sticker management	<ul style="list-style-type: none"> • High-level analysis of excise-duty returns with sticker inventory shows substantial differences.
5. Evaluation of internal review and administrative review	<ul style="list-style-type: none"> • High-level analysis of settlement of administrative review
6. Documentation of information from investigation and evaluation of status of implementation	<ul style="list-style-type: none"> • Investigation inventory and trend analysis
7. Evaluation of cost of tax-collection	<ul style="list-style-type: none"> • Tax-cost survey report • Prior year tax-cost ratio
8. Evaluation of unified tax system and use of information technology	<ul style="list-style-type: none"> • Information of IT systems in revenue • Inventory of current year updates
9. Recording of revenue arrears and recovery	<ul style="list-style-type: none"> • Analysis of revenue arrears
10. Income recognition under long-term contracts	<ul style="list-style-type: none"> • Inventory of long-term contract from revenue system • Inventory of long-term contracts from expenditure system

- For the financial audit, tools given in this Audit guide are usable while working on AP 2 of FAM.
- For the performance audit, tools given in this Audit guide are usable based on subject matter of the PA.
- For the performance audit, tools given in this Audit guide are usable based on subject matter of the CA (while working on PA 2 of CAM).

NAMS - During the planning of audit, auditor need to develop/select the appropriate audit checklist given in this guide. The selection may be at the Checklist Group level or Checklist Head level or Checklist Area level.

7. Execution⁴

During the audit execution, auditor need to follow appropriate procedure for reviewing and obtaining appropriate audit evidences⁵. In certain circumstances where issues which has not been identified during the planning stage come to the knowledge of the auditor, auditor needs to update the audit plan (checklist) or create new checklist to gather the required audit evidences.

Audit Execution Steps

Step II-01: Administrative arrangement for field audit	Step II-02: Evaluation of financial information (Rajaswa ko Arthik bibaran)
i. Authorization and field visit	i. Checking with ledger balance
ii. Entry meeting	ii. Confirmation with bank records
iii. Allocation of audit tasks within audit team members	iii. Checking with revenue vouchers
	iv. Confirmation with revenue related transactions
Step II-03: Determination of appropriate samples for each risk-area	Step II-04: Review of audit samples on the basis of planned checklist
i. Identification of issues for sampling	i. Collecting audit evidences (tippot and supporting documents)
ii. Fixing the number of samples for audit	ii. Drafting observation
	iii. Drafting report paragraphs
Step II-05: Communicating the observation	
i. Communicating with the auditee and supervisor	
ii. Collecting feedback	
iii. Assessing feedback and correction of observation	
iv. Exit meeting	

NAMS - During the execution of audit, auditor need to test the issues identified at the planning stage. In some cases, auditor may need to revise the audit plan.

⁴ To be applied with Para 5.3 of Financial Audit Guide and Para 4.3 of Compliance Audit Guide Para

⁵ Chapter 5 of Financial Audit Guide and Chapter 3 of Compliance Audit Guide

8. Reporting⁶

Auditor needs to report appropriately all the observations considering their materiality and significance to the auditee and legal requirements. In case where the issue is material and pervasive it may require immediate attention of the senior management or those charged with governance and appropriate intimation to the audit supervisor. The auditor needs to communicate such matter to the appropriate level.

Reporting Steps

Step III-01: Communicating the observation	Step III-02: Preliminary audit report
	i. Drafting PAR
	ii. Supervisor's review on draft PAR
	iii. Finalizing PAR
	iv. Issuing PAR

For the subject-matter of revenue audit issues are direct reporting of the conclusions under performance audit or compliance audit. For the compliance audit, auditor needs to report the conclusions as prescribed in CAM.

This audit conclusions for FA, for matters identified under this revenue audit guide need to be reported in 'compliances of legal requirements section of the audit report' as defined in FAM.

NAMS - Reporting of revenue audit is same as reporting of issues under any type of audit in NAMS.

9. Follow up⁷

Similar to the follow up of the other issues reported, auditor need to follow up audit in the issues relating to revenue audit.

NAMS – Follow up for revenue audit issues, is same as for any other audit in NMAS

10. Quality control and quality assurance

For each stage of audit i.e. planning, execution, reporting and follow up, auditor needs to ensure the quality control system as prescribed in the standards, frameworks and manuals have been followed. The procedures to be followed during the audit will be subject to the review during quality assurance.

NAMS –QC/QA are inbuilt in NAMS for audit procedures under FA, PA or CA.

⁶ To be applied with Para 6.3 of Financial Audit Guide and Para 5.3 of Compliance Audit Guide Para

⁷ To be applied with Para 7.3 of Financial Audit Guide and Para 6.3 of Compliance Audit Guide Para

Part II

Institutional Issues for Revenue Audit

C. Institutional system

Revenue is one of the technical subjects within general government. While collecting the revenue, some sort of institutional set-up must be maintained. The institutional set-up may be applicable within the authority, between authorities, between the authority and the taxpayer or for the taxpayers only. Auditor needs to consider the structural status of the institutional issues to evaluate the efficiency and effectiveness of the authority in addition to the requirement of compliance with the laws.

Examples of the major revenue authorities

Federal Government-

-MOF

-Department of Custom, IRD, Department of revenue investigation, FCGO,

-Ministry of Land Management, Cooperatives and Poverty Alleviation

Province Government

-Ministry of Economic Affairs and Planning

Local Government

Importance of evaluation of institutional systems in the revenue audit

- i. Legal framework either federal, provincial, or local level is volatile in the case of revenue laws
- ii. Similar law may be implemented in different region, especially in the case of local level or provinces
- iii. Auditor is only one common evaluator for the revenue system in all the (761) governments or executives
- iv. Uniform evaluation and reporting will assist executives to identify the potential common procedure to simplify the revenue system and avoidance of double taxation
- v. Auditor may analyze the differences between rulings issued by same authority or various authority on the same revenue issue

How to accommodate institutional system checklist in the revenue audit plan

- i. Normally, annual audit plan (AAP) will prescribe the audit risk-areas regarding institutional set up and revenue policy. Entity level plan (ELP) will have periodic or annual issues as additional risk-areas. Any special issue, if relating to the office, may be identified for office level plan (OLP)
 - ii. Based on the identified risk-area, auditor needs to allocate appropriate checklist as prescribed below.
 - iii. These checklists are, if not indicative of a particular type of office, common and general for all types of offices. Auditor needs to develop appropriate checklist based on risk-area and sources of audit evidences.
-

11. Revenue Documentation

Background:

For the revenue, there are many types of governance procedures and controls, from the constitution to charts of accounts. Specific type of assessments has been described in this Revenue audit guide. In this section, general control system has been considered.

Constitutional power

According to following provisions of the Constitution of Nepal, following level of government may levy the revenue through the act:

- | | |
|-------------|--|
| Article 115 | Federal government may frame the revenue law from federal parliament within the scope of Schedule 5, 7 and 9. |
| Article 203 | Provincial government may frame the revenue law from respective provincial legislature within the scope of Schedule 6, 7 or 9. |
| Article 227 | Local level may frame the revenue law from its municipal council within the scope of Schedule 8 and 9 |

Constitutional authority

According to Schedule 5, 6 and 8 of the constitution, sources of revenue are allocated solely to the federal, provincial, or local level. Schedule 7 and 9 prescribes the combined list as per follows:

Schedule 5	Schedule 6	Schedule 8	Schedule 9
Federal list	Province list	Local list	Combined list
Customs duty, excise duty, VAT, corporate income tax, personal income tax, remuneration tax	Agricultural income tax	Property tax, house-rent tax, business tax, land tax,	
Passport fee, visa fee	Land and building registration	Land and building registration	Natural resources royalty
	Entertainment tax	Entertainment tax	
	Advertisement tax	Advertisement tax	
	Vehicle tax	Vehicle tax	
Tourism fee	Tourism fee	Tourism fee	Tourism fee
service charge	service charge	service charge	service charge
Fine and penalty	Fine and penalty	Fine and penalty	Fine and penalty

In the constitution one head of revenue has given more than one single-power list or concurrent list. Many of the above powers, for example tourism, entertainment, advertisement etc., has not been effectively implemented by Province or Local Level.

Under the principle of single-tax-administration, intergovernmental fiscal arrangement law prescribe the role and responsibility of management of the revenue under the concurrent list.

Objectives:

Review of authority to tax, adequate maintenance of revenue database and public availability of legal documents

Risk:

Collection, recovery, recording, totalling, reporting, billing, bill-control may have lapses resulting in revenue loss.

SN	Issues	Basis of checking
1.	Whether all sources of income of the office has been recorded adequately, for example <ul style="list-style-type: none"> ▪ Rent from house, shed, land, pond etc. ▪ Royalty or charge from license or similar ▪ Service charges and fees as per business of office ▪ Charge from hording board, park, etc. ▪ Sale of tender / bid documents ▪ Other potential sources of income 	Rajaswo Aarthik bibaran, files
2.	Whether the agreements for each source of income has been adequately maintained, for example, <ul style="list-style-type: none"> ▪ Agreements are updated and recorded properly ▪ Agreements are updated but not well recorded ▪ Agreements and records are not updated 	Updated records, budget speech, executive minutes
3.	Whether the agreements for each sources of income are kept securely, for example, <ul style="list-style-type: none"> ▪ Retained in safe place within the office ▪ Retained in office as general files ▪ Documents are stored somewhere other than office (controlling entity, chief's residence, some other's premises) 	Documentation arrangement
4.	Whether collection / recovery of revenue is less than the legally prescribed amount <ul style="list-style-type: none"> ▪ Less assessed ▪ Less recovered 	Assessment files, legal provisions

SN	Issues	Basis of checking
5.	Whether the assessment has been made misinterpreting the legal provision benefiting a particular person or persons	Assessment files, legal provisions
6.	Whether collected / recovered revenue has been deposited as prescribed, <ul style="list-style-type: none"> ▪ not deposited ▪ deposited but not supported adequately ▪ deposited with a delay and potential risk of teeming & lading 	Revenue accounting ledger
7.	Whether revenue record (<i>lagat</i>) is updated, <ul style="list-style-type: none"> ▪ for this year revenue ▪ opening balance of <i>lagat</i> from previous year(s) 	Revenue accounting ledger, revenue records
8.	Whether revenue arrears from previous years has been brought down as the outstanding arrears	Revenue accounting ledger, revenue records
9.	Whether revenue has been deposited into security deposit account instead of into the consolidated fund	Revenue accounting ledger, revenue records

12. Authority to tax and availability of legal documents

Background:

Constitution of Nepal has prescribed appropriate authority for the revenue collection on the basis of defined nature or type. Auditor needs to evaluate the issues relating to authority to tax, whether it is within the office or not and the legal provisions governing such authorities.

Example of tax authorities

- i. Federal Government
 - Inland Revenue Department – income tax, value added tax, excise duty
 - Department of Customs – customs duty and other import-export related taxes and duties
 - Malpot office (to be transferred to local level) – capital gain on disposal of land or building
 - For non-tax revenue – any offices having sources of revenue
 - ii. Provincial government
 - Ministry of Economic Affairs and Planning
 - Transport office
 - For non-tax revenue – any offices having sources of revenue
 - iii. Local level
 - Local level executive
 - Ward offices
 - For non-tax revenue – any offices having sources of revenue
-

Objectives:

Review of authority to tax and public availability of legal documents.

Potential Audit Risk:

Taxes and duties may be levied without adequate authority and tax laws may not have been made publicly available.

Due to insufficiency of resources (personal capacity, publishing infrastructure, computer facility etc.) or willingness, especially for local authorities, the revenue law may not be available to the respective taxpayers.

SN	Issues of evaluation	Basis of checking
1.	Auditor needs to evaluate the legal environment of tax law, whether, <ul style="list-style-type: none">▪ All the taxes, duties, levies, or charges are charging through legislative authority (such as an act of the parliament)	Publication date of rajpatra for relevant revenue law,

SN	Issues of evaluation	Basis of checking
	<ul style="list-style-type: none"> ▪ The act has been published ▪ The tax is within the authority defined in the constitution 	Constitutional provisions
2.	<p>Auditor needs to evaluate the collection mechanism for the tax as, whether,</p> <ul style="list-style-type: none"> ▪ Taxes are collected directly from taxpayers ▪ In the case, tax has collected through person other than authority itself, there is registration procedure in the tax law ▪ Taxpayers receive the certified receipt for the tax payment, issued by the authority or in the name of the authority 	Assessment and collection procedure as per law and practice
3.	<p>Auditor needs to evaluate, whether the tax law prescribes:</p> <ul style="list-style-type: none"> ▪ Registration and deregistration procedure for taxpayers ▪ Assessment method (self-assessment or assessment by the authorised officer) ▪ Assessment period (tax-period) ▪ Assessment deadlines ▪ Assessment of tax in prescribed format 	Registration records/documentation Assessment documentation Appeal process and documentation
4.	<p>Auditor needs to evaluate the timely access of legal documents to the assessing officers as well as to the respective taxpayers as, whether following documents are publicly available before the date of charging tax:</p> <ul style="list-style-type: none"> ▪ Tax laws (act and regulations) ▪ Directives and circulars ▪ Rulings ▪ Case laws 	Publication of legal texts Public availability of case laws
5.	<p>Auditor needs to evaluate the recording system of the authority, whether appropriate records are maintained and updated for,</p> <ul style="list-style-type: none"> ▪ Registration and deregistration ▪ Revenue list (<i>lagat</i>), if any ▪ Assessment records ▪ Collection records ▪ Action records ▪ Updates on IT-database, if any ▪ OAG Forms 101 -115, as applicable ▪ Bill control register -OAG Form 904 	Respective documents Process documents
6.	<p>There are regulations or directives or circulars that supplement and detail the provisions of the tax laws that meet the following requirements, whether,</p>	Updated legal text Updates at least annually

SN	Issues of evaluation	Basis of checking
	<ul style="list-style-type: none"> ▪ They are clear, comprehensive and consolidated as a set of regulations available in a single and accessible place ▪ They are updated regularly; ▪ The responsibility for their maintenance is defined. 	
7.	<p>Whether the legal framework provides for the following,</p> <ul style="list-style-type: none"> ▪ The right to review on request of the taxpayer during the assessment process by the authority ▪ Provisions to respond to a request for review at the assessment level by way of administrative review by authority independent from the assessment process that has the authority to grant remedies and includes the right for judicial review. ▪ Establishes the matters that are subject to such reviews ▪ Establishes timeframes for issuance of decisions by the assessing authority and by the authority conducting administrative review. 	<p>Appeal mechanism Practical procedures for appeal Defined time-frame and its compliance records</p>
8.	<p>Tax law is impartial to the extent, whether,</p> <ul style="list-style-type: none"> ▪ It is free of discriminative tax rates or quantification ▪ It contains marginal relief (i.e., additional tax is not more than additional income) ▪ It does not levy withholding tax on regular business transactions ▪ It is clear on determination of geographical sources of income ▪ It amends law itself rather than numerous circulars and rulings ▪ It uses the tax treaty or investment treaty provisions, if any ▪ It contains action against officials, and it is effective in substance 	<p>benchmarking indicators and the analysis of legal provisions</p>

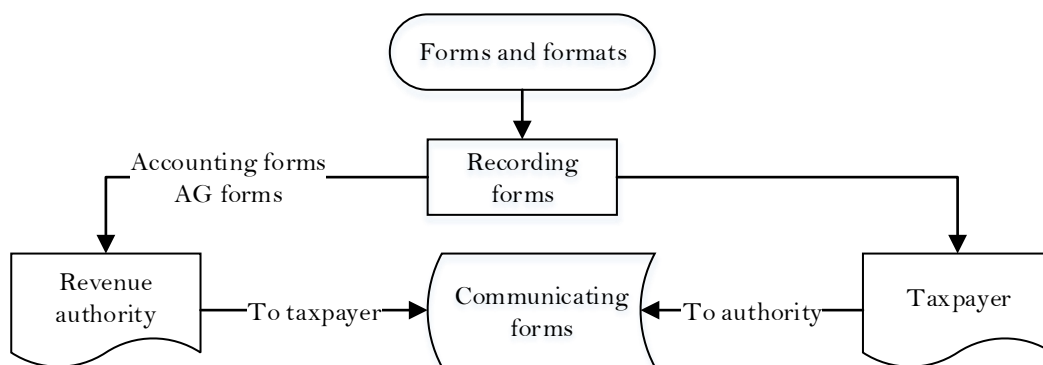
13. Forms and formats

Background:

Depending upon the complexity of the tax law, there should be appropriate number of forms and formats for tax records. They may be usable within the authority, may be communication between the authority and the taxpayer and may be maintained by the taxpayer. Appropriate forms and formats will ease management of revenue base, whereas ad hoc or arbitrary forms creates revenue disputes.

The forms and formats will be four types:

- i. Recording forms
 - a. Formats of documents those to be maintained by the revenue authority, which will be the forms and formats related to the revenue payers – registration record, assessment records, payment records etc. (but not accounting forms, which will be AG forms)
 - b. Formats of documents those to be maintained by the taxpayer, which will be the forms and formats related to the transactions
- ii. Communicating forms
 - a. Forms of documents those to be filed to the revenue authority by a taxpayer
 - b. Forms of document those to be issued by the revenue authority to a taxpayer.



Objectives:

Review of adequacy of forms and format for smooth implementation of tax administration.

Potential Audit Risk:

Taxes and duties may be levied without adequate documentations.

Sl.	Issues of evaluation	Basis of checking
1.	<p>Auditor needs to evaluate the appropriateness of forms and formats prescribed by the authority comparing the nature, size and complexity of the transactions of the tax being evaluated. Some cases, the formats are prescribed in the regulation, whereas other cases, the power to issue the formats rests with the authority. For example, For the income tax, many documents need to be prescribed by the Director General (DG) of IRD. Auditor needs to evaluate, whether DG has prescribed sufficient and appropriate forms for tax-accounting as,</p> <ul style="list-style-type: none"> ▪ Cost-sheet (Sec. 15 of Income tax law) ▪ Loss- records for Sec. 20 or 36 ▪ Accounting records for long-term contracts for Sec. 26 ▪ Annuity or finance lease records for Sec. 32 ▪ Transfer pricing documents for Sec. 33 ▪ Communicating formats for Sec. 43, 45, 46, 104 – 110 ▪ Tax-base balance sheet for Chapter 9 ▪ Negotiation format Sec. 110A 	Prescribed formats
2.	<p>Apart from income tax forms, whether there are adequate forms available for recording, assessment, re-assessment of the revenue, for example ,</p> <ul style="list-style-type: none"> ▪ advertisement tax (by local authority) ▪ Agriculture income tax (for provinces) ▪ Vehicle tax (for provinces) ▪ Royalty on natural resources or electricity (for federal) 	Prescribed formats
3.	<p>Accounting forms: According to financial procedure and financial accountability law, Revenue or other forms of receipt (Sec. 27), whether,</p> <ul style="list-style-type: none"> ▪ Recorded in same day (if not possible next) of receipt; ▪ Deposited in the same day (if not possible next) of receipt; ▪ Transferred the bank balance to consolidated fund on the same day of bank deposit; 	Prescribed formats

14. Ruling and circulars

Backgrounds:

Director General of IRD may issue the advance ruling to a particular person and public circular to all. In the cases of contradiction with law, benefits from ruling will be continue until withdrawn in writing.

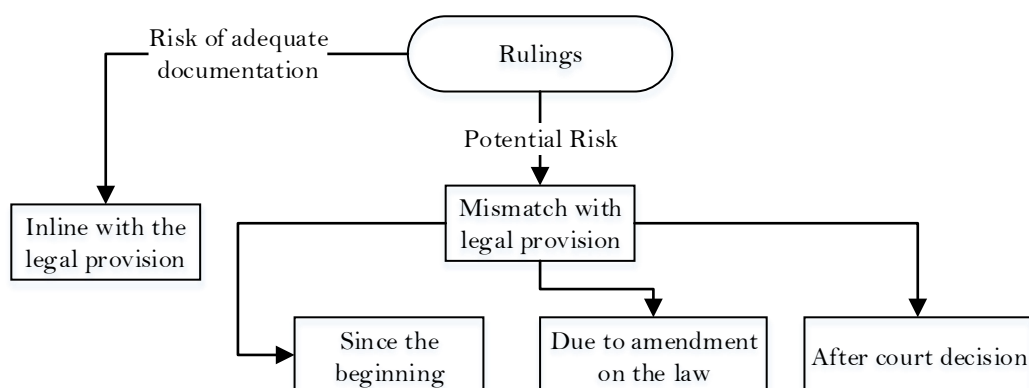
For revenue other than tax, concerned authority may issue the rulings and circulars as per the provision of respective laws. For example, local authority or provinces may issue the circulars on the basis of their legislative provisions. Ministry of land management is responsible for clarification on registration revenue etc.

Objectives:

Review of compliance of existing rulings with legal provisions

Audit Risk:

Rulings, under the law, may be issued for the benefit of the taxpayer. The risk is that such ruling may not be withdrawn even after further clarification in directives, by court case or after inclusion in the law itself.



Sl.	Issues to be evaluated	Basis of checking
1.	Whether updated list of rulings and circulars are available, <ul style="list-style-type: none">Income tax relatedVAT relatedExcise duty relatedCustoms relatedLand TaxHouse and Land Tax Rules	List of updated circulars
2.	Whether existing rulings reviewed, at least annually, or after each amendment / revision / issue of <ul style="list-style-type: none">Act or regulationsDirectives	Review plan and review report

Sl.	Issues to be evaluated	Basis of checking
	<ul style="list-style-type: none"> ▪ Court cases 	
3.	Whether existing rulings contradict with other interpretations withdrawn in writing	Review plan and review report
4.	Whether rulings to different taxpayers or public circulars contradict with each other	Review plan and review report

15. Self-assessment

Backgrounds:

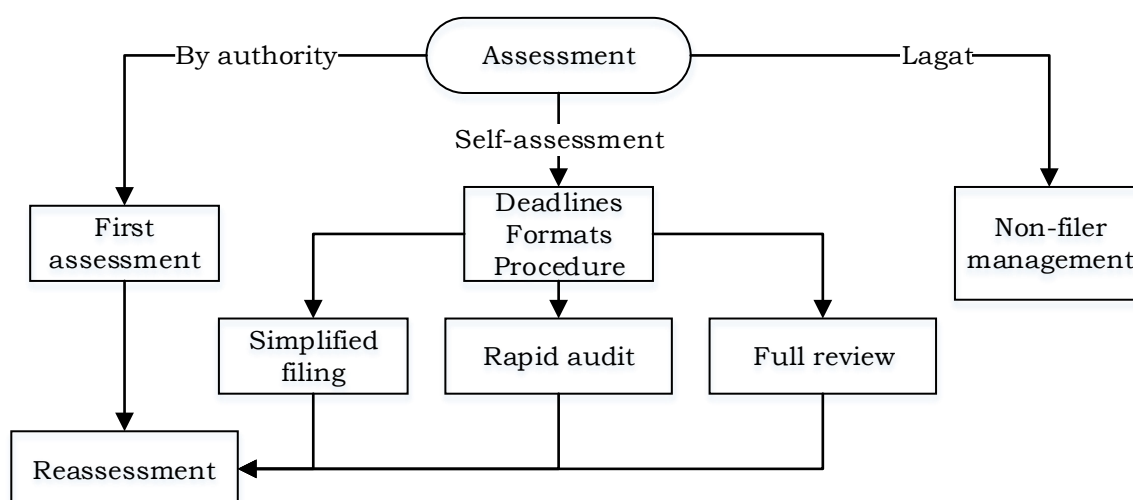
Most of the revenue laws allow the revenue payer to declare their respective taxes. Revenue authorities are only responsible for high level verification of self-assessment except when such self-assessments are selected for specific assessment. Verification may be in form of desk-review or rapid-audit in nature. Authorities need to prescribe the sufficient forms and procedure for self-assessment procedure.

Objectives:

Evaluation of adequacy of self-assessment procedure.

Potential Audit Risk:

There may be identifiable weakness in the self-assessment procedure and prescribed procedure that may not have been followed properly



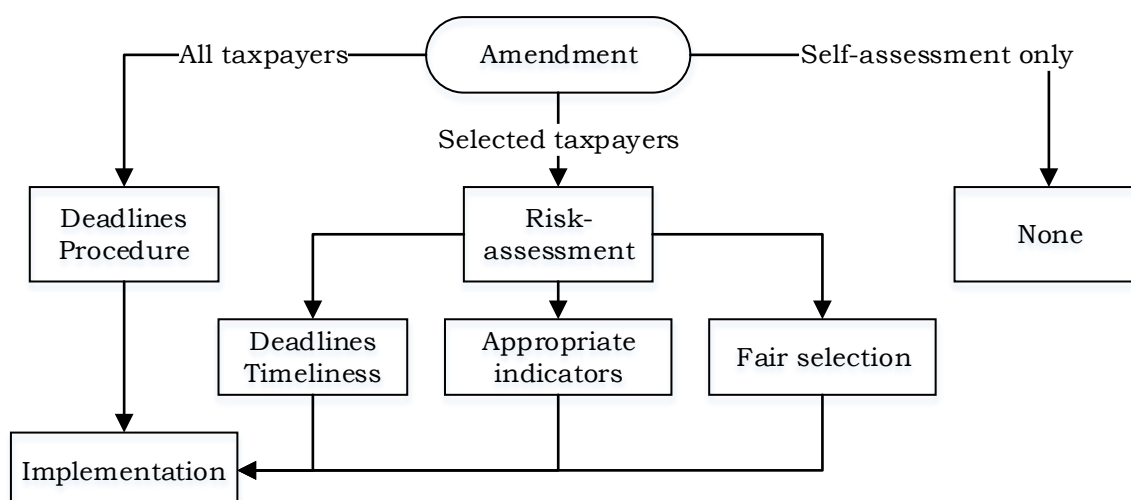
Sl.	Issues to be evaluated	Basis of checking
1.	Whether the legal provision for self-assessment procedure has: <ul style="list-style-type: none">▪ Pre-defined deadlines▪ Pre-defined forms▪ Pre-defined procedures	Tax law
2.	Whether rapid audit procedure has been adopted at the time of filing of self-assessment returns	Tax law, procedure, circulars
3.	Whether authority makes the corrections on the basis of rapid audit procedure	Rapid audit reports, corrections

Sl.	Issues to be evaluated	Basis of checking
4.	Whether revenue has been collected immediately on filing self-assessment	Circulars and practice
5.	Whether <i>lagât</i> has been maintained for the pre-defined sources of revenue	Updated <i>lagât</i>
6.	Whether authority has any plan for recovery of <i>lagat</i> or arrears	Recovery plan

16. Amended assessment: Selection

Backgrounds:

For self-assessment procedure for income tax, value added tax, excise duty (with exceptions), the department uses the reassessment procedure. For the reassessment, department uses the risk-based selection of taxpayers' returns.



In the case of reassessment by Inland Revenue Department, allowable timeframe is four years. The deadlines for four-years is different in each tax laws. The deadlines is:

- For the income tax, four-years from filing due date; e.g. for the purpose of income year 2077/78, the deadline is 2082 Ashoj end.
- For the value added tax, four-years from latest of filing due date and filed date; e.g. for the purpose of tax-period 2077 Srawan, which filed on due date, the deadline is 2081 Bhadra 25.
- For the excise duty, the act has not prescribed the amendment period.

Amendment procedure

Following is the general procedure for amendments:

Step 1: Selection, normally on risk-based, if not compulsory reassessment

Step 2: Servicing notice to the taxpayer for submitting documents and financial information

Step 3: Obtaining the information and documents from taxpayer within the prescribed time limit

Step 4: Analysing the transaction and confirming the self-assessment return

Step 5: Serving notice to the taxpayer, in the case of deviations than what ought to be in the particular transaction/class of transactions

Step 6: Obtaining the clarification from the taxpayer

Step 7: Issuing Amended assessment notice as per respective law.

Objectives:

Evaluation of adequacy of selection procedure for reassessment.

Potential Audit Risk:

There may be identifiable weakness in the selection procedure and prescribed procedure may not be followed properly.

Sl.	Issues to be evaluated	Basis of checking
1.	Taxation authority may not able to make amendment in all self-assessment tax-return. In such cases, they often use risk-based selection approach using weighted risk-scoring method. Auditor needs to ensure, whether risk-scoring and weight for selection of taxpayers has been, <ul style="list-style-type: none"> Reviewed according to prescribed method Appropriate and represents the risk Used appropriately for selection 	Selection circular, analysis report
2.	Whether selection has been made in the year of self-assessment on the basis of score <ul style="list-style-type: none"> Selected within same year Selected one-year later Selected two-years later Selected then-after 	List of selection
3.	In the case of selection in later years, whether selection has made for all pending years within the four years stipulated in the tax laws.	List of selection
4.	Whether manual (discretionary) selection is <ul style="list-style-type: none"> fair and based on identified revenue risk fair to the industry fair to the different group of taxpayers 	List of selection
5.	Where office selects the taxpayer under manual selection procedure, verify whether the taxpayer is: <ul style="list-style-type: none"> Searched on the premises during the year Goods, vehicle, data etc. have been seized during the year A Non-filer taxpayer Non-registered if requires compulsory registration 	Reconciliation of searches and list of selection

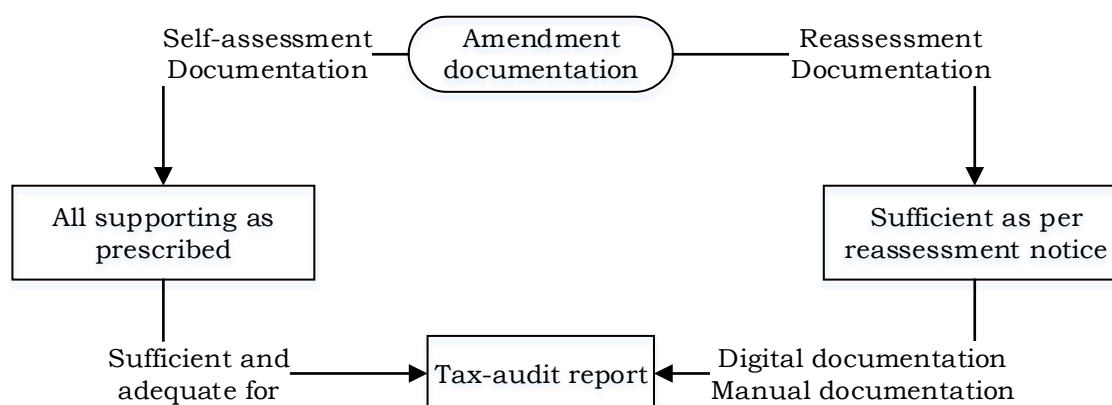
Sl.	Issues to be evaluated	Basis of checking
	<ul style="list-style-type: none"> Identified as revenue-risk during the investigation (documented) 	
6.	Whether manual selection is made according to departmental guidelines	Guidelines and list of selection

17. Amended assessment: Adequacy of documents

Backgrounds:

Taxpayer submits following documents by the end of amended assessment:

- Prescribed general documents and business-specific documents according to the directives for filing income tax return and online filing;
- instructed documents as the response of written letter under:
 - Sec. 83 of Income tax Act, 2058
 - Sec. 23 of Value added tax Act, 2052
 - Sec. 10D of Excise duty Act, 2058;
- clarification with further documents on the response of notice issued under:
 - Sec. 101(6) of Income tax Act, 2058
 - Rule 29(1) of Value added tax Regulation, 2053
 - Sec. 10B(4) of Excise duty Act, 2058;



Objectives:

Evaluation of adequacy of documents at the time of assessment by the tax-officer [federal income tax department]

Potential Audit Risk:

Auditor needs to evaluate the full audit report, amended assessment order on the basis of adequacy of documents in the taxpayer file.

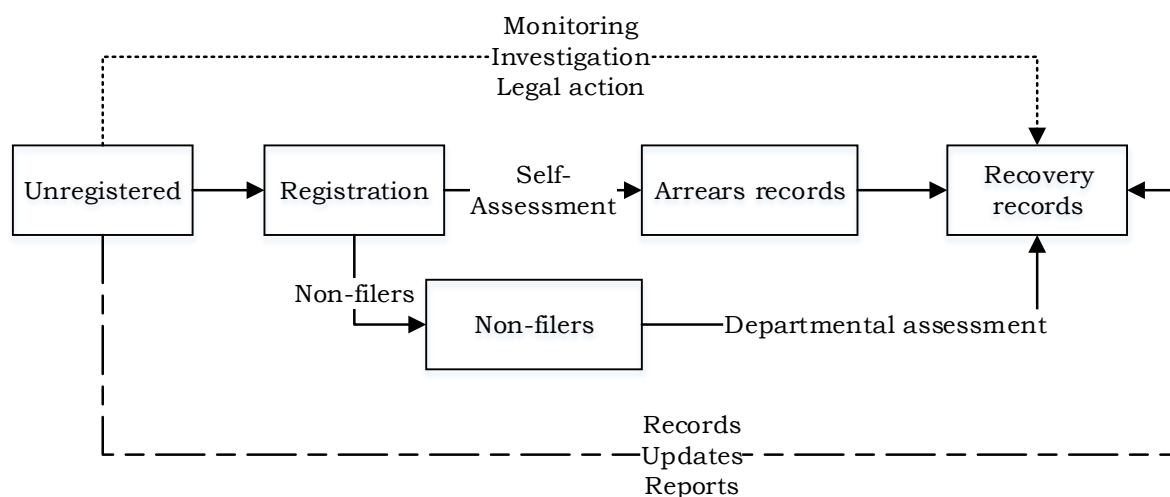
Sl.	Issues to be evaluated	Basis of checking
1.	<p>At the time of filing of income tax return, following documents need to be filed along with the rerun. Auditor needs to confirm their submission:</p> <ul style="list-style-type: none"> ▪ Audited financial statements, ▪ Supporting on interest payment ▪ Staff payroll matching the expense including capitalised, if any 	<p>Review of filed tax returns and comparison with filing directives</p>

Sl.	Issues to be evaluated	Basis of checking
	<ul style="list-style-type: none"> ▪ Staff retirement fund contribution ▪ Pool-wise depreciable assets including purchases during the year ▪ Pool-wise repair expenses ▪ Withholding tax statements (not required if WHT filed online) ▪ Forex computation sheet 	
2.	<p>At the time of amended assessment, tax officer issues a formal letter asking taxpayer to submit the documents as per tax law. Those documents are evidences for the income and expenses as reported in the income tax return. Auditor needs to evaluate, on the basis of size, nature and complexity of the business of taxpayer, the adequacy of those documents for the assessment, whether,</p> <ul style="list-style-type: none"> ▪ They were adequate for nature, size and complexity of the taxpayer, ▪ All the requested documents were submitted during the reassessment procedure, ▪ Requested documents are matching with the audited report ▪ Adequate supporting documents were taken for reassessment, 	<p>Notice for information and collected documents</p>
3.	<p>During the amendment, tax-officer prepares full assessment report with details of account balance and appropriate transactions. Auditor needs to review the full assessment report with the sufficiency of the supporting documents thereto. In the full assessment file, whether,</p> <ul style="list-style-type: none"> ▪ Sufficient supporting documents support the data in form of account balance, transactions, or other information ▪ Purchase and sales in the financial statements, income tax, value added tax and excise duty, as the case may be, reconciled ▪ Information relating to other parties (sales, purchase, interest, royalty etc.) reconciled 	<p>Supporting documents in the full audit file</p>

18. Taxpayer management

Backgrounds:

Taxpayer management is one of the major activity of offices generating tax revenue. Depending upon the taxation, there are taxpayer management procedures prescribed by either law or administrative arrangement.



Many taxpayers may be beyond the scope of tax-net. To capture those taxpayers as the regular taxpayer, offices may have approved program for monitoring or legal actions. Auditor needs to review the progress of those program as well.

Objectives:

Evaluation of taxpayer management system of the office

Potential Audit Risk:

Taxpayer within the tax-net may not be captured and monitored.

Sl.	Issues to be evaluated	Basis of checking
1.	Tax offices maintains update list of taxpayers in accordance with registration for a particular type of tax. Auditor needs to evaluate, <ul style="list-style-type: none">whether taxpayer records have maintained updatewhether taxpayer records cover all the taxpayers identified by any monitoring reportwhether mandatory registration has been implemented adequately	Updated records
2.	Tax offices has the market monitoring programme in their annual plan. Based on monitoring report,	

Sl.	Issues to be evaluated	Basis of checking
	<ul style="list-style-type: none"> ▪ whether evidences of transaction have been found but the taxpayer has not been registered in respective tax ▪ whether evidences of transaction have been found but the issue has not been included in tax-assessment ▪ whether evidences of transaction have been found and included in tax-assessment, but adequate penalty has not been charged 	Monitoring plan and reports
3.	<p>Whether there are numerous seizures, searches or investigations during the year but assessments or civil cases against taxpayer are:</p> <ul style="list-style-type: none"> ▪ None; ▪ Minimum; or ▪ All 	Seize and search reports

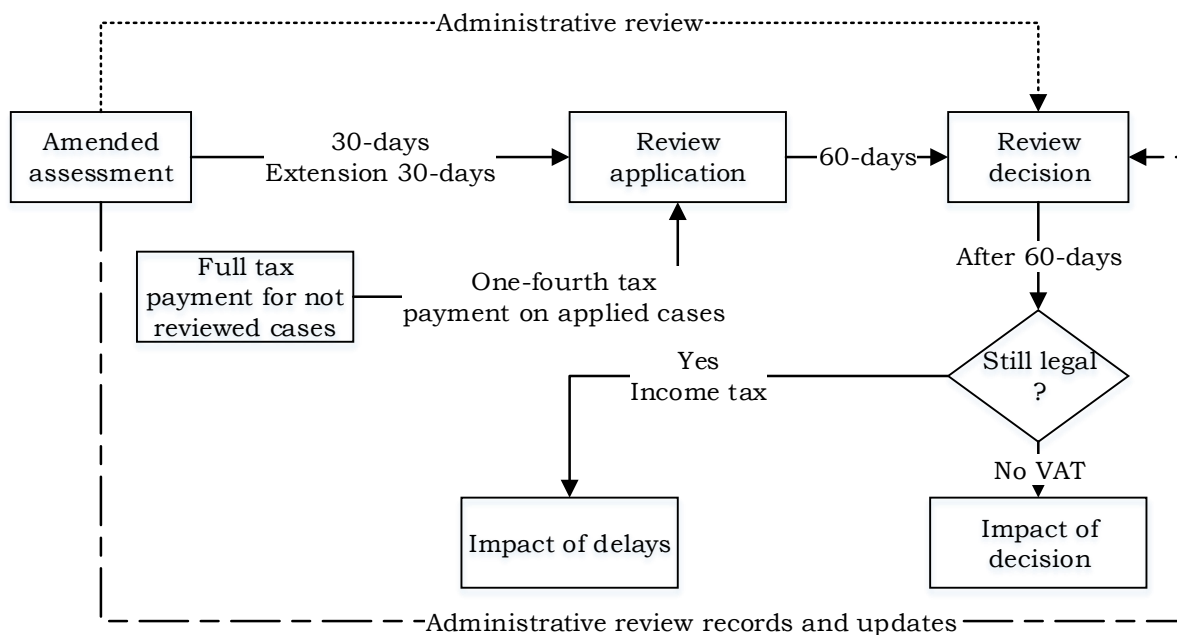
19. Administrative Review

Backgrounds:

Administrative review procedure is provided for in income tax, value added tax, excise duty for the aggrieved taxpayer. For the customs duty, there is valuation review procedure at committee or DG level. These review procedures are alternative dispute resolution (ADR) for prompt and low-cost settlement of issues under question.

The review procedure is time-bound activity as follows:

- Sixty – days from date of application for income tax related administrative procedure as per Sec. 115 of Income Tax Act, 2058;
- Sixty – days from date of application for value added tax related administrative procedure as per Sec. 31A of Value added Tax Act, 2052;
- Sixty – days from date of application for excise duty related administrative procedure as per Sec. 19 of Excise duty Act, 2058.
- Sixty – days from date of application for classification related issue as per Sec. 61A of Customs duty Act, 2064.
- Ninety – days from date of application for valuation related issues as per Rule 44 of Customs duty Regulation, 2064.



Objectives:

Evaluation of efficient settlement of administrative reviews

Potential Audit Risk:

Delay settlement of administrative review leads failure of intended purpose of ADR

Sl.	Issues to be evaluated	Basis of checking
1.	<p>Auditor needs to review the comparative progress of settlement of administrative review, whether</p> <ul style="list-style-type: none"> ▪ Issues filed for administrative review have been settled within time period as prescribed in the law ▪ The settlement contributes the propriety of such mechanism as conceived in the tax laws ▪ The taxpayer obtains prompt response on their review applications 	Analysis of filing date and decision date
2.	<p>Department or other agency may evaluate the reliability of administrative review procedure through study reports or assessment report. In other cases, its reliability and effectiveness may be measure as part of tax cost compliance assessment.</p> <p>Auditor needs to review those reports for assessment of effectiveness of administrative review procedure: Whether, Administrative appeal procedure has been successful as an ADR tools</p>	Study reports
3.	<p>In case of ambiguity in the text of tax laws, legal benefits are awarded towards the taxpayers (those persons who were not involved in law-drafting processes). During the administrative review, whether,</p> <ul style="list-style-type: none"> ▪ Such ambiguous issues were addressed ▪ Awarded towards the benefit to the taxpayer ▪ Same treatment has been applied to different taxpayers. 	Study reports, appeal decision

20. Revenue target and achievement

Backgrounds:

Revenue target will be determined as following:

Step 1: Gross estimation of national resources by National Resources committee incorporated under Sec. 7 of Financial Procedure and Financial Accountability Act, 276 and Rule 13 of Financial Procedure and Financial Accountability Regulation, 2077;

Step 2: National Resources committee will submit the report of estimation to ministry of finance

Step 3: Federal Finance minister presents annual estimation of revenue to the parliament as per Article 119 of the constitution (Province Finance minister to Province legislature as per Article 207 and to municipal council as per Article 230)

Step 4: Ministry of finance allocates, as the best practice, the target based on the government level estimation.

Similarly Ministry of finance fix the monthly as well as annual target of revenue collection, monitoring, reassessment etc.

Auditor needs to evaluate the achievement and evaluate the outcomes with the cost involved for such activity.

Objectives:

Evaluation of targets and achievements

Potential Audit Risk:

The targets may be missed without adequate justification

Sl.	Issues to be evaluated	Basis of checking
1.	Ministry gives the collection target for revenue to the revenue office, whether, <ul style="list-style-type: none">▪ Monthly target has been planned parallel to monthly planning of activities▪ Office prepares the monitoring report at least on monthly basis▪ Changes to the plan have been made based on the monitoring report▪ Revenue has been collected as per target, under collection adequately justified	Target and achievement reports
2.	Ministry gives the collection target for revenue arrears to the revenue office, whether,	

Sl.	Issues to be evaluated	Basis of checking
	<ul style="list-style-type: none"> Monthly target has been planned parallel to monthly planning of activities Office prepares the monitoring report at least on monthly basis Changes to the plan have been made based on the monitoring report Monitoring report contains inactive or non-filers taxpayer separately Revenue arrears have been recovered from inactive and non-filers Arrears recovered as per target and non-recovery adequately justified 	Target and achievement reports
3.	<p>In the cases of transfer of jurisdiction over any taxpayer, their arrears have been transferred to the new jurisdiction. For instance to and from LTO or MLTO. Whether,</p> <ul style="list-style-type: none"> Revenue arrears in the record of transferring office has reduced with sufficient supporting Revenue arrears on the transferee office has been included with sufficient detail 	Transfer and reconciliation statements
4.	<p>Ministry gives the tax reassessment target for the revenue office, whether,</p> <ul style="list-style-type: none"> Monthly target has been planned parallel to monthly planning of activities Office prepares the monitoring report at least monthly Correction has made based on the monitoring report Reassessment has completed as per target 	Target and achievement reports
5.	<p>Inland Revenue Department assess the non-filers (for the purpose of VAT) and deemed assessment (for the purpose of income tax). The department allocates the non-filer assessment target for to the revenue office, whether,</p> <ul style="list-style-type: none"> Monthly target has planned in the parallel to monthly planning of activities Office prepares the monitoring report at least on monthly basis Changes to the plan have been made based on the monitoring report Assessment of non-filer has been completed as per the set target 	Target and achievement reports
6.	<p>Government needs to monitor the tax ratios to charge adequate rate of tax and types of tax. Auditor needs to evaluate the tax ratios comparison with similar and neighbouring economies, with same or similar industries and with previous years data, whether,</p>	

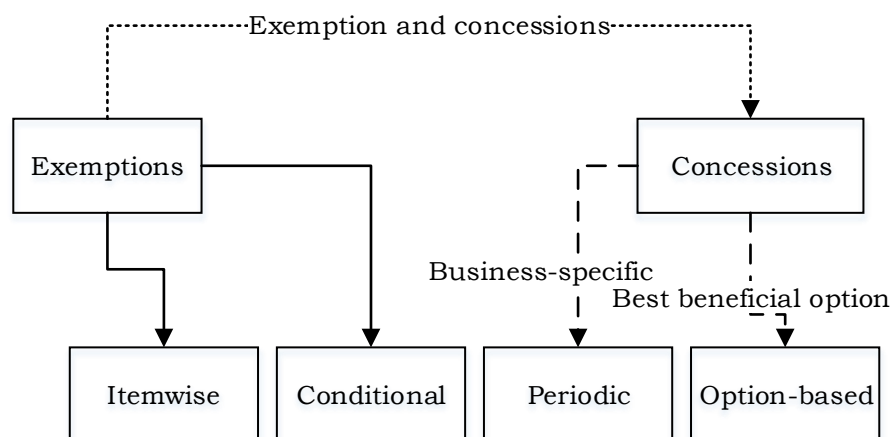
Sl.	Issues to be evaluated	Basis of checking
	<ul style="list-style-type: none"> ▪ VAT collections as percent of total tax collections (ref. one-third of total tax is indicative and adequate) ▪ Tax ratio as percentage of Gross Domestic Product (ref. 18% for low income economics and 25% for medium income economics) ▪ VAT productivity (VAT collected as percentage of GDP) ▪ Administrative cost of taxation (indicator compares the ratios with regional neighbouring countries or with same or similar economies; and comparison with previous years data) 	Study reports

21. Revenue exemption and concessions

Backgrounds:

Though horizontal equity is one of the major principles of taxation, tax law allows certain concessions and exemptions. Concessions and exemptions are intended to either for:

- vertical equity among taxpayers in the form of positive discrimination
- promote national interest in the form of development, employment, or environment
- attract huge investments in the otherwise unattractive area
- control the cost for basic needs - goods and services



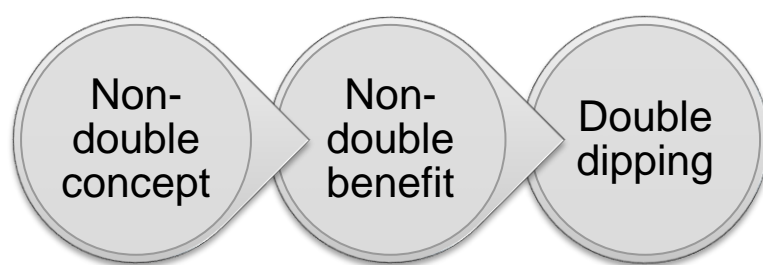
Types of exemption or concessions

There may be different types of exemption or concessions. The types are:

- person-based, where all of the income or transaction of the taxpayer is exempt from tax; e.g. entity having exemption by treaty, Nepal Rastra Bank, sector-based listed companies, rural cooperatives, etc.
- business-based, where the tax exemption is allowed to the specific part of income or transaction of taxpayer; e.g. special business, power-sector, IT-sector, industrial income from industries established in the special economic zone, etc.
- item-based, where only specified item is exempt from taxation; e.g. VAT exempt goods or services

Objectives:

Evaluation of tax concessions and exemption



Potential Audit Risk:

There may be concessions and exemption for benefit to particular class of taxpayer as against the national policy

Sl.	Issues to be evaluated	Basis of checking
1.	<p>In the tax law, exemptions must be as minimum as possible in number and should be provided for expressed objectives. Auditor needs to evaluate, whether,</p> <ul style="list-style-type: none"> Exemptions are minimum (given as exception and not as the norm) Legal text for exemptions is clear without ambiguity Exemptions are not provided for commercial items Exemptions matches with the objectives as described Exemptions do not create the cascading effect of tax Exemptions are not intended for the benefit of particular taxpayer or class of taxpayers Exemptions are made with adequate study and expressed descriptions Benefit of exemption is assessable 	Act, regulation, directives, circulars, budget speech, tax-policy documents
2.	<p>In the tax law, concessions must be as minimum as possible in number and should be provided for expressed objective. Auditor needs to evaluate, whether,</p> <ul style="list-style-type: none"> Concessions are minimum (given as exception and not as the norm) Concessions are periodic and minimum for the limit of investment cycles Legal text for concessions is clear without ambiguity Concessions are not provided for commercially competitive business Concessions matches with the objectives as described above Concessions are not intended for the benefit of particular taxpayer or class of taxpayers 	Act, regulation, directives, circulars, budget speech, tax-policy documents

Sl.	Issues to be evaluated	Basis of checking
	<ul style="list-style-type: none"> Concessions are made with adequate study and disclosed the details with logical descriptions 	
3.	<p>There may be cases of exemptions and concessions in one tax period and same activity / business taxable in the next period and again exempt for next period. Such practices indicate unstable tax principle and generally exempts/concede to particular taxpayers or class of taxpayers. Auditor needs to evaluate, whether,</p> <ul style="list-style-type: none"> Tax principle for exemptions or concessions are logically stable over period(s) exemptions or concessions then taxable, again exemptions or concessions is not intended for a particular taxpayers or class of taxpayers. exemptions or concessions for a short period has been utilized by small number of taxpayers or not utilised at all. 	<p>Historical analysis of Act, regulation, directives, circulars, budget speech, tax-policy documents</p>
4.	<p>Tax authority reviews the impact from exemptions and concessions periodically. Auditor needs to evaluate, whether,</p> <ul style="list-style-type: none"> There are periodic studies on the impact The terms for the study is sufficient to make assessment of impact from exemptions and concessions Study reports have published Study reports have implemented There are issues of benefits to particular taxpayers from exemptions and concessions Concession and exceptions are tax expenditures and are quantified in such studies and publicly reported 	<p>Study reports Parliamentary discussion minutes</p>
5.	<p>Taxation authority monitors the taxpayers benefiting the exemptions and concessions periodically. Auditor needs to evaluate, whether,</p> <ul style="list-style-type: none"> There are periodic monitoring programmes There are monitoring reports Recommendations of monitoring reports have been evaluated and implemented 	<p>Study reports Parliamentary discussion minutes</p>

Part III

Income tax

D. Income Tax

Income tax is one of the major sources of federal government. Income tax is levied in accordance with the provision of Income Tax Act, 2058. From the authority of Income Tax Act, 2058 (ITA), GON has promulgated Income Tax Regulation, 2059 (ITR). IRD has issued the Income Tax Directives (ITD) and other specific directives for implementation of income tax laws.

Income tax is person-based tax. For the resident person, its coverage is extra-territorial jurisdiction, whereas for a non-resident, only the income having source in Nepal is taxable. Person may be either individual or entity. For the taxing purpose, only following person need to pay tax:

- Person having taxable income during the income year,
- Person being a permanent establishment repatriating income during the income year, or
- Person having only final withholding tax income or defined- taxed income.

Income tax is levied on person having either or all of:

- Income from active involvement of person as:
 - Employment income (remuneration relating to use of labour),
 - Business income (industry, trading, or services),
- Income from passive involvement of person as:
 - Investment income, and
 - Windfall gain income

Resources for auditors
Income tax Act, 2058
Income tax Regulation, 2059
Income tax Directive, latest edition
Filing income tax return Directive, 2061
Windfall gain on casino directives, 2072
Capital tax Directive, 2076
Long-term contract Directive, 2073
PE Directive, 2077
Tax-treaties – 12 nos.
Case laws
Model income tax act of symmetrica, 2002 – IMF
Commentary on Income tax act of symmetrica, 2002 - IMF

Taxable income

Income tax on taxable income is the major component of tax revenue. The method of determination of taxable income is as follows:

Step 1. Determination of income year – in normal circumstances Srawan to Ashadh is taken as the income year and in special cases, the period may be lower than this period. In case of Sec. 64 and fraud, the period may be longer than twelve-months.

Step 2. Computation of inclusions – Excluding the income that is subject to final withholding tax, general items of inclusions for the employment, business and investments will be as follows:

- Gross amount of proceeds in form of service charge, sale of goods and other charges based on activities
- Net amount in form of gain in the case of disposal of assets or liabilities

Step 3. Computation of deduction of expenses – all the expenditure relating to the business or the investment with following exceptions

- The expense is not an ineligible expense as defined in Section 21 of Income Tax Act
- The expense has incurred during the income year
- The expense has incurred in the name of taxpayer
- The expense has incurred for the purpose of earning taxable income

Step 4. Income from business or investment- Total of inclusions less deduction of expense will be the income from business or investment. In the case of loss, it can be carried forward up to 7 years

Step 5. Assessable income – the total of income from employment, business and investment is assessable income. For a resident person, assessable income includes all the incomes derived by the taxpayer from any source of country (full-tax liability). For a non-resident, only Nepal source income will be assessable income (limited tax liability)

Step 6. Taxable income – deducting the reduction (contribution for retirement fund by a natural person and donation by any taxpayer) from assessable income is taxable income.

The tax is levied on taxable income.

22. Income from business

Background:

One of the main functions of LTO/MLTO/IRO/TSOs is tax-audit of individual business taxpayer.

1. Preliminary basis for income tax audit

For the income tax audit, following are the major preliminary basis for auditor:

- Income tax return for the income year under scrutiny and immediate earlier year
- Income tax reassessment notice for the income year under scrutiny and immediate earlier year
- Full-audit report along with other taxes
- Prescribed documents those to be submitted with income tax return filing
- Information collected under Section 83 notice
- Tax-base balance sheet for the income year under scrutiny and immediate earlier year

2. Types of business

In the business sector, the taxpayer may be:

- Trader, who involves in the purchase and sale of goods manufactured by other or purchased through import
- Manufacturer, who involves in the process of conversion of raw materials to finished goods
- Service provider, who engages delivering service
- Contractor, who involves in the construction or installation procedure
- Investment firm, who involves in the investment in or investment out activities, like insurance or investment company, annuity business, rent-earners

Though the tax system is similar with rare exceptions, the business may be classified in accordance with their owner as:

- Sole proprietorship firm (owned by natural person, whether registered or not), where progressive tax rate is applicable if the owner is resident
- Partnership firm (owned by natural persons up to 19 partner, whether registered or not)
- Entity (owned by resident or non-resident, individual or multi-national companies)

For the income tax purpose, a person may have multiple businesses.

3. Types of inclusions

In the business inclusions, following are the inclusions in general:

- Disposal-based income recognition for business - Sec. 7
 - gross proceeds from disposal of trading stock
 - net-gain from disposal of business assets or business liabilities
 - net-gain from the depreciation pool

Characterization of tax-assets and liabilities

Assets in business

- i. Trading stock – raw materials, work-in-progress, finished goods
- ii. Depreciable assets – infrastructure, office equipment and furniture, vehicles, plant and machineries, intangibles
- iii. Business assets – land, advances, deposits, bills, prepaid

Assets in investments

- i. Non-business chargeable assets – securities
- ii. Non-business chargeable assets – land or buildings of natural person

Business liabilities

- i. All liabilities
 - ii. Loan loss provisions for bank and general insurance
-

- activity-based income recognition for business
 - gross proceeds from delivery of services - Sec. 7
 - net-income recognition for change in basis of accounting - Sec. 22
 - net realised foreign exchange gain - Sec. 24
 - recognition of interest portion of finance lease and annuity - Sec. 32
 - quantification of foreign associate income - Sec. 69
 - quantification of interest from tax refund - Sec. 113

4. Deduction of expense

All the expense during the income year by the taxpayer to earn inclusions is deductible according to Sec. 13 and Sec. 67.

However, in accordance with the provision of Sec. 21 following expense are not deductible:

- Non-business expense in the form of personal or domestic expense of the proprietor (consumption cost) or expense to earn tax-exempt or final withholding taxed income
- Cost of a capital nature
- excluded cost
 - income tax
 - bribes
 - penalties on breach of law
 - cash-payment over prescribed ceiling
 - payments to person not having permanent account number

Capital cost

i. Natural resources related cost	Basis of tax accounting
ii. Cost of assets having technical useful life more than twelve-months	
iii. Outgoings for payment of liabilities	
	i. Cash basis of tax accounting
	ii. Accrual basis of tax accounting

Though the all of the expense to earn the inclusions is deductible as per Sec. 13, there are certain allocation formulae in the following characterize head of expense:

- Interest expense⁸
 - Siphoned out for personal use – non-deductible
 - Siphoned out for third-party – non-deductible
 - interest during construction – cost to the respective asset
 - paid to the exempt controller – capped with adjusted taxable income
 - remaining interest – deductible expense
- cost of disposed trading stock⁹
 - value of closing stock at the minimum of cost per unit or market price – recognised as assets at the cut-off date
 - remaining cost – deductible expense
- repair and improvement¹⁰
 - aircraft overhauling – fully deductible
 - over than seven percentage of depreciation base – cost of respective pool of assets under deferred recognition method
 - seven percentage of depreciation base – deductible expense
- pollution control cost¹¹
 - above the ceiling amount of 50% of adjusted taxable income from business – cost of respective pool of assets under deferred recognition method
 - amount of 50% of adjusted taxable income from business – deductible expense
- research and development cost¹²
 - above the ceiling amount of 50% of adjusted taxable income from business – cost of respective pool of assets under deferred recognition method
 - amount of 50% of adjusted taxable income from business – deductible expense

⁸ Section 14 of Income Tax Act, 2058

⁹ Section 15 of Income Tax Act, 2058

¹⁰ Section 16 of Income Tax Act, 2058

¹¹ Section 17 of Income Tax Act, 2058

¹² Section 18 of Income Tax Act, 2058

Capital cost for depreciable assets is deductible in the form of depreciation expense. The depreciation is computed on pool-basis classification¹³.

- Classification on pool
 - A –infrastructures like buildings, road
 - B – office equipment, computers, printers, furniture
 - C – vehicles
 - D – other tangibles like plant and machineries, natural resource related cost
 - E – individual intangible assets
- Recognition rule, if first use or placed for use:
 - till Poush-end – full recognition
 - falls between Magh to Chaitra – two-third recognition and one-third deferred recognition in the beginning of next income year
 - falls between Baisakh to Ashadh – one-third recognition and two-third deferred recognition in the beginning of next income year
 - in the case of disposal of pool, full recognition irrespective of date of first use or placed for use
- Depreciation rate
 - For pool A, B, C and D, the rate is 5%, 25%, 20% and 15%, which may subject to acceleration by one third
 - For pool E individual intangibles – straight line method
- Disposal of pool assets
 - Gross proceeds will be deducted from depreciation base of respective pool, any over recovery will be inclusions during the income year
 - Terminal depreciation will be allowed on the disposal of all of the assets in the pool

5. Deduction of losses

Loss from business or investment is deductible as per following rules¹⁴.

Rule of quarantine:

- Income source -based:
 - Business loss can be set off with either business or investment income
 - Investment's loss can be set off with investment income only
- Geographical sources of income-based:
 - Nepal source loss can be set off with either Nepal or any foreign source income
 - Foreign source loss can be set off with income having same country only
- Loss from exempt or concessional business or investment can be set off with same or similar income only

¹³ Section 19 and Schedule 2 of Income Tax Act, 2058

¹⁴ Section 20 of Income Tax Act, 2058

Set off rule:

- Horizontal set off – current year loss can be set off with current year income, if allowed by rule of quarantine
- Vertical set off – earlier seven-years (twelve-years in the case of BOOT, specified power-sector or petroleum extraction business) loss can be set off with current year income, if allowed by rule of quarantine
- Carry back vertical set off – loss from long-term contract may be carry back on the completion year or disposal of long-term contract
- The taxpayer may opt the best beneficial option for set off of losses.

6. *Geographical sources of income*

Sources of income is one of the critical factors in income tax. Section 67 provides the principles and method for determination of sources of income. To determine the Nepal source income, there should be positive remainder (for the loss reverse) in:

Inclusions having source in Nepal	$Inclusions_{Nepal}$
(–) Deduction of expense to earn such inclusions	$Deductions_{Nepal}$
Income having source in Nepal	$Income_{Nepal}$

- inclusions having source Nepal will have two sources as:
 - disposal proceeds/gain from disposal of assets or liabilities in Nepal
 - activities performed in Nepal
- Deductions will be all the expenses to earn inclusions in Nepal (see above for deductible expenses)

Inclusions having source in Nepal

A. <i>Disposal proceeds/gain from disposal of assets or liabilities in Nepal</i>	<i>Source formulae</i>
i. Trading stock	Residency of owner
ii. Depreciable assets – infrastructure	Place of immovable property
iii. Depreciable assets – other than infrastructure	Residency of owner
iv. Business/non-business assets – land or building	Place of immovable property
v. Business assets/non-business assets – investments in securities, advances, deposits, bills, prepaid	Residency of owner
vi. Business liabilities	<u>Residency of owner</u>

B. Activities performed in Nepal

i. Passive income – interest, dividend, investment return, royalty, technical fees	Residency of payer
ii. Employment by GON anywhere	Residency of payer
iii. Employment by other	Place of exercise of employment
iv. Insurance premium	Place of risk
v. Cross-border transportation	Place of first-step for the transportation
vi. Rent	Place of assets under lease
vii. Services and other activities	Place of performance of activities
viii. Accepting restriction	Same source if self-performed

7. Special quantifications

In the income tax accounting, there are many special quantifications comparing with financial accounting. Major items of special quantifications are described in below chapters. Some the remaining special quantifications are as follows:

- In the case of sole proprietorship firms maintaining cash basis of accounting (e.g., in the case of conversion of presumptive taxpayer or tax-on-turnover based taxpayer or other) changes into tax accrual basis of tax accounting, the items need to be adjusted on the basis of non-double recognition (or non-double non-recognition) method. The net impact is either inclusions or deduction in the year of conversion - Sec. 22
- In the case of receivables, payables, debt-obligations, or cash balance in the foreign currency or foreign investments, only realized gain or loss is inclusions or deduction of expense - Sec. 24
- In the case of liabilities not required to pay, if allowed earlier as deduction of expense under accrual basis of tax accounting, that portion of liability will be inclusions – Sec. 25
- In the case of finance lease or annuity arrangement, recognition of interest portion of finance lease and annuity - Sec. 32
- In the case of debt-claim converting into bad, changing the form of assets (except the case of merger of assets and liabilities under Sec. 47), change in the controlling interest in an entity (except the case of merger of banks or insurance business under Sec. 47A), changing residential status of a person, all of the assets owned or liability owed will be deemed as disposal at the market price – Sec. 41
- In the case of transfer of assets or liabilities to another person, the disposal proceeds will be valued at market price, if not to a subsidiary unit – Sec. 45

- In the case of an involuntary disposal with replacement by similar assets within one year of disposal, the non-recognition rule is applied for both transactions – Sec. 46
- In the case of multiple assets purchased or sold at a time, the quantification of individual assets will be at the proportionate market price of individual assets – Sec. 49
- In the case of beneficiary of entity obtained the benefits from an entity, which is higher than tax-base of profits, then unrealized profits to the extent of benefit will be part of inclusions for the purpose of distribution [Sec. 53(4) or Sec. 56(3)] or change in control (Sec. 57)
- In the case of approved retirement fund cease to exist due to removal of its approval, all the remaining fund will be the inclusions – Sec. 64

8. *Special re characterization*

In the following cases, department has mandate to make re characterization of the income:

- Indirect payment – In the case of income of a person has transferred to another person in the indication of or in the instruction of underlying taxpayer, department may re characterize such indirect payment to the underlying taxpayer - Sec. 29
- Transfer pricing – In the case of international transaction between two or more associated persons (associated enterprises), the department may re characterize the transaction (of sale or purchase, loan and interest, royalty etc.) at arm-length price that may be applicable between two independent persons in same nature, condition and circumstances – Sec. 33
- Income splitting arrangement – In the case of sources of income owned by one person has transferred to another person to avoid the potential tax arising from the resources, the department may re characterize the income to the beneficial owner – Sec. 34
- General anti-avoidance rule – In the case of taxpayer, unilaterally or collectively, misuses the legal text to avoid the tax, the department may re characterize the transaction or disregard the transaction – Sec. 34
- Dividend stripping – In the case of beneficiary of an entity having tax-base of profits or unrealized profits on its assets and liability disposes its interest in the entity to another person, at the time of distribution of the profits to the extent of such profit, the dividend is deemed to be paid to the outgoing beneficiary – Sec. 58.

9. *Other obligations for a taxpayer*

According to income tax law, taxpayer requires to comply following conditions:

- Compliance on withholding tax (WHT) – payer requires to withhold the withholding tax on the rate as prescribed in Sec. 87 – 89 at the time of payment.
 - Failure of withholding, the WHT deemed to be withheld as per Sec. 90

- WHT return requires to file within 25th days from end of withholding month, the failure is subject to fee at the rate of 2.5% p.a. of total WHT
- Withheld tax will have the first of the priority over other payments as per Sec. 103
- Compliance on tax collected at source (TCS) – payer requires to collect the TCS tax on the rate as prescribed in Sec. 95A at the time of authenticating the transaction.
 - Failure of collecting, the TCS deemed to be collected as per Sec. 95A
 - TCS return requires to file within 25th days from end of collecting month, the failure is subject to fee at the rate of 1.5% p.a. of total TCS
- Filing estimated tax return within Poush-end of income year, failure is subject to a fee under Sec.117
- Filing income tax return within three-months from end of income year, failure is subject to a fee under Sec. 117
- Maintenance of all of the documents those are requires to substantiated for a transaction, failure is subject to a fee under Sec. 117(2)
- Payment of installment tax as per Sec. 94-95, insufficiency is subject to 15% p.a. interest under Sec. 118
- Payment of all other tax as prescribed in Sec. 85, delay is subject to interest under Sec. 119.

Objectives:

Enforcement of provisions of income tax laws

Potential Audit Risk:

Non-compliance with tax laws

Sl.	Issues	Basis of checking
1.	Whether inclusions, as applicable, are included in reassessment adequately: <ul style="list-style-type: none"> ▪ income recognition for business - Sec. 7 ▪ income recognition for change in basis of accounting - Sec. 22 ▪ realised foreign exchange gain - Sec. 24 ▪ fringe benefits for the business sector - Sec. 27 ▪ recognition of interest portion of finance lease and annuity - Sec. 32 ▪ quantification of net gain on disposal of business assets and business liabilities - Sec. 36 ▪ quantification of foreign associate income - Sec. 69 ▪ quantification of interest from tax refund - Sec. 113 	Full audit report, income tax return and attachments
2.	Income tax law prescribes the criteria for deduction of expenses from business or investment income. These expense or expenditure should be in compliance with the	

Sl.	Issues	Basis of checking
	provision of Sec. 21 as allowed for deduction while computing taxable income. According to Sec. 13 of the act for the general deductions, whether, the expense is: <ul style="list-style-type: none"> ▪ Incurred during the income year (time-matching) ▪ Incurred by the taxpayer (person-matching) ▪ Incurred to earn the taxable income under given head (inclusions- matching) 	Full audit report, income tax return and attachments
3.	In the case where interest is deducted from the inclusions under Sec. 14, whether, <ul style="list-style-type: none"> ▪ Follows the criteria given under general deduction u/s 13 ▪ Is not for siphoning-out debt ▪ Does not include the interest that needs to be capitalised as interest during construction ▪ Is within the limit of Sec. 14(2) in the case of interest paid to the exempt – controller(s) 	Full audit report, income tax return and attachments
4.	In the case of cost of trading stock disposal is deducted from the inclusions under Sec. 15, whether, <ul style="list-style-type: none"> ▪ Follows the criteria given under general deduction u/s 13 ▪ Follows the allocation formula for cost determination ▪ Follows the evaluation basis as lower of cost or net realisable value (market price) 	Full audit report, income tax return and attachments
5.	In the case of depreciation of depreciable assets, depreciation is deducted from the inclusions under Sec. 19, whether, <ul style="list-style-type: none"> ▪ Purchase of depreciable asset complies with the provision of Sec. 21 ▪ Classification of depreciable assets is appropriate ▪ Partial-recognition rule has been applied for new assets ▪ Disposal proceeds has been adjusted in the respective pool of assets in full amount ▪ Rate of depreciation, including acceleration and terminal assets, is adequate ▪ Computation of depreciation expense and tax-base of pool is adequate 	Full audit report, income tax return and attachments
6.	In the case of repairs of depreciable assets is deducted from the inclusions under Sec. 16, whether, <ul style="list-style-type: none"> ▪ Follows the criteria given under general deduction u/s 13 ▪ Classification of repairs on respective pool of depreciable assets is adequate ▪ Ceiling has been taken correctly 	Full audit report, income tax return and attachments

Sl.	Issues	Basis of checking
7.	In the case of pollution control expense or research expense is deducted from the inclusions under Sec. 17 or 18, whether, <ul style="list-style-type: none"> Follows the criteria given under general deduction u/s 13 Classification of expense is adequate in the respective group of expense head Ceiling has been taken correctly 	Full audit report, income tax return and attachments
8.	In the case of loss on foreign exchange is deducted from the inclusions under Sec. 24, whether, <ul style="list-style-type: none"> Follows the criteria given under general deduction u/s 13 Realized foreign exchange loss has been recognized 	
9.	Whether deduction of loss, as applicable, have been deducted in reassessment adequately: <ul style="list-style-type: none"> Sec. 20 current year business loss Sec. 20 previous seven years business loss For the previous year(s), reassessment of whole of the transaction of relevant year(s) confirms the carried down business loss 	Full audit report, income tax return and attachments
10.	Whether the suppliers and buyers of taxpayers were verified during reassessment (settlement of mismatch report)	Matching report
11.	Whether the withholding tax and party-wise inclusions or deductions matches for significant transactions	Full audit report
12.	Whether cash-flow statements have been reviewed during reassessment procedure	Full audit report
13.	Whether production recovery norms and production matches during the income year	Full audit report
14.	Whether characterisation and quantification of transactions matches as per act, rule, directives, public circulars or advance rulings	Full audit report
15.	Whether appropriate allocation formula has been used for the transactions matches as per act, rule, directives, public circulars or advance rulings	Full audit report
16.	Whether reductions have computed as per legal provisions	Full audit report
17.	Whether concessions have computed as per legal provisions	Full audit report
18.	Whether tax-rate has applied appropriately	Full audit report
19.	Whether WHT and TCS credit has allowed as per legal provisions	Full audit report

23. Banking business

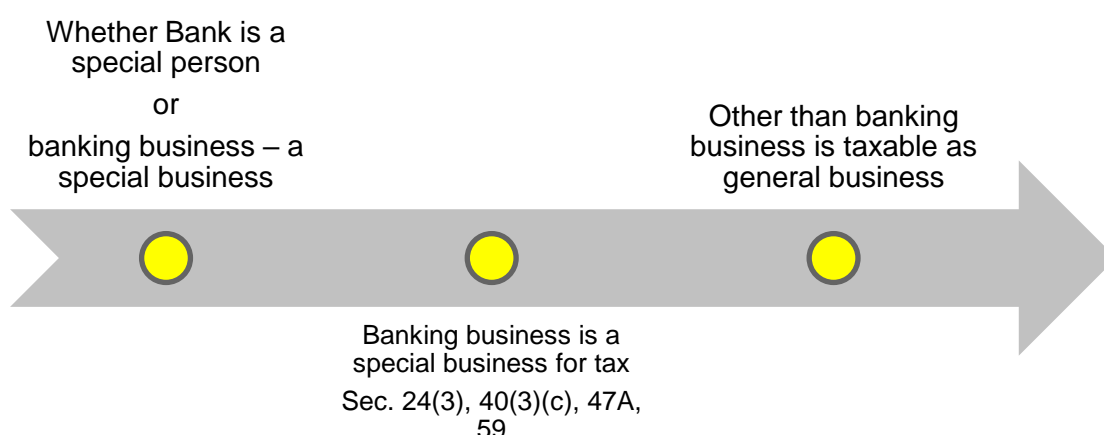
Background:

Banking business is one of the major contributors for income tax revenue. There are special provisions relating to banking business.

Banking business has been defined in explanation of Sec. 59. In the banking business, as defined in that section, the financial accounting as prescribed by NRB is acceptable for the tax purpose under Sec. 24(3). However, recognition of interest income is practically accepted.

To promote the merger among banks, the tax impact from merger has been nullified under Sec. 47A.

Banking is the highly regulated business, and special tax rate of 30% is levied for banking business.



Objectives:

Review of reassessment of taxpayers having banking business where specific banking provisions are applicable in addition to the general business provisions.

Potential Audit Risk:

Income tax may be under reported in banking business.

Sl.	Issues	Basis of checking
1.	Whether interest income has been recognised as per NRB guidelines – Sec. 24(3)	

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> Interest receivables and interest suspended has been tallied and reconciled Interest receivables is higher than interest suspended Interest receivables is less than interest suspended 	Financial statement, income tax return, full-audit report
2.	Whether foreign exchange gain or loss has been recognised as per NRB guidelines Sec. 24(3)	Financial statement, income tax return, full-audit report
3.	Whether classification of loan & bills and non-banking assets has been recognised as per NRB guidelines Sec. 24(3) and Sec.59 <ul style="list-style-type: none"> Loan and bills Non-business assets Investments 	Financial statement, income tax return, full-audit report
4.	Whether SAAR has been applied in the issues described in ITA (the detail has described in General business above)	Financial statement, income tax return, full-audit report
5.	Whether tax-base balance sheet has been prepared during reassessment procedure	Tax-base balance sheet
6.	Whether income tax rate has applied as per law	Income tax law

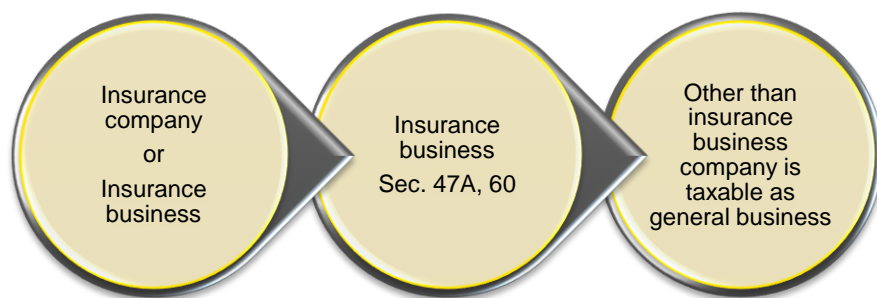
24. General insurance business

Background:

General insurance business is another major source of income tax revenue. Tax law has prescribed special taxation provisions under Sec. 60 in addition to general business tax accounting provisions.

To promote the merger among general insurance companies, the tax impact from merger has nullified under Sec. 47A.

Insurance is highly regulated sector and special tax rate is applied for insurance business.



Objectives:

Review of reassessment of taxpayers having general insurance business where specific insurance provisions are applicable in the addition to the general business provisions.

Potential Audit Risk:

Income tax may be under reported in insurance business.

Sl.	Issues	Basis of checking
1.	Whether the insurance premium or re-insurance premium has been recognised as per Sec. 60 <ul style="list-style-type: none"> Gross premium collected during the year has been recognised as income Compensation received (received or receivable) during the year has been recognised as income Other incomes have been recognised and quantified as per other sections of the act Income relating to investment insurance recognised separately as investment insurance business (Sec. 61) 	Financial statements, income tax return, full audit report
2.	Whether the deduction is limited to compensation payment (paid or payable) and premium refund during the income year as per Sec. 60 <ul style="list-style-type: none"> Reinsurance premium paid during the year has been recognised as expense Compensation payment (paid or payable) during the year has been recognised as deduction Premium refund during the year has been recognised as deduction 	Financial statements, income tax return, full audit report

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> Other expenses have been recognised and quantified as per other sections of the act 	
3.	Whether the claims lodged but not finalised has been disclosed and evidences adequately	Financial statements, income tax return, full audit report
4.	Whether unexpired risk provision has been computed as per Section 60.	Financial statements, income tax return, full audit report
5.	Whether SAAR has been applied in the issues described in ITA (the detail has described in General business above)	Financial statement, income tax return, full-audit report
6.	Whether appropriate tax-rate has been applied for computing tax.	Financial statements, income tax return, full audit report

25. Investment insurance business

Background:

Investment insurance business is another major source of income tax revenue. Tax law has prescribed special taxation provisions on general business tax accounting in Sec. 61. In the investment insurance business, income or expense relating to insurance will not be part of tax accounting. Premium, reinsurance, compensation or refunds are neither business nor income or expense for investment insurance. Life-insurance fund is also not the part of tax accounting.

To promote the merger among general insurance companies, the tax impact from merger has nullified under Sec. 47A.

Objectives:

Review of reassessment of taxpayers having investment insurance business where specific investment insurance provisions are applicable in the addition to the general business.

Potential Audit Risk:

Income tax may be under reported in investment insurance business.

Sl.	Issues	Basis of checking
1.	Whether the income from investment insurance business (Sec. 61) includes: <ul style="list-style-type: none"> All general income as per the quantification of other sections of income tax law 	Financial statements, income tax return, full audit report

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> Income not to include any premium or compensation Income relating to general insurance have been recognised separately as general insurance business (Sec. 60) 	
2.	<p>Whether the deduction is limited to general deduction as:</p> <ul style="list-style-type: none"> under Sec. 13 -21 and other sections of tax law Reinsurance premium, compensation, premium refund during the year has not been recognised as expense Life insurance fund or other fund has not been recognised as deduction 	Financial statements, income tax return, full audit report
3.	Whether the claims or liability has been beyond the scope of loss on disposal of business assets and liability during the year	Financial statements, income tax return, full audit report
4.	Whether SAAR has been applied in the issues described in ITA (the detail has described in General business above)	Financial statement, income tax return, full-audit report

26. Special quantifications – Long-term Contract

Background:

Long-term contract (LTC), as defined in Sec.26, is the contract:

- having contract period more than twelve months initially
 - per-contract basis – individual contract needs to be accounted separately
 - initial contract period is basis for determination of contract period
 - contract period is computed from date of site-transfer to intended date of taking over, defect liability period is not part of initial contract period
- is relating to construction, installation or assembly related works or supervision
 - construction works,
 - renovation but not repairs,
 - demolition,
 - installation or assembly of equipment or plant,
 - engineer's supervision on above not including the excluded contracts
- is a deferred return in nature (means income cannot reliably estimate for each six-months during the contract period)
 - defined return, where the return for each six-month can be estimated reliably, contract will be excluded contract

- deferred return, where the return for each six-month cannot have a reliable estimation, contract will be included
- is not relating to life – insurance, retirement, or security contract (known as excluded contract).

Examples of long-term contracts

Civil works

- i. designed by the employer – contracts will be limited for construction of the employer design
- ii. designed and built – contractors will design the works and then construct the approved design
- iii. engineering, procurement, and construction – contractor is responsible for design, purchase and install of equipment and construct in a single package
- iv. engineering procurement construction and financing – contractor is responsible for design, purchase and install of equipment, construction, and financial arrangement within a single package

Demolition and renovation

- v. Demolition
- vi. renovation

Installation and assembly

- vii. Equipment
- viii. Plants and machineries

Construction supervision

- ix. Design of the works
- x. Engineering of the above contracts

What to include

- i. single site
- ii. single package of single works
- iii. cascading contracts having different sites

Contractor or sub-contractor

- iv. Main contractor
 - v. Sub-contractor
 - vi. Nominated sub-contractor
-

Contracts for real estate in the form of business is not long-term contract, because, in substance, it is sale of goods.

Contract-wise tax accounting is applicable for long-term contract.

The inclusions for the particular contract is the estimated income on the basis of percentage of completion basis.

$$\text{Percentage of completion} = \frac{\text{cumulative direct site} - \text{cost incurred till date} \times 100}{\text{incurred direct site} - \text{cost} + \text{estimated cost for completion}} \%$$

The inclusion formula may be in summary as follows:

Estimated revenue till income year-end

Contract amount as agreed	+
Variation order adding the contract amount	+
Variation order reducing the contract amount	+
Value-engineering benefits	+
Price adjustments (±)	±
Change in legislation adjustments (±)	±
Estimated revenue	(A)

Percentage of completion

Direct site-cost till date (real expenditure)	(B)
Direct site-cost of for remaining works (estimated)	(C)
Total direct site-cost (estimated expenditure)	(D)=B+C

Percentage of completion $(E) = \frac{B}{D} \%$

Site expenditure

Cumulative inclusion till the year-end	(F) = (A) × (E)
Cumulative estimated gain from the site till this year	(G) = (F) - (B)
Inclusions from the site for this year	(H) = (G) - (G _{Last_Year})

Objectives:

Review of reassessment of taxpayers having special quantification of long-term contracts

Potential Audit Risk:

Income tax may be under reported.

Sl.	Issues	Basis of checking
1.	For a long-term contract: <ul style="list-style-type: none"> Individual contract has been identified for a long-term contract Contract has been identified as long-term contract as defined in Sec. 26 	Documents submitted with income tax return, full audit report
2.	Whether individual long-term contract, <ul style="list-style-type: none"> Cumulative income has been recognised as per Sec. 26 Cumulative income has been recognised as per Sec. 26 Current year income has been recognised as per Sec. 26 	Documents submitted with income tax return, full audit report

Sl.	Issues	Basis of checking
3.	Whether cumulative sheet for each long-term contract has been described in each contract with sufficient information as defined in Income tax directive and LTC directive	Documents submitted with income tax return, full audit report
4.	Whether individual income has been brought in the income computation for tax accounting and details of each contract has been analysed during the reassessment.	Documents submitted with income tax return, full audit report

27. Special quantifications – Merger

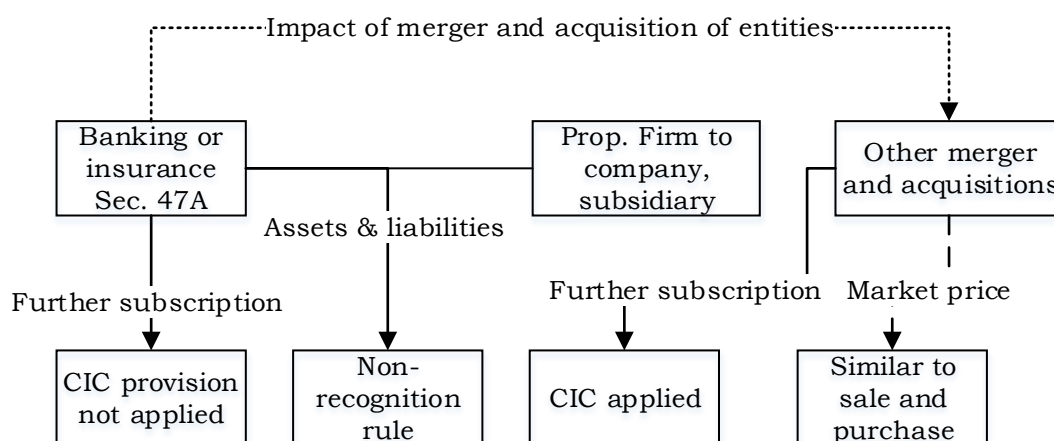
Background:

Merger or acquisition of entities are not covered under any special provisions for tax accounting. However, there is an ambiguity that can be drawn from the special provisions relating to banking business and investment business.

For the merger or acquisitions of banking businesses or insurance businesses, gain from merger is almost nil and unrelieved loss are also transferred to the absorbing company.

For merger of other entities, there are two alternatives for tax computation:

- At the market price in general case
- At the net-outgoings or net-incomings in the case of conditions under Sec. 45(6)
- No tax -attributes will be transferred into absorbing entity in both the cases.



Objectives:

Review of reassessment of taxpayers having special quantification of merger

Potential Audit Risk:

Income tax may be under reported or tax-base of new company may be wrongly accounted

Sl.	Issues	Basis of checking
1.	For benefits for merger under Sec. 47A, whether <ul style="list-style-type: none">▪ Letter of intent for merger has been filed to the department.▪ Completion letter has been filed▪ Merger has been completed within two years from date of letter of intent	Letter of intend Letter of completion
2.	On the completion letter under Sec. 47A, whether, <ul style="list-style-type: none">▪ Tax-base balance sheets (individual and consolidated) have been filed with reconciliation▪ Closing income tax return till the date of merger has been filed within three-months from the date of completion of merger▪ Method of absorption has been described adequately▪ List of existing shareholders has been filed with completion letter▪ Gain on disposal of liability has been reported and included in closing income tax return of outgoing company▪ Detail of voluntary retired personnel including WHT on additional payment has been deposited as per law	Transfer sheet, valuation sheet, full audit report
3.	For the merger of two or more entities, the business combination for tax accounting will be equivalent to independent business transaction of sale or purchase at market price as per Sec. 45. Auditor needs to evaluate, whether, <ul style="list-style-type: none">▪ All assets and liabilities have been quantified at market price on the date of merger▪ In the case of transfer of assets and liabilities at cost under Sec. 45(6), all of the provision of the said sub-section have been fulfilled by all of the merging entities▪ Tax-attributes (for example, interest under Sec. 14(3), loss under Sec. 20 or 36, foreign tax credit under Sec. 71, etc.) have not been transferred into absorbing entity▪ Transfers have been reported to the department in accordance with Sec. 46(3)	Agreement, tax-base balance sheet, full audit report, financial statements CIC statement, if applied

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> The merger has created change in control as per Sec. 57 	

28. Special quantifications – Change in Control

Background:

Change in shareholding structure or underlying owner by fifty percent or more in any three-years period is treated as change in control (CIC) for tax accounting and reporting as per Sec. 57. On the date of CIC, there will be a deemed disposal of all assets and liability at the market price as self-supply as per Sec. 41.

1. Preliminary requirements

Following information are preliminary requirements for CIC analysis:

- CIC will be applicable in the company and partnership firm only.
- Changes in either type of shareholders -equity-holders or preference-holders, the treatment will be same. Therefore, shareholders records for last three years is the first essential for CIC.
- In the case of company having another entity as shareholder, the relation till the underlying owner is required.
- Date of changes in the control is critical date for CIC.
- Tax-base balance sheet on the date of CIC
- Market price of assets or liabilities is another requirement.

2. Timing for CIC

CIC will be applicable when the change in shareholding structure or underlying owner by fifty percent or more in any three-year's period.

In the case of company, where CIC has applied within last three years, then the earlier date for the CIC will be latest CIC date.

3. Direct changes for CIC

Following changes will be considered for computation of changes in shareholding structure:

- Sale or transfer of shares held by existing shareholder, if holds 1% or more
- New issues with different ratios or to new shareholders
- Redemptions of preference shares

- d. Buy-backs of existing shares (but excluding treasury stock¹⁵)

4. Indirect changes for CIC

In the case of underlying shareholding, the sale or transfer of shares held by underlying owner in any level of existing shareholder, if effectively holds 1% or more.

The residency of underlying owner is irrelevant for changes for CIC. Therefore, tax-treaties does not affect the CIC impact.

5. Exclusions for CIC

Following changes will not be considered for computation of changes in shareholding structure:

- a. Sale or transfer of shares by shareholder holding less than 1% or underlying shareholder effectively holding less than 1%
- b. Forfeiture and reissue or adjusted-issue will not be considered.
- c. Investments in treasury stock
- d. Mortgaged or pledged shares
- e. Transfers or new issues not affecting shareholding ratios

6. Quantification of assets and liabilities

All the assets and liabilities on the date of change in control will be revalued at market price and unrealised profits will be recognised for tax-accounting.

Objectives:

Review of reassessment of taxpayers having special quantification of CIC

Potential Audit Risk:

Income tax may be under reported or tax-base of new company may be wrongly accounted for.

Sl.	Issues	Basis of checking
1.	In the case of change in shareholdings either by way of sale, transfer, fresh-issue of shares, directly or indirectly, by 50% or more in any three-year's period,	

¹⁵ Income tax law prescribes special provision for treasury stock (i.e. investment in own shares of listed company), which is prohibited by the Company Act, 2063. Therefore, tax provision will not be applied in practice.

Sl.	Issues	Basis of checking
	<p>tax accounting for change in control (CIC) is required u/s 57. In the company, whether,</p> <ul style="list-style-type: none"> ▪ Shareholding structure has been filed at least annually with income tax return, if not filed tax officer collects information through notice u/s 83 during reassessment ▪ Shareholding information contains direct controller (more than 1%) and underlying indirect controllers ▪ Statements of cumulative changes has been obtained for each three-years period 	Shareholding structure, full-audit report
2.	<p>In each reassessment of a company, department collects information regarding CIC and change in structure of shareholders (direct and indirect both). Auditor needs to ensure the adequacy on, whether,</p> <ul style="list-style-type: none"> ▪ Declaration of shareholding structure has been obtained from taxpayer, ▪ Tax officer verifies such declaration ▪ The verification from tax officer is adequate and effective for reassessment 	Shareholding structure, full-audit report
3.	<p>In the case of CIC, company has to file two income tax returns. For the first income tax return, whether,</p> <ul style="list-style-type: none"> ▪ Period covers from first day of income year to date of CIC ▪ All assets and liabilities on the date of CIC has been valued u/s 41 and recognized as income ▪ Depreciable assets are deemed as disposal, hence no periodic depreciation ▪ Tax-attributes (e.g. unrelieved loss, unabsorbed interest u/s 14(3) etc.) from absorbed company has not been carried into absorbing company ▪ Income tax return has been filed within three-months from date of CIC 	Income tax return, Shareholding structure, full-audit report
4.	<p>In the case of CIC, company has to file two income tax returns. For the second income tax return, whether,</p> <ul style="list-style-type: none"> ▪ Period covers from date of CIC to year-end date ▪ Opening tax-base is market price of all assets and liabilities carried from the first tax-period ▪ Depreciation has been computed based on the tax base equivalent to new purchase on the date of CIC ▪ Tax-attributes from absorbed company has not been carried into absorbing company 	Income tax returns

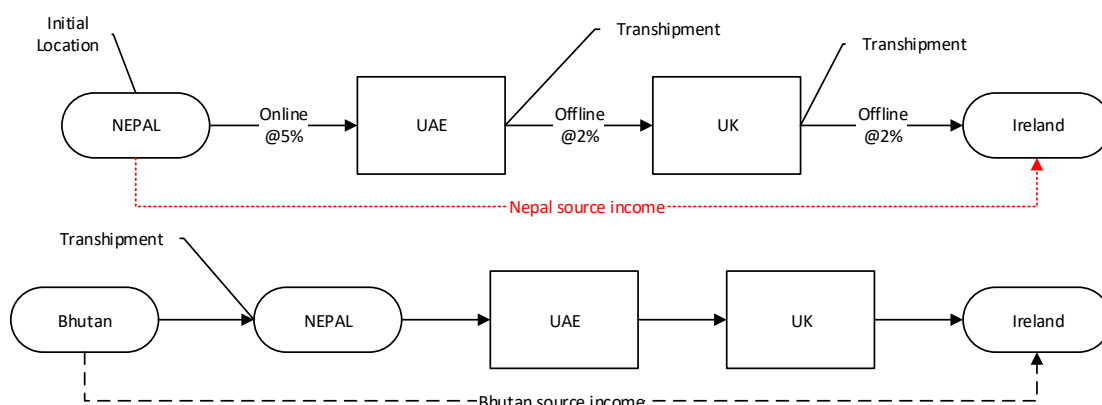
Sl.	Issues	Basis of checking
5.	In the case of CIC through issuing new shares, whether the issuance price is appropriate with the value of shares of shares before such issuance.	Value of issues, full audit report

29. Special quantifications – Cross-border transportation

Background:

Cross-border transportation has special tax accounting procedure as prescribed in Sec. 70 of income tax act. In fact, there are following different approaches of cross-border transportation:

- Resident-owned carrier – usual tax accounting as per Sec. 7
- Non-resident-owned carrier:
 - If the transportation within Nepal - usual tax accounting as per Sec. 7
 - If the transportation from Nepal to foreign destination:
 - Transshipment in Nepal - no tax
 - Nepal to first destination – 5% of charge
 - After first destination – 2% of charge



In the case of carrier is owned by resident of treaty-state, no tax is levied in the international transportation.

Objectives:

Review of reassessment of taxpayers having income from international transportation initiated in Nepal

Potential Audit Risk:

Income tax may be under reported or non-reported

Sl.	Issues	Basis of checking
1.	<p>Fees for international transportation of passengers and goods initiated from Nepal is taxable income for the non-resident carrier with exception for tax-treaty countries. In the cross-border transportation, each individual foreign carrier needs to file the return and pay tax. Verify whether,</p> <ul style="list-style-type: none"> ▪ Update record of international carrier has been maintained ▪ Update record of flight from Nepal has been maintained ▪ Non-resident carrier files income tax return ▪ Income tax return discloses the fee for international transportation initiated from Nepal as well as off-line transportation for the transportation initiated from Nepal 	<p>Flight detail record CIAA confirmation</p>
2.	Whether updated record of international flights and fee (initiated from Nepal to first destination and from first destination to final destination) has been matched with individual taxpayer	<p>Flight detail record CIAA confirmation</p>
3.	Whether appropriate tax rate has been applied	Tax law, directives

30. Special quantifications – Dividend tax

Background:

Dividend tax is one of the major sources of income tax. Though quantification of dividend computation seems conventionally simple, but there are few issues that make dividend tax complex. The complexity can be resolved through tax-base balance sheet, if any.

1. Applicability

Distribution from company or partnership is subject to dividend tax.

For the income tax purpose, company includes registered company, unregistered body of individuals, partnership having 20 or more partners, public enterprises, cooperatives, non-governmental societies or any other institution having registration.

2. Exclusions

Following distributions are excluded from dividend tax:

- a. Redistribution
- b. Industries from special economic zone till specified years
- c. Capitalization of profits by special industries or tourism sector

- d. Dividend received from controlled foreign entity
- e. First two years for merged banks and insurance companies
- f. Dividend received by approved retirement fund, mutual fund, federal government, provincial government, or local authorities
- g. Dividend distributed by rural cooperatives or agro-forestry based cooperatives

3. Dividend will be inclusions for distributing entity

Dividend above the tax-base of profits will be included in the inclusions of distributing entity according to Sec. 56(3).

Carrying-amount of profits	200	
Tax-base of profits		100
Distribution of dividend	160	160
Distribution above profits		60
(inclusions as per Sec. 56(3) to make economic double taxation)		
Further distributable profits	40	0

To determine the dividend attracting for inclusions, auditor needs to compare the distributions tax-base balance

Objectives:

Review of reassessment of dividend tax

Potential Audit Risk:

Income Tax may be under-paid

Sl.	Issues	Basis of checking
1.	<p>Dividend tax is levied on two cases of distribution of profits – capitalisation and payment. For the quantification of dividend, quantification of the profits is critical. The auditor needs to evaluate, whether,</p> <ul style="list-style-type: none"> ▪ Reassessment file contains tax-base balance sheet of the entity showing tax-base of capital contribution and tax-base of the profits ▪ Capitalization from the profits has been recognised as dividend ▪ Payment to the beneficiary has been identified while actual amount is paid 	Tax-base balance sheet, full audit report

Sl.	Issues	Basis of checking
2.	<p>Whether the payment to the beneficiary is,</p> <ul style="list-style-type: none"> ▪ Within the limit of accumulated dividend income (no dividend tax is levied) ▪ Within the limit of tax-base of the profits (this is distribution of dividend for tax purpose) ▪ Within the limit of account-base of accumulated profits but above the limit of the tax-base of the profits (above the limit of the tax-base of the profits is distribution without profit) ▪ Made using the corporate instruments like redemption, buy-back, forfeiture etc. (capital-first rule applies to the extent of capital reduction) 	Dividend tax payment receipt, financial statement, full audit report
3.	Whether the distribution without profit (as computed above) has been included in the inclusions of the company	Income tax return, full audit report
4.	Whether the beneficiary has received the payment from the entity without formal declaration of dividend (payment will be dividend as per Sec. 53)	financial statement, full audit report
5.	For the merged banking business, whether the dividend tax waiver has been allowed within first two years of merger	Letter of intent, full audit report

31. Withholding tax from taxpayer

Background:

Taxpayer requires to comply the withholding tax (WHT) provisions of Income tax law. Timing, amount, deposit and other compliance of WHT is one of major items of tax law.

1. Who requires withhold tax

Payer needs to withhold the withholding tax if following conditions fulfils:

- Payment by a resident payer
- Payee is receiving Nepal source income
- Item of payment is subject to the items covers in Sec. 87 – 89.

2. When to withhold

Resident payer needs to withhold the WHT at the time of payment.

3. How much to withhold

Withholding tax rate varies from year to year. Auditors need to use appropriate rate in the income year concern.

4. Failure to withhold

Withholding tax is deemed to have withheld at the time payment, irrespective of actually withheld or not. The withholding agent is obliged to deposit the appropriate amount of withholding tax within twenty-five days from end of month of payment.

Objectives:

Review of reassessment of taxpayers on WHT compliance.

Potential Audit Risk:

WHT may be reported inappropriately.

Sl.	Issues	Basis of checking
1.	Personnel cost is subject to WHT as per Sec. 87. Auditor needs to ensure, whether, <ul style="list-style-type: none">▪ Total of personnel cost and WHT has been reconciled▪ Personal WHT is (sufficient) correctly calculated▪ Monthly WHT has been deposited▪ Interest has been levied on delayed deposit	Financial statements, staff-pay sheet, deposit records Full-audit report
2.	There are many issues of payments subject to WHT as per Sec. 88 - 89. Auditor needs to ensure, whether, <ul style="list-style-type: none">▪ Total of payment heading, where all the payments are subject to WHT and WHT has been reconciled▪ WHT is sufficient as per respective provision of tax law▪ Monthly WHT has been deposited▪ Interest has levied on delayed deposit	Financial statements, WHT return, deposit records Full-audit report
3.	Receipt by the taxpayer may be subject to WHT in many cases. WHT claimed for credit and sales need to match each other. Auditor needs to ensure, whether, <ul style="list-style-type: none">▪ Corresponding income has been recognised from claimed WHT▪ Claimed WHT is within same year of income as per Sec. 93	Financial statements and corresponding tax credits

32. Tax collection on disposal of securities

Background:

According to Sec. 95A of the act, Nepal Stock Exchange Limited requires collecting Tax Collected at Source (TCS) on gain on disposal of listed companies.

Individual entity requires to recover TCS on gain on disposal of unlisted companies.

Method of computing gain

Gain on disposal of securities is the difference between gross-incomings (Sec. 39) and gross-outgoings (Sec. 38). The outgoings will be computed as:

- a. Weighted average cost for outgoings for listed securities¹⁶ disposed by a resident natural person
- b. For the remaining cases of disposal of securities, one-to-one calculation is applicable to compute the gain
- c. In the case of bonus-share issued from profits, outgoings is face value of securities

1. Timing of TCS

Following is the timing of TCS:

- a. In the case of listed-securities, date of transaction in stock-exchange floor
- b. In the case of unlisted securities, date of decision of transfer by the board of directors (BOD) or person appointed by the BOD for the purpose of authentication of transactions relating to securities

2. Non-cash transfers

Collecting agent requires to collect TCS in form of cash, even in the case of non-cash transfers

Objectives:

Review of adequacy of TCS

Potential Audit Risk:

TCS collection may be the case of under recovery

¹⁶ CDS and Clearing Ltd.'s software computes weighted average cost for each stock held by each individual. The computation is not automatic at the CDS-end. Individual investor needs to compute.

Sl.	Issues	Basis of checking
1.	For the TCS on gain from disposal of securities, whether, <ul style="list-style-type: none"> ▪ Appropriate quantification has been made for determination of gain ▪ Tax officer has examined the proceeds on the disposal and evidences have been recorded ▪ Tax officer has examined the adequacy of the evidences of the computation 	CDS/NEPSE/broker records Monthly TCS return
2.	Whether monthly TCS return has been received	Monthly TCS return
3.	Whether monthly TCS return has detailed the transaction of proceeds, gain and TCS	Monthly TCS return
4.	Whether TCS has been collected on disposal of right of the right-shares	Monthly TCS return

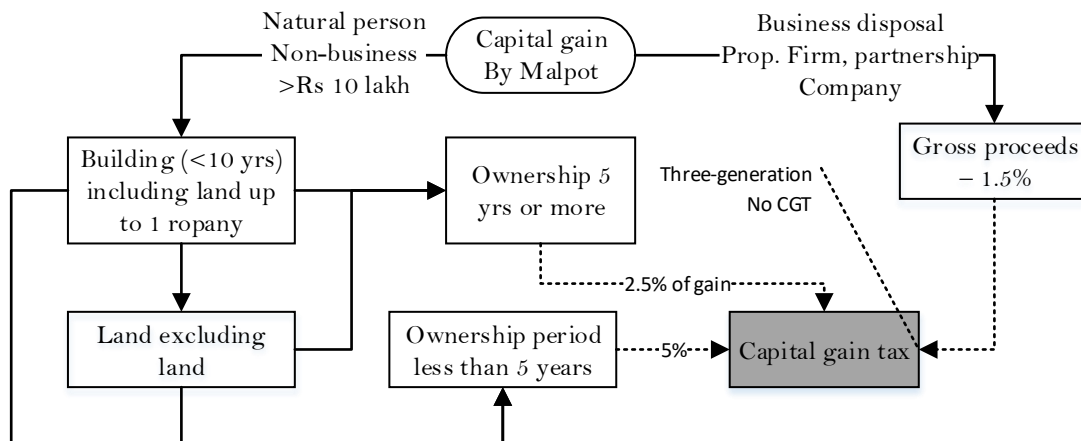
33. TCS from Mālpot-office

Background:

According to Sec. 95A of the act, Land Revenue (*Mālpot*) office collects tax on gain on disposal of land and buildings as tax collected on source (TCS) basis. There are three types of cases for TCS as:

- Gain on disposal of land by natural person if proceeds is more than Rs. 10 lakhs (2.5% of gain if ownership is more than or equal to five years and 5% of gain if the ownership is less than five years¹⁷)
- Gain on disposal of building by natural person if proceeds is more than Rs. 10 lakhs (2.5% of gain if ownership is more than or equal to five years and 5% of gain if the ownership is less than five years)
- Turnover based tax on disposal of land or building by entity (1.5% of gross proceeds)

¹⁷ The TCS rate may vary from year to year. Auditor should aware of the year of transaction and rate of TCS on that year.



For the identification of building owned by natural person, there are special rules such as:

- Building includes land to the extent of double of plinth area of building
- Building that is owned and resided for more than ten years is non-taxable
- Building (and land) transferred within three generation without consideration is not taxable

Objectives:

Review of adequacy of TCS

Potential Audit Risk:

TCS collection may be the case of under recovery

Sl.	Issues	Basis of checking
5.	For the TCS on gain from disposal of land or building by natural person, whether, <ul style="list-style-type: none"> ▪ Appropriate quantification has been made for determination of gain ▪ Same proceeds has been taken for registration and TCS purpose 	Registration sheet current and earlier
6.	For the TCS on gain from disposal of land or building by natural person, whether, the period of ownership and rate of TCS is appropriate	Registration sheet current and earlier
7.	For the TCS on gain from disposal of land or building by natural person, whether, appropriate area of land has been assumed for building	Registration sheet construction completion certificate
8.	For the case of waiver of TCS on gain from disposal of land or building by natural person, whether,	Municipal certificate

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> ▪ Adequate evidences of transfer without consideration within three-generation produced ▪ Adequate evidences of construction and residency more than ten-years produced 	
9.	In the case of part disposal, allocation formula for the cost of land or building has been used as per Sec. 49 of the act.	Valuation report

E. Value Added Tax

Value added tax is another major source of revenue of federal government and from which revenue is shared to provinces and local levels under fiscal transfers. Value added tax is levied in accordance with the provision of Value Added Tax Act, 2052. Under the authority of Value Added Tax Act, 2052, GON has promulgated Value Added Tax Regulation, 2054 and VAT Directives and specific directives.

34. Registration in VAT

Background:

Registered person recovers VAT on its supply of goods or service. VAT is levied on supply of goods or services within Nepal. However, there are many cases of VAT exemption either item-based or condition-based.

Resources for auditors
Value added tax Act, 2052
Value added tax Regulation, 2053
VAT Directive, latest edition
Computerized billing Directive, latest edition
Goods transport Directive, latest edition
Case laws

1. Exemption types

Exemptions either item-based or condition-based are for the better livelihood of general public and positive intervention in the market. Schedule 1 of Value Added Tax Act, 2052 has prescribed numerous goods in the category of VAT exemption. The exemption may be classified as:

- a. harmonized system code-based goods
- b. services like handicraft, sports, translation, electricity,
- c. Conditional VAT exemption
 - i. User-based exemption, e.g., Tap-water, tanker-water for drinking (not for construction or commercial purpose), seeding tray,
 - ii. Buyer-based exemption, e.g., green-house imported, certain import by pharmaceutical industries,
 - iii. Seller-based exemption, e.g., Tobacco leaf, is sold by the farmer, research from university, canteen or hostel by academic institution, services from governments,
- d. Recommendation-based exemption, e.g., import on the recommendation from department of industry, department of drugs, alternative energy promotion center, department of electricity etc.

2. Cascading effect

Though exempt goods or services is beyond scope of VAT collection on the supply, VAT payment on its input is not allowed for set off. Therefore, exempt goods or services are VAT-inclusive, if VAT paid on its production process (or unregistered

party within the supply-chain). Exempt goods or services, if used as input to produce VAT attractive output creates cascading effect of VAT.

For example, construction cost for electricity is VAT attractive, and electricity is exempt. Printing service is VAT attractive. The buyer of printing service pays VAT on final printing service at 13%, which includes a portion of VAT on construction cost of power-house.

3. Subjective exemption

Some of the exemptions have subjective interpretation. Auditor needs to care the most appropriate and formal interpretation in this regard. Examples for subjective exemptions, where definition of the exempt goods or services is not available, are, e.g., health service, air-travel, financial services, accidental insurance, artist, sport-person, newspaper, drinking water etc.

4. Registration

Registration is one of the main points for value added tax. Three types of registrations are applicable in VAT:

- a. Compulsory registration:
 - i. Threshold based business
 - ii. Business type-based business
- b. Voluntary registration
- c. Temporary registration (no-threshold):
 - iii. Temporary business as exhibition
 - iv. Temporary business as joint venture

Traditional registration procedure is changing as biometric registration has been introduced since 2076. The tax obligation is not waived for the potential taxpayer subject to compulsory registration or temporary registration.

Objectives:

Review of compliance of registration clause of law

Potential Audit Risk:

Taxpayers may be beyond of the scope of tax-net

Sl.	Issues	Basis of checking
1.	Tax officer's needs to ensure the registered person requires to collect VAT on supply of goods or services if	

Sl.	Issues	Basis of checking
	<p>they are not VAT exempt. Failure of taxpayer is subject to penalty and assessment of tax. Auditor needs to evaluate the performance of office, whether,</p> <ul style="list-style-type: none"> ▪ Tax officer has adequately monitored the goods or services supplied by the taxpayer is subject to VAT or exempt. ▪ The full audit report describes the name of goods or services having significant volume of transaction ▪ The full audit report describes the significant suppliers supplying to the taxpayer under tax-audit. ▪ Tax officer has the field-monitoring program on the taxpayer declaring exempt supply ▪ The field-monitoring program has been implemented adequately ▪ In the cases of non-compliance, tax has been assessed and penalty has been imposed 	Full audit report, monitoring report
2.	<p>Tax officers needs to ensure the compliance of compulsory registration of taxpayers. Failure of taxpayer is subject to penalty and subject to assessment of tax. Auditor needs to evaluate the performance of tax officer, whether,</p> <ul style="list-style-type: none"> ▪ Tax officer has the threshold-monitoring program for identification of unregistered person based on threshold for compulsory registration ▪ The threshold-monitoring program has been implemented adequately ▪ Tax officer has the field-monitoring programme for geographical-business based compulsory registration ▪ The field-monitoring program has been implemented adequately ▪ In the cases of non-compliance, tax has been assessed and penalty has been imposed 	Full audit report, monitoring report
3.	<p>Tax officers need to ensure the compliance of temporary registration for short-term business e.g. exhibitions [Exhibition business is an event-based business]. Tax officer needs to ensure the presence of temporary registered participants, if they are not registered persons. Auditor needs to evaluate the performance of tax officer, whether,</p> <ul style="list-style-type: none"> ▪ There were exhibitions (or other short-term businesses attracting VAT) within the jurisdiction 	Full audit report, monitoring report

Sl.	Issues	Basis of checking
	<p>of tax officer during the period covered under the audit</p> <ul style="list-style-type: none"> ▪ Tax officer has records of exhibitions or similar events and the records are updated ▪ Tax officer has made temporary registration of unregistered person participating in the event ▪ Temporary registered persons have filed the VAT return and deregistration within seven days from end of even ▪ Adequate VAT has collected from temporary registered persons 	
4.	<p>Tax officers needs to ensure the compliance of temporary registration of joint business. For the joint business, there is no threshold for compulsory registration. That means all the joint venture business needs to obtain registration. Auditor needs to evaluate, whether,</p> <ul style="list-style-type: none"> ▪ Tax officer has records of joint business within jurisdictions and the records are update ▪ Tax officer has made temporary registration of joint business ▪ Temporary registered persons have filed the VAT return ▪ Adequate VAT has been collected from temporary registered persons 	Full audit report, monitoring report

35. Determination of VAT

Background:

For the commercial transactions, VAT is the difference of output tax and input tax. Output tax is the gross amount of collected tax and input tax is the allowable credit for purchase by the taxpayer.

1. Supply

VAT is levied in each supply of goods or services. For the purpose of VAT, supply includes either of:

- a. Sales – having cash consideration either in form of cash-before-delivery (CBD), cash-on-delivery (COD) or on credit.
- b. Exchange – having non-cash consideration either in form of goods or services or otherwise
- c. Transfer – not having any consideration
- d. Agreement for or permission for sales, exchange, or transfer on the date of timing of supply

2. Supply includes self-supply

Following cases of consumptions of own goods or services will be the supply in the form of self-supply:

- a. Consumption (other than raw materials for manufacturing) of trading goods, or manufactured goods
- b. Purchased goods used for other purpose than to produce VAT attractive output
- c. Goods sent to international flights for sale
- d. Goods in the hands at the time of deregistration

Self-supply will be valued at market price on the date of self-consumption or exit from VAT attractive regime.

3. Timing of supply

Timing of supply for the purpose of VAT recovery is the earliest of:

- a. Invoicing time – this is invoice writing time, whether goods or services has delivered, manufactured, purchased or not
- b. Delivery time
 - i. Handover of goods to the recipient or first carrier appointed by the recipient
 - ii. In the case of goods in the transit, acceptance time for re-route the goods
 - iii. In the case of installment, the due date of installment
 - iv. Services

- Completion time for a standalone service
 - In the case of service having milestone, completion date of individual milestone
 - Telecom services by operator, date of invoice
- c. Receipt time for consideration
- i. Cash-before-delivery (but not the advances, if any)
 - ii. Receiving goods or services in the case of exchange arrangement
 - iii. Regular payments

4. Taxable amount

Generic method of taxable amount is determined as follows:

Market price on the date of timing of supply	(a)
Supply-associated additional costs (e.g., transportation, lab cost, packaging etc.)	(b)
Supply-associated taxes and duties of federal, provincial, or local level	(c)
Supply-associated benefits to the recipient in the form of quantity discount or trade-discount	(d)
Taxable amount (T)	<u>(a) + (b) + (c) – (d)</u>

Basis of market price has three exceptions:

- a. Log-wood where royalty will be the basis for taxable amount, if royalty is higher than selling price
- b. Second hand goods, where taxable amount will be the amount of gross profit of individual supply taking VAT as cost
- c. Notified goods (liquor, cigar, cigarette, and telecom recharge cards) or price published items (e.g., motor spirit, high speed diesel, LP gas) supplied for the purpose of consumption, where consumer price published will be the taxable amount of the supply

In the following cases, the supply will attract quantification at market price on the timing of supply of goods or services:

- a. Supply without consideration (transfers, excluding transfer of business complying with the procedure provided in Sec. 5A)
- b. Supply covering only partial consideration
- c. Supply having under-invoicing (whether buyer pays full consideration, but supplier issues the tax-invoice at the lower than actual consideration)
- d. Self-supply

5. Tax invoices

Registered person requires to issue tax-invoice in each supply, whether the supply is VAT attractive or exempt. For the retailer having permission from tax-officer, may issue abbreviated tax invoice for the sales up to Rs. 10,000.

Buyer, if instructed by the tax-officer or revenue investigating officer, needs to produce the tax-invoices during the transit of goods. In the case of goods transfer between the branches of same taxpayer, stock-transfer mechanism is applicable. In both cases of transportation of goods, Vehicle & Consignment Tracking System. Monitor's the movement.

In the following four cases of supply, unregistered person collects VAT without issuing tax invoices (Sec. 12A and 15(3):

- a. Log-wood seller (national or private or community forest)
- b. Goods sold by federal, provincial, or local level
- c. Goods or services sold by public enterprises
- d. Goods sold by international institutions

6. Credit notes

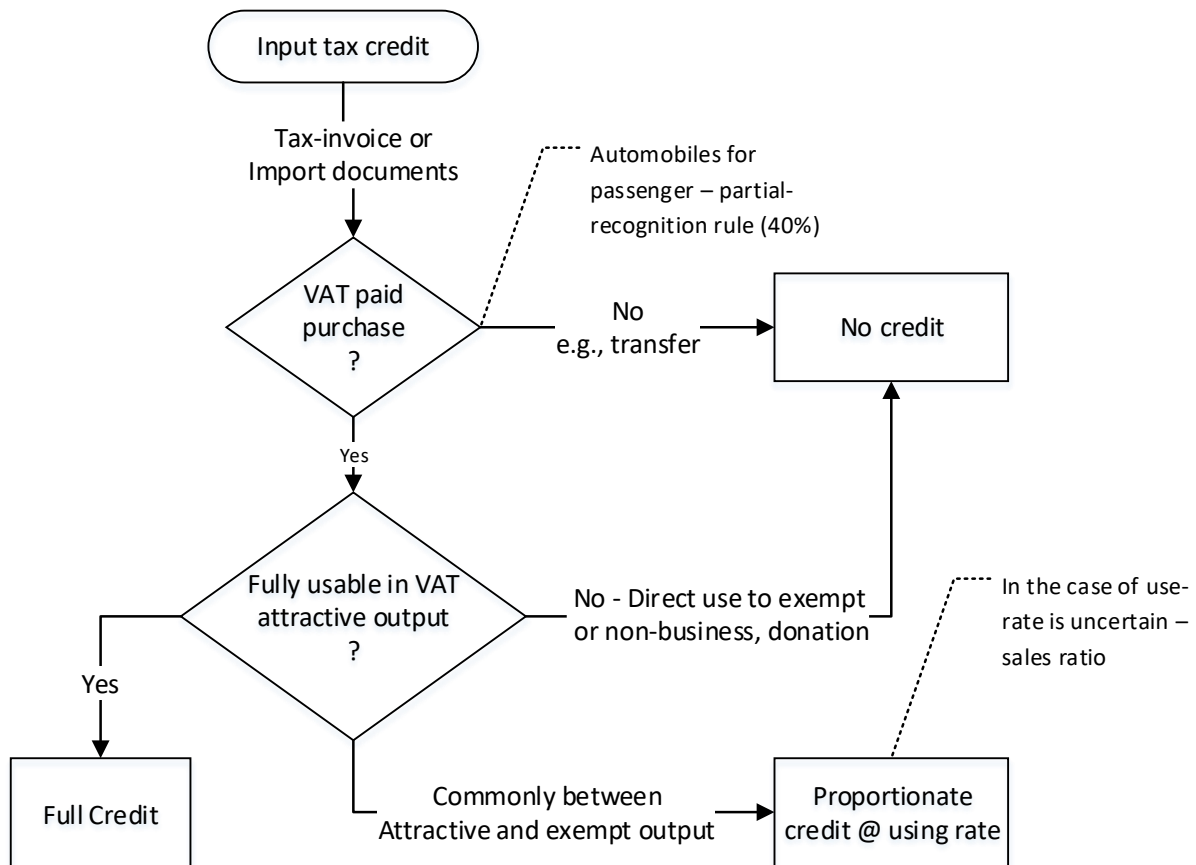
In the case of goods return from the buyer or the substance of issued tax-invoice requires amendments after its issue, the seller issues the credit-note to the buyer (in the reversal case, debit-note). Amount of VAT from the credit note may be adjusted through 'anya thap-ghat' in the VAT return.

Registered person requires to inform, through VAT return, the number of cases of debit-note or credit-notes.

7. Input tax credit

Registered person obtains eligible input tax credit. The eligibility for the credit is as follows:

- a. VAT paid purchases for the business use, excluding the no-credit goods (soft drink, hard drink, food, entertainment, petrol, diesel, LP gas)
- b. Potential use for VAT attractive output to the extent of ratio of VAT attractive output
- c. Supported by the purchased tax-invoice on own name and PAN



8. Credit without tax invoice

Input tax credit is allowed in the VAT payment without supported by tax-invoice in the following cases:

- Wood-purchasers, if purchased as per Sec. 12A
- Purchases from public entities as defined in Sec. 15(3)
- Import of goods, if supported by import documents
- Service importation, if paid directly to the tax officer.
- In the case of VAT payment directly to the tax officer for the VAT unpaid cost of business construction, input tax credit is not allowed.

9. Taxpayer's documentation

VAT law prescribes following documents, those requires to be collected, prepared and retained by a taxpayer:

- Purchase and sales tax-invoices
- Debit and credit notes
- Purchase and sales books
- Debit note book and credit note book
- Import documents and export documents
- VAT return filed to the tax officer

10. Filing documentation

Department requires to maintain following documents regarding a taxpayer:

- a. Personal information – Registration documents and updates therein, Branch records
- b. Earlier reassessments
- c. VAT returns
- d. Return detail, the summary of VAT return
- e. Audit Trial Report, the ledger of transaction relating to tax-periods

Objectives:

Evaluation of adequacy of output tax and input tax

Potential Audit Risk:

VAT assessment may be understated

Sl.	Issues	Basis of checking
1.	Section 20 of VAT act prescribes the conditions for reassessment by tax officer. Whether, <ul style="list-style-type: none">the selection of taxpayer for reassessment has been based on a particular condition and collected informationthe documents collected during the reassessment were adequate compared with the condition of reassessmentthe condition(s) and evaluation during full reassessment matches with each other	Selection procedure, selection sheet
2.	During the reassessment, tax officer evaluates the output tax. Whether, <ul style="list-style-type: none">The output tax matches with the sales in financial statements and the income tax returnThe output tax has been collected on sale of capital assetsThe output tax is matches with purchase and sales statementsInter-taxpayer sales and purchase matches or in the case of mismatches, reconciliation statement has been prepared	VAT return, return detail, financial statements, income tax return
3.	All the persons having VAT-attractive transactions more than the threshold require to collect output tax on their supply of goods or services, irrespective of motive of business. Whether,	VAT return, return detail, financial statements, income tax return

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> The output tax has been collected by person dealing VAT attracting supply more than threshold but not having the profit motive The transactions have been segregated into supply of services and grant 	
4.	Whether tax officer has evaluated the output tax under Sec. 17(4) on the assets being unused or in cases of self-consumptions, if any	Full audit report, financial statements
5.	<p>Taxpayer needs to comply the various compliance procedures like billing rules, retention of documents, displaying certificate or tax-plate etc. as prescribed. Tax officer needs to evaluate the compliance status in the full audit (assessment).</p> <ul style="list-style-type: none"> Whether full audit report has section describing compliance of billing rule, documents retentions, displaying etc. Whether taxpayer permitted for computerised billing has been evaluated in the full audit report 	Full audit report, financial statements
6.	<p>Whether input tax credit on general purchase matches with</p> <ul style="list-style-type: none"> Financial statements and income tax return Capital purchases as indicated in financial statement With sale and purchase statements of other parties 	Return detail, Full audit report, financial statements
7.	<p>For the taxpayer having mixed output with both VAT-attracting including zero-rated and VAT exempt goods or services,</p> <ul style="list-style-type: none"> Whether computation of proportionate credit has been applied Whether full audit report has described the computation basis for proportionate credit Whether the valid basis has been adopted for proportionate credit on capital items 	Return detail, full audit report
8.	<p>In the case of credit continuity for the loss of stock,</p> <ul style="list-style-type: none"> Whether the prescribed procedure under the VAT law has been fulfilled Whether the timeframe has been as per law Whether insurance coverage has been adjusted Whether treatment in financial accounts and income tax return has adequate reconciliation for VAT adjustments 	Loss reports, Return detail, full audit report

36. Reverse-charging VAT

Background:

Taxpayer needs to pay VAT on purchase directly to the tax officer in two cases of purchases:

1. Importation of service under Sec. 8(2)

- a. Date of supply for the importation of services is the earliest of date of completion of service (including completion of milestone or instalment due date) or date of payment of service charge, or the part thereto.
- b. Taxable amount in the case of importation service is amount paid or payable to the Foreign Service provider. The conversion of foreign currency will be at the selling price of Nepal Rastra Bank exchange rate on the date of supply.

2. Business construction under Sec. 8(3)

- a. Applicable for the business construction for self-use, rent, sale, or transfer having construction cost of Rs.5 million
- b. Construction cost includes the cost of works, design and permission cost, interest during construction and other construction associated cost
- c. Timing of supply is the tax-period or the month
- d. Taxable amount for reverse charging VAT is the total of VAT unpaid cost excluding design and permission cost, interest during construction

Objectives:

Evaluation of adequacy of recovery of reverse charging VAT

Potential Audit Risk:

VAT assessment may be understated

Sl.	Issues	Basis of checking
1.	In the case of reverse charging of VAT on import of services, whether, <ul style="list-style-type: none">▪ Separate payment has been made for reverse charge from import of service▪ Withholding tax on service and reverse charge VAT matches with each other▪ Full audit report describes adequately on reverse charged VAT on import of services	Purchase sheet and payment slip, full audit report
2.	In the case of reverse charging of VAT on business construction, whether	

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> ▪ Capital construction in financial statement and reverse charging has been analysed in full audit report ▪ Capital construction and reverse charging VAT matches with each other, either directly or through a separate reconciliation statement ▪ Tax officer has levied required amount of reverse charge from business construction from either VAT registered person or unregistered person ▪ Reverse-charging VAT has not been allowed for input tax credit 	Financial statement, payment slip, full audit report

37. Refund of VAT

Background:

There are numerous situations of VAT refund in the tax law.

1. Types of refund

- a. Refund request through VAT return
 - i. Exporter having more than 40% of total sales during the tax-period
 - ii. Continuous four-months credit amount
- b. Application and recommendation method
 - i. Continuous four-months over-paid amount
 - ii. Person and projects having diplomatic privileged or duty-privileged
 - iii. Collection by error
 - iv. Tourist
 - v. Re-exports
 - vi. Incapacitated person's VAT on purchase scooter
 - vii. Pharmaceutical industries
 - viii. Consumers paying through digital means

2. Limitation period

VAT refund must be claimed within three years limitation period

3. Eligible amount of refund

- a. For exports having more than 40% of total sales during the tax-period, eligible amount of refund is whole of the credit amount at the tax-payer end
- b. For the continuous four-months credit amount, eligible amount of refund is minimum credit in the last five months inclusive of current month
- c. For the continuous four-months over-paid amount, eligible amount of refund is minimum amount of over-payment in the last five months inclusive of current month
- d. In the other cases, eligible amount of refund is the paid VAT on purchases or imports

Objectives:

Review of compliance of VAT refund

Potential Audit Risk:

Over refund or weak compliance of refund provisions

Sl.	Issues	Basis of checking
1.	<p>Tax officer is required to maintain the refund records.</p> <ul style="list-style-type: none"> Whether, in each types of VAT refund, tax officer has maintained adequate records showing types, names and other description of refund The records have been updated and are adequate The records have been certified 	Refund records, files
2.	<p>Whether, for individual VAT refund,</p> <ul style="list-style-type: none"> Conditions as defined in law has been complied with refund decision Procedures as defined in the law has been fulfilled up Refund has been made within the time limit prescribed in the law Sufficient evidence have been collected in the refund file Refund amount has been within limit supported by the condition and evidence 	Refund records, files
3.	Whether continuous four months credit amount or over-paid amount of refund is eligible minimum amount as per law	Refund records, files
4.	Whether, in the case of group of companies controlled by same person(s), the refund eligible for one company or firm has made with monitoring tax arrears in other firms/companies	Refund records, files, and cross-examination
5.	Whether VAT refund has been accounted for adequately and financial statement has been prepared accordingly	Financial records

F. Excise duty

Excise duty is one of the major sources of federal government. Excise duty is levied in accordance with the provision of Excise Duty Act, 2058. From the authority of Excise Duty Act, 2058 (EDA), GON promulgated Excise Duty Regulation, 2059 (EDR). IRD issued the excise and specific directives and circulars.

38. Licensing

Background:

According to Sec. 8 and 9 of Excise duty Act, 2058, producer, importer, warehouse/storage, and seller dealing excisable goods needs to obtain license from excise-officer.

In each finance act, list of goods under excise duty is published for a period from Jestha 15 to next Jestha 14. All the person dealing such goods needs to obtain excise-license.

Resources for auditors

Excise duty Act, 2058
Excise duty Regulation, 2059
Liquor Act, 2031
Liquor Rules, 2033
Excise duty Directive, latest edition
Case laws

Objectives:

Review of excise officer's compliance on licensing

Potential Audit Risk:

Weak License management may result in losses of the excise duty-base

Sl.	Issues	Basis of checking
1.	<p>Tax officer requires to maintain the list of persons who are dealing excisable goods either producing, importing, storing or selling in the jurisdiction.</p> <ul style="list-style-type: none">Whether the excise officer has maintained such list and has updated periodicallyWhether PAN-holders under the jurisdiction of excise officer dealing excisable goods are included in the listWhether active PAN-holder dealing excisable goods have renewed their licenseWhether excise officer has monitored the non-renewals	License records, study report
2.	<p>Person producing self-issuance goods needs to renew their license annually but are required to file monthly excise-duty return. Whether,</p>	Renewal records

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> Excise officer has updated list of persons producing self-issuance goods Taxpayers are filing monthly returns, and on failing to file returns the excise officer has suspended the business as per the law 	
3.	Whether adequate license fee has been collected at the time of issuance of licenses and their renewals	License record, financial statements
4.	<p>Excise officer may suspend the license as per Sec. 9B or may cancel the license as per Sec. 9C. Whether excise officer has,</p> <ul style="list-style-type: none"> Maintained the updated list of taxpayers whose licenses are to be suspended or cancelled The suspension or cancellation has been made as per the law All the arrears have been collected before suspension or cancellation 	License record, suspension file

39. Determination of Excise duty of controlled items

Background:

Production of liquor (alcoholic production like wine, sider, beer, molasses, sprit or their alcoholic raw materials and controlled packaging items) is controlled item. There are numerous control mechanisms for the liquor production, storage, and sales.

Similar controls with some modifications are applicable for tobacco related items like cigar and cigarette.

Objectives:

Evaluation of adequacy of control over liquor and revenue form liquor

Potential Audit Risk:

Excise duty assessment may be understated

Sl.	Issues	Basis of checking
1.	Excise officer has maintained the record of taxpayer having controlled-items production, storage and sales. <ul style="list-style-type: none">Whether, the excise officer has maintained such records and those are updated	Taxpayers' records and file
2.	Licensed person is required to file monthly excise duty return and other documents within 25 th day of end of each month. Whether, <ul style="list-style-type: none">Prescribed monthly return has been filedPrescribed forms, as prescribed, have been filedInter-firm information matches with each other or has been reconciled appropriately	Taxpayers' records and file
3.	Rule 25 of Excise duty regulation states that the daily record of molasses needs to be filed to the excise officer in form no. 12 on monthly basis. <ul style="list-style-type: none">Whether excise officer has maintained the updated recordsDifferences on the records are verified and excise duty levied accordingly	Taxpayers' records and file
4.	Whether production from raw material is within the prescribed limit	Taxpayers' records and file
5.	Whether process-wise records are verified by the excise officer and duty has levied on each deviation	Taxpayers' records and file
6.	Whether pre-approval has been taken before importing or producing the prescribed / licenced items	Taxpayers' records and file

Sl.	Issues	Basis of checking
7.	Whether consumption of raw materials, packing material, excise duty sticker, flow meter record and actual production matches with each other	Taxpayers' records and file
8.	Determination of excise duty is in accordance with the legal provision as on the date of levying such duty	Taxpayers' records and file
9.	Whether excise duty has been paid in advance before the issue of finished goods	Taxpayers' records and file

40. Determination of Excise duty – self-issue

Background:

Person other than those licenced for controlled items are required to file their monthly excise duty return within 25th day from end of each month.

Objectives:

Evaluation of adequacy of output tax and input tax

Potential Audit Risk:

Excise duty assessment may be understated

Sl.	Issues	Basis of checking
1.	Licensed person is required to file monthly excise duty return and other documents within 25 th day of end of each month. Whether, <ul style="list-style-type: none">▪ Prescribed monthly return has been filed▪ Prescribed forms, as prescribed, have been filed▪ Inter-firm information matches with each other or have been reconciled appropriately	Taxpayers' records and excise-return
2.	Section 10D of Excise duty act prescribes the conditions for reassessment by tax officer. Whether, <ul style="list-style-type: none">▪ the selection of taxpayer has been based on a condition determined by collecting information for reassessment▪ the documents collected during the reassessment were adequate in accordance with the conditions for reassessment▪ the condition(s) and evaluation during full audit matches with each other	Taxpayers' records and excise-return
3.	During the reassessment, tax officer evaluates the output tax. Whether, <ul style="list-style-type: none">▪ The output excise duty matches with sales in financial statements, VAT return and income tax returns▪ The output duty has been collected on all excisable supplies▪ The output duty matches with other evidence submitted▪ The output duty matches with stock records and productivity norms	Taxpayers' records and excise-return
4.	Taxpayer needs to comply the various compliance procedures like billing rules, retention of documents,	

Sl.	Issues	Basis of checking
	<p>etc. as prescribed. Tax officer needs to evaluate the compliance status during the full audit.</p> <ul style="list-style-type: none"> ▪ Whether full audit report has section describing compliance of billing rule, documents retentions etc. ▪ Whether taxpayer has been permitted for computerised billing has evaluated in full audit report ▪ Billing for excise duty and VAT has been reconciled 	Taxpayers' records and excise-return
5.	<p>Whether input tax credit has been allowed</p> <ul style="list-style-type: none"> ▪ To the extent of consumed raw material (only) ▪ To the extent of excise duty paid for raw (only) materials for controlled items 	Taxpayers' records and excise-return

G. Customs duty

Customs duty is another major source of revenue for the federal government. Custom duty is levied in accordance with the provision of Customs Duty Act, 2064. From the authority of Customs Duty Act, 2064 (CDA), GON has promulgated Customs Duty Regulation, 2064 (CDR). Directives and circulars under the law issued by the Department of Custom.

41. Customs management

Background:

Customs area management is major act for better implementation of customs duty collection. There should be clear customs-area or premises control mechanism including having a Standard Operative Process (SOP) for customs administration. Customs agent management is another activity for the customs management.

Objectives:

Review of customs area management

Resources for auditors

Customs Duty Act, 2064
Customs Duty Regulation, 2059
HS Code, latest edition
GAAT 1994
Bonded warehouse procedure, 2076
EXIM code procedure, 2073
Customs procedure
Case laws

Potential Audit Risk:

Lack of control or weak control on customs area management enhances the risk of revenue leakage

Sl.	Issues	Basis of checking
1.	Whether customs office has clear and defined area as customs area and the defined inward and outward route	Physical verification, study report
2.	Whether the customs area has been further divided (segregated) and used for <ul style="list-style-type: none">▪ Import storage▪ Laboratory▪ Export storage▪ Weighing space/physical verification space▪ 	Physical verification, study report
3.	Whether the security arrangement for customs area covers <ul style="list-style-type: none">▪ Regular monitoring systems▪ Sufficiently lighted▪ CCTV or other controls in all areas	Physical verification, study report

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> Adequate security personnel and their internal checking systems in place Periodic monitoring meeting and reports 	
4.	<p>Whether examination of goods within the customs area is,</p> <ul style="list-style-type: none"> Performed by designated personnel only Performed in the prescribed time only The time is pre-planned and documented Issues written notice of examination 	Physical verification, study report
5.	Whether agent management system is satisfactory in accordance with the legal procedure.	Physical verification, agent report

42. Valuation and classification

Background:

Classification of goods is one of the major activities for levying custom and other import duties. Customs duty law follows the harmonized nomenclature for classification of goods for international trade. Department of customs publishes the HS code details annually.

For the valuation, customs duty law expresses the GATT procedure under Sec. 13.

Objectives:

Review of adequacy of classification and use of appropriate valuation for import duties

Potential Audit Risk:

Import duties may understate

Sl.	Issues	Basis of checking
1.	Importer/exporter declares the value of goods in the prescribed declaration form. Customs officer evaluates the sufficiency of the declaration on the basis of document submitted; whether, <ul style="list-style-type: none">▪ importer/exporter declares the value of goods with sufficiently detailed documents▪ customs officer has evaluated the documents and declaration along with other supporting including value declared by other importers	Pragyapan patra, finance act, customs duty act, commercial invoices, bill of lading, insurance, I/c, if any
2.	According to prevailing system, goods and its specification in the proforma invoice and import documents should be matched. <ul style="list-style-type: none">▪ Whether specification in proforma invoice and commercial invoice are same▪ Whether classification and purpose as described in proforma invoice, commercial invoice, declaration form and release letter are same▪ The duties and concessions are applied with the above details	Proforma invoice, Pragyapan patra, finance act, customs duty act, commercial invoices, bill of lading, insurance, I/c, if any
3.	In the case of revision on valuation (of goods and transit cost both) by the customs officer, whether, <ul style="list-style-type: none">▪ Additional documents from the importer has been requested under Sec.13(6)▪ The method of valuation and reasons thereto has been described in detail▪ The computation of valuation has been sufficiently supported	Pragyapan patra, finance act, customs duty act, commercial invoices, bill of lading, insurance, I/c, if any

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> The revised valuation matches with the valuation of similar cases with other importer or same importer in earlier consignments 	
4.	<p>For the alternative valuation under GATT, customs officer has to have up to date access on:</p> <ul style="list-style-type: none"> Product and pricing information of goods imported through same customs office or other customs offices Product and pricing information of goods in the international market Product and pricing information of goods in the domestic market Production knowledge in terms of raw material and finished goods or usability of imported goods 	Pragyapan patra, finance act, customs duty act, commercial invoices, bill of lading, insurance, I/c, if any
5.	In the case of manual computation of valuation by either importer or customs officer, arithmetic accuracy has been maintained and checked by person other than the one who had prepared it	Pragyapan patra, finance act, customs duty act, commercial invoices, bill of lading, insurance, I/c, if any
6.	Foreign exchange rate for valuation is the NRB rate on the date of release of goods. Whether customs officer has used the appropriate foreign exchange rate for the valuation	Pragyapan patra, finance act, customs duty act, commercial invoices, bill of lading, insurance, I/c, if any
7.	<p>After valuation of goods, appropriate classification is required for charging import duties (or export duties). Whether,</p> <ul style="list-style-type: none"> Classification has been made in accordance with the use of goods Classification has made in accordance with HS Code nomenclature Classification has made in accordance with clarification issued by the valuation / revaluation committee 	Pragyapan patra, finance act, customs duty act, commercial invoices, bill of lading, insurance, I/c, if any

43. Determination of Import duty

Background:

After valuation and classification of goods, another step for import - export is determination of duty. For the purpose of import duty, it includes customs duty as well as other duties applicable to the particular import.

Objectives:

Review of appropriate rate of duties applied and collected

Potential Audit Risk:

Import duties may understate

Sl.	Issues	Basis of checking
1.	Based on classification and valuation customs duty is levied applying the rate as fixed by customs law. Whether, <ul style="list-style-type: none">▪ The customs duty rate has been applied in accordance with customs law applicable on the respective date▪ The concessions and exemptions on the customs duty has been applied in accordance with the law and other legal provision applicable on the respective date	HS code, finance act, pragyapan patra
2.	Apart from customs duty, there are various import duties based on nature of goods. Whether, customs officer collects following duties as per valuation of import and each individual law, as appropriate, <ul style="list-style-type: none">▪ Agro-duty▪ Excise duty▪ Health-risk tax▪ Infrastructure development tax▪ Road construction fee▪ Road repair and maintenance fee▪ Pollution control fee▪ Value added tax▪ Income tax collected at source	HS code, finance act, pragyapan patra
3.	In the case of import on guarantee or on the basis of bonded-warehouse facility, whether, the guarantee has been received for the total of the above taxes and duties, as applicable.	HS code, finance act, pragyapan patra
4.	In the case of concessions on the import duties applicable under trade agreement such as SAFTA, SAARC, India, Tibet etc., whether,	

Sl.	Issues	Basis of checking
	<ul style="list-style-type: none"> Concessions are allowed with full compliance of the conditions of the treaty or law along with, at least, certification of origin and supporting documents issued by the authority as prescribed in the treaty conditions Supporting documents from governmental agencies of Nepal, if any 	HS code, finance act, pragyapan patra
5.	<p>Whether customs officer evaluates the potential splitting arrangement due to rate differences on</p> <ul style="list-style-type: none"> Unrealistic goods imported splitting where less duties in total for individual parts but higher in case of combined whole Same item classifying more than one code with similar description Classifying finished product as pieces in the form of spare parts 	HS code, finance act, pragyapan patra
6.	<p>There are various concessions on import duty on goods for consumption of development project. For such concession, Ministry gives the list of goods or conditions in detail. Whether,</p> <ul style="list-style-type: none"> The Customs officer verifies the compliance of conditions for the concessions The concession has been allowed on the basis of expressed authority of the officer 	HS code, finance act, pragyapan patra
7.	Whether concessions import duty on goods transit to-and-from foreign territory into-or-from Nepal or goods imported or exported for repair is appropriate	HS code, finance act, pragyapan patra
8.	Whether goods released under bonded-warehouse facility (or to the industry in SEZ) has been evaluated as per the prevailing legal provisions	Deposit slip, declaration, bonded warehouse certificate
9.	In the case of delay release, whether adequate demurrage has been levied	pragyapan patra, entry-exit record
10.	<p>Recovered duty needs to be deposited into bank as per prevailing law. Whether,</p> <ul style="list-style-type: none"> There is direct deposit into bank system used for revenue and daily reconciliation system is in place Collected money deposited into bank by the customs officer within the time stipulated in the law Bank reconciliation is being done periodically 	Banking documents, revenue records

H. Other tax revenue

Customs duty is another major source of revenue for the federal government. Custom duty is levied in accordance with the provision of Custom Act 2064. From the authority of Custom Act, 2064 (CDA), GON has promulgated Custom Regulation, 2064 (CDR). Directives and circulars under the law issued by the Department of Custom.

44. Tax revenue - other

Background:

Apart from above broad taxes, there are numerous taxes levied by either federal, provincial or local level.

Objectives:

Review of other taxes

Potential Audit Risk:

Lack of control or weak control taxes enhances the risk of revenue leakage

Sl.	Issues	Basis of checking
1.	Auditor needs to review collection, recording, depositing and reporting of following tax revenues, as applicable to the auditee: <ul style="list-style-type: none">▪ Rent of properties	Financial information, receipt, decision files
2.	Auditor needs to review collection, recording, depositing and reporting of following tax revenues, as applicable to the auditee: <ul style="list-style-type: none">▪ Land and building registration▪ House rent tax▪ Other Rent tax	Financial information, receipt, decision files
3.	Auditor needs to review collection, recording, depositing and reporting of following tax revenues, as applicable to the auditee: <ul style="list-style-type: none">▪ Foreign education tax▪ Vehicle tax▪ Infrastrure use tax▪ Agro-vetenary tax▪ Akhetopahar tax	Financial information, receipt, decision files

I. Non-tax revenue

Background:

Apart from above, there are various types of non-tax revenue for federal government, provincial government or local level. Auditor needs to verify their adequacy in the receipt of revenue.

Objectives:

Review of non-tax revenue management

Potential Audit Risk:

Lack of control or weak control on non-tax revenue management enhances the risk of revenue leakage

Sl.	Issues	Basis of checking
1.	<p>Following non-tax revenue may be recovered by either federal government, provincial government, or local level as per their own finance law and other relevant law:</p> <ul style="list-style-type: none">a. interest and dividendb. Rent from public leasec. Royalty - Forest royalty, Mining royalty, Power royalty, Tourism royalty, Other royaltyd. Tourism related -tourism fees, Tracking feese. sale of agro-forestry goods, sale of used goods, sale of public assetsf. Service charge related to water service, canal service, electricity service, education service, examination fees, administrative services, transportation servicesg. Licenses - radio license, otherh. judicial finesi. administrative finesj. insurance compensationk. pollution control fees <p>Auditor needs to verify whether they are:</p> <ul style="list-style-type: none">▪ Within the scope of law▪ Recovered adequately as per law▪ Accounted adequately▪ Documented adequately▪ Reported adequately	<p>Finance law, transaction supporting, revenue records</p>

Sl.	Issues	Basis of checking
2.	<p>Following non-tax revenue may be recovered by either federal government as per finance law of federal government and other law:</p> <ol style="list-style-type: none"> Postal charge Registration charge of – company, agency, weapons, mining permission Royalty - casino, telecom telephone ownership import-export permission passport fee, visa fee <p>Auditor needs to verify whether they are:</p> <ul style="list-style-type: none"> ▪ Within the scope of law ▪ Recovered adequately as per law ▪ Accounted adequately ▪ Documented adequately ▪ Reported adequately 	Finance law, transaction supporting, revenue records
3.	<p>Following non-tax revenue may be recovered by local level as per finance law of local level and other law:</p> <ol style="list-style-type: none"> parking fee house design fee recommendation fee registration of personal affairs relationship certification business tax <p>Auditor needs to verify whether they are:</p> <ul style="list-style-type: none"> ▪ Within the scope of law ▪ Recovered adequately as per law ▪ Accounted adequately ▪ Documented adequately ▪ Reported adequately 	Finance law, transaction supporting, revenue records
4.	<p>Following non-tax revenue may be recovered by provincial government as per finance law of respective province and other law:</p> <ol style="list-style-type: none"> television permission business registration driving license forestry charge <p>Auditor needs to verify whether they are:</p> <ul style="list-style-type: none"> ▪ Within the scope of law ▪ Recovered adequately as per law ▪ Accounted adequately ▪ Documented adequately ▪ Reported adequately 	Finance law, transaction supporting, revenue records

Sl.	Issues	Basis of checking
5.	<p>Federal government offices or local level may recover judicial charges as per finance law of respective level and other law.</p> <p>Auditor needs to verify whether they are:</p> <ul style="list-style-type: none"> ▪ Within the scope of law ▪ Recovered adequately as per law ▪ Accounted adequately ▪ Documented adequately ▪ Reported adequately 	<p>Finance law, transaction supporting, revenue records</p>



महालेखापरीक्षकको कार्यालय Office of the Auditor General

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Babar Mahal, Kathmandu, Nepal

नीति योजना तथा जनशक्ति विकास महानिर्देशनालय



पत्र संख्या २०७७/७८ च नं ०३

मिति २०७७/४/१६



विषय नेपाल सरकारी लेखापरीक्षण मानकको कार्यान्वयन सम्बन्धमा

नेपाल
२०१६

श्री सबै विभागहरु

श्री सबै महानिर्देशनालयहरु

श्री सबै निर्देशनालयहरु

महालेखापरीक्षकको कार्यालय ।

उपरोक्त सम्बन्धमा लेखापरीक्षण ऐन, २०७५ को दफा २९ ले दिएको अधिकार प्रयोग गरी महालेखापरीक्षकले गर्ने लेखापरीक्षणलाई वस्तुपरक, विश्वसनीय र भरपर्दो बनाई लेखापरीक्षणको गुणस्तर अभिवृद्धि गर्न साविकमा स्वीकृत भएका सरकारी लेखापरीक्षण मानदण्ड एवं सरकारी लेखापरीक्षण नीति मानदण्ड खारेज गरी सर्वोच्च लेखापरीक्षण संस्थाहरुको अन्तर्राष्ट्रिय संगठनले जारी गरेका अन्तर्राष्ट्रिय लेखापरीक्षण मान (INTOSAI Framework for Professional Pronouncements, IFPP) मा आधारित "नेपाल सरकारी लेखापरीक्षण मान" (Nepal Government Auditing Standards, NGAS) २०७७/४/१६ मा स्वीकृत गरिएको छ । अतः कार्यालयबाट यस वर्षदेखि लेखापरीक्षण गर्दा तपसिलका नेपाल सरकारी लेखापरीक्षण मानको कार्यान्वयन गर्नु हुन अनुरोध छ ।

तपसिल

NGAS नम्बर	नेपाल सरकारी लेखापरीक्षणमानको नाम
INTOSAI-P 1	The Lima Declaration
INTOSAI-P 10	Mexico Declaration on SAI Independence
INTOSAI-P 12	The Value and Benefits of Supreme Audit Institutions- making a difference in a life of citizens
INTOSAI-P 20	Principles of Transparency and Accountability
ISSAI 100	Fundamental Principles of Public-Sector Auditing
ISSAI 130	Code of Ethics
ISSAI 140	Quality Control for SAIs
ISSAI 200-299	Financial Audit Principles
ISSAI 300-399	Performance Audit Principles
ISSAI 400-499	Compliance Audit Principles
ISSAI 2000-2899	Financial Audit Standards
ISSAI 3000-3899	Performance Audit Standards
ISSAI 4000-4899	Compliance Audit Standards

जानकारीको लागि

माननीय महालेखापरीक्षकज्यू ।

भवदीय

(घनश्याम पराजुली)

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"जनहितका लागि जवाफदेहिता, पारदर्शिता र निष्ठा प्रवर्धनमा विश्वसनीय लेखापरीक्षण संस्था"