

Tax Policy and Enterprise Development in South Asia
Research Design Document

1. Institutional Information

1.1. Name of institution : Institute for Integrated Development Studies (IIDS)

1.2. Country of origin : Nepal

1.3. Research theme : *TAX POLICY AND ENTERPRISE DEVELOPMENT IN SOUTH ASIA*

1.4. Institution Focal Person / Member, Steering Committee (Name, Designation, Contact Information)

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1.5. Team Leader (Name, Designation, Contact Information)

Dr Bishnu Dev Pant, Team Leader

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2. Literature Review

2.1. Data sources

Primary Source:

Surveys, Personal Interviews and Focus Group Discussions

These Interviews will target

- Serving and former civil servants (especially Customs & Excise and Income Tax Groups including personnel from revenue administration authorities, relevant Ministries, and enterprise development authorities including those mentioned above, trade and export control authorities, etc.)
- Interviews with the civil servants at the major custom check points of Nepal (i.e. Birathnagar, Nepalgunj, Birgunj, Tatopani, and Bhairawa)
- Non-state actors including entrepreneurs /traders / professional associations, associations of home-based workers, Chambers of Commerce and Industry, NGOs active in this area, and scholars who have written on this issue.
- Government officials involved in assessments and evaluations of tax bases, setting and revising of rates, and administering property taxes
- Government officials involved in land administration, governing aspects such as land registration and record-keeping, tenure, use, rights, markets, etc. at the local (and/or higher) levels
- Non-state stakeholders of land markets, including real-estate agencies, banks and lending institutions, NGOs advocating for land rights, etc.

Secondary Source:

Census of Manufacturing Establishment, 2006/2007, Survey of Small Manufacturing Establishment, 2008/2009, IIDS Business Expectation Survey, 2011/2012, Industrial Policy 1992, Three Year Plan Approach Paper 2010/10-2012/13 and other data's published by Central Bureau of Statistics, Ministry of Finance, Nepal Rastra Bank – Central Bank of Nepal, Industrial Promotional Board, World Bank, UNDP and other donors.

2.2. Key knowledge gaps

- Extremely limited data at disaggregated level.
- National level data has not been updated since 2008 which is the most recent available data on SMEs and manufacturing enterprises.
- Nepal still lacks a National Agency that is solely dedicated to research and analysis of tax policies and impacts which creates a big vacuum in the continuing build up of specific tax knowledge in Nepal .
- Nepal is currently in a post conflict situation characterized by much political uncertainty and very weak tax governance.

3. Conceptual and Theoretical Framework

3.1. Research Questions

Theme 1: The Impact of Tax Exemptions and Concessions on Enterprise Development

- What is the extent to which small enterprises face biases in tax exemptions and incentives?
- What is the extent to which these biases disproportionately impact small enterprises operating in the undocumented economy and/or those owned/managed by women?
- What are the impacts of tax exemptions and concessions on entrepreneurs and SMEs in terms of enterprise performance and productivity, (including any disproportionate impacts on women informal entrepreneurs) ?
- What are the impacts of biased tax regimes on emigration of entrepreneurs and skilled labor, the extent to which this contributes to ‘brain drain’ in South Asian countries?

Theme 2: The Impact of the Value-Added-Tax (VAT) on Enterprise Development

- What are the progressivity impacts of VAT burden on small enterprises and workers (particularly those operating in the undocumented economy), in terms of labor market outcomes, entrepreneurship and productivity at the bottom-income spectrum and in low value-added sectors?
- How are entrepreneurs (particularly those owning/managing small enterprises in the undocumented economy, especially women entrepreneurs) treated by VAT administration systems, against indicators of compliance costs and taxpayer friendliness?

Theme 3: The Impact of Property Tax on Enterprise Development

- What are the weaknesses in property tax systems that create and/or sustain informal land markets at the local levels, (including weaknesses in policy, administration, capacity and resources)?
- What is the nature and magnitude of impacts of land informality on entrepreneurs (owning/managing small enterprises) and workers (employed by small enterprises) operating in the undocumented economy (especially women)?

3.2. Definitions of key concepts and their translation into measurable parameters of enquiry

Theme 1: Tax Exemptions and Concessions: Key Concepts and Measurable parameters

1. Definitions of SMEs (much variations across countries and even within countries in different sectors)
2. Distribution of SMEs by sectors , location, ownership, gender ,etc
3. Specific types of tax exemptions and concessions
4. Variations in exemptions by types of SMEs
5. Performance of SMEs “ before “ and “after” tax exemptions and concessions
6. Clarity of guidelines
7. Information availability on tax concessions and exemptions to SMEs
8. Tax exemptions and concessions requirements and costs
9. Impact if any of tax exemptions and concessions on SME variables

- employment,
- value added,
- fixed assets,
- wage bill,
- access to credit,
- expenditure on public goods and services,
- willingness to formalize (for non-compliant firms)
- willingness to emigrate

Theme 2: VAT and Enterprise Development - Measurable parameters

1. VAT rate variations by SMEs in different sectors
2. VAT Exemptions for SMEs in different sectors
3. VAT registration process and issues for SMEs
4. VAT Administration system and friendliness to SMEs
5. VAT compliance costs for SMEs and others
6. VAT impact on SME enterprise development with particular emphasis on

- employment,
- value added,
- fixed assets,
- wage bill,
- access to credit,
- expenditure on public goods and services,
- willingness to formalize (for non-compliant firms)
- willingness to emigrate

Theme 3: Property Tax and Enterprise development - Measurable parameters

1. Nature and type of property taxes
 2. SMEs and property taxes
 3. Property tax administration and SMEs
 4. Impact of property taxation on SMEs with respect to
 - Land acquisition
 - Land ownership
 - Land use and control
- 3.3. Hypothesized relationships between parameters (few are identified)
- Most SMEs are in the informal sector and therefore outside the realm of most taxes and this appears to be increasing.
 - Tax exemption and concessions procedures are too cumbersome for most SMEs to be benefitted from.
 - Tax exemption and concessions are relatively insignificant for SME development in the context of poor infrastructure, weak SME support institutions and increasingly insecure environment.
 - Tax incentives are not conditional on outcomes and may have little or no relationship with impacts.

4. Analytical Framework

4.1. Policy analysis framework (problem definition, policy alternatives, evaluation criteria for policy alternatives, and recommendation of alternative)

- SMEs and Tax incentives

Central question here is why most SMEs continue to operate in the informal sector in spite of many incentives by the government to move to the formal sector. The trend at least for Nepal appears to be increasing. The incentives and exemptions do not appear to be having any effect. Are they just in paper? To what extent have they been translated on the ground? Who is actually doing anything about increasing the effectiveness of these measures? Are tax incentives the real priority of SMEs or are there other factors and issues?

- VAT and Enterprise Development

In spite of over two decades of VAT implementation, compliance rates are still very low in Nepal. Many SMEs complain that it is very difficult to comply with VAT regulations and unnecessarily adds costs to the business. Although many experts point out that there are too many VAT exemptions in Nepal, SMEs argue that the VAT threshold needs to be lowered if SMEs and indeed even other bigger businesses are to remain competitive. If larger firms are reported to outsource VAT compliance, it is not difficult to understand the low compliance rates.

- Property Tax and Enterprise Development

Although land tax is one of the oldest taxes in Nepal, it continues to face many problems of dual ownerships, poor and inadequate records, fake owners and so on. However for most SMEs land ownership, especially in urban areas may be out of question, if they do not own their own land because of the escalating land prices. This issue of property taxation and its impact on enterprise development has been among the least explored issues in Nepal.

In all the three issues listed above, there are both common and specific dimensions. Some of the common themes also need to be identified as they cut across all the three issues.

First issue is the understanding of the **overall political and economic environment** in the context of SME and tax incentives. Some of the important highlights need to be identified and these are:

- Nepal is currently in a post conflict situations characterized by weak governance, poor infrastructure, lack of energy security, militant labor unions (especially maoist unions), rigid labor laws ,and lack of security to business people who have been kidnapped, threatened and even killed
- Nepal has faced a long period of low economic growth which has resulted in huge outmigration from the country. The economic prospects appear to be quite bleak and quite discouraging to any potential SME investor. Although conditions are slowly changing, they are far from normal.

- This general condition of the economy has far greater impact than any specific type of tax regime.

The second important aspect is the **fiscal environment** of the country. While Nepal's tax administration and tax support infrastructures have improved over the years, they are far from adequate and responsive to changing situations. Nepal's performance with respect to most taxes compares very poorly with most South Asian countries. Tax reforms in the past have made improvements but much improvement is needed in many areas of fiscal policies, support institutions and coordination. Nepal's fiscal policies need to do much more to generate an enabling environment where MSE growth goes hand in hand with greater tax compliance.

The third important aspect is the need for better understanding between the **formal and the informal economies** in Nepal. In the context of both SMEs and enterprise development this is critically important if policies are to be effective. So long as the informal sector continues to increase, it is a strong reflection of continuing policy distortions and high cost of policy compliance.

4.2. Level of analysis (national, sub-national, etc.)

Data and Key Informant Interviews will be collected both at national and district level.

4.3. Analytical approach and assumptions

There are two major parts to our analysis and assumptions. The first is the review of the literature that is available to date on the issues identified above. Based on this we will try identify gaps that can be specifically addressed during the field work.

Data availability and reliability will be the key determinant of nature of analysis of the issues identified earlier.

Analytical tools and techniques to be applied

Statistical Software like SPSS or STATA will be used for analyzing the data. The data will be analyzed based on descriptive statistics, correlation and regression analysis ect.

5. Data Collection Methodology

5.1. Research Methods

5.1.1. Key Informant Interviews

5.1.1.1. List of intended respondent types with examples

- Government officials at Customs & Excise & VAT and Income Tax Groups including personnel from revenue administration authorities, relevant Ministries, and enterprise development authorities including those mentioned above, trade and export control authorities, Government officials in land administrations, etc.

- Non state actors including traders, manufactures and professional associates. Federation of Nepalese Chambers of Commerce and Industries (FNCCI), Nepal Chamber of Commerce (NCC), real estate agencies, banks and lending institutions, active NGOs in this area and scholars and experts in this issue.
- Representatives of international donor communities like World Bank, UNDP etc.

5.1.1.2. Instrument (semi-structured interview outline)

- The parameters for inquiry for the semi-structured interview will include; employment, value added, fixed assets, wage bill, access to credit, expenditure on public goods and services, willingness to formalize (for non compliant firms), willingness to emigrate, compliance cost, perception and behavior of tax authorities and officials towards small enterprise, land acquisition, land ownership and land use and control.

5.1.1.3. Sample frame (including secondary sources tapped for developing it)

5.1.1. Survey Research

- In the proposed study, we will basically draw samples from the Survey of Small Manufacturing Establishment (SSME) conducted in 2008-2009 by Central Bureau of Statistics (CBS) of Nepal. SSME covers the registered entities having less than 10 people employed. This type of survey is conducted in every 10 years on the regular basis and covers broad areas of manufacturing sectors. The CBS also conducts Census of Manufacturing Establishments (CME) every five years, collecting and analyzing data for industries or establishments employing more than 10 peoples.
- Since major objective of the study is to observe the impacts of tax exemptions and tax concession, VAT reforms and property tax on the development of small scale industries (SSI) in Nepal, so we will concentrate on to those small scale industries which have less than 10 employees.
- According to the SSME 2008-2009, there are altogether 32326 establishments in operations. Most of the establishments are in the rural areas. Among the total small manufacturing establishments, Kathmandu accounted 12.47% of the total SSME followed by Morang of 7.05%, Jhapa(6.25%), Lalitpur(4.39%), Sunsari(4.08%) respectively. These five districts altogether accounted more than one third (34.90 %) of the total various small manufacturing industries of Nepal.
- If we classify the distribution of small manufacturing industries on the basis of Nepal Standard Industrial classification (NSIC) 2000, manufacturing of grain mill products alone covers larger share(38.76%), followed by the manufacturing of wearing apparel (16.71%), Manufacturing of furniture (10.28%), the manufacturing of jewellery and related articles (6.5%), the manufacturing of structural metal products(4.59%). All these five types of manufacturing products accounted for 77 % of the total manufacturing products.

5.1.1.1.Sampling design and rationale

- Since there are many manufacturing sectors that exist in Nepal, the survey will cover the five major Nepalese manufacturing sectors: manufacturing of grain mill, manufacturing of wearing apparel, manufacturing of furniture, the manufacturing of jewellery and related articles and the manufacturing of structural metal products. The information regarding total number of registered businesses in the respective sectors was provided by the SSME, 2008-2009 of CBS of Nepal.
- The survey will be conducted in major business and industrial corridors in Nepal while ensuring the representation of all five development regions: Eastern, Central, Western, Mid-western and Far-western. The following business and industry districts will be selected as study areas: Kathmandu and Lalitpur, Morang, Sunsari, Kaski, Parsa, Banke, Rupandehi, Sindhupalchowk and Makwanpur.
- We will collect disaggregated data on those units after consulting the CBS, Nepal.

Composition of manufacturing Industries in major manufacturing districts

Districts	grain mill	wearing apparel	furniture	jewellery and related articles	structural metal products	Total manufacturing entity
Kathmandu & Lalitpur						5666
Morang (Birathnagar)						2278
Banke (Nepalgunj)						342
Sunsari (Itahari)						1319
Makwanpur (Hetauda)						411
Parsa (Birgunj)						1214
Kaski (Pokhara)						925
Rupendehi (Bhairawa & Butwal)						1109
Sindhupalchowk						206
Total						13156

- **Sample Selection**

Total number of survey to be conducted in each sector will first be identified using the weight of the respective sector based on the number of registered businesses in each sectors of each districts. Samples of male and female owned manufacturing entities will be calculated after assigning proportional weightage. Relevant information and data will be collected after interviewing the owner or in charge of those entities.

5.1.1.2.Survey instrument (including field pre-testing procedure)

- The questionnaires will be pretested in one of the sample districts.

5.1.1.3.Action Plan (primary sampling units and dates they are sampled)

- Both survey and key informant interviews will be held and conducted by the first nine months of the Year 2nd.

5.1.1.4.Data collection protocols (including field team training, organization, monitoring and reliability checks)

- Data will be collected by experienced field team of IIDS.

5.1.1.5.Data entry and verification protocols

- Data will be entered in CS Pro software and imported to SPSS or other statistical software for detailed analysis.

6. Reporting Formats for Year 1, 2 and 3 deliverables.

The peer review of Year 1 research deliverables will be provided by the fourth quarter First Year.

The peer review of Year 2 research deliverables will be provided by the fourth quarter of Second Year.

The peer review of Year 3 research deliverables will be provided by the second quarter of Final Year.

7. Team Composition

7.1. Names, designations, qualifications, experience, and responsibilities of Team Leader and other Team Members

Name	Designations	Qualifications/ Experience	Responsibility
Dr. Bishnu Dev Pant	Team Leader	<p>Ph. D. (applied statistics), Indian Statistical Institute, India, 1983</p> <p><i>Degree in Statistics</i>, Department of Statistics, Tribhuvan University, Kathmandu, Nepal (with majors in economic statistics, econometrics), 1976</p> <p>(Professionally trained statistician/ quantitative economist, with over 30 years of working experience at both national and international levels.)</p>	<p>Develop detailed research design documents</p> <p>Prepare or develop conceptual and theoretical framework</p> <p>Prepare or develop analytical framework</p> <p>Design and conduct baseline survey and key informants survey</p> <p>Prepare detailed workplan</p> <p>Conduct policy analyses</p> <p>Conduct meta analyses at regional level</p> <p>Develop 3 country studies 1 for each research theme</p>
Dr. Mahesh Banskota	Senior Economist/ Project Advisor	<p>Ph. D in Planning</p> <p>Cornell University, New York;</p> <p>M.A in Economics</p> <p>Delhi School of Economics, Delhi University, Delhi, India</p>	<p>Overall co-ordination and guidance,</p> <p>Help to develop detailed research design documents</p> <p>Help to prepare conceptual and theoretical framework</p> <p>Help to prepare or develop analytical framework</p> <p>Help to conduct policy analyses</p> <p>Help to conduct meta analyses at regional level</p>

Mr. Manbar S. Khadka	Economist/ Team member	M.S. in Agricultural & Resource Economics University of Maryland, USA	Develop detailed research design documents Prepare or develop conceptual and theoretical framework Prepare or develop analytical framework Design and conduct baseline survey and key informants survey Prepare detailed work plan Conduct policy analyses Help to prepare 3 country studies 1 for each research theme
Ms. Priyanka Malla	Economist/ Team member	M.S. in Financial Economics (University of Buffalo, USA)	Develop detailed research design documents Prepare or develop conceptual and theoretical framework Prepare or develop analytical framework Design and conduct baseline survey and key informants survey Prepare detailed work plan Conduct policy analyses Help to prepare 3 country studies 1 for each research theme
Mr. Nandakaji Budhthoki	Economist/ Team member	M.S. in Development and Resource Economics, Norwegian University, OSLO	Develop detailed research design documents Prepare or develop conceptual and theoretical framework Prepare or develop analytical framework Design and conduct baseline survey and key informants survey Prepare detailed workplan Conduct policy analyses Help to prepare 3 country studies 1 for each research theme
Mr. Ashwasthama Pokhrel	Field Coordinator/ Data Analysts	B.L. (Tribhuvan University, Kathmandu) Twenty five year's experience on research programme, training management, field research management, data management and analysis,	Develop research tools, develop data analysis formats, monitor the field activities (baseline and key informants survey), data verification and data analyses
Mr. Shankar Aryal	Project Coordinator	M. A. in Political Science, Tribhuvan University, and Kathmandu) Twenty year's experience on Socio-economic research programme, training, Coordination, facilitation and monitoring.	Overall coordination, facilitation and monitoring of project activities

Note: This format draws on the attached Research Design Guidelines. These may be referred to for guidance and detail.