

**Office of the Auditor General, Nepal**  
Public audit reform and capacity building

# **Government Auditing Standards**

Part 3: Segment Audit  
Guidelines  
Revenue audit

October 2005

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## **Glossary**

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## **Preface**

Revenue Audit is an independent and important domain of public auditing. Revenue constitutes all kinds of government receipts including tax, duty, fee, levies, interest, dividend, income from sale of assets, investment, and services, leasing of government property, etc.

This revenue audit guide has been prepared for the improvement of quality of revenue audit and to fulfill the requirement of compiled guide collecting information from various Acts, Rules, Circulars and Directives relating to Income Tax, Value Added Tax, Excise Duty, and Customs Duty. This guide will help co-ordinate the audit approaches and procedures and thereby help to accomplish revenue auditing work effectively.

The existing Revenue Audit guide of OAGN became outdated as several important pieces of legislation have been developed and passed into law after having been prepared by the Ministry of Finance and also there was several amendments in the Finance Proceedings Act, Finance Administration Rules, Income Tax Act, Value Added Tax which replaces existing Sales Tax, Contract Tax, Entertainment Tax etc, Customs Act, Excise Act. Accordingly, It is necessary to have one updated Revenue Audit Guideline for OAGN.

This Revenue Audit Guide sets out good practices to facilitate auditing of revenue collected by HMG's. Its primary purpose is to provide guidance while auditing revenue.

The Guide should be seen as a guide only, as it does not cover all systems, or prescribe specific solutions for particular problems. This guide should read in conjunction with operational guideline part II covering the general aspect of the audit including Audit Strategy and Planning Memorandum, Obtaining effective audit evidence, Review and interpretation of audit findings, Reports and presentation, Debriefing.

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## Abbreviations

Except where the context otherwise requires, the following abbreviations are applied throughout this Guideline:

AG	Auditor General
ASOSAI	Asian Organization of Supreme Audit Institutions
BG	Bank Guarantee
DG	Director General
DOI	Department of Industry
DRP	Duty Refundable Procedure
DTCO	District Treasury Controller Office
FAR	Financial Administration Regulation
FCGO	Financial Controller General's Office
FY	Fiscal Year
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
HMG/N	His Majesty's Government of Nepal
HRD	Human Resource Development
INTOSAI	International Organization of Supreme Audit Institutions
IRD	Inland Revenue Department
IRO	Inland Revenue Office
IT	Income Tax
MOF	Ministry of Finance
MRP	Maximum Retail Price
NPC	National Planning Commission
OAG/N	Office of Auditor General of Nepal
PAN	Permanent Account Number
RID	Revenue investigation Department
SAFTA	South Asian Free Trade Area
SAI	Supreme Audit Institutions
TDS	Tax Deducted at Source
TPIN	Tax Payers' Identification Number
VAT	Value Added Tax
WTO	World Trade Organization

# General Revenue Audit Guide

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## 1.1 Introduction

**1.1.1** Revenue Audit is an independent and important domain of public auditing. All kinds of government receipts including tax, duty, fee, levies, interest, dividend, income from sale of assets, investment, and services, leasing of government property, etc. are known as Revenue.

**1.1.2** This guide covers the broad principles and guidelines and methodology to be followed by the auditors in auditing revenue. This guide is to be used in conjunction with the provisions of the Operational Standards with respect to risk assessment and audit methodology. This guide basically lays down the audit methodologies for the audit of the principal sources of revenue. Revenue is collected under the provisions of the various Acts like Income Tax Act, Value Added Tax Act, Excise Duty Act etc at the rates specified in Finance Act passed by the Parliament (Finance Ordinance Promulgated by the Government) every year and other relevant law and regulations.

**1.1.3** The major source of the government revenue in Nepal comprises of customs duty on import and export, value added tax, income tax, other taxes, fines, royalty, fees, dividend, interest, repayment of loan, return on investment, sale of services, assets and investment etc. (For broad source of revenue receipts refer budget statement of the relevant year).

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## 1.2 Purpose of Revenue Audit Guide

**1.2.1** The Revenue Audit Guide developed by OAG in 1995 needs to be revised and updated as new laws such as the Value Added Tax Act, Excise Duty Act and Income Tax Act were promulgated and major changes made in the Customs Duty Act since then.

**1.2.2** The broad purpose of this guide is to:

- Assist revenue auditor to manage and conduct revenue audit in an effective manner,
- Promote efficient and effective revenue audit practices, and
- Set out a basic framework for appropriate professional judgment and enhance skills of revenue auditor.

**1.2.3** This guide is broadly divided into two parts. The first part includes audit of Direct tax with elaboration in conducting audit of Income tax. The second part of the guide outlines the procedures for the audit of indirect taxes and indirect taxes such as Value Added Tax, Customs Duty and other receipts including Vehicle tax, Royalties, registration fee etc.

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### **1.3 Main features of Revenue Audit Guide**

**1.3.1** Public audit is carried out in accordance with the audit mandate although audit approach, methodology and strategy depends upon the prevailing legislation, procedural and administrative arrangement, management systems etc. applied by the entity. The audit exercise could be modified according to the changes or alteration in operational arrangement of the entity as mentioned earlier. This guide is also the outcome of the enactment of new Acts e.g. Value Added Tax Act 2054, Income Tax Act 2058, excise Duty Act 2058 and major amendments to Customs Act 2019. Main features of this guide is summarized below:

- Covers general principle, requirement and objective of revenue audit.
- Suggests audit approach and methodology.
- Incorporates concept of audit sampling.
- Identifies significant risk areas and matters of audit consideration.
- Provides ready reference in the form of checklist for verifying compliance with laws (for major revenue heads).
- Applicable for compliance and performance based audit.

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### **1.4 Revenue audit mandate**

The revenue receipts are subject to OAG audit to ensure the legality of levy of various taxes and effectiveness of collection. His Majesty's Government is legally mandated to raise financial resources for each fiscal year. The major audit mandate available to the Auditor General is summarized below:

**1.4.1 Constitution of the Kingdom Of Nepal-** The Constitution of Kingdom of Nepal, 1990 mandates the Auditor General (AG) to audit the accounts of Government offices in a manner prescribed by the law with due consideration to the regularity, efficiency, effectiveness and the propriety of the transaction. The audit mandate available to AG covers the audit of the Government expenditure and revenues.

**1.4.2 Audit Act -** The Audit Act 1991 has elaborated the AG mandate and outlines his authority, matters of audit significance including audit encompassing the principles of 3Es, i.e. Economy, Efficiency and Effectiveness.

**1.4.3** Provisions of the Audit Act are summarized below.

Auditors are required to see whether:

- The financial transactions comply with the existing laws and the evidence relating to items of income and expenditure are sufficient;

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- The accounts have been maintained in the prescribed forms and such accounts fairly represent the position of the transactions;
- The inventory of government assets is accurate and up-to date, and the arrangement for protection and management of governmental property is adequate;
- The arrangements for internal audit and internal control of cash, kind and other governmental property against any loss, damage and abuse are adequate and if so, are pursued;
- The accounts of revenue, all other incomes and deposits are corrected and the rules relating to valuation, realization and methods of book keeping are adequate and if so, are followed;
- The accounts of income and expenditure of industrial and business services, and their balance of cash and kind, and the arrangements and rules relating to their financial transactions are adequate and if so, are observed;
- The organization, management and job allocation of the office are sufficient and proper and are operating accordingly;
- The available resources, means and assets are properly utilized and the maintenance and insurance coverage against any loss or damage has been properly arranged;
- The progress has been achieved within scheduled time and the quality and quantity of the work is satisfactory;
- The objective and policy of the Office is explicit and the program is delineated conforming to the specified objective and policy;
- The program is being implemented within the limits of approved cost estimate and the proceeds received in comparison to the cost is reasonable;
- The arrangements for maintaining data relating to target, progress and cost are adequate and reliable; and
- On the propriety of all authorizations issued in respect of any grant of national property whether fixed or current, or underwriting of any revenue, or any contract, license or permits relating to mining, forest, water resources, etc. and any other act of abandoning fixed or current assets of the nation.

**1.4.4** The audit has to be conducted with due regard to regularity, economy, efficiency, effectiveness, and propriety of transactions. The constitution has also authorized the AG to ask for all required documents relating to accounts from any government office in course of audit.

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## **1.5 INTOSAI & ASOSAI Declarations on Revenue Audit**

### **The Lima Declaration of Guidelines on Auditing Precepts (1977)**

**1.5.1** Supreme Audit Institutions shall be empowered to audit the collection of taxes to the maximum possible extent and, in doing so to examine individual tax files.

**1.5.2** Tax audits are primarily audits for legality and regularity. However, when auditing the application of tax laws, Supreme Audit Institutions shall also examine the efficiency and organization of tax collection and the achievement of revenue targets and, if appropriate, shall propose improvements to the legislative body.

### **ASOSAI Bali Declaration of 1988**

**1.5.3** Audit Mandates of many SAIs provide generally for the audit of public accounts which include revenues such as tax receipts. However, SAIs should seek clear and specific legal authority for undertaking comprehensive tax audits in conformity with the relevant provisions of the Lima Declaration on Auditing Precepts.

*Also refer ASOSAI Research Paper on Government Revenue-Accountability and Audit published in 1998.*

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## **1.6 Objective of revenue audit**

**1.6.1** The Constitution has given the responsibility to AG to audit all receipts of the government credited to Consolidated Fund. Traditionally, the objective of revenue audit was confined to correctness of accounts and collection of revenue. The massive investment in the governmental and public sector is being mobilized mainly through taxation and hence systematic audit became the need of the OAG. Therefore revenue audit is also being conducted with regards to efficiency, economy and effectiveness of the revenue collecting agencies. The main objective of the revenue audit can be summarized below:

- To execute the mandate, audit all receipt which are to be deposited to Consolidated Fund or to other funds established by the Act of Parliament or the Executive Order;
  - To satisfy that collection of revenues are lawfully made;
  - To verify that procedure and checks are properly applied;
  - To ascertain that accounts are duly kept;
  - To verify the efficiency of internal control and accounting systems;
  - To verify the accuracy of revenue estimates and to ensure that the revenue estimates are fair and based on adequate data and sound footing;
  - To review refunds and exemptions of revenues and their legality; and
  - To ensure that the power to raise revenue is used not only for raising revenue but also to regulate economy as per the government policies.
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## 1.7 Scope of audit

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

**1.7.2** All receipts deposited in the consolidated fund are subject to the audit of OAG, including the following:

Type of Receipt	Income Head
Direct Taxes	<ul style="list-style-type: none"><li>• Income Tax</li></ul>
Indirect Taxes	<ul style="list-style-type: none"><li>• Value Added Tax</li><li>• Excise Duty</li><li>• Customs Duty</li></ul>
Non-Tax Receipt	<ul style="list-style-type: none"><li>• Vehicle tax</li><li>• Registration/Administrative fee</li><li>• Sale of services</li><li>• Royalty</li><li>• Interest on loan</li><li>• Principal repayment</li><li>• Sale of Investment</li><li>• Dividend on Investments</li><li>• Others (Refer budget statement)</li></ul>

**1.7.3** In addition to above, there are certain users charges, levies or fee, such as road-cess, irrigation fee, price equalization fund that is collected as per separate notification that are not forming part of the consolidated fund but are deposited into a separate fund. All such funds are subject to OAG audit coverage.

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## 1.8 Basic principles and requirements of revenue audit

**1.8.1** In recent years INTOSAI and ASOSAI has laid stress on the audit of individual tax assessment, although many SAIs are still confined to the audit of collection and accounting. Considering the declaration of INTOSAI, ASOSAI and other such regional organization, most of the SAIs have focused on system based revenue audit. The main principles of revenue audit can be outlined as below:

- To examine that revenue is correctly and promptly assessed, realized and credited to government account;
- To ensure the adequacies of Rules, Regulations and procedure to secure effective check on collection and proper allocation; and
- To ask for further information to form the judgment for effectiveness of the system and compliance of law.

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Basic requirement of revenue audit has been illustrated below:

**1.8.2 Access to Information** - Access to information is very crucial for the audit. Revenue audit remains incomplete without access to complete information. Audit Act, 1991 has given OAG full authority to have the access to the information or records maintained by the government entities; however OAG has no direct access to the personal records of the tax payers. In such a situation either the OAG auditors can perform the audit of documents available with the agencies, alternatively the agencies could be asked to collect required information or records from the taxpayers and submit for the audit purposes.

**1.8.3 Audit Evidence** - In each and every audit, evidence is important to support the audit observation. Government Auditing Standards also emphasizes to keep sufficient and appropriate evidences to support the audit observations. Particularly in revenue audit, validation of audit observation is vital task because in most of the cases such observation ultimately affects the taxpayer. Similarly, revenue authorities also require such evidences in order to initiate further action to resolve audit observation.

**1.8.4 Co-operation from Revenue Authorities** - Relation between auditor and the auditee should be cordial to benefit in promoting accountability in government operation through audit results.

The nature of co-operation may be:

- To provide full access to books of accounts, records and information;
- To make full disclosure of information;
- To acknowledge genuine audit observation;
- To respond audit queries in time;
- To feel that auditors work for value addition and enhances the credibility of the entity.

**1.8.5 Examination of Revenue Return** –Revenue Offices maintain separate file for each and every taxpayers and are arranged in proper order. These files contain the documents and information such as Annual Income Returns along with financial statements and details showing information in prescribed format, Bank Deposit Voucher, Monthly VAT return, PAN certificate, TDS details etc. Other revenue offices should also maintain the files like vehicle registration, excise etc. in a proper order. Irrespective of the audit methodology applied, examination of individual files of taxpayers is crucial to find out the risk areas of tax evasion and tax avoidance in the tax assessment. Review of such file is useful for case study purpose and outcome of study helps to support the audit findings. Examination of these files is also helpful in giving audit opinion.

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**1.8.6** It is important that individual revenue files are examined to evaluate the adequacy of the system and procedures of assessment and collection. As the examination of all files is neither feasible nor necessary, best result may be obtained through concentrating on high value and risk areas. Selective auditing of business income cases rather than salary assessment, investigations of reported evasions and use of suitable statistical sampling techniques in the review of files are preferred practices.

**1.8.7** With regard to sampling, samples may be selected from each system of assessment. Sampling may also be based on the volume of revenue collected. Samples may be selected for each sub-head depending on the size of the revenue collection. Appropriate sampling is essential to provide opinion on the accuracy, fairness, efficiency and effectiveness of every type of revenue.

**1.8.8** For other revenue receipts where separate tax payer's files are not maintained, the auditor if the scope of the audit so require, should ascertain the method of documentation and recording and suitably develop and apply audit checks.

**1.8.9** Data and information on tax payers collected by the tax authority may be verified against other available independent sources. Review of tax files covers the following activities:

- Record keeping of tax payers;
- Submission of returns files;
- Collection of information to determine taxable income;
- Examination of accuracy in assessment;
- Timely delivery of assessment orders to tax payers; and
- Progress on realization.

In addition to the information available in the files and records, auditors may ask for further evidence from the tax payer through revenue authorities.

**1.8.10 Use of Experts** - Audit is a multi-disciplinary functions but experts of each and every discipline may not be available in any Supreme Audit Institution In such a case OAG may engage an independent expert to provide expert opinion and the guidance on any issue disputed by the auditee. Engagement of an independent expert in the audit is also recommended by internationally adopted auditing standards. The Audit Act has also authorizes AG. To engage the services of experts for audit work wherever felt desirable.

Use of experts in revenue audit helps not only to validate the audit observations but also become easy to convince the authorities concerned about audit findings.

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The audited entities, may at times disagree with the opinion of an independent expert. In such cases, advice of Attorney General or the Ministry of Law and Justice could be a suitable option to resolve the issue, although it is not mandatory for the OAG to obtain such advice.

**1.8.11 Documentation** - Documentation is a standard auditing practice that helps to improve audit efficiency and is important for every type of audit. In revenue audit, the auditor has to report the areas of system improvement in revenue administration and cases of revenue leakages as identified in the course of the audit. The auditor must, therefore accumulate written documentation that has followed at field level (e.g. adequate planning and supervision of audit work, proper study and evaluation of the existing internal control). Similarly auditor has to gather sufficient competent evidential matter through auditing techniques (viz. inspection, inquiry and confirmation etc.) to support the audit findings or observation. Without proper evidence and its documentation auditor would have no basis to decide the audit observation. (*Refer General Audit Guides for more detail*).

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### 1.9 Audit approach

**1.9.1** The audit mandate and the INTOSAI & ASOSAI pronouncements require OAG also to carry out performance-based audit of government expenditure and revenue. Performance audit does not only confine to verification of regularity of financial transactions but requires evaluation of efficiency and effectiveness of program or activity.

**1.9.2** For performance audit it is suggested to refer the "Performance Audit Guide" developed by OAG in 1999.

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### 1.10 Types of revenue audit

With due consideration to the increasing volume of revenue and complexity of revenue administration, OAG has followed various methods of revenue auditing as mentioned below:

**1.10.1 Regularity audit-** Regularity auditing is a method of auditing which ensures the compliance of revenue administration with the existing regulations. For this purpose, audit has to ensure the correctness of the financial statements of revenue and verify whether the computation method and rates of revenues are as prescribed by law and whether the revenue collected were properly deposited into consolidated fund or other funds as appropriate.

**1.10.2 Propriety audit** – The Audit Act has authorized the Auditor General to use its best judgment in auditing. Such propriety is used by OAG in cases where the executive agency had abandoned fixed or current assets of the government or had offered special privileges to someone, even though, the executive agency might have performed its duty on the basis of the existing laws but that may cause or already might have caused loss of revenue or that may immediately or in the long run might create adverse impact on the public or national interest.

**1.10.3 Performance audit-** Performance auditing is a method, which evaluates economy and efficiency in the use of available resources and examines whether the intended result has been achieved. It is mainly concerned with the examination of the operation of the revenue administration and to review whether the intended result has been achieved.

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## **1.11 Audit Methodology**

**1.11.1** The audit methodology should be designed in a way so as to achieve the audit objectives as provided in the audit mandates. The revenue audit procedures and methodology should meet the standard prescribed in the Audit Act. The objective of revenue audit is to ensure that revenue is assessed and collected according to the provisions of the applicable laws and that error of omissions and commissions are avoided in assessments. The audit also seeks assurance that pre and post control systems operate efficiently and in accordance with the objectives stated in the legislations. Audit should identify the loopholes in the legislations as well as revenue administration that could be misused to defeat the objectives of the legislations and should suggest measures to remedy the same. Audit shall devise adequate procedures for dealing and identifying revenue avoidance due to inadequacy of revenue laws.

**1.11.2** An efficient revenue collection system is very important for mobilizing the budgetary resources of the government and establishing revenue audit as a specialized and independent domain is very important. Revenue audit shall be mainly system based and the scope of audit shall extend to cover efficiency, economy and effectiveness of revenue administration. The basic objectives of the audit are to ascertain that:

- Systems are designed and operated effectively to ensure that all tax payers are brought on record;
- Collection procedures framed under the laws and regulations are adequate to secure prompt collection and allocation of revenue and that these procedures are observed;
- Taxes and duties levied are collected promptly;
- Computation of interest/penalty on overdue amounts is correct;
- Facilities granted are adhered to;
- Amounts collected are properly accounted for and classified to the budget heads correctly;
- Legal action reserved by the law and regulation against defaulters is taken promptly; and
- Any abandonment of revenue is fully justified.

**1.11.3 Strategic Evaluation-** The auditors should also perform Strategic evaluation. This evaluation covers the analysis of the targets and the budgets set for revenue collection to assess the reasonableness of the same against certain benchmarks. The factors to be considered in such evaluation would comprise the general condition of the economy, the development in infrastructure and other areas, the GDP ratio and other related matters. The budgets may also be compared with those of other developing nations of the world to assess whether the same is practical in relation to the current economic conditions prevalent in the country. In addition to the strategic evaluation of the budgets, audit shall also focus on reducing the gap between revenue that is actually collected and the amount that should be received. The amount that should be received may be assessed through various independent methods and techniques adopted by the auditors based on their judgments and sampling techniques.

**1.11.4 Evaluation of internal control systems -** Internal control systems in revenue administration include every management system that tries to identify if any important job relating to collections have been missed by any level of management personnel. Such evaluation helps management to adopt appropriate systems for the protection of government revenue. Internal audit report may also provide areas of audit significance. Audit should evaluate the internal control systems in every revenue stream to identify whether:

- Statement of returns have been collected and assessed;
- Assessment orders have been delivered to tax payers in time which resulted in timely collection of revenue;
- Access to assets and records is permitted only in accordance with management's authorisation;
- Tax evasion has been minimised.
- Evaluation of execution of control systems

**1.11.5 Checking of Records and Accounts -** Government entities are required to maintain records and books of account in the formats approved by the AG. These formats are called AG forms. Initially the concerned authorities considering the requirement and nature of the business design such forms. Within IRD revenue accounts and formats are kept manually, but IRD has also attempted to maintain records in electronic format although this is yet to be approved by the AG.

**1.11.6** Audit of collection and accounting is important to ensure that revenues are promptly collected and properly brought to account. Similarly financial statement of revenue collected and arrears can be verified with the books of account. Presently, tax authorities are maintaining different sets of books and AG Forms for accounting and information purposes. These books and records are audited with a view to ensure that:

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- The approved AG forms are properly kept, updated and duly signed by the responsible officer;
- Revenues collected have been properly classified;
- Records of PAN holders and other identification is updated;
- Records of advance or installment received from tax payers is kept properly and update;
- Records of tax arrears is updated and follow up is made for recovery of such arrears;
- Record of VAT registration, refund, non filers and collection is kept up-to date;
- Record of excise license issued, monthly and annual returns etc. are maintained; and
- Custom Declaration forms and the record of goods imported under DRP are maintained.

**1.11.7 Audit of Assessments** - In recent years, INTOSAI has placed emphasis on the importance of audit of revenues, in particular the tax assessments that is distinguished from the audit of collection and accounting of taxes. After the introduction of self assessment of Income Tax and VAT by the tax-payer itself in Nepal, the audit of assessment has become more significant. Under this system, it is believed that all the citizens are honest tax payers.

In the audit of assessment, validation of audit observation or audit finding is challenging because the books of accounts remain with the taxpayers and revenue authority also normally refute the audit objection raised by an audit. Likewise information or data base of taxpayer's transactions are neither kept by tax authorities nor adequate disclosure are made by taxpayers. In such a situation audit needs to be professionally conducted. The method of audit of assessment may include the following:

**1.11.8 Audit of Individual File** – Besides checking the arithmetical accuracy of computation of tax and levies, violation of tax laws and procedures is accorded priority and carefully reviewed by the audit. Findings on individual cases in different Revenue Offices are summarized and grouped to evaluate its impact on revenue collection and administration. Such grouping helps to formulate general opinion about the efficiency with which the assessment are framed, the extent of compliance with laws and the particular area which need attention. Such opinion should be backed by adequate representative cases.

Instances noted in any individual case may not appear to be of any significance at a first glance but its cumulative ramification may cause heavy revenue loss to the government. Isolated cases not representing the universe/ population are left to revenue authorities for remedial or corrective actions. Auditor, based on his competence and experience, shall evaluate such risk on individual file.



**1.11.9 System Audit** - Under the system based audit, although revenue of assessment files is the basis for forming the opinion about the functioning of the entity and giving example in support of the opinion, functional arrangement, execution, adequacy of the laws, compliance of laws by taxpayers, internal control mechanism etc. within the revenue collecting agencies are reviewed. Such systems are also examined from the perspective of regularity, orderliness, efficiency etc.

System audit needs thorough study of concerned revenue administration. The selection of the subject or particular area of tax regime needs to be decided in advance. For such type of audit, strategic planning needs to be formulated and implemented within a time span of three to five years. Performance audit approach needs to be applied for system or procedural audit. Detailed write up of laws, rules, regulation and information be collected so as to make comprehensive review report commenting upon various function of the audited issues. System review could provide a platform for making changes in the policy, legislation and procedure. For this purpose sectoral case study may also help audit to focus on deficiency of the system and procedure.

**1.11.10 Industry Analysis** - In Nepal, the contribution of corporate sector in revenue is more than two third of the total revenue. The major contributors are large public and private sector corporations of which a significant number are listed with the Nepal Securities Exchange. Inter firm and intra firm comparison of the industry performance, e.g. standings in the industry, capital and revenue base, market share, raw material consumption etc. in the current and past years could lead to make a judgment on the industry profitability and the magnitude of revenue evasion or revenue avoidance.

**1.11.11 Database Analysis** - Management Information System and maintenance of database is crucial for effective Revenue administration. Revenue authorities collect and compile variety of information, such as total number of tax payers, total number of returns filed, industry-wise tax collected, number of returns under departmental review and appeal with the appellate authorities, amount in arrears, revenue target and achievement, details of defaulters in filing returns, ratio of revenue, profit and tax, GDP ratio of direct and indirect taxes etc. These information could form basis for the audit to assess the efficiency and effectiveness of revenue administration.

In course of applying above methodology, sampling technique needs to be used applying systematic basis and statistical sampling method as required by audit objectives. Details of selection of sample size are given in subsequent paragraph. For convenience, it is suggested that audit should be conducted at audit establishment. It will enable auditor to obtain prompt clarifications to its queries and examination of other relevant documents.

**1.11.12 Analysis of Notification and Fiscal Statutes** - During the course of audit, differences in opinion on matters of statutes/judicial pronouncements arise between audit and revenue administration. In such instances, auditors may try to find solutions from their own sources. Different offices may deal with the issues in different ways and another office may follow the manner of resolution adopted by one office. Auditors may also ask for advice from the Inland Revenue Department, Ministry of Finance, Ministry of Law and Justices etc. In the absence of correct explanation, auditors may interpret legal provisions objectively. Auditors need to foresee the effects of interpretation of tax laws. Its material effects on revenue should be judged and auditors need to comply with the meaning and objective of revenue statutes.

**1.11.13 Audit of legality** - The constitution of Kingdom of Nepal guarantees that no tax can be levied without legal authority. Accordingly, compliance of legal provision by taxpayers as well as by revenue authorities needs to be examined in conducting the audit. Non-compliance of legal provision may cause dire financial consequences as penalty and punishment to taxpayers and loss of revenue to the government. The auditor also has to be careful in pointing out the irregularity and must ensure that the objections raised are legally sustained otherwise it may be contested on legal ground.

**1.11.14 Audit of compliance with reference to Financial Proceedings Act 2055 and Financial Regulation 2056** – The auditor, in addition to verifying the compliance with relevant laws and regulations shall also consider the compliance with the general provisions relating to revenue of Financial Proceedings Act 2055 and Financial Regulation 2056, where appropriate. A summary of such Act and Regulations is given in *Appendix -I*

**1.11.15 Interim Audit** – During the audit in the year 2062/63, audit is carried out for the revenue collected in 2061/62. Similarly, in case of audit of tax assessment audit is carried out only after two years of revenue collection i.e. in the year 2061/062, Income Tax Authorities does the assessment of 2060/061 and it is audited only in 2062/63. Interim audit could be conducted to identify the non compliance and correction of the same on a timely manner.

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## 1.12 Audit Sampling

**1.12.1** It is important that individual revenue files are examined to evaluate the adequacy of the system and procedures of revenue assessment and collection. With the growth of volume and complexity of government revenues and expenditure it has neither been possible nor feasible to conduct audit of all files audit as desired result could be obtained by concentrating on high value and high-risk areas. Selective auditing of business income rather than salary assessment, investigations of reported evasions and use of suitable statistical sampling techniques in the review of files are preferred practices.

**1.12.2** Audit sampling is the application of a compliance or substantive audit procedure to less than 100 percent of the items within account balance are class of transactions to enable the auditor to obtain and evaluate evidence of same characteristics of the balance or class and to form or assist in forming conclusion concerning that characteristics. Sampling is the "process of learning about the lot by looking at a little" helps the auditor in forming an opinion or submitting recommendation on a particular audit area by examining on a small percentage of transactions or operations. For example, the total number of Income tax returns, monthly VAT returns, Customs Declaration Forms etc. cannot be covered by the audit because these returns or forms are thousands in number. In such situation use of statistical sampling techniques becomes useful.

**1.12.3 Sampling Methods** – Sampling items should be selected in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an equal opportunity of being selected. There are a number of sampling methods but auditor may adopt any of the following commonly used methods:

**1.12.4 Random Number Selection** – This method ensures that all items in the population or within the stratum have a known number or equal chance of selection, for example, by use of random number table which are constructed to achieve the audit objective. This is similar to lottery sampling, e.g. in the population of 500 files, each one has a 500 chance of appearing in the sample.

**1.12.5 Systematic or Interval Selection** – It Involves selecting items using a uniform interval between selections, the first interval having a random start. The interval might be based on a certain number of items. (e.g., every 30<sup>th</sup> voucher) or on monetary totals (e.g., every Rs. 5,000/- in the cumulative value of the population)

**1.12.6 Haphazard Selection** – It may be an alternative to random selection provided that the auditor attempts to draw a representative sample from the entire population with no intention to either include or exclude specific unit when using this method one should guard against making a selection that is biased, for example, towards items which are early located, as they may not be representative.

**1.12.7 Stratified Selection** - Stratification is the process of dividing a Population into sub-population, that is, a group of sampling units, which have similar characteristics (Often monetary Value). The strata must be explicitly determined so that each sampling unit can belong to only one stratum. Stratification enables the auditor to direct his/her efforts towards the items which potentially certain the greater monetary error. For example, audit might direct attention to larger-value items for Account Receivables by sub-dividing into goods sold to customers, rupee size, class etc. to detect material over statement errors.

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**1.12.8 Cluster Selection** - It consists of division of total items into sub-group or cluster and selecting at random some cluster entirely. It should however, be remembered that measurement of the sample is distinct from the method selected for sampling. It is possible to select the sample by statistical method and yet measure or evaluate the results by compliance or substantive audit procedures. This method is most suited to those tests, which have a single objective.

An illustrative criteria for selecting tax payers files or Customs Declaration Forms for the audit of Income tax and Customs duty respectively are given below:

### **1.12.9 Basis of selecting taxpayers files**

- Selection by nature of business or Industry e.g. Manufacturing, Tourism, Transport, Banking and Finance, Trading houses, Multinational companies.
- Based on legal status of the entity, e.g. Public or Private Limited Company, Partnership Firms
- Selection of IROs based on their achievement of revenue collection target.

### **1.12.10 Basis of selecting Customs Declaration Forms**

- Harmonized Code wise based on high or low duty rate;
- Commodity wise, e.g. petroleum products, machinery, automobile, IT goods, spares, agricultural products;
- Duty free items;
- Industrial raw material;
- Collection of particular month(s), week(s) or days; and
- Selecting pre- determined percentage of numbers of Customs Declaration Forms.

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## **1.13 Audit Process**

**1.13.1** Revenue Audit Division of OAG is responsible for planning, execution, reporting and follow up of revenue audit.

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## **1.14 Quality Assurance**

**1.14.1 Supervision and review of audit work** – Proper and timely supervision of audit work is necessary to provide assurance to the auditor to enable him in forming an opinion on the fairness of the transactions. Supervision could be done at different phases of the audit. Supervision at primary phase, middle phase and final phase of the audit is preferable. Timely supervision provides instructions to auditors to proceed in accordance with the audit plan and guidance as to verification to be carried out to obtain assurance on the fairness of transactions. Supervision must ensure that the audit teams to support their observations have compiled work papers and other evidences. Supervisors have to ensure that work has been carried out in accordance with the audit plan and quality of work has been maintained.

**1.14.2 Interpretation of revenue statutes** – During the course of audit, differences in opinion on matters of statutes/judicial pronouncements arise between audit and revenue administration. In such instances, auditors may try to find solutions from their own sources. Different Inland Revenue offices may deal a particular issues in different ways and another office may follow the manner of resolution adopted by the other offices. Auditors may also ask for advice from the Department of Inland Revenue, Ministry of Finance, Ministry of Law and Justices etc. In the absence of satisfactory explanation, auditors may interpret legal provisions objectively. Auditors need to foresee the effects of interpretation of tax laws. Its material effects in revenue collection should be judged and auditors need to fully conversant with the spirit and objectives of revenue statutes.

During the course of an audit, auditors may come across certain judgments of revenue or appellate courts which conflict with or are contradictory with the provisions of the revenue laws. Such conflicting judgments should be looked into and the auditors should draw attention of the tax authorities to make suitable amendment in laws or issue clarifications based on such judgments.

**1.14.3 Continuous Training** – Auditors should be given training on a continuous basis. (Refer HRD plan)

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## **1.15 Audit Follow-up**

**1.15.1** The responsibility to clear up audit observations and implementation of audit suggestion lies with the Revenue Authorities. The action taken by such authorities needs to be reviewed and followed up within a timeframe prescribed by OAG. Normally, follow up audit is carried out to review whether:

- Appropriate action has been taken, the audit issues resolved and therefore, matter could be closed.
- Actions initiated but remained incomplete. The progress may be reviewed.
- Problems being faced in the implementation of audit recommendations.
- Recommendations not implemented and may be reported again.

**1.15.2** Follow up audit is also useful in assessing the value addition by the audit in improving the government financial and revenue administration and initiatives taken by Revenue Departments on audit recommendations.

**1.15.3** Report on Status of prior audit findings should be given in preliminary audit report.

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## Income Tax

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### 2.1 Introduction to Income Tax

**2.1.1** Income from one or more sources as explained in the Income Tax Act, 2058 (“Act”) is called the assessable income. Expenses allowable under the Act are deducted from the assessable income and the taxable income is arrived at. Income tax is levied on the taxable income at the rate prescribed in the Schedule-1 of the Income Tax Act. Income tax includes income tax, additional tax, advance tax, fine, fee and deposit made under the Act under the following income heads:

- Business;
- Employment; and
- Investment.

**2.1.2** The income of a person for an income year from any employment, business, or investment includes the following:

- Income (excluding exempt income) of a resident person from the employment, business, or investment of the year irrespective of the location of the source of the income; and
- Income (excluding exempt income) of a non-resident person from the employment, business, or investment of the year but only to the extent the income has a source in Nepal.

**2.1.3** For each income year, income tax is imposed on and realised from the following persons:

- A person, who has taxable income for the year;
- A foreign permanent establishment of a non-resident person situated in Nepal and has repatriated income during the year; and
- A person, who receives a final withholding payment during the year.

**2.1.4** Every person carrying out any business or profession and the person required to make TDS is required to obtain Permanent Account Number (PAN), although it is optional for employees whose only source of income is from employment from the single resident employer at a time.

**2.1.5** Any person having taxable income (except otherwise provided in the Act) is required to file a return of income for the year in a prescribed format. Such returns shall specify the person’s assessable income from each employment, business and investment, and the source thereof. A checklist of documents that should be attached to tax returns submitted by taxpayers is given in *Appendix-2*.

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## Chapter 2

### Income Tax

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**2.1.6** A person who derives or expects to derive any assessable income during an income year from a business or investment is required to pay tax for the year in advance in specified installments. Taxes on employment income is deducted by the employer at source and deposited with the tax authorities within stipulated time. Certain payments as specified in the Act are subject to tax deduction at source that is deposited by the withholder within stipulated time.

**2.1.7** Interest at the prescribed rate is charged if the advance tax deposited in installments is lower than the actual tax liability for the year. Similar interest is levied on late deposit of tax deducted at source.

**2.1.8 Basic Features of the Act** - Taxation is mainly used to raise resources and also to reduce inequalities of income and wealth in the society. Taxation is considered to be an effective tool in the hand of the state to achieve the socio-economic goal of the nation. The Constitution of the Kingdom of Nepal provides that the levy of tax must be affected through legislation. In another words tax is levied under the authority of law, so that rights of property and liberty of the people under the constitution can be safeguarded.

**2.1.9** For conducting revenue audit the auditor is expected to possess adequate knowledge and understanding of prevailing tax laws. Such knowledge of the Act and its features help auditors to plan audit and identify the risk areas. Some of the important features of the Act are described in the following paragraphs.

- The Act has broadened the tax base. Tax rates are spelt out in the Act itself and the tax rates and concessions are harmonized on equity grounds.
- A full-fledged self-assessment system as explained hereinafter is implemented and the presumptive taxation and current year taxation system are strengthened.
- The scope of discretionary interpretation of the tax administration is drastically reduced ensuring simplicity, uniformity and the transparency. The Act has also defined the power and authority of the tax administration.
- The Act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.
- The appeal system is further streamlined by making it mandatory for the taxpayers to file an objection with the IRD for administrative review before appealing to the Revenue Tribunal.

**2.1.10 Book keeping obligation** - Self-assessment system in income tax regime is based on books of account. Accordingly taxpayers are obligated to maintain proper account of their financial transactions and based on this tax liability is to be determined by themselves

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## Chapter 2 Income Tax

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**2.1.11** The Act has not prescribed any particular system of accounting but it should be compatible with accounting standards as prescribed by law or Generally Accepted Accounting Practices.

**2.1.12 Assessment of taxable income** – The main feature of Act is the introduction of self-assessment system of assessing tax liability. Under this system, taxpayers are responsible for determining taxable income and paying tax. The Act has treated taxpayers as an alternative tax officer and expected to determine tax liability in accurate and correct manner. Under the self-assessment system the role of the tax authorities is of a facilitator rather than an administrator.

**2.1.13 Voluntary compliance by Taxpayers** – The basic theme of self-assessment is to encourage voluntary compliance of tax laws by taxpayers and permitting them to determine their tax liability in a hassle free manner. The tax returns are to be simply accepted on the assumption that acceptance is an act of faith, which is backed by sanction.

**2.1.14 Penalty and Punishment:** Non-compliance of statutory or legal provisions of tax laws attracts penalty and punishment, particularly, under self-assessment system, non-compliance results into heavy penalty. The penal provisions are listed in *Appendix-3*.

**2.1.15 Collection of tax, remission and refund** – The taxpayers are required to pay taxes in advance and in installments. Similarly, taxpayers are under obligation to make Tax Deduction at Source (“TDS”) on specified payments and deposit with relevant Inland Revenue Office within stipulated time. In case of excess payment of tax, refund together with interest is made.

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### **2.2 Audit objective and scope**

**2.2.1** The Revenue Audit Guide provides guidance for the audit of assessment of tax at IROs to identify any possible leakage of revenue or misinterpretation of the provisions of the Act. This chapter outlines the matters to be considered by an auditor for performing the tax audit.

**2.2.2** Audit should not be limited only to the checking of collection of revenues in line with the accounts rendered by the collectors but, wherever possible, a check should be made to see whether or not levies and collection of tax were confirming to legislation.

**2.2.3** Audit should review to ensure that taxes are levied and collected in accordance with the provisions of law, collection is promptly made, classified and deposited into correct account, and properly accounted for. The audit should also verify that there has not been any negligence in the matter of collections or exaggeration in the estimates.

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**2.3 Risk areas and control measures**

2.3.1 The auditors should evaluate the following risk commonly encountered in the revenue administration. These risk areas are classified into two broad heads of Accounting Control and Administrative Control.

Risk Areas	Control Measures
<b>Accounting Control</b>	
<p>IRO might not have systematic records of the taxpayers, which may adversely affect on tax revenue.</p> <p>A person having a taxable income (except otherwise mentioned) may be running his business without registering with the IRO.</p>	<p>IRO is required to maintain systematic records of the taxpayers.</p> <p>Person with a taxable income (except otherwise mentioned) must receive PAN and display such registration certificate at his business place.</p>
<p>Taxpayer may conceal his actual transaction to avoid his tax liability.</p>	<p>With a view to include all transactions of the tax payers, tax officer is authorized to ask for explanation, make tax payer submit additional documents or obtain further information about the tax payer from other governmental or non-governmental agencies for the satisfaction of the tax officer before making tax assessment.</p> <p>Further, if tax officer is not satisfied with the explanation, he can make re-classification or re-characterization of the transaction.</p>
<p>It is possible that the income tax staff, in collusion with the taxpayer may change the record of the income tax due and reduce his tax burden.</p>	<p>Every letter or information received in office should be registered with serial number and registration date.</p>
<p>Tax may not have been realised for the period after expiry of tax exemption under Industrial Enterprise Act. (for those who were obtained such exemption before enactment of new IT Act).</p>	<p>Registers for such exemptions are maintained in the IRO from the period beginning the exemptions.</p>

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Income Tax

Risk Areas	Control Measures
<b>Accounting Control (cont'd)</b>	
It is possible that the staff maintaining the records of the taxpayer may have collusion with the taxpayer and may not disclose significant data of the assessee.	In order to avoid such problem. IRO is expected to maintain up to date records of the taxpayer.
Taxpayer may not submit required papers and documents along with his self assessment tax return.	Tax payers declaring tax by their own are required to submit their statements as prescribed by the DG of the IRD and they have to submit audited financial statements.
It is possible that a registered person may not submit tax returns.	To avoid such situation tax officer is authorized to make tax assessment of such assessee on its best judgment.
Tax officer may reduce the tax liability due to collusion with the taxpayer.	In order to control such problem DG may examine the assessment files at any time.
There is a system of recognising as complete assessment if a small taxpayer with a turnover of a specified threshold and a taxable income up to a specified amount deposits a fixed amount specified in the Act. It is possible that big businessmen may take advantage of such provision and may run his business in the name of such small taxpayers.	See whether there is a system of maintaining separate records/MIS system of each tax payer and monitored whether the small tax payer has imported goods in a large quantity or he has a lot of local transactions than the declared volume of his business.
It is possible that tax officer may have collusion with the taxpayer and may submit the report with less tax liability by disclosing less transaction.	In order to control such situation, in-depth review of the selected files can also contribute to draw a comfort level.
It is possible that various government agencies may not provide information to the tax officer relating to the taxpayers.	In order to avoid such problems, IRO may request to the concerned agency to provide necessary information relating to the taxpayer.

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Risk Areas	Control Measures
<b>Administrative Control (cont'd)</b>	
A person having only remuneration as a source of income need not submit tax returns but submit a statement of TDS from his office. In this situation, a taxpayer may not disclose income from other sources.	In order to avoid such problems, there is a system of deducting tax in advance on the payment of meeting fee, commission, dividend, bonus, copy examination fee etc. to government officials or any person.
It is possible that a taxpayer, who is a temporary resident, may leave the country without submitting tax returns.	To avoid this situation tax officer may ask to deposit tax in advance or he may ask to provide guarantee from the temporary resident.
The taxpayers may claim TDS made by the other institutions as advance tax without adequate supporting documents i.e. TDS certificate or the deposit slip.	Advance Tax in the form of TDS is verified from the collection book before adjusting it to the tax payable by the taxpayers.
Assess may be running his business without crediting the tax as per the assessment order.	In order to avoid this situation, system of collection tax in advance is exercised as disclosed in the returns at the time of registering the income tax returns. In addition if the taxpayers do not deposit taxes as assessed, tax officer may order to stop the business or prohibit import/export, or stop transfer of the assets or take into possession the taxpayers assets.
It is possible that a person liable to pay income tax may close or sell out the business or may change the name of the business without paying the tax due.	A person must inform the IRO before closing or selling out the business.

## **2.4 Matters of audit consideration**

**2.4.1** While formulating audit plan, the audit team needs to have adequate knowledge and understanding of the business of the auditee as described in General Operational Standards. The area of knowledge may include organizational policies, objectives, strategy, main functions and organizational set up etc., which enable audit team to carry out audit in systematic manner.

**2.4.2** Taking into account the mandate, the audit should not be confined in examining compliance aspect only but it should cover the efficiency and effectiveness of operational and procedural aspects as well to make audit report meaningful.

**2.4.3** Potential areas for audit scrutiny may change depending upon the legislation, organizational arrangement, procedures adopted by audited entity, audit objectives and risk areas which the audit team needs to look into in framing audit plan.

**2.4.4** Based on the audit methodologies suggested in this Guide, the matters to be considered for conducting revenue audit is summarised below for the proper understanding of the audit team.

**2.4.5 Audit of Assessments** – Normally tax assessment involves the steps such as filing of return, scrutiny or tax audit by tax authorities, computation of and payment of tax etc. The matters to be verified shall include:

- Verify that the return submitted by an assessee is complete in every respect and conform to the rules and regulations and are adequately supported by audited financial statements (where required by law) and is duly signed by the tax-payer.
- Verify that documents are submitted in the format as specified by the Inland Revenue Department.
- Information received on taxpayers from the market survey or from any other sources are classified and documented and such information is verified while reviewing the returns filed by the taxpayers.
- Verify best judgment assessment cases in respect of taxpayers who have received PAN but have not submitted the tax returns. If such assessment has not been completed, auditors should take note of the same, otherwise if assessment has been made, auditors should see whether the assessment order has been delivered to the assessee. Further verify that whether tax officer had obtained explanation from the assessee, required taxpayer to produce necessary documents and evidence and verified the information from other available sources, to its best satisfaction.

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## Chapter 2 Income Tax

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- Auditors should consider following to ascertain whether tax officer has made any assessment which reduces the taxable income of the assessee:
  - (a) Whether the expenses mentioned below which are not permissible by laws are allowed as deduction from the taxable income:
    - i. Expenses to the extent to which they are of a domestic or personal nature as defined in the Act.
    - ii. Tax payable under the Act and fines and similar penalties paid to a government or a political subdivision of a government of any country for breach of any law or regulations or by-laws framed there under.
    - iii. Expenses to the extent to which they are incurred for deriving exempt income or final withholding payments.
    - iv. Cash payment in excess of Rs 50,000 incurred by a person having annual turnover exceeding 2,000,000 for the purposes other than that specified by the Act.
    - v. Capital expenditure or foreign income tax.
    - vi. Repair and maintenance expenses, Pollution control expenses, Research and development cost, Donation, and Interest etc.; were charged in excess of limit provided by the Act.
    - vii. Expenditure that is not supported by adequate evidence and expenditure that is not related to the business, were also booked.
    - viii. The amount of bad debt that was written off but recovered subsequently and not included in the assessable income.
    - ix. Any provisions for expenditure or transfers to reserve are treated as expenditure.
  - (b) The auditor should also confirm that depreciation on assets was charged at the rate and in a manner as prescribed in Schedule 2 of the Act.
  - (c) Verify that if the stock is carried forward from the previous year, the basis of the valuation of stock is reasonable.
  - (d) Taxes are not reduced by resorting to transfer pricing mechanism, and all dealings between the associated persons are made at arms length basis.
  - (e) There may be case of income splitting. Tax officer may need to consider the arrangement made with a view to avoid tax by income splitting.

**2.4.6 Evaluation of Departmental Review (Tax Audit, Investigation and Tax Refund)** – Under the provision of the Income Tax Act taxpayers are required to determine their tax liability under self-assessment system and report to the tax authority in a prescribed manner. A summary review followed by a detailed review of such returns are undertaken by IRO with a view to identifying any act of non-compliance with legal provision including errors of omission and commissions committed by taxpayers. Such acts attract penalty under the Income Tax Act. This being the core area of revenue audit, requires focused attention of the auditor, the significance ones requiring auditor's attention are outlined below:

- Targeted number of files to be reviewed by IRD against numbers actually reviewed. Targets were based on available resources and risk involved in nature of taxpayer's business.
- Basis of selecting review samples and its reliability.
- IRD considered all the material factors mentioned under the audit of assessment.
- Review the cases of seizer of books of accounts of taxpayers by IRD and the amount of taxes and penalties imposed and collected.
- Number of cases where irregularities were found and notices served for reassessment or fines and penalties imposed.
- Action taken to mitigate the revenue losses observed from the reviewed files, e.g. random visit to selected assessee's place of business especially to high risk and high yielding taxpayers and to review their records.

**2.4.7** The prevailing Income Tax Act has made provision of tax refund. This being relatively a new concept in Nepal, tax authorities do not carry much experience and therefore, the audit should closely examine that:

- All refunds were supported with an application of the taxpayer;
- Relevant documents supporting the refund were available on record;
- The refund was permissible under the law and did not include unauthorized amounts;
- Refunds were made on timely manner so that interest is not paid.

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## Chapter 2 Income Tax

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**2.4.8 Audit of Collection and Enforcement** – Tax collection and enforcement of law is a main function of tax administration that is also reflective of their efficiency and effectiveness. Auditors should examine the following:

- Taxes are collected promptly:
  - Collection meets target;
  - Installment/Advance tax recovery is promptly made;
  - Tax at Source is deducted and deposited timely;
  - Tax arrears are followed up and realized effectively;
  - Tax amounts are properly classified and accounted for; and
  - The taxpayer has made appropriate tax deduction from relevant payments and the TDS statement along with the tax deposit receipt has been submitted to the IRO within stipulated time.
- Notices for additional tax demands resulting from the departmental reviews are promptly sent.
- Legal actions initiated and fines and penalties are levied on tax defaulters.
- Purchase and Sales Register maintained by the taxpayer under VAT Act are duly certified by IRO.
- Potential cases of tax evasion or tax avoidance are referred for detail investigation.
- Market survey is regularly conducted to identify persons having taxable income engaged in business without obtaining PAN.
- Tax authorities effort has led to increasing the number of new taxpayers year on year.
- Records of assessee who have ceased to earn income or closed their business have duly notified IRO and information on such assessee has been scrutinized and proper record thereof are maintained.

**2.4.9 Operational Arrangements (Taxpayers' services, Tax returns and Administration)** – In view of the spirit of self-assessment, the tax authorities are no more considered to be an administrator but are expected to play a role of a facilitator to the taxpayer. This requires implementation of well-defined systems and procedures and rules and regulations to make revenue administration smooth, efficient and taxpayer friendly. Tax authorities are expected of encouraging voluntary compliance of tax laws by the taxpayers that shall ultimately enhance the tax collection and also the credibility of tax authorities. To achieve this objective the auditor is expected to ensure that:

- Appropriate policy, adequate guidelines, comprehensive manuals are prepared and available to tax authorities as well as to the taxpayers

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## Chapter 2 Income Tax

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- Responsibilities and functions within IRD/IROs are clearly defined.
- Rules and regulations are amended in the light of court judgments or as determined by IRD for giving fair treatment to the taxpayers.
- Advance rulings at the request of taxpayers are promptly issued.
- Cases filed for administrative review before IRD are promptly resolved and outcome is notified to the taxpayer.
- Taxpayer's records are maintained in a way that they could be easily retrieved when needed.
- All pending appellate and judicial cases are regularly followed up and adequate cooperation is provided to relevant authorities for speedy settlement.
- Taxpayer's facilitation services are kept efficient and educational programmes are implemented to encourage voluntary compliance of tax laws.

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### **2.5 Relevant laws and regulations**

**2.5.1** The following Acts, Rules, and Circulars are relevant for the audit of income tax and the auditors are expected to have thorough understanding of the same:

- Income Tax Act 2058;
- Income Tax Regulation 2059;
- Finance Act; and
- Circulars and notifications issued by IRD from time to time.

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### **2.6 Audit checklist**

**2.6.1** The illustrative checklist is given in *Appendix -3* that may be updated at the time of audit based on the audit objectives and risk assessment.

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## Value Added Tax

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### 3.1 Introduction

**3.1.1** Value Added Tax (“VAT”) is a scientific system of indirect taxation in which tax is charged on selling price so that the ultimate burden of tax is passed on to customers. It is basically tax on consumption and collected at each stage of production and distribution. VAT applies to each commodity as it passes through the production and distribution channels but only to the ‘value additions’ to each stage in the production and distribution process.

**3.1.2** In Nepal VAT was introduced on 16 Nov. 1997. VAT replaces the old Sales Tax, the Contract Tax, the Hotel Tax and the Entertainment Tax.

**3.1.3** VAT is a tax imposed on the value added to goods and services consumed in Nepal. The tax is based on the principle that each producer or distributor adds value, in some way, to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution chain. There is the presumption that VAT is shifted forward completely to the consumer.

**3.1.4** VAT is a broad-based tax as it covers the value added to each commodity by a entity during all stages of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion. It is also regarded as the backbone of income tax system in Nepal.

**3.1.5** After promulgation of the VAT Act in Nepal in 1998, VAT is levied at the rate specified in VAT Act (amended by Finance Act for the Fiscal Year) (“FY”).

**3.1.6 Registration** – Registration is required for any business having annual taxable turnover of more than the limit prescribed or belonging to an associated group, which has aggregate annual taxable turnover exceeding the limit prescribed as per Vat Regulation, 2053. Small tax payer having taxable turnover less than prescribed limit may apply for registration.

**3.1.7 Assessment** – VAT registered person is required to submit VAT returns under self assessment system to the Inland Revenue Department (“IRD”) Section 18 and 17 of the VAT Act covers the procedures of submitting returns and collecting tax.

**3.1.8 Collection** – VAT registered person is required to deposit VAT amount along with VAT return within the period prescribed in the Act. Section 18 and 19 of the VAT Act covers the procedures of submitting returns and collecting tax.

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## Chapter 3

### Value Added Tax

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**3.1.9 Administration** – IRD is responsible for implementation of VAT in Nepal. It works as a facilitator to provide necessary information to the public. Since the implementation is based on the self assessment it requires mainly desk review until and unless there is demand of refund on which it performs details review of the transaction.

The IRD has established separate departments for monitoring and supervision of business houses responsible for collecting and depositing VAT. The VAT auditor (in-house auditor of IRD) performs detail audit for VAT and Income tax on the selected files and carries out re-assessment on the facts determined during the audit.

A taxpayer who is not satisfied with the tax assessment of a tax officer may submit application before the Director General (“DG”) of IRD for administrative review within 30 days from the date of receiving such decision. In doing so, taxpayer has to pay full amount of undisputed tax whereas 50% of disputed tax and penalty should be submitted as deposit or bank guarantee.

**3.1.10 Tax setoff and Refund** – Under the VAT producers, distributors and people providing services impose VAT on the product or the services sold or provided. The difference between the VAT collected on sales and the VAT paid on purchases determines the amount a registrant must remit or the amount that may be claimed as a refund.

In other words, if the tax on sales is more than the tax on purchases the person remits the difference. If the tax on sales is less than the tax on purchases, the person may carry forward this credit for next month.

A tax payer who makes credit return can set-off the credit amount in subsequent tax period and where such amount cannot be set off for continuous six months period, a tax payer can claim for refund. A tax payer whose total turnover comprises more than 50% export turnover can immediately apply for the refund.

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## 3.2 Objective and scope

**3.2.1** The objectives of VAT audit are as follows:

- Widening of tax base with a view to bringing in sources, which are presently excluded.
- Revising the indirect taxes with a view to simplicity, efficiency and harmonization avoiding cascading in order to avoid distortions.

**3.2.2** VAT is applicable to the following transactions:

- Goods and services supplied within the Kingdom of Nepal;
- Goods and services imported to the Kingdom of Nepal; and
- Goods and services exported from the Kingdom of Nepal.

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**3.2.3** Similarly, the following persons are directly or indirectly required to register with the VAT authorities:

- A person having turnover in excess of the threshold defined by the Vat Rule.
- Professional having turnover in excess of the threshold defined by the Finance Act.
- A person dealing with the Government offices and public sector enterprises as they can procure goods in excess of limit prescribed from VAT registered supplier only. (Rule 56).
- Similarly, Government organization, public enterprises and registered person entering into contract or for annual consultancy services with value exceeding prescribed limit (Rule 6 ka).
- Procurement of goods with prescribed amount for trading purposes can be made from the VAT registered supplier only. (Sec 14.4).

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### **3.3 Systems of submitting returns and collecting tax**

**3.3.1 VAT Returns** – VAT registered person is required to submit VAT returns under self assessment system on monthly/ Bi-monthly/ tri-semester basis to the IRD within 25<sup>th</sup> day of the end of the month/ bi-month/ quarter.

Such returns must be submitted to the tax officer or “through post office registry”. Such return must be furnished whether or not taxable transactions are carried out during the period.

The recipient of services in Nepal from a person who is not registered and is outside the Kingdom of Nepal shall have to assess and collect tax at the taxable value in accordance with the provisions of Act and Rules.

**3.3.2 VAT Collection** – VAT registered person is required to deposit VAT amount along with VAT return within the period prescribed in the Act. VAT registered person is entitled to set off VAT paid on procurement against VAT amount collected on sales.

The tax payer from the particular district, where no Inland Revenue Office (“IRO”) is situated, can deposit VAT amount and submit returns within prescribed time to the concerned District Treasury Office (“DTO”). The DTO then forwards the collection within prescribed time to the concerned Inland Revenue Office.

VAT amount collected at Custom point should be deposited into VAT account by Customs Office and submit VAT returns to the nearest IRO within prescribed time.

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**3.4 Risk areas and control measures**

**3.4.1** The auditor should consider the following risk areas while performing the audit and reviewing internal control of the auditee.

<b>Risk areas</b>	<b>Control measures</b>
<b>Registration</b>	
<p>A person having turnover in excess of the threshold defined by the VAT Rule may run his business without registering for VAT.</p> <p>A person not registered for VAT may be collecting VAT through tax invoices and not depositing with the IRO.</p>	<p>A tax officer may examine, if there is a reasonable ground to believe that a taxpayer required to be registered under this Act has been involved in a taxable transaction without being registered.</p>
<p>A person may run more than one similar business to avoid threshold limit for VAT registration.</p>	<p>IRD should have effective control mechanism to identify and control such cases.</p>
<b>Assessment</b>	
<p>A registered person may not submit VAT returns in due time.</p>	<p>In case of default Assessment will be based on the Computer software installed at IRD for the tax period on the basis of the information provided by the tax payer at the registration time. Such assessment will be valid until further evidence provided by the tax payer.</p>
<p>Fake tax invoice may be presented to set off VAT payable.</p> <p>VAT invoice raised by the tax payer may be cancelled after payment and presented as a cancelled invoice.</p>	<p>While performing audit under sec 23 the tax auditor should review the possibility of such circumstances.</p>
<p>In case of manufacturing industries, input-output value addition may not be in accordance with the industry average.</p>	<p>The Department of Industry (“DOI”) and other agencies have prescribed standard norms for input-output ratio.</p>

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<b>Risk areas</b>	<b>Control measures</b>
The tax payer may use the goods and services for non-taxable transaction on which tax credit was already claimed	Goods on which tax credit has been made is used for non-taxable transaction shall constitute deemed sales and tax shall be collected accordingly.
Tax invoice generated from computer system may not reflect true transaction value.	IRD has direct access to the software installed at the tax payer business place and review such instances.
<b>Collection</b>	
VAT may not be collected and deposited on services provided by unregistered foreign consultant as per sec 8(2).	While performing audit under sec 23 the tax auditor should make cross reference to TDS deducted on payment made to foreign consultants.
Fines may not have been charged and recovered from the assessee for the non compliance of the various provisions of the VAT Act.	The computer software installed at IRD automatically calculates all applicable interest, fines or penalty to be levied for non-compliance. IRD management should have mechanism in place to recover such amount on timely manner.
<b>Administration</b>	
Tax payer may not raise the tax invoice or raise it for the value less than the actual transaction value.	<p>IRD should have the mechanism for cross verification of the individual invoice on a sample test basis to confirm the tax invoice in the prescribed format. The absence of tax invoice and its value can also be cross checked with the other tax invoices of a similar nature on a sample test basis.</p> <p>IRD can procure the items of under-invoiced value.</p> <p>Since the tax payer pays the VAT collected on sales net of VAT paid on purchase, tax officer should cross tally the VAT paid on purchase from the file of the related vendor independently.</p>

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<b>Risk areas</b>	<b>Control measures</b>
<b>Administration (cont'd)</b>	
It is possible that tax officer may have collusion with the tax payer and may not disclose all the significant non compliance issue identified during assessment.	Revenue Investigation Department (“RID”) has been monitoring such cases to minimize the possibility. However, in-depth review of the selected files also contributes to draw a comfort level.
<b>Refund</b>	
The tax payer may claim ineligible refund.	IRD should make refund only after conducting a detail investigation or an examination of the claims.
Local sales can be presented as export sales and claimed for refund.	Refund claim for export sale should be supported by export document.
Tax credit may have been claimed for transaction which has been applied for refund.	Once it has been applied for refund, it cannot be claimed for set-off.

### 3.5 Matters of audit consideration

3.5.1 While performing VAT audit, the auditor should consider the followings:

- VAT returns submitted by tax payer comply with the existing laws & regulations;
- VAT amount deposited by tax payer tallies with the revenue record maintained at IRD;
- arrangements for internal audit of the concerned IRO are adequate and the report points out VAT related matters;
- accounts such as revenue, all other incomes and deposits are correct and the rules relating to evaluation, realization and methods of book keeping are adequate and if so, are they followed;
- the organisation, management and job allocation of the IRO are sufficient and proper and are they operating accordingly;
- Any function is being unnecessarily performed in duplication by any employee or agency or any essential function is being omitted;

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- The available resources, means and assets are properly utilized and the maintenance and financial risk against any loss or damage has been properly arranged;
- The progress has been achieved within scheduled time and the quality and quantity of the work is satisfactory;
- The arrangements for maintaining data relating to target, progress and cost are adequate and reliable;
- Verify that fines and penalties have been levied as per the Act for non compliance of the various provisions of the Act;
- Review the basis for the refund of the VAT applicable to the export industries and to the VAT exempt organizations;
- The tax audit conducted by IRO covers all areas of the account of the assessee;
- The IRO maintains records for tax, penalty, interest, and fine recoverable and it is adequate and up to date;
- The IRD/IRO has mechanism to monitor the person required to be registered in accordance with the provision of the Act have been actually registered;
- Cancellations of registration have been made in accordance with provisions of the Act;
- Tax officer has used power of sec 23 of the Act and conducted field visit to inspect the assessee from time to time on regular basis; and
- Cash collected from the tax payer has been deposited to revenue treasury on daily basis.

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### **3.6 Relevant laws and regulations**

**3.6.1** The following Acts, Rules, and Circulars are relevant for the audit of VAT and the auditors are expected to have thorough understanding of the same:

- VAT Act 2052;
- VAT Rules 2053;
- Finance Act; and
- Circulars and notifications issued by IRD from time to time.

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### **3.7 Audit checklist**

**3.7.1** The illustrative checklist is given in *Appendix -4* that may be updated at the time of audit based on the audit objectives and risk assessment.

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## Customs Duty

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### 4.1 Introduction

**4.1.1** Customs is a form of indirect tax. It is payable upon goods or merchandise being imported or exported. Customs duty is different from tax as it is paid before the act permitted under the law is carried out. For instance, customs duty is paid before the goods are cleared whereas income tax is paid subsequent to the taxable event, which is earning of income.

**4.1.2** The Customs Act, 2019 levies duty on goods exported from Nepal and imported into Nepal from other countries. The power of the Act is used not only for raising revenue but also to regulate economy, to encourage or discourage a situation which calls for import or/and export of goods. Customs revenue includes import and export duty, demurrage charges, declaration form charges, and excise refund from India, etc.

**4.1.3** Before 1951, the trade relation of Nepal was very limited with India and Tibet. At that time, the customs revenue collection system was given to the private sector on contract since the institutional base was weak and fragmented. The Customs Commissioner's office at central level was first established in 1957. It was replaced by Department of Customs and Excise in 1962. As the volume of trade and trading partners grew, the role and scope of customs was expanded with new challenges. Therefore, Customs was separated from Excise in 1966 and established as a separate department under the Ministry of Finance. From that day, it is working as a distinct department mainly to collect revenue.

**4.1.4 Goods Classification System** – Beginning in 1982/83, Nepal introduced an internationally recognized harmonized system for classifying goods for import /export. Goods are classified into 21 sections, 97 chapters, and approximately 1244 headings and 5255 subheadings. A six digit code is used to classify the goods, with two more digits for sub-classifying goods according to each country's needs. All major goods in the world are covered by this system.

**4.1.5 Valuation of Goods** – According to General Agreement on Tariff and Trade ("GATT") 1994, the basis for the valuation of the goods imported is the transaction value. Customs duty is levied according to the transaction value. The "Transaction Value" mentioned in Article 13 of Customs Act, 1962, shall mean the total declared amount by the importer, which is actually paid or payable by the buyer to the seller to import goods. It also includes the amount incurred or likely to be incurred for freight, insurance and all other expenses up to the border of the Kingdom of Nepal. If the documents of the freight, insurance and all other expenses are not submitted, the Customs officer shall determine the transaction value on the basis of the presumptive expenses. The Director General of the Department of Customs may fix the norms for expenses incurred or likely to be incurred for the purpose of determining the transaction value.



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**4.1.6** As per the GATT there are six methods for customs valuation.

- Transaction value of the goods;
- Transaction value of the identical goods;
- Transaction value of the similar goods;
- Deductive value method;
- Computed value method; and
- Fall back method.

Customs offices should follow the methods one after another.

**4.1.7** Customs officer shall have to follow the fundamental principles of the World Trade Organization (“WTO”) in regard to the determination of value, whether or not the buyer and seller are related.

**4.1.8** Customs officer shall ask for appropriate reason and enough evidence if the transaction value declared is less than the declared value of the pre-imported identical or similar goods.

**4.1.9** In case such transaction value is verified on the basis of the documents and reasons presented by the importer, Customs officer shall accept the value with due justification in circumstances the transaction value could not be determined even in accordance with the above, the customs officer shall accept with justification on the basis of documents and reasons presented by the importer if such transaction value is verified. Customs officer shall forward such acceptance to the Department of Customs for review of the assessed value.

**4.1.10** If the transaction value provided by the importer is not proven valid, Customs officer shall assess the transaction value based on the principles specified and shall notify the same with reasons to the importer.

**4.1.11** In case the importer is not satisfied with the transaction value determined by Customs officer, the importer may within 15 days appeal to the Director General of Customs directly or through the Customs office concerned for review of the assessed value. The application submitted to the customs office has to be forwarded to the Director General within 7 days. The Director General shall normally give his decision within 21 days on such application. The Director General may consult Expert Committee while making decision upon such appeal.

**4.1.12** If the transaction value determined by Customs officer is more than the transaction value originally established by the owner, a hundred percent chargeable duty is levied on such difference value in addition to the normal duty. Or with the prior approval of the Director General such goods could be purchased or get it purchased on the declared value plus freight, insurance and five percent profit on it.

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**4.1.13** In case the transaction value of the goods could not be ascertained by the Customs officer there and then and the importer wishes to clear his goods from the customs, the Customs officer may determine a provisional value of the goods. The importer is permitted to clear his goods by placing upon deposit the amount of customs duty chargeable on the value. The goods cleared, the transaction value has to be determined within thirty days.

**4.1.14** After the clearance of goods from Customs office, post clearance audit of selected firms or commodities will be carried out by an official designated by the Director General. Criteria for selecting firms or commodities will be as specified by the Director General. If the value is found to be under-stated in course of Post Audit, duty shall be recovered on such under-stated value and additional duty is charged on such duty and other penalties shall be imposed under prevalent laws.

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### 4.2 Objective and scope

**4.2.1** The Objectives of this guideline is to help the auditor to ensure the following:

- Custom duty has been collected on all goods imported into Kingdom of Nepal and Exported from the Kingdom of Nepal in accordance with the provision of the Customs Act 2019.
- Revising the Customs duty with a view to simplicity, efficiency and harmonization avoiding cascading in order to avoid distortions.

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### 4.3 Systems of submitting declaration and collecting duty

**4.3.1 Collection of Duty** – The person importing or exporting goods on which duty may or may not be chargeable must submit a declaration form (Pragyapan Patra) to the Custom office in a prescribed format. If the value of imported goods is less than the prescribed limit, or if some one brings in goods on which duty is not chargeable under the personal luggage regulations, declaration forms need not be submitted.

After the registration of the declaration forms, a Customs officer or any inspector assigned by him will determine whether the goods are permitted for import/export and whether the actual size, weight and quality, etc. agree with the declaration form. If such examination confirms the declaration form to be correct and the goods are not dutiable, the Customs officer marks the form accordingly, but if the goods are dutiable, valuation will be made for the purpose of Customs duty and a receipt for the collected duty will be issued to the concerned person. No one can remove his goods from the Customs office without the marks or the receipts described above.

#### **4.3.2 Refund from India under DRP**

According to the trade treaty between Nepal and India, excise duty paid in India may be refunded by His Majesty Government of Nepal. Therefore, excise duty paid in India by the importer may be deducted from the total custom duty receivable by the Customs office in Nepal on submission of the relevant documents by the importer. For the specified goods imported under DRP procedures, and if goods liable to central excise transmitted under central excise seal to Nepal' 'Invoice form' is prepared in four copies. This form is called Nepal Invoice. The first copy of the form is certified by the Indian excise officer and forwarded to the Indian custom office at the border along with the goods. That Office marks the form with red ink and forwards it to the Nepalese Customs Office at the border. The second and third copy of the Nepal Invoice is forwarded to the Department of Customs in Nepal and to Indian Director General of Inspection Customs and Central Excise.

**4.3.3** In this way all customs offices prepare a separate records of such imports and forward a monthly statement of such records to the Nepalese Department of Customs. The Department of Customs prepares up to date records and takes necessary action to get the Indian Excise Duty refunded.

**4.3.4** Determination of value of goods imported under DRP shall be as follows:

- Value shall be determined by adding the expenses of insurance, freight and other, if any, in whichever value is greater between the value determined by government of India for the purpose of assessing excise duty and ex-factory or ex-depot price.
- No other rebate shall be accepted except the rebate allowed in maximum retail price (MRP) of the imported goods clearly mentioned.
- Clearly and separately mentioned freight in invoice and the receipt of payment of premium of insurance shall be accepted. In circumstances, no separate mention of freight in invoice is made and no receipt of payment of premium is presented the value shall be determined by adding minimum 5% of the invoice value for the freight and insurance.
- The amount of excise duty paid in India of goods imported under DRP shall be deducted from the customs duty chargeable as per tariff. Nevertheless no amount of Indian excise duty shall be deducted from the chargeable customs duty on the difference found in freight, insurance and value plus other expenses.

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**4.3.5 Barter System** – Barter system can be defined as export of one goods with import of another goods of same value from the same person. In this situation the value may or may not have been reflected. If the value is reflexible than the transaction value method will be followed to determine the value of the goods. However, if the value is not reflexible than the other method of valuation should be followed to determine the value of the goods under barter system.

Goods eligible to be dealt under barter system and the country have been specified.

**4.3.6 Vehicles, Equipment, or Goods imported under customs privileged facility or full or partial duty facility or imported under 1% duty** – Vehicles, machines, equipment and goods imported under customs privilege (diplomatic privilege) or full or partial duty privilege or imported with the imposition of only one percent customs duty or imported temporarily by placing on record or on bank guarantee on condition to take them back later shall be charged customs duty in accordance with rules on the amount of value that remains after reducing as depreciation at the rate of ten percent per annum up to five years on residual basis from the value fixed at the time of importation in case goods are presented as gift or donation or sold to any person of the importer keeps them for his own use in the Kingdom of Nepal. In determining the value in this way the duty shall normally be assessed on the basis of (value) in foreign currency fixed at the time of importation except in circumstances when the value differs substantially from the value of similar goods of regular import. In case the goods in question has been imported second hand the facility of depreciation on such item shall be accorded after deduction the period of use (utilization) of the item not exceeding five years (of such utilization).

**4.3.7 Bonded Warehouse Facility** – Bonded warehouse facilities are allowed to the following:

- Readymade garments exporting to India and third countries
- Industries exporting goods to third countries
- Industries (other than readymade garments) exporting goods up to 80%of its production to India.

The above facility holder industries, while exporting their goods, are required to do transaction through letter of credit or proper banking channel. Authority letter to Bonded Warehouse shall be issued by Customs Department.

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**4.3.8** Import of raw material or auxiliary raw material (except packing material) are allowed under Record or Bank Guarantee of amount of duty calculated at normal rate plus 25% additional duty amount for 6 months to 12 months period.

**4.3.9** The above Bank Guarantee shall be released on the submission of following documents after exporting goods made from such imported raw material within 11 months period:

- Application for release of Bank Guarantee;
- Evidence of goods exported;
- Evidence of Foreign currency earned duly certified by concern Bank; and
- Ratio of consumption of raw material duly certified by concern entity.

**4.3.10** A minimum of 20% value addition is must while exporting goods after production from using such imported raw material.

**4.3.11** Customs duty at applicable normal rate with additional 25% will be recovered on failure of the submission of the application to release the Bank Guarantee within 11 months period.

**4.3.12** Duty applicable for the Goods imported for Duty Free Shops through Bonded warehouse may be allowed under Cash deposit or Bank Guarantee facilities. On the submission of evidence of goods sold from duty free shop the chief of customs office may allow 100% discount and order to release the Bank Guarantee.

**4.3.13** Duty applicable for the catering goods or goods for international in-flight Duty Free Shop imported by the airlines may be allowed under Cash deposit or Bank Guarantee facilities. On the submission of evidence of goods sold in international flight the Chief of Customs office may allow 100% discount and order to release the Bank Guarantee.

**4.3.14** Bonded warehouse facility can be provided to Nepali textile industries on the recommendation of textile industries association to import raw material for selling finished products to readymade garments for export purposes.

**4.3.15** Bank Guarantee facilities may be allowed under 'Buy Back Agreement' to industries having bonded warehouse facility.

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**4.3.16 Exporter without having bonded warehouse facility** – Cash Guarantee (Deposit) facility may be allowed against applicable import duty on the import of raw material or auxiliary raw material (except packing material) to industries not having bonded warehouse facility but involve in exporting goods through letter of credit or proper banking channel or earned foreign currency by in-country sale of goods.

**4.3.17 Goods re-export or re-import** – In case where Goods manufactured in Nepal and exported through proper customs process if re-imported due to rejection by the party or any other reason than the applicable customs duty on import as per section 10 of the schedule 1 of the Finance Act 2061 can be waived by the Chief of Customs office. The Chief of Customs office is required to inform Director General immediately about the waiver of such duty. At the same time import duty applicable on the raw material or auxiliary raw material relating to that finished product originally allowed to be imported under Bank Guarantee shall be recovered as the same can not be treated as export.

Notwithstanding any provision mentioned in bilateral or multilateral agreement between HMG and other countries, import is allowed under deposit of duty for the goods imported from one country and intends to re-export it to another country within 3 months time. On the submission of evidence of earning in foreign currency (not less than purchase value mentioned in Pragyapan Patra at the time of import), and evidence of export the deposit will be refunded within one month time after deducting only 10% of applicable import duty.

No customs duty will be levied on the re-export of goods due to inferior quality or not matching with Quality Standard or not meeting the objective of the import or any other reason after getting approval from Customs Department on the condition of taking back same type of goods within 60 days or getting refund the amount of foreign currency paid within the prescribed time limit. Application for the same has to be submitted to the department within 3 months of the import. If the goods can not be exported due to inferior quality than the same can be disposed off on the cost of importer, however, no duty will be levied on the same.

Re-used Industrial Plant & Machinery can be allowed to be re-exported on the recommendation of Department of Industry (“DOI”).

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**4.3.18 Special provision for import of vehicles** – Vehicles in the nature of recondition, used, or not falling under Nepal vehicle pollution standard 2056 (except ambulance and fire brigade), are prohibited to be imported. However, officials from diplomatic mission or military or police department returning home after completion of one year or more service abroad can be allowed to import own used vehicles on the recommendation of Ministry of Pollution and Environment.

Vehicles for personal use in-housed by tourists under CARNET system are allowed to be retained without duty for temporary period of 6 months in a 12 months period. If such vehicles were not taken back by the tourists within allowed period of time than it will be automatically seized.

Temporary import of a tractor, vehicle, tourists vehicle or other transport vehicle are allowed subject to prescribed terms and conditions and payment of minimum customs duty as prescribed.

**4.3.19 Vehicles, Equipments, and Goods imported under customs facilities, fully or partial duty facilities, import under records or Bank Guarantee facilities** – Vehicles, Equipment, and Goods imported under customs facilities or fully or partial duty facilities or imported under 1% facility as per decision of HMG or imported under records or Bank Guarantee facilities, if sold or gifted or used for personal purposes, than customs duty will be recovered after allowing 60% discount on the applicable duty. The said discount will be effective only on transaction after 5 years of import. The said facility will be allowed only once to the diplomat during his service tenure in Nepal.

Temporary import of Vehicles, Equipment or Goods for particular purpose are allowed to be imported under record or Bank Guarantee on the condition of re-exporting the same within 3 months time. If such goods are not re-exported within 3 months time than the same will be seized by the Customs Department except otherwise period extended by HMG, or sold, or gifted, or used for personal purposes after payment of applicable duty.

With regards to import of vehicle or means of transportation or Plant & Machinery or other equipment in the name of contractor of the project in operation within the kingdom of Nepal the provision for customs duty will be as follows:

- Temporary import of vehicle, equipment, or other goods in the name of contractor are allowed against partial payment of duty or under record or Bank Guarantee against the applicable duty as per the agreement with the HMG or as per decision of the HMG.

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- The period of the stay in Nepal should be mentioned in the Pragyapan Patra at the time of import. Extension of the stay period is required to be obtained in case of extension of the project period.
- A separate identity will be given to such vehicles and other means of transportation at the time of registration. The same will not be renewed after completion of the project period.
- Such imported vehicles, equipment and other goods can not be transferred to other project without payment of applicable duty.
- Such imported vehicles, equipment or other goods should be re-exported within 3 months time after completion of the project except otherwise extended.
- In case of non-compliance or non payment of duty the same will be seized by the Customs department.

**4.4 Risk areas and control measures**

4.4.1 The auditor should consider the following risk areas while performing audit.

Risk Areas	Control Measures
Possibility of mistaken or fraudulent declaration of the goods imported or exported.	<p>The following system checks such activities:</p> <ul style="list-style-type: none"> <li>▪ Importer/Exporter must state his name, address, Permanent Account Number, details of the goods including quantity and value etc. in the declaration form and attach the invoice and other necessary documents.</li> <li>▪ Transport operator should also submit a statement showing his name, address, the means of transport, the vehicle number and details of the goods transported.</li> <li>▪ Insurance documents provide the details of goods.</li> <li>▪ Goods will be allowed for import/export after they have been checked by the customs officer or inspector on duty.</li> </ul>
The open border with India increases the possibility of avoiding Custom Duty on import.	Customs check posts are in many places to control such import.



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Risk Areas	Control Measures
Passengers coming from foreign countries may conceal gold, silver etc. to evade customs duty.	Body checking and baggage checking are employed by the custom inspector.
Someone might leave imported goods unattended on the customs counter, aircraft or any other place in the customs area.	Custom officers are authorised to check all locations, including aircrafts and customs areas.
Goods imported/exported might remain in the warehouse for years, causing a loss of customs revenue and creating a risk that the goods might be damaged.	<ul style="list-style-type: none"> <li>▪ Demurrage will be charged if goods are not cleared from the customs within seven days.</li> <li>▪ If the goods are not cleared within specified period, the Customs officer may issue a notice to the owner to clear the goods from the customs or may order for auction the goods.</li> </ul>
Theft or loss of goods may occur in the Customs warehouse.	All goods must be recorded and the warehouse must be properly secured.
Loss of revenue may occur, if the goods seized are not auctioned promptly.	<ul style="list-style-type: none"> <li>▪ Existing regulations state that perishable goods and other goods whose value may quickly reduce should be auctioned immediately.</li> <li>▪ Notice of 30 days before auctioning other goods.</li> </ul>
There is a risk of losing customs revenue from the vehicles and equipment which were temporarily imported duty exempt, on the condition that they will be exported from Nepal after.	If those goods are sold or used for personal purposes, customs duty must be paid or the goods will be seized by the government.
Collusion between Customs staff and importers/exporters could result in less duty being collected.	Customs staffs are subject to surprise checks by the Department of Revenue Investigation and by National Vigilance Center.

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<b>Risk Areas</b>	<b>Control Measures</b>
Customs staff might not credit the right amount of duty to the bank.	Cash receipts are issued at the time of collecting revenue. Each receipt is properly accounted for by the Accounts Section which also checks that revenue is credited to the bank promptly.
Importers may receive customs rebates from goods manufactured in a most preferential country, but imported from some other country which is not subject to customs rebate.	Such rebate is given only on the following conditions: <ul style="list-style-type: none"> <li>▪ Goods are shipped from the most preferential country.</li> <li>▪ Goods must be insured in the most preferential country.</li> <li>▪ Certificate of origin has been produced.</li> <li>▪ Payment certificate has been produced.</li> </ul>
VAT may not have been recovered on the import under DRP procedures.	Only customs and excise duty paid in India are allowed to be deducted at the customs point.
Under invoicing under Bank Guarantee/ Cash Guarantee.	Different types of valuation method will be followed to identify such instances.
Attempts may have been made to manipulate in the Quantity and Quality.	Surprise physical verification by the Customs officer at the check post may reduce such risk.
Post clearance audit may not have been carried out.	As per WTO standards post clearance audit is mandatory for each type of customs transactions.
<b>Risk Areas</b>	<b>Control Measures</b>
Value may not have been appropriately determined in case of goods imported under Barter system.	Review on test basis may reduce such risk.
The exporter may not submit the evidence of the export.	It is mandatory to submit evidence of export before releasing Bank Guarantee or Cash Guarantee.

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<b>Risk Areas</b>	<b>Control Measures</b>
Prohibited goods may export or import.	Surprise physical verification by the customs officer at the check post may reduce such risk.
Goods may be allowed to import or export under certain conditions	Those conditions have to be full filled before releasing BG or Cash Guarantee as the case may be.
Importer and Exporter may have close relation with each other that may affect the invoice amount	Different valuation method available to the Customs officer to determine the transaction value.
Following expenses may be mentioned in the invoice and included in the transaction value: <ul style="list-style-type: none"> <li>▪ Interest on the installment payment</li> <li>▪ Transportation, fitting and construction charges after import, tax and other duty</li> </ul>	Those expenses should not be part of the transaction value.
<b>A separate list is provided in the Finance Ordinance for the following condition of import:</b> <ul style="list-style-type: none"> <li>▪ Allowable imports under full or partial custom facilities.</li> <li>▪ Allowable import under customs privileged facilities or 1% duty as decided by HMG.</li> <li>▪ Allowable import under custom facilities of 1% duty.</li> </ul>	

**4.5 Matters of audit consideration**

**4.5.1** Auditor should assess compliance with the Customs Act 2019 and other relevant Acts, regulations and departmental guidelines and determine the following:

*Declaration Form (Pragyapan Patra)*

- The auditor should review the declaration form in depth and should ensure whether:
  - the owner of the goods has described the particulars of the goods correctly;
  - the Customs duty has been collected on the basis of the higher of the value of the goods determined for the purpose of raising customs duty according to the Finance Act applicable for the fiscal year or the sales price shown on the invoice;
  - transportation cost of the goods, insurance, and other related costs are included in the dutiable cost and they are agree with the supporting documents;

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- the details of the goods mentioned in the declaration form agree with the invoice;
- the duty rate charged and the arithmetic calculations are correct;
- correct harmonize code has been mentioned in the form;
- Same amount of duty has been recovered against the same nature of goods;
- Various types of revenue levied by Finance Act such as custom duty, countervailing duty, value added tax, local development fee, agriculture improvement fees, special fees etc have been recovered;
- Supporting document such as invoice, shipping document, bill of lading, packing list, insurance certificate, certificate of origin, letter of credit, transporter's invoice etc have been attached with the declaration form while importing and exporting goods;
- The declaration form have been verified and certified by authorized custom officials; and
- Those committing fraud in connection with the import/export of goods are prosecuted.

### *Other matters*

- The auditor should determine the adequacy of records of goods seized when being smuggled into the country across the border. The records should show on what basis the goods were seized and how, e.g., informers, border police, etc.
- If some travelers are found guilty of carrying goods without declaring them, the auditors should examine the record for whether the persons were arrested on information provided by INTERPOL or through the initiative of the customs staff.
- The auditor should determine if there are any goods in the customs warehouse in conditions shown below and, if so, what action has the customs officer taken:
  - goods prohibited for import/export;
  - goods with dock shortage;
  - goods for which the owner did not pay customs duty and goods were not cleared from the customs;
  - goods for which departmental valuation is not yet completed or the customs code number has not yet been fixed;
  - goods withheld by the customs officer for further enquiry;
  - goods which are pending due to court cases;
  - The goods seized but not auctioned;

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## Chapter 4 Custom Duty

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- According to customs regulations, the government is liable for the loss or damage to goods in the customs warehouse, with some exceptions. Auditors should note examples of the loss or damage of goods for which government can not be held liable;
- There is no clear provision for seizing goods which are not cleared from the Customs, even after the notice issued to the owner to collect their goods. Auditors should check the warehouse for goods lying for many years;
- The auditor should determine if the following actions have been initiated in respect of the goods seized by the office:
  - Whether perishable goods and livestock have been auctioned within 24 hours of being seized, according to the customs regulations;
  - As the date for the auction of the non-perishable goods is not clearly mentioned in the Customs regulations, the auditor should see if such goods have been retained for years without auctioning;
- The auditor should examine the following matters in respect of temporarily imported vehicles, machinery and equipment, etc.:
  - Whether customs duty has been collected for such goods if they were sold, given as gifts or used for the personal purpose;
  - Whether vehicles were seized which were not taken out of Nepal after the end of the project period;
- If there are cases detected by the Revenue Investigation Department or National Vigilance Center, where the customs officer has under valued the goods imported/exported, verify the customs declaration form for such cases;
- The following matters should also be considered in addition to ensuring that customs revenue is credited to the consolidated fund:
  - Whether the amount mentioned in the declaration forms, cash receipts, records and bank vouchers agree with each other;
  - If the office has used computer processing, the auditors should verify whether the figure shown by the computer and the bank voucher agree;
  - Whether the cash receipts were pre-numbered and used serially;
- The following matters should be verified to ensure that the goods imported from the most preferential countries were properly rebated:
  - Whether the shipping document exists which proves that the goods were actually shipped from the most preferential country;
  - Whether the goods were insured in the most preferential country;
  - Whether the payment was made through the bank of the most preferential country;

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## Chapter 4 Custom Duty

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- The following matters should be considered to detect if the goods imported under the DRP system were sold in India:
    - Whether there is a system of collecting customs duty, if customs records have not shown the collection of customs duty for the goods imported from India under the DRP system for which necessary documents have been received from the Indian Customs Office;
    - Indian Customs Office uses serial numbers with red ink on the DRP forms. During the course of the audit, the auditor should verify if the numbers are used serially;
  - Excise refund from India is not possible if the customs office in India does not make the DRP forms available to HMG. In such cases the auditor should know whether HMG has initiated any dialogue with the Government of India on this issue;
  - Auditor should assess whether Countervailing Custom Duty has been realized as provided by Finance Act;
  - The Customs office maintains record of goods imported under customs privileged/ facility, such as, full or partial waiver of duty, imported on duty of 1%, or imported on returnable basis under cash or bank guarantee deposit etc, and has mechanism to cross-check and collect duty on sale, use, gift etc of those goods. The value will be after allowing 10% depreciation on written down value for 5 years;
  - The Customs office maintains proper record of vehicles in-housed by tourists for temporary period of upto six months in a year without duty. If they are not returned (re-export) within validity period of six months than the assets may be seized except for valid reason;
  - Goods temporarily imported under condition of return back against deposit or Bank Guarantee must be taken back within 3 months or extended period of import otherwise they will be sized;
  - Goods temporarily imported by the Project under agreement with HMG under record, partial duty, or Bank Guarantee customs facilities are required to return back within 3 months. Failure to return back may liable to goods seize by Customs office except otherwise extended. Similarly, such imported goods can not be transferred from one project to another project without payment of applicable duty.
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Chapter 4  
Custom Duty

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**4.6 Relevant laws and regulations**

**4.6.1** The following Acts, Rules, and Circulars are relevant for the Customs audit and the auditors are expected to have thorough understanding of the same:

- Customs Act 2019;
- Customs Rules;
- Finance Act;
- Circulars and notifications issued by Customs Department from time to time;
- Other circular issued by Department of commerce;
- GATT;
- WTO;
- SAFTA;
- Export Import Control Act, 2013; and
- Other relevant documents

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**4.7 Audit checklist**

**4.7.1** The illustrative checklist is given in *Appendix -5* that may be updated at the time of audit based on the audit objectives and risk assessment.

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## Excise Duty

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### 5.1 Introduction

**5.1.1 Excise Revenue** – The Excise duty is levied on a manufacturer or producer in respect of commodities produced or manufactured by him or imported into Nepal. The Excise Act 2058, levies excise duty on goods produced and imported in Nepal. Excise revenue also includes license and renewal fees, fines, penalties and amounts realized through auctions.

The effect of Excise duty is also faced by narrow range of population. At present, large sales volumes, few producers, limited consumer, inelastic demand and lack of close substitutes are the basic charm of excise system in the country. The basic relatively simple administrative efforts provide limited opportunities for tax evasion. Excise duty is a very helpful instrument to control the consumption which is regarded as lacking merit or as likely to cause negative externalities.

**5.1.2 Controlling Excise** – The Excise duty has been governed and regulated by the Excise Act 2058, Excise Regulation 2059, and Alcohol Regulation 2033. As provisioned in the law, the excise commodities are closely controlled and supervised by the Government from their production to selling stage. Licensing requirement is adopted for all excise commodities and it is given by both Department as well as field offices. Excisable commodities are realized for sale with an excise stamp to assure the sales of taxed commodities. Among the excise commodities, special provision is made for alcoholic beverages and tobacco because of high sensitivity with respect to the revenue as well as negative externalities. They are controlled and supervised physically from their starting stage of manufacturing to last selling stage. The excise personnel are stationed in the factory to maintain controls of production and sales. The deployed persons have been responsible to control, supervise and monitoring the products. In respect of less sensible goods such as cement, soft drink and some plastic products they have been regulated by self-removal system.

Export is exempt from Excise Duty.



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## Chapter 5 Excise Duty

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**5.1.3 Licensing System** – Anyone wishing to manufacture, export, sale or store excise dutiable goods must obtain license from the Excise office. The licence must be renewed annually. Renewal shall be done upon payment of specified fees within one month from the date of expiry and within two months from the date of expiry with a fine of 10% of the applicable fees. If it is not renewed within two months, it lapses automatically.

The license must be displayed in a way that everybody can see it.

License holders must submit statements of excisable goods in the prescribed form to the Inland Revenue Office within the period specified in the Act.

**5.1.4 Credit/ Claim** – Liquor/Beer producers are allowed to claim input tax credit for excise duty paid on raw materials used for providing excisable goods/services.

Provision is made for an Administrative Review at IRD if the decision made by Excise officer is not acceptable to the taxpayer. In such case, taxpayer has to submit an appeal within 35 days from the date of receipt of such decision. Taxpayer can approach the Revenue Tribunal if he is not satisfied with the Department's decision.

**5.1.5 Offences** – Failure to comply with the Excise Act shall be liable to penalties. In general, following are applicable to have committed offences:

- Engaged on manufacturing, selling and storing excise goods or providing excisable services without license.
- False statement or documents in connection with excise liability.
- Under reporting of excise liability.

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## 5.2 Objective and scope

**5.2.1** The Objectives of this guideline is to help the auditor to ensure the following:

- Excise duty has been collected on all goods manufactured and imported within the Kingdom of Nepal in accordance with the provision of the Act.
  - Revising the Excise Duty with a view to simplicity, efficiency and harmonization avoiding cascading in order to avoid distortions.
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**5.3 Systems of submitting returns and collecting duty**

**5.3.1 Excise Duty Collection** – Excise is levied at the rates prescribed in Excise Act and amended by Finance Act every year. Excise duty is recovered at the time of issue of the goods for sale from the factory.

In case of specified goods, excise has to be recovered at the time of production and the producer may be asked to deposit the estimated annual excise computed by the excise officer for the year, regardless of the amount of actual sales.

In case of services, excise is recovered at the time of issue of the invoice.

In case of import, at the time it is considered as import for the customs purpose.

All transfer/sale of the goods from the warehouse shall be made only in the presence of the Excise Officer and that a record of the same should be maintained.

Manufacturers of excisable goods except from alcohol and cigarettes can apply to the Inland Revenue Office for permission to self issue of the products. Upon permission, such self issue organizations shall maintain a day book showing the quantity and value of production and sales and the records shall be presented to the excise staff for verification on demand. Such self issuing organizations shall send monthly report to the Inland Revenue Office.

**5.3.2 Determination of Price for collecting Excise Duty** – In case of production, the factory price determined by the producer or the price determined by the Department based on the cost of production.

In case of import, cost determined for the Customs duty purpose after adding the customs duty. However, if similar goods are produced in the country, cost as determined above or the cost determined for the custom's purpose, which ever is higher.

In case of services, as per the invoice raised.

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Chapter 5  
Excise Duty

**5.4 Risk areas and control measures**

**5.4.1** The auditor should consider the following risk areas while performing audit.

<b>Risk Areas</b>	<b>Control Measures</b>
The factory owner might misstate the quantity, quality or value of goods removed from the warehouse, resulting in understatement of the amount of excise duty payable.	Goods are taken out from the warehouse in the presence of Excise Officer and he verifies the correctness of the requisition form. Such goods can be detained by the excise officer.
Factory owner might purchase on an excise duty exemption basis, more quantity of raw materials than needed by the factory and might sell the excess without paying the duty.	Department of Commerce issues license on the basis of the recommendation of the Department of Industry. At that time, the plant capacity is determined. Later purchases are checked against plant capacity on an annual basis.
Factory owner may show excessive consumption of raw materials compared with the finished goods produced.	Use of raw materials in excess of the established norm is regarded as used for production of the product attracting highest excise duty and excise duty recovered.
Liquor, cigarette and illegal drugs might be produced without a license to do so.	Regular checking is done by the Excise staff and occasionally by the Revenue Inspection Department.
There is a possibility of collusion between the factory owner and the resident excise staff, to reduce the amount of excise duty payable.	There is a provision for an annual independent check of each mill and factory.
Excise duty may be under charged based on lower price at traditional rate.	Excise revenue is charged on ex-factory price.

Chapter 5  
Excise Duty

Risk Areas	Control Measures
<p>Factory owners of alcohol might show excess wastage or loss than the actual loss</p>	<p>Factory owner should make arrangement for excise officer or other staff assigned by the excise officer to inspect the stock at least once in a year. Upon verification, the inspecting officer should sent recommendation to the Department through excise office for the approval of such loss specifying the reason for the shortage. Upon receipt of such recommendation, department can approve such shortage.</p> <p>Factory owner should make proper arrangement for the preservation of the raw materials like molasses, spirit etc. Loss in excess of the established norms due to inadequate preservation arrangement is considered as used for the production of alcohol attracting highest excise duty.</p>

**5.5 Matters of audit consideration**

**5.5.1** In addition to checking compliance with the Excise Act 2058 and with other relevant acts, rules, regulations and circulars, the auditors should determine the following:

- Ensure that Excise duty is levied on goods at the rates given in Annexure of the Excise Act.
- Whether the Excise Office has maintained a record of the organizations applicable to the excise duty like factories producing excisable goods, importers, hotels, restaurants and shops selling liquor etc.
- Whether the cost of goods sold was calculated ex-factory price:
  - Whether the quantity and quality of the goods and the amount of duty to be paid agree with the requisition form.
  - Whether there is adequate documentation for the goods sold excise duty exempt on the basis of receiving foreign currency.
- Whether excise duty exempt goods acquired during the year are in excess of that actually needed, based on the production capacity of the factory.

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## Chapter 5

### Excise Duty

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- Whether the consumption of raw materials was in excess of input output ratios established by the department, and:
  - Whether adequate procedures were followed by the Department of Excise to determine wastage and leakage, in the absence of established norms.
  - Whether the excise duty was levied at the highest rate when raw material consumption was in excess of approved ratios.
  - Enquire what was done with the by-products of the factory?
- Whether proper records are maintained for the illegal drugs detected and seized showing how they were detected and their disposition, e.g., auctioned, destroyed, given to the appropriate agency for handling or still on hand (and why).
- Whether the Excise office maintained records showing the name, year and amount of Excise duty arrears.
- Whether there is evidence that the factory inventories were examined and reports submitted by the staff of the Inland Revenue Department.
- Whether the formula has been properly applied for calculating the cost of goods for excise duty purposes. The cost should include cost of production and the profit. Excise duty and taxes shall not be included.
- Whether a record has been maintained at the Custom point to record the import of excisable goods giving details of name of the license holder, quantity of goods and cost price.
- In case of goods on which excise to be recovered at the time of production, Excise officer can demand for a deposit in advance equivalent to the estimated excise amount recoverable during the year.
- For import of excisable goods under L/C, the importer should furnish a detail of quantity, value and harmonized code of such goods to the excise office.
- Ensure that Bidi manufacturer has used the Band Roll procured from the Excise Office for production and sales and a record maintained for such Band Roll.
- Verify that stock at the alcohol distillation plant is verified by the Excise officer at least once in a year. Any shortage due to vaporization or leakage shall be certified and written to the IRD for rebate through Excise office.
- Ensure that Excise duty not paid is recovered with a late payment fine of .05% per day.
- Stock at the warehouse of factory whose license has been cancelled can be sold with the approval of the Department upon payment of the outstanding Excise duty. If outstanding duty is not paid, Department can recover it out of the proceeds from the auction of such goods. Any excess amount shall be returned to the owner.

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## Chapter 5

### Excise Duty

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- Verify whether records of raw materials and finished stock have been maintained as specified by the Excise Rules, 2059 and are certified by the Excise officer.
- Persons holding the license for production of alcohol shall follow the following procedures:
  - They should produce the alcohol blending only with the spirit produced from authorized steel plant.
  - Producers of alcohol should exercise proper care on preservation of the stock of raw materials like spirit, molasses etc. Any loss of raw materials due to the negligence shall be considered as used for the production of the alcohol attracting highest excise duty.
  - Batch and serial number, name of the manufacturer and the UP of the alcohol should be mentioned in every bottle of the alcohol produced.
  - Inspection register should be maintained at distillery or brewery as specified by the Department. Excise officer or any person authorized by him should fill in the register giving date of inspection and the lapses noted in the production process.
  - Record should be maintained showing the raw materials used and the percentage of the water in fermentation of the flavor and the quantity of such flavor should be recorded and information of the same should be given to the Excise officer prior to the distillation.
  - Record of alcohol distilled showing the quantity and the UPS as per Annexure -10 and detail of sales of alcohol and excise duty thereon as per Annexure -11 of the Excise Rules should be maintained.
  - Records of food grains and fruits used in the production of alcohol should be maintained and certified by the Excise officer or any staff assigned by him.
  - 19 liters of ENA or 20 liters of rectified spirit of 65 OP should be produced from per quintal of Khudo. Any shortage in the production should be approved by the Department.
  - 3 days advance notice should be given to the Department for the closure of the industry for any reason.

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## Chapter 5 Excise Duty

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- Persons holding the license for production of cigarettes shall follow the following procedures:
  - They should maintain the record of imported and domestic tobacco used in the production of cigarettes as per Annexure - 5 of the Excise Rule 2059 and certified by the excise staff on duty.
  - Stock record of tobacco used and the cigarettes produced there from in Annexure -6 of the Excise Rules 2059.
  - Prior approval should be obtained from the Department for the proportion of domestic and imported tobacco for various qualities of the cigarettes. Cigarettes ready for sales should be properly packed and stock taken out for sales from the warehouse should not be brought back without the approval of the Excise office.
  - Stock record at packaging department for cigarettes packed giving details of no of packets, serial number and the date as per Annexure -7 of the Excise Rules 2059.
  - Stock record at warehouse as per Annexure -8 of the Excise Rules 2059.
  - Requisition for issue of cigarettes from warehouse for sales as per Annexure -9 of the Excise Rules 2059.

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### **5.6 Relevant laws and regulations**

**5.6.1** The following Acts, Rules, and Circulars are relevant for the audit of Excise Duty and the auditors are expected to have thorough understanding of the same:

- Excise Act 2058;
- Excise Rules 2059;
- Finance Act; and
- Circulars and notifications issued by Inland Revenue Department relating to Excise from time to time.

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### **5.7 Audit program/ checklist**

**5.7.1** The illustrative checklist is given in *Appendix -6* that may be updated at the time of audit based on the audit objectives and risk assessment.

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## Non-Tax Revenue

### 6.1 Vehicle Tax

**6.1.1 Introduction** – All vehicle owners have to pay Vehicle Tax to the Government under the provision of Vehicle Tax Act, 2031. Vehicle, for the purpose of the Act, is the vehicle operated by the machine on the land like Jeep, car, lorry, truck, bus, van, minibus, motorcycle, scooter, auto-rickshaw, tempo etc. Vehicle Tax is levied to the person having a vehicle at the rate as prescribed in the Finance Act of the relevant financial year.

**6.1.2 Obligation to pay Tax** – Every person, who is the registered owner of the vehicle on the first day of Srawan, has to pay the tax earlier of Chaitra-end or the date of Renew. But, if the vehicle is transferred during the year, tax is recovered on prorata basis up to the month of transfer. For the newly registered vehicle, the prorata tax is levied from the month of custom clearance.

**6.1.3 Collection Time** – Registration, renewal or transfer of the vehicles can take place only upon payment of tax. However, tax has to be paid within Chaitra end. If tax is not paid within the specified time, penalty is imposed at the following rates:

- |   |                   |
|---|-------------------|
| ▪ Upto 30 days                            | 5% of Tax Amount  |
| ▪ 31 to 45 days                           | 10% of Tax Amount |
| ▪ After 45 days to the end of Fiscal Year | 20% of Tax Amount |
- If tax is not paid within the stipulated time, tax officer can recover the tax by seizing and auctioning the vehicle.
  - If the sales proceed from the auction is not enough for the tax, other property of the tax payer can be seize and make auctioned.
  - Any amount recovered in excess of the defaulted tax amount shall be refunded to the vehicle owner within two years on demand. Amounts not demanded within two years shall deposit in the *Consolidated Fund*.
  - If the tax payer deposits the tax amount including fines during the time of processing of the auction, the process shall be stopped levying 10 % extra fine.

**6.1.4 Exemption and Waiver** – Vehicle tax is exempt to the:

- Vehicle registered in the name of HMG.
- Vehicle registered in the name of Diplomats person or entity.
- Vehicle registered in the name of person, project, and international institution as contracted by HMG.
- Vehicle registered in the name of Local Entity.
- Vehicle registered in the name of Not-for- profit Organisation as certified by HMG.
- Person having scrapped vehicle or vehicle not operated by any reason as certified by the government.



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Chapter 6  
Non-Tax Revenue

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Government on the notification in the official gazette may waive the fine in full or partial with some reason.

**6.1.5 Documentation** – Transport management office shall maintain individual records of all vehicles registered.

**6.1.6 Risk Area, Internal Control System and Auditor’s Check List** – A list is given in *Appendix -7*.

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## 6.2 Registration fee

**6.2.1 Legal Provision** – All transactions as prescribed in the Civil Code (*Muliki Ain Registration ko Mahal*) has to be registered. The rate of the registration fee is prescribed in the Finance Ordinance each year. (schedule 4 of the Finance Ordinance, 2061 for FY 2061/062)

**6.2.2 Registration required** – According to the provision of the Civil Code, following transactions require registration:

- Document of Adopted child.
- Document of distribution/ merger of Immovable property.
- Transfer/ sale and exchange of property including movable assets.
- Mortgage documents.
- Transfer will after death.

For the audit of the revenue, registration fee is collected by Land Revenue office. Registration of the transfer/ sale of land is the major area for the audit.

**6.2.3 Collection Time** – Registration fee is collected at the time of registering the transaction.

**6.2.4 Registration Fees** – As per the relevant Finance Act or Finance Ordinance of the concerned.

**6.2.5 Valuation for collecting Registration Fee** – Valuation of the property/documents for collecting registration fee differs from ministry to ministry. The auditor should ensure that the valuation method specified by the concerned ministry is applied for collecting registration fee.

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Non-Tax Revenue

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**6.2.6 Documentation** – Land Revenue Office keeps the record of transaction registered in the order of registration number. The registered documents contains the supporting documents relating to the respective transactions like copy of Land Ownership Certificate, cash receipt of Land Revenue, copy of Citizenship Certificate etc.

**6.2.7 Risk Area, internal control system and auditor’s check list** – A checklist is given in *Appendix -8*.

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**6.3 Royalty from  
electricity producers**

**6.3.1** Royalty is one of the major contributors of non tax revenue. Royalty from electricity, natural resources like stone, sand etc., casino, and electricity are the sources of royalty. Procedure for the audit of royalty from electricity is given hereunder for sample. Auditors should plan and audit other royalties accordingly with reference to the relevant laws and regulations.

**6.3.2 Legal Provision** – As per Section 11 of Electricity Act, 2049, every hydro electricity generation license-holder shall pay the royalty to His Majesty’s Government of Nepal on the basis of installed capacity and actual sales.

**6.3.3 Imposition of Royalty** – According to the section 11 of the Electricity Act, 2049, the royalty is levied after the date of commercial production of the hydro electricity. For the first 15 years from the date of commercial production, the royalty is Rs. 100 per installed capacity in kilowatt plus 2% of the average sales. After 15 years of commercial production, the rate is Rs. 1,000 per installed capacity in kilowatt plus 10% of the average sales.

**6.3.4 Determination of Royalty** – The installed capacity of the electricity production is approved by the department at the time of licensing. The license holder has to file the annual report and a copy of income and expenditure account for the year within six months from the closure of the fiscal year. The royalty payable based on average sales is calculated and verified based on this document.

**6.3.5 Risk Area, internal control system and auditor’s check list** – A checklist is given in *Appendix-9*.

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## **6.4 Interest income**

**6.4.1** Interest earned on the loan provided to various institutions by the Government is known as interest income.

**6.4.2** The auditor should verify that the interest has been calculated at the rate prescribed in the agreement and been recovered in accordance with the terms and condition mentioned in the agreement.

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## **6.5 Deposits**

**6.5.1** All Government Offices and Courts have revenue as well as deposit transactions. Thus deposits are collected on account of the following transactions:

- Revenue received in advance or the amount deposited in lieu of revenue where the applicable revenue is not immediately ascertainable;
- Security deposit received for tenders for or supply of goods or services; and
- Deposit made as per the court orders or as demanded by various HMG Offices.

### **6.5.2 Matters for audit consideration**

- Revenue due or accrued is not treated as deposit and all due amount is promptly adjusted to revenue;
- Deposit received against supply of goods or service or for civil works are deposited into a separate bank account and not used for any other purpose;
- Unreconciled or unidentified amounts are reviewed regularly and adjusted to revenue, where appropriate;
- Old or long outstanding amounts are properly tracked and system is in place ensuring that refunds are made only to an authorized person;
- Refunds are adequately supported and documented; and
- Adequate records are maintained and outstanding amount is properly carried over to next year.

### **6.5.3 Audit procedures**

The auditor should verify that:

- All deposits received is credited to a bank account designated by the FCGO or relevant DTCO and the bank account is operated only by the joint signature of the Office in-charge and the chief of financial administration section;
- After the accomplishments of tasks for which the deposit was kept is adjusted to revenue account as per the prevailing laws or in terms of the contract within stipulated time or if no time is specified within 15 days of the task being accomplished;

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Non-Tax Revenue

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- Amount deposited in the bank for which no supporting document is submitted to the relevant office is adjusted to revenue within 90 days of the deposit;
  - Deposit maintained with the completed projects or the offices that are closed out is transferred to relevant office or to an office designated by it. Such office is responsible for the adjustment or refund of such deposit;
  - The deposits outstanding as on the date the FAR 2056 came into force against which no task is pending is adjusted to revenue with a condition that refund could be made as and when claim is received with due evidence;
  - Unreconciled deposit or the amount in respect of which the depositor could not be identified is credited to revenue within the period stipulated in FAR;
  - The FCGO is required to publish a list of the above mentioned deposits in each financial year advising to lodge refund claims. If no claims are received within the stipulated time the same is adjusted to revenue account;
  - Appropriate accounts are maintained as per Rule 113 of FAR 2056;
  - A monthly reconciliation with the bank statement is performed and discrepancies, if any, are followed up and appropriate departmental action is initiated against the responsible person if;
  - Each office, within seven days of the completion of each month or within 35 days of the end of each financial year, as the case may be, submits the monthly and annual financial statement of deposit held by them to DTCO with a copy to concerned Ministry/Department;
  - Each Ministry/Department compiles the deposit statement received from the subordinate offices and submits annual statement to OAGN and FCGO. The relevant DTCO prepares a district-wise deposit statement each tri-semester/ annually and submits to FCGO. Based on these statements FCGO prepares a consolidated deposit statement at central level; and
  - Outstanding deposits are carried over to next financial year.
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**Checklist on compliance with Financial Procedures Act 2055 and  
Financial Administration Rule 2056**

1a.	Revenue received by relevant office shall be deposited into a bank account as specified.	<b>Section 12(1)</b>
b.	Revenue shall be received in the form of an account payee draft, account payee cheque certified as good for payment by the relevant bank, paying-in-slip of the bank located in the relevant district or cash. A cash receipt shall be issued to acknowledge such receipt	<b>Rule 10(1)</b>
c.	All receipts duly classified into relevant revenue head shall be deposited into a designated bank account on the date of the receipt or the following day	<b>Section 13(1)</b>
2.	The official failing to deposit shall be subjected to a penalty of 10, 15 and 25 percent for the delay of 10 days, 15 days or more respectively. In case of delay of more than 15 days shall also be subjected to departmental action.	<b>Section 13(4)</b>
3.	The respective office after depositing the money shall prepare a daily and monthly statement of revenue with 7 days of close of each month and submit along with the statement prepared as per Rule 12 to relevant office and the Controller General Office.	<b>Rule 11, 12 &amp; 14</b>
4a.	Each office within 35 days of the close of respective financial year shall prepare an annual statement of revenue received and the amount in arrears and shall submit to respective office related Treasury and Controller General Office and the office of the Auditor General	<b>Rule 15</b>
b.	The relevant Treasury and Controller General Office, based on the above said annual financial statement shall reconcile with the detail shall prepare a districtwide compiled statement and submit to Controller General Office.	<b>Rule 16</b>
c.	Based on the monthly and annual statements received as per Rule 14 and 15 respectively, the relevant office shall prepare a consolidated Revenue Account in a format specified by the Office of the Auditor General.	<b>Rule 18</b>

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**Checklist for Documents to be submitted by taxpayer along with the Tax Return**

**Name of Tax payer:**                      **Pan Number:**                      **Income Year:**  
**Nature of business:**  
**Yearly Transaction:**  
**Income/Sales Rs:**                      **Date of Submission of Return:**  
**Direct Expenditure Rs:**                      **Extension of submission date if any:**  
**Indirect Expenditure Rs:**

S. No	Documents	Yes	No	NA	Remarks
1	<b>Audited Financial statement in the format prescribed by Company Act 2053 and annexure to the financial statement:</b>  Financial Statement showing comparative figures for 2 years.  Statement of Creditors and Debtors.  Statement of Loans and Interest expenses.  Statement of Stock.  Details of Purchase and Sales.  Details of Direct Cost.				
2.	<b>Others</b>  Special fee is paid as per the Finance Act.  Additional fee and interest is levied for not submitting the return within the stipulated time period as specified in the Act.  Estimated tax statement, TDS statement submitted.				
3	<b>List of statements to be submitted as per the Income Tax Act 2058, Section 77(1)</b>				
3.1	<b>List of documents to be submitted by all tax payers:</b>  Details of interest paid to an individual in excess of Rs 50,000  Details of salary, allowances, bonus and other benefits and reimbursements paid to the employees  Detail of contribution made to the Provident Fund or Retirement Fund on behalf of the employees.				

S. No	Documents	Yes	No	NA	Remarks
	<p>Detail of Fixed assets purchased, capitalised and disposed off during the year from the asset pool for computation of depreciation and allowable repair and maintenance expenses.</p> <p>Details of TDS made along with the name of payee, amount paid, TDS withheld and date of deposit.</p> <p>Detail showing receipt/payment in excess of Rs 10 lakhs from/to an individual along with the name of the party, PAN number and the purpose.</p> <p>Detail of profit/loss made from foreign exchange fluctuation and the method of calculation.</p> <p>Detail of Insurance premium paid, insurance claims recovered and amount of claim lodged but yet to be recovered.</p> <p>Detail of quantity and value of closing stock and the method of valuation.</p>				
3.2	<p><b>Additional documents to be submitted by the Manufacturing Industries:</b></p> <p>Production Account.</p> <p>Detail of cost price including transport, insurance, bank commission and local taxes of raw materials and auxiliary raw materials costing of the loss of finished stock.</p> <p>Detail of quantity and value of all by –products in excess of 5% of the production.</p> <p>Copy of declared selling price of the product, if any.</p> <p>In case of sales through agent, agency agreement and detail of commission paid and TDS deducted there from.</p>				
3.3	<p><b>Additional documents to be submitted by the person doing business:</b></p> <p>Where the import is made through Letter of Credit, the detail of bank opening the LC, LC number, amount of Foreign currency utilised and foreign currency yet to be utilised.</p> <p>Detail of quantity and value of goods along with the name of buyer/supplier and their PAN number for local sales/purchase in excess of Rs 1 lakh.</p> <p>If loan is availed from the bank for import, detail of loan and interest thereon.</p>				

S. No	Documents	Yes	No	NA	Remarks
3.4	<p><b>Additional documents to be submitted by the contractors:</b></p> <p>Copy of the contract agreement.</p> <p>Contract wise detail of income and expenses.</p> <p>Copies of the Running Bill and support for payment received.</p> <p>Head wise/ work wise approval of the contracting party for price escalation.</p> <p>Proof of lease or rental payment and detail of TDS made for the goods used in the contract and tax deposit slip.</p> <p>Detail of subcontracts, if any.</p>				
3.5	<p><b>Additional documents to be submitted by the person doing Commission Business:</b></p> <p>Copy of the commission agreement with local/foreign companies mentioning the rate of commission.</p> <p>Copy of bank statement showing deposit of the commission received.</p> <p>Detail of party wise commission received.</p> <p>Details of the income other than agency income.</p>				
3.6	<p><b>Additional documents to be submitted by the Hotels:</b></p> <p>Cost centre wise income and expenditure statement for the rooms, restaurant, laundry, telephone, transport, foreign exchange etc.</p> <p>Detail of commission paid to the Travel Agents/ others and the rate of commission.</p> <p>Proof of bank deposit of all foreign currency received.</p> <p>Detail of amount received from credit card transaction.</p> <p>Detail of facilities given to the Diplomats while using the hotel facilities.</p> <p>Detail of loan and interest, if any.</p>				



S. No	Documents	Yes	No	NA	Remarks
3.7	<p><b>Additional information to be submitted by the Travel Agencies, Trekking and Tourism Industries:</b></p> <p>Income and expenditure statement showing the daily rate and amount charged for ticketing, cargo, hotel booking, trekking and other income.</p> <p>Detail of direct expenses incurred on ticket, cargo, hotel booking etc.</p> <p>G.S.A agreement with airlines, if any.</p> <p>Detail of payment/ receipt made to/from foreign companies</p> <p>Certificates of deposit of the foreign currency to the bank.</p> <p>Detail of ticket sales of different airlines and the amount of commission received there from.</p>				
3.8	<p><b>Additional documents to be submitted by the Banks and the Financial Institutions:</b></p> <p>Classification of bad loans as per Nepal Rastra Bank (NRB) directives.</p> <p>Certificate of tax exempted income and the expenses incurred in generating such income.</p> <p>Detail of Interest income from investment or deposits in the foreign banks.</p> <p>Detail of interest free deposits.</p> <p>Copy of agreement between the local bank and the foreign bank in case of joint venture banks.</p> <p>Detail classification of bad loan, deposit and interest income</p> <p>Detail of income other than interest income</p> <p>Detail of off balance sheet items (Bid bonds, Performance bond, Guarantee).</p>				
3.9	<p><b>Additional documents to be submitted by the Transport Business:</b></p> <p>Detail of income and the reimbursement received.</p> <p>Detail of truck hire charges for transport and TDS made thereon.</p> <p>Detail of expenditure incurred in transport outside Nepal.</p>				

S. No	Documents	Yes	No	NA	Remarks
3.10	<p><b>Additional documents to be submitted by the Insurance Companies:</b></p> <p>Detail of area wise income and the expenditure from non life insurance business.</p> <p>Detail of investment made for tax free income and the income received there from.</p> <p>Detail of income and expenditure in foreign currency for re insurance.</p> <p>Detail of commission paid to the agents and the re insurers and TDS made thereon.</p> <p>Detail of premium paid and payable for re insurance.</p>				

**Checklist for compliance with Income Tax Act**

<b>Particulars</b>	<b>Act Ref</b>	<b>Yes</b>	<b>No</b>	<b>NA</b>	<b>Remarks</b>	<b>W.P Ref.</b>
Ensure that tax has been calculated at the rate prescribed under schedule 1 of Income Tax Act.	Sec 3					
Verify that the provision regarding the small tax payer of turnover up to Rs 12 Lakh and net income up to Rs 1.20 lakhs are adequately complied with.	Sec 4(4)					
Verify tax on income repatriated by foreign permanent establishment in Nepal as per rate prescribed in Schedule-1(2.6).	Sec 4(5)					
Verify that the assessable income calculated in accordance with the provision of the Act.	Sec 6					
Ensure that the calculation of tax on business income is done in accordance with the provision of the Act.	Sec 7					
Ensure that tax on remuneration has been computed in accordance with provision of the Act.	Sec 8					
Ensure that tax on investment has been computed in accordance with the provision of the Act.	Sec 9					
Ensure that Tax exempt income is not included in the computation of tax on business, remuneration, and investment income.	Sec 10					
Ensure that concession and facilities provided to business entity have been considered.	Sec 11 Sec 11a					
Ensure that donation paid to Exempt institution up to limit provided by the Act are allowed as deduction.	Sec 12					
Ensure that allowable expenditure are only based on the fact that they are incurred by the person during the Fiscal Year for generating business and or investment income.	Sec 13					

Particulars	Act Ref	Yes	No	NA	Remarks	W.P. Ref.
Ensure that interest is allowed as deduction in accordance with the provision of the Act. Further, Interest paid to person controlled by tax exempt institution is restricted to 50% of the adjusted taxable income without including interest income or deducting interest expenses for the year plus interest income.	Sec 14					
Ensure that Cost of sales are calculated in accordance with the provision of the Act and are allowed as deduction.	Sec 15					
Ensure that repair and maintenance Expenses are allowed as deduction in accordance with the provision of the Act. Further, R&M expenses of entity except airlines industries are restricted to 7% of the depreciation basis of the year.	Sec 16 read with IT rules					
Ensure that Pollution Control expenses are allowed as deduction in accordance with the provision of the Act. Further, it is restricted to 50% of the adjusted taxable income of the business.	Sec 17					
Ensure that Research and Development expenses are allowed as deduction in accordance with the provision of the Act. Further, it is restricted to 50% of the adjusted taxable income of the business.	Sec 18					
Ensure that the depreciation is calculated in accordance with the provision of schedule-2 of the Act. Further, Special industries are allowed to take additional one third depreciation of the year.	Sec 19					
Ensure that loss on business or investment is allowed to set-off against profit in accordance with the provision of the Act. Normally, loss carried for past four years are allowed to set-off.	Sec 20					

Particulars	Act Ref	Yes	No	NA	Remarks	W.P. Ref.
<p>Ensure that following deduction are not allowed:</p> <ul style="list-style-type: none"> <li>▪ Expenses of Domestic and Personal nature;</li> <li>▪ Tax to be paid under this Act and Fines and Penalties in breach of any law &amp; regulation or by-laws to the government of any countries;</li> <li>▪ Expenses against income exempt under section 10 and final withholding tax;</li> <li>▪ Cash payment in excess of Rs50,000 at a time by a person with an annual turnover of more than Rs 2 million except payment to certain specified institutions as prescribed such as: Govt., constitutional body, Govt. controlled organizations, Banks and financial institutions, etc.</li> <li>▪ Distribution of profit by an entity;</li> <li>▪ Subject to Sections 14 to 20 and 71 no deduction is allowed for expenses of capital nature or foreign income tax.</li> </ul>	Sec 21					
Ensure that provision regarding accounting for tax purposes are complied with by the assessee.	Sec 22					
Ensure that Provisions regarding accounting on cash basis are complied with.	Sec 23					
Ensure that Provisions regarding accounting on accrual basis are complied with.	Sec 24					
Ensure that Bad debts written off is allowed for deduction in accordance with provision of the Act and bad debts recovery has been accounted for as income.	Sec 25					
In case of long term contract ensure that income is recognised in accordance with the provision of the Act.	Sec 26					

Particulars	Act Ref	Yes	No	NA	Remarks	W.P. Ref.
Ensure that quantification, allocation, and classification of the payments are in accordance with the provision of the Act.	Sec 27					
Ensure that incomes received in foreign currencies are converted in to NRs in accordance with the provision of the Act.	Sec 28					
Ensure that insurance claim received is accounted for as per the provision of the Act.	Sec 31					
Ensure that provisions regarding payment against annuity, sale on hire purchase, and finance lease are complied with in accordance with the provision of the Act.	Sec 32					
<b>While reviewing tax on business and or investment income the following need to be considered:</b>						
Ensure that net gains derived by a person from the disposal of the business assets or liabilities of his business during an income year is calculated in accordance with the provision of the Act.	Sec 36 (1)					
Ensure that net gain derived from the disposal of the investment in taxable non-business chargeable assets of a person in an income year is calculated in accordance with the provision of the Act.	Sec 36 (2)					
In the case of losses suffered from the disposal of the assets or liabilities of a foreign source, ensure that deduction allowed only to the extent of the gains derived from the disposal of the assets or liabilities of a foreign source.	Sec 36 (3)					
Ensure that gains made by a person from the disposal of an asset or liability is calculated in accordance with the provision of the Act i.e. difference between the total of the incomes received from that asset or liability and the total of the expenses (outgoings) incurred for the asset or liability at the time of the disposal.	Sec 37					

Particulars	Act Ref	Yes	No	NA	Remarks	W.P. Ref.
Ensure that disposal of assets and liabilities is determined in accordance with the provision of the Act	Sec 40					
Ensure that dividend tax has been recovered on the distribution of profit as defined in sec 53	Sec 54					
Ensure that specific provision relating to Banking and Insurance Business are complied with	Sec 59, 60 & 61					
Ensure that tax has been recovered from the foreign permanent establishment in Nepal	Sec 68					
Ensure that foreign tax credit has been calculated in accordance with provision of the Act	Sec 71					
Ensure that the provision for Double Taxation Avoidance Agreement and other provision as mentioned in the concern International Agreement are complied with	Sec 73					

### **Penalties & Punishment**

Particulars	Act Ref	Yes	No	NA	Remarks	W.P. Ref.
<i>Statement of estimated tax not submitted</i>	95					
<i>Return of income not filed</i>	96					
<i>Books of account not maintained</i>	81					
– Fee	117					
– Punishment	128					
<i>Statement of TDS withholdings not submitted</i>	90					
– Fee	117(3)					
– Punishment	118					
<i>Installments not deposited within prescribed time limit. Advance tax short deposited</i>	94					
– Interest	118					
– Punishment	123					

Particulars	Act Ref	Yes	No	NA	Remarks	W.P. Ref.
<i>failure to pay tax</i>						
– Interest	119					
– Punishment/Penalty	123					
Penalty for making false and misleading statements or omitting material facts						
– Fee	120					
– Punishment/Penalty	124					
<i>Penalty for Aiding &amp; Abetting</i>						
– Fee	121					
– Punishment	127					
Offence of impeding and coercing tax administration						
– Punishment	125(1)					
<i>The department shall make Assessment of Tax and Fee</i>						
	122					

The following table may help the auditor to ascertain the penalties and punishment for the non-compliance.

Non compliance	Penalty/Fee/Interest	Punishment
<p><i>Statement of estimated tax not submitted</i> (sec 95 requires person to submit statement of estimated tax before or along with the first installment of advance tax).</p> <p><i>Return of income not filed</i> (Sec 96 requires person to file return of income not later than 3 months or extended time limit maximum of 3 months as per sec 98).</p> <p><i>Books of account not maintained</i> (sec 81 requires person to maintain books that are necessary to explain information to be provided in a return).</p>	Under Section 117, a fee of 0.1% p.a. of assessable income (including any income but excluding any expenses for the period) or Rs1,000 per annum whichever is higher.	No special punishment but punishment of Rs5,000 to Rs30,000 will be levied for failure to comply with Act or rules as per section 128.



Non compliance	Penalty	Punishment
<i>Statement of TDS withholdings not submitted</i> (Sec 90 requires person to submit statement of TDS withhold within 15 days after the end of the month).	Under Section 117 (3), 1.5% per annum of TDS amount to be charged for each month and part thereof.	Same as above.
<i>Installments not deposited within prescribed time limit</i> (Sec 94 requires person to submit advance tax in 3 installment of 40:30:30 percent in 6, 9 and 12 months period respectively).  <i>Advance tax short deposited</i> (Advance tax as deposited above is less than 80% of actual tax liability for the period).	Under Section 118, 15% interest on payable amount for the each month and part thereof. (from the due date until the date of assessment u/s 99 e.g. submission of return).	Under Sec 123 Penalty of Rs 5,000 to Rs 30,000; OR  Imprisonment of 1 month to 3 months; OR both.
<i>failure to pay tax.</i>	Under Section 119, interest @15% p.a. is levied for the default period on the outstanding amount of tax. For the purpose of calculating Interest as above, extension granted under Section 98 is ignored.	Under Sec 123 Penalty of Rs 5,000 to Rs 30,000; OR  Imprisonment of 1 month to 3 months; OR both.
Penalty for making false and misleading statements or omitting material facts.	Under Section 120, 50% of under payment of tax if the referred statement happen to be misleading <b><i>without</i></b> knowingly or recklessly.  100% of under payment of tax where the statement is made false or misleading knowingly or recklessly.	Fine of not less than Rs 40,000 and not more than Rs 160,000 or an imprisonment for a term of not less than 6 months and not more than 2 years or both (Sec 124).
<i>Penalty for Aiding &amp; Abetting</i> – a person who knowingly or recklessly aids or abets another person to commit an offence on evasion of tax or counsels or induces another.	Under Sec 121, person to commit such an offence shall be liable for 100% of underpayment of tax.	50% of the penalty imposed u/s 120 on main offender (Sec 127).
Offence of impeding and coercing tax administration under Section 125 (1).	None.	Fine of not less than Rs 5,000 and not more than Rs 20,000 or an imprisonment for a term of not less than 1 month and not more than 3 months or both.

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### **Assessment of Tax and Penalties**

Under Section 122, the Department shall make an assessment of the interest and penalties for which a person is liable under this section.

Liability for interest and penalties under this chapter with respect to a particular failure is calculated separately for each section of this chapter.

The imposition of interest and penalties under this chapter is in addition to any other tax imposed by this Act and does not relieve any person from liability to criminal proceedings under chapter 23.

When assessment has been made, under this section, the Department shall serve the person a written notice of assessment stating the reason for making the assessment, the amount of interest and penalties levied, calculation etc.

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**Checklist on compliance with Value Added Tax Act**

Particulars	Act Ref	Yes	No	NA	Remarks	W.P. Ref.
Verify that the IRO has system of monitoring timely deposit of tax	Sec. 21					
Ensure that the tax officer has considered the prevailing market value under arms-length transaction to determine the taxable value.	Sec 12					
Ensure that the IRO has system of monitoring the enforcement of tax invoice.	Sec 14					
Ensure that the IRO has adequate coordination with the other Govt. Organizations, Public Institutions to obtain the information regarding the taxable transactions being carried by registered person.	Rule 6 ka					
Ensure the IRO tax auditor has reviewed that any adjustment in the purchase and sales book are being made only through approved debit/ credit note	Rule 20					
While carrying tax audit by IRO, appropriate review has been made to ensure that the tax offset made by the assessee are in accordance with the provision of the Act.	Sec 17					
Review that IRO has made all refunds only after detail examination of the tax invoice and other relevant documents.						
Ensure that all cancellation of the registration is being made as prescribed.	Sec 11(3)					
Ensure that Bank Guarantee facility is being provided only to the eligible tax payers.	Sec 8ka					

<b>Particulars</b>	<b>Act Ref</b>	<b>Yes</b>	<b>No</b>	<b>NA</b>	<b>Remarks</b>	<b>W.P. Ref.</b>
Review on test basis that all penalties prescribed in the Act wherever applicable has been charged and been recovered.	Sec 29					
Ensure that the reassessment has been done in accordance with the provision of the Act.	Sec 31a					
Ensure that VAT are allowed to be set-off on the goods lost due to fire, theft etc. in accordance with the manner as prescribed.	Sec. 16 kha					

**Checklist on compliance with Customs Duty Act**

<b>Provision</b>	<b>Customs Act Sec. Ref.</b>	<b>Yes</b>	<b>No</b>	<b>NA</b>	<b>Remarks</b>	<b>W.P. Ref.</b>
Ensure that Pragyapan Patra has been filled on each import and export of all types of goods, whether attracting customs duty or not except from the goods carried by person for personal use imported under Jhiti Gunta	5					
Ensure that in case of goods not cleared from the Custom's warehouse within the stipulated time, demurrage is levied. If there is a reason for the waiver of the demurrage charges, it can be waived by the officer assigned	6					
Ensure that the chief of customs office is maintained waiver limit up to Rs 100,000						
Ensure that Rebates allowed on the customs duty are in accordance with the duty specified by HMG in the official gazette.	9					
Verify that Import duty is levied on the goods manufactured and exported from Nepal and re imported to the country except from the undelivered parcel.	10					
Customs duty recovered can be refunded in part/ full if exported within three months from import and descriptions tallies to the record of the custom office.	11					
Ensure that Customs duty paid has not been refunded on certain goods	12					
Ensure that the transaction value is determined in accordance with the provision of the Act. (Actual cost, freight insurance up to customs point etc.)	13					

Provision	Customs Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
Ensure that Goods taken under possession has been deposited with the Customs Officer. Goods of perishable nature/ livestock can be auctioned but the income there from shall be booked as income in deposit account.	20					
Ensure that ownership of the goods transfers to HMG in case of confiscated goods and goods not cleared from the customs within the stipulated time	22					
Ensure that prizes given to person giving information of illegal export/ import are in accordance with law.	22(a)					
Ensure that Goods are cleared from the customs only upon the payment of penalties levied.	30					
Ensure that custom duty has been collected from the travelers whether accompanied or unaccompanied except allowed as per law						
Verify whether custom duty has been recovered on the goods of Indian origin imported from India at the discounted rate of 10% and 7% of custom duty for dutiable goods (value based) up to 40% and above, respectively.	Finance Ordinance 2061 (3)					
Verify whether custom duty has been recovered on the goods of Chinese origin imported from Tibet at the discounted rate of 5% of applicable custom duty.	Finance Ordinance 2061 (4)					
<b>DRP Procedures:</b>						
Verify that the transaction value determined is based on the higher of the value determined by Govt. of India for excise duty and factory/ depot invoice plus freight, insurance and other cost etc.	Finance Ordinance 2061 (11)					

Provision	Customs Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
Verify that the excise duty paid in India is allowed as set-off from the customs duty to be paid in Nepal.						
Verify that supporting documents are sufficient to allow excise duty paid in India to set-off against Customs Duty.						
Such supporting documents may be: Declaration form, Nepal Invoice, Commercial Invoice, Transport doc., Insurance, packing list, bill of export, PAN with VAT No., firm/company reg. cert. if any, Industry reg. cert. if any, appointment of customs agent if any, entity recommendation to import if any.						
<b>Goods imported under customs privileged/facility:</b>						
Ensure that duty has been collected on the goods imported under customs privileged/ facility and sold, gifted, used in the country subsequently.	Finance Ordinance 2061 (12)					
Verify that the transaction value is determined in foreign currency and after allowing depreciation for 5 years @10% on written down value of the assets.						
<b>Provisions relating to Bonded Warehouse:</b>						
<p>Ensure that facilities of bonded warehouse has been given only to the following:</p> <ul style="list-style-type: none"> <li>▪ Readymade garments exporting to India and third countries.</li> <li>▪ Industries exporting goods to third countries.</li> <li>▪ Industries (other than readymade garments) exporting goods up to 80%of its production to India.</li> </ul>	Finance Ordinance 2061 (8)					

Provision	Customs Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
Ensure that the above industries can only operate through letter of credit or proper banking channel.						
Verify that the Customs Office maintains record of Bank Guarantee obtained from the above industries for 6-12 months period against applicable import duty including additional 25% amount of duty.						
Verify that such Bank Guarantee has been released within 11 months of import of such material on the submission of following documents: <ul style="list-style-type: none"> <li>▪ Evidence of Export.</li> <li>▪ Evidence of Foreign currency earned duly certified by concern Bank.</li> <li>▪ Ratio of consumption of raw material duly certified by concern entity.</li> </ul>						
Ensure that at the time of export at least 20% value added to the transaction value determined by customs office.						
Ensure that applicable customs duty with additional 25% has been recovered on failure of the release of bank guarantee within 11 months as above.						
<b>Provisions relating to exporter without having Bonded Warehouse facility:</b>						
Verify that the Customs Office maintains record of Bank Guarantee obtained from the above industries for against applicable import duty.	Finance Ordinance 2061 (9)					



Provision	Customs Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
Verify that Bank Guarantee has been released within 12 months of import of such material on the submission of following documents: <ul style="list-style-type: none"> <li>▪ Application in prescribed format.</li> <li>▪ Evidence of Export or domestic sales against foreign currency.</li> <li>▪ Evidence of Foreign currency earned duly certified by concern Bank.</li> <li>▪ Ratio of consumption of raw material duly certified by concern industry department.</li> </ul>						
Ensure that penalty of 10% of duty along with applicable customs duty has been recovered in case of failure to export or earn foreign currency against goods imported under such Bank Guarantee facility.						
<b>Provisions relating to Goods re-exported or re-imported:</b>						
Ensure that report of waiver of duty applicable on re-import of exported goods u/s 10 has been submitted to Director General.	Finance Ordinance 2061(10)					
Verify that duty of 10% of applicable duty has been recovered before releasing Bank Guarantee for Import duty on re-exporting of imported goods within 3 months period subject to provision of bi-lateral or Multi-lateral agreement.						
Ensure that duty has not been levied on the export of used assets on the recommendations of Industry Department.						
<b>Special provision for import of vehicles:</b>						
Ensure that vehicles in the nature of reconditioned, used, or beyond Nepal vehicle pollution standard are not allowed to import.	Finance Ordinance 2061(12)					

Provision	Customs Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
Ensure that approval from Ministry of population and environment has been obtained on the import of own used vehicle by officials of Nepal Police, Military or Diplomatic mission after completion of at least one year service abroad.						
Ensure that Customs duty has been recovered on the temporary import (upto 3 months) of vehicles (except under Carnet) as follows: <ul style="list-style-type: none"> <li>▪ Tractor-@Rs75/day.</li> <li>▪ Tractor with tailor or only tailor (except loaded tractor to be returned within 48 hours) - @Rs250/day.</li> <li>▪ No duty on loaded tailor to be returned within 48 hours or other vehicles to be returned same day from same custom point.</li> </ul>						
<ul style="list-style-type: none"> <li>▪ Car, Jeep, Van upto 30 days @ Rs 250/day.</li> <li>▪ Bus, Minibus including Tourists vehicle upto 30 days @Rs 300/day.</li> <li>▪ Motorcycle upto 30 days @Rs75/day.</li> <li>▪ Three wheeler upto 30 days @Rs 150/day</li> <li>▪ Tractor for transportation of goods @ Rs 500 for up to 7 days.</li> </ul>						
Ensure that Vehicles temporary imported are returned back within stipulated time as per declaration form or with penalty of Rs375/day for motorcycle and Rs 600/day for vehicles with valid reason. Otherwise the same has to be sized.						

Provision	Customs Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
Ensure that customs duty on import of spare parts such as chesis, engine, motor etc has been recovered @ 1% for electronic and battery operated vehicles and @ 5% for other vehicles. Similarly discount of 33% of duty has been allowed on import of electronic and battery operated vehicles.						
Ensure that customs duty @2.5% has been recovered on import of tractor for agriculture purposes						
Verify that the rate applied for import and export are in agreement with rate prescribed in Finance Act for the year.						
<b>Vehicles, Equipments, and Goods imported under customs facilities, fully and partial duty facilities, import under records or Bank Guarantee facilities:</b>						
Ensure that duty has been recovered on sales, gift, or use of Vehicles, Equipment and Goods imported under such facilities (duty of 1%).  A rebate of 60% on normal duty is allowed if the related goods have been sold after 5 years.						

### Penalty Provisions for Customs duty

The auditors should verify that penalty is charged to the owner of the goods for non compliance with the various provisions of the Customs Act.

Provision	Customs Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
The auditor should ensure that the Customs Office has mechanism to identify the issues and recover penalty as per prevailing rules under the following transactions:						
▪ Person Importing or exporting or attempting to do so from the customs point other than the point specified in Section 3, or assisting in hiding such goods.	34.1					
▪ Person trying to remove the goods on or before arrival to Customs office with the intention of not paying Customs Duty.	34.2					
▪ Giving wrong descriptions of the goods in Pragyapan Patra.	34.3					
▪ Submitting fake supporting such as Invoice, Bill or Draft.	34.4					
▪ If owner of the goods unlock customs warehouse with the intention of loss or pilferage of the goods.	34.5					
▪ Any person unlock customs warehouse with the intention of pilferage of the goods.	34.6					
▪ Importing or Exporting goods without paying customs duty.	34.8					
▪ Submitting false or manipulated declaration form.	34.9 & 34.10					
▪ Loss of goods at the warehouse due to ignorance of the concern customs staff.	34.11					
▪ Unauthorized customs officials removes or order to remove goods from the warehouse.	34.12					
▪ Create disturbance to the customs officer on use of power as per Act.	34.13					
▪ Any unauthorized person acting as owner or agent while clearing the goods.	34.14					
▪ Any breach of Act or law where penalty has not defined in the Act.	34.15					

**Checklist on compliance with Excise duty Act**

<b>Provision</b>	<b>Excise Act Sec. Ref.</b>	<b>Yes</b>	<b>No</b>	<b>NA</b>	<b>Remarks</b>	<b>W.P. Ref.</b>
Excise duty is levied on goods as per Annexure 1 of the Act.	3(1)					
Excise duty paid on the raw materials used in the production of excisable goods can be setoff from excise duty collected on exit of the finished goods.	3(2)					
Late fee shall be levied at the rate of .05% per day on excise duty not paid as per 3(1) above within the stipulated time.	3(3)					
No excise duty shall be levied on goods exported outside Nepal.	3(a)(1)					
Cash deposit or Bank Guarantee shall be issued for excise duty payable on export as per above.	3(a)(2)					
The procedures for refund of the deposit or release of bank guarantee shall be as specified by the department.	3(a)(3)					
No excise duty shall be levied on sales made by approved duty-free shop or bonded warehouse.	3(b)(1)					
At the time of procurement of excisable goods by the duty-free shop or bonded warehouse, cash deposit or bank guarantee shall be issued for excise payable on such purchase.	3(b)(2)					
Release of the cash deposit or Bank Guarantee shall be as specified by the department.	3(b)(3)					
Excise Duty shall be recovered at the following point of time: <ul style="list-style-type: none"> <li>▪ For goods, upon issue of the goods for sales.</li> <li>▪ For services, upon issue of the invoice to the customers.</li> <li>▪ For import, upon considered as import for the custom purposes.</li> </ul>	4(1a) 4(1b) 4(1c)					

Provision	Excise Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
Irrespective of the above, if excise has to be levied at the time of production for certain goods, the procedures will be as specified.	4(2)					
The quality and the percentage of alcohol exported with the approval are subject to inspection by the excise office any time. If the alcohol contains is more than 1% or the quality is different from the approved quality, it shall be considered as the revenue leakage and such leakage amount shall be the recovered with additional 25% penalty.	4(3)					
Verify that price is determination for excisable goods as follows: <ul style="list-style-type: none"> <li>Factory price determined by the producer of excisable goods at the time of sales or, price determined by the department based on cost of production.</li> </ul>	7(1)(a)					
On import, price determined for custom purpose including custom duty.  But if such goods are also produced in Nepal, price determined as per 7(1)(a) above or price determined as per 7(1)(b) whichever is higher.	7(1)(b)					
In case of services, as per the invoice raised by the service providers.	7(2)					
For the purpose of recovery of the excise duty, the Department may re- determine the price if felt necessary.	7(3)					
A production norm shall be established for industries engaged in production of ethanol, rectified spirit and ENA from molasses.	7(4)					
Any short production shall be considered as used for production of highest grade alcohol	7(5)					

Provision	Excise Act Sec. Ref.	Yes	No	NA	Remarks	W.P. Ref.
No one shall produce, import, sale or store excisable goods or provide services attracting excise duty without registration.	8					
The License can be cancelled by the department for non fulfillment of the terms of the license.	10					
If excisable goods are removed from the factory or imported without paying excise, excise officials can demand for a proof of payment of the excise.	11					
<p>As per Excise Rules 2059, ensure that following records are adequately maintained, are up to date and certified by the excise staff on duty:</p> <ul style="list-style-type: none"> <li>▪ Production and Sales daily Stock Register. Annex -4</li> <li>▪ Stock record of raw materials (local as well as imported tobacco). Annex -5</li> <li>▪ Stock record of tobacco used and the cigarettes produced there from. Annex -6</li> <li>▪ Stock record at packaging department for cigarettes packed. Annex -7</li> <li>▪ Stock record at warehouse. Annex -8</li> <li>▪ Requisition for issue of cigarettes from warehouse for sales. Annex-9</li> <li>▪ Record of alcohol distilled. Annex-10</li> <li>▪ Detail of sales of alcohol and excise duty. Annex-11</li> <li>▪ Daily record of Molasses produced and sold and submit monthly record. Annex-12</li> </ul>						

**Penalty Provisions for Excise duty**

<b>Provision</b>	<b>Excise Act Sec. Ref.</b>	<b>Yes</b>	<b>No</b>	<b>NA</b>	<b>Remarks</b>	<b>W.P. Ref.</b>
<i>Goods removed from the ware house or from custom without paying excise duty:</i> – Penalty	12					
<i>Excise duty not paid or person dealing with the excisable goods without obtaining a license to do so:</i> – Penalty – Punishment	16					
<i>Non compliance with the excise act or rules:</i> – Penalty	17					



### Risk Area, Internal Control System and Auditor's Check List on Vehicle Tax

Following are some of the risk area and internal control system established for the Vehicle Tax.

<b>Risk Area</b>	<b>Measures established in the internal control system.</b>	<b>Audit Procedure</b>
The <i>Lagat (Record)</i> of vehicles not update.	All the <i>lagat</i> shall keep in the update condition. The chief of the office is responsible for it.	Review the updated <i>Lagat</i> .
Vehicle category and capacity may be understated and less tax paid.	Technical Statement Form shall be filled before paying the tax. The tax is calculated on the basis of the technical Statement Sheet and the rate of tax prescribed in the Finance Act.	Ensure the technical statement sheet is obtained in all the cases. And review some calculation as per the sampling rule requires.
Technical statement may be different from the office record.	Both statements should be the same.	Check the blue book and technical statements.
Vehicle tax may not be paid.	The assessing officer can seize and auction the vehicle for the recovery of tax.	
Vehicle in the good condition may be declared as damaged and the tax may not be paid.	The statement declaring that the vehicle is damage is to be approved by the office at the time the vehicle is damaged.	Ensure that there is adequate documents like approval, police report, etc.
Tax may not be paid within stipulated time.	Ensure that penalty is levied for delayed payment.	Confirm the penalty for the belated returns.
Revenue may be paid for other purpose but claimed against vehicle tax.	Revenue head should match.	Confirm and report if the revenue head is different.

### Risk Area, internal control system and auditor's check list on Registration Fee

Following are some of the risk area and internal control system established for the Vehicle Tax.

S. No.	Risk Area	Measures established in the internal control system.	Audit Procedure
<b>Land transfer/sale:</b>			
1.	Valuation of the land and building may be understated.	Land Revenue Office fixes the minimum rate of land for different categories.	Minimum Prescribed Rate Book.
2.	Minimum valuation rate is determined less than the market rate.	Land Valuation Committee frequently reviews the rate explaining the basis of valuation.	Review the actual transaction rate of the similar type of land around the Revaluation date.
3.	Categorisation of the land may not be systematic.	Department has a policy of Categorisation of the land based on locality, road access and other factors.	Review the comparative Categorisation of the land within different period and by different offices.
4.	Transaction may be registered below the minimum rate.	The concern officer certify the document saying the actual value of the transaction is not less than minimum rate.	Check the actual value and minimum rate prescribed.
5.	Location of the Land, road access and category may be misstated.	The survey office confirms the road access, type of road, and other specifications of the land. Report of the local authority is also obtained.	<ul style="list-style-type: none"> <li>▪ Cross check the report of the local authority with the report of Survey Office.</li> <li>▪ Check the map of the land.</li> <li>▪ If necessary, visit the place and confirm the Categorisation.</li> </ul>
6.	Registration may be made for the land without paying the land revenue.	All land revenue shall be paid before any registration.	Review the cash receipt for the land revenue.
7.	Sale of land may be register as gift.	Registration officer confirms and signs the deed of gift after confirming from both buying and selling parties.	<ul style="list-style-type: none"> <li>▪ Signed document shall review.</li> <li>▪ The rate of registration fee is higher in the case of the gift.</li> </ul>

S. No.	Risk Area	Measures established in the internal control system.	Audit Procedure
8.	Registration of the transaction may be done in the district other than the district situating land.	Land ownership certificate, cash receipt of land revenue shall submit to the district of registration and the struck of the name of the existing owner and entry of new owner shall be done in the district situating the land.	The rate of the land and building, minimum rate and registration amount shall be verified obtaining with appropriate evidences.
9.	Gift to the person other than close relative may be registered as gift to close relatives.	Relationship certificate shall be attached with the documents.	Check the Relationship Certificate.
<b>Loan and tamsuk:</b>			
10.	Mortgage ( <i>Dristi, Bhoga and Lakha</i> ) can be registered at a lesser amount than the actual amount.	Original mortgage deed shall be produced for the registration.	Check the original deed and the registration fee levied.
<b>Registration in other district (<i>Bejilla pass</i>):</b>			
11.	Fee may be recovered at the normal rate for the registration of the transaction relating to other district.	The Finance Act prescribes higher rate of Registration Fee for the <i>registration of the other districts</i> .	Confirm the rate of registration for such transaction from the finance ordinance of the concerned year.
12.	Minimum valuation prescribed by the concern district may be understated.	Registration Officer shall obtain the minimum valuation rate from the concerned district.	Review the valuation rate of the concern district with the actual amount of registration.
13.	The applied valuation rate may be older one than present rate or the party themselves present the minimum rate list.	Registration Officer shall obtain the document from the concern district with official letter.	Check for the person presenting or collecting the minimum rate list.

### Risk Area, internal control system and auditor's check list on Royalty

Following are some of the risk area and internal control system established for the Royalty.

S. No.	Risk Area	Measures established in the internal control system.	Audit procedure
<b>Royalty based on Installed Capacity:</b>			
1.	License-holder may not file the royalty return.	As per the provision of rule 90 and 91 every License-holder has to submit the Income and Expenditure Account and Annual Report to the Department.	Year and date of filing the account and annual reports.
2.	Installed capacity may be under stated.	In the license for electricity generation, the installed capacity is clearly states.	Verify the capacity as state in the royalty return and office copy of the license.
3.	License may be given in the multiple stages but royalty return may not be submitted for all components.	The license holder should have made return in the consolidated form. Verify the installed capacity as stated in the return to generation license.	Verify the capacity as state in the royalty return and office copy of the license.
4.	Royalty may be calculated in the generation after deducting the capacity utilized for internal use.	This type of royalty is levied based on installed capacity as per the provision of section 11 of the act. The royalty should be paid on licensed capacity.	Check the license and confirm the royalty.
5.	Plant installed having more capacity than the license capacity and the royalty may be paid on licensed capacity only.	Installed capacity should be equal to the licensed capacity. Installation of high capacity plant than the licensed capacity is infringement of the law.	Check the royalty is based on installed capacity or not. If the installed capacity is higher than the license, the person is envisioning the license.
6.	Royalty in the first year may be proportionate based on the date of first commercial production.	As per Section 11 of the Act, Royalty based on the installed capacity is to be paid for the whole year and it cannot proportionate.	Confirm if any proportionate on the first year.
<b>Royalty based on Installed sales:</b>			
7.	Sales unit and sales proceeds may be understated.	Income and Expenditure Account should be produced with the annual return.	Verify the royalty amount based on sales and sales revenue.
8.	Sales unit and generated unit of the electricity may be different.	Electricity consumed in the power house may be deducted from the generation unit.	Confirm the produced units and internal consumption.

S. No.	Risk Area	Measures established in the internal control system.	Audit procedure
9.	Electricity used by the offices other than power house may be deducted as internal consumption.	The producer should keep updated record of internal consumption, commercial consumption and sales.	Review the records produced to the department and royalty calculations.
10.	Rate of royalty may be charged at the lower rate in the 16 <sup>th</sup> year.	In the 16 <sup>th</sup> year the rate of royalty is Rs 1000 per installed capacity in Kilowatt and 10% of the average sales value.	Be care such type of problem may come in the years increasing the rate of royalty.
<b>Documentation and revenue:</b>			
11.	Updated list of the license-holder may not be kept.	The department should keep the updated records of the license-holder.	
12.	Royalty return may be filed but the actual payment may not be paid.	Royalty should be paid within the time prescribed by the department and total amount shall be paid with the return.	
13.	10% of the royalty is to be paid to the local authority and only 90% of the royalty is deposited in the central treasury. The amount equivalent to the 90% of the royalty may be paid.	Total royalty is first paid to the department and 10 % of the same is allocated by the department to local authorities.	

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# Glossary

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<b>Tax payer</b>	A Tax payer means a person within the definition of Income tax Act, Value Added Tax, Customs Duty, and excise Act and shall include natural person and entity.
<b>Revenue</b>	Revenue means all kinds of Government receipts including tax, duty, fee, levies, interest, dividend, income from sale of assets, investment, and services, leasing of government property, etc.
<b>Tax</b>	Tax means as prescribed under Income Tax Act, Value Added Tax.
<b>Duty</b>	Duty means duty as prescribed in Customs Duty Act and Excise Duty Act
<b>Employment</b>	Employment means any kind of past, present or prospective employment.
<b>Tax Deducted at Source (TDS)</b>	TDS means a part of tax to be deducted in advance while making payments in consideration of employment, investment returns, service fees, and contracts or agreements at the rate prescribed in the Income Tax Act.
<b>Income</b>	Income means the income earned by any person through employment, business or investment, and the total amount of such incomes calculated under the Income Tax Act.
<b>Income Year</b>	Income Year means the period beginning on Shrawan 1 (July 16) of a year and ending on the last day of Ashadh (July 15) of the next year.
<b>Assessment</b>	Assessment means assessment of Tax/VAT/Duty to be made under the Income Tax Act/Value Added Tax/ Customs Duty Act, and Excise Act.
<b>Person</b>	Person means a natural person or an entity
<b>Business</b>	Business means any kind of industry, trade, profession or any other similar kind of business transaction; the term includes a past, present or prospective business of a similar kind.
<b>Investment</b>	Investment means an act of holding or investing one or more assets, except as mentioned below: (1) Act of holding any assets used personally by the person who owns it. (2) Employment or business. Provided that the act of holding a non-business taxable asset shall be treated as investment.

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<b>Transaction</b>	Transaction means the act of supplying any goods or services
<b>Taxable Transaction</b>	Transaction means the act of supplying any goods or services
<b>Taxable value</b>	Taxable Transaction" means a transaction mentioned in sub-section (1) of Section 5;
<b>Goods</b>	Goods" means any kind of property whether movable or immovable;
<b>Services</b>	Services" means anything other than goods;
<b>Supply</b>	Supply" means the act of selling , exchanging and delivering any goods or services, or the act of granting a permission thereto or of contract thereof for a consideration;
<b>Consideration</b>	Consideration" means anything to be received for money, goods, services or value
<b>Import</b>	Import" means the act of importing any goods or services in the Kingdom of Nepal pursuant to prevailing laws
<b>Export</b>	Export" means the act of exporting any goods or services outside the Kingdom of Nepal pursuant to prevailing laws

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