

ECONOMIC POLICY NETWORK

Policy Paper 18

STUDY ON EXCISE DUTY

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This report has been prepared by Mr. Madhab P. Ghimire, Macro Economic Specialist.

Inputs from various stakeholders during interactions at Advisory Committee meetings, and the workshop organized by the EPN Focal Unit have been incorporated in the report.

Foreword

Economic Policy Network (EPN) initiated in August 2004 is an undertaking of the Government of Nepal with an Asian Development Bank (ADB) Technical Assistance (TA) to develop and institutionalize an open, responsive and result oriented economic policy formulation process based on sound economic analysis and dialogues with the partnership of public and private sector, academia, and independent professionals, to support and consolidate the Government's economic policy reforms on poverty reduction strategy. The initial focus has been in the areas of macroeconomic management; trade, investment and employment; infrastructure development; and tourism, agriculture, and regional development through four thematic advisory committees chaired by the secretaries of the respective implementing ministries, and guided by a high-level steering committee. The present study is an outcome of the initiative under the Advisory Committee for Economic Policy on Macroeconomic Management chaired by the Secretary of the Ministry of Finance.

This report has attempted to identify the coverage and scope of excise duty in the present endeavor. The trend and current structure of excise duty and its contribution to government revenue has been critically analyzed. The study has suggested tariff adjustment under bilateral and multilateral trade agreements and has prescribed policy reforms accordingly. The recommendations are the outcomes of consensus reached among major stakeholders through various consultations and the EPN workshop. I hope the findings and recommendations will be helpful for policy makers for future reforms.

I would like to thank Mr. Madhav Prasad Ghimire for carrying out the study. I also thank all those who have provided inputs for the report during the interactions, the advisory committee meetings, and the EPN technical workshop held in Nepal Administrative Staff College, Jawalakhel, Lalitpur. The work of the Advisory committee for macro economic management is to be commended for selecting the issue and for following through with the study. I would also like to appreciate the entire EPN team for their hard work. Last but not least, I would like to thank the ADB for supporting this initiative.



Dr. Posh Raj Pandey
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Executive Summary

Background

- The Civil code 1854 has given legal basis for imposing excise duty on liquor, mining of iron, animal bones, hashish, cannabis, timber wood etc. The Excise Act 1959 authorized the government to impose excise duty on domestic industrial products like matches, sugar, liquor etc. The Liquor Act 1975 was promulgated, which gave legal basis to introduce distillery system in the production and distribution of liquor. The Excise Act 2002 authorized the government to raise revenue from selected import products and services.

Objectives

- The Government's main objective of levying excise duty is the mobilization of revenue.
- In order to discourage the consumption of health hazard products the excise duty is therefore imposed on the manufacture of the products like beer, liquor, tobacco and cigarettes.
- The excise duty is also imposed to protect the domestic industries from unfair competition.
- It is also applied to protect the environment.

Revenue Collection

- The total revenue from excise duty has consistently increased each year since 1990. The total duty was Rs. 1095.0 million in 1990, which more than doubled in seven years in 1997(Rs. 2298.2 million) . The 1997 duty further doubled in six years in 2003(Rs. 4785.1 million) which increased by 33 percent (Rs. 6445.9 Million) in 2005. The total excise duty increased almost six fold during the 1990-2005 periods.
- It should however be noted that the growth rate of total excise duty has fluctuated widely from year to year. The growth rate was as low as 1 percent (2002) to 30.13 percent (2004). The year-wise excise duty pattern shows that the growth rate has been less than 5% for five years, less than 10 % for three years, and 17 to 30 % growth for six years.
- The contribution of total excise duty in the Gross Domestic Product reveals that the ratio is less than one percent from 1990 to 2002. It has however slightly increased from 1.09 percent to 1.26 percent in the next three years (2003-2005).

Structure of Duty

- The structure of excise duty reveals the significance of revenue generated from three excisable items –cigarette, liquor and beer.
- The contribution of cigarette, liquor and beer together is on average more than 90 percent of the total excise duty during 1995-2005 periods.

Range of Excisable Products

- The number of selected excisable products has been reduced over the period. The selected excisable products numbered 14 in 1964. The number increased to more than hundred during the period 1964 to 1990.
- In 1997, the number of excisable products was 13 which increased to 21 in 1998. The number has further increased to 30 in 2006(January).

Rate of Excise Duty

- The duty on beer was Rs 20 per liter in 1996, the rate of which increased almost every year. Now it stands at Rs 45 per Liter. In case of 30 UP liquor, the duty per LP Liter was Rs 205 in 1997 which now stands at Rs 350 in 2005. The duty rate of filter cigarette of 70mm length was Rs. 255 per M (1000sticks) in 1996, which stands at Rs 340 per M in 2005.

Production

- The beer production has increased marginally in the last three years. The liquor production has fluctuated from year to year and has almost stabilized in the last few years.
- The cigarette production has also declined in some years but has shown steady increase in the last three years. The fluctuation is attributed to the internal disturbances in the country. The volume of production of soft drinks has increased more than 50 percent from 1995 to 2005, and more than three times in fifteen years.

Organization

- The Department of Excise was created in 1965 to administer the excise duty in an effective and efficient manner. The Department was merged with the Department of Sales Tax in 1993 which was changed into Department of Value Added Tax in 1996.
- The Department of Excise and Sales Tax was consolidated with the newly created Department of Inland Revenue in 2001.
- As a result of this organizational change, the excise function got least priority in the Department, despite the fact that excise duty was the fourth single largest revenue contributor. About 98 staff (full time and part-time) which is about 10.59 % of the total manpower (925), is allocated to administer the excise functions.
- The organizational structure shows that there are three tiers in the administration- Department level, District level and the Manufacturer level. There are 22 field offices in 19 districts.
- It should be noted that 71 staff position are vacant in the Department.

Collection cost

- The collection cost of the Department of Inland Revenue is 0.43 percent in 2005, which is lower than the collection cost of the Department of Customs (0.92%). The total expenditure ratio is 0.59 percent. It is interesting to note that a study conducted in 1985 found that the collection cost of excise was 1.6 percent in that year. Larger number of excisable products is based on specific rates except in all kinds of vehicles and motor cycles which are based on value.

Acts

- The Excise Act 2002, Excise rules 2002 and amendment thereof by the Finance Act 2060, 2061 and 2062 have made provisions for excisable products, collection methods, and exemption of excise duty, deputation of the excise inspectors, licensing process, regulating mechanisms and penalty of the wrongdoers.

Unpredictability

- Unpredictability of the government's excise policy during the period is notable. It is particularly observed in the organizational structure, frequent increase of the rate of

excise duty without extensive homework, deduction of excise duty paid on the raw materials etc.

Discretionary Authority

- The Excise Act has empowered the government with the discretionary authority. The government official can fix the price of the manufactured goods for the excise duty purpose. It can order to reassess the price or instruct the manufacturer to include additional price taking into consideration the cost. It has not defined the cost and it has not stipulated whether the manufacturer should be consulted.
- The excise official has also the authority to issue search warrant and arrest the accused if the excise official has “adequate basis” to do so. The penalty clause has provisioned for the financial penalty or imprisonment or both which gives a wider leeway to the decision maker in awarding penalty.

Least priority to excise

- As the newly created Department of Inland Revenue is vested with the administration of Income Tax, Value Added Tax and the Excise Duty; it has to devote more time to address problems of income tax and VAT as the number of tax payers increased substantially compared to the excise which is considered to be less complicated tax in terms of number of taxpayers and the sources of revenue.
- The officials are not properly trained on technical matters.
- The junior staff assigned to the plants is from the revenue service. They are neither trained in the technical matter nor have the motivation to work.

Leakage

- Despite legal and administrative provisions to control the leakage, the huge leakage and the corresponding loss of revenue is frequently reported. The Department of Inland Revenue believes that the leakage amounts to more than 40 percent annually. Knowledgeable sources claim that it is grossly underestimated.
- The controversy regarding the duplicate stickers and the duplicate crown cork is also rampant. It seems that the monitoring on periodic basis, which the Acts have made provisions have not been effective because of the lack of financial and technical analytical skill of most of the staff.

WTO

- In the course of negotiation to accession to WTO, Nepal made commitment on customs tariff rate, other duty and charges (ODCs) and customs valuation. Accordingly, Nepal agreed to tariff binding rate which obligated Nepal to adjust its tariff in a time bound schedule. The major commitments that Nepal made in WTO are presented below.

Table A: Major Commitments in the Process of accession of Nepal to WTO

(Selected Commitments)

Commitments	Due Date
Custom Tariff for agriculture products (42 Percent)	31/12/2006
Custom Tariff for industrial products (24 Percent)	31/12/2013
Full Implementation of Customs Valuation Agreement	31/12/2006
Zero tariff rates on IT goods	31/12/2008
Reduction of other duties and charges to Zero rate	31/12/2013

Source: Report of the Working Party on the Accession of the Kingdom of Nepal to World Trade Organization

- The Department of Customs has estimated the revenue loss of tariff adjustment and the loss due to the elimination of ODCs. The tariff adjustment will lead to the loss of about Rs.956 million in customs duty. The loss of duty from the agriculture reform fee and local development fee will amount to Rs 556 million and Rs 1846 million respectively. The shortfall of VAT collection is amounted to Rs. 436.6 million. The combined effect of this is the drop of revenue to the tune of Rs 3.80 billion which is a substantial amount for Nepal.

BIMST-EC

- In order to prevent the negative effect on revenue from trade and to protect the domestic industry from unfair competition, the Negotiation Committee agreed to draw negative list which will include 20 percent of the 5224 HS subheads of trade. Nepal has to submit the negative list which is not subjected to elimination or reduction of tariff. During the next round of negotiation, it is expected to finalize the negative list.

SAFTA

- SAFTA has a provision for drawing sensitive list in order to prevent adverse effect on the revenue from trade and to protect domestic industries from unfair competition. The Trade Liberalization Program allowed including 20 to 25 percent of HS Subheads in the sensitive list.
- As BIMST EC and SAFTA agreements have allowed drawing negative or sensitive list in order to protect revenue and the domestic industries, the revenue implication for short term is marginal.

Bilateral Agreements

- Nepal had signed Treaties of Transit and Trade as well as the Agreement of Cooperation to Control Unauthorized Trade with India. They accord each other unconditional most favored nation treatment. They exempt imports of certain primary products from duties or any form of quantitative restriction on a reciprocal basis. India had granted preferential treatment to industrial products manufactured in Nepal on the basis of non-reciprocity in order to promote industrial development in Nepal. India provided access to Indian markets free of customs duty and the quantitative restriction for all articles with some restriction on four products.
- Agreement on Trade with India states “The Government of India will allow to His Majesty’s Government of Nepal payment of the excise and other duties collected by the Government of goods produced in India and exported to Nepal provided that :
 - (i) such payment shall not exceed the import duties and like charges levied by His Majesty’ Government on similar goods imported from any other country, and

- (ii) His Majesty's Government of Nepal shall not collect from the importer of the said Indian goods so much of the import duty and like charges as is equal to the payment allowed by the Government of India".
- If the excise duty of India is higher than the import duty of Nepal, Nepal will not receive the excise duty refund equivalent to the difference between the Indian excise duty and the Nepal's import duty.

Recommendations

- It is suggested to formulate a three year rolling plan which may indicate annual target, strategy to achieve the target, and review mechanism covering legal, institutional, administrative components.
- The amendment of the Excise Act and the Liquor Act should be initiated with a view to respond to the changing socio economic situation. The discretionary authority of the officials should be curtailed.
- The juvenile drinking should be made more stringent and seller should be liable for punishment in case of infringement of the Act. The penalty should be more severe and if proven guilty of violating the provisions of the Acts, the accused must serve jail sentence.
- The government needs to give prominence to the excise duty in the organization. It may not be advisable to create a new Department in the face of financial difficulty. It is therefore recommended to add one more Deputy Director General, one Financial Analyst and one high level liquor expert in the Department, who can devote full time in the excise function. They should be capable to carry out analytical exercise based on the information and to visit the factories and monitor the performance at a frequent interval.
- They should interact with the consumer groups, citizen Groups NGOs engaged in addressing the problems associated with the juvenile drinking and smoking.
- The application of excise rate on petroleum products, production and supply of timber, is necessary as the government is obligated to drop the agriculture fee, local development fee from the customs tariff.
- The anomalies in the excise duty of liquor, its raw material and wine should be corrected.
- The government should standardize the size and quality of the stamps and ask the manufacturers to make arrangements for its supply. The option would be to establish security press in collaboration with the private sector. The problem of leakages of the excisable products should be addressed through an integrated approach.
- The definition and classification of the excisable products should be made compatible with the HS Code nomenclature of the customs.
- As excise duty is a stable source of revenue for the government, it is imperative to protect and support the liquor, cigarette and beer industry.
- Budget allocation should be increased to build up and up grade the capacity of the department.

Study on Excise Duty

1. Background:

Excise duty is a government tax on selected goods which are manufactured, sold or used in the country. This traditional definition of the excise duty has been widened in scope in recent years. It is also applied on service sector and the import of selected goods and commodities.

The Civil code 1854 has given legal basis for imposing excise duty on liquor, mining of iron, animal bones, hashish, cannabis, timber wood etc It was believed that the duty was raised to cover the expenditure on war with Tibet. The Excise Act 1959 authorized the government to impose excise duty on domestic industrial products like matches, sugar, liquor etc. The Act was revised in 2002 expanding the scope of excisable products. The government is now authorized to impose excise on service sector as well as on the import of goods on a selective basis.

During the Rana regime, the excise duty was collected on a contract basis. After 1951, the contract system to raise excise duty from hashish and cannabis was terminated and the license system was introduced. The contract system on other products was continued. The contract system of low grade production and distribution of liquor was particularly significant. The Liquor Act 1975 was promulgated, which gave legal basis to introduce distillery system in the production and distribution of liquor.

A separate Department of Excise was established in 1965 by bifurcating the Department of Customs and Excise. The purpose was to make the excise administration more effective and efficient in order to raise revenue from different kinds of domestic products on selective basis. The Department established field offices in various parts of the country. The Department was abolished in 1998. Its responsibilities were transferred to the newly created Department of Inland Revenue and one director in the New Department was given specific responsibility on the excise administration and similar responsibility was assigned to section officer in 22 field offices. The Department of Inland Revenue has delegated its authority of issuing excise license to 17 treasury offices. As the customs tariff rate has shown declining trend in the last few years, it is necessary for the government to explore alternative means to compensate for the loss of revenue and mobilize additional revenue to meet the growing administrative expenses. Excise duty is the potential area which is expected to contribute substantially in the future. This study is therefore an attempt to explore the potential, examine the status and the constraints and suggest recommendations for resource mobilization.

2. Methodology:

The Study is based on reviews of published and unpublished documents from the various sources. Secondary data have been collected, compiled and analyzed from the different published and unpublished documents. The study had focused from 1990 to 2005. Discussions were held with the government officials, former government officials and the representatives of the private sector on various aspects of the excise duty. Consultant visited one liquor factory in Kathmandu in order to familiarize with the production process.

3. Excise Duty: Objective

The government of Nepal has levied excise duty to achieve multiple objectives.

The Government's main objective of levying excise duty is the mobilization of revenue. The government declares its social objective of discouraging the consumption of health hazard products. The Excise duty is therefore imposed on the manufacture of the products like beer, liquor, tobacco and cigarettes..

The countervailing duty was imposed on imported products to protect the domestic industries from unfair competition. The excise duty applied for the domestic manufacturing industry is also applied without discrimination to the identical or similar products imported from the foreign countries. As a member of WTO, the provisions of WTO discourage to discriminate against the domestic and foreign products. Hence this objective of protection of the domestic industries by the imposition of countervailing duty has lost its significance in recent days.

The excise duty is also applied with the objective of protecting the environment .The example is excise duty on plastic paper bags, the production of bricks and the import of vehicles.

4. Excise Duty: Review of the Status

4.1 Excise duty collection

The total revenue from the excise duty has consistently increased each fiscal year since 1990¹. The total duty was Rs. 1095.0 million in 1990, which more than doubled in seven years in 1997(Rs. 2298.2 million) . The 1997 duty further doubled in six years in 2003 (Rs. 4785.1 million) which increased by 33 percent (Rs. 6445.9 Million) in 2005. As a result of the consistent increment, the total excise duty increased almost six fold during 1990-2005 periods. (Table I and Figure I)

It should however be noted that the growth rate of total excise duty has fluctuated widely from year to year. The growth rate was as low as 1 percent (2002) to 30.13 percent (2004). The year-wise excise duty pattern shows that the growth rate has been less than 5% for five years, less than 10 % for three years, and 17 to 30 % growth for six years.

¹ Fiscal Year is mentioned in calendar year in this Report. For Example 1990 indicates fiscal year 1989/1990.

Table 1: Excise Duty- Comparison with various indicators (Rs in Million)

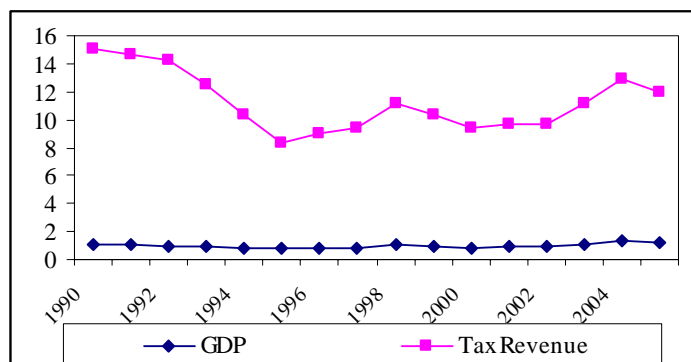
Years	GDP (at Current Price)	Tax Revenue		Excise Duty		Ratio of Excise Duty to GDP and Tax Revenue	
		Total	Growth Rate	Total	Growth rate	GDP	Tax Revenue
1990	99,702	7,283.9		1,095.1		1.1	15
1991	116,127	8,175.8	12.2	1,200.1	9.6	1.03	14.7
1992	144,933	9,875.6	20.8	1,414.3	17.8	0.98	14.3
1993	165,350	11,662.5	18.1	1,452.8	2.7	0.88	12.5
1994	191,596	15,371.5	31.8	1,592.5	9.6	0.83	10.4
1995	209,976	19,659.9	27.9	1,657.3	4.1	0.79	8.4
1996	239,388	21,667.9	10.2	1,944.2	17.3	0.81	9
1997	269,570	24,424.3	12.7	2,298.2	18.2	0.85	9.4
1998	289,798	25,939.8	6.2	2,885.8	25.6	1.01	11.1
1999	330,018	28,752.9	10.8	2,953.2	2.3	0.89	10.3
2000	366,251	33,152.1	15.3	3,127.7	5.9	0.85	9.4
2001	394,052	38,864.9	17.2	3,771.1	20.6	0.96	9.7
2002	406,138	39,330.1	1.2	3,807.1	1.0	0.94	9.7
2003	437,546	42,587.1	8.3	4,785.1	25.7	1.09	11.2
2004	474,129	48,172.9	13.1	6,226.8	30.1	1.31	12.9
2005	504,107	54,104.8	12.3	6,445.9	3.5	1.26	11.9

Source: Economic Survey Various years and Budget Speeches, Various years Ministry of Finance

The ratio of excise duty to total tax revenue does not show consistent pattern in the study period. It was more than 10 percent from 1990 to 1994, which declined to less than 9.5 % from 1995 to 1997. It however increased to 11.1 % in 1998 and 10.3 % in 1999, which again declined in the next three years. During the period 2003 to 2005, it has however shown increasing trend registering increasing ratio of 11.2 % to 12.9 percent. The contribution of total excise duty in the Gross Domestic Product reveals that the ratio is less than one percent from 1990 to 2002. It has however slightly increased from 1.09 percent to 1.26 percent in the next three years (2003-2005).

The increasing trend is mainly due to the introduction of excise duty on the import of all kinds of vehicles and the motorcycles. If we deduct this new instrument of the excise duty, the growth of excise revenue is marginal (See Table 3). The other reason for the increase in excise revenue is due to the frequent increase in the rates of excise duty in most of the products and some increase in the volume of production of major excisable products.

Figure 1: Ratio of Excise Duty to GDP and Tax Revenue



4.2 Composition of indirect tax

The relative contribution of customs, VAT and Excise duty in total indirect tax is presented in Table 2.

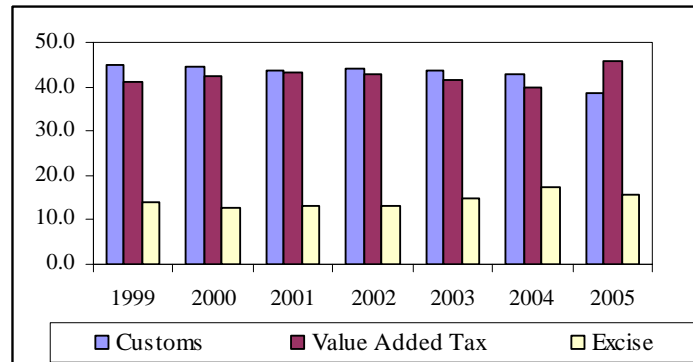
Table 2 : Composition of Indirect Tax
(Rs. in Million)

Years	Customs		Value Added Tax		Excise		Total Indirect Tax	
	Amount	%	Amount	%	Amount	%	Amount	%
1999	9,517.7	44.8	8,765.9	41.3	2,953.2	13.9	21,236.8	100
2000	10,813.3	44.7	10,259.7	42.4	3,127.6	12.9	24,200.6	100
2001	12,552.1	43.7	12,382.4	43.1	3,771.2	13.1	28,705.7	100
2002	12,658.8	44.1	12,267.3	42.7	3,807.1	13.2	28,733.2	100
2003	14,236.4	43.8	13,459.7	41.4	4,785.1	14.7	32,481.2	100
2004	15,554.8	42.9	14,478.9	39.9	6,226.7	17.2	36,260.4	100
2005	15,701.6	38.3	18,885.4	46.0	6,445.9	15.7	41,032.9	100

Source: Economic Survey (Various years), Budget Speech 2005/06, Ministry of Finance, HMGN

The comparison shows that the contribution of excise duty has remained less than 14 percent until 2002 and started rising since then which now stands at 15.7 percent of the total indirect tax in 2005. As the government changed the tariff structure of the customs in the vehicle import reducing the import tariff from 130 percent to 80 percent and imposing corresponding excise duty of 32 percent on the vehicles import, the relative contribution of customs declined whereas the contributions of excise and VAT correspondingly increased.

Figure 2: Composition of Indirect Tax



4.3 Structure of Excise Duty

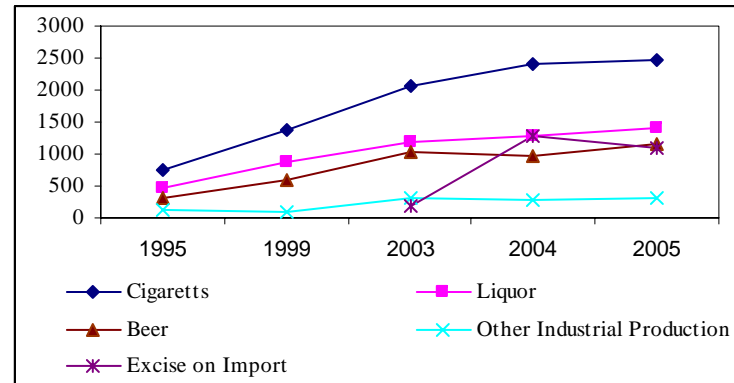
The structure of excise duty reveals the significance of revenue generated from three excisable items – cigarette, liquor and beer – in total excise duty. The government introduced detail classification of revenue source in different heads in 1995, which shows six revenue heads in the excise duty in comparison to only two heads before 1995. The contribution of cigarette, liquor and beer together is on average more than 90 percent of the total excise duty during 1995-2005 periods. In the last three years, the excise duty on import of vehicles and motorcycles is contributing significantly which is 16.8 percent of the total excise duty in 2005, compared to 4 percent in 2003. The excise duty from the cigarettes is the single largest contributor of the total excise duty (Table 3 and Figure 3).

Table 3 : Structure of Excise Duty (Rs in Million)

Description	1994		1995		1999		2003		2004		2005	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Industrial Production Excise	1592.2	100.0				0.0						
Liquor Contract	0.3	0.0				0.0						
Cigarettes			746.7	45.1	1373.6	46.5	2052.5	42.9	2393.1	38.4	2472.9	38.4
Bidi			10.7	0.6	46.4	1.6	4.7	0.1	3.3	0.1	3.4	0.1
Liquor			469.2	28.3	865.0	29.3	1179.9	24.7	1266.6	20.3	1395.9	21.7
Beer			314.2	19.0	589.1	19.9	1032.5	21.6	982.5	15.8	1164.4	18.1
Other Industrial Production			116.5	7.0	79.1	2.7	324.7	6.8	296.2	4.8	325.2	5.0
Excise on Import						0.0	190.8	4.0	1285.1	20.6	1084.1	16.8
Total Excise Duty	1592.5		1657.3	100.0	2953.2	100.0	4785.1	100.0	6226.8	100.0	6445.9	100.0

Source: Economic Survey, 2061/62, Ministry of Finance For year wise details see Annex 1

Figure 3: Structure of Excise Duty (Rs in Million)



4.4 Excisable Products:

The number of selected excisable products which attracted excise duty has been reduced over the period. The introduction of Excise Act 1959 and the related excise regulation replaced the 1854 Civil Code. It is reported that the selected excisable products numbered 14 in 1964. The number increased to more than hundred during the period 1964 to 1990. The reform in the excisable products started in 1990s. In order to impose excise duty in a few sensitive products; most of the duty of excise was adjusted in customs tariff and sales tax. The major contributor in the excise duty such as liquor, beer and the cigarette remained under the excisable duty. The excise duty was applied on five major Harmonized code (HC 17 sugar: HC21 edible preparations: HC22 beverages and spirits: HC24 tobacco: HC25 cement; HC87 vehicles and parts and accessories thereof). The objective of the excise duty was to mobilize revenue, to discourage the consumption of health hazard products, to provide protection to the domestic industry by imposing countervailing duty, and the protection of environment. In 1997, the number of excisable products was 13 which increased to 21 in 1998. The number has further increased to 30 in 2006 (January). The reason for the increase in the number is the excise duty imposed on the service sector, the motor cycles and wine made from apple and other fruits (12% alcohol content). (See Annex IV).

4.5 The Rate of Excise duty

One of the reasons for the growth in the annual collection of revenue from the excise duty is the frequent increase in the rate of excise duty in liquor, beer and cigarettes. Excise duty is considered to be the easiest duty to apply as the number of manufacturers is limited in number and the burden of such duty is passed on to the consumer. It is illustrated with a few examples. The duty on beer was Rs 20 per liter in 1996, the rate of which increased almost every year. Now it stands at Rs 45 per Liter. In case of 30 UP liquor, the duty per LP Liter was Rs 205 in 1997 which now stands at Rs 350 in 2005. The tax base of liquor was changed every year from 1998 to 2003. The base remained the same from 2003 to 2005 (July) which was drastically changed in 2006 (January). Similarly, filter cigarette of 70mm length has attracted excise duty which has increased every year. The duty rate was Rs. 255 per M (1000 sticks) in 1996, which stands at Rs 340 per M in 2005. The excise duty for molasses has also increased from Rs. 13 per quintal to Rs. 35 per quintal in seven years. Although the government adjusted the rate of excise duty in a frequent interval apparently to protect the revenue in real terms, it has not been done in a systematic and objective manner. It appears that the adjustment in the excise duty was guided mainly to balance the revenue deficit, treating excise revenue as residue. This kind of increment and frequent revision in the list of excisable products has however created uncertainty among the investors.

The rate of excise duty of cigarettes, beer, molasses and liquor is presented in Table 4, Table 5 and Table 6 below.

Table 4: Excise Duty of Cigarette (in Rs)

Description	1998	1999	2000	2001	2002	2003	2004	2005
Up to 70 mm in length								
Filter Per m	255	260	260	285	300	330	340	340
Non Filter per m	80	90	90	110	125	155	160	160
More than 70 mm								
Filter per m	325	330	335	365	385	425	440	440
Non Filter per m	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
More than 75 mm								
Filter per m	450	450	460	500	530	565	575	575
Non filter per m	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
More than 85 mm								
Filter per m	600	600	625	675	710	750	770	770
Non Filter per m	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Note: Per m means 1000 stick cigarette

N/A: Not Applicable

Source: Finance Act (Various Years) Ministry of Finance Kathmandu

Table 5: Excise Duty of Beer and Molasses (Rs)

Description	1998	1999	2000	2001	2002	2003	2004	2005
Alcohol content up to 5% (Per liter)	31	32	33	36	38	42	45	45
Molasses(Per quintal)	13	20	20	20	25	25	30	35

Source: Finance Act (Various Years) Ministry of Finance Kathmandu

Table 6: Excise Rate of Liquor (Rs.)

Description	Unit	1998	1999	2000	2001	2002	2003	2004	2005	2006	2006 Jan
40 UP to 50 UP (Bottled)	LP Liter										
More than 50UP(Bottled)	LP Liter										
40 UP to 50 UP(open)	LP Liter										
More than 50UP(Open)	LP Liter										
High Quality liquor											
35 UP and less than 35UP	LP Liter										
Liquor											
15 UP											400
25 UP											350
30 UP											350
30UPor less than 30UP up to 30 UP		225		235	245						
25 and 30 UP(Bottled)	LP Liter		225								
30UP to 40UP	LP Liter	110	115			150					
40 UP(Bottled)	LP Liter										200
Less than 40 UP	LP Liter					260	275	320	340	340	
50 UP	LP Liter										75
65UP (Pouch)	LP Liter										
30UP to 40UP	LP Liter										
More than 40Up		35	40	42	42						
40 UP to 65 UP	LP Liter			125	135		160	195	200	200	
More than 65UP	LP Liter					44	50	70	75	75	
70 UP	LP Liter										10

Note: Excise Duty on liquor was applied on specific and advalorum basis until 1996. Since 1997 the duty is in specific rates. For further details, see Annex III.

The classification of UP for excise duty is frequently changed, which makes comparison difficult.

Source: Finance Act (Various Fiscal Years), Ministry of Finance

4.6 Production Trend of the Excisable Products in selected years

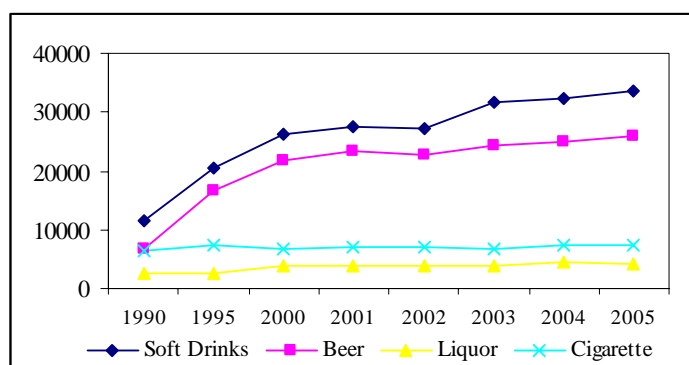
The production of beer has increased since 1995. The beer production however increased marginally in the last four years. The liquor production has fluctuated from year to year and has almost stabilized in the last few years. It should be noted that from 1990 to 1995 the volume of production was almost stagnated. The production increased more than 50 percent in the next five years. The production remained almost at the same level in 2001. The volume of production declined in 2002 and remained at the same level in the following year. In 2004 the volume of production increased by almost 17 percent compared to the previous year. But its production has marginally declined in 2005. Explanation given to this fluctuation of production is the law and order situation of the country, which had disrupted the domestic distribution and the social movement in some of the districts to declare it as liquor free zone. The producers also blamed the government for creating uncertainty in the policy, frequent change in the excise duty and closure of some of the distilleries. The cigarette production has also declined in some years but has shown steady increase in the last three years. The fluctuation is attributed to the internal disturbances in the country. The volume of production of soft drinks has increased more than 50 percent from 1995 to 2005, and more than three times in fifteen years. The demand for soft drinks has increased due to rapid urbanization and intensive advertisement. (Table 7 and Figure 4)

Table 7: Production of selected Excisable Products

Commodity/Year	Unit	1990	1995	2000	2001	2002	2003	2004	2005
Soft Drinks	000Liter	11520	20592	26211	27522	27100	31603	32472	33657
Beer	000 Liter	6838	16776	21725	23354	22800	24162	24977	25951
Liquor	000 Liter	2460	2500	3847	3885	3700	3792	4437	4317
Cigarette	Mil sticks	6317	7430	6584	6979	6900	6812	7268	7421

Source: Economic Survey, 2004/2005 (Table 8.10) Ministry of Finance HMGN

Figure 4: Production of selected Excisable Products



Source: Economic Survey, 2004/2005, Ministry of Finance HMGN

4.7 Organization:

The Department of Excise duty was created in 1965 to administer the excise duty in an effective and efficient manner. The Department was merged with the Department of Sales Tax in 1993, which was named Department of Value Added Tax in 1996, in an ongoing effort to introduce VAT in Nepal. As the Department was fully engaged in the initiation of VAT, the officials could not pay much attention to the administration of excise duty. The Department of Excise and Sales Tax and the Department of Tax was consolidated in the

newly created Department of Inland Revenue in 2001. The Department of Inland Revenue was entrusted with the administration of Value Added Tax, Income Tax and Excise duty. As a result of this organizational change, the excise function got least priority in the Department, despite the fact that excise duty was the fourth single largest revenue contributor. It is illustrated with the fact that about 98 staff (full time and part-time) which was about 10.59 % of the total manpower (925), is allocated to administer the excise function which may be compared with the 555 excise staff positions when the Department of Excise was functioning before 1993. The organizational structure shows that there are three tiers in the administration – Department level, District level and the manufacturer level. There are 925 staff positions in the Department and the field offices. Out of this number, 261 are the gazetted, 466 non-gazetted and others 198. There are 22 field offices in 19 districts. Moreover, the gazetted staff assigned to the excise function is 3 in the Department and 24 gazetted staff in the field offices. It should be noted that 71 staff positions are vacant in the Department (Table 8).

Table 8: Total number of positions including excise positions

Department of Inland Revenue

Description	Total number of positions			
	Gazetted	Non-Gazetted	Others	Total
Department of Internal Revenue	47 (3)	44 (3)	21	112 (6)
Field Offices-22	214 (24)	422 (68)	177	813(92)
Total number of excise staff:	261 (27)	466(71)	198	925(98)
Ratio of excise Staff to total				10.59
Vacant Position	27	44		71

Note: Figures in parenthesis indicates the number of excise staff out of total positions.

Source: Annual Report 2061/62, Department of Inland Revenue

As the complexity of excise administration is increasing, the need for technical competence and the effective monitoring and follow up is all the more obvious. In view of this and the greater significance attached to the domestic resource mobilization in the context of the liberal trade regime and the declining customs tariff rate, the number of excise staff is grossly inadequate to explore the potentiality of the excise duty and to discharge the continuous follow up actions.

4.8 Cost of Collection of Revenue:

The government has to spend on the collection of revenue. The expenditure pattern on the Department of Inland Revenue is presented below. It is compared with the expenditure on the Department of customs. Collection cost of the Department of Inland Revenue is compared with the revenue that this Department has collected. As a significant part of excise and VAT revenue is collected at the customs point, the expenditure/revenue ratio may be underestimated in case of Department of customs and overestimated in case of Department of Inland Revenue. In order to get the average figure of collection cost of the revenue departments, total expenditure/ total revenue ratio is also presented in Table 9. If we assume that 10 percent of staff is engaged in the collection of excise duty, the collection cost of excise duty is insignificant.

Table 9: Comparison of Expenditure to revenue (Rs in million)

Year	Customs			Inland revenue*			Total		
	Revenue	Expend	Ratio	Revenue	Expend	Ratio	Revenue	Expend	Ratio
1999	9517.7	82.1	0.86	18232.1	74.8	0.41	27749.8	156.3	0.56
2000	10813.3	87.3	0.81	21322.9	80.2	0.38	32136.2	147.5	0.46
2001	12552.1	102.6	0.82	25700.1	96.6	0.38	38252.2	199.2	0.52
2002	12658.8	131.5	1.04	25480	124.5	0.49	38138.8	256	0.67
2003	14236.4	130.3	0.92	26936.3	118.6	0.44	41172.7	248.9	0.6
2004	15554.8	143.9	0.93	30920.7	125.8	0.41	46475.5	269.7	0.58
2005	15701.6	143.8	0.92	35797.5	140.1	0.39	51499.1	283.9	0.55

* It includes income tax, value added tax and excise duty

Source: Economic survey, 2004/2005 (Table 2.2, 2.4 and 2.5) Ministry of Finance

The collection cost of Department of Inland Revenue is 0.39 percent in 2005, which is lower than the collection cost of the Department of Customs (0.92%). The total expenditure ratio is 0.55 percent. The knowledgeable sources have the opinion that 2 to 3 percent is the collection cost in other developing countries. The figure of Japan shows 1.60 percent collection cost. It is interesting to note that a study conducted in 1985 found that the collection cost of excise was 1.6 percent in that year in Nepal.

4.9 Specific vis-à-vis Advalorum Tax:

The Government of Nepal has applied both specific and advalorum rates for charging excise duty. Specific rate is simple to administer and is applied in the countries which have weak administration. The manufacturer provides information to the excise offices which need to be analyzed in order to determine advalorum tax. As it is a complex system of analysis it demands qualified and skilled manpower. The history of tax base in Nepal shows that before 1990, the government applied advalorum rates in majority of products when Department of Excise was functioning independently. In cigarettes, beer and liquor the government had the policy to make liable the manufacturer to pay the greater of the advalorum or the specific rates of excise duty. This policy was changed in 1995 and was imposed specific rates. Larger number of excisable products is based on specific rates except in all kinds of vehicles and motor cycles which are based on value. (See Annex II)

4.10 Review of legal provisions:

The Excise Act 2002, Excise rules 2002 and amendment thereof by the Finance Act 2060, 2061 and 2062 have made provisions for excisable products, collection methods, and exemption of excise duty, deputation of excise inspectors, licensing process, regulating mechanisms and penalty of the wrongdoers. Section 7 of the Act has made provisions for the fixation of price for excise purposes. For products, it will be either sale price of the manufacturer or the Department may fix the price taking into consideration the production cost. In case of imported product, the sum of price fixed for customs purposes and the customs duty charged for the product. Excise rate is applied to mark up prices of the imported products. For the services, it is based on invoice. The department has also the authority to revise the price or impose additional price for excise purposes. If the products are exported or sold in the bonded warehouse or the duty free shop, such products are exempted from the excise duty. Section 8 enables the government to issue license charging fee to the applicant for the production, distribution, import, storing of excisable products. Section 11 empowered the government to issue search warrant against the party if there is adequate basis for issuing such warrant. If found guilty, the excise officer can penalize the accused by imposing fines or sentence him up to one year imprisonment or both. The aggrieved party may appeal to the Director General for review and against review decision, the party may appeal to the revenue

Court or the party may file a case against the excise officer's decision in the revenue court(Section 19 and 23). The Liquor Act 1975 is a specialized Act of Liquor. It provisions for regulating production, trade, licensing, etc. Sales are restricted. Without license, excisable products can not be produced, distributed or sold.

5. Problems and Constraints:

The review of the status has brought out sharply various problems in the excise duty. The total revenue from the excise duty has not increased to the extent that it should have increased. The extent of increase is largely attributed to the increment in the excise rate and the identification of new excisable products. Moreover, the frequent change in the organizational structure of the excise department and the least priority in the manpower allocation despite excise duty being the fourth largest revenue contributor, are some of the issues that need further analysis. It should however be underlined that the problems and constraints that the industry and the government face have largely emanated from the abnormal law and order situation of the country in the last ten years. The prolonged internal conflict escalated intensively in the last four years, which added complexity in the enforcement of law. Frequent strike and bandh, military operations, extortion or threat of extortion of money from the manufacturers led to the disruption in the supply chain of excisable products, particularly the production and distribution of large revenue contributing products like liquor, beer and cigarettes. Large scale illegal production and distribution of low quality liquor in the rural areas is attributed to the deteriorating law and order situation of the country.

5.1 Unpredictability

The government was collecting excise duty from as many as 100 products before the Department was merged with the Department of Sales Tax in 1993. As a part of the ongoing reform measures on the revenue policy and the program, the government reduced the number of excisable products and limited to 20 to 30 products which are sensitive to health and the environment conservation. During the period, the government's excise policy passed through erratic changes. It is particularly observed in the organizational structure, frequent increase of rate of excise duty without extensive homework, deduction of excise duty paid on the raw materials etc. Having no clear policy in a proper perspective resulted in the least priority to the excise duty in the organizational structure. The government allowed the loose or pouching system of the liquor production which was withdrawn after two years. The government policy on the deduction of excise duty paid on the raw materials used in the production of liquor and the beer has been frequently changed. Similar is the case in approving the loss in the production process. It seems that the government is acting on an adhoc basis. It has focused to raise excise duty without giving importance to the future of the industry.

5.2 Discretionary Authority:

The Excise Act has empowered the government with the discretionary authority. The government official can fix the price of the manufactured goods for the excise duty purpose. It can order to reassess the price or instruct the manufacturer to include additional price taking into consideration the cost. It has not defined the cost and it has not stipulated whether the manufacturer should be consulted. It has not even explained the circumstances leading to the repricing or additional pricing. The excise official has also the authority to issue search warrant and arrest the accused if the excise official has "adequate basis" to do so. The act has not clarified the meaning and the content of the adequate basis. It seems to be the discretion of the official. The penalty clause has provisioned for the financial penalty or imprisonment

or both which gives a wider leeway to the decision maker in awarding penalty. It is interesting to note that the Excise Act and the Liquor Act differ in the penalty clause. As the products are sensitive in nature, which has direct effect on the health and happiness of the person and the family, the penalty should be specific and severe to deter possible crime in the future. Similarly, Excise authority has the authority to abrogate the license if the licensee acts against the public interest. But the act has not explained what constitutes public interest. The Act also provides that the government can impose excise duty at the time of production, which will be treated as advance payment. There is always possibility of using this authority at a time of the cash crunch of the government, which may lead to the liquidity problem and financial cost to the manufacturer. The Act has made provision for the deduction of loss in the manufacturing process of the liquor and the beer. The excise officer has the authority to grant up to 2 percent loss in liquor and 4 percent loss in crown cork. If it is more than the stipulated loss, the excise official has to recommend to the Department of Inland Revenue for approval. The Director General has open ended authority to decide the case without the time limit and the accountability is questionable. As the Department was reluctant to approve the loss, the cases are still pending with the Department for many years. The Act which was amended through the Finance Act in January 2006 has made provision for blanket approval for the loss up to 1.5 percent for the case pending before 2002. These are some of the selected examples to show that the government has still to work to make the Acts more transparent, accountable and participatory.

5.3 Least priority to excise

As the newly created Department of Inland Revenue is vested with the administration of Income Tax, Value Added Tax and the Excise Duty; it has to devote more time to address problems of income tax and the VAT as the number of tax payers increased substantially compared to the excise which is considered to be less complicated tax in terms of number of taxpayers and the sources of revenue. The officials, who are assigned to work in excise section, are not motivated to work as they aspire to work in the income tax section which is considered to be professionally challenging. The officials are not properly trained on technical matters. As the senior officials are busy in addressing the income tax and the VAT problems, the junior excise officials are least interested in monitoring and taking follow up actions in controlling the leakage in revenue. The number of staff in excise function is 10.59 percent of the total strength, which is inadequate to analyze the manufacturer's report of performance on a regular basis. Moreover, these staff has not been trained to carryout research and analytical functions. As the manufacturers are modernizing the plants, the technical know how of the staff which is lacking or inadequate, has not been updated to cope with the modernization. The junior staff assigned to the plants is from the administrative section. They are neither trained in the technical matter nor have the motivation to work. Overall, the least priority accorded to the excise function in the Department is an issue which needs to be addressed immediately. As the membership in the WTO has necessitated mobilizing additional revenue to compensate for the loss of revenue from customs tariff and other duties and charges now being imposed in the customs point, it has added urgency to introduce reform measures in the excise duty.

5.4 Leakage

The government has various ways of controlling the evasion or leakage of revenue and protecting the health of the people from excessive use of the product. The government issues license to produce, distribute, sales and storage of the excisable products. The manufacturer has to get license for the new brand of product. License fee are charged for issuing the license. The government has the physical control in the manufacturing of sensitive products

such as beer, liquor, cigarette and molasses (self removal system is granted to the products, which have least contribution in revenue). The excise officials are present at the factories. The excise inspector has to check the production and distribution of the product. The excise officer is expected to inspect the production process and its quality, state of raw materials and output, sales and revenue collection every month and report the status along with his recommendation to the Department of Inland Revenue. The excise official has the authority to collect sample of production from the manufacturer and also from the market for the laboratory test. The government has also issued guidelines for the recovery ratio of the raw materials used to produce liquors and beer. The government has started the policy of making mandatory the use of sticker in every bottle of liquor and is in the process of making it mandatory for the beer and the cigarette. For bidi the government issues band role of stickers. In case of beer, the use of crown cork is controlled and is expected to check the leakage. If the accused is found guilty, heavy penalty is awarded.

Despite legal and administrative provisions to control the leakage, the huge leakage and the corresponding loss of revenue is frequently reported. Although it is difficult to say how much leakage exists as there is no national survey conducted on excisable products, the Department of Inland Revenue believes that the leakage amounts to more than 40 percent annually. Knowledgeable sources claim that it is grossly underestimated. The reason for such a huge proportion of leakage is attributed largely to illegal production of low quality liquor at domestic level, smuggling of foreign liquor and cigarettes in the domestic market and lack of effective monitoring and follow up. The Auditor General's Report states that license of some of the manufacturers has not been renewed for five years and the department does not know their existence indicating lack of monitoring and follow up, the recovery from the tobacco to manufacture different brands is grossly underestimated, the exemption of production loss during the production process is claimed by the manufacturer and is largely not verified by the Department of Inland Revenue. The beer factory claims loss of crown cork during the production process and it is not properly verified before awarding exemption. Although the presence of excise inspectors is ensured in every stage of production and export of the product, they are not trained persons. They have no knowledge of the technical process which is very much complicated. The controversy regarding the duplicate stickers and the duplicate crown cork is also rampant. It seems that the monitoring on a regular basis, which the Acts have made provisions, have not been effective because of the lack of financial and technical analytical skill of most of the staff. Analysis should be on the technical and production process, financial and marketing aspects. On the basis of research, the follow up measures should be taken. Despite the government efforts to reduce the consumption on the ground of health hazard, the demand for sumptuary products is increasing year by year. Strong monitoring and follow up actions at the manufacturing, selling and marketing level is lacking.

5.5 Revenue implication of Multilateral, Regional and Bilateral Agreements

5.5.1 WTO

Nepal signed a Protocol on the accession of the Kingdom of Nepal to the WTO Agreement on September 11, 2003 and became member of WTO as 147th member on April 23, 2004.

In the course of negotiation to accession to WTO, Nepal had made commitment on customs tariff rate, other duty and charges (ODCs) and customs valuation. Accordingly, Nepal agreed to tariff binding rate which obligated Nepal to adjust its tariff in a time bound schedule. The major commitments that Nepal made in WTO are presented below.

Table 10 : Major Commitments in the Process of accession of Nepal to WTO

(Selected Commitments)

Commitments	Due Date
Custom Tariff for agriculture products (42 Percent)	31/12/2006
Custom Tariff for industrial products (24 Percent)	31/12/2013
Full Implementation of Customs Valuation Agreement	31/12/2006
Zero tariff rates on IT goods	31/12/2008
Reduction of other duties and charges to Zero rate	31/12/2013

Source: Report of the Working Party on the Accession of the Kingdom of Nepal to World Trade Organization

The commitments presented in the above Table shows that Nepal has to adjust customs tariff by 2006, 2008, and 2013. According to this commitment, tariff rate of 137 HS Sub heads, which falls in Chapter 84, Chapter 85 and Chapter 90 (machineries, equipment, information technology and electrical goods), should be reduced to Zero rate by 2008. Similarly the tariff rate of vehicles should be reduced progressively to 60 percent and 40 percent by 2013. In 2006, the tariff rates of some sub heads should be reduced to 30 percent, 25 percent, 20 percent, 10 percent and 5 percent from 40 percent, 15 percent and 10 percent. The tariff binding rates of agriculture products is 42 percent which is above the current tariff rate. Nepal may choose to adjust upward the tariff rate of agriculture related trade.

Government of Nepal collects ODCs at the customs point. The government has made commitment to reduce the ODCs in a phased schedule to Zero rate by 2013. Local development fee, Special fee and Agriculture Reform fee are the ODCs in the context of Nepal. In order to fulfill the commitment made to WTO, the government has started implementing it in a phased manner. The government has dropped the special fee in all subheads except in the import of vehicles, petrol, diesel and the kerosene. Agriculture reform fee is reduced from 10 percent to 8 percent which are reflected in the Finance Act 2005/2006. The average customs duty has started falling which is shown in Table 11. Average rate of customs duty has declined from 10.4 percent in 2002 to 8.6 percent in 2005. As a percent of dutiable imports, the average rate has declined from 13.7 percent to 11.5 percent.

Table 11: Average rate of Custom duties (Rs in Million)

Items	2002	2003	2004	2005
Total Imports	109,272.6	137,020.4	133,035.3	143,137.1
Of which : Dutiable imports	83,218.6	93,049.1	94,314.0	106,791.2
Total Import duties	11,366.9	10,578.1	11,451.7	12,277.9
As a percent of total imports	10.4	7.7	8.6	8.6
As a percent of dutiable imports	13.7	11.4	12.1	11.5

Source: Department of Customs

The Department of Customs has estimated the revenue loss of tariff adjustment and the loss due to the elimination of ODCs. The tariff adjustment will lead to the loss of about Rs.956 million in customs duty. The loss of duty from the agriculture reform fee and local development fee will amount to Rs 556 million and Rs 1846 million respectively. The shortfall of VAT collection is amounted to Rs. 436.6 million. The combined effect of this is the drop of revenue to the tune of Rs 3.80 billion which is a substantial amount for Nepal.

5.5.2 BIMST-EC

Nepal became a signatory of the Framework Agreement on the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation Free Trade Area (BIMST-EC Free Trade Area) in February 2004. Article 3 of the Framework Agreement has made provisions for Trade in Goods. It states that the products, except those included in the Negative List, shall be subject to tariff reduction or elimination on (a) Fast Track and (b) Normal Track basis. Article 10 of the Agreement has established Trade Negotiation Committee. The Negotiating Committee has entered into eleven rounds of negotiation among the members which led to the understanding to the principals of negotiation. The principals laid down that out of 5224 of HS subheads, 10 percent of subheads fall under the Fast Track which is subjected to progressive reduction leading to elimination of tariff within an already agreed timeframe. Under the normal track, out of 5224 HS subheads (accept the 20 percent HS subheads under the Negative List), the remaining subheads are subjected to Zero or 1 to 5 percent tariff.

In order to prevent the negative effect on revenue from trade and to protect the domestic industry from unfair competition, the Negotiation Committee agreed to draw negative list which will include 20 percent of the 5224 HS subheads of trade. Nepal has to submit the negative lists which are not subjected to elimination or reduction of tariff. During the next round of negotiation, it is expected to finalize the negative list.

5.5.3 SAFTA

The Resolution on South Asia Free Trade Area (SAFTA) was adopted at the 12th SAARC Summit held in Islamabad, Pakistan on 4 to 6 January 2004, where all the SAARC member countries were the signatories. The SAFTA has incorporated Trade Liberalization Program

which made provisions to reduce tariff progressively and expand the coverage of HS Subheads in an agreed timeframe. SAFTA has a provision for drawing sensitive list in order to prevent adverse effect on the revenue from trade and to protect domestic industries from unfair competition. The Trade Liberalization Program allowed drawing 20 to 25 percent of HS Subheads in the sensitive list.

As BIMST EC and SAFTA agreements have allowed drawing negative or sensitive list in order to protect revenue and the domestic industries, the revenue implication for short term is marginal. However, member countries have agreed to enter into negotiation for reducing the number of HS subheads in the sensitive list in four years. As each round of negotiation is expected to reduce the HS Subheads in the sensitive list, the revenue implication has to be assessed during the negotiation. It is therefore premature to project the revenue impact in the short term.

5.5.4 Bilateral Agreements

Nepal had signed bilateral trade agreements with 17 countries and a Trade Cooperation Agreement had been signed with the European Union. The Agreements provided most favored nation treatment on reciprocal basis. These Agreements are basically related to trade in goods. As a member of WTO, Nepal has to treat all members indiscriminately. So these agreements except agreement with India may not have much relevance in the present context

Nepal had signed Treaties of Transit and Trade as well as the agreement of Cooperation to Control Unauthorized Trade with India. They accord each other unconditional most favored nation treatment. They exempt imports of certain primary products from duties or any form of quantitative restriction on a reciprocal basis. India had granted preferential treatment to industrial products manufactured in Nepal on the basis of non-reciprocity in order to promote industrial development in Nepal. India provided access to Indian markets free of customs duty and the quantitative restriction for all articles with some restriction on four products such as vegetable fats, acrylic yarn, copper products and zinc oxide manufactured in Nepal on the basis of certificate of origin. India has listed following products in the negative list, which are:

Alcoholic liquors and beverages
Perfumes and cosmetics
Cigarette and tobacco

As India is giving preferential treatment to our products, it is difficult to project revenue loss. As the customs tariff rate is declining annually in India, the pressure will mount to align the tariff rate with India resulting in the revenue loss. Nepal India Treaty of Trade Agreement Article III and Protocol to the Treaty of Trade “With reference to Article III” states “The Government of India will allow to His Majesty’s Government of Nepal payment of the excise and other duties collected by the Government of goods produced in India and exported to Nepal provided that :

- (I) such payment shall not exceed the import duties and like charges levied by His Majesty’ Government on similar goods imported from any other country, and
- (ii) His Majesty’s Government of Nepal shall not collect from the importer of the said Indian goods so much of the import duty and like charges as is equal to the payment allowed by the Government of India”

If the excise duty of India is higher than the import duty of Nepal, Nepal will not receive the excise duty refund equivalent to the difference between the Indian excise duty and the Nepal's import duty.

6. Recommendation:

6.1 The government of Nepal has not stipulated the vision for the Excise duty. The revenue policy as envisioned in the Tenth Plan (2002-2007) has not even mentioned about the excise duty except in broad terms like administrative and legal reforms and the controlling of leakages of the tax system as a whole. Indeed, the policy of excise duty seems to have not been an integrated part of the national revenue policy. It is the fourth largest single source of revenue which is raised from a limited number of manufacturers and the importers in selected products. It appears to have been taken for granted that the excise duty will continue to be a large source of income. Indeed, the accession to WTO has the implication of reduced tariff rate and the loss of revenue over the next 7 years. It is most likely that the excise duty has to contribute a larger portion of the compensation of the loss of revenue. It is therefore necessary to recognize that different aspects of excise duty should be integrated in a forward looking plan for the next three years. It is suggested to formulate a three year rolling plan which may indicate annual target, strategy to achieve the target, and review mechanism covering policy, legal, institutional, administrative components.

6.2 The amendment of the Excise Act and the Liquor Act should be initiated with a view to respond to the changing socio economic situation. The discretionary authority of the officials should be curtailed. The disqualification clause of the applicant should be stipulated so as to make it more transparent to the applicant who should know the expectation of the government while approving the application. The juvenile drinking should be made more stringent and supplier should be liable for severe punishment in case of infringement of the Act. The penalty should be more severe and if proven guilty of violating the provisions of the Acts, the accused must serve jail sentence corresponding to the degree of criminal offence.

6.3 The excise function is subsumed in the Department of Inland Revenue. The government needs to give prominence to the excise duty in the organization. Having realized the weaknesses in the excise administration, the Minister of Finance announced through the budget speech (2005/2006) to establish new Department of Excise duty with a purpose to strengthen the institutional capacity (Para 195 of the speech). As a follow up, the Ministry of Finance formed a task force under the chairmanship of former Secretary Mr. Narayan Raj Tiwari. The Task force submitted a report on Revenue Administration Institutional Reform in June 2006 recommending, inter alia, to establish the Department of Excise². As discussed in this study the weaknesses underlined in the excise administration are, inter alia, the inadequate monitoring and follow up actions and lack of research and analysis of the information documents forwarded by the industries as required by law. In order to address these weaknesses, it is necessary to add more high level administration and technical staff

² The Tiwari Report has considered other options as well. The options are : transferring the responsibility of excise to the Department of Customs; forming the Tariff Board making the Departments of Excise, Income Tax, Customs and Value Added Tax as Directoriat of the Tariff Board, and strengthening the Inland Revenue Department with additional staff and authority for excise functions.

with specific responsibility and adequate authority. It should be noted that the government policy is to utilize existing organizational capacity rather than creating a new organization entailing huge financial implication. It may therefore not be advisable to create a new Department in the face of financial difficulty in the country. Moreover it is not justified to create a new Department to administer about 30 manufacturing industries of excisable products in a limited number of districts. It is recommended to add one more Deputy Director General and one Financial Analyst and recruit the liquor expert in the vacant position in the Department of Inland Revenue, who should devote full time in the administration of excise duty. They should have the capability to carry out analytical exercise based on economic, financial and technical information and to visit the factories and monitor the performance at a frequent interval. They should interact with the manufacturers, consumer groups, citizen groups, NGOs etc. and engage them in addressing the problems associated with the juvenile drinking and smoking. The Ministry of Finance should review the experience of the proposed organizational arrangements in 3 years time frame and, if found adequate justification, a new Department of Excise should be formed.

6.4 Moreover, the Department is understaffed as 71 positions of the Department remained vacant until the last fiscal year (2005). The positions should be filled in as soon as possible.

Exploration of new excisable products is necessary. In order to compensate for the loss from the reduction of tariff rate and the environmental consideration, the application of excise rate on petroleum products, production and supply of timber may be considered as a compensation for the loss of revenue due to the implementation of WTO Agreement. The existing rate is frequently revised which has added complication to the implementation. It should be revised in an interval of three years taking into account the consumer price index. However, the anomalies in the excise duty of liquor, wine and raw materials used for liquor should be corrected, which is shown in the following table.

6.4.1.1 Table 12: Average Excise Rate for 1% alcohol content

Liquor	Alcohol content	Excise Rate	Average Excise
	%	Rs	per 1% alcohol
15 UP	49	400	8.16
25UP	43	350	8.14
30UP	40	350	8.75
40UP	34	200	5.88
50UP	29	75	2.59
70UP	17	10	0.59
Wine	17	80	4.71
Beer	5	45	9.00

Source: Consultant's calculation

Average excise for 1% alcohol in beer is the highest (Rs. 9.00), whereas 70 UP alcohol attracts lowest duty (Rs. 0.59). Moreover, the duty on raw material used in preparing liquor

is higher than the duty applied on prepared liquor of 70 UP³. (For technical note, see Annex VI). The duty applied on 12 percent alcohol content in wine is Rs. 45 per liter whereas the duty on 17 percent alcohol content is Rs 80 per liter. As per HS Code nomenclature the 17 percent alcohol content wine is used only for food for dressing purposes. The duty rate for this is higher than the duty rate of 12 percent alcohol content wine which is consumed by the people.

6.6 The definition and classification of excisable products as per the Excise Act are not compatible, in most of the products, with the Harmonized Code used in the Customs. For example, while applying excise duty on soft drinks, it has defined soft drinks as containing up to 1 percent alcohol, which is incompatible with the HS Code nomenclature which defines soft drinks containing up to 0.5 percent alcohol.

The Excise Act has not defined fruit juice in a way that is compatible with HS code. HS Code has classified fruit juice in terms of raw material used i.e. orange, apple, grape etc. As a member of WTO, the nomenclature used for the products should be in harmony with the nomenclature in the HS code. It will make comparison with the international trade more scientific and help to control smuggling. Moreover, it becomes easier to introduce ASYCUDA system and apply all the models developed under this system. In order to introduce HS Code⁴ in the excise, a committee should be formed to examine the administrative, technical, legal aspect as well as the revenue implication of the proposed changes. The committee should comprise of the Deputy Director General from the Department of Inland Revenue, liquor expert, and representative from the Department of customs, Chief of the Laboratory, Department of customs, representative from the liquor industry, beer industry, and producer of the spirit.

6.7 The government implemented the regulation requiring the manufacturers to fix stamps on each liquor bottle. The government has also announced to fix excise stamps (sticker) in each beer bottle and introduce excise stamps in each cigarette packet as well. The manufacturers have fixed stamps in the liquor bottles. The awarding of contract for the supply of stickers, importation of stickers, the distribution of stickers to the manufacturers pose a challenging task to the excise administrators. Delay of a few days in the chain of supply of stickers to the manufacturers will create problem in the production and distribution of liquor or beer. Moreover, the quality of stickers has begged many questions. In order to overcome this kind of situation, the government should standardize the size and quality of stamps and ask the manufacturers to make arrangements for its supply. As it has to be imported from foreign countries, the private sector will also face similar constraint in the supply, which will have adverse consequences on production. The option would be to establish security press in collaboration with the private sector in Nepal.

³ Subsequent to the discussion on the First draft on July 2, 2006; the Finance Bill presented to the Parliament on July 12, 2006, corrected the anomaly. For detail see Epilogue in Annex VIII of this Report.

⁴ Subsequent to the discussion on the First draft on July 2, 2006; the Finance Bill presented to the Parliament on July 12, 2006, has incorporated Harmonized System Code in the Excise. For detail see Epilogue in Annex VIII of this Report.

6.8 The problem of leakage should be addressed through an integrated approach. It should start from the manufacturer's application, monitoring of the factories, follow-up in the market etc. Committees at the ward level should be constituted with the broader representation from the society in order to make people aware of the health hazard in case of drinking impure and duplicate liquors. Moreover, the committee should be instrumental in creating awareness of bad consequences of juvenile drinking and smoking.

6.9 The excisable product industry which is contributing a substantial and stable amount of revenue needs support from the government, for making the industry more competitive and efficient in the face of liberal trade regime. Support may include, inter-alia, the following areas:

- National Market Survey on liquor
- Participation of the Industry in the formulation of the Act and Regulations
- Collection of information on illegal domestic production of low quality liquor
- Facilitate the industry by providing bank guarantee in lieu of excise duty payment for a limited period

6.10 The collection cost of revenue is very low in Nepal, compared to the cost of collection in Nepal 20 years ago. It is grossly inadequate compared to the collection cost in Japan. The budget for the Department of Inland Revenue should be increased for the purpose of funding the recruitment of qualified and technical staff, training of the officials, cost of follow-up visits, and cost of interaction program with the manufacturer, police, citizen groups, NGOs, etc. The need to build up and upgrade the capacity of the department calls for immediate attention.

7. Suggested Follow up Studies

1. Excise Duty vis-à-vis WTO compatibility and correlation between VAT and Excise
2. Mismatch in the excise duty rate of India and the customs duty rate of Nepal
3. National Survey of liquor production and consumption
4. Possibility of introducing excise duty on ad-valorem basis

5 Tax burden on a consumer, change in the consumption pattern and behavior

Policy Action Matrix on Excise Duty

Description	Constraints	Recommended Improvements	Activities	Indication of Achievements	Responsible Agency	Time Frame
1. Excise Revenue Planning	Policy	Medium Term Excise Planning	<ul style="list-style-type: none"> • Projection of Revenue for three years • Target • Strategy 	<ul style="list-style-type: none"> • 3 Year Medium Term Plan (Rolling Plan) 	Ministry of Finance	One Month
2. Monitoring and Evaluation	Administration	<ul style="list-style-type: none"> • Assign responsibility to Under Secretary at the Ministry • Assign specific responsibility to the Deputy Director General of Dept of Inland Revenue 	<ul style="list-style-type: none"> • Monitor the collection of Revenue • Study and analyze the information that the manufacturers submit to the Department through the excise office in the district. • Verify the information • Inspect the factories, markets, at a frequent interval • Submit a Report on the findings and suggestions covering policy, legal, institutional and administration every trimester • Follow up on the 	<ul style="list-style-type: none"> • Report on the findings and suggestion • Collection of Excise Revenue 	Ministry of Finance and Department of Inland Revenue	Immediate

Description	Constraints	Recommended Improvements	Activities	Indication of Achievements	Responsible Agency	Time Frame
			previous suggestions			
3. New Positions	<ul style="list-style-type: none"> • Policy • Institutional • Financial • Administration 	<ul style="list-style-type: none"> • Create new positions 	<ul style="list-style-type: none"> • Create a new position of Deputy Director General • Create a new position of Financial Analysts • Upgrade the position of liquor expert • Fill the vacant positions • Review this organizational arrangement in three year time frame 	New Position in the organization chart	<ul style="list-style-type: none"> • Ministry of Finance • Ministry of General Administration 	Six month
4. Excise Act and Liquor Act	<ul style="list-style-type: none"> • Policy • Legal 	<ul style="list-style-type: none"> • Amendment of the Acts 	<ul style="list-style-type: none"> • Define the words like "Appropriate Condition" "Cost of manufacturing" • Elaborate specifically the conditions of disqualification • Address Problems of juvenile drinking and smoking • Make penalty clause more severe with the jail sentence mandatory, corresponding to the 	Amended Acts and Regulations thereof	<ul style="list-style-type: none"> • Ministry of Finance • Ministry of Law and Justice 	Six months

Description	Constraints	Recommended Improvements	Activities	Indication of Achievements	Responsible Agency	Time Frame
			degree of offence			
5. Awareness	<ul style="list-style-type: none"> Administration 	<ul style="list-style-type: none"> Integrated approach to address the problem of leakage and Juvenile drinking and smoking 	<ul style="list-style-type: none"> Standardize the size and quality of stamps to be used for liquor, beer and cigarette Form a committee to follow up the distribution and sale of liquor, beer and cigarettes Committee may have representation from citizen's groups, NGOs, Police, prominent persons in the society. Intensive Campaign against drinking and smoking 	<ul style="list-style-type: none"> Standardization of the size and quality of stamps Formation of Committees Advertisement 	<ul style="list-style-type: none"> Ministry of Finance Department of Inland Revenue 	One month
6. Support to the Industry	<ul style="list-style-type: none"> Administration 	<ul style="list-style-type: none"> Establish confidence and understanding between the government and the manufactures 	<ul style="list-style-type: none"> Carry out national market survey Seek participation in the formulation of Acts Seek information from the manufacturers on the illegal production of 	<ul style="list-style-type: none"> Minute of the meeting Amendments of the acts 	<ul style="list-style-type: none"> Ministry of Finance Manufacturers Distributors Wholesalers 	

Description	Constraints	Recommended Improvements	Activities	Indication of Achievements	Responsible Agency	Time Frame
		, distributors and wholesalers	liquor which is widespread at the domestic level <ul style="list-style-type: none"> Seek recommendation from the manufacturers issuing license to the distributors and wholesalers 			
7. HS Code Nomenclature	<ul style="list-style-type: none"> Administration Technical 	<ul style="list-style-type: none"> Make definition and classification of excisable products compatible with the HS code of the Customs 	<ul style="list-style-type: none"> Constitute a committee to examine the administrative, technical, and legal and revenue implications and recommend a specific proposal for implementation. 	<ul style="list-style-type: none"> Amendment of the Excise Duty Act Committee Report on HS code 	<ul style="list-style-type: none"> Ministry of Finance Department of Inland Revenue Department of Customs 	Two months
8. New Products and Restructuring the existing rate	<ul style="list-style-type: none"> Policy 	<ul style="list-style-type: none"> Introduce excise rate on new products 	<ul style="list-style-type: none"> POL Products, Timber Restructure duty rates of liquor, wine, beer and cigarettes 	Finance Acts incorporating Excise duty for new products	<ul style="list-style-type: none"> Ministry of Finance 	Immediate
9. Budget	<ul style="list-style-type: none"> Finance 	<ul style="list-style-type: none"> Increase 	<ul style="list-style-type: none"> Funding for new 	Budget Allocation	<ul style="list-style-type: none"> Ministry of 	Immediate

Description	Constraints	Recommended Improvements	Activities	Indication of Achievements	Responsible Agency	Time Frame
Allocation		budgetary allocation	Positions <ul style="list-style-type: none"> • Research and Development • Funding for training • Funding for monitoring and follow up • Physical facilities 	(Red book)	Finance	

ANNEXES

ANNEX I: Terms of Reference

Study Topic: A Study on Excise Duty

This assignment is equivalent to one-man month. The consultant should establish adequate interactions with key informants, stakeholders and other concerned including government agencies while conducting the study.

Task details:

1. Explain the role of excise duty in government revenue system.
2. Review the trend and current structure of excise duty and contribution to government revenue
3. Analyze excise duty in the changing context, specifically in WTO context
4. Analyze tariff adjustment under bilateral and multilateral trade agreements.
5. Identify the coverage and scope of excise duty.
6. Provide a policy- action matrix containing (a) constraints (policy, legal, institutional, administrative, and others if applicable); (b) recommended policy improvements; (c) activities; (d) indicators of achievement; (e) responsible agencies; and (f) timeframe (immediate, intermediate, and long-term)
- 6 The paper should include an executive summary not exceeding five pages.
- 7 The consultant is requested to provide a short article, in English or Nepali, related to the above topic, to be published in a national daily for information dissemination.
- 8 Submit draft report (electronic and hard copy) to the EPN Focal Unit within 30 days from the date of assignment.
- 9 Present the draft at the Advisory Committee meeting (to be scheduled by the EPN).
- 10 Present revised draft (incorporating comments from the Advisory Committee and external reviewer) at the workshop organized by the EPN.
- 11 Present final report (incorporating comments from the Workshop) at the Advisory Committee meeting for final validation. Submit final report to the EPN Focal Unit (electronic and hard copy).

ANNEX II: List of Persons met

Government of Nepal

Shrestha, Ram Kumar	Joint Secretary (Revenue) Ministry of Finance
Bist, Bal Govind	Director General , Department of Customs
Shrestha, Rana Bahadur	Director General, Department of Internal Revenue
Shrestha, Abanindra	Joint Secretary, Ministry Of Finance
Banskota, Krishna Hari	Joint Secretary (Revenue) Ministry of Finance
Thapa, Bharat Bahadur	Secretary, Ministry of Industry, Commerce and Supply
Silwal, Narayan	Secretary, Prime minister and Cabinet Secretariat
Pant, Rabi Raj	Director , Department of Customs
Basyal , Hari Prasad	Under Secretary(WTO), Ministry of Industry, Commerce and Supply
Poudyal, Pradeep D.	Under Secretary, Ministry of Industry, Commerce and Supply
Duwadi, Ram Mani	Under Secretary, Department of Inland Revenue
Neupane, Chakrapani	Senior Divisional Chemist (Lab), Department of Customs

Private Sector

Karki, Min Bahadur	Director General, Confederation of Nepalese Industries (CNI)
Shrestha, Dinesh	Chairperson, Customs and Excise Duty Committee FNCCI
Shrestha, Ramesh	Chief of Operation , Himalayan Distillery
K. C., Rabi	General Manager, Surya Nepal Private Limited
Silwal, Surendra	Corporate Manager, Gorkha Brewery
Goswami, Amit	Chief Executive Officer, Nepal Distillery
Shrestha, Kedar Man Singh	Senior Expert (Tax and Excise)FNCCI

Former Officials of the Government

Ligal, Prithivi Raj	Former Vice Chairman, National Planning Commission
Sharma,. Shanker	Former Vice Chairman, National Planning Commission
Acharya, Bhanu Prasad	Former Secretary, Ministry of Finance
Ghimire, Bansi Dhar	Former Financial Comptroller General
Kayastha, Puspa Man	Former Under Secretary, Department of Excise

ANNEX III: Structure of Excise Duty (Rs in Million)

Description	1990		1991		1992		1993		1994		1995		1996		1997	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Industrial Production Excise	1094.8	100.0	1199.6	100.0	1414.1	100.0	1452.4	100.0	1592.2	100.0		0.0		0.0		
Liquor Contract	0.2	0.0	0.6	0.0	0.2	0.0	0.4	0.0	0.3	0.0		0.0		0.0		
Cigaretts		0.0		0.0		0.0		0.0		0.0	746.7	45.1	872.3	44.9	1062.7	46.2
Bidi		0.0		0.0		0.0		0.0		0.0	10.7	0.6	7.2	0.4	4.1	0.2
Liquor		0.0		0.0		0.0		0.0		0.0	469.2	28.3	535.3	27.5	636.6	27.7
Beer		0.0		0.0		0.0		0.0		0.0	314.2	19.0	405.1	20.8	489.1	21.3
Other Industrial Production		0.0		0.0		0.0		0.0		0.0	116.5	7.0	124.3	6.4	105.7	4.6
Excise on Import		0.0		0.0		0.0		0.0		0.0		0.0		0.0		
Total Excise Duty	1095.0	100.00	1200.2	100.00	1414.3	100	1452.8	100	1592.5	100	1657.3	100	1944.2	100	2298.2	100.0

Description	1998		1999		2000		2001		2002		2003		2004		2005	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Industrial Production Excise																
Liquor Contract																
Cigaretts	1421.7	49.3	1373.6	46.5	1438.2	46.0	1757.9	46.6	1813.2	47.6	2052.5	42.9	2393.1	38.4	2472.9	38.4
Bidi	5.2	0.2	46.4	1.6	5.6	0.2	5.4	0.1	4.2	0.1	4.7	0.1	3.3	0.1	3.4	0.1
Liquor	809	28.0	865	29.3	935.5	29.9	1033.1	27.4	930.2	24.4	1179.9	24.7	1266.6	20.3	1395.9	21.7
Beer	555.4	19.2	589.1	19.9	665.3	21.3	843.7	22.4	807.2	21.2	1032.5	21.6	982.5	15.8	1164.4	18.1
Other Industrial Production	94.5	3.3	79.1	2.7	83.1	2.7	130.8	3.5	252.3	6.6	324.7	6.8	296.2	4.8	325.2	5.0
Excise on Import											190.8	4.0	1285.1	20.6	1084.1	16.8
Total Excise Duty	2885.8	100.0	2953.2	100.0	3127.7	100.0	3770.9	100.0	3807.1	100.0	4785.1	100.0	6226.8	100.0	6445.9	100.0

Source: Economic Survey, 2004/05, Ministry of Finance

ANNEX IV: Excisable Products and Services

SNO	Items	Unit	Rate (Rs.)
1	Molasses	Quintal	35
2	Semi processed Sugar	Quintal	65
3	Fruits Juice or soft drinks using Juice	Liter	1
4	Pan Masala	Kg.	200
5	12% Alcohol content wine from Apple and other fruits	Liter	45
6	17% Alcohol content wine made from fruits	Liter	80
7	Champaign, Sherri and Perry	Liter	140
8	More than 17% Alcohol content wine, cocktail, liquor .	Liter	140
9	Cocktail drinks	Liter	80
10	Beer	Liter	45
11	Country Beer(Chang)	Liter	15
12	Denatured Spirit	Liter	10
13	Thinner, Solvent(HS 3814)	Liter	15
14	Anhydrous ethanol	Liter	6
15	Raw materials(spirits) used for 57.38- 80 % alchohol contentLiquor	LP Liter	100
16	Rectified spirit, Silent spirit (ENA)used for alcohol(80% or more)	Liter	30
17	Liquor		
	15UP strength	LP Liter	400
	25UP	LP Liter	350
	30UP	LP Liter	350
	40UP	LP Liter	200
	50UP	LP Liter	75
	70UP	LP Liter	10
18	Soft Drinks with less than 1%alchohol content	Liter	3
19	All kinds of soft drinks(No alcohol)	Liter	1
20	Cigarettes		
	70 mm and less /filterless	000 sticks	160
	70 mm/ Filter	000 sticks	340
	70-75 mm(filter)	000 sticks	440
	75--85mm(filter)	000 sticks	575
	more than 85mm (filter)	000 sticks	770
21	All kinds of Cigar	Stick	2.6
22	Bidi	000	45
23	Pipe Tobacco	KG	500
24	Jarda, Khaini mdade from tobacco	KG	190
25	Packed raw tobacco	KG	120
26	Cement	Mt. Ton	105
27	All ceramic bricks(imported only)	000 unit	525
28	Vehicles		
	All kinds of vehicles, autoricksaw and their chasis	advalorum	32%
	Single cab pickup and their chasis	advalorum	15%
	Delivery van and their chasis	advalorum	15%
	Mini Buses and their chasis	advalorum	4%
	Motor cycles	advalorum	4%
29	Health Services except services by HMG Hospitals or com hospitals	advalorum	5%
30	On receipt issued by Manpower Supplying Agency	Advalorum	2%

Source: Finance Ordinance 2062(January), Ministrty of Finance

ANNEX V: Excise Rate of Liquor

Description	Volume	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2006 Jan
40 UP to 50 UP(Bottled)	LP Liter	Rs 70 or 75%	90										
More than 50UP(Bottled)	LP Liter	Rs 35 or 55%	90										
40 UP to 50 UP(open)	LP Liter	Rs 75 or 80%											
More than 50UP(Open)	LP Liter	Rs 45 or 135%											
High Quality liquor													
35 UP and less than 35UP	LP Liter	Rs 150 or 150%											
Liquor													
15 UP													400
25 UP													350
30 UP													350
30UPor less than 30UP						235	245						
up to 30 UP				225									
25 and 30 UP(Bottled)	LP Liter		205		225								
30UP to 40UP	LP Liter			110	115			150					
40 UP(Bottled)	LP Liter		90										200
Less than 40 UP	LP Liter							260	275	320	340	340	
50 UP	LP Liter		45										75
65UP (Pouch)	LP Liter		30										
30UP to 40UP	LP Liter												
Morethan 40Up				35	40	42	42						
40 UP to 65 UP	LP Liter					125	135		160	195	200	200	
More than 65UP	LP Liter							44	50	70	75	75	
70 UP	LP Liter												10

Source: Finance Act (Various Fiscal Years), Ministry of Finance

Note:Excise Duty on liquor was applied on specific and advalorum basis until 1996 Since 1997 the duty is in specific basis.

The classification of UP for excise duty is frequently changed, which makes comparison difficult.

ANNEX VI: Technical Note on Excise duty on raw materials and prepared liquor.

Assumption:

The alcohol content of 70 UP Liquor:

$$= \frac{(100 - 70)}{7} \times 4 = 17.2 \%$$

The London Proof Liter of 330 ML. Liquor Packing

$$= \frac{17.2 \times 0.330}{57.38} = 0.098 \text{ LP Liter}$$

The Finance Act (January 2006) has the Excise Duty of Rs. 10 Per LP Liter.

Now, the Excise Duty for 0.098 LP Liter is;

$$0.098 \times 10 = \text{Rs. } 0.98 \text{ (or 98 Paisa)}$$

1 Liter ENA of Spirit is used to make 18 bottles of 330 ML. 70 UP Liquor. The Excise Duty for 18 Bottles of Liquor = $18 \times 0.98 = \text{Rs. } 17.64$

The excise duty paid on the ENA is Rs 30 which is higher than the excise on prepared liquor of 70 Up. Thus the excise duty of raw material is higher than the prepared liquor.

ANNEX VII: References

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ANNEX VIII: Epilogue

The Consultant submitted the Policy Paper for discussion at the Advisory Committee Meeting chaired by Dr. Bhoj Raj Ghimire, former Secretary, Ministry of Finance, on July 2, 2006. Subsequent to the discussion and the submission of the revised draft of the Report on July 10, 2006, Budget was presented to the Parliament on July 12, 2006. The Finance Bill 2006/2007 has incorporated some of the recommendations particularly related to the harmonized Code and the excise duty rate of 70 UP Whiskey.

The Finance Bill contains amendment to the Excise Act 2002 with Annex on the excisable products, and excise rates. The number of excisable products has increased from 30 to 43 commodities. A Column is added on the Harmonized Code/SubHead Numbers. The commodities have been defined and classified on the basis of the explanatory notes of the Harmonised System. For example fruit juice is classified as per the source of raw material (orange, grapefruit, pineapple etc). Definition of soft drinks is clarified and the excise rate is fixed as per LP Liter in case of prepared whiskey, wine and other liquors.

As suggested in the policy paper, anomaly in the excise rate of raw material (ENA) and the prepared 70 UP whiskey has been corrected.