

Leveraging Entrepreneurship for Advancing Prosperity (LEAP)
LIBERATING TRADING SECTOR



Photo: Bikram Rouniyar



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ABBREVIATIONS AND ACRONYMS

CA	Certifying Authority
CO	Commerce Office
COFEMER	Federal Commission for Improving Regulation
CSIDB	Cottage and Small Industry Development Board
DFTQC	Department of Food Technology and Quality Control
DoC	Department of Commerce
DoCSI	Department of Cottage and Small Industry
Dol	Department of Industry
DSMCP	Department of Supply Management and Consumer Protection
DSMPCI	Department of Supply Management and Protection of Consumer Interest
FMCG	Fast Moving Consumer Goods
FNCSI	Federation of Nepalese Cottage and Small Industries
GAP	Good Agricultural Practice
GDP	Gross Domestic Product
HLTSRC	High-Level Tax System Review Commission
IEA	Industrial Enterprise Act
ILO	International Labour Organisation
IRD	Inland Revenue Department
IRO	Inland Revenue Office
KFVDB	Kalimati Fruit and Vegetable Development Board
KMCO	Kathmandu Metropolitan City Office
KW	KiloWatts
MEDEP	Microenterprise Development Program
MoST	Ministry of Science and Technology
MSEs	Micro and Small Enterprises
MSMEs	Micro Small and Medium Enterprises
NBSM	National Bureau of Standard and Metrology
NMEFEN	National Microenterprise Federation of Nepal
NPR	Nepalese Rupees
OCC	Office of Controller of Certification
OCSI	Office of Cottage and Small Industries
OECD	The Organization for Economic Co-operation and Development
PAN	Permanent Account Number
PWC	Price Waterhouse Cooper
RIK	Registers and Information System
SARE	Rapid Business Opening System
TDS	Tax Deductible at Source
VAT	Value Added Tax
VDC	Village Development Committee

PAPER AT A GLANCE

The paper looks into the major government regulations involving enterprise registration, taxation, and standards governing domestic trading microenterprises of Nepal and highlights the difficulties relating to compliances of such regulatory requirements. The paper attempts to offer recommendation on revising certain aspects of the regulations to ease the process of doing business in Nepal for aspiring micro and small entrepreneurs.

The cumbersome regulatory regime that overwhelms the limited comprehension ability of the micro entrepreneurs has grossly compelled them to stay in the informal sector. As a consequence, such informally operating trading microenterprises are forced to adopt regressive business practices that are not favourable to the growth (even sustenance in many cases) of the business. Meanwhile, the unfavourable environment for microenterprises in Nepal that bars their growth is even likely to hinder the wider economic progress of Nepal as the past empirical studies conclude sizable contribution of MSEs on the national GDP and employment status as a worldwide phenomenon.

Trading entrepreneurs face regulatory hurdles right from the inception of their business as they are presented with the redundant requirement to record their identity at various level of governments ranging from central to local. The frequency of the burden continues as the entrepreneurs are expected to deal with the perplexing taxation system on a quarterly basis leading them to fall prey to the nuances of the regulators and bureaucracy. The intensity of falling victim to the convoluted regulation system does not stop here as trading entrepreneurs are also often found accused and charged for not following the compliance standards that are either unreasonable in nature or are enforced to the wrong segment of the value-chain. Importantly, such regulatory difficulties not only hinder the progress of the trading enterprises but also demotivate potential entrepreneurs to step up into the formal economy.

The paper identifies several proven resolutions as setting up a one door regulatory provisions and simplifying the tax filing mechanism for trading microenterprises that is believed to have yielded fantastic results around different parts of the world. It follows with recommendations for regulatory amendments as adoption of online registration system fortified with digital signature infrastructure, facilitation of enterprise registration and taxation services from a local government avenue, and enforcement of only suitable compliance requirements that it believes shall significantly reduce the regulatory hurdles for trading enterprises while boosting the rate of formalization amongst them.

1.1 Nepalese Microenterprises and Informality

'**Microenterprises**' were formally recognized as a category of enterprises in Nepal only after the Industrial Enterprise Act (IEA), 2016. The IEA defines microenterprises as enterprises with a fixed capital of less than Nepalese Rupees (NPR) 500,000; annual transaction of less than NPR 5,000,000; electricity consumption of less than 20 KiloWatts (KW) and a human resource of nine or less people (including the owner of the enterprise). However, this definition is still limited to enterprises that fall under the purview of the Ministry of Industries. Since trading enterprises in Nepal fall under the purview of the Ministry of Commerce, the term 'microenterprise' still lacks official recognition in the trading sector.

Department of Commerce (DoC) defines **trading enterprises** as enterprises that are only involved in transferring/selling goods directly to customers without processing the goods or changing its nature. These enterprises operate at the lower level of the supply-chain. Trading enterprises however can also be involved in packaging/repackaging products or selling bulk products on unit basis or vice-versa. In Nepal, microenterprises operating in the trading sector are regulated by a different government agency—the DoC—as against the Department of Industry (DoI) or Department of Cottage and Small Industry (DoCSI) in case of manufacturing or service enterprise.

Criteria Relating to Private firms, 2071 (2014)¹ lays down a list of trade and commerce activities which can be useful to categorise certain activities under the trading sector.

The trade/commerce sector does not have a "microenterprise" category, and therefore the DoC does not legally recognize Industrial Enterprise Act (2016)'s definition of the same. However, in order to discover the level of regulatory hurdles and costs faced by these enterprises, it is first necessary to identify the conditions that qualify trading firms as microenterprises. Hence, the enterprises that require the least amount of capital (i.e., NRs 300,000 for operating in Kathmandu and certain Terai districts) as advised by the private firm categorization and capital requirement section (Section 12.2.5)² of Criteria relating to Private Firm, 2071 (2014) followed by the DoC could be taken as a logical definition for trading microenterprises, and the same is taken as the definition of trading microenterprises in this paper.

As such, following activities would fall under the category of trading microenterprises:
agricultural tools, food grains, vegetables, fruits, plastic products, shoes, slippers, herbal products, soft drinks, water, hardware (except iron rod and cement), computer, photocopy, printer parts, LP Gas, domestic liquor, cosmetics, mom-and-pop stores, stationery, wood, utensils, jute products, fish, meat, plants, sweets, sports equipments, milk and dairy products, four-legged furnitures, electrical equipments, kerosene and medicines.

1 Retrieved from the DoC: <http://www.doc.gov.np/uploads/Regulations/firm%20standards%20%20final1pg.pdf>

2 Activities that qualify as a micro-enterprise as per the Criteria relating to Private Firm, 2071 (2014): agricultural tools, food grains, vegetables, fruits, plastic products, shoes, slippers, herbal products, soft drinks, water, hardware (except iron rod and cement), computer, photocopy, printer parts, LP Gas, domestic liquor, cosmetics, mom-and-pop stores, stationery, wood, utensils, jute products, fish, meat, plants, sweets, sports equipments, milk and dairy products, four-legged furnitures, electrical equipments, kerosene and medicines.

In Nepal, most of the trading firms with a minimum capital value of NRs 300,000 are mostly found to be involved in retailing or trading staple foods, Fast Moving Consumer Goods (FMCG), and fresh vegetable & fruits. This study concentrates on the given categories of trading enterprises that are exclusively operating within the borders of Nepal.

For a country like Nepal, microenterprises may be regarded as one of the most viable options to create employment opportunities and consequently reduce poverty. They can be a gateway for employing a bulk of unskilled and semi-skilled labour, thus also hastening the pace of secondary and tertiary sector growth. Individuals involved in such activities could generate sustainable revenue streams and expedite the development process (Kongolo, 2010).

Having said that, many Nepalese enterprises of such scale can be said to have been operating in the informal sector. Prakash Sharma, National Project Coordinator of International Labour Organisation (ILO)'s 'Way out of Informality' project (2012-2017) estimated that Nepal's present informal economy is equivalent to roughly 38% of the country's Gross Domestic Product (GDP) (P.Sharma, personal communication, February 10, 2017)³. Furthermore, the Bishnu Prasad Gyawali, Director of Department of Cottage and Small Industry (DoCSI) estimates that 80% of small enterprises currently operational in Nepal are informal in nature (B.P. Gyawali, personal communication, January 25, 2017)⁴. Encouraging the formalization of these informal enterprises is crucial as it has a far-reaching implication for the nation's economy at large.

The International Labour Organization (ILO) in 1972 termed informal sector activities as entrepreneurial activities that are unregistered, unrecorded or unregulated by government authorities despite being functional and profitable in nature (Becker, 2004). Many of the micro enterprises that are operating in Nepal are also neither tracked in any official government statistics, nor do they pay any form of taxes. In that sense, many of these microenterprise operators can be said to be participants of the informal sector. However, it is important to recognize that although these unregistered micro-enterprises operate informally they are not necessarily engaged in criminal activities, or activities that would otherwise be illegal. A vast majority of informal economic activities still provides goods and services whose production and distribution are perfectly legal as per the law of the land (Becker, 2004). The delivery of these goods and services happens via street-hawking, trading at make-shift houses, offering roadside services, etc., and they strictly rely on day-to-day profit for survival (Gurto, 2009). Most of these micro-entrepreneurs tend to be economically weak ones who also lack the knowledge of government regulations and their compliance procedures.

Hernando De Soto, a renowned Peruvian economist offers a legalist definition to informal economy. He identifies informal work arrangements as a rational response by entrepreneurs to skip excess regulation by government bureaucracy. As per this school of thought, entrepreneurs often make superficial cost-benefit calculations while determining whether or not to engage in legal arrangements (Becker 2004). Entrepreneurs choose to participate only in those legal arrangements that are worth the cost. Where costs exceed benefits, entrepreneurs tend to engage only in some of the regulatory processes, i.e. skip the other ones. This legalist definition appears to be relevant in the context of Nepal as well. Poorly constructed legal frameworks and the subsequent legal hurdles to compliance naturally urge entrepreneurs to skip legalization procedures. A survey conducted by Samriddhi in (2013) showed that all of the surveyed road-side mom-and-pop stores were only partially registered, i.e. registered in less number of authorities than they actually needed to be.

3 P. Sharma is the National Coordinator of Way Out of Informality: Formalising Informal Economy Program of the ILO

4 B.P Gyawali is a Director at the Department of Cottage and Small Industries

Having to visit multiple agencies for registration to fulfil the regulatory requirements was a major reason for such partial registration or semi-formality.

1.2 Hurdles in entering the formal economy

The bureaucratic ineffectiveness and regulatory complexity relating to enterprise registration and regulation compliance hinder the least capacitated informal enterprises from entering the formal economy.

i. Cumbersome registration procedure

Samridhhi Foundation (2013) identified cumbersome registration processes to be one of the hurdles for officially registering an enterprise in Nepal. Visiting four different regulatory bodies that are spread across central and local governments is extremely inconvenient for small shopkeepers. It does not justify the time, cost and energy that would have to be spent on complying with these processes. Moreover, the lack of coordination among regulatory agencies and their own unique set of Acts and regulations further discourages many microenterprise operators from entering the formal economy.

In what is a significant observation and also a validation to this claim, a report on Microenterprise and Small Enterprise Policy review in Nepal conducted by ILO in association with Microenterprise Development Program (MEDEP) in 2005 reported that 47.6% of their survey participants viewed the registration process to be complicated, 24% believed registration was an unnecessary cost, while 14.3 percent considered it to be too time-consuming (ILO, 2005).

ii. Inefficient tax regulation and inconsistency in tax enforcement

The tax regulation in Nepal is also one of the factors that discourages enterprises to come under official recognition (Loayza, 1997). The need to visit two different government agencies – Local Municipality/Village Development Committee (VDC) and Inland Revenue Department (IRD) - makes the registration for tax process inconvenient for business owners. This incentivizes entrepreneurs to operate in the informal economy, even if it means limiting their activities to small scale business.

Safavian, Graham, and Gonzalez-Vega (2001) identified inconsistency of tax enforcement standards in developing countries with unstable law enforcement as a major setback for enterprises desiring to comply with official regulation. Similarly, inability to enforce already complicated tax regulations also hinders enterprises from entering the formal sector (Becker 2004). In the case of Nepal, the necessity to bribe government officials to get compliance work done discourages struggling enterprises to come into formal sector, as the foreseen benefit is less than the cost involved.

Birgunj, a trading city in the southern belt of Nepal, for example, witnessed an inconsistency in enforcement of taxes when the local government unexpectedly enforced business tax provisions on local enterprises, even though its enforcement was grossly undermined in the past. The hasty enforcement of this local tax provision added unexpected compliance burden to local enterprises that were completely unprepared for it. When the local government lost its right to draw the well-paying excise duty to the then newly established Inland Revenue Department (IRD) functioning under the central government, they resorted to the Local Self-governance Act, 1999 to identify additional revenue sources that they authorised impose on businesses operating under them.

(Based on conversations with local stakeholders during the field visits)

1.3 Impacts of Avoiding Formality

As discussed, enterprises operate informally due to regulatory difficulties and inconsistencies in their enforcement. In order to skip regulatory hurdles and related hassles, entrepreneurs undertake an alternative course like remaining sub-optimally small, adopting fewer productive technologies, using irregular procurement and diverting resources (Samriddhi, 2013).

i. Capping the operation size to remain sub-optimally small:

According to Loyaza (1997), firms willing to operate informally often choose to cap their size of operation because it is easier to detect large and more physical capital-intensive firms. Growing firms are also more likely to attract additional regulatory attention (Safavian, Graham, and Gonzalez-Vega, 2001). The fear of being exposed to regulatory entities through business expansion instead incentivizes informal enterprises to purposefully stagnate their business volume and not re-invest in the business.

ii. Ignoring advanced business process mechanisms to avoid formal channels:

Firms attempting to avoid exposure to legal agencies also choose to ignore advanced business process mechanisms that may lead to interactions with the formal sector. They have tendencies to remain consistent with primitive business processes despite their being relatively inefficient and time consuming. A survey conducted by Assad Ullah in 2014 found that informal enterprises did not use formal banking channels - comparatively advanced transaction mediums such as bank checks and online transfers - as they feared exposure to legal agencies. He identified that 99% of enterprises belonging to the informal economy still chose to use cash for transactions, while only 64% of the enterprises belonging to formal economy chose the same.

1.4 Disadvantage of operating in the Informal Sector

Avoiding legal hurdles bring about several business impediments that lead to stagnation of business to making compromises in favour of inefficient processes.

i. Risk of being apprehended

The enterprises operating in the informal sector are always at a risk of being apprehended, since the presence of such enterprises is illegal as per the law. The government can forcefully seize such enterprises or press legal charges at any point.

ii. Inability to access formal and sizeable financing options

Remaining in the informal sector also deprives enterprises from accessing better financing opportunities. Even when financial access is not completely denied, informally operating enterprises can only access expensive, short-term financing options provided by non-institutional sources. Such options are often unfeasible given their modest profit structures.

A survey of Pakistan-based small formal and informal enterprise exhibited that long-term financing was exclusively available to legally registered enterprises.

Type of loan	Formally operating enterprises	Informally operating enterprises
Short-term loan	14%	9%
Long-term loan	21%	0%
Not applicable for any type of loan	64%	91%

Source: Assad Ullah (2014). A survey of Formal and Informal economy at Sharaqpur Bazaar in Pakistan

In Nepal, microenterprises running informally are only eligible to take credits and loans from informal lenders, personal networks and micro-finance institutions. Such institutions mostly offer credits with high interest rates for a short period of time.

iii. Deprivation from Insurance Converge

Business insurance facility provides a pragmatic solution to minimize losses for various risks that also boosts investor's confidence for growth (Karki & Khatiwada, 2015). Moreover, entrepreneurs with insured enterprises are eligible to gain better financing deals from formal financial institutions such as Commercial Banks. This is because having insurance coverage generates a sense of payback security among potential creditors. Enterprises operating in the informal sector are abstained from insurance coverage and are hence not only unable to secure their businesses from risks related to property and inventory but also losing out on good financing opportunities.

iv. Inability to access marketing channels

Ghimire (2011) acknowledged that informal and unregulated microenterprises are often unable to benefit from opportunities available through linkages to proper marketing channels. On a similar front, Ullah (2014) acknowledges that small informal enterprises are locked out of supplying to government procurement deals and also sell less to institutional buyers in comparison to their formal counterparts. In Nepal, trading enterprises that have not been registered at the Department of Commerce (DoC) are ineligible to do business with any government agency or partake in any public procurement bidding.

Market privilege	Formally operating small enterprises	Informally operating small enterprises
Ability to bid on public procurement	Can bid	Cannot bid
Dealing with institutional buyers	Don't sell: 50%	
Sell: 50%	Don't sell: 71%	
Sell: 29%		

Source: Assad Ullah (2014). A survey of Formal and Informal economy at Sharaqpur Bazaar in Pakistan

v. Vulnerable to external hazards

Enterprises belonging to informal sectors are also vulnerable to external hazards as they are poorly protected by the police and the judicial courts from crimes committed against their property. Ironically, informal entrepreneurs are known to have paid between 10 to 15 percent of their gross income as bribes to government officials just to operate normally in relatively corrupted economies (Loyaza 1997). Ultimately, the informal enterprises are found to be in substantial disadvantage compared to their formal counterparts.

1.5 Regulatory simplification to assist enterprise formalization and growth

Entering the formal economy provides enterprises with opportunities to qualify for risk mitigating insurance schemes, property rights and contract enforcement assurances that increase their chances of securing better financing options from institutional lenders (Ullah, 2014).

The overall benefits of formalizing such microenterprises transcends beyond just the entrepreneurs and subsequent enterprises. The benefits largely assist national economic growth and well-being as well. Given the strong interconnectivity of Micro Small and Medium Enterprises (MSMEs) on economic growth and development of Nepal as discussed previously, implications of microenterprise growth on the economy can be expected to be substantial.

Many micro-entrepreneurs operating informally have the desire to scale up their business. The survey conducted by Ullah (2014) identified that 83% of the informal enterprise owners have the willingness to expand their enterprise and at least 53.9% of the informally operating retail institutions surveyed by Samridhhi (2013) had similar aspirations. This attitude towards sustainable business growth among informal entrepreneurs significantly reinforces the relevance of accommodating such entrepreneurs into the formal economy.

The National Coordinator for ILO's Way out of Informality Project, Mr. Prakash Sharma, highlights the necessity of having immediate incentives for participants of the informal economy when they enter the formal sector. He emphasizes the necessity and effectiveness of incentives in luring such participants into the formal sector. However, it is also important to maintain a caution to ensure

that the incentives are not actually perverse incentives. These need to be clearly laid down and time-bound. The idea is to only offer a common ground for competition to deprived informal participants of the economy so they can compete fairly for welfare of the society. It should be ensured that the value of free market and resulting welfare of society is not compromised by exclusively protecting a special group of enterprises from market competition despite their inefficiencies.

Hernando De Soto's approach to the legalist definition of informal sector finds difficult legal compliance to be a barrier for enterprise formalization. On similar regards, Becker (2004) advises the government to lower the cost of establishing and operating enterprises by simplifying registration and licensing procedures, enforcing appropriate rules and regulations, and claiming reasonable and fair taxation.

This research thus attempts to analyze Nepal's enterprise-related regulations in order to identify how existing problems could be solved, to enable formalization of informally operating microenterprises. In doing so, the study specifically diagnoses the said important regulatory provisions for private trading-related microenterprises: market entry processes, taxation policies and procedures and compliance with standards.

The study concentrates on the trading sector as it makes a considerable contribution to the economy of Nepal. The Economic Survey for 2015/16 shows the trading sector (wholesale/retail trade) to be the largest contributor to Nepal's Gross Domestic Product (GDP) among non-agriculture sectors. Micro and Small Enterprises (MSEs) involved in the trading sector employ the second largest number of people following the manufacturing sector (Ghimire, 2011). Further, self-employment generated by engaging in local micro-retailing/trading activities is also substantial.

2.1 Market Entry for Trading Microenterprises

2.1.1 Issues with Registration requirements for trading microenterprises

2.1.1.1 The need to visit multiple agencies to fulfil registration process

Micro enterprises belonging to the trade sector need to be registered at three government agencies (ranging from local to central government) to be formally recognized as an established trading firm in Nepal. The registration requirement for a domestically trading micro-enterprise with basic business objectives can be fulfilled by registering with the following:

1. Municipality or VDC at local level in order to be registered at local government.
2. DoC or Commerce Offices at the central level in order to be registered at central government.
3. IRO at the central level in order to be registered for tax related purposes and to obtain Permanent Account Number (PAN) and Value Added Tax (VAT) registration.

Samriddhi (2013) recognized that visiting these multiple government agencies for registration is cumbersome for micro entrepreneurs with limited capacity and resources. As these authorities do not share registration information with each other, enterprises are required to register with each one separately (p.21).

Besides, the fact that an applicant needs to produce same fundamental documents to each of these agencies redundancy caused due to lack of approval synchronization among them (FNCSI, n.d.).

2.1.1.2 Excessive documentation

The following list details the redundancy exhibited by different government agencies.

1. Application form and Consent form (Kabuliyatnama) have to be filled during business registration at both central level government (DoC/CO) and local level government (Municipality and VDC).
 - a. Application "b" form (Darkhastha "Kha" form) for registering at DoC
 - b. A separate registration form for registering at Municipality/VDC
2. Fundamental documents such as copy of citizenship certificate and passport-sized photograph have to be submitted at all registration agencies (i.e., local level (municipality/VDC), Central level (DoC/CO), and Tax office (IRO)).

3. No objection approval letter from surrounding neighborhood and community, if required, has to be submitted at both central level and local level while registering
 - a. Approval letter from neighborhood for registering at DoC/Commerce Office (CO)
 - b. No objection commitment signature from adjoining land owners/neighbors for registering at Municipality/VDC
4. Land estate ownership/rental agreement letter and location map need to be presented at all registration agencies (i.e., local level (municipality/VDC), Central level (DoC/CO), and Tax registration office (IRO))

Although this might not be a direct hindrance to formalization, the time and energy spent can still be substantial. Therefore, reducing redundancy through better inter-agency co-ordination is a low- hanging fruit that is easy, feasible and effective.

Mexico had a highly inefficient and redundant administrative procedure to register a firm, which took over 30 days. It scored at the bottom in the category of 'time to complete procedures' ranking 69th out of 85 countries. Mexico later consolidated the formalities demanded by all government agencies and reduced business registration to just one agency at the local level. This reduced the time to register an enterprise by a whopping 95%!

2.1.1.3 Lack of Policy Harmonization

There exists a lack of policy harmonization among government agencies that register enterprises. This problem between Municipalities/VDCs and DoC/COs makes the formalization process unclear and complicated for enterprise owners. Each government agency is often found to be prioritizing their own line of policy direction, disregarding those of other government agencies. Thus, the information retrieved from a single agency could be incomplete as they can purposefully undermine the requirements of other government agencies. In fact, agencies might even misinform the requirements related to other agencies even though each of them implicitly holds the responsibility to provide authentic information for public welfare.

For instance, the registration officers of DoC and DoCSI that deal with registering enterprises at central level, consider it unnecessary to register at municipalities/VDCs. However, registration officers at the municipalities consider registering with them to be legally important based on Self-Governance Act 1999. Since failing to register with any one particular agency renders enterprises informal and prone to punishment, this lack of policy harmonization across government agencies has created hazardous regulatory confusion among enterprise owners.

Likewise, the use of complex set of vocabularies and arcane structuring of the regulation documents makes it almost impossible for a layman to understand the regulatory registration requirements without consulting an expert or government official. Even going through brief

enterprise registration regulatory documents such as Private Firm Registration Act, 2014 and Partnership Registration Act, 2020 is too time consuming for entrepreneurs trying to quickly learn the fundamentals of formalizing their businesses on their own. Therefore, significant simplification and re-structuring of existing regulatory documents is essential for making them comprehensible to the relevant general public. After all, when language becomes a tool of alienating, instead of communicating, it needs to be simplified (Ullah 2014).

2.1.1.4 Inaccessibility of District Registration Offices

The ILO (2005) survey finds that registration offices are far from enterprises located at the outskirts of a district. The cost of traveling to and from the registration office for registration purposes becomes particularly high for microenterprises located in remote areas. This issue remains relevant despite the government's arrangement for business registration in all 75 districts (Shrestha, 2010). Even though there are only five commerce offices and one DoC in the country - where trading and commerce related business can be registered - Cottage and Small Industry Development Board (CSIDB) or Office of Cottage and Small Industries (OCSI) are present in all districts. These offices are authorized to register trade sector related enterprises where commerce offices are not present. However, such district registration offices are also located far away from microenterprises located in remote peripheries which forces them to incur substantial travel cost and energy for registering their enterprises.

As an example, Prakash Sharma, National Coordinator for ILO's Way out of Informality Project shared that entrepreneurs residing at the furthest localities under the authority of Bhaktapur OCSI have to travel for a day to reach the registration office.

2.1.2 Recommendations

2.1.2.1. Consolidating the registration requirement to a single government avenue

To solve the regulatory hurdles that require trading entrepreneurs to register at different agencies for complete formalization, Samriddhi (2013) proposed delegating all registration requirements to a single government agency that is easily accessible to local entrepreneurs. This would substantially ease the registration compliance procedure for entrepreneurs as they would only have to interact with one agency with a single set of requirements (p.41). Moreover, if all registration is done at the local Municipality/VDC level, it would be easier to disseminate required information to relevant agencies. This would help mitigate the redundancies and inefficiencies resulting from lack of co-ordination and approval synchronization among different government agencies.

Mexico witnessed a success by adopting a similar approach as proposed above. The Federal Commission for Improving Regulation (COFEMER) implemented the Rapid Business Opening System (SARE) which consolidated the formalities demanded by different registration agencies making it possible for entrepreneurs to fully register their business at only one local government agency (OECD, 2013). It continuously coordinated with the municipal governments in Mexico to launch SARE model of "one-stop municipality base registration shop" in different municipalities starting May 2002 (Bruhn, 2013). This change was in response to the highly inefficient administrative procedure in Mexico that took over 30 days to register a firm (Djankov et al., 2002), which made it the economy with the highest amount of informal sector among its Latin American counterparts. The informal economy accounted for 27% to 49% of the Mexican GDP, depending on the measurement method.

Using SARE, COFEMER streamlined the formalization process of MSEs that pose no health or environmental risks to two days through regulatory simplification and administrative engineering (Kaplan, Piedra, & Seira, 2011). By reducing the number of registration related administrative procedures from 7.9 to 2.7, and required number of visits to government offices from 4.2 to 1 time, SARE managed to reduce the number of days required to start a business from 30.1 to 1.4 (i.e., 95.3% reduction). This thus increased the likelihood of business registration in the municipalities by approximately 26.2% (Bruhn, 2013). Meanwhile, 75,168 new jobs were formalised, thus inviting USD 1200 Million worth of investment in formal sector within four years of program's operation (Kaplan, Piedra, & Seira, 2011).

Given that this program only incorporated minor service and retailing enterprises prone to least accident and health hazards, the noteworthy results appear highly relevant to micro trading enterprises. According to the World Bank's Doing Business Report, such programs contribute to more than 20% of new firm creation in developing countries, thus exposing its relevancy in global context (World Bank, 2006).

Time and again, the Government of Nepal has attempted to simplify enterprise related regulatory provisions through the concept of One-Stop Service Centers (also known as Ekal Bindu Sewa Kendra). This concept has been introduced in the past two IEAs in 1993 and 2016 with detailed provisions to provide tax exemption, subsidy and other infrastructural services, besides registration, to all class of enterprises (IEA, 2016). However, its success in creating a single avenue to complete the entire enterprise registration process cannot be expected to go into implementation as smoothly for it does not ensure participation of municipality/VDCs. Nevertheless, according to a director of DoCSI, Bishnu Prasad Gyawali, facilitation of tax-related and business registration procedures through this (proposed) one stop service center could still minimize the need to redundantly visit different agencies.

Although the One-Stop Service Centers were conceptualized 25 years ago in the IEA 1992, a detailed working directive of the same does not exist to date. Moreover, experts even doubt its feasibility. Chandrakanta Adhikari, Executive Director of National Microenterprise Federation of Nepal (NMEFEN), fears that One-Stop Service Centers are prone to having problems related to hierarchical authority, which may result in ineffective service delivery. For instance, decisions made by the representative of One-Window Service Center (say under-secretary) can be withheld by the officer at the main office (say Joint-secretary), causing authorization delay. ILO (2005) also identifies lack of decentralized decision making as the main problem behind ineffective local-level one-door registration facilities that have been established in 25 districts in Nepal. Due to similar issues related to authority, such facilities have only been able to act as information portals for its clients. However, optimum delegation of authority to such service facilities can solve this issue.

Progress as seen in relation to Implementation of SARE in Mexico in 9 years

2002

COFEMER initiated the program called SARE from Municipal level

2006

75,168 new firms created and **194,557** New jobs created

2010

SARE implemented in 20 Municipalities. Reduced number of business days to register a business from **32** to **2** days

2011

SARE implemented in 19 Municipalities. Reduced number of business days to register a business from **21** to **2** days

Progress as seen in relation to Implementation of one-stop service centre in Nepal in 25 years

1992

First introduced one-stop service centre program in IEA 1992

2016

Again Introduced one-stop service centre program in IEA 2016

No progress in terms of development of further procedural directive and regulations for proposed one-stop service centre in last **27** years

2.1.2.2. Localizing the registration process on instilment of Federalism:

Nepal's federalization is a great opportunity to transfer enterprise registration and compliance matters to local governments (i.e. Metropolitan Cities/Municipalities/VDCs and their respective wards). As the central government devolves its power to state and local governments, initiating the responsibility transfer of enterprise related regulations to local governments should be a priority.

Bishnu Prasad Gyawali, a director at DoCSI acknowledges that the establishment of One-stop Service Centres in each municipality will greatly ease the process for local enterprise owners. This will eventually save time, money and effort of these entrepreneurs. He shares that such practice would strategically eliminate the need to visit different government agencies in order to fulfil enterprise registration and tax related issues. This will also resolve the shortcoming of having only a central-level agency by involving local-level government participation.

On the other hand, Prakash Shrestha, Taxation division head of Kathmandu Metropolitan City Office (KMCO), believes that the idea of devolving the regulatory authority to local municipality, might still not be adequate. While the pursuit to Federalism has invited consolidation of multiple Municipalities and VDCs, the residents at the remotest area will still find it difficult to reach these outlets due to the huge areas they cover. Instead, he recommends devolution of registration and regulatory authority to individual ward offices, while allowing Municipality to reserve monitory and supervisory role.

Moreover, Shrestha also recommends establishing such One-Stop Service Centres in every ward, since the area coverage of each VDC or Municipality is in the verge of further expansion as Nepal moves towards federalism. He shares that in doing so, the locally-elected Municipality/VDC/ward officers will be more proactive in serving the local entrepreneurs because they have an obligation to guard their local vote banks by keeping locals satisfied with their services.

Furthermore, in multiple interviews conducted with high-ranking bureaucrats, it was identified that they are hopeful about enterprise registration and regulation procedure being delegated to local government. They anticipated this to happen at least to a certain extent since implementation of Federalism expects devolution of certain authorities down the line.

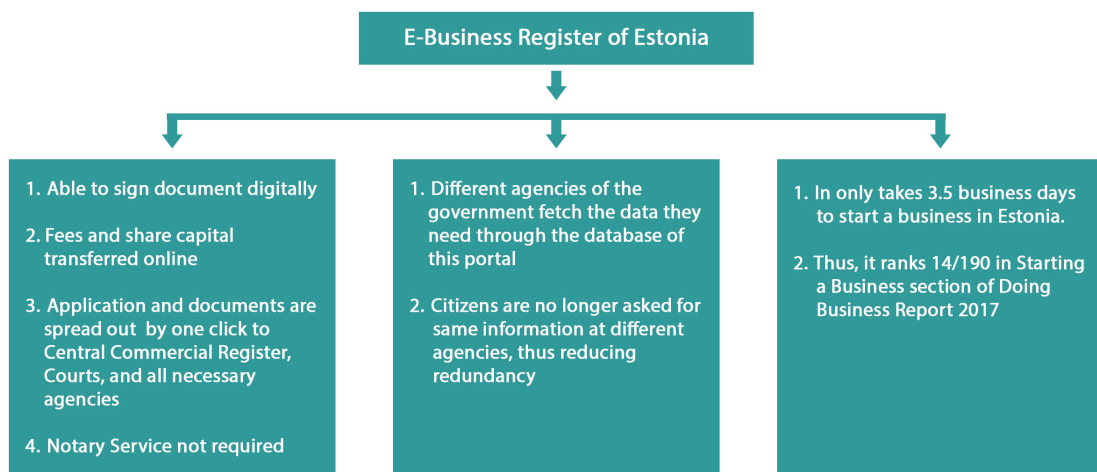
2.1.2.3. Digitizing registration and compliance requirements:

While institutionalization of the One-Stop Service Centres can be an immediate solution, building capability of the local entrepreneurs to access registration agencies located even miles away via digital/electronic medium should be the next priority.

Electronic/digital solutions to registration normally pertains to e-registration and e-compliance services facilitated through interactive and secured online platforms along with proper provisions for online payment and digital signature. This solution that eases and extends the registration capabilities of local enterprises has already been practiced in countries all over the world such as Portugal, Republic of Korea, Germany, and even in recently developing countries such as Chile, Indonesia, and the former Yugoslav Republic of Macedonia in the last few years (World Bank, 2016). Doing Business Report 2016 recognizes that electronic registration platforms greatly reduce complex registration procedures and

redundancies that warrant third-party assistance (p. 60). Most of all, it prevents one of the biggest hurdles for local entrepreneurs - traveling long distances frequently to get their enterprises registered.

E-Business Register, undertaken by Centre of Registers and Information System or RIK (Estonian acronym for the agency), is one of the most successful and inspirational electronic enterprise registration initiatives that substantially simplified the registration process for entrepreneurs. The initiation allowed applicants to electronically submit all applications and digitally signed documents to Central Commercial Register, Courts, and all necessary agencies (Ernst & Young, 2012). More importantly, it helped entrepreneurs of all categories to easily register their enterprises from home within hours. Such digitization of enterprise related administrative procedure has also helped Estonia secure the 14th position among 190 countries in Starting a Business category of the Doing Business Ranking (Doing Business Report, 2017).



Source: Doing Business Ranking and RIK official webpage.

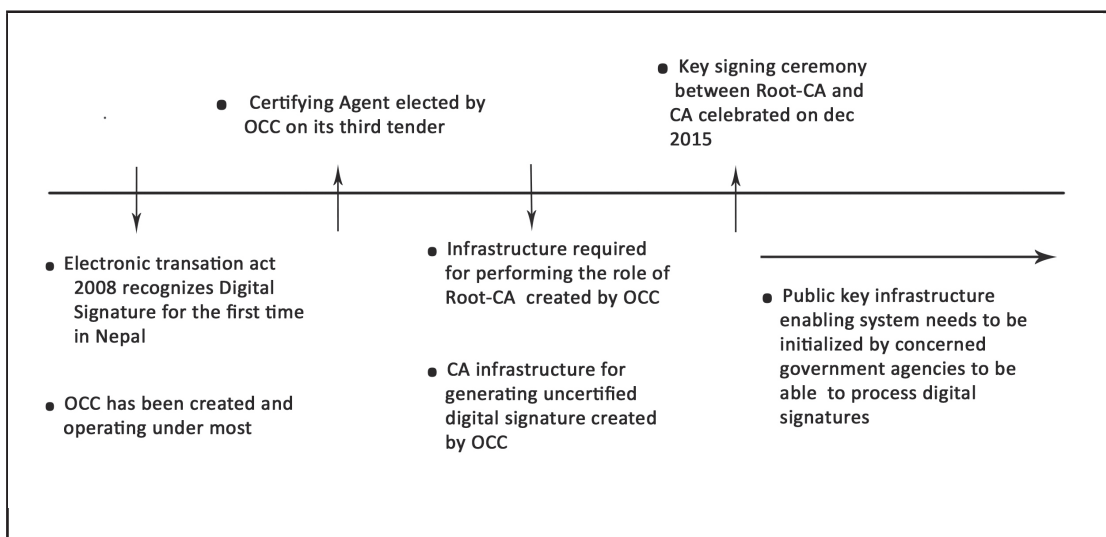
Nepal witnessed the initiation of e-governance (i.e. gateway to digitalization of enterprise registration and other official affairs) after digital signature was formally recognized by the Electronic Transaction Act, 2008 A.D. The legal validation of digital signature was eventually followed by establishment of Office of Controller of Certification (OCC) (now acting as Root Certifying Authority (CA-Root)), who later elected the Certifying Authority (CA) responsible for generating uncertified digital signature for public use. The concerned agencies have already produced essential infrastructure and technology for certifying digital signatures, generating uncertified digital signatures, and storing public key signatures that are required for full-fledged digital signature to come into practice. Moreover, the official inauguration of provision for utilizing legally valid digital signatures was also conducted on December 2015 after technical co-operation between both parties was fulfilled.

However, even a year after the formal recognition of digital signatures, enterprise and tax registering agencies still refuse to accept digital signatures thus preventing complete e-registration. For instance, despite the overall electronic filing procedure, the IRO still requires applicants to be physically present at the IRO office just to sign and retrieve their PAN. Meanwhile, DoC has virtually no electronic medium to communicate with beneficiaries

except for a dummy “online-registration button” in its web-portal that leads the users nowhere.

According to Bhaskar Bhandari, chairman of Radiant Infotech Nepal, Digital Signature Infrastructure has been completely built in the last 10 years. The only thing that is needed in order to give life to this technology in Nepal, is the willingness of concerned government agencies to recognize the Digital Signature system. By enabling Public Key Infrastructure in their software system, which in itself is easily affordable, the public could start using Digital Signatures. However, Satish Subedi, Chief Engineer at OCC, believes that it is equally important to raise ownership towards this technology among concerned government agencies and stakeholders, while it is being initialized for public use. He also believes it to be more of a gradual process than the one that happens overnight.

Therefore, it is recommended that technology-centric agencies such as OCC and Ministry of Science and Technology (MoST) should collaborate with and encourage such line agencies to introduce online registration services that can enable entrepreneurs to completely comply with registration requirements via online medium.



Use of complete e-registration services also seemed to be highly relevant for micro-level enterprises of any sector. Bishnu Prasad Gyawali, a director of DoCSI, believes that even uneducated micro entrepreneurs have high potentials to benefit from technologies such as Digital Signature and e-registration. He attributes strong reception of Internet technology and web-based services in rural Nepal to be the most stunning evidence to draw such conclusions. This recognition also seems to be the motivation behind DoCSI’s initial steps towards e-registration services.

Bhandari from Radiant Infotech Nepal in fact recognizes e-registration services to be even more relevant for microenterprises established in remote areas. For micro-entrepreneurs who have the least amount of time and financial resources to communicate with government registration offices located miles away, the amount of time and money saved in being able to communicate digitally is enormous.

The Challenge with Street Traders

Simplification or consolidation of enterprise registration as mentioned above can definitely reduce substantial difficulties related to formalization for trade related micro entrepreneurs with acute capability constraints. The tentative arrangements that have been made or can be made by the government in the forthcoming future to institutionalize such concepts seem probable. However, even the successful institutionalization of such concepts, still leaves out the least capacity holding and vulnerable trading microenterprises that widely represent the informal economy.

Street traders and traders established in make-shift facility at roadsides generally comprise such vulnerable group of micro traders, who are known to be one of the largest subgroups of the informal economy (Becker, 2004). Some of them - who resemble informal labourers rather than enterprise owners/entrepreneurs - are often not able to gather even the most fundamental documents such as rental agreement/estate ownership documents or utility bills that are primarily necessary to legally register an enterprise says Prakash Sharma, National Project Coordinator for Way out of Informality ILO.

According to Prakash Shrestha, the taxation division head of KMCO, the potential of such traders to come under the legal provision or formalization is not possible, as they completely violate the conduct expected by the Metropolitan City. They are considered illegal not because they are operating without the consent of any government agency, but because they are encroaching the public space allotted for commute and other public purposes, to conduct trade. Moreover, the Metropolis also denies recognizing such traders in their books because doing so will automatically require the department to take responsibility for them. Since they do not have a permanent location, finding them in the future will be an extremely difficult task. Further, Shrestha says that such traders cannot be held accountable for selling products that can compromise user's safety because they lack enough identity to be recognized. The officials even believe that it is technically important to submit documents that expose a trader's personal and enterprise residence identification (i.e., location evidence), to prove them to be an authentic trader.

On the face of it all, a feasible way to guide such informally (and illegally) operating traders under legal provision would be to relocate them to a certain organized market. However, this idea of relocation makes street traders lose their location advantage of selling at public commute areas where people find it most convenient to purchase basic things. This idea has been tested and failed in the past.

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Similarly, the alternative solution, as agreed by the taxation division head of KMCO is to provide such street-traders with an Identity card representing their legal status in future. This is if they can provide documents regarding the source of the products that they trade. However, the Metropolis cannot afford having them situated in areas that are not allotted for commercial purpose.

2.2 Paying Taxes as a Trading Microenterprise

2.2.1 Taxation related requirements in Nepal for Trading Microenterprises

2.2.1.1 Taxes imposed by the Central level

Trading microenterprises established either as a sole-proprietorship or partnership firm, should first retrieve a Business PAN from the nearest of 22 IROs or 26 Taxpayers' Service Offices. These offices are located around the country and function under Inland Revenue Department (IRD). Besides, IRD-authorized Chambers of Commerce and Commerce Associations are also enabled to facilitate PAN registration service for the ease of local businesses.

PAN also serves as the fundamental basis for processing Tax Deductible at Source (TDS), VAT and Excise duty that are commonly applicable for trading enterprises. Importantly, Business PAN does not need to be renewed and will stay unchanged throughout the lifetime of the entity.

Application for obtaining Business PAN can be made both manually or electronically via online system. However, entrepreneurs still have to gather few fundamental documents while making application for PAN such as:

- a) Business registration certificate for Private or Partnership firm obtained from either DoC or Municipality office
- b) Two passport-sized photographs of the owners of the enterprise
- c) Locational map exposing the presence of the enterprise
- d) Rental agreement/Estate ownership document of residence in where the enterprise is located

Although the entire application for PAN can be done via electronic medium, one still needs to be physically present at the PAN office to retrieve the PAN. However, acceptance of readily available digital technology provision in Nepal could enable the tax authority to eliminate the need for entrepreneurs to come to the PAN distributing centre altogether.

In being registered at the tax office, all microenterprises initially have to deal with income tax whereby they are expected to deposit their tax liability annually, within three months after the end of each financial year.

Trading microenterprises are required to comply with different systems of income tax regime applicable to them depending on their income and transaction volume, or ownership type:

2.2.1.1.1 Presumptive tax system

Typically, presumptive tax system is applicable for the smallest kinds of trading microenterprises running as sole-proprietorship with least amount of annual transaction volume and income level at least below NRs 2 million and NRs 200,000 respectively. This income tax system appears to be the simplest of its kind and is not applicable to partnership firms or above. Presumptive tax system simply requires taxpayers to deposit a fixed amount of tax as prescribed on basis to the characteristic of their business residence along with a Debit-01-03-03-64 tax description form. Importantly, enterprises falling under this income tax system are not required to keep books of account as they are solely expected to deposit their tax amount within 3 month after the end of fiscal year on basis to their "location of business". However, receipt copies and fundamental documents proving their annual trading and income position within this income tax system is required.

The annual tax liability for microenterprises belonging to Presumptive Tax system appears as follows:

Characteristic of business residence	Annual Tax Liability
Trading within Metropolitan and Sub-Metropolitan Cities	NRs 5,000
Trading within Municipalities	NRs 2,500
Trading outside of above regions	NRs 1,500

Source: Finance Act, 2016/17

The taxes are subject to be paid within 3 months after the end of Fiscal year. Deadline to deposit tax amount can be extended for next 3 months at most.

All in all, presumptive tax system attempts to simplify the tax procedures for microenterprises that do not have the capability to maintain the books of account.

2.2.1.1.2 Instalment-based Income tax system:

Microenterprises involved in annual transaction above NRs 2 million and earnings above NRs 200,000 are required to file their tax under Instalment-based tax system (before turnover tax system was introduced recently). This income tax system essentially requires microenterprises to deposit income tax on three instalments throughout the financial year on different times based on their annual earning. Entrepreneurs are expected to estimate their annual income for the given financial year through "self-assessment" and deposit certain percentage of their estimated tax on income periodically as mentioned below:

Due date	Tax liability
Mid-January (End of Paush as per Nepali Calendar)	40% of the expected annual tax liability
Mid-April (End of Chaitra as per Nepali Calendar)	70% of the expected tax liability that is payable after reducing previous instalment's deposit
Mid-July (End of Ashadh as per Nepali Calendar)	100% of the expected tax liability that is payable after reducing previous instalment's deposit

Deadline for depositing the tax amount can only be extended for a total of 3 months for the whole financial year.

As enterprises are expected to deposit certain percentages of the tax amount in different periods, there are certain methods to determine the tax amount for enterprises with different ownership type. While flat income tax rate of commonly 25% on annual income is applicable for partnership-based enterprises, enterprises owned as sole-proprietorship generally have to follow progressive income tax system as mentioned below:

Income level (for single owned sole-proprietor firm)	Business Income Level (For Couple owned sole-proprietor firm)	Tax Rate for the particular range of income
Upto NRs 350,000	Upto NRs 400,000	No0ne
For above NRs 350,000	For above NRs 350,000	15% tax rate
For above NRs 450,000	For above NRs 500,000	25% tax rate
For Income above NRs 2,500,000		25% tax rate + (40% of the 25% tax rate) = 35%

Source: Finance Act 2016/17

Importantly, microenterprises paying their income tax under this system have to submit a Debit-06-02-03-64 form during each instalment period, and also Debit-03-03-03-64 form within 3 months after the end of each fiscal year to detail the actual annual income. Likewise, auditor-examined Balance sheet, Profit & Loss statement, Business cash-flow, and accounting policy along with audit report is also mandatorily required during the annual tax filing. While further documents proving the legality of the business may be required, at least Debit-15-02-03-64 form for the purpose of computing business income will need to be attached with Debit-03-03-03-64 income description form.

Enterprises are also expected to be roughly accurate in self-assessing their predicted annual income on which they are expected to make timely payment throughout the fiscal year. Deviation above 10% in terms of underestimation of predicted income tax for each instalment results to penalization in terms of 15% interest rate charge on the difference figure.

2.2.1.1.3 Turnover based Income tax system

The provision of the instalment-based system requires excessive description and compliance, discouraging microenterprises with limited resource capabilities to comply. On such regards, Taxpayer community's consistent request and High-Level Tax System Review Commission's (HLTSRC) suggestion has finally led Financial Act 2016/17 to introduce the system of Turnover based tax for enterprises (including microenterprises) conducting annual transaction above NRs 2 million but less than the VAT threshold (i.e., NRs 5 million worth of annual transaction of general commodities). In general, Turnover based tax rates are implied on total sales transaction (turnover) being made, i.e., unlike to instalment-based tax system in which tax rates are implied on estimated business income.

Basically, enterprises falling under Turnover tax system are required to deposit their tax amount on two semi-annual instalments by submitting a Debit-02 description form on given dates as provided below.

Due date	Tax liability
Mid-January (End of Paush as per Nepali Calendar)	Effective Turnover tax on sales turnover until early January (Paush 20 as per Nepali Calendar)
Mid-July (End of Asadh as per Nepali Calendar)	Effective Turnover tax on sales turnover presumed to be until mid-July on basis to turnover made until early July (Asadh 20 as per Nepali Calendar) minus tax deposited on first instalment during Mid-January

Importantly, enterprises eligible for Turnover-based tax system also should not have involved in TDS regime and must be unregistered at VAT regime. Likewise, unlike in Instalment-based tax system, the enterprises under turnover tax system also should not have claimed for medical tax credit (NRs 750 or 15% of the medical expense, whichever is less allowed as per section 51 of Income Tax Act, 2058 BS.)

Turnover-based tax rates for different kind of trading businesses are as follows

S.N.	Business type	Tax Liability
1.	Enterprises involved in businesses like sales/distribution of Gas cylinders and Cigarettes whereby Commission/Margin up to 3% is levied during their sales.	0.25% of the total sales turnover until stipulated period
2.	Enterprises involved in businesses except for the ones mentioned in No. 1	0.75% of the total sales turnover until stipulated period
3.	Enterprises involved in all kind of businesses with less than NRs 5000 worth of turnover tax during any instalment	NRs 5000 flat rate

Source: Finance Act 2016/17

2.2.1.2 Local Level Tax regime applicable for Microenterprises

The Local Self-governance Act, 1999 of Nepal also allows local government (i.e., Municipalities/VDCs) to levy business tax to any enterprise (including microenterprises) trading in the locality. In fact, according to Prakash Shrestha, Taxation division head of

KMCO, it is primarily to levy business tax from enterprises for which the local government forces enterprise registration at the local-level.

Basically, the locally-levied business tax is not calculated based on income earned or sales turnover made by an enterprise in any given time period or fiscal year. The tax is solely levied on the basis of tax amount set by the local government of a particular locality (Municipality/VDC) for a particular kind of business. For instance, KMCO levies a range of tax amount for enterprises involved in particular kind of trading business based on the size of the enterprise trading inside Kathmandu Metropolitan as given below

Kind of trading business	Minimum tax amount	Maximum tax amount
Liquor, tobacco, Video and Audio electronics trading	NRs 500	NRs 10,000
Construction materials, Computer, Electronics goods, Camera, Television, Radio, Carpet, Petroleum products trading	NRs 1,500	NRs 3,000
Daily edible commodities and clothes	---	---
Automobiles and Automobile parts traders	NRs 500	NRs 3000

Source: KMCO revenue brochure, n.d.

Meanwhile, enterprises of all sizes are also affected by Rent tax to be paid to concerned municipality. Though the municipality allows entrepreneurs (tenant) and house-owners to decide among themselves regarding who shall pay the tax it is often the tenant/entrepreneur who are required to pay the tax either voluntarily or via the house-owner given the relative inelasticity of rent demand compared to supply.

Entrepreneurs willing to deposit their house-rent tax by themselves specifically have to face particular complication of having to visit both IRO/Taxpayers Service Office at Central level and Municipality Office at local level to deposit the different proportion of rent tax. The entrepreneur needs to pay 12% of house rent as rent tax, of which 10% has to be deposited at the central level tax authority whereas the remaining 2% has to be deposited at the respective municipality office.

2.2.1.3 Firm Deregistration and Tax

Micro entrepreneurs are also required to deregister their business PAN by applying for PAN deregistration at any revenue office as they close their enterprise. In doing so, it is mandatory for enterprises to also obtain the Tax Clearance Certificate until the final date of business from the revenue office indicating clearance of all tax liabilities. However, a deregistered PAN will only remain as inactive in the government system which can be revisited by the relevant authority at any time if required.

Documents required during deregistration of Business PAN:

- a) Officially formatted application letter for deregistration of Business PAN
- b) Enterprise deregistration certificate obtained from concerned enterprise registration office/department
- c) PAN registration certificate along with certificate of any other tax that the enterprise is registered at (for instance excise duty license)
- d) Tax clearance certificate signifying clearance of all dues related to Income tax until the time of business liquidation

2.2.2 Observations and Recommendations

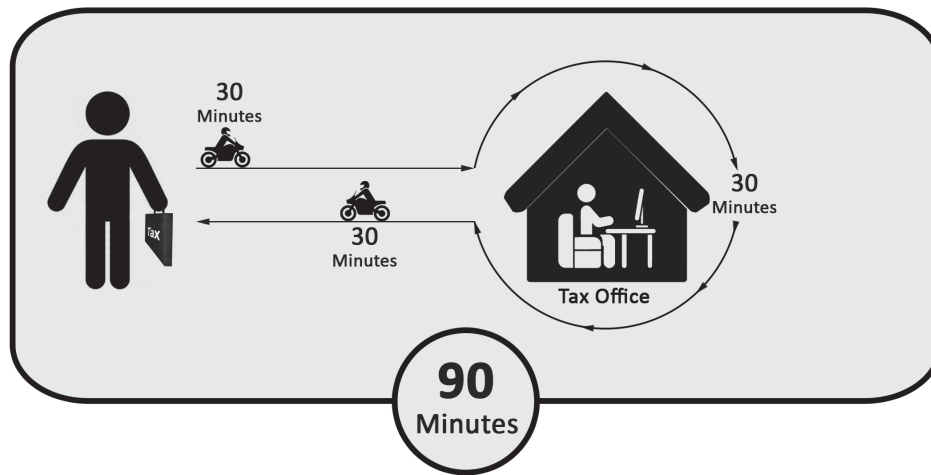
2.2.2.1 Necessity to visit multiple doors for tax purpose

The necessity to visit both central level tax agency (IRO) and local government agencies (Municipality/VDCs) for complying with tax regulations (viz., income tax and business tax) related to enterprise are a redundancy. Given that IRO and individual municipalities are not inter coordinated among themselves, an entrepreneur is expected to visit both agencies to process their respective tax related requirements.

Tax compliances further burden the entrepreneurs by making them pay a single tax (i.e., House rent tax) partially at the IRO and partially at the respective municipalities/VDCs. The government agencies seem to be only passing along the trouble of them not being able to co-ordinate tax revenue among themselves to entrepreneurs/taxpayers.

Recommendation: Institutionalizing representation of the IRO in the municipality

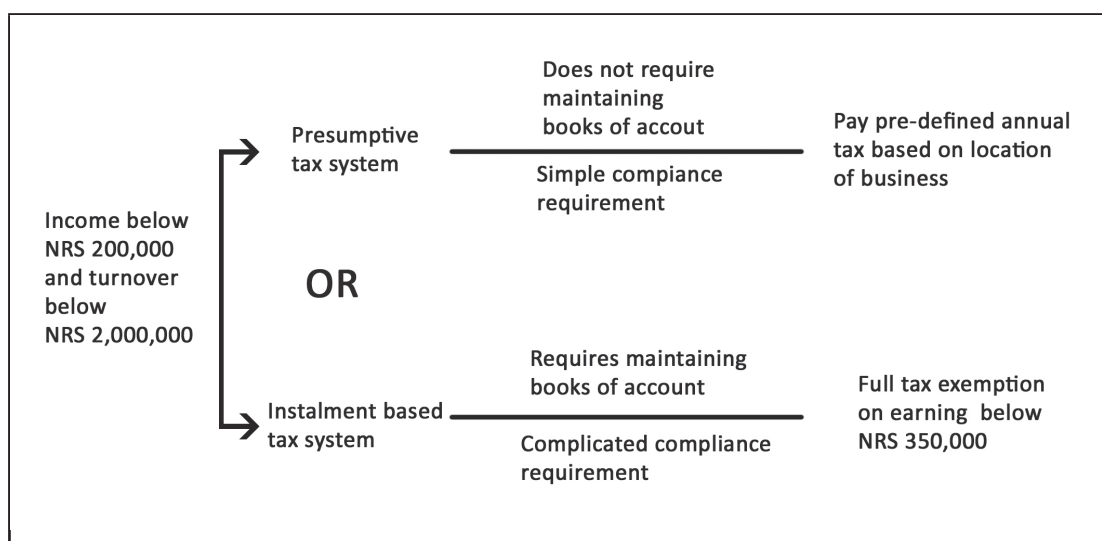
Institutionalisation of a system whereby entire enterprise-related tax affairs could be fulfilled through single government agency (say Municipality/VDC) would considerably reduce the hassles to the entrepreneurs. These agencies could further co-ordinate with the IRO to process the necessary tax requirements, reducing the redundancy of micro-entrepreneurs having to visit one more government agencies. Doing so will ultimately reduce the compliance burden to less-capacity-holding entrepreneurs. Meanwhile, it will signal compliances becoming simpler which could encourage informally-running enterprises to formalise.



Cost of paying taxes = 72,000,000 minutes a year
(assuming an average tax payer lives 30 minutes far from tax office)

2.2.2.2 Unnecessary complication of tax system for micro taxpayers

The income tax regime is overly complicated for microenterprises as unnecessary provisions and income tax systems are presented to them than required. To be specific, the tax system allows sole-proprietor trading microenterprises with annual turnover and income of less than NRs 2 Million and NRs 200,000 respectively to file their taxes under either the presumptive tax system by paying certain stipulated tax amount (by filing Debit-01-03-03-68 income description form) or the regular instalment-based tax system (by filing Debit-03-03-03-68 income description form) by submitting entire books of accounts and other necessary description. An enterprise of such transaction and income bracket is in fact exempt from paying tax if it manages to file its tax via the complicated Instalment based tax system that calculates tax based on certain income earned by the enterprise.



*Source: Legal Provision on Income Tax Act 2058 on Return Filing and Tax payment period and Recovery of Tax with Additional charges and penalty on Late and Non-compliance (IRD Brochure), 2017

However, most owners/managers of small and micro retails have limited capital and little formal education in business and accounts (Samriddhi, 2013). Considering that the least-capacity-holding entrepreneurs rarely have the necessary skill sets to maintain scientific books of account, it becomes simpler for them to forgo the compliances under the instalment-based tax system. From the regulator's perspective as well, the simpler and lesser the number of mechanisms, the easier it becomes to monitor and administer taxes. Consultations with most of the traders (during the course of this study) have shown that they are paying taxes under the presumptive system. Furthermore, tax officials have also been found to recommend this system for taxpayers, for the very reasons like simplicity and ease to monitor and administer. Therefore, it makes sense to do away with a system that least-capacity-holding entrepreneurs are ready to forgo.

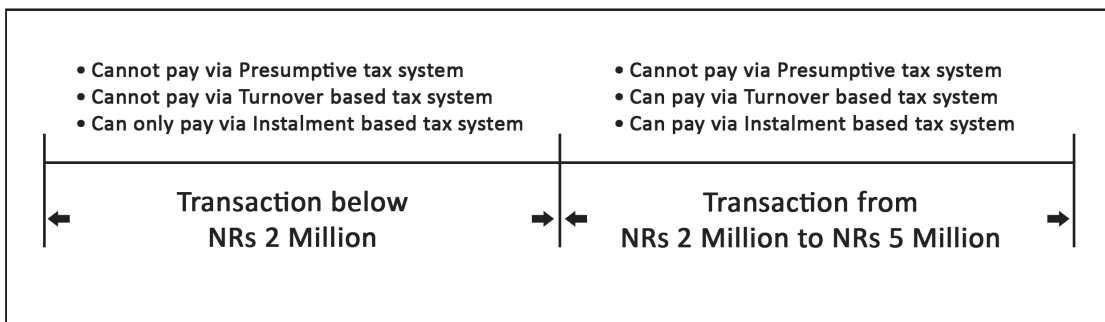
Recommendation: Simplifying the tax provision via exclusively presumptive tax system

The tax filing choices for such entrepreneurs can be simplified by enabling enterprises of such income and turnover bracket to file their taxes directly through presumptive tax system which is very simple to comply with and requires less administrative task for the

regulators as well. Technically, such simplification of tax provision can save a lot of time, effort, and resource for both micro entrepreneurs and the tax authority. Most importantly, it can reduce tax related confusion and fear among other entrepreneurs running informally to incentivize them to come under formal mechanism.

2.2.2.3 Observation: Least earning partnership-based Microenterprises at a disadvantage

Trading microenterprises running under a partnership model with least income and transaction volume are not allowed to file their tax through the simple presumptive tax system even though their counterparts belonging to same income-transaction range but established as Sole-proprietorship can. In fact, the law even seems to remain quiet about their ability to file their tax via Turnover based tax system (explicitly applicable for both sole-proprietor and partnership enterprises whose annual turnover range between NRs 2 Million to NRs 5 million) that appear to be a simpler system to comply with compared to Instalment based tax system. Henceforth, such enterprises have no other choice than to resort to the complicated instalment based tax system that require them to deal with income wise tax on an estimated basis three times a year while maintaining complex books of account.



*Source: Legal Provision on Income Tax Act 2058 on Return Filing and Tax payment period and Recovery of Tax with Additional charges and penalty on Late and Non-compliance (IRD Brochure), 2016

In pursuit of simplification of tax compliances, Indonesia embraced the tax provision to simply charge 1% final income tax on turnover for smallest forms of taxpaying enterprises operating under any ownership structure available in 2013. Targeted measures like this reduce the burden for corporate income tax calculations and minimize future disputes for small taxpayers (Price Waterhouse Coopers, 2017).

Recommendation: Enabling partnership microenterprises to file through simpler tax systems

It is highly recommended that least capacity holding partnership microenterprises be given equal access to simpler forms of income tax systems. Not including these institutions will defeat the motive of simplifying the taxation system for microenterprises.

With the similar purpose, Indonesia adapted a tax provision to simplify the tax regulations in 2013. Indonesia charged 1% final income tax to the smallest forms of tax paying enterprises having annual turnover of below USD 370 thousand. This category constitutes enterprises of all ownership structures available in Indonesia having annual turnover below USD 370 thousand (Pwc, 2017). Price Waterhouse Cooper (2017) believes tax reforms as such targeted to small tax-payers reduces considerable burden for income tax calculations and minimizes future disputes and complications.

2.2.2.4 Observation: Unintended eternity of the businesses

Deregistration of PAN (in case an entrepreneur wants to wind up a particular microenterprise) can only lead the PAN or the tax registration of the business to be in inactive state. Therefore, the unique PAN of an enterprise will remain forever despite the willingness of the entrepreneurs to completely shut it down.

While the unique PAN/tax registration of an enterprise is never collapsed, so will not the tax affairs of the enterprise under the registration. Therefore, the tax authorities can always revisit the tax affairs of a deregistered enterprise anytime in future by ordering the former-entrepreneur to produce the relevant past tax related documents if required. Though unintended, possibility of such unexpected further request for compliance with regards to collapsed enterprises with valid tax clearance certificate not only burdens the entrepreneurs, but also generates a sense of perpetual fear among entrepreneurs of their forgone entrepreneurial involvements. In fact, such burden and fear can weigh heavy in demotivating limitedly able entrepreneurs from even venturing to any entrepreneurial endeavour in the first place.

On the other hand, provision to be completely assured of not needing to worry about previous entrepreneurial involved after being granted for enterprise deregistration gives entrepreneurs the needed confidence to try novel endeavours as the previous involvement fails. Besides, creating the environment that inspires continuous entrepreneurship also enables room for frequent innovation that assists productivity growth of the economy.

Recommendation: Creating provision for wiping the slate clean once and for all

Enterprise regulations should always allow entrepreneurs to be able to clear the slate clean if the entrepreneur has been found clear of all overdue responsibilities as required by law during the time of deregistration. As much does the regulation regarding registering a formal business needs simplification to motivate entrepreneurs to come into the formal sector, so does the process of deregistering or exiting a business. Therefore, it is recommended that government validate the already required tax clearance certificate obtained from IRO/Taxpayers' service office and deregistration approval obtained from DoC/CO/DoCSI in a manner that does not require the entrepreneur to be answerable about the deregistered enterprise in future.

2.2.2.5 Observation: Inadequate information on tax related concerns

The information disseminated by the tax authority regarding tax compliances does not seem to clarify the usual concerns of a layman. The information disseminated by public communication mediums (i.e. brochures and official website) about the tax compliances

to be fulfilled by different kinds of businesses does not provide enough clarifications. The provided information is not explicit regarding the eligibility of enterprises with different ownership structures (viz. sole-proprietor and partnership) on different tax systems. For instance, whether least earning enterprise operating under partnership ownership structure can file their tax on basis of Presumptive tax system (submitting Debit-01-03-03-68 description form) or not is not explicit. Likewise, it is also not explicit if a sole-proprietorship firm eligible for presumptive tax system has the option to file their income tax by following the stipulated progressive tax rate if they desired.

Inability to become well-known of all concerns regarding applicable tax compliance requirement is primarily the reason behind entrepreneurs not being able to file their tax requirements by themselves, thus requiring assistance from tax experts by paying hefty charges. On the other hand, tax officials are also often too busy in their clerical work to communicate with taxpayers, thus creating a huge communication gap among the authority and taxpayers. Such conditions eventually leave confused entrepreneurs vulnerable to corrupt officials leaving them the only choice of bribing to get jobs done. Such difficulty with regards to enterprise related tax compliance not only creates financial burden for entrepreneurs but it can also demotivate informally running entrepreneurs to come into the formal sector as they perceive registering at tax authority can only add further burden.

Kedarnath Guragain is a staple food trading micro entrepreneur established at Jorpati-15, Kathmandu who expresses frustration in the yearly taxation procedure at the Taxpayers' service office. While paying the stipulated presumptive tax is not so much of a problem for him, the fact that he cannot even pay in a simple manner makes him unwilling to even visit the tax office. According to him, there is always something that he is told that he is doing wrongly every year that he goes to pay tax. And, it often makes him bribe someone from the office or the people lingering around the office get his job done. Even now after running his vegetable outlet for more than half a decade, he is still not completely known about the every bit and nuances of the most simple income tax system that is relevant to him.

Recommendation: Simplifying the tax provision while keeping communications intact

Simplifying the tax provisions in a way that can be well conveyed to a layman is a very essential to condition taxation system as being non-burdensome and welcoming. Besides, tax procedure simplification also seems to reduce the tax-related corruptions in the economy.

As an evidence, Moldova, during its transition from a socialist to market-based economy witnessed considerable reduction in tax related corruption prevalent during Soviet regime as it embraced numerous "flat tax reforms" (Criclivaia, 2015).

Likewise, the officials of IRO/Taxpayers' Service Office should also become more proactive in letting their taxpayers (or entrepreneurs) know of fundamental tax related queries that concern them. On such regard, it is advisable for tax authority to introduce more

mediums that can allow the authority to communicate the frequently-revised tax laws to the concerned clients. Advancing mass-media technologies as online and toll-free help-desks that is accessible to the mass can always come handy for such purposes. All in all, as simplifying the tax provision plays a part in easing up the tax compliance for taxpayers, so does communicating the contemporary provisions of tax clearly.

2.3 Compliance to Standards

2.3.1 Some Standards-Related Requirements for trading microenterprises

Formal trading enterprises involved in retailing or trading staple foods, FMCG, and fresh fruits and vegetables are often required to fulfil standards that are especially required by different agencies:

- i. Department of Commerce (DoC)
- ii. Department of Food Technology and Quality Control (DFTQC)
- iii. Department of Supply Management and Protection of Consumer Interest (DSMPCI), and
- iv. National Bureau of Standard and Metrology (NBSM).

2.3.1.1 Standards relating to trading practice

Microenterprises relating to retailing/trading FMCGs, staples and fresh groceries are expected to meet certain trading standards as per the requirement of Black-marketing & Some Other Social Offence and Punishment Act, 1975 enforced by Department of Supply Management and Protection of Consumer Interest (DSMPCI). The expected trading standards as prescribed by the Act refer to product pricing standard, price displaying standard, and repackaging standards.

2.3.1.1.1 Product pricing and display of prices

The product pricing standard applicable to trading microenterprises technically requires traders to not charge customers higher than the price fixed by the producer, importer or main distributor. These are applicable for the goods prescribed by Government of Nepal upon a notification published in Nepal Gazette. The price of staple foods and utilities or other commonly sold goods are often fixed by the government on such basis. Meanwhile, traders are also required to display the pricelist of such commodities in specific format/standard as prescribed by Black-marketing & Some Other Social Offence and Punishment Act, 1975.

Likewise, as per the same Act, the products for which the government has not fixed prices should only be sold with maximum profit margin of 20% at all times.

2.3.1.1.2 Repackaging

Black-marketing & Some Other Social Offence and Punishment Act, 1975 requires traders preferring to sell products by repackaging them in certain size and quantity to maintain a minimum packaging standard. The standard requires traders to at least clearly mention the stipulated price, quantity, and the weight of the product that is repackaged. Besides, expiry and production date may also be required for commodities that are perishable and hazardous if used or consumed after certain time period.

2.3.1.2 Standard related to Food Quality

The food quality related standard to be followed as per Food Act, 1967 and enforced by Department of Food Technology and Quality Control (DFTQC) and other divisions is directly relevant to the micro-traders of different categories of food products that this study concentrates on. The prevailing food quality standard requires traders to have their products fall within quality standard limit recognized by the DFTQC. On such regards, frequent monitoring is conducted by the Department at the trading site of the traders in order to ensure quality of food. Food products that are not up to the required quality standard are seized or destroyed at the expense of the traders themselves.

2.3.1.3 Standard related weight and measurement

Standard Measurement and Weight Act, 1968 enforced by National Bureau of Standard and Metrology (NBSM) also requires traders involved in selling stipulated quantity of staple foods by measuring them in a weighing scale to follow measurement related standard.

First and foremost, such traders have to register their names on payment of the prescribed fees within the prescribed period and obtain a license from the Inspector in order to use a standard weighing machine for trading purpose. Such license for utilizing standard weighing machines is only provided after it is inspected by the NBSM official.

Likewise, this weight standard compliance also requires labels to be affixed on sealed packages clearly indicating the weight of goods contained therein. Actual deviation in the weight of the products than being instructed in such sealed package will mean violation of the standard making the entrepreneur liable for prosecution.

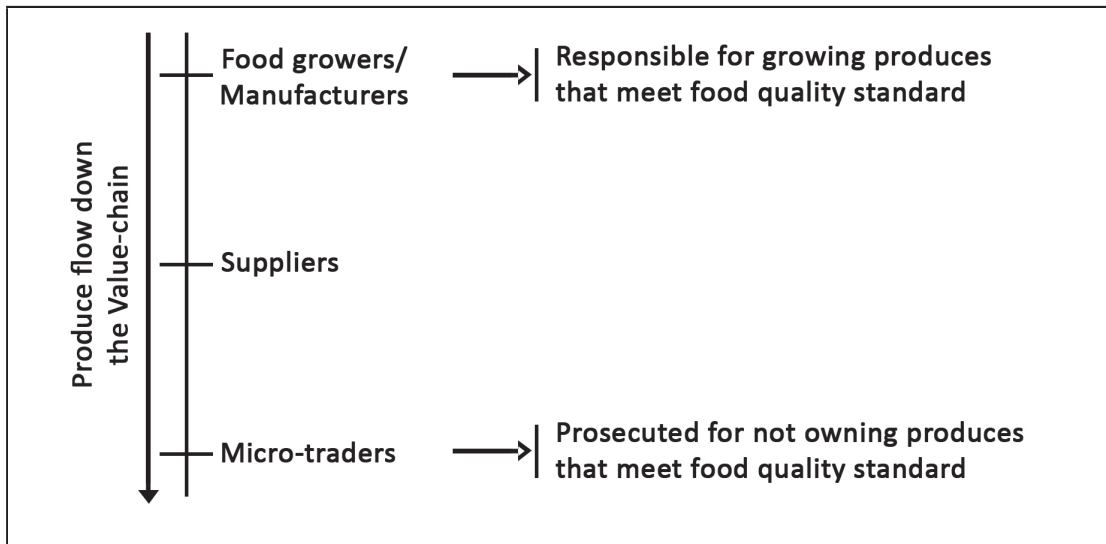
Meanwhile, compliance related to disclosing the weight of the product in the packaging is also discussed in the Black-marketing & Some Other Social Offence and Punishment Act, 1975.

2.3.2 Observation and Recommendation

2.3.2.1 Observation: Unjustifiable and burdensome compliance responsibilities for fresh produce traders

The retailers who sell fresh groceries do not have any involvement in the production of these vegetables and fruits. However, the quality standard provision requires micro-retailers of fresh groceries to maintain the quality of their products to certain limit as specified by Department of Food Technology and Quality Control (DFTQC) or the in-house quality control department of Kalimati Fruit and Vegetable Development Board (KFVDB). The food that do not meet the standards will be confiscated and destroyed. This appears to be quite unreasonable for such traders as they do not have any ability to control or even determine the quality of products. In fact, they do not even seem to understand the technical requirement behind food quality related standard, as it should have been the concern of food growers rather than retailers. The destruction of the retailer's product leaves them vulnerable to a requirement that they are helpless about.

Samridhi Foundation (2013) on its study also identified retail stores having to bear the burden of poor compliance of quality standard higher up in the value chain (i.e., manufactures and produces) as the prosecution is rather incidental to retailers than to-be-quality concerned manufacturers or producers.



Recommendation: Simplification of standards to more realistic ones

It is advisable that quality concerned departments should only enforce quality standards that can be complied by the micro-traders of fresh produces who are actually merely involved in inventorying and selling produces produced by a different party (i.e., food growth) up in the value chain. Therefore, there needs to be a demarcation on the standards that is relevant to entities with different responsibilities based on their position in the value chain. In simple terms, the enforcement of standards concerning the production method and the inputs used in producing the produce in relation to Good Agricultural Practice (GAP) needs to be limited to food-growers. Whereas, standards that relates to inventorying and trading such fresh produce to end consumers relevant to such micro-traders needs to be specified and enforced accordingly.

Meanwhile, confiscating and destroying the produces on grounds of production quality after they have been purchased and paid for by the micro-traders unnecessarily burdens fresh produce trading microenterprises who are least able to afford such inventory loss.

Indra Kumari owns a small stall where she sells cabbage to her customers at KFDVDB. She specifically holds grievance against the sample testing procedure that she needs to comply regarding the quality of the food that she sells at her shop. Particularly, she renounces the fact that the sample testing is done at her shop (i.e., the trading site) rather than at the farm site from where the produces are originally brought in from. She complains that with the minimum margin she makes, she cannot afford to have her goods dumped by the monitoring officers as she had already paid for it including the charges she has to bear in transporting the produces. Besides, she also believes that it is logical to have such test and prosecution conducted at the farm-site only as farmers are the ones who are responsible to determine the quality standard of the product by only deploying optimum amount of chemical fertilizers and food manipulation procedures.

2.3.2.2 Observation: Unreasonable application of packaging standard

Black-marketing & Some Other Social Offence and Punishment Act, 1975 enforced by Department of Supply Management and Consumer Protection (DSMCP) requires traders selling packaged products to mandatorily have labels describing at least the name, price, quantity, weight, and manufacturing and expiry dates of the product mentioned in the package. Besides, the Standard Measurement and Weight Act, 1968 enforced by National Bureau of Standard and Metrology (NBSM) also requires traders to affix labels on sealed packages clearly indicating the weight of goods contained therein that is being weighed by the inspected weighing machine. Technically, the requirement to affix weight mentioning label is also applicable in case the trader choose to self-package the product that can also be sold openly (especially staple foods) after weighing it to a certain weight by putting the demanded portion of it inside a plastic bag.

However, the rationality in enforcing a trader to affix label on the outside of the product that could be sold openly anyway after it is sealed does not seem to be quite convincing. Although it is true that the trader will not remeasure the product quantity in presence of the customer if it is already well packaged, the customer still retains the discretion to request for rescaling or can choose not to buy at all. Therefore, the practice of self-packaging is still not complicated enough to be outside the limit of consumer awareness by which they are likely to be swindled. Therefore, adding one more cost incurring standard requirement on traders for attempting to ease up the trading process is not justifiable.

Recommendation: Eliminate the label standard on openly sellable products

Given that the intention of this standard requirement is to mostly make sure that the consumers are not cheated by being sold with quantities that is below what is charged for, it can be instead said that it is still within the purview of the consumer to ask for rescaling if s/he is in any doubt. Therefore, the government does not need to intervene and add more regulatory burden on matters that can be easily dealt by the market players themselves. It is advisable that the government does not enforce labelling requirement for products that can be sold openly as well. The Standard Measurement and Weight Act, 1968 needs to be revised to liberate traders from having to affix labels on self-packaged staple products that are regularly sold openly.

Under complex enterprise laws, entrepreneurs, especially the ones that operate with the lowest capital and make some of the smallest volumes of transactions in the economy choose informality as an alternative work arrangement as a rational response to excessive regulation. This is true in the context of Nepal as well, as evinced by the non-formality of the scores of small street-side retail stores that spread across the country.

This paper has diagnosed regulations pertaining to the formalisation of business (in this case, market entry), taxation, and standards that least-capacity traders in Nepal have to comply with. It has been seen that small reforms in the way the regulations are administered could considerably eliminate the compliance difficulties for least-capacity trading microenterprises. The recommended reforms further hold the potential to encourage more and more entrepreneurs operating in the informal economy to formalise their businesses and reap the benefits of formalisation for their own growth and scalability.

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