

Leveraging Entrepreneurship for Advancing Prosperity (LEAP)
LIBERATING SERVICE SECTOR



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ABBREVIATIONS AND ACRONYMS

BFI	Banking and Financial Institutions
CO	Commerce Office
COFEMER	Comisión Federal de Mejora Regulatoria
DCC	District Coordination Committees
GDP	Gross Domestic Product
ICLS	International Conference of Labour Statisticians
ILO	International Labour Organization
IRD	Inland Revenue Department
IRO	Inland Revenue Office
KMCO	Kathmandu Metropolitan City Office
kW	Kilowatt
LSGA	The Local Self Governance Act
LSGR	Local Self Governance Regulation
LTO	Large Taxpayers Office
MEDEP	Micro Enterprise Development Programme
MSME	Micro, Small and Medium Enterprises
NMEFEN	National Micro Entrepreneurs Federation Nepal
NRs.	Nepalese Rupees
OCC	Office of Controller of Certification
OCR	Office of the Company Registrar
OCSI	Office of Cottage and Small Industries
OECD	Organisation for Economic Co-operation and Development
PAN	Permanent Account Number
SARE	Sistema de Apertura Rápida de Empresas
VAT	Value Added Tax
VDC	Village Development Committee

PAPER AT A GLANCE

In the contemporary world, micro enterprises are seen as vehicles for entrepreneurship, contributing to aggregate employment, production and national income. But there has been a growing recognition that micro entrepreneurs, sometimes, operate partly or wholly in the informal sector when they start their ventures. In the context of Nepal, 93% of the micro enterprises continue to work in the informal economy and constitute approximately 38% of the GDP, which has resulted in the burgeoning need to examine the characteristics and motives behind operating informally.

All of this begs a question as to why these micro-providers opt to function informally in the first place. At a policy level, the enactment of Industrial Enterprise Act in 1992 instigated the motive to evade the cumbersome process of formalization. This act placed the small micro enterprises and the considerably large service enterprises into the same basket and imposed stringent regulations that not only proved to be costlier for the entrepreneurs, but deterred their involvement altogether. Excessive regulatory compliances, high entry fees and taxes, along with administrative delays upheld as the other few causes associated with circumventing formalization.

In particular, the provision for registration in Nepal is tedious, to say the least. An entrepreneur who intends to register his/her business needs to bear the hassle and cost of visiting a multitude of government agencies. The lack of coordination between these agencies intensifies the entrepreneur's plight, manifesting an inordinately high indirect cost and time. The tax regime guiding the service sector microenterprises further cripples the already dismal formalization process in Nepal. An entrepreneur is expected to pay business tax to the local authorities as well as income-based tax to the central authority. This again creates duplication of work. Moreover, the existence of multiple forms of tax system flusters the entrepreneurs. The policy disharmony is yet another facet that confuses the entrepreneurs. On account of the current transition of Nepal from a unitary to a federal structure, the provinces have been given exclusive power over business and trade. However, no provision directly addresses the micro or small enterprises fostering the need for policy enactment. Hence, we cannot discredit the fact that there exists series of loopholes in the existing administrative and legal provisions.

Although, it is true that the informal sector is economically viable and does not bear the cost of taxes and regulatory provisions, studies have evidenced that formal firms are more productive as compared to the informal firms. Not only do these informal firms experience barriers to access finance, but they also face issues related to uninsured property rights and legal obstacles. The government also suffers alongside because of the loss in revenue that could have, otherwise, been collected in the form of tax from these informal enterprises. Formalization, as evinced, paves the ways for better credit facilities, improved infrastructure, and broader customer base that has an affirmative impact on the firm's advancement. In order to corroborate formalization, we need to ensure that the existing policy and regulatory regimes must be made enterprise friendly.

Based on this analysis, we attempt to propose workable recommendations to facilitate the formalization of the informal firms. To ease the registration process, a one-window service centre that enables submission of regulatory documents should be crafted. Besides, the authorities should leverage digital technologies and provide cost efficient, qualitative and timely services. A single system of taxation that addresses the entrepreneurs' disorientation should be provisioned. To administer the inter-agency coordination failure, policies that ensure harmonization must be shaped. Similarly, with reference to the government restructuring, the existing laws need to be streamlined in favour of the federal structure; de-concentration of central agencies and empowerment the local government, at the same time, will ease the operations.

Microenterprise is a term first employed in practice by Nobel laureate, Mohammad Yunus, in his seminal work on microfinance¹. Micro enterprises, with its own distinction today, stand at differences in policy measures, implications when compared to small or medium enterprises. Synonymous to microbusiness², microenterprises are mostly categorized on the basis of a total employee count of less than ten, though some countries also include capital and annual turnover as a measure of defining microenterprise. Given the small employee size and a low turnout recorded, microenterprises traditionally have been family businesses with a high density in developing countries.

Given low employment capacity, microenterprises generally function within the informal economy of a country. On the formal statistics, there are 70–90 million formal microenterprises globally, including those in high-income Organisation for Economic Co-operation and Development (OECD) countries. About 78–85 percent of formal microenterprises (60–70 million) are in developing economies. Amongst a range of 410-550 million Micro, Small and Medium Enterprises (MSMEs) globally, approximately 15-19 percent fall in the formal bracket. A large portion amounting to approximately 70-80 percent are operating in the informal economy. In context of Nepal, 93 percent of all MSMEs are categorised under micro enterprises, majority of which continue to work in the informal economy³. The term informal economy has been defined given different lenses employing different aspects governing alternate dimensions. Thus, it becomes imperative to study the definition in context which provides for the foundation of research. Likewise, analysis of the clear definition of the informal economy is a must in order to understand it better and recognize its contribution to the overall economy in terms of employment and income generation. The theoretical model of economic development takes into assumption an unlimited supply of labour in most developing countries. A further assertion was the absorption of the surplus labour in the industrial sector as the developing countries expanded their respective economies. Thus, the small-time producers, traders and, casual workers would be absorbed in the formal economy ultimately diminishing the informal sector into a null⁴.

Traditionally, the informal economy has been perceived negatively as one involving: undeclared labour, tax evasion, criminal and illegal activities (Horn et al, 2002). However, there are evidenced number of informal activities operating in the economy that are legal and non-criminal in nature (Becker, 2004). The informal economic activities are not necessarily performed with the intention to avoid taxes, regulatory compliances and social security contributions. However, as their transactions are not recorded, they tend to be termed illegal but it is not criminal in nature (ILO, 2002). Therefore, the informal economy and criminal activities should not be studied as synonymous to each other. In order to have a clarity of the notion of the informal economy, we should attempt to outline the various definitions provided by research institutions and scholars.

1 Planning in Bangladesh: Format, Technique, and Priority, and Other Essays, Md. Yunus, 1976

2 Microenterprise is formally used for businesses which access microcredits as a growth agent; though the term is now used without this distinction

3 IFC Enterprise Dataset 2011, Nepal: CBS, SEPT (2007)

4 Dual Sector Model; W. Arthur Lewis (1954)

The first International Labour Organization (ILO) employment mission in 1972 to Africa, Kenya, observed the informal economy as one that is unrecognized, unrecorded, unprotected and unregulated by public authorities, that is not only subsistent but also has the potential of earning high profit. According to the 15th International Conference of Labour Statisticians (ICLS), “informal sector enterprises are private unincorporated enterprises owned by individuals or households that are not constituted as separate legal entities independently of their owners, and for which no complete accounts are available that would permit a financial separation of the production activities of the enterprise from the other activities of its owner(s)”. This includes unincorporated enterprises owned and operated by individual family member or by several members of the family. Additionally, it also includes unregistered partnership businesses and co-operatives formed by members of different households. Excluded units are ones, which produce goods solely for their own consumption, units in the agricultural sector and, units above a certain threshold to be determined according to national circumstances (Husmanns, 2005 p. 3). Most small firms in the developing countries are informal as they have not been registered as a legal entity (OECD, 2009 and data from IFC 2010).

Over the years, the debate on the large and heterogeneous informal economy has crystallized into four dominant schools of thought with reference to its nature and composition that are as follows:

- According to the dualist school, informal sector comprises of marginal activities that provide income for the poor and insurance at the time of crisis, and is excluded from formal economy. (Hart 1973; ILO 1972; Sethuraman 1976; Tokman 1978). The exclusion of the so-called informal sector is caused due to imbalances between the growth rates of the population and of modern industrial employment, as well as a mismatch between people’s skills and the structure of modern economic opportunities (Chen, 2012).
- As according to the structuralist school, the informal economy is subordinated to the formal economy. The subordination reduces the input and labour costs and increases the competitiveness of the large firms (Moser 1978; Castells and Portes 1989). The Structuralists maintain that the nature of capitalism drives informality; the attempts by larger firms to reduce costs and increase their competitiveness, ability of these firms to react against the organized labour, and react against state regulation especially, regulatory compliances, taxes and global competition (Chen, 2012).
- The legalist school argues that the informal sector comprises the micro entrepreneurs who deliberately choose to operate informally as a rational response to avoid costs, time and effort of formal registration. They lack property rights and hence their assets are not legally recognised (de Soto 1989, 2000). The hostile legal system leads to the self-employment informally outside of law.
- The Voluntarists also focus on informal entrepreneurs who deliberately try to avoid regulations and taxation. However, they do not blame the cumbersome registration process. The entrepreneurs primarily engage in a cost-benefit analysis of formalization. Provided that they find out formalization is relatively costlier, they choose to stay informal. The Voluntarists argue that the informal enterprises have an unfair advantage over formal ones as they can avoid costs of regulatory compliance and taxes. Hence, they claim that these enterprises should be brought to formal sector in order to avoid unfair competition and increase the tax base (Chen, 2012).

1.1 Contribution of Informal Economy.

The importance of informal economy can be traced by its contribution to the economy as a whole. Due to lack of sound empirical data for informal enterprises, its size and contribution cannot be known with certainty but researchers and institutions have tried to estimate the size and contribution of the informal sector by using various techniques. As according to Huitfeldt and Jutting (2009), on average half of the jobs in non-agriculture sector in emerging and developing world are informal. In some regions, including Sub-Saharan region and South Asia, the rate is as high as 80 percent of the non-agricultural jobs.

Table 1: Average size of Informal Economy around the world

Countries	Average size of Informal Economy- Value added in percent of official GDP 1999/2000	Average size of Informal Economy- Labour force in percent of official Labour 1999/2000
Developing countries:		
Africa	42 (23)	48.2 (23)
Central and South America	41 (18)	45.1 (18)
Asia*	29 (26)	33.4 (26)
Western OECD countries	18 (16)	16.4 (7)
North American and Pacific OECD countries	13.5 (4)	-

*All the countries are not developing countries such as Japan, Hong Kong and Singapore

Source: Schneider (2002)

1.2 Cost of informality to businesses.

The contribution of the informal economy, thus, can be approximated to a significant number, if not through exact empirical numbers. The advantages of staying put within the sector also seems to be viable given the absent cost of taxation, regulatory provisions etc. but, the flip-side does add to a significant list of potential disadvantages faced. The given differentiation highlights the problems and related advantages that could benefit the firms advancing towards a legal framework.

Table 2: Features of formal and informal sector

Formal	Informal
Formal Contract and Letter of Appointment	Verbal Contract and no Letter of Appointment
Regularity of employment	Irregular employment
Fixed wage rate	Uncertain wage rate- Low income
Fixed working hours	Long and Uncertain Working Hours
Legal Provision of Protection	Non- existence or poor level of legal protection
Government Benefits	
Access to credit through financial institutions	
Ability to transact within e-commerce	

Source: ILO, Social Protection for People in Informal Economy of Nepal, 2004

These are the problems faced by the people working in an informal economy as a whole. There are added problems faced by the microenterprises operating in the informal sector which have constrained their growth. Despite the fact that the informal sector does not bear the cost of regulation, it is evidenced that informal firms tend to be less productive than the formal ones (Loayza and Rogilini, 2008). Informal firms face problems such as financing, regulatory/legal obstacles, uninsured property rights making them less productive (Demirguc-Kunt et al., 2006).

The major problem faced by micro firms operating in the informal sector is the access to finance, a feat that has contributed to a high degree of stagnation in the firms. Inability to register property and assets adds to the lack of collaterals required for borrowing from banks, financial institutions and other micro-lending agencies which might be offering credit at lucrative payback options. The availability of the access to credit empowers the entrepreneurs to execute their innovative ideas improving the business environment; resulting into the Schumpeterian process of 'Creative Destruction' of making the economy vibrant. (Ayyagari, Demirguc-Kunt, Maksimovic, 2008) However, the lack of such facility results in stagnation of the economy it operates in.

Beck et al., confirm that small and new firms face higher financing obstacles in comparison to large and older firms. There is 39% probability that small firms list financing as a major hindrance, while such probability for the medium firms and large firms is 36% and 32% respectively. According to Becker (2004), 41 percent of the informal enterprises' primary problem is lack of finance. Furthermore, micro firms seeking for relatively small credit face high transaction costs and high-risk premiums as they have less credibility and less collateral to offer. In addition, when these firms are operating in the informal sector, it is almost impossible to get loans from the Banking and Financial Institutions (BFIs). The informal enterprises do get credits from informal sources like family and friends, money lenders, however the price of borrowing, i.e. interest rates are comparatively higher, thus increasing the cost and further affecting the financial stability of the business. Evidence of about 95 percent of the informal enterprises are financed through these sources (Becker, 2004). Money lenders in the developing countries charge from 5- 10 percent a month (Djankov, Lieberman, Mukherjee, Nenova, 2002). So, what happens to the growth of the micro enterprises when they face financing obstacles? Beck and Demirguc-Kunt (2006), present the reasoning that micro enterprises are more likely to face financing obstacles than large firms and this thus, has double the impact on the growth figure. Hence, micro and small enterprises growth is largely affected due to financing problems.

Another problem that informal enterprises face has been identified as the lack of property rights. The unreported and unrecorded economic activities deprive the informal enterprise owners from access to the formal system that gives them legal ownership of their property (De Soto, 2003). So, the absence of a legal identity inhibits the expansion of their respective businesses via increase in the capital stock.

Another problem that comes with informality is vulnerability. The informal enterprises are vulnerable to harassment by the inspection officials of the government and are even forced to pay a bribe to look away (Djankov et al., 2002). If the informality status is revealed, the firms may have to give up a significant part of their output as a fine or bribe. It has been estimated that informal firms in transition economies pay around 20 percent of their revenues to government officials in the form of bribes (Djankov et al., 2002 as in World Bank). Hence, 20 percent of the total revenue is amounted as the cost of being informal. More importantly, this might affect the growth of these firms as they would prefer to scale down their operations to remain shadowed from the inspections conducted by authorities (Loayza and Rigolini, 2008).

1.3 The Costs of Informality to the Government

The major cost that government faces due to informality is the loss in revenue. When there are large informal enterprises operating in the economy, the government would have a smaller tax base, adversely affecting revenue. When the taxes and regulations are higher, the costs of formalizing the small and micro businesses would outweigh the benefits; and if these small businesses are forced into formalization, many of them would have to shut down. Therefore, the lower tax regime and appropriate regulations would only bring them into the formal sector thereby increasing the tax base of the government (Djankov et al., 2002).

The major economic cost identified by Djankov et al. (2002) is the amount of money the government has to spend on various programs to tackle poverty such as: health care services, subsidized housing, unemployment benefits, training etc.. These programs focus on the same people operating in informal sector, though the extent of relief achieved through the programs is contentious. Glaeser and Gyourko (2002), suggested that the government would do better if it could shift its priority from social security programs (like basic housing) to building a conducive environment where businesses could grow and prosper.

Then despite a significant contribution to the national economy and other consequences, why has formalization not been encouraged? Primarily because it was intended to be a natural order in the shift of labour surplus from the informal sector to the formal industrial sector. However, in contrast to the prediction of Arthur Lewis, informal sector has been rising gradually in the developing world in the past three decades (Becker, 2004).

1.4 Causes of Informality

Loayz and Rigolini (2008), identify excessive regulations as one of the major hindrances to formality. They establish that regulations are fixed cost to the businesses. The cost of meeting the regulatory compliances is fixed irrespective of the production. Auriol and Warlters (2005) also confirm that the cost of binding by the regulations is fixed and, largely sunk. The level of taxation and social security contributions has an insignificant effect on the shadow economy⁵. The direct cost such as fees and taxes are a small portion of the total cost of setting up the business (Auriol and Warlters, 2005).

A cross country study conducted by Djankov et al. (2000) found out that on average the official cost of registration is 34 percent of the Gross Domestic Product (GDP) per capita. On an average, it involves 10.17 steps and 63.05 business days to get a business registered. This includes the official time and cost; and excludes the bribes and administrative delays which also tend to be high in developing countries. Thus, the enterprises have to contribute a certain amount of its produce in order to meet the designated regulations. This directly hampers the small businesses with relatively low output. So, only the workers and firms with higher output have the incentives to meet the regulations, as it would account for a small portion of their total production. Auriol and Warlters (2005) estimated that 1% rise in entry fees, measured in terms of per capita income leads to 14% increase in size of informal sector.

5 informal economy is synonymously referred to shadow economy

Auriol and Warlters (2005) have also asserted that there are relatively higher barriers to enter into the formal sector in the form of the lengthy procedures, increased number of days, higher registration fees etc. in low income developing countries. They empirically verify that these regulations, increasing the barriers, coincide with the deliberate government policy to raise tax revenue. The barriers to entry generate market power for the firms in the formal sector thereby creating restrictions on competition in the formal sector generating rents that can be appropriated by the government in the form of entry fees or taxes or both adding to revenue. Hence, they have empirically established positive relationship between country's barriers to entry and government's tax revenue.

Another barrier that has been identified is the prolonged regulation that needs to be accounted for to remain formal, thus being a barrier in itself. The obligations to retain the legality status might prove to be a barrier to get formalized at first. Lagos (1995) exclaims that in the case of micro enterprises, with relatively low economic transactions, declaration and payment of taxes might have a smaller impact on them being formalized; but book-keeping might be costly which affects the decision to formalize. Specifically, the Value Added Tax (VAT)⁶, is not technically a cost to the entrepreneur as its incidence is transferred to the consumers by adding the VAT amount to the price of final goods. However, the micro entrepreneurs face an added cost due to lack of expertise in calculating and transferring the VAT amount to the consumer. Furthermore, adding the VAT amount to the prices reduces the competitiveness of micro enterprises with respect to the big enterprises producing similar goods or services.

1.5 Benefits of Formalization

Rand and Torn (2011) in their study have shown that formalization leads to an increase in the overall profit of the firm and their capital stock. Loayza (1996) provides evidence, through his study in Latin America, that a decrease in unofficial activity will stimulate economic growth through greater investments in public goods and services which becomes possible through the increase in tax revenues. The benefits of operating legally include: better access to credit, infrastructure, other productive public goods and, a broader customer base, all of which may in turn have a positive impact on the firm's profit (McKenzie & Sakho, 2010). Fajnzylber, Maloney, and Montes-Rojas (2011) through their study in Brazil provide evidence for hiring regulated contracted labour and operating from more established location ultimately resulting into higher revenue, profit and capital use by officially registering.

1.6 Empirical Evidences

In 1996, Brazil introduced a scheme 'SIMPLES' (Integrated System for the Payment of Taxes and Social Security Contributions of Micro and Small Enterprises) which revisited its tax policy and tax rates aiming to increase the formalization of the micro enterprises. Fajnzylber, Maloney, and Montes-Rojas (2011) in their paper⁷ have tried to find whether high tax rates and complex tax regulations work as a barrier to formalization or not through an extensive survey of the micro enterprises in Brazil. And, if formalization improves the performance of the firm, measured in terms revenue, profits and capital stock, or not.

⁶ Value added tax

⁷ "Does formality improve micro-firm performance? Evidence from the Brazilian SIMPLES program", 1996

Their quantitative analysis found an increment of 11.6 percent in the licensing rate, an increase in 7.5 percent of the firms registered as formal entities, an increase of 6.3 percent of the micro enterprises registration and an increase in 72 percent of the tax registration.

So, the question is that whether formalization has had any effect on firm performance? In their estimates, they found that formalization had a significant positive impact on revenues and profits of the firm. The formalized firms generate 57 percent more revenues and 49 percent higher profits than non-licensed firms. Besides, formalization leads to an increase in the share of paid employees in employment by 10 to 40 percent. The access to capital increased by around 20 percent. The effect of formalization in the volume of capital stock has been found inconsistent across the samples and estimation techniques.

Comisión Federal de Mejora Regulatoria (COFEMER)⁸, introduced and implemented Sistema de Apertura Rápida de Empresas (SARE)⁹ in an attempt to simplify state and municipal regulations and formalities involved in registration and establishment of businesses (OECD, 2013). This program was especially brought to facilitate the process of business registration and operation of the small and medium businesses. Bruhn (2013) conducted research on the effect of registration reform on the informal businesses of Mexico.

SARE simplified the business registration task procedures and offices required to be visited to start a business by reducing the number of days, from 30.1 to 1.4, 7.9 to 2.7, and from 4.2 to 1, respectively (Bruhn, 2013). After the implementation of SARE, the number of formal business owner increased by 5 percent (Bruhn, 2008). Bruhn (2013), approached his study by categorizing the informal business owners into the one having characteristics of formal business owners and others having characteristics of wage workers. He concluded from his analysis that the business owners from wage worker species are less likely to become formal businesses, however they are 22.3 percent more likely to become wage workers. In municipalities with high pre-reform constrained to entrepreneurship, the informal owners with formal business species are 26.2 percent likely to get registered as formal businesses.

Similarly, Kaplan, Piedra and, Seira (2011) have also estimated the impact of SARE in business formalization. Their analysis shows the estimated effect of program is additional creation of the firm by 4.7 every month. The SARE program also increased employment by 10 percent on a monthly basis.

1.7 Informal economy in Nepal

A large portion of the informal economy in Nepal comprises of micro enterprises¹⁰. The first attempt to outline a government policy catering to the micro enterprise sector was outlined in 2008¹¹, ten years after the first micro enterprise development programme was initiated in 1998¹² in collaboration with the United Nations Development Programme (UNDP). With the Industrial Policy 2010¹³, the existing definition and classification of micro enterprises were revised to a higher

8 or COFEMER known as Federal Commission for Improving Regulation in English

9 or SARE known as System for Quick Business Start-up

10 (2000) Binod K. Shrestha, "SME Promotion Strategies and Poverty Alleviation in Nepal," in "Private Sector Development and Poverty Reduction: Experiences from Developing Countries," Small Enterprise Promotion and Training working paper no. 20

11 Micro Enterprise Policy 2008, MoICS, 2008

12 Micro Enterprises Development programme (MEDEP) was initiated in 1998 with the technical and financial support of the United Nations Development Program (UNDP) during the government's ninth five-year plan with its main objective of poverty alleviation through developing micro enterprises and creating off-farm employment opportunities for rural poor and socially excluded

13 Industrial Policy 2010, Government of Nepal

fixed capital bracket of about Nepalese Rupees (NRs). 200,000, a hundred percent increase from the value in the policy of 2008. The Nepal Government through the 2016 Industrial Enterprise Act legislates microenterprises for the first time as a unit with a maximum of nine employees (including the owner), a paid-up capital of up to NRs. 500,000 and electricity consumption of 20 kilowatt (kW), amongst others. The existence of the informal economy in Nepal is not certain; various tentative figures have been provided by the people of various agencies. In Nepal, 93 percent of the micro enterprises, 5.7 percent of the small enterprises and 1.3 percent of the medium enterprises are operating in the informal sector¹⁴. As according to the National coordinator of the ILO's project 'Way out of informality: Formalizing Informal Economy, informal economy accounts for 38 percent of GDP of Nepal. Adhikari (2011) also maintains that the informal economy covers 38.4 percent of the GDP in Nepal. Government of Nepal, Central Bureau of Statistics (GON/ CBS, 2009) in The Labour Force Survey of 2008 estimated that around 2,142,000 people aged 15 and above are employed in non-agriculture informal sector which is about 70 percent of the total non- agricultural employment.

Besides, Mr. Chandrakanta Adhikari, the executive Director of National Micro Entrepreneurs Federation Nepal (NMEFEN), claimed that a large number of microenterprises are semi-formal as, they have not fulfilled all the requirements, and have registered in few agencies only. Most of the semi-formalized microenterprises are only registered in municipality/Village Development Committee. Samriddhi (2013) in a survey conducted among the entrepreneurs in micro retail stores also found that many of them have been partially registered or partially formalized.

Table 3: Persons aged 15 and above employed informally by various industries

Industry	No. of people employed informally (000)	In percentage
Total	11332	100
Agriculture and Forestry	8674	76.54
Fishing	3	0.03
Mining and quarrying	27	0.24
Manufacturing and recycling	721	6.36
Electricity, Gas and Water	99	0.87
Construction	352	3.11
Wholesale and retail trade	684	6.04
Hotels and restaurants	191	1.69
Transportation, communication and storage	166	1.46
Financial Intermediation	15	0.13
Real estate, renting and business activity	67	0.59
Public administration and social security	24	0.21
Education	147	1.3
Health and Social Work	40	0.35
Other community, social and personal services.	87	0.77
Others	35	0.31

Source: Labor Force Survey 2008, CBS

14 Small Enterprise Promotion and Training(SEPT) and Central Bureau of Statistics(CBS)- Nepal, 2007

The above table is the sector wise classification of the people working in the informal economy. Broadly, these can be classified into Manufacturing, Service and Trading sectors. In this paper, the policy studied is specifically for the service sector, focusing on the enterprises operating in the service sector

1.8 Defining Service Sector

Unlike manufacturing enterprises (producing the goods) and trading enterprises (performing the act of buying and selling without adding value in terms of quality and quantity of the goods), enterprises in the service sector produce the intangibles and also add value. The contribution of service sector to GDP is NRs. 380.40 billion¹⁵ in Nepal. However, this figure does not include a large chunk of enterprises operating in the service related informal sector, of which majority are micro enterprises. Since, there are a large number of informal enterprises running in the informal sector, their growth may be hindered by the aforementioned barriers. Hence, it is necessary to implore reasons for the informality by addressing the regulatory barriers and problems that have inhibited them to operate in the informal economy.

Before the enactment of the recent Industrial Enterprise Act, there was no specific provision for the incorporation of the 'microenterprises'. These enterprises had to be registered as Cottage or Small as according to the nature and capital of the business as per the Industrial Enterprise Act, 1992. By definition, service enterprises with capital up to NRs. 30 million were categorized as small industries. As the micro service enterprises having a small amount of capital to the enterprises with capital as high as NRs. 30 million were put into the same basket with same tight regulations, it made the registration relatively costlier for these micro enterprises, discouraging them from registering their business.

Furthermore, as according to Mr. Chandrakanta Adhikari¹⁶, most of the microenterprises have been running informally as there was no provision for registration of enterprises under the heading of microenterprise. The new Industrial Enterprise Act 2016 lacks regular and procedural directives on microenterprises. Thus, the new Industrial Enterprise Act with specific provisions for the micro enterprises is in no state of instant action.

15 Economic survey, 2015/16

16 the executive Director of NMEFEN (National Micro Entrepreneurs Federation Nepal)

As mentioned above, there were no provisions of registering the enterprises under the heading of 'Micro Enterprises' as according to law in Nepal until the recent formulation of the Industrial Enterprise Act, 2016. The Industrial Enterprise Act, 1992 had classified industries into Cottage Industries, Small Industries, Medium-Scale Industries and Large-Scale Industries. The micro level service producing industries have to register as Small Industries. In order to completely register a micro level service industry, the aspiring entrepreneur has to register in three government agencies ranging from local government to central government agencies. The following are the agencies where a micro enterprise is to be registered:

2.1 Registration Agencies

2.1.1 Office of the Small and Cottage Industries

The first step in the process of registration of a service-sector micro enterprise is establishing a legal entity. According to the Industrial Enterprise Act, 2016 an individual who is willing to open up a new micro service industry could do so by registering it under the category of micro enterprises at the Office of Cottage and Small Industries (OCSI) of the respective district where the entrepreneur has intended to operate his/her business. The enterprises that meet the following criteria will be classified as micro enterprises:

- a) Enterprises having a fixed capital of up to NRs. 500,000
- b) Enterprises with the total employee of up to 9 people including the entrepreneur.
- c) Enterprises with annual transaction not exceeding NRs. 5 million
- d) For the enterprises using machines, the capacity of machines should not be more than 20 kW¹⁷.

An entrepreneur who wishes to register a micro industry has to register it as either a sole proprietorship firm or a partnership firm according to the Private Firm Registration Act, 2014 and Partnership Act, 2020 respectively. The following documents are required:

- 1) Citizenship Certificate
- 2) Application 'B' form
- 3) Estate ownership document/ rental contract if the estate is rented
- 4) 2 passport sized photos¹⁸

A partnership firm, in addition to these documents, has to submit an agreement between the partners.

¹⁷ Source: Clause 15 (1) (a), Industrial Enterprise Act, 2016

¹⁸ Source: Procedural Manual of DCSI, 2072

2.1.2 Inland Revenue Office

Inland Revenue Office (IRO) is the secondary registration body in Nepal. It is constituted under the Inland Revenue Department (IRD) and is responsible for administering taxes within Nepal. There are 49 offices under the IRD around Nepal including one Large Taxpayers Office (LTO), 22 Inland Revenue Offices and 26 Taxpayer Service Offices (TSO). Under the registration category, this office is responsible for issuing Permanent Account Number (PAN), registration of Value Added Tax (VAT) and Excise of the businesses and industries which have been registered as a legal entity at the Office of the Company Registrar (OCR), Department of Industry (DOI), Commerce Office (CO) and Office of Cottage and Small Industries (OCSI).

The micro enterprises operating in service sector after registering their respective industry in the OCSI have to file an application at the IRO and acquire a PAN/VAT before going into operation. However, after operation, if the annual transaction of the service sector industry exceeds NRs. 20,00,000, the business will have to register for VAT.

For the registration of PAN/VAT, an entrepreneur has to submit the following documents.

- a) PAN/VAT registration application form
- b) Stamp of NRs. 10
- c) Registration certificate issued by OCSI
- d) A photocopy of citizenship certificate and 2 passport sized photos
- e) Land certificate photocopy of the proposed location
- f) Location map of the proposed industry/trading business¹⁹



2.1.2.1 Excise Registration

The Excise Act, 2058 requires micro enterprises operating in the service industry to get registered for Excise Duty and requires them to pay the excise duty as specified. In order to obtain such license, the business must be a registered PAN holder and will have to submit application under the heading 'Service Providing License'. However, no laws related to excise have specified the services that are excisable and the amount to be paid as duty. This contradiction might affect the service businesses as it creates confusion among the entrepreneurs in the service sector. Nevertheless, the following services have been categorized under sales and distribution category.

- a) Restaurants serving alcohol and alcoholic beverages.
- b) Restaurants selling cigarettes and tobacco related products²⁰

With regards to the abovementioned categories, the license is valid up to one fiscal year while it should be renewed at the end of every fiscal year. In order to renew the license, one has to again file an application letter of renewal at the tax office with charge.

2.1.3 Municipality/ VDC

The Local Self Governance Act (LSGA), 1999 and the Local Self Governance Regulation (LSGR), 2000, require all businesses operating in the respective VDCs and Municipalities to be registered in the Village Development Committee (VDC) and Municipality offices. According to Prakash Shrestha, Taxation division head of Kathmandu Metropolitan City Office (KMCO), the requirement for registration in the local authority is primarily meant to collect the taxes from the businesses within the jurisdiction of the local authority (Shrestha P., Personal Interview, Feb 1 2017). The business tax serves as a primary source of revenue to the local bodies.

Following documents are to be submitted for registration in the Municipality/VDC

- a) Recommendation and consent letter from the ward office
- b) No objection commitment from the adjoining neighbours
- c) The filled Industry registration application form available at the ward office
- d) Photocopy of citizenship certificate and 2 passport sized photos
- e) Photocopy of land ownership certificate of the proposed location²¹

2.2 Issues with Registration Process

2.2.1 Multiple regulatory agencies involved

One of the common problems faced by micro entrepreneurs operating in service sector is the hassle and cost of visiting a multitude of government agencies to get their businesses ready for operation. Even though the direct cost of registration or fees may not be very high, the indirect cost manifested in the form of labour cost and time is highly significant. This cumbersome process directly increases the cost of formalization, discouraging the small and micro enterprises from getting registered. Moreover, the service sector micro entrepreneurs dealing with alcohol and alcoholic beverages and cigarettes sold by the micro level restaurants also have to obtain an excise

²⁰ Source: Section 6, IRD Brochure related to Excise Licensing, 2015

²¹ Source: Section 5.1, Industry/ Trading business registration and municipality, FNCSI

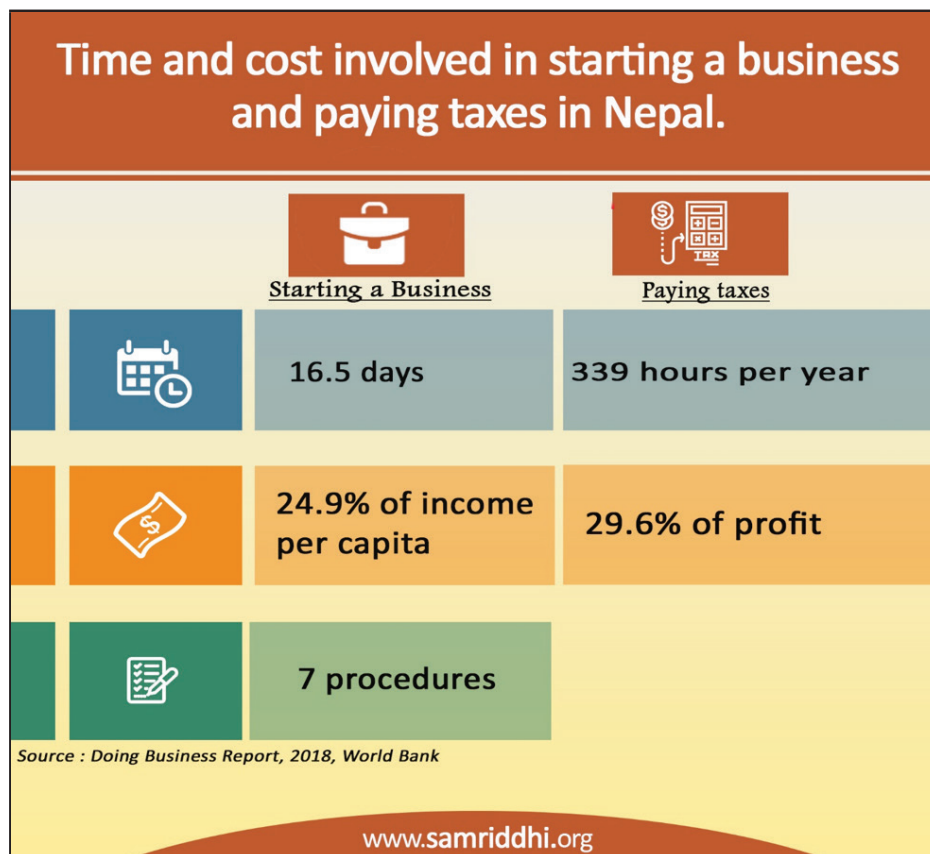
license. It is also required to renew the license yearly. For obtaining and renewing the license a certain sum of money is to be paid as mentioned in The Excise Duty Rules, 2002. This again directly adds to their cost.

2.2.2 Lack of proper flow of information

Upon interviewing, several microenterprises operating in the service sector lack proper information regarding the full process of registration of their business. They were unaware of the various regulations to be met in order to complete the process of business registration. Also, micro entrepreneurs are not in a position to trade their time for searching all the relevant information as it further adds to their list of costs. As there is no mechanism for proper flow of information, these enterprises may unknowingly be operating informally or semi-formally.

2.2.3 Lack of Inter-Departmental Coordination

There is lack of inter-departmental coordination among the departments and agencies involved in the business registration process as there is no mechanism by which these agencies can share information among each other. Furthermore, the onus of keeping records and evidence of completion of the steps above lies completely on the entrepreneur than on the government. Had there been an apparatus to share such document, it would have been a great relief for those entrepreneurs as one department could send the documents provided by the entrepreneurs to all other departments, relieving them from the burden of having to submit same documents again and again.



3.1 Types of Taxes

Like most other enterprises, micro enterprises operating in the service sector also have to pay income tax to the central tax authority i.e. the IRD. IRD collects taxes through the Inland Revenue Offices and Tax Payer's Service Offices located at different places around the country. There are three types of income-based taxes that the service sector micro entrepreneurs are liable to pay as per the nature and size of their respective businesses. Additionally, the entrepreneur will have to pay business taxes to the respective municipal/ VDC office.

3.1.1 Income tax to be paid on instalment basis

This tax is applied to the income of the business. This system of taxation requires the micro entrepreneurs in the service sector to deposit the tax amount of a fiscal year in three instalments. The entrepreneurs have to estimate their annual income and deposit prescribed percentage of the estimated tax amount in three instalments.

Table 4: Income tax to be paid on instalment basis

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

Source: Income tax Act, 2058

In this method of payment of income tax, the percentage of tax to be paid depends upon the nature of the enterprise. If the enterprise is registered as a partnership-based enterprise, 25 percent flat income tax is levied, whereas if the enterprise is registered as a sole-proprietor enterprise, the progressive system of taxation is applicable. The following table show the details of the progressive income taxation system.

Table 5: Income tax rates for various income levels

Business 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
NPR 0- 350,000	NPR 0- 400,000	No taxes
For above NPR 3,50,000	For above NPR 400,000	15 percent tax rate
For above NRs 450,000	For above NRs 500,000	25 percent tax rate
For Income above NRs 2,500,000		25 percent tax rate + (40 percent of the 25 percent tax rate)

Source: As per Finance Act 2016/17

While paying each instalment of the taxes, the entrepreneur has to estimate the income and taxes to be paid through a self-assessment process and fill up the details of the estimated amount of income tax to be paid in every instalment in a prescribed form and pay accordingly. Furthermore, the entrepreneur will also have to submit the details of actual income and tax liabilities by filling up the prescribed form within 3 months after the end of the fiscal year. Additionally, auditor examined balance sheet, Profit & Loss statement, Business cash-flow, Accounting policy and Audit report are also mandatorily required during annual tax filing.

If the estimated income tax that has to be paid turns out to be more than the actual one, the amount will be credited into the entrepreneurs account and will be reduced from the next year's tax balance. However, if there is an underestimation of more than 10 percent, the entrepreneur will have to pay an additional 15 percent rate of interest along with the deficit amount.

3.1.2 Presumptive tax system

Presumptive tax system has been introduced with an aim to ease and facilitate tax payments to the micro tax payers. The instalment-based tax system is very cumbersome in the sense that the income taxes are to be paid on 3 instalments during which the details of the estimated income have to be submitted. Again, the details of the actual income are also to be submitted along with all other documents as mentioned above. This discourages the entrepreneurs, especially the small and micro to pay the taxes.

The service sector businesses with an annual transaction of up to 2 million rupees and income of 200,000 rupees and registered as sole-proprietor enterprise could opt for the Presumptive tax regime. In this system of taxation, the sole-proprietor has to submit the details of his/her annual transaction and income by filling up a prescribed form at the end of the fiscal year. Upon meeting the criteria (s), he will have to pay certain amount of money as tax depending upon the location.

Table 6: Presumptive income tax based on location

Location	Amount of Presumptive tax
Metropolitan or Sub- Metropolitan Area	Rs.5000
Municipal Area	Rs.2500
Outside of the Metropolitan, Sub- Metropolitan and Municipal Area	Rs.1500

Source: Income tax related brochure, IRD

3.1.3 Turnover Tax System

Turnover system of taxation²² has been introduced for the facilitation of payment of taxes to the taxpayers who are comparatively bigger than the ones on the Presumptive tax category. According to the Finance Act, 2073, the enterprises operating in the service sector are liable to pay 2 percent of the total annual transaction as Turnover tax.

However, there seems to be problem in the provision regarding the Turnover tax system pertaining to service sector enterprises. As mentioned, service enterprises having an annual transaction of more than NRs. 2 million to the amount up to which registration in VAT is not mandatory, can file tax under this system. However, there is a provision that the service-based enterprises having an annual transaction of more than 2 million rupees have to mandatorily get registered in VAT. So, the laws seem to be contradicting and confusing.

3.2 Problems with taxation system

3.2.1 Involvement of multiple agencies

Again, for payment, the micro entrepreneurs would have to visit two different government authorities. For the payment of income taxes/ turnover tax/ presumptive tax one has to go to the IRO, follow all the legal procedures and pay taxes accordingly. Furthermore, he/she will also have to go to the local authority for the payment of business tax. This has again caused duplication in the work. This also reflects lack of co-ordination between the central level authority and local authorities.

3.2.2 Discriminatory laws

The provision of paying presumptive and turnover tax, which is relatively easier as the detailed accounts and audits are not required, is only applicable to the sole-proprietor service micro enterprise and not to the partnership one. Even though the objective of these tax systems claim to facilitate payment of taxes to small businesses with low transaction, the small partnership businesses with low transactions are restricted from these systems of taxation. Thus, these systems do not seem to fulfil their actual objective and are hence, discriminatory.

3.2.3 Multiple taxation regime

One important problem that has been identified is the existence of various forms and systems of taxes (presumptive, turnover, progressive) to be paid in multiple instalments, taxes to be paid in a single instalment; various types of excise registration and fees, etc. The existence of multiple systems may create confusion, especially among the micro entrepreneurs because neither are they able to understand the category they fall into and the tax systems that they have to follow, nor are they financially capable to spend money on hiring an expert who could deal with these matters.

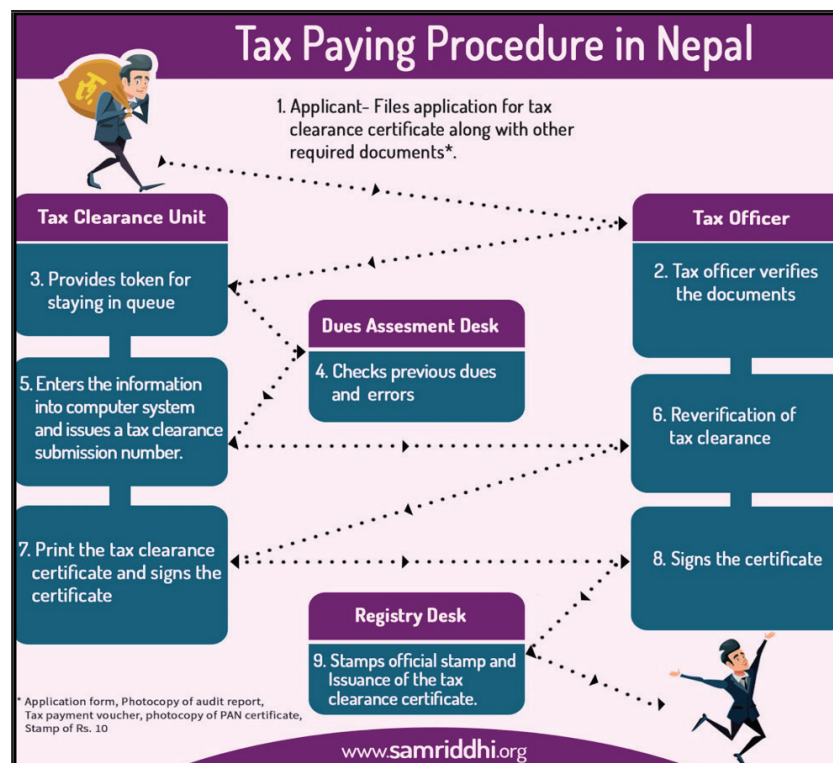
²² Applicable to the enterprises having an annual transaction of more than NRs 2 million to the amount up to which registration in VAT is not mandatory

3.2.4 Policy Disharmony

The Industrial Enterprise Act, 2016 provides an income tax exemption to the micro enterprises for a period of five years (from the date of their operation). However, the authority responsible for the implementation of this provision i.e. the tax authority complies with the Finance Act and Income Tax Act. Since the following acts have not been modified as per the new Industrial Enterprise Act, the tax exemption policy is largely being left out during implementation. The disharmony thus, creates confusion among the micro entrepreneurs as they may face a hard time, adding to their reluctance to register the business.

To summarize, existing literature explains that excessive regulations and numerous compliances to be met are the primary causes that induce enterprises to operate informally. Furthermore, the entry and tax regulations and various compliances to be met by service sector enterprises in Nepal are cumbersome and are out of reach for the local entrepreneurs, with a similar case in the taxation regime.

As mentioned above, high barriers to entry manifested in the form of high cost of registration, complex registration procedure and licensing process, multiple agencies to be visited for getting the business registered, taxation regime which is difficult to understand and uneasy mode of payment of taxes are the primary reasons behind the micro enterprises operating in the informal economy. The entry regulation and taxation regime are also characterized by all of these aforementioned factors that induce informality. Thus, we can conclude that these are the potential factors behind operation of large informal sector in Nepal.



Restructuring Due to Change in Government Structure

The federal structure of the country ushers in a new policy regime for enacting policy in the country. Under the new system, as per the Constitution of Nepal²³, a joint concurrency between the Federation and State is largely in-charge of contracts, partnerships, bankruptcy and insolvency. Also, within the shared competency are matters related to labour laws, employment and professional occupations. The states have been given the exclusive power over businesses and trade. No provision directly addresses micro or small enterprises so the above can be deduced through the legislative lists as detailed in Schedules 5-9.

On the contrary, the taxes pertaining to the sector are collected by multiple jurisdictions as defined by the same schedules. Business tax is collected by the local government while corporate income tax lies under the prerogative of the federal government. A micro enterprise (as explored earlier) also has to pay several other taxes which include land, property, VAT, fee and registration costs; divided amongst the three jurisdictions as given below;

Table 7: Distribution of taxation between jurisdictions ²⁴

FEDERAL	STATE	LOCAL
Customs and Excise	Land registration	Land and Building Registration Fee
Value Added Tax	Motor Vehicle Tax	Motor Vehicle Tax
Corporate Income Tax	Entertainment Tax	Service Charge
Service Charge, Fee	Service Charge, Fee	Business Tax
Penalty	Penalty	Land Revenue Collection
		Penalty

Source: Constitution of Nepal, 2015

While formalization numbers at a record low are available, primary reason for the unavailable means of deduction, several other aspects of the sector should be taken into consideration while initiating a reform on the subject. Sustainability of micro enterprises is as important as promoting the initial entrepreneurial entry benefits. A sick micro enterprise²⁵ would not necessarily aim to achieve the same goals as envisioned by policy makers. Hence, analysis on the growth models and sustaining microenterprises is an equally important dimension to be considered.

The microenterprise spread over Nepal averaged approximately 20 percent as recorded in 2012 with the highest concentration in the central development region (29.2 percent) while the lowest

²³ Constitution of Nepal 2015, promulgated September 20, 2015

²⁴ As per Schedules 5-9, Constitution of Nepal, Government of Nepal

²⁵ A Micro or Small Enterprise may be said to have become sick, if (A) Any of the borrowal accounts of the enterprise remains NPA for three months or more OR (B) There is erosion in the net worth due to accumulated losses to the extent of 50percent of its net worth during the previous accounting year: Reserve Bank of India, Guideline

lay in the far-western region (14.2 percent). Classification of the political landscape since then has seen a change given the promulgation of the new constitution. Thus, a revised landscape map of the microenterprise would significantly aid the policy makers at the local level to further refurbish the policy in their respective jurisdictions.

Table 8: Geographical Distribution of Micro Enterprises in Nepal (1998-2011) ²⁶

Region	State	Total	Percentage
Eastern	1,2	9225	17.3
Central	2,3	15573	29.2
Western	4,5	7990	15
Mid-western	5,6	13038	24.4
Far-western	7	7519	14.1
Total		53345	100

Source: Micro Enterprise Development Programme (MEDEP), 2011

Given the current geographical overlap of the regions with the current administrative-geographical arrangement of Nepal, the following jurisdictions would be encompassed as above. Due to ambiguity in the administrative differences, no conclusion can be studied to design policy in the current government format.

²⁶ Micro Enterprises Survey, 2009, Microenterprises Development Programme, 2012

From our analysis, we can conclude that the problem lies in the existing policy and regulatory regime which are not enterprise friendly. The entry and tax regulations are such that they do not favour registration of the informal service enterprises. From the evidences observed in various countries, we can also conclude that reforms in tax system and entry regulations can have positive impact on the formalization process. Thus, from the analysis of Nepalese regulatory regime and international practices, we attempt to provide some of the recommendations to improve the entry and tax regulation and thus, to facilitate formalization of the informal firms.

5.1 Recommendations for Easing Registration

5.1.1 One- window service centre

Establishment of one window service centre, as in the case of Brazil (One stop shop) comprising the representatives from all the relevant government agencies would significantly reduce the time and effort required for formalization of micro enterprises operating in service sector. Apart from saving time and effort, when all the service related to business registration are provided from one single place, the entrepreneurs will not have to search for the information and find out the required agencies where the enterprise is to be registered, thus solving the problem of lack of proper knowledge and information regarding enterprise registration.

5.1.2 Going Digital

Other potential way to facilitate entry and formalization of the service sector enterprises is making the business registration and tax registration process electronic. If the registration of the enterprises through an online platform is made available, the entrepreneurs do not have to be physically present to submit the required documents in order to get their business registered. However, there must be provision of digital signature and electronic payment for the success of online registration.

Although, some of the government enterprises claim to have gone digital, they still do not accept the digital signature. Due to this, the entrepreneurs have to be physically present at the concerned office to sign all the submitted documents. The Office of Controller of Certification (OCC), the responsible agency for regulating the digital signature, needs to co-ordinate with other government agencies in order to build the infrastructure and capacity of these government agencies for proper implementation of digital signature.

5.2 Recommendations for improvement in tax system

5.2.1 Making provision of a single system of taxation

It would be much comprehensible and easier for the entrepreneurs if there were a single system of taxation. A flat income system can be a very effective measure to do so as it is easier to calculate

the tax to be paid by the enterprises of any income category. In addition to that, it will increase the administrative efficiency as the administrator will not have to look into all the details of the enterprises, categorize them and make them understand the different systems of taxation and the category in which they fall in. Thus, it will be efficient and easy for both, entrepreneurs and the administrators.

5.2.2 Harmonization of policy

As mentioned above, the disharmony in policy creates confusion among the entrepreneurs. Therefore, the harmonization of policies is a current necessity. The cause of this disharmony is the lack of co-ordination among the concerned government agencies. In the case of income tax exemption, the lack of co-ordination between the Ministry of Industry and Ministry of Finance has hindered the smooth and proper implementation of the policy thereby creating confusion and distrust among the entrepreneurs towards the government. Therefore, proper co-ordination and policy harmony is a must.

5.3 Recommendations for facilitation in the new federal setup

Since no law besides the Local Governance Act, 2017 is available for cross-verification, ambiguity prevails of the exact inter-relationship of these jurisdictional functions. Answers on the exact procedural changes would have to be laid to help transfer microenterprises into the formal sector. The following recommendations within the aspect would help aid the entrepreneurs, both new and existing, easing burden and avoiding time-costs:

5.3.1 Long Period Licensing

Post registration, Micro enterprises should be considered for three to five-year time period licenses to avoid the annual renewal fee. This would help ease the entrepreneur to comply with the regulatory frameworks timely and allow them to adapt to the structure while aiding them to integrate in the formal system. Furthermore, it would also incentivise these enterprises towards formalization adding to a symbiotic benefit to the owner and the government. Similarly, protection against payment delays should be considered given the erratic complexity of the government structure.

5.3.2 Information Utility Service

A potential problem, identified earlier, was the lack of procedural and compliant information amongst the micro enterprises. With the new government design in place, complexities are further added leaving the entrepreneurs clueless on the different procedures to be followed. This potential lack of information could also result in firms not meeting rules and procedures devised by the government. This could further cause conflict given anomalies in catering to the rule of law.

5.3.3 Additional Benefits

Even though, micro enterprises have been provided a five-year tax-free scheme, the same is an incentive of the erstwhile government architecture. Other modifications which might provide for extra tax breaks for showing growth and performance, graduation from the micro to small enterprise category etc. would significantly incentivise for enterprises towards formalization while also laying ground for sustainability. Since, business tax comes under the purview of the local governments, variations of the policy would help to deduce the best practise to be followed to achieve growth from the sector.

5.3.4 Empowering Local Governments

Microenterprises, specially within the service category cater to a small jurisdictional space which significantly reduces the possible spill over effects of policy over a large territory unlike other small and medium enterprises. Since the federal principle of subsidiarity also recommends the lowest level to cater to policy, local governments through federal and provisional law should be encouraged to legislate and regulate microenterprises. This would also benefit the diverse differences in the range of services required by a common citizen, given the vast difference in geographical setup influencing the nature of business across Nepal.

5.3.5 Fostering Policy Linkages

While municipal units (rural and urban) are adequately sized to contain potential externalities, linkages should be fostered through the District Coordination Committees (DCC) (Article 220) to help reduce the possible spill over effects of policy changes from one municipality to another adjacent municipality. This would foster healthy competition and reduce possible cases of collusions due to changes in policy between adjoining municipalities.

5.3.6 De-concentration of Central Agencies

The three federal agencies currently in-charge of different aspects of implementation and administration of the sector would have to be de-concentrated from the unitary, central format to the provincial or local units to ease procedural compliances required for microenterprises. These include: Office of Small and Cottage Industries, Inland Revenue Office and the Excise Registration Department. Similarly, restructuring in the role of municipalities along the lines of the role played by VDCs would also be needed to ease operations.

5.3.7 Restructuring existing laws

Even though the current Industrial Enterprise Act was passed post the promulgation of the federal constitution, it fails to address the division of power amongst the provinces and local units. Hence, all laws concerning the subject should be reviewed to reflect the constitutional division of power to fully utilise the potential reasoned for the federal regime.

Micro enterprises in itself have remained an ambiguity, guised behind the larger umbrella of MSME research and statistical analysis. However, it should be noted that the micro in the group contributed to 93 percent of the total number of the group. Though the data is a result of the year 2007, subsequent impact evaluations under the Micro Enterprise Development Programme (MEDEP) have been suggesting a growth in the numbers. Moreover, the subject has been constantly studied with respect to differences in caste and gender bias research studies. However, data on the micro enterprises considerably limits to show the performance, contribution to the gross domestic product, output generated by the services, employment generated by the sector amongst others. Similarly, due to recent developments in categorization legislation, a systematic dataset exploring the same has not been formalised.

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