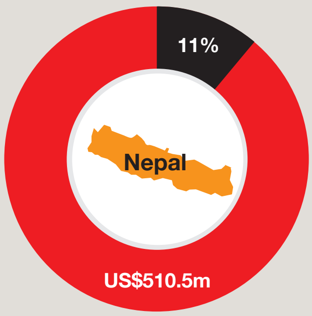
Make it Count for Girls:

Why Nepal should re-invest amounts lost to tax incentives in girls' education

Policy Brief



Nepal loses an estimated **US$510.5 million** each year to tax incentives. Just **11%** of this could educate all 283,500 girls currently out of primary school.

In Nepal, there are 283,500 girls not in primary education.

PHOTO: RASHIK MAHARJAN/ ACTIONAID

Background

Nepal ranks as one of the poorest countries in the world in terms of per capita GDP.[1] Government revenue as a percentage of GDP is around 23-24%,[2] which is similar to other similar economies in Asia[3] but significantly lower than most advanced economies that raise the equivalent of 35-36% of GDP in revenues.[4]

Meanwhile, an estimated 283,500 girls of primary school age are not in education, and 51% of adult women are illiterate.[5] According to World Bank data, until recently Nepal spent 17.1%[6] of its budget on education. However, an analysis of its 2017/2018 budget suggests that this has dropped dramatically to 9.91%.[7] Moreover, the total allocation for education in 2017/18 is a mere1.24% of Nepal's estimated GDP.[8] This is far below the 4-6% benchmark recommended by UNESCO.[9]

In order to ensure that there is sufficient funding for quality education for all, including girls, the government must prioritise education in its budgeting but also increase the overall revenue it collects. One key way of doing this will be to collect more tax, in particular by reviewing the various tax incentives it grants and the tax treaties it signs with other states.

This briefing will examine tax incentives and tax treaties in Nepal and look at what the potential revenue lost to these could have achieved if invested in girls' education. This will include looking at what the increased GDP growth resulting from more girls entering education is likely to be.

1. See CIA World Factbook, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html#tz
2. See IMF data, http://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?sy=2015&ey=2022&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=55&pr1.y=10&c=558&s=NGDP_RPCH%2CGGR_NGDP&grp=0&a=
3. See IMF data, http://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?sy=2015&ey=2022&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=51&pr1.y=17&c=505&s=GGR_NGDP&grp=1&a=1
4. See IMF data, http://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?sy=2015&ey=2022&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=51&pr1.y=17&c=505&s=GGR_NGDP&grp=1&a=1
5. World Bank data, see http://datatopics.worldbank.org/education/country/nepal
6. See World Bank data, http://datatopics.worldbank.org/education/country/nepal
7. See 2017/18 Budget Speech. http://www.mof.gov.np/uploads/document/file/Budget_Speech_207475_20170530011441_20170601052107.pdf See also 'Budget 2017/18: Educational Perspecitve' by the National Campaign for Education Nepal
8. The budget allocation for education is R66.12bn, the equivalent of US$631.87bn using December 2017 exchange rates. With the IMF estimating the overall annual GDP at US623.31, the budget allocation is 2.7% of total GDP.
9. See UNESCO, https://en.unesco.org/news/key-milestones-reached-new-education-goals-0

Key figures

Number of girls not in primary education	283,500
Percentage of GDP spent on education	2.7%
Estimated revenue lost to tax incentives and tax treaties	US$510.5m
Annual cost per pupil to government	US$91.11
Annual cost per pupil to family	US$103.36
Total annual cost per pupil – government and family contributions combined	US$194.47
Percentage of total cost per pupil paid by parents	53.14%
Cost per year of educating all girls not currently in primary education	US$55.13m
Additional GDP per year per girl who has completed (as opposed to not completed) primary education	US$118.59
Total additional GDP per year if all girls currently not in primary education had completed primary education	US$33.62m
Total additional GDP over a 45 year working life (at current prices, not adjusted for inflation) if all girls currently in primary education had completed primary education	US$1.51bn

Tax incentives

A tax incentive (also known as a tax break) is, in essence, a special tax deal given to a company to encourage it to invest. There are many kinds of tax incentives, but they can broadly be placed into two categories: ***statutory***[10] tax incentives that are open to all companies that meet certain criteria; and ***discretionary***[11] tax incentives that are bespoke deals for an individual company.

Tax exemptions in Nepal: STATUTORY

The statutory Corporate Income Tax (CIT) rate in Nepal is 25%, apart from the cigarette, alcoholic beverage and financial companies who pay 30%. Below are some examples of industries that receive lower CIT rates.

- 0% CIT on electricity generation and distribution for the first 7 years of operation, then half of normal CIT rates for a further 3 years.[12]
- 0% CIT for 7 years on oil and natural gas operations that start commercial operation before April 2019, then halved rates for a further 3 years.[13]
- Income from the export of an intellectual asset is taxed at 75% of the normal rate, and the sale of an intellectual asset at 50% of the normal rate.[14]
- 20% CIT for special industries (manufacturing industries except tobacco and liquor related industries).[15]
- 20 percent income tax limit is applicable for power development and transmission.[16]
- 20% CIT is applicable for export income.[17]
- Industries that establish activities in 'underdeveloped areas' pay 10-30% of normal CIT rates for the first 10 years of operation.[18]

The government of Nepal loses US$510.5m every year to harmful tax treaties and incentives.
PHOTO: RASHIK MAHARJAN/ACTIONAID

10. **Statutory tax incentives -** These apply to companies that meet certain criteria, generally because they are operating in a sector that the government wants to encourage, are producing for export, or are located in a particular area, particularly special economic zones. In addition to reductions or exemptions from corporation tax, companies are sometimes exempt from withholding taxes on payments abroad; trade taxes on imports and exports; VAT on imports etc.
11. **Discretionary tax incentives -** These are specific to a particular investor, and are negotiated between the company and the government, and generally only available to large multinational investors, putting domestic businesses at a distinct disadvantage. Many of the most unfair examples are found in the contracts negotiated between governments and investors in the extractive industries (oil, gas and mining).
12. See p. 15, T R Upadhya & Co., Chartered Accountants http://www.trunco.com.np/publications/Nepaltaxreport2016.pdf
13. See p. 16, T R Upadhya & Co., Chartered Accountants http://www.trunco.com.np/publications/Nepaltaxreport2016.pdf
14. See p. 16, T R Upadhya & Co., Chartered Accountants http://www.trunco.com.np/publications/Nepaltaxreport2016.pdf
15. Sharma. C. (2015). Tax Incentives in Nepal: An Overview. IMF Seminar paper. Retrieved from https://www.imf.org/external/np/seminars/eng/2015/asiatax/pdf/sharma.pdf
16. Sharma. C. (2015). Tax Incentives in Nepal: An Overview. IMF Seminar paper. Retrieved from https://www.imf.org/external/np/seminars/eng/2015/asiatax/pdf/sharma.pdf
17. Sharma. C. (2015). Tax Incentives in Nepal: An Overview. IMF Seminar paper. Retrieved from https://www.imf.org/external/np/seminars/eng/2015/asiatax/pdf/sharma.pdf
18. See p. 15, T R Upadhya & Co., Chartered Accountants http://www.trunco.com.np/publications/Nepaltaxreport2016.pdf

Special Economic Zones (SEZs)

The SEZs provide a number of different incentives. These include:

- CIT is exempt for the first 5 years of operation. For the next 5 years, companies only pay half of what the relevant rate at the time is. If the investor buys more than 60% of its raw materials domestically, the halving of the CIT extends to 10 years after the initial 5-year period.[19]
- If, however the company is operating from a SEZ in a mountainous or hilly area, the initial tax holiday will be for a full 10 years, and then for the next 10 years CIT will be halved.[20]
- Dividends from companies in SEZs are exempt from tax for the first 5 years, and then halved for the next three years.[21]
- Complete exemption from Value Added Tax (VAT).[22]
- Targeted exemptions from excise duty.[23]

Tax incentives Nepal: DISCRETIONARY

Nepal has in recent year been hit by a number of tax scandals, including one involving the largest telecoms provider (with a European company as the majority stakeholder) being accused by the Auditor General of avoiding huge sums of money through advanced tax planning involving Cypriot subsidiaries;[24] and another in which the so-called Tax Settlement Commission effectively agreed to exempt companies from an unpaid tax bill totaling US$202m.[25] The latter could be seen as a tax exemption as it exempts companies from paying tax they are liable for, however for the purposes of this briefing we will not include that figure in the estimated loss from tax incentives as it refers to sanctioned non-payment of tax rather than a pre-operations agreement that a certain company is exempt from or enjoys lower rates of certain taxes.

Due to the secretive nature of discretionary tax incentives, we do not have a total overall figure for amounts lost to these in Nepal. However, the total estimated loss to both discretionary and statutory tax incentives is likely to be an underestimation of the true scale of the problem.

Tax incentives Nepal - total estimated losses

According to a report by the Nepalese Auditor General, losses to tax incentives during the 2016/2017 tax year totaled US$510.5m[26] (using November 2017 exchange rates). This was the equivalent of 10.3% of total tax revenues that year.[27] This figure does not include discretionary tax incentives given to individual companies or tax losses from the SEZs, as relevant data to calculate such tax losses is not publicly available. The overall figure is therefore likely to be higher.

Total estimated loss from tax incentives: US$510.5m

Every child has a right to education.
PHOTO: RASHIK MAHARJAN/ACTIONAID

19. See article 27(2) Special Economic Zone Act 2016: http://www.seznepal.gov.np/downloads.php?id=7
20. See article 27(2) Special Economic Zone Act 2016: http://www.seznepal.gov.np/downloads.php?id=7
21. See article 27(3) Special Economic Zone Act 2016: http://www.seznepal.gov.np/downloads.php?id=7
22. See article 28 See Special Economic Zone Act 2016: http://www.seznepal.gov.np/downloads.php?id=7
23. See article 29 See Special Economic Zone Act 2016: http://www.seznepal.gov.np/downloads.php?id=7
24. See 54th report of the Auditor General http://www.oagnep.gov.np/downloadfile/annual%20audit%20report_english%20version_1503298234.pdf
25. See 54th report of the Auditor General http://www.oagnep.gov.np/downloadfile/annual%20audit%20report_english%20version_1503298234.pdf
26. See 54th report of the Auditor General http://www.oagnep.gov.np/downloadfile/annual%20audit%20report_english%20version_1503298234.pdf
27. See 54th report of the Auditor General http://www.oagnep.gov.np/downloadfile/annual%20audit%20report_english%20version_1503298234.pdf

Tax treaties

Tax treaties determine how much, and even if, countries can tax multinational companies. They provide certainty to international businesses by indicating which taxes will be limited when making money overseas. This certainty is often provided through restrictions on the rights of the treaty signatories to tax different types of income. In the overwhelming majority of cases, these tax treaties override any national law. If a tax treaty rate is lower than the rate set in national law, companies that are able to use the tax treaty route will very often pay less tax than similar local companies. Tax treaties can also prevent double taxation.

Tax treaties can restrict the ability of a country like Nepal to tax multinationals in a number of ways, including the way that capital gains are taxed and when Nepal can tax the profits of a company – so-called permanent establishments. The tax loss attributable to these provisions in tax treaties can be difficult to quantify. The fact that this briefing will not attempt to quantify such tax losses does not mean that they may not be significant. In fact, ActionAid analysis in 2016 showed that Nepal's tax treaty network often limits its ability to tax capital gains made by foreign entities. Meanwhile, several permanent establishment provisions in the tax treaties Nepal has with other countries limits its ability to tax the business profits of foreign entities.[28]

Tax treaties can also restrict a country's ability to charge withholding taxes when money is being transferred out of a country, e.g. as dividends, interest payments or royalty payments. It does so by applying lower tax rates on the transactions between treaty partners than it would if there was no tax treaty in place. The withholding tax rates in Nepal's tax treaties are fairly low, especially those on dividend payments. However, as the statutory withholding tax on dividend payments is only 5%, this does not give rise to any tax treaty-related tax losses. Similarly, none of the rates in Nepal's tax treaties for interest and royalty payments are lower than the statutory rate. This largely reflects the low statutory tax rates. Overall, this means that the withholding tax rates in Nepal's tax treaties do not, on their own, lead to any tax losses for Nepal.

Table 1: Withholding taxes in Nepal's tax treaties

Country	Dividends	Interest	Royalties
Statutory rates	5%	10%	15%
Austria	5%	15%	15%
China	10%	10%	15%
India	5%	10%	15%
Korea (South)	5%	10%	15%
Mauritius	5%	15%	15%
Norway	5%	15%	15%
Pakistan	10%	15%	15%
Qatar	10%	10%	15%
Sri Lanka	15%	15%	15%
Thailand	10%	15%	15%

Source tax treaty rates: https://ird.gov.np/Content/ContentAttachment/1/दोहोरोकरमुक्तिथावत्तियिछलनरिाध8122016105226AM.pdf

Most children out of school are girls.
PHOTO: KARIN SCHERMBRUCKER/ACTIONAID

28. See 'Mistreated' dataset http://www.actionaid.org/publications/mistreated-tax-treaties-are-depriving-worlds-poorest-countries-vital-revenue

Education

Everyone has a right to education. This is a right enshrined in international human rights treaties from the Universal Declaration of Human Rights (article 26)[29] through to the International Covenant on Economic Social and Cultural Rights,[30] the Convention on the Rights of the Child[31] and many others. To be clear – countries should invest in girls' education because girls have a right to education.

However, in addition to the rights perspective, there is also an economic argument for investing in girls' education. A more highly educated population is likely to be more productive and to generate higher economic growth. Below are some calculations of what the growth dividend of investing some of the money lost to tax incentives and tax treaties in girls' education would be.

According to UNICEF data, an estimated 577,000 children of primary school age in Nepal are not in education. Assuming half of these are girls, we can estimate that approximately **283,500 girls of primary school age are not in education.**[32] There are many reasons why girls might not attend school. For the purposes of this calculation, we will assume as a starting point that with the right financial support, all of these girls would complete their primary education. This will provide us with illustrative headline figures that we can work backwards from.

According to research commissioned by ActionAid, Nepalese families spend an estimated **US$103.36**[34] per year, per pupil in school[35] (using November 2017 exchange rates). According to the research, the majority of the money was spent on admission, notebooks, school uniforms and exam fees.[36] Meanwhile UNESCO data for 2015 concludes that the Nepalese government spends on average **US$91.11** per pupil (at November 2017 exchange rates). Separate UNESCO data also confirms that families in Nepal spend more on a pupil's education than the state does.[37] The total combined expenditure per pupil is therefore **US$194.47.** The total cost at current expenditure levels to educate the 283,500 girls of primary school age currently not in education would therefore be **US$55.13m**, around a tenth of Nepal's tax incentives losses.

We will now calculate the growth dividend from investing in girls' education and compare this to the estimated cost of educating every girl of primary school age not currently in education. A working paper for the World Bank developed methods for estimating the growth dividend of investing in girls' education.[38] The paper looks, amongst other things, at the productivity of those girls *with* primary school education as opposed to those without. In doing so, the paper factored in a number of variables such as the effect of productivity if there was an increase in labour supply; and also for that for girls currently not completing primary education there may be factors other than education preventing them from reaching the same level of productivity as those girls who *do* currently complete primary school.

The study uses data from the IMF, the ILO, the World Bank and others to calculate the increased productivity per girl who has completed primary education in seven developing countries. The average of these seven countries is a **productivity gain of 14.85% when girls complete primary school** as opposed to when they do not. As the study does not look specifically at Nepal, for the purposes of this briefing we will use the developing country average as a proxy for the productivity gain in Nepal. With current GDP per capita estimated by the IMF at US$798.61,[39] a 14.85% increase in productivity would

29. See Universal Declaration of Human Rights http://www.un.org/en/universal-declaration-human-rights/
30. See the International Covenant on Social, Economic and Cultural Rights http://www.ohchr.org/Documents/ProfessionalInterest/cescr.pdf
31. See the Convention on the Rights of the Child http://www.ohchr.org/Documents/ProfessionalInterest/crc.pdf
32. See UNICEF's 'All Children in School – Nepal Case Study' (2016) phttp://unicef.org.np/uploads/files/927615134285223000-all-children-in-school-report-2016.pdf
33. See 'Tax Loss and Education', study commissioned by ActionAid and carried out by NEAT (2017). Estimate not disaggregated for primary vs. secondary school students
34. Note that UNESCO has this figure slightly lower for public schools but much higher for private schools: http://uis.unesco.org/sites/default/files/documents/who-pays-for-what-in-education-national-revealed-through-accounts-2016-en_0.pdf
35. See NEAT study 2017
36. See NEAT study 2017
37. See UNESCO data: p. 4 http://uis.unesco.org/sites/default/files/documents/who-pays-for-what-in-education-national-revealed-through-accounts-2016-en_0.pdf
38. See 'Measuring the Economic Gain of Investing in Girls: The Girl Effect Dividend' by Jad Chaaban Wendy Cunningham, 2011. Policy Research Working Paper 5753.
39. See IMF data: https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?sy=2015&ey=2022&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=82&pr1.y=12&c=558&s=NGDPDPC&grp=0&a=

mean each girl who completed primary education would add an additional **US$118.59** to the Nepalese economy annually. Collectively the 283,500 girls currently not in primary education would add **US$33.62m** to the Nepalese economy annually. Current annual GDP is estimated by the IMF to be US$23.31bn,[40] meaning getting all age-relevant girls currently not in education through primary school would add **0.14%** to the Nepalese economy each year.

Provided a working life of 45 years, in current prices (not taking into account inflation), the added value to the economy of educating these girls would be **US$1.51bn.** Meanwhile, the compound effect of the annual increase in GDP from investing in the education of girls currently not in the education system over a working life would be **6.50%.**[41]

Governments must prioritise funding for girls' education.
PHOTO: RASHIK MAHARJAN/ACTIONAID

40. See IMF data: https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/weorept.aspx?sy=2015&ey=2022&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=24&pr1.y=11&c=558&s=NGDPD&grp=0&a=
41. In the desirable but unlikely event that all of the girls currently out of school completed not just their primary education but also their secondary education – and using the World Bank paper's (Chaaban and Cunningham, see above) calculation that completing secondary education (as opposed to completing neither primary nor secondary education) leads to a productivity gain of **32.7%** per girl, which in turn – using the methodology described above – would lead to an estimated **US$261.15** increase in productivity per year per girl. This would result in a collective **US$74.04m** or **0.32%** increase in GDP per year, or a compound **15.46%** over a 45-year working life.

Conclusions and recommendations

This paper has shown that Nepal loses an estimated US$510.5m of tax revenue annually to tax incentives, and is likely to incur further tax losses from its tax treaty network. Meanwhile, approximately 283,500 girls of primary school age are not in education. ActionAid's research has found that parents pay roughly half of the total annual costs of education per pupil which is estimated at US$194.47. The total annual cost of educating all the girls currently not in education is estimated at US$55.13m, barely more than a tenth of Nepal's tax losses to tax incentives.

While the primary reason ActionAid advocates for greater investment in girls' education is because it is a fundamental human right, this paper demonstrates that doing so is also beneficial to the economy as there is a long-term growth dividend to be had from investing in girls' education that far out-strips any costs involved. In fact, by ensuring that all girls currently not in education finish primary school, Nepal could see a growth dividend of US$118.59 per year from their increased productivity, or US$1.51bn over a 45-year working life.

Nepal must invest more in girls' education, and by addressing its tax regime it has the opportunity to raise the revenues needed to do so.

With this in mind, ActionAid urges the government of Nepal to:

1. **Act** swiftly to reduce the amount of tax revenue forfeited to tax incentives.

2. **Stop** offering harmful tax incentives and only other incentives selectively to facilitate development. All current tax incentives – including discretionary tax incentives and those applicable to special economic zones – should be reviewed to assess whether they are fit for purpose, including undertaking a cost-benefit analysis.

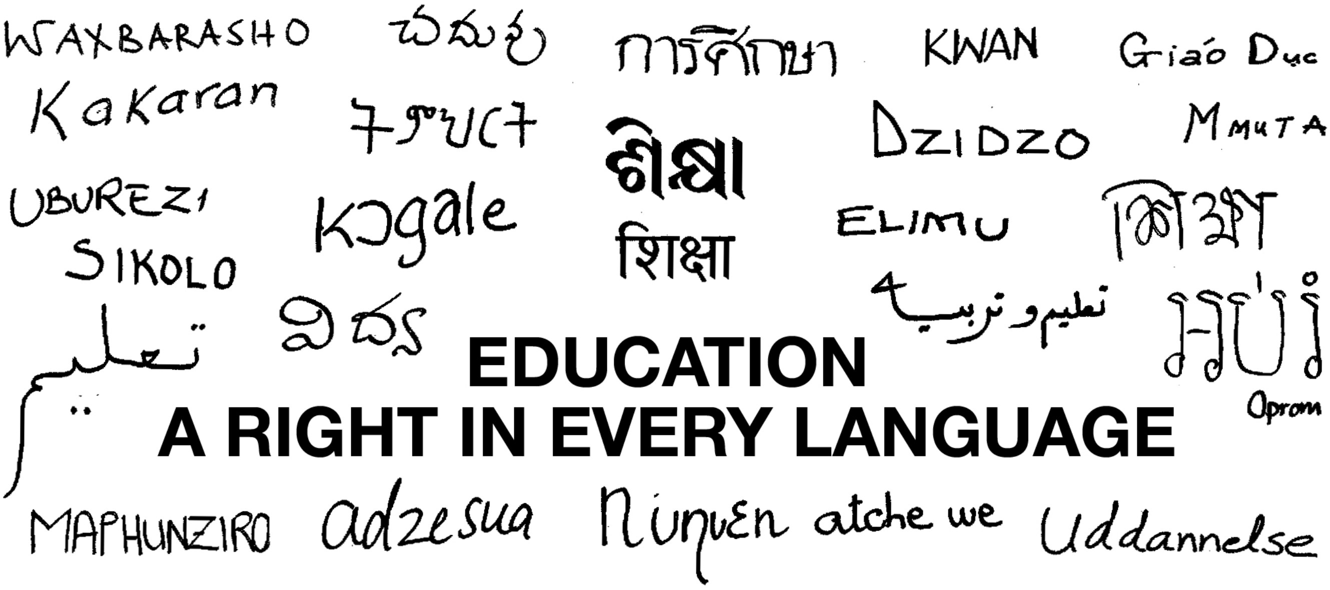
3. **Subject** all tax incentives – both statutory and discretionary – to public scrutiny, including by parliament, media, civil society and citizens. This should include publishing an annual overview of the costs of tax incentives as part of the annual budget, so the public can see the impact of corporate tax incentives.

4. **Review** tax treaty networks – as well as current withholding tax rates, e.g for dividend and interest payments abroad - to ensure that they do not result in tax losses and renegotiate those that do. Cancel or renegotiate disadvantageous tax treaties.

5. **Invest** 20% of the tax revenue raised by reducing tax incentives and tax treaty regimes in education, especially girls' education.

6. **Ensure** that public education is free, compulsory and of good quality and that there are no economic barriers that might prevent families sending their girls to school.

7. **Ensure** that education budgets are gender-sensitive and that adequate financing is available for measures proven to tackle persistent barriers to girls' education.



EDUCATION
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International Registration number: 27264198

Website: **www.actionaid.org**
Telephone: **+27 11 731 4500**
Fax: **+27 11 880 8082**
Email: **mailjhb@actionaid.org**

ActionAid International Secretariat,
Postnet Suite 248, Private Bag X31, Saxonwold 2132,
Johannesburg, South Africa.

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This briefing was written by Anders Dahlbeck in collaboration with Mark Curtis and NEAT with input from Asmara Figue and staff at ActionAid Nepal and ActionAid International.