CHAPTER I

INTRODUCTION

1.1 Background of the Study

Tax is a compulsory contribution to the government made without reference to a particular benefit received by the tax payer. It is a personal obligation to pay tax and there is no direct relationship among tax, benefit and individual tax payers .According to Adam smith "Tax is a contribution from citizens for the support of the state". It affects the overall structure of the whole economy. It has some goals to transfer from private to the public sector, to distribute the cost of government fairly by among people and to promote economic growth stability and efficiency.

Economic development has been one of the most popular slogans in almost all the developing countries all over the world. Similarly, achievement of high rate of economic growth rate, reduction of income disparities and poverty and improvement of living standard of people are some of the development strategies towards which most of the government's efforts have been directed in developing countries. It is known that government needs more revenue for overall economic development and state welfare. Besides this, for meeting day to-day expenditure, government also requires some sources of income, these are the challenging tasks, which demand increasing necessity of regular expenditure in general and development expenditure particular. However, resource mobilization is very low, compelling the government to depend on foreign assistance heavily (Parajuli, 2009). Development expenditure has been dependent almost entirely on foreign aid. We know, external assistance is uncertain, inconvenient and not good for healthy development. Foreign aids are not bad for economic development of the nation, but the experience of most of the developing countries shows that there are negative effects of increasing international grants and loans to finance and the public development activities. Thus, the government should depend on its own resources for generating revenue to spend these regular as well as development activities.

The government collects the revenue from the different sources such as taxes, fees, penalties, grants, loans etc. However, across all the sources of collecting the public revenue, taxation is the main source. It is a key instrument of collecting the public revenue. Hence, to earn the sufficient revenue, each and every government of almost all country charges tax to its people. In Nepal, there is urgent need of increasing public revenue because the demand of public funds for public expenditure is very high. Taxation is the better instruments to increase public revenue than the other sources such as deficit financing and money creation. That's why there is no any other better alternative of taxation. It is the key instrument for resource mobilization in such countries. Therefore tax yield should be responsive to the increase in GDP of the country i.e. tax revenue should be increased together as GDP increases. Hence, the researcher and academics are interested to observe whether the tax revenue of the country is increasing with the rate of increase in GDP or not, by measuring elasticity and buoyancy coefficients. Tax revenue may change due to variety of factors such as change in income, changes in legal tax base, and changes in efficiency of tax administration and collection and among others.

Developing countries like Nepal needs huge amount which can be mobilized through two sources i.e. internal sources and external sources. Internal fund are limited so most of development activities depends on the external sources. External source of financing are bilateral and multilateral aids, grants and loan from foreign countries internal source of government revenue can be divided into two parts direct and indirect tax revenue can be divided into two parts direct and indirect tax. Direct taxes are levies on income and property but indirect taxes are imposed on are person but paid partly or wholly by another person. Indirect taxes are imposed on consumption of goods and services. Similarly duties, fees, fines, royalties are source of non-tax revenue. In the internal stage of economic development indirect taxes have significant role but after a certain stage of economic development is reached direct taxes have a significant role.

Taxation is an important instrument for fiscal policy which can be used for mobilization resources for capital formation in the public sector. To raise ratio of savings to national income and thereby raise resources for development, it is necessary that marginal saving rate be kept higher than the average saving rate. By imposition of direct progressive taxes on income profits and higher rates of indirect taxes such as excise duties and sales tax on luxury goods for which income elasticity of demand is higher, the marginal saving rate can be made higher than the average saving rate. This will cause a continuous increase in the saving rate of the economy.

An important merit of taxation is the main important source of resource mobilization for development but it also cuts down consumption of goods and thereby helps in checking inflation .Whereas direct tax on income, profits and wealth reduce the disposable incomes of the people and thereby tend to reduce aggregate demand in the economy, indirect taxes directly discourages the consumption of the goods on which they levied by raising their prices.

1.2 Statement of the Problem

Economic development is the prime concern of every nation of the world. Government therefore, has to carry out various socio-economic tasks to maintain economic stability, to attain high economic growth and to maintain law and order in the country. Thus the government expenditure can increase by greater amount than the government revenue. To attain the economic growth government requires huge amount of resources to finance its developmental works. In this sense, the problem to fulfill this gap has become the major issue regarding the fiscal interaction of every developing country like ours.

Nepalese taxation is suffering from different inherent problems like increasing resource gap, domination of indirect taxes to total tax revenue, domination of tax revenue to total revenue, low responsiveness and productivity of tax yield, low tax GDP ratio, weak tax administration, narrow tax base, inelastic tax system and frequently changing tax rates. It is commonly known that resource gap has been a serious bottleneck on the process of economic development of Nepal. Nepal is indeed, facing a serious and rapidly growing financial resource gap. Its amount has been increasing from the very beginning of the budget practices. The main reason for this growing resource gap is the one sided growth of government expenditure as compared to revenue generation from domestic sources. This leads to dependency on foreign grants and loans. Foreign aid must be treated as complementary to the internal resources mobilization rather than substitutes. The efforts should be made to reduce the dependency on foreign aid due to its serious limitations. Deficit financing can be the other alternative to meet the growing resource gap but it leads to inflationary pressure. Hence, mobilization of additional resources from domestic sources seems to be the only viable long term solution to meeting this challenge of resource gap in the context of Nepal. The need has, therefore become urgent for mobilizing domestic resources. In this sense, taxation has appeared as one of the most effective fiscal policy instrument for achieving the desired development objectives of Nepal.

Developing countries like Nepal needs huge amount which can be mobilized through two sources i.e. internal sources and external sources. Internal funds are limited so most of development activities depends on the external sources. Taxation in context of many developing countries has become the ultimate method of resource mobilization. In the context of Nepal, the role of taxation has increased since the initiation of national planning in1956 for the purpose of economic development. Development however depends upon resource mobilization. And the major source of domestic resource mobilization is taxation. Government collects revenue from tax and non-tax sources. Tax is key source for revenue mobilization. Taxes are major fiscal policy instrument and important government policy tools have an important role in increasing the rate of capital formation and thereby a high rate of economic growth can be achieved. Increase in taxes may be directed to increase in saving through the postponement of consumption. To increase in saving as available for making useful and productive investments.

Therefore revenue mobilization is challenging proposition in an economy like Nepal where a majority of the people live in object poverty and the people engaged in economic activities have extremely limited taxable capacity.

1.3 Objective of the Study

The objective of the study is to examine the trend and structure of government revenue in Nepal for the period of 1990/91 to 2015/16.

1.4 Significance of the Study

Nepal is developing country suffering from the resource gap from the very beginning. The country has adopted the policy to mobilizing the internal resources to the maximum level. In present scenario, taxation has become a powerful instrument for mobilizing the resources. Since tax revenue is a major source of internal revenue in Nepal. Tax can play an important role in the process of development in developing countries like Nepal which needs higher revenue to fulfill various responsibilities. If it is properly implemented tax provides various financial needs.

Mobilization of resources is the key factor in fiscal policy implementation, especially in a developing country like ours where the demand of public funds for public expenditure is high. In this context, taxation has become a powerful instrument for mobilizing the resources. Since, tax revenue is a major source of domestic revenue in Nepal. The study simply analyzes different tax structure of Nepalese economic.

1.5 Limitation of the Study

The main limitations of the study are listed below:

a. The research covers only 26 years period data from FY1990/91 to FY 2015/16.
b. Through this is based on annual data, advanced time series econometrics tools are not applied.

1.6 Chapter Plan

This plan is divided into five different chapters. The first chapter Introduction which includes background information, statement of the problem, objectives of the study, significant of the study and limitation of the study. The second chapter is Review of Literature which deals about theoretical concept and empirical overview. The third chapter explains the Methodology employed in the present study. In chapter four Structure of Nepalese Tax systems has been studied. Finally in the last chapter Summary of Main finding, Conclusion and Recommendation are presented.

CHAPTER II

REVIEW OF LITERATURE

This chapter provides theoretical and empirical review of literature related to structure of tax in economic growth. In particular, it provides the shed on theoretical aspects of tax, its definition, principle, types and its distribution. Likewise, it reviews the journal article, aspects, published unpublished theses and dissertation.

2.1 Theoretical Review

Tax is defined as a compulsory contribution to the government made without reference to a particular benefit received by the tax payer. Primary purpose of taxation is to divert control of economic resources from tax payers to the state for its own by households and enterprises but influences the allocation of economic sources, recognizes social costs that are not reflected in market prices and affects the distribution of income and wealth (Goode, 1984). Taxes have emphasized in all countries developed as well as developing because they have the potentially for increasing the yield of tax system and achievement a system of taxation that satisfies the demand for equality and social justice (Singh, 1991).

Most of the developed countries collect 60-80 percent of internal resources from direct taxes and income tax. Unfortunately, developing countries like Nepal have to rely on indirect tax because of lack of administrative efficiency and effectiveness, lack of tax culture and awareness among the tax payers, very low level of income per capita, prevalence of black economy and due to the presence of poverty. Indirect tax has no role to reduce income and wealth inequality rather it creates excess burden and protects inefficient industries. Thus ultimately, the UDCs have to give more priority to the direct taxes. In Nepal, income tax is the third largest source of total tax revenue which is 15 billion in FY 2006/07. Thus it has been considered as one of the major element of government's revenue.

With the advent of supply side economics the role of taxation has become even more crucial. Taxation is not only an effective instrument for resource mobilization a 'boot-strap' operation for financing economic development-but also a tool-kit for revenue collection to sustain growth and maintain equity and stability in the economy. In developing economies resource gap is critical and widening resulting to huge fiscal and budgetary deficits over the year. Same holds true in Nepal. The growing resource gap is frequently off-set by mobilizing internal and external borrowing and consequently shifting the burden of debt to posterity. Therefore, revenue mobilization is challenging proposition in an economy like Nepal where a majority of the people live abject poverty and the people engaged in economic activities have extremely limited taxable capacity. In addition, legal base of taxation is compressed with unlimited tax shelters and tax administration lacks innovative mechanism to identify new taxpayers and bring them into tax-net. In recent years, unsanctioned economic activities have greatly increased resulting to poor voluntary compliance due to indifferent attitude of the taxpayers towards government spending. Nepal’s tax system is trapped into diminishing efficiency of tax administration and increasing delinquency on the part of taxpayers (Dahal, 2009).

After the great depression of 1930s the function of government has been increased considerably. For smooth functioning of government has got various sources of revenue. Tax is an important instrument of government to mobilize the resources to achieve the objectives.

2.1.1 Principles of Taxation

Equity, efficiency and administrative feasibility are there major principles of tax design for Low income countries the most important role of taxation is mobilize the resource for development. As an instrument of resource mobilization its principle function lies in raising the volume of public saving to be used for capital formation on consistent with growth of saving in the economic as a whole. The quantitative role, of tax policy for the mobilization of development finance may be considered in two aspects; static and dynamic (Tripathy, 1978).

2.1.2 Horizontal Vs Vertical Equity

The ability to pay theory satisfies the ideals of horizontal and vertical equity. Horizontal equity means equal treatment of equal and the ability theory, by charging less from the poor and more from the rich, attains it. The vertical equity meaning unequal treatment of unequal is also achieved treatment of unequal's is also achievement by the ability theory through the principle of equal marginal sacrifice or what is called the least aggregate sacrifice (Lekhi, 2004).

In simple words, horizontal equality calls for equal treatment of people in equal position. However, as cannon of equality, the concept requires that equals be treated equally. For instance, in case of income tax broad-based tax including income from all sources independent of its use. This broad definition is mostly in line with efficiency and avoidance of excess burden. We also interpret the horizontal equity as follow; all citizens of the country should pay equal amount of taxes. All tax payers with equal abilities should bear taxes. Among the three points, third one is the most relevant to the principle of horizontal equity. Vertical equity means that citizens with large income group pay more taxes than the citizens of smaller incomes groups. It thus considers that as a citizen's ability to pay increases, his taxes should be increased. In fact, nobody can question the equity the equity of proportion that a rich man should pay more taxes than a person. In case, there is any controversy, it centers on the structure of the controversy, it centers on the structure of the effective of taxes. Therefore, the problem of vertical equity is how to implement a given, presumably progressive, distribution of tax bill with a minimum of excess burden (Thapa, 2008).

2.1.3 Direct Vs Indirect Taxation

Based on these indices of ability, taxes can, most conveniently, be divided into two categories: direct and indirect tax, Direct being these levied immediately on the person, who are to bear the so levied (Hikes, 1956). In traditional Language, impact and incidence are upon the same person, the tax is said to be direct and if not, the burden is shifted and the real income of someone else is affected i.e. impact and incidence are upon different people, them the tax indirect (Walker, 1953).

Direct tax is tax which is paid by the person on whom it is imposed legally. In other words, if the incidence of a tax rests upon the person who bears its impact also, then it is called a direct tax. Therefore, the direct taxes can't be shifted to other. For example: Tax on income, production, inheritance, gift, and so on. Role of direct taxes in developing economics are discourage speculative investment, control over inflation, inducement to agriculture sector, restriction on consumption, reduction in inequalities of income and element of equality. Direct taxes like taxes on land, capital gains tax etc. are imposed to prevent speculative investment. Direct taxes are also to be used to reduce to some extent, inequalities in the distribution of income and wealth. Such tax policy will check unproductive investment and release a greater amount of resources available for productive investment. Direct taxes especially progressive taxes control inflation. Since the distinction effects of the progressive rates in the non-functional personal income are low, they would be more important for checking an inflationary pressure associated with the development expenditure. Besides the personal income taxes can be adopted to have a built-in-flexibility so as during inflationary period that a higher proportion of additional income will pass on to the government.

Indirect tax is a tax which is imposed on one person but can be paid either partly or wholly by another person. Thus in the case of indirect tax, the impact and incidence of tax can be shifted to the other person. For example, excise duty, sales taxes, import and export duties, tax on rail, bus etc. are the example of indirect tax because its burden shifted by the trader on the consumer. When an individual income changes time to time which needs to a change in the consumption land as well under such condition direct can’t serve as an index to the ability to the pay where as the indirect tax can appraise individuals changing income. Thus, under such condition indirect taxes are complementary.

2.1.4 Interventionist Vs Reductionism Approach

In shaping developing tax policy, there are mainly two approaches; Interventionist and Reductionism. The interventionist tradition represented in the early post war period by such prominent analysis's as Heller and Kaldor achievement of a variety of policy adjectives through the tax system, but it should do so. The educationist tradition, government not only cannot achieve many of the policy goals earlier postulated but should not or as the "public choice" school would a have it, will not or as they have it will not try to do so (Bird and Oldman, 1990).

A central concern of tax policy makers in Low income countries is how best to produce adequate revenues to finance public sector activities without unduly discouraging the private sector’s essential contribution growth. In this respect, traditional interventionist approach to taxation is replaced by reductionism approach, which is generally termed as supply side taxations shows clearly that in the context of

Low income countries the general direction and strategy of this approach is both widely acceptable and workable. This approach is mainly based on the idea that widespread tax evasion in Low income countries can be controlled by broadening tax bases and lowering tax rates, where the marginal rate of personal income tax is excessive. Plausible through it may appear however, it is well established in principle that there is no reason to expect lower tax rates in them to reduce evasion. In this connection the following argument is important; if evasion is cost-less, that is, the probability of detection and penalization is infinitely small as is the case in all too many countries then the mere reduction of the nominal tax rate will have no effect at all on evasion(Dahal, 2006).

2.1.5 Appropriate Tax Policy for Low Income Countries

The tax system is said to be perfect and successful only when additional revenue is mobilized without creating excess burden to the tax payers with no charge in the tax role and legal, base and with modest discretionary change attributed to improving efficiency in tax administration. The tax system in, Nepal calls for a periodic reform to ensure growth, equity and stability (Dahal, 2009).

Equity, growth, efficiency, and stability are major objectives of tax policy, which are conflicting each other. A tax system based solely on efficiency ground is unrealistic, which that designed solely for equity purposes cannot be justified on locative grounds. The degree of progressively will, in practice, continue to be dictated by political and social consensus rather than by the optimizing formula of tax economists. However, it is accepted that high tax rates and narrow and selective tax bases can create distortions, encourage unproductive activities, rode the revenue base and lower the effective tax rates below the intended nominal tax rates. Tax cuts without reforms in the tax base can introduce more distortions of efficiency and equity than they connect, especially, if they result in inflationary finance (Gandhi, 1974).

In developing and underdeveloped countries indirect tax is appropriate than direct tax In those countries the income level of people is very low, The source of income is not fixed but changed with time. Most of the people live in subsistence level. Therefore to impose direct tax is not justifiable and direct tax people. That is why, in those countries indirect tax, is important source for collecting tax. This indirect tax is included in price of commodity, its burden cannot be directly solved and hence there is less possibility to increase dissatisfaction among people. Luxurious goods and the goods, which are injurious to the public health, should be taxed at high rate, normal goods should be taxed at medium rate and necessaries should be free from tax.

2.1.6 Contribution of Tax in Economic Growth

The important of the topic addresses here derive from the income tax's central role in revenue generation , its impact on the distribution of after-tax income, and its effects on a wide variety of economic activities. The important is only heightened by concern about the long term economic growth rate (Gorden 2016 & Summers 2014) .

By "Economic growth", we mean expansion of the supply side of the economy and of potential GDP. This expansion could be an increase in the annual growth rate, a onetime increase in size of economy that does not affect the future growth rate but puts the economy on a higher growth path, or both. Our focus on supply side of the economy in the long run is in contrast to the short term phenomenon, also called "economic growth", by which a boost in aggregate demand in a slack economy ,can raise GDP and help align actual GDP with potential GDP.

The financing of tax cuts significantly affects its impacts on long term growth. Tax cuts financed by immediately cuts in unproductive governments spending could raise output, if they are not financed by spending cuts, tax cuts will lead to an increase in federal borrowing, which in turn will reduce long term growth. The historical evidence and simulation, analyses suggest that tax cuts that are financed by debt for an extended period of time will have little positive impact on long term growth and could reduce growth.

A fair assessment would conclude that well designed tax policies have the potential to raise economic growth, but there are many stumbling blocks along the way and certainly no guarantee that all tax policy affects growth, a tax change will be more growth inducing to the extent that it involves (a) large positive incentive (substitution) effect that encourage work, saving, and investment (b) small or negative income effects ,including a careful targeting of tax cuts toward new economic activity, rather than providing windfall gains for previous activities;(c) reduction in distortions across economic sectors and across different types of income and consumption ; and (d) minimum increase in or reduction in, the budget deficit.

2.2 Empirical Review

2.2.1 International Empirical Review

Sabine (1966) writes about the tax structure that leads a country to alter its level and the rate of growth through changes in the individual element that constitute the tax structure. For him, economic development depends on a carefully thought-out and well organized tax structure.

Tanzi (1976) has been studied the various aspect of united states. The basic purpose of this study was to measure the elasticity and built in flexibility of Vs individual income inflation that the been affected by both the legal change and inflation over the period FY 1963-1972 A.D. and to take an attempt to relate these changes in the sensitivity of the tax to the events of the period we found that, the elasticity of tax revenue (T1) with respect to taxable income in the elasticity of tax with respect to adjusted gross income (AGI) from about 1.4 (in 1963 A.D.) to about 1.5 (in 1972 A.D.). It implies that the erosion in the real value of the basic exemption and of the recent standard deduction associated with a continuation of the recent inflationary pressures, and the consequent possible decline of the elasticity at T with respect to AGI, shouldn't have much at on effect on the overall elasticity of the tax. In the absence of further tax reforms, the tax yield should continue to grow at a much faster than nominal income.

Richard Goode (1986) writes that taxation diverts the economic resources from taxpayers to the state for its own use. Taxation not only restraints total spending by households and individuals but influences the allocation and affect the distribution of income and wealth. The level of taxation of a country is measured by the ratio of the tax-revenue to GDP, which is determined by the demand for government expenditure, the availability and willingness to use non-tax sources of finance including borrowing and money creation and taxable capacity. The tax effort can be measured only after quantifying the taxable capacity. The taxable capacity primarily depends on the per capita income in excess of the subsistence level while the ability of government to collect taxes depends on administrative effectiveness. The actual tax ratios reflect both taxable capacity and tax efforts. He also analyzed the tax structure and the stage of development. As the country develops the ratio of direct tax to indirect tax increase gradually and becomes the direct tax dominant finally.

Mishra (2005) analyze the tax structure of Jharkhand state of India. He estimated buoyancy coefficient of sales tax. With reference to gross state domestic product (GSDP) of Jharkhand by using the regression approach. The buoyancy of sales tax is found to be more than unity implying that sales tax revenue would continue to grow faster than GSDP provided no reduction in tax rates or tax base is undertaken.

Of course, change in one tax can be financed by change in other taxes, too. A related literature considers the relationship between growth and the mix taxes used. Arnold et al. (2011) use a panel dataset of 21 OECD countries over the 1971-2004 periods and find that corporate and personal income taxes have the most negative consequences for growth, while consumption taxes and property taxes are less harmful. Acosta Ormaechea and Yoo (2012) use similar result. As in the case discussed above of income tax cuts that are financed by reductions in government spending rather than budget deficits, the growth potential of income tax cuts is disincentives for work, saving, and investment.

The popular discussion of the link between tax cuts and economic growth often starts with the presumption that tax cuts will boost growth. While substitution effects of tax cuts will boost labor supply and saving, it is not all clear that this will translate into a stronger supply side of the economy because of several other effects. The second is, in the case of tax reforms, the higher taxes on the other activities that are now included in the broadened tax base. The third is, in the case of tax cuts not paid for by reduced government spending, the offsetting effects of higher budget deficits and thus interest rates on economic activity.

Berheim (2002) surveys the literature on the response of saving to generic changes in the after tax return and concludes that there is little evidence for a large. In the case of saving, there must also be a link between the behavioral response of higher saving to the tax cut and economic activity. Chetty et al. (2014) review the uncertain literature on saving incentives and present new evidence that the incentives do not raise overall saving. Many studies have considered the causal link between saving and growth. The general conclusion in the literature, well articulated by Carroll and Weil (1994),is that the observed positive relationship reflects a casual pathway from growth to saving, rather than savings to growth.

2.2.2 Nepalese Empirical Study

In Nepal's tax structure, various researchers have found heterogeneous responsiveness of taxes to GDP. Dahal(1984) was studied various aspects of Nepal's tax structure for the period 1952/53 to 1981/82 in general and 1964/65 to 1981/82 in particular. In this period the overall all elasticity of the total revenue equals almost unity (1.01), for indirect tax it is marginally higher than unity (1.02) compared with the elasticity of direct ax (0.68) and the elasticity of tax revenue is 0.92 reflecting the tax system less responsive is 0.92 reflecting the tax system less responsive to change in income. But the buoyancy coefficient for the same period are 1.54 for total revenue, 1.52 for tax revenue, 1.63 for indirect tax and 1.23 for direct taxes.

Timlsina (2007) analyzed the inelastic tax structure in Nepal for the period 1975 to 2005.this means taxes aren’t responsive to changes with most elasticity coefficient reporting below unity. The tax system isn’t progressive adequately also in the case of proxy bases. A progressive tax system needs to an at least greater than unity value of coefficient of elasticity. Timlsina found that elasticity coefficients of total revenue, total tax revenue, excise duties, import duties, income tax, and VAT are 0.59,0.51,0.49,0.54,0.41 and 0.55 respectively and buoyancy coefficients for the same are 1.14,1.12,0.98,1.05,1.37 and respectively. The low built in flexibility (elasticity) observed in Nepalese tax system is explained trough variety of factors such as exemption, tax incentives, duty waivers, low compliance and the large sectors of the economy which are not subject to taxation. Therefore the automatic response of the tax to income is low. However, the higher coefficient obtained the sensitivity (buoyancy) analysis focus on the role of discretionary measures in obtaining a steady source of tax revenue throughout the review period.

Revenue mobilization of Rs. 475.01 billion with Rs. 427.01 billion collected from tax revenue and Rs.48 billion from non-tax revenue is estimated for the current fiscal year 2015/16. The shares of tax and nontax revenues to the total revenue stood at 87.7

percent and 12.3 percent with revenue mobilization of Rs.405.86 billion in previous fiscal year 2014/15. The shares of tax and non-tax revenues to the total revenue mobilization from the fiscal years 2011/12 to 2013/14 remained close to 87 percent and 13 percent respectively while such shares are expected to remain at 89.89 percent and 10.11 percent in current fiscal year 2015/16.

Contribution of goods and services based tax has attained the top position in the tax revenue collected between FY 2011/12 and the current fiscal year with about 45 percent share to the total revenue. During this period, contribution of income, profit and capital gains taxes, and that of foreign trade based tax to total revenue remained close to 21 percent and 18 percent respectively. The share of property tax in the form of direct tax to the total revenue collected in fiscal years from 2011/12 to 2014/15 remained below 2 percent while such share went up to 2.3 percent in previous fiscal year. Likewise, the property tax amounting Rs. 12.04 billion is expected to be mobilized in current fiscal year contributing 2.54 percent to the total revenue. The share of other taxes to the revenue mobilization in the fiscal years from 2011/12 to 2015/16 has remained about 0.5 percent.

Dahal (2009) analyze in developing economies resource gap is critical and widening resulting to huge fiscal and budgetary deficits. The growing resource gap is frequently of by mobilizing internal and external borrowings and consequently shifting the burden of debt to posterity. Therefore, revenue mobilization is challenging proposition in an economy like Nepal where a majority of the people live in abject poverty and the people engaged in economic activities have extremely limited taxable capacity. In addition, legal base of taxation is compressed with unlimited tax shelters and tax administration lacks innovative mechanism to identify new taxpayers and bring them into tax net. The tax burden ratio is estimated to be 15.7% of GDP in FY 2008/09. In Nepal's tax structure revenues are buoyant but inadequate to supplement development activities. Interestingly, there was no adverse impact of conflict on internal revenues and. subsequently. ODA to Nepal have increased over the years. The tax system suffers from structural constraints with tremendous administrative and procedural complexities envisaged in the existing Income Tax Act, which lacks simplicity and transparency.

Thus, we come to conclude that offers the restoration of democracy, Government of Nepal has been adapting to discretionary measures to emanate and mobilize tax to raise its revenue. The conclusion that can be derived from the review of Nepalese empirical study is that various studies have found d the heterogeneous responsiveness of the particular tax system to the GDP. This may be due to change made by tax authority in the fiscal policy over study period. Moreover, different value of elasticity and buoyancy coefficient estimated by above discussed studies might be due to the choice of the base year, time interval and choice of proxy variable. However, this review disclose the fact that there has been no research which compares the structure of Nepalese tax system before and after restoration of democracy in 1990, under the assumption that structure changes may have occurred in the revenue generation due to the different policies adopted by GoN. During these two periods, hence, an attempt is made in the present study to address the issues as what is the structure and responsiveness of Nepalese tax system before and after the restoration of democracy in 1990.

CHAPTER III

METHODOLOGY

This chapter provides detail discussion on study period, nature and sources of data. In particular, it will be design to achieve the objective of the study. The main objective of the study is to show trend and structure of government revenue in Nepal.

3.1 Research Design

This research study analyzes the structure and contribution of taxes in Nepal during the period of FY (1990/91-2015/16). This study is based on secondary data and the approach of this study is largely descriptive for this purpose, we will estimate some models. Variables are used in this modern have been explained analytically. The main variable used in the modern are Taxation and Gross Domestic Product (GDP).

3.2 Sources of Data

The study will be based on the secondary data. The required data will collect from various secondary sources such as,

- MOF, Economic Survey on various issues.
- MOF, Budget speech of various years
- Central Bureau of statistics (CBS)

3.3 The Study Method

Collected data have been categorized on the basis of nature and its different simple and complex tables. Most of the data have been presented in tables and some are in diagram. In this study simple, multiple percentage, histogram, bar-diagram and trend line have been used to present the facts and information.

3.4 Data Analysis

Only descriptive has been employed for the analysis of structure and trend of tax in Nepal. For the effective use of the other methods suitable data on legal tax bases and simple tax structure are necessary for this study. Tables are used to get the result for the achievements of the objective study.

CHAPTER IV

TREND AND STRUCTURE OF GOVERNMENT REVENUE IN NEPAL

This chapter provides overall over view of Nepalese tax system and recourse mobilization. Data collected from the secondary sources are analyzed in this chapter. This chapter also provided description about structure of Tax system in Nepal.

4.1 Background

According to 'Theory of tax structure change during economic development' the share of direct taxes will increase with rise in per capita income, while the contribution of indirect taxes subsequently declines (Henrich, 1965). Excessive dependence on customs duties is manifestation of backward economy characterized by predominance of underemployment in informal sector. Direct taxes have strategic significance and its superiority is claimed over indirect taxes on the ground of neutrality, welfare and excess burden (Hick-Joseph, 1939). The Hicks-Joseph proposition established superiority of direct taxes over indirect taxes, for direct taxes do not cause a reorganization of consumer's choices which is not dictated by changes in the costs of production, a high level of sustainable economic development is always coupled with increasing contribution of direct taxes to the tax structure. The role of indirect taxes became prominent after the dissolution of traditional society. Nevertheless, the debate on direct vs. indirect taxes is sterile, for both taxes have intrinsic values with tremendous potential to mobilize revenue in developing economies (Walker, 1955). This is equivalent to walking on two legs-a balancing factor.

Recurrent expenditure is evidently higher compared with capital expenditure; revenue deficit does not exist in Nepal's tax structure. However, fiscal and budget deficits are higher the international level and the prospect for counterpart funding is extremely limited to ensure partnership in development activities pursued by external assistance. In Nepal's tax structure revenues are buoyant but inadequate to supplement development activities. Interestingly, there was no adverse impact of conflict o internal revenues and, subsequently, ODA to Nepal have increased over the year. The import duties are collected at customs point, which are mostly located in urban-centered border areas, and VAT on imported goods is also collected at the same customs points. Internal as well as external borrowings also moderately and shaped by import duties in Nepal, and revenues from customs and VAT have increased with growing size of import from India and overseas over the year.

4.2 Overall Revenue Trend and Structure in Nepal

The history of taxation in Nepal dates back to antiquity. However, modern tax system begins with the advent of democracy and manifestation of the first consolidate budget comprising revenue and expenditure of the kingdom of Nepal in 1951.For this contract system collecting taxes was gradually replaced by the system of collecting taxes directly by the tax officials. Since 1951, tariff boards has been constitute at different times to provide suggestion to rationalize the customs schedule .The Excise Act 1958, the Custom Act 1962 and the Land Revenue Act1964 ,were introduced in order to consolidate various excise ,custom duties, land revenue laws, and unify tax system throughout the country. Modern taxes like income tax, foreign investment tax, urban house and land tax, were introduced in 1959/60.Sales tax was introduced at the retail level in 1965/66,then moved to the wholesale level in 1968,and further shifted to the import/manufacturing point in 1974. VAT was introduced in 1997, in the place of the sales tax, hotel tax, entertainment tax, Air flight tax and contract tax. Until now several new taxes were include in the Nepalese tax family after 1951, a few taxes were abolished and some of the abolished taxes were restarted over the year.

When the GoN presented first budget in the fiscal year 1951/52, the revenue structure was typically that of traditional economy with 73 percent of government receipts coming from non-tax sources and land tax only. But later in the late1950s the share of non-tax revenue declined drastically, because of the increasing contribution of indirect tax on foreign trade . In 2007/08, the share of non-tax source was 20.9 % of total revenue compared to 23.8 % in 1990/91. The data on table 4.4 shows that the contribution of tax revenue in total revenue is almost 80 percent of total revenue and never declined below 75 percent except in FY 1991/92. Thus, the role of tax revenue in domestic resource mobilization is highly significant.

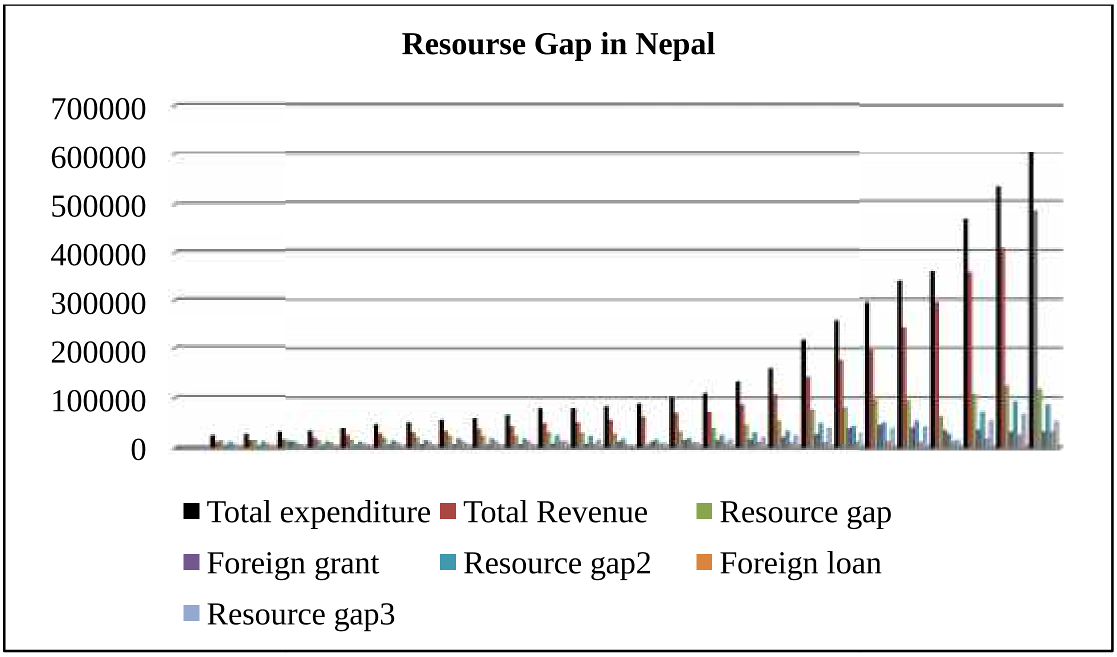
However, various reforms have been initiated to improve the quality of services in tax administration, make the administration taxpayer friendly and increase the revenue yield required for meeting expenses of various development activity.

4.3 Resource Gap in Nepal

Resource gap is the gap between expenditure and revenue. To bridge the gap between expenditure and revenue, internal and external loans are based in Nepal's case, there is increasing reliance, especially on foreign loan for deficit financing so that increasing outstanding debt the repayment of principle and interest are also increasing each year. This again necessities further borrowing. Therefore, special emphasis needs to be given to mobilize internal resources in order to meet the resource gap.

In overall resource gap, three types of gaps are measured and used in the analysis of resource gap. The overall resource gap pattern is shown in the following figure.

Figure 4.1: Resource Gap in Nepal



Source: Various Economic Surveys

Resource Gap (A-B)

The gap between revenue and expenditure rose from Rs 12819.8 million in FY1990/91 to Rs 119054 million in FY2015/16 which was about nine times more than FY 1993/94. This figure shows that the poor performance of domestic resource mobilization. Total expenditure increased slowly up to 2005/2006 after period 2007/2008 total expenditure increased in highly up to 2012/2013 this process continued and total expenditure increased in too highly.

Resource Gap {A-(B+C)}

This is the gap after dedication of foreign grants to domestic gap. It was Rs.10655.0 million in FY1990/91 was gradually increased toRs.56576 in FY2015/16. When foreign grants were increased resource gap were decreased likewise if foreign grants were decreased resource gap were increased. This shows that foreign grants should be increased to increase for minimizing the revenue gap.

Resource gap {A-(B+C+D)}

The revenue gap is taken as the different between total expenditure and total revenue after deducting foreign grant and foreign loan. In FY 1990/91 this gap was Rs.4398.2 million which was gradually increase to Rs.53348.0 million in FY 1998/99. Again it was decreased in FY1999/2000 it was become Rs.5854.8 million. This gap was fluctuated for the study period. It means small proportion of amount of foreign loan will decrease every year in the future.

The above study shows a clear indication of the serious and growing foreign resource problem in Nepal. The increasing magnitude of resource gap clearly indicates that there is an urgent need for mobilization additional resources. Income tax has appeared as one of the most effective fiscal policy instruments to mobilize additional resources and for achieving the desired developmental objectives of Nepal.

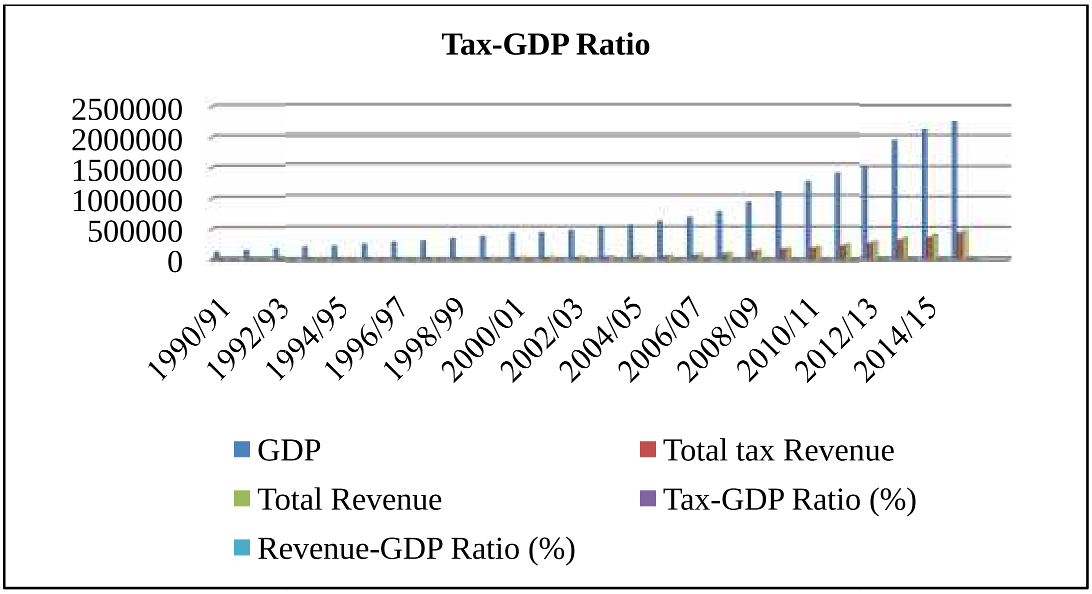
4.4 Tax –GDP Ratio

Tax GDP ratio is the absolute measure for estimating the revenue mobilization. Tax GDP ratio help to compare the tax performance of different countries. The tax revenue as percentage of GDP is known as Tax-GDP ratio. High Tax-GDP ratio is desirable for economy. Tax GDP ratio of the low-income countries is the lowest than the middle and high-level income economics country. Nepalese tax revenue as the percentage of GDP is the lowest on all the low-income economics country. Middle-GDP ratio. High-income economics like Switzerland, United Kingdome and United States has the highest tax-GDP ratio.

Nepal is one of the least developed countries of the world with GDP per capita of $ 468 in fiscal year 2007/08 (Economic Survey 2008/09). Nepal’s GDP per capita is the lowest one in South Asia. Majority of its population depend on agriculture which is largely traditional and characterized by low productivity. Agriculture sector, the source of livelihood for about 80 percent of Nepalese that contributes about one-third of total GDP is still free from the income taxation. About 21 percent of total populations are still under the line of absolute poverty. The poor performance of tax GDP ratio of Nepal has led to the problem of resources

The Gross Domestic Product (GDP) in Nepal expanded 6.30 percent in 2017 from the previous year. GDP Annual Growth Rate in Nepal averaged 4.48 percent from 1993 until 2017, reaching an all time high of 8.60 percent in 1993 and a record low of 0.10 percent in 2001. Tax GDP ratio and Revenue –GDP ratio in Nepal from FY 1990/91 to FY 2015/16 is presented in the figure 4.2.

Figure 4.2: Tax GDP Ratio



Source: Various Economic Surveys

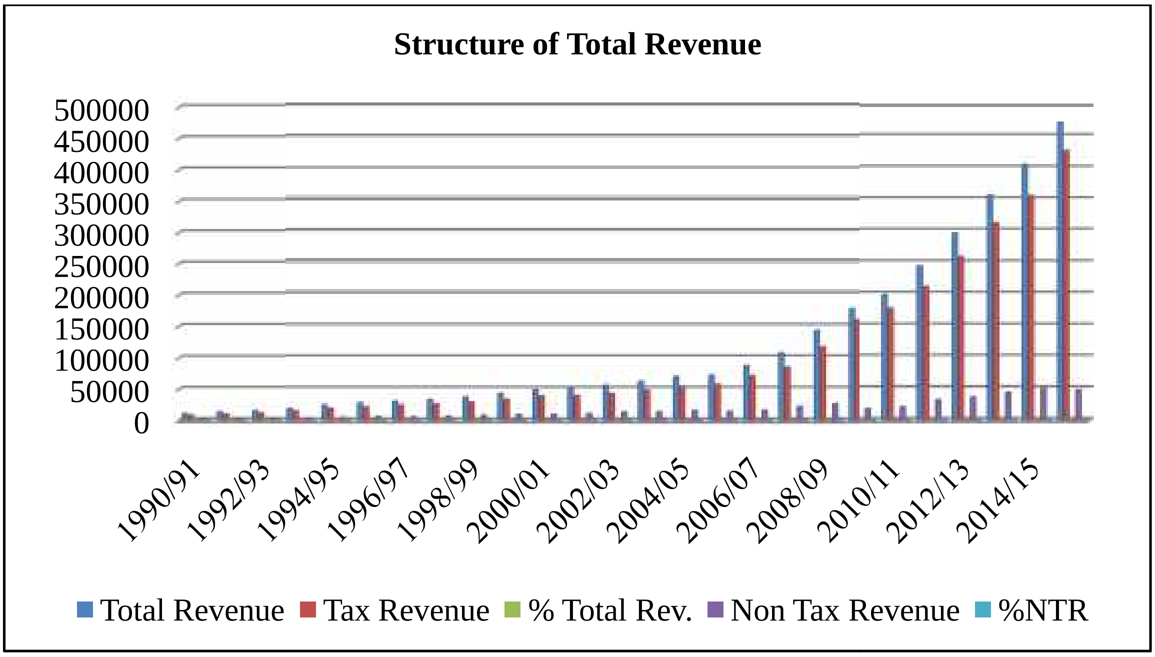
Tax –GDP ratio of the FY 1990/91 was 7.04 percent and revenue GDP ratio was 9.2 percent for the same year. Tax –GDP ratio has fluctuated from 70.4 to 18.98 percent during the study period. Minimum Tax-GDP ratio was 7.04 percent in the FY 1990/91 and maximum 18.98 percent in 2015/16. Revenue –GDP ratio fluctuated from 9.24 percent to 21.12 percent. Revenue –GDP ratio was maximum in FY2015/16 and minimum in FY1990/91.

4.5 Structure of Total Revenue

When the GoN presented first budget in the fiscal year 1951/52, the revenue structure was typically that of traditional economy with 73 percent of government receipts coming from non-tax sources and land tax only. But later in the late 1950s the share of non-tax revenue declined drastically, because of the increasing contribution of indirect tax on foreign trade. In 2007/08, the share of non-tax source was 20.9 % of total revenue compared to 23.8 % in 1990/91. The data on table 5.2 shows that the contribution of tax revenue in total revenue is almost 80 percent of total revenue and never declined below 75 percent except in FY 1991/92. Thus, the role of tax revenue in domestic resource mobilization is highly significant.

Total revenue of Nepal is composed of tax revenue and non-tax revenue. In figure 4.3, total revenue for the study period from FY1990/91 to 2015/16 has been increasing year by year. Tax and non-tax revenue has been two basic components to sum of total revenue had played a dominant role for the contribution of total revenue. Tax revenue over the time not exceeded 90.11 percent and fluctuates up and down over the years. In FY2002/03 the contribution to tax revenue was 75.7 to total revenue, which was lowest, compared to other study year. Similarly, in the FY 2002/03 the contribution of Non-tax revenue to the total tax revenue is highest (i.e. 24.3 percent) and in the FY2009/10, its contribution to the total tax revenue is lowest (i.e. 10.22 percent).

Figure 4.3: Structure of Total Revenue



Source: Various Economic Surveys

Above figure 4.3 explain the Tax and non Tax structure over countries' total revenue. Table shows that tax revenue is contributing more in total revenue than that of non-tax revenue. In FY 1990/91 the contribution to total revenue from tax revenue is highest ever but in FY 2002/03 tax revenue contribution is least i.e., only 74.99%. The composition of the total revenue with the tax revenue and Non-tax revenue is also clearly explained in the figure. Where the tax revenue has played the dominant role for the total revenue. It covered around 85 percent of the total revenue in this study period for FY1990/91 to 2015/16 of Nepal.

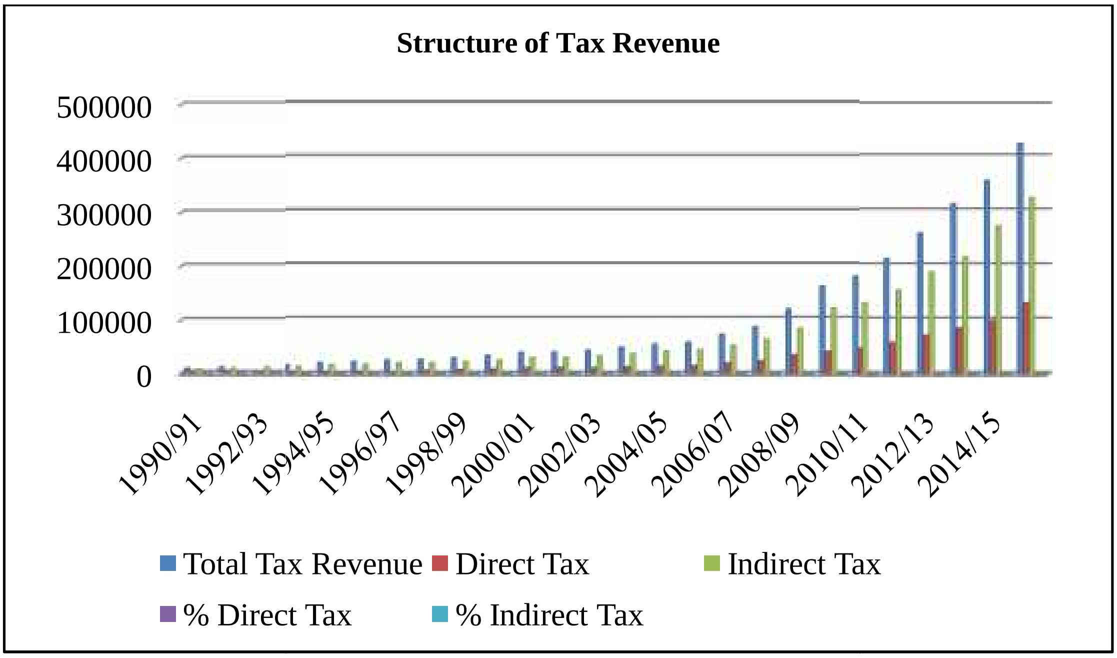
The above figure shows that in composition of total revenue, tax revenue has dominant role because the figure shows in FY 1991/92 total revenue Rs. 9875.6 million where 73.08 percent is contributed by tax revenue and remaining by non-tax revenue. Tax revenue slightly increased up to the year 2009/10 except in years 1995/96, 1997/98 and 2002/03. This tendency is continuous and in FY 2015/16 total revenue is Rs. 475012.1 million and 87.81 percent has been contributed by total tax revenue and remaining by non-tax revenue. It is clear that tax revenue has dominant role in Nepalese economy.

4.6 Structure of Tax Revenue

In the context of our country, tax revenue is a major source to mobilize internal resource because it has been dominating the total government revenue by contributing about 80 percent of total revenue. Tax revenue constitutes of two components: direct tax and indirect tax. Generally the tax on consumption is known as indirect tax where as taxes on income and capital is known as direct taxes. Tax structure of any country is composed of both direct as well as indirect taxes. In Nepal’s context, indirect tax constitutes of custom duty, excise duty, sales tax/VAT etc. Likewise, direct tax includes land tax, property tax, income tax, vehicle tax etc.

The structure of Nepalese tax revenue is presented in the figure 4.4 in terms of direct tax and indirect tax revenue from FY 1990/91 to 2015/16.

Figure 4.4: Structure of Tax Revenue



Source: Various Economic Surveys

The contribution of tax revenue in the total revenue is significant from the very beginning. The figure shows, there has been simultaneous increment in both direct tax and indirect tax in absolute term during the study period. The amount of tax revenue was Rs. 908.6 million in the FY 1975/76, in which share of direct tax was 25.9 percent whereas 74.1 percent was the share of indirect tax. By the FY 2008/09, tax revenue has increased up to Rs 117051.9 million where the percentage share of direct tax and indirect tax is 70.7 and 29.3 respectively. The decline in the share of indirect tax in total tax revenue is because of the adaptation of the liberalization policy by the government. And, increasing trend of direct tax implies that country should give emphasis on mobilizing the resources through direct taxation rather than indirect taxation.

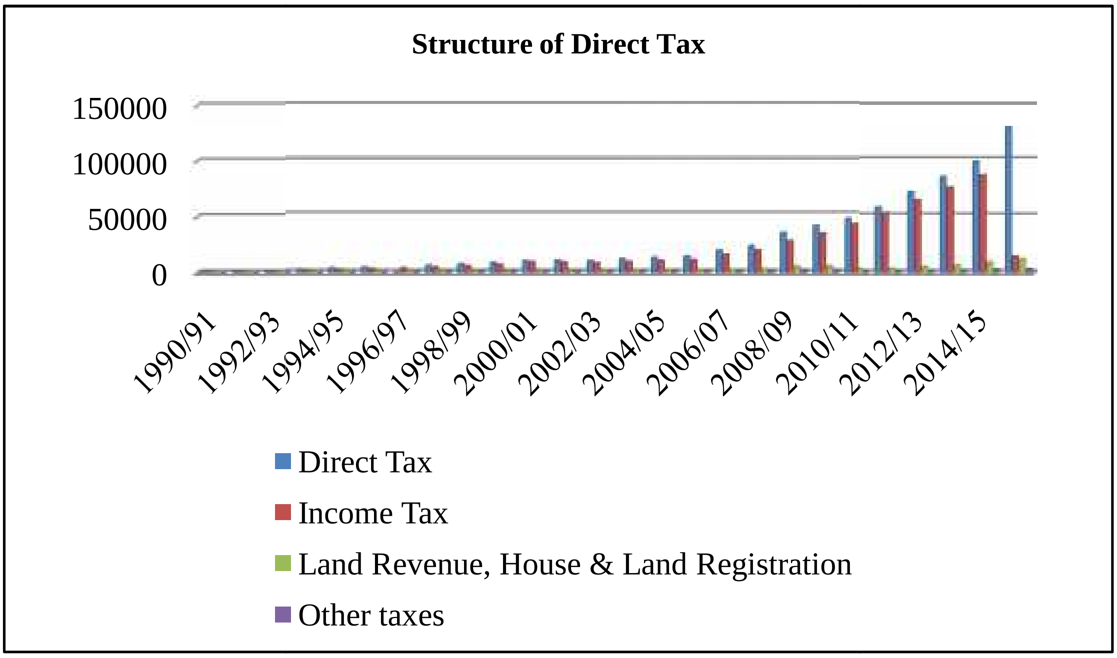
Figure 4.4 shows that structure of tax revenue with the direct tax and indirect tax. Here, line representation of indirect tax amount is closer to the line of the total revenue, where as the line representation of direct tax is far from the line of total revenue. This showed that the contribution of direct tax in the total revenue is much lesser than the contribution of indirect tax on it. But over the years tax is found to increase.

4.7 Structure of Direct Tax

In Nepal's tax structure, the premier components on direct tax revenue are: a) income tax b) land revenue, house and registration c) others direct taxes .The land revenue and registration has divided into land revenue, House and land registration fees. Similarly, tax on property, profit and income has divided into the income tax from the public enterprises, income tax from the semi-public enterprises, income tax from remuneration, urban house and land tax, vehicles tax, tax on the interest and other taxes.

The large amount of direct taxes on total tax revenue signifies the maturity of the economy. For example the amount of direct tax one half of the tax revenue signify the tax structure of well developed countries and one fifth or one sixth portion of total taxes signify the least d development countries. Nepal being least developed country on and average, the tax revenue contributed by indirect tax had nearly 75 percent during study period. New tax system mainly focuses to the income tax and property tax by widening its tax bases.

Figure 4.5: Structure of Direct Tax



Source: Various Economic Surveys

Graphically, the structure of direct tax is shown in figure (4.5). Here, the line representation of tax on property, profit and income amount is closer to the line of direct tax, where as the line representation of land revenue and registration is far from the line of the direct tax. This showed that the contribution of tax on property, profit and income in the direct tax is much higher the in the contribution of land revenue and registration.

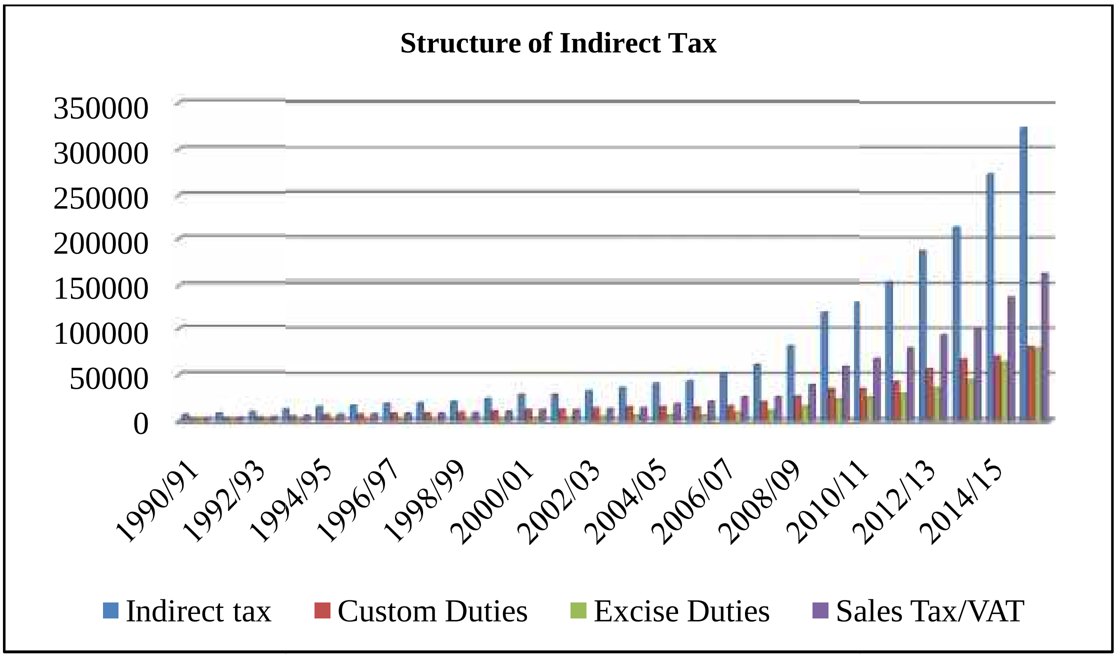
The major components of direct tax are income tax, land tax and house and land registration tax. However, the major components of direct tax keep changing in Nepal. Until the FY 1993/94 vehicle tax was considered as direct tax and from FY 1994/95 it has been classified under the indirect tax. Figure 4.5 shows the different heads of the direct tax and their contribution to the direct tax.

Since the income tax was introduced in the FY 1959/60, its contribution to the direct tax is very low in the early days. In the FY 1975/76 income tax occupied 45.1 percent of the direct tax. Its share in the direct tax has been increasing continuously which is 87.3 percent in the FY 2007/08. The contribution of land revenue declined sharply from the early period. But the contribution of house and land registration which was very low in the beginning increased in the later days and reached 35.8 percent in the FY 1991/92 but declined then after. However, it has again increased to 30.5 percent in the FY 2015/16 along with some fluctuations.

4.8 Structure of Indirect Tax

The main feature of the Nepalese fiscal structure is heavy reliance on indirect tax. In Nepal's tax structure .the premier components of indirect tax are custom duties, excise duties and value added tax (VAT). Custom duties are one of the important tax items in revenue collection. It contributed 32.0 to 45 percent of total indirect taxes during the study period which is shown in table (4.6). Since VAT has been introduced in 16 November 1997 in place of sales tax, hotel tax, contract tax, air flight tax and entertainment tax in Nepal.

Figure 4.6: Structure of Indirect Tax



Sources: Various Economic Surveys

Graphically the composition of indirect tax is clearly shown in the figure (4.6). In the beginning the contribution of VAT in the indirect tax had much more than other taxes. However, beyond 2004/05 the VAT was increased faster than other and become largest contributed element of the indirect taxes. The duties and excise duties have been increased slowly and smoothly than the VAT.

Indirect tax is considered regressive in nature. Since, Nepal's current tax structure is highly dominated by indirect taxes; it is not justifiable on the ground of equity and progressiveness. However, the country being a member of international and regional trade organizations like WTO, SAFTA, BIMSTEC and others, this increasing reliance on direct tax can be justifiable on the equity ground, which is improving slowly.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Nepal, being in the process of economic development needs higher government expenditure to meet the purposed development programs. This ultimately creates the resource gap. On the other hand, foreign aid, loan and grant as well as domestic borrowing are not considered as the permanent solution to fulfilling the resource gap between expenditure and revenue. In this connection, the share of non-tax revenue is very low and to raise the revenue from these sources, one needs higher capital accumulation in comparison to its return and government equally thinks about the welfare view. These facts justify that the ultimate and permanent solution to bridge up this gap only by taxation. The raise on tax rate is not only its solution. Therefore, the improvement in tax structure is required. Taxation is not only an instrument of obtaining higher revenue, but also the medium to eliminate undesirable effects in the economy as well as the introducer of desirable effects.

In the developing countries like Nepal, lack of sufficient financial resources is the main constraints for national economic development. A lot of fund is required to meet the additional financial requirements for the development activities of the country. Nepal has been suffering from shortage of capital to accelerate the economic growth. The expenditure of Nepalese government is increasing year by year. To meet the additional capital requirement Nepalese government has been using external and internal resources. Internal resources are preferable for sustainable economic development. Nepal has been unable for proper mobilization of internal resources. Thus, fiscal deficit and resource gap of Nepal have been increasing every year.

Revenue mobilization of Rs. 475.01 billion with Rs. 427.01 billion collected from tax revenue and Rs.48 billion from non-tax revenue is estimated for the current fiscal year 2015/16. The shares of tax and nontax revenues to the total revenue stood at 87.7 percent and 12.3 percent with revenue mobilization of Rs.405.86 billion in previous fiscal year 2014/15. The shares of tax and non-tax revenues to the total revenue mobilization from the fiscal years 2011/12 to 2013/14 remained close to 87 percent and 13 percent respectively while such shares are expected to remain at 89.89 percent and 10.11 percent in current fiscal year 2015/16.

To solve this problem income tax is the most important source for internal resources generation in which taxation occupies the major portion. Regarding this fact, this study attempt to analyze the importance and contribution of tax to the Nepalese revenue. After identify introduction about it, review of literature has been observed to address core elements like income tax and its development.

The analysis of the preceding chapter give the clear cut picture that taxation is an instrument for resources mobilization that would help to bridge the revenue and expenditure gap. The gap is due to the increase in expenditure, which is higher and faster than revenue growth. The study with help of secondary sources of data, such as budget speech of various years, economic survey on various issues, Ministry of Finance (MOF) Nepal, various issues of quarterly economic bulletin and various publications of CBS, NRB and WB has found the contribution of taxes of Nepal 1990/91 to 2015/16. Also study showed the tax structure of Nepal for same period. The tax system in Nepal is circumscribed by serious structure constraints with tremendous administrative and procedural complexities envisaged in the existing Income Tax Act that it lacks simplicity and transparency. Tax payer are often unaware about the specific size of the tax they are not comply with, because tax is determined arbitrarily between tax payer between tax payers and the official resulting in enormous corruption.

The important finding of the study of 26 years from fiscal year 1990/91 to 2015/16 are summarized as below:

i. Government expenditure of Nepal is increasing at the faster rate than the increase in revenue. Therefore, resource gap has existed in Nepalese economy and in fiscal year 1990/91 was Rs.12819.8 million and it had extended to Rs.119054 million in the fiscal year 2015/16. Resource gap of final year is approximately more than half of the government. The real resources gap is increasing day by day. Increasing trend of real resources gap indicates that it is necessary to mobilize additional domestic resources for collecting the sufficient funds to the government.

ii. Government revenue is mainly the composition of non-liable external and internal revenue. Tax and non-tax revenue are the sources of the income. There is dominant share of tax revenue in Nepalese revenue structure. The contribution of tax revenue to total revenue ranges from 76.2 percent to 80.80 percent during the study period. The contribution of non-tax revenue to total revenue ranges from 23.8 percent to 18.17 percent.

iii. Nepalese tax revenue is comprised of direct tax and indirect tax. There is dominant role of indirect tax revenue in Nepalese total tax revenue structure. Indirect tax is considered to be more regressive than direct taxation in nature. These signify that we are depending upon such regressive tax system which gives more burdens to the consumer group.

iv. Major components of direct tax revenue are land revenue registration and tax on property, profit and income. The share of income tax revenue, comprising income tax from public enterprises, income tax from semi-public enterprises, income tax from private corporate bodies, income tax from individuals, income tax from remunerations and tax on interest, total direct tax revenue has been dominant role over the study period.

v. Major components of indirect taxes are VAT, Excise duties and Customs duties. In which, share of VAT is increasing from beginning period of the study until last period.

vi. The share of Direct tax to GDP has been increasing in slow pace where as the share of Indirect tax to GDP has been increasing in fast rate.

vii. This study shows the Indirect taxes in general contain better automatic growth potentialities then Direct taxes.

5.2 Conclusion

Increasing the tax revenue is not an end itself, rather it is a means to meet the fiscal imbalance, reduce inequality of wealth and income, and make proper allocation of resources and incentives to work and invest, which would lead to increase in productivity, and hence, the national income. Thus, raising revenue is only one of many goals and a tax system must be administratively feasible. Moreover, the equality principle cannot be neglected and the tax system must be achieved simultaneously, so tax reform is a matter of trade-offs.

Given amount of revenue can be abstained with higher tax rates, but if the tax base is narrow it leads to higher chances of tax evasion. So broadly based taxes are supposed to be useful with smaller rates. As increased revenue is necessary to enhance and strengthens overall domestic resource mobilization, were upward adjustment in the rates, or even the introduced of new taxes, may not be able to ensure desirable increase in revenue.

Nepal is one of the least development country surrounded by the two highly growing Asian economies, India and Republic of China. Nepalese economy is suffering from ineffective, effortless and over ambitious plans, programs and policies. Moreover, Nepal is even today fighting against whatever bottleneck identified before the starting of planned period. With the change in the time, challenges for Nepalese economy also increase.

Many well-designed and well-meaning tax policies have field due to the lack of intuitional and administrative capacities of the government. Thus a logical inference that can be drawn is that Nepal has been suffering from serious financial crisis due to lack of tranquility during the past few years. Its stability in terms of the availability of higher revenue resources without causing excess burden to the 'have-nots' groups depends on the ability of the government as to what extent it can increase the taxable capacity, which is generally measured by the per capital income and on the willingness and preparedness of

5.3 Recommendations

On the basis of the finding of this study, effectiveness of tax system depends upon the tax administration. One of the most important bottlenecks for unsound tax system in Nepal is inefficient, unscientific and corrupted tax administration; some recommendations have been made for a sound and effective tax system, which could be considered by the concerned authorities while reforming Nepal's tax system. They are as follows:

i. The general direction of tax reforms should be toward broadening the tax base and lowering tax rates in the long run.

ii. The tax base should be broadened, especially in the areas of income tax and VAT.
iii. The tax policy should have a clear cut direction and be consistent with a long run perspective of the policy. The tax policy should be concentrated on optimum revenue mobilization for reducing tax revenue expenditure gap.
iv. The present Nepalese tax structure depends heavily on indirect taxes. The more than 80 percent share of indirect tax to total revenue over the study period have been mentioned in the results. The inelastic nature of tax revenue is due to the sluggishness of direct taxes as there is sample scope for tax evasion and avoidance. So the effective way for more revenue generation from direct taxes is to make them progressive supported by a competent tax administration.
v. The absence of progressive tax system structure creates disparity in the distribution of income and wealth. Therefore, progressive direct taxes like income tax and property tax to be considered as an effective measure to reduce inequality in the distribution of income and wealth. Hence, prudent wealth tax should be imposed on unproductive accumulation of wealth while making productive investment tax free.
vi. Regular and effective training should be needed and proper education should be given to tax officials as well as tax payers regularly.
vii. Cost of collection is one of the determined of efficiency of tax administration. Therefore, the concerned authorities should pay great attention to reduce the cost of tax collection.

REFERENCES

Adhikari, R.P. (1995). Tax Elasticity and Buoyancy in Nepal, *Economic Review, An Occasional Paper*, NRB No. 8.

Agrawal G.R, (1979). “Role of Income Tax in Nepal’s Tax Structure” *The Economic Journal of Nepal*, Institute Humanities and Social Science .TU.

Agrawal, G. R. (1978). *Resource mobilization for development*. *The Reform Income Tax in Nepal*, Kathmandu: Centre for Economic Development Association, p. 21-23.

Agrawal G.R. (1980). *Resource Mobilization in Nepal*. Kirtipur: CEDA, TU

Aryal, J. P. and Gautam, K. (2001). *Quantitative Techniques*. Second Revised Edition, Kathmandu: New Hira Books Enterprise.

Cutt, J. (1969). *Taxation and Economic Development in India.* New York: Frederick A. Praege.

Dakal, M. K. (1999). *The Development Challenge of Nepalese Economy*. Kathmandu: EFAS.

___________2004). *Nepalese Economy: Toward Building a Strong Economic Nation State.* Kirtipur: CEDECON, TU and New Hira Book Enterprises.

__________ (2009). "Taxation in Nepal: Structure, Issues and Reforms". *The Economic Journal of Nepal*, Vol.32, No.1 Issuse No, 123,1-13.

Goode, R. (1984). *Government Finance in Developing Countries*. New Delhi: Tata McGraw Hill.

Ministry of Finance (2002). *Income Tax Act 2002.* Kathmandu: GON.

Kandel, N. R. (2003*). Guidelines to from a Thesis and Dissertation*. Kathmandu: New Hira Books Enterprises.

Lekhi R. K. (2004). *Public Finance.* New Delhi: Kalyani Publication.

Mishra, S. P. (2005). "Elasticity and Buoyancy of Sales Tax in Jharkhand" September.

Meier, G.M. and Rauch, J.E. (2000). *Leading Issues Economic Development*, Seventh edition. India: Oxford University Press.

MoF (2016-2017). *Economic Survey*, (Various Issues). Kathmandu: Singha Darbar.

MoF (2016-2017). *Budget Speech.* (Various Issues). Kathmandu: Singha Darbar.

Mong G. S. (1984). “Sensitivity of Tax Yield and Their Forecasting” *The Economic Journal of Nepal.* Vol. 7, No. 1 Page 20-31

Musgrave. R.A. and Miller, M. (1948). “ Build- in –Flexibility” *American Economic Review*,Sept.

Nepal Shankar Prasad (2004). “Taxation of Income in Nepal”, *Economic Journal of Nepal*, Vol. 26, No.3, Issue 103

Nepal, Mani K(1995). *Structure and Responsiveness of Nepalese Tax System*. An Unpublished Master's Degree Thesis, Central Department of Economics, Tribhuvan University, Kirtipur, Kathmandu.

Parajuli, S. (2009). *Revenue Policy and Revenue Administration*. Kathmandu: Makalu Books Publication.

Pechman A. J (1918). *Federal Tax Policy*. Third edition, Washington: Library of Congress.

Prest, A. R. (1962). “The Sensitivity of the Yield of Personal Income Tax in the United Kingdom” *The Economic Journal*, Vol 72,PP 576-96.

Reejal, P. R. (1976). *Revenue Productivity and Equity Aspect of Nepal’s Taxation: A Structural Analysis* For the Period 1964/65 to 1970/71. CEDA, TU

Schiller B.R. (1994). *The Economic Today*, Sixth edition. Washington: Library of Congress Cataloging in Publication Data.

Sahota, D.S. (1961). *Indian Tax Structure and Economic Development*. London: Asia Publishing House.

Singh R.D. (2000). *Taxation in Nepal.* An Unpublished Master's Degree Thesis, Central Department of Economics, Tribhuvan University, Kirtipur, Kathmandu.

Tanzi, V (1976): The *Sensitivity of the yield of U.S. Individual Income Tax and tax Reform of the past Decade*". IMF Staff Paper, Vol. XXIII No. 2, 441-454.

Wolff, H. K. and P. R. Pant (2003*).A Handbook for Social Science Research and Thesis Writing.* Third Edition. Kathmandu: Buddha Academy Publisher and Distributors Pvt. Ltd

Websites:

http://www.imf.org

http://www.ird.gov.np

APPENDIX

Table 4.1

Resource Gap in Nepal (1990/91 to 2015/16)

(Rs. in Millions)

Fiscal year	**Total expenditure**	**Total Revenue**	**Resource gap**	**Foreign grant**	**Resource gap**	**Foreign loan**	**Resource gap**
	A	**B**	**A-B**	**C**	**A-(B+C)**	**D**	**A-(B+C+D)**
1990/91	23549.3	10729.5	12819.8	2164.8	10655.0	6256.7	4398.2
1991/92	26418.2	13512.7	12905.5	1643.8	11261.7	6816.7	4444.8
1992/93	30897.7	15148.4	15148.4	11956.0	11956.0	6920.9	5035.1
1993/94	33597.4	19580.9	14016.5	2393.6	11622.9	9163.6	2459.3
1994/95	39060.0	24575.2	14484.8	3937.1	10547.7	7312.3	3235.4
1995/96	46542.4	27893.1	18649.3	4825.1	13824.2	9463.9	4360.3
1996/97	50723.8	30373.5	20350.3	5988.3	14362.2	9043.6	5318.6
1997/98	56118.3	32937.9	23180.4	5402.6	17777.8	11054.5	6723.3
1998/99	59379.0	37257.4	22321.6	4336.6	17985.0	11852.4	6132.6
1999/00	66272.5	42893.8	23378.7	5711.7	17667.0	11812.2	5854.8
2000/01	79835.1	48893.6	30941.5	6753.4	24188.1	12044.0	12144.1
2001/02	80072.2	50445.5	29626.7	6686.1	22940.6	7698.7	15241.9
2002/03	84006.1	56229.8	27776.3	11339.1	16437.2	4546.4	1189.8
2003/04	89442.6	62331.0	2711.6	11283.4	15828.2	7629.0	8199.2
2004/05	102560.5	70122.7	32437.8	14391.2	18046.6	9266.1	8780.3
2005/06	110889.2	72282.1	38607.1	13827.5	24779.6	8214.3	16565.3
2006/07	133604.6	87712.2	45892.4	15800.8	30091.6	10053.5	20038.1
2007/08	161349.9	107622.5	53727.4	20320.7	33406.7	8979.9	24426.8
2008/09	219661.9	143474.5	76187.4	26382.9	49804.5	9968.9	39834.6
2009/10	259689.1	177990.9	81698.2	38546.0	43152.2	11223.4	30009.8
2010/11	295363.4	198376.3	96987.1	45922.2	51064.9	12075.6	38989.3
2011/12	339167.5	244374.1	94793.4	40810.3	53983.1	11083.1	42900.0
2012/13	358638.0	296021.0	62617.0	35229.0	27388.0	11969.0	15419.0
2013/14	465052.0	356621	108431	36374	72087	17999	54058.0
2014/15	531558.0	405866	125695	32478	93214	25616	67598.0
2015/16	601016.0	481962	119054	32478	86576	33228	53348.0

Sources: Various Economic Surveys

Table 4.2

Tax-GDP Ratio in Nepal

(Rs. In Millions)

Fiscal Year	GDP	Total tax Revenue	Total Revenue	Tax-GDP Ratio (%)	Revenue-GDP Ratio (%)	Growth rate of tax revenue
1990/91	116127.0	8176.30	10729.80	7.04	9.24	
1991/92	144933.0	9875.60	13512.70	6.81	9.32	25.94
1992/93	165350.0	11662.0	15148.40	7.05	9.16	12.10
1993/94	191596.0	15371.0	19580.9	8.02	10.22	29.26
1994/95	209976.0	19660.0	24575.2	9.36	11.72	25.51
1995/96	239388.0	21668.0	27893.1	9.05	11.65	13.50
1996/97	269570.0	24424.3	30373.5	9.06	11.27	8.89
1997/98	289798.0	25939.8	32937.9	8.95	11.37	8.44
1998/99	330018.0	28752.9	37257.4	8.71	11.29	13.11
1999/00	366241.0	33152.1	42893.8	9.5	11.71	15.13
2000/01	413429.0	38865.0	48893.6	9.40	11.07	13.99
2001/02	430397.0	39330.6	50445.5	9.13	11.72	3.17
2002/03	460325.0	40896.0	56229.8	8.89	12.21	11.47
2003/04	500699.0	48173.0	62331.0	9.62	12.45	10.85
2004/05	548485.0	54104.7	70122.7	9.86	12.79	12.50
2005/06	611118.0	57430.4	72282.1	9.39	11.83	3.08
2006/07	675859.0	71126.7	87712.2	10.52	12.98	21.35
2007/08	755262.0	85155.5	107622.5	11.27	14.25	22.70
2008/09	910160.0	117051.9	143474.5	12.86	15.76	33.31
2009/10	1083415.0	159785.3	177990.9	14.74	16.43	24.06
2010/11	1248482.0	177227.2	198376.3	14.19	15.89	11.45
2011/12	1387482.0	211721.8	244374.1	15.25	17.62	23.19
2012/13	1522853.0	259214.9	296021.0	17.02	19.44	21.13
2013/14	1941624.0	312441.2	356620.7	16.09	18.36	20.47
2014/15	2120470.0	355957.7	405866.4	16.78	19.14	13.81
2015/16	2248691.0	427011.0	475012.1	18.98	21.12	17.04

Table 4.3

Contribution of Tax and Non-tax Revenue as Percent of Total Revenue

(Rs. In Millions)

Fiscal Year	**Total Revenue**	**Tax Revenue**	**% Tax Revenue**	**Non Tax Revenue**	**%NTR**	**Growth rate of TTR**	**Growth rate of NTR**
1990/91	10729.5	8176.3	76.2	2553.2	23.8		
1991/92	13512.7	9875.6	73.1	3637.1	26.9	20.78	42.45
1992/93	15148.4	11662.5	77.0	3485.9	23.0	18.09	-4.16
1993/94	19580.9	15371.5	78.5	4209.4	21.5	31.80	20.76
1994/95	24575.2	19660.0	77.9	4945.1	20.1	27.90	17.48
1995/96	27893.1	21668.0	77.7	6225.1	22.3	10.21	25.88
1996/97	30373.5	24424.3	80.4	5949.2	19.6	12.72	-4.43
1997/98	32937.9	25939.8	78.8	6998.1	21.2	6.20	17.63
1998/99	37257.4	28752.9	77.2	8504.5	22.8	10.84	21.53
1999/00	42893.8	33152.2	77.3	9741.6	22.7	15.30	14.55
2000/01	48893.6	38865.0	79.5	10028.6	20.5	17.23	2.95
2001/02	50445.5	39330.6	78.0	11114.9	22.0	1.20	10.83
2002/03	56229.8	42586.9	75.7	13642.9	24.3	3.98	22.74
2003/04	62331.0	48175.6	77.3	14155.3	22.7	17.79	3.76
2004/05	70122.8	54104.8	77.2	16018.0	22.8	12.31	13.16
2005/06	72282.1	57427.0	79.4	14855.1	20.6	6.15	-7.26
2006/07	87712.2	71126.7	81.1	16585.5	18.9	23.85	11.65
2007/08	107622.5	85155.5	79.1	22467.0	20.9	19.72	35.46
2008/09	143474.5	117051.9	81.6	26422.6	18.4	37.46	17.61
2009/10	177990.9	159785.3	89.8	18205.6	10.2	36.51	-31.10
2010/11	198375.9	177227.2	89.3	21148.7	10.7	10.92	16.17
2011/12	244372.9	211723.0	86.6	32651.1	13.4	19.46	54.39
2012/13	296021.1	259214.9	87.6	36806.2	12.4	22.43	12.73
2013/14	356620.7	312441.2	89.81	44179.5	11.13	20.53	20.03
2014/15	405866.4	355955.7	90.11	49910.7	11.08	13.93	12.97
2015/16	475012.1	427011.0	80.80	48001.1	8.17	19.96	-3.83

Table 4.4

Growth Rate of Tax

Year	Growth rate of GDP	Growth rate of total revenue	Growth rate of tax revenue	Growth rate of non tax revenue
1990/91				
1991/92	24.8	25.94	20.78	42.45
1992/93	14.08	12.10	18.09	-4.16
1993/94	15.87	29.26	31.80	20.76
1994/95	9.58	25.51	27.90	17.48
1995/96	14.00	13.50	10.21	25.88
1996/97	12.60	8.89	12.72	-4.43
1997/98	7.50	8.44	6.20	17.63
1998/99	13.8	13.11	10.84	21.53
1999/00	10.97	15.13	15.30	14.55
2000/01	12.88	13.99	17.23	2.95
2001/02	4.10	3.17	1.20	10.83
2002/03	6.95	11.47	3.98	22.74
2003/04	8.77	10.85	17.79	3.76
2004/05	9.54	12.50	12.31	13.16
2005/06	11.41	3.08	6.15	-7.26
2006/07	10.50	21.35	23.85	11.65
2007/08	11.74	22.70	19.72	35.46
2008/09	20.51	33.31	37.46	17.61
2009/10	19.03	24.06	36.51	-31.10
2010/11	15.23	11.45	10.92	16.17
2011/12	11.13	23.19	19.46	54.39
2012/13	9.57	21.13	22.43	12.73
2013/14	27.49	20.47	20.53	20.03
2014/15	9.2	13.81	13.93	12.97
2015/16	6.04	17.04	19.96	-3.83

Table 4.5

Structure of Tax revenue

(Rs. in Millions)

Fiscal Year	Total Tax Revenue	Direct Tax	Indirect Tax	% Direct Tax	% Indirect Tax	Growth rate of DT	Growth rate of IDT
1990/91	8176.3	1284.7	6891.6	15.7	84.3		
1991/92	9875.6	1487.1	8388.5	15.1	84.9	15.75	21.72
1992/93	1162.5	189.6	9782.9	16.1	83.9	26.39	16.62
1993/94	15371.5	2657.4	12714.1	17.3	82.7	41.38	29.96
1994/95	19660.0	3797.0	15863.0	22.8	77.2	42.88	24.77
1995/96	21668.0	4385.2	17082.8	21.2	78.8	15.49	7.69
1996/97	24424.3	5233,8	19190.3	21.4	78.6	19.35	12.34
1997/98	25939.8	6028.5	19911.3	23.2	76.8	15.18	3.76
1998/99	28752.9	7296.7	21456.2	25.4	74.6	21.04	7.76
1999/00	33152.2	8554.9	24597.3	25.8	74.2	17.24	14.64
2000/01	38865.0	10199.7	28665.7	26.2	73.8	19.23	16.54
2001/02	39330.6	10597.4	28733.2	26.9	73.1	3.90	0.24
2002/03	42586.9	10105.7	32481.2	23.9	76.1	-4.64	13.04
2003/04	48175.6	11883.9	36273.8	24.7	75.3	17.60	11.68
2004/05	54104.8	13061.0	41043.8	24.1	75.9	9.90	13.15
2005/06	57427.0	13961.5	43465.5	24.3	75.7	6.89	5.90
2006/07	71126.7	18980.3	52146.4	26.7	73.3	35.95	19.97
2007/08	85155.5	23087.7	62067.8	27.1	72.9	21.64	19.03
2008/09	117051.9	34320.3	82731.2	29.3	70.7	48.65	33.29
2009/10	159785.3	40396.0	119389.3	29.3	70.7	17.70	44.31
2010/11	177227.2	46720.3	130506.9	25.3	74.7	15.66	9.31
2011/12	211723.0	57770.2	153951.6	27.3	74.7	23.65	17.96
2012/13	259214.9	71407.5	187807.4	27.5	72.5	23.61	21.99
2013/14	312441.2	84757.0	214030.0	27.13	72.87	18.69	13.96
2014/15	355955.7	98490.9	272570.0	27.67	72.33	16.20	27.35
2015/16	427011.0	130557.2	324130.0	30.5	69.42	32.56	18.92

Source: Various Economic Surveys

Table 4.6

Composition of Direct Tax Revenue (1990/91 to 2015/16)

(Rs. in Millions)

Fiscal Year	Direct Tax	Income Tax	Land Revenue, House & Land Registration	Other taxes	Growth rate of Income tax
1990/91	1284.7	783.8	456.6	46.0	
1991/92	1487.1	875.0	571.3	40.7	11.64
1992/93	1879.6	1108.2	685.5	85.9	26.65
1993/94	2657.4	1804.3	830.11	22.6	62.81
1994/95	3797.0	2640.6	937.7	218.7	46.35
1995/96	4385.2	3205.4	1079.6	100.2	21.39
1996/97	5233,8	3829.4	1015.4	389	19.47
1997/98	6028.5	4499	1006.7	522.8	17.49
1998/99	7296.7	5646.5	996.3	653.9	25.51
1999/00	8554.9	6757	1013.3	784.6	19.67
2000/01	10199.7	9153.9	607.8	438	35.47
2001/02	10597.4	8903.6	1121.3	512.5	-2.73
2002/03	10105.7	8132.2	1414.2	559	-8.66
2003/04	11883.9	9504.0	1697.5	682.1	16.87
2004/05	13061.0	10456	1799.2	805.8	10.02
2005/06	13961.5	10933.6	2180.3	847.4	4.57
2006/07	18980.3	15730	2238.7	1011.6	43.87
2007/08	23087.7	19067.5	2933	1087.2	21.22
2008/09	34320.3	27479.7	5248.4	1592.2	44.12
2009/10	40396.0	33832.1	5510.8	1053.7	23.12
2010/11	46720.3	42066.3	3552	777.7	24.34
2011/12	57770.2	52880	3587	1303.2	25.71
2012/13	71407.5	64178.3	5309	1920.2	21.37
2013/14	84757.0	75636.0	6671.1	2449.9	17.85
2014/15	98490.9	86165.7	9399.4	2925.8	13.92
2015/16	130557.2	14138.0	12149.4	3269.8	8.59

Source: Various Economic Surveys

Table 4.7

Composition of Indirect Tax (1990/91 to 2015/16)

(Rs. in Millions)

Fiscal Year	Indirect tax	Custom Duties	Excise Duties	Sales Tax/VAT	Growth rate of CD	Growth rate of ED	Growth rate of tax/VAT
1990/91	6891.6	3044.3	1200.3	2647.0			
1991/92	8388.5	3358.9	1419.3	3610.3	36.39	10.33	18.25
1992/93	9782.9	3945.1	1452.6	4385.3	21.47	17.45	2.35
1993/94	12714.1	5255.2	1592.3	5866.6	33.78	33.21	9.62
1994/95	15863.0	7017.9	1657.5	7187.6	22.52	33.54	4.09
1995/96	17082.8	7327.4	1945.9	7809.5	8.65	4.41	17.40
1996/97	19190.3	8309.1	2302.1	8579.3	9.86	13.40	18.31
1997/98	19911.3	8499.9	2886.5	8524.9	-0.63	2.30	25.39
1998/99	21456.2	9517.5	2952.5	8986.2	5.41	11.97	2.29
1999/00	24597.3	10813.3	3132.7	10651.3	18.53	13.61	6.10
2000/01	28665.7	12479.0	3804.8	12381.9	16.25	15.40	21.45
2001/02	28733.2	12492	3973.3	12267.3	-0.93	0.10	4.43
2002/03	32481.2	14236.4	4777.5	13467.3	9.78	13.96	20.24
2003/04	36273.8	15554.2	6221.4	14498.2	7.65	9.26	30.22
2004/05	41043.8	15701.5	6446.3	18896	30.33	0.95	3.61
2005/06	43465.5	15343.7	6306.4	21615.4	14.39	-2.28	-2.17
2006/07	52146.4	16707.6	9343.2	26095.6	20.73	8.89	48.15
2007/08	62067.8	21062.5	11189.6	26095.6	0.00	26.07	19.76
2008/09	82731.2	26792.85	16237.59	39700.92	52.14	27.21	45.11
2009/10	119389.3	35151.1	24315.1	59923.1	50.94	31.20	49.75
2010/11	130506.9	35708	26315.1	68483.8	14.29	1.58	8.23
2011/12	153951.6	43395.4	30256.2	80300.0	17.25	21.53	14.98
2012/13	187807.4	56914.9	36244	94648.5	17.87	31.15	19.79
2013/14	214030.0	67680.0	45390.0	100960.0	6.67	18.91	25.23
2014/15	272570.0	71000.0	64750.0	136820.0	35.52	4.91	42.65
2015/16	324130.0	81750.0	79820.0	162560.0	18.81	15.14	23.27

Source: Various Economic Surveys