

A Study on Income tax Collection from Merchant Banker

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A THESIS

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INTRODUCTION

1.1 Background of the Study

Economic development is the prime concern of every nation in this world. For the economic development of a particular nation, its government bears huge responsibility towards its people. To fulfill its responsibility, government need funds to operate different activities within a country. Such activities include both general and developing activities. General activities are performed for the enforcement of right of every citizen provided by the constitution as living in a fearless manner, equal right towards nations resources etc. Development activities are performed for providing transportation, education, health and public utilities facilities to the community. Government collects revenue through two sources: (i) internal and (ii) external sources.

Developing country like Nepal has limited sources of internal funds so most of the development activities depend upon the external sources. The external sources of finance are bilateral and multilateral grants, loans from foreign countries and fund from donor agencies. These sources have been limited, inconvenient and not suitable to boost up the Nepalese economy due to the vested interest of the programs and policies of the donor countries and agencies and need to pay high interest, acceptance of the inappropriate condition to take the loan. Government tries to finance resources through internal sources. It is very important to developing country like Nepal to mobilize internal resources where adequate natural resources and low cost labor force is available. Situation of Nepal is different, Nepal is not able to mobilize its natural resources effectively, small and stagnant industrial sector, partial monetization of the economy, poor performance of public sector enterprises, poor rate of economic growth, inadequate tax efforts, deficiencies on tax policies, laws and administration etc.

Internal sources of public funds are important not only for necessary financing funds, but also for proper utilization of external sources. Based on the nature of sources, public funds are also classified into revenue (public income) and borrowing (could be external and internal). The public income or revenue includes: (a) taxes (b) revenue from Government

corporations and public enterprises (c) fees (d) special assessment (e) fines and penalties. Among them tax is the major source of collection of the government revenues. In Nepal, about 77% of total revenues comes from tax revenues and the rest 23% from non-tax revenue (Amatya, pokheral and Dahal, 2004: page 3).

According to Seligman (as cited in Kandel 2005) "A tax is a compulsory contribution from the person to the government to defray the expenses incurred in the common interest of all without references to special benefit conformed." Kandel again, cited that the tax is levy paid or to be paid by the natural or an artificial person to the government without getting corresponding benefits of goods or services provided by government. Thus, taxes play vital role in the government revenue.

Simply, tax is a compulsory contribution to the state from a person. Both the natural / artificial person (entity or corporate body having tax liabilities) as defined by law, has obligation to pay taxes to the government. The taxpayer does not receive the equivalent benefit from the government. Tax paid to the government is spent for common benefits and interest of the people. Taxes are classified into two major categories viz, direct tax and indirect tax. The tax directly paid by a person who is legally bound is known as direct tax. Such tax is income tax, windfall tax, interest tax, property tax, vehicle tax, house & Land tax, contract tax etc. Indirect taxation means a tax that is imposed to one person but partly or wholly paid by another. Such tax may be custom duty, value added tax, entertainment tax, excise duty, sales tax, hotel tax, passenger tax etc. In Nepal, direct tax contributes about 21% and Indirect tax contributes about 79% in the tax revenue of government (Amatya, Pokharel and Dahal 2004: page 3,4).

Income tax is one of the most popular direct taxes. It is charged on personal income according to the law of nation. Income includes all the income, which are receiving from business, investment & employment. Income tax is superior to indirect tax because it is imposed on the basis of paying capacity of the taxpayer. People whose income is below the taxable income are free from the obligation of income tax. It may possible to reduce the gaps in income by imposing higher rate to those who are having high income and from that collected amount, providing necessary to the people with very poor economic condition. Hence, it will help for the people with very poor economic condition. It may help to make equitable economic distribution in the society. Balanced regional economic development is

also possible through the provision of income tax. The government should charge higher income tax on the income from urban area and less on the income from remote area. Income tax holiday and incentives would help to develop the priority sector of a national economy. "Income tax has become an effective investment to ensure balanced socio-economic growth." (Mathew (1975), Musgrave & Musgrave (1998)).

Income tax plays a major determinant role in Nepalese economy. It is the major source of government revenue. It is recognized as a good financial tool to narrow inequality of income. It helps to reduce regional economic imbalance by providing tax concession and holiday to business or industry, which are established in remote area. It is also helpful for generating the concept of social responsibility toward the nation and keeps the people vigilant to see the public money may not be misused.

The contribution of income based taxes is much smaller to the total revenue for developing countries in comparison to developed countries and is likely to remain same for some time to come despite the efforts over the years of many least developed countries to raise more revenue. There are mainly four reasons as why income tax yield is less in developing countries as compare to developed ones. They are problems of defining income, problems of assessing and measuring it, the choice of rates, allowance and deducting and difficulties of tax collection.

Income tax is main source of government revenue. It is useful to balance economic development. Nobody can doubt that, the equal distribution of income is also possible through progressive income tax. It is being realized that contribution of income tax to the revenue of government must be increased in Nepal. Nepal has adopted the income tax system for last four half decades. But Nepal's past experience shows that the government is unable to maximize the share of income tax to the public fund as per expectation. Being developing country, Nepal has been facing many problems in financial sectors. Merchant Bank plays a vital role in economic and financial development of the country being work as a bridge, which provides every kind of financial assistances to industries and commerce. They play a highly significant role in mobilizing funds of savers to ingestible channels assuring of promising return on investments and thus can help in meeting the widening demand for ingestible funds for economic activity. The service of merchant banker could cover project counseling and pre-investment activities, feasibility studies, project reports,

design of capital structure, issue management and underwriting, loan syndication, foreign currency finance, merger, amalgamations and takeover, venture capital and public deposits.

Merchant banking activities comes under the jurisdiction of Securities board of Nepal and the approval is to be taken from therein. Some of the banks, development banks & finance companies licensed from Nepal Rastra Bank are permitted to act as Merchant Banker along with Elite Capital Limited approval from Securities Board alone is acting as merchant banker and some others in pipeline. Here lots of financial systems are being slowed down due to insufficient capital, technical & financial support. Merchant banks encourage them by its versatile service like project counseling, corporate counseling, portfolio management and venture capital and issue management.

List of merchant banker, which are licensed by Securities Board of Nepal up to February, 2009, are as below:

Table 1: Name list of merchant banker licensed from Securities Board of Nepal

S.N.	Names	Address
1	Ace Development Bank Ltd.	Narayanchour, Kathmandu
2	NMB Bank Ltd.	Babarmahal, Kathmandu
3	Citizens Investment Trust	Putalisadaki, Kathmandu
4	NIDC Capital Markets Ltd.	Kamalpokhari, Kathmandu
5	Nepal Finance Co.Ltd.	Kamaladi, Kathmandu
6	Nepal Share Markets and Finance Ltd.	Ramshahapath, Kathmandu
7	United Finance Ltd.	Kamaladi, Kathmandu
8	National Finance Co.Ltd.	Pako Newroad, Kathmandu
9	Elite Capital Ltd.	Jamal, Kathmandu
10	Vibor Development Bank Ltd.	Tripureshwor, Kathmandu
11	Nepal Housing & Merchant Finance Limited	Dillibazar, Kathmandu
12	Development Credit Bank Ltd.	Kamaladi, Kathmandu

However this study contains only that of seven merchant banker as follows,

- Ace Development Bank Ltd.
- NMB Bank Ltd.
- Citizens Investment Trust.
- Nepal Housing & Merchant Finance Ltd.
- Development Credit Bank Ltd..
- NIDC Capital Markets Ltd.

➤ Nepal Share Markets and Finance Ltd.

A good merchant banker would be considered being one who is expert, honest, has integrity and capacity to develop public relations. Whenever a business concern needs funds from the capital market it would usually approach the merchant banker rather than banks or financial institutions. By providing various services to public, business organizations and government, merchant banking and finance companies earn profit because they are profit-oriented entities so they must pay income tax out of their net profits. It is therefore income tax of merchant banks and finance plays a role like a brick in government revenue.

1.2 Statement of problem

Underdeveloped countries are facing various problems in the process of economic development. For the economic development sufficient resources are needed. One of the major sources of the public revenue is income tax in Nepal. It is charged on a person's income. With the increase in government expenditure, the source of government revenue must be increased. But the expenditure of the government of Nepal has been increasing at a faster rate than the increase in revenue. Being a developing country, most of the Nepalese people are below the poverty line; nearly one-third of the total population (about 30.85%) live below the poverty line as per the Nepal Economic Survey FY 2006 - 2007 and GDP per capita is \$ 383 (According to Nepal Economic Survey FY 2006 - 2007) It shows that it needs a huge amount of capital for the economic development of Nepal. It is possible only when the volume of resources could match with the requirement.

Nepal is a developing country. Most of the developing countries of the world should make investment heavily on infrastructure and activities for balanced social and economic development of the nation. That is why the government has been under pressure to spend a huge amount in education, health, physical construction and so many areas. There seem to be three reasons contributing to strong pressure to spend. (Leaving aside general price changes): the growth of population; the emergence of strong local and the emergence of strong world options.

The development of the country will be possible when the government can mobilize its own internal revenue, which constitutes tax and non-tax revenue. Tax revenue constitutes a

significant position in government revenue. In the total tax revenue indirect tax has greater portion than direct tax. In Nepal only 0.5% of the total population pays the income tax (Economic Survey 2005/06) Past experience shows that, there is poor taxpaying habit in Nepalese people. There are various problems about income tax administration like, proper record about the number of income tax payers, defective selection of personal, lack of training and education to tax payers and tax officers, undue delay in making assessment, lack of responsibilities of officials on their work, existence of corruption, and lack of motivation to concerned authorities etc. Because of the inefficiency of the administration and increasing corruption, people have to faith in the working of government and its organization.

The income tax is the vital source of the government revenue. Two types of income tax are applied i.e. personal income tax and corporate income tax. Most of the personal taxpayers do not reveal the income sources even they earn significant amount. They hardly keep the accounts. Similarly, some companies have been practicing to evade the tax liabilities by hiding incomes. As a result, the actual collection of income tax is very low and problem has been stable continuously due to corruption too. The laws of tax authorities also cause low revenue generation of the government. The discretionary power of the tax personal and the tax assessment procedure or the income tax system of Nepal harass the taxpayer in the payment of tax and cause the reduce the income tax revenue. Similarly the department cannot find out the actual number of income tax payers.

In the contest of developing countries like Nepal government cannot raise more income tax from corporation because high income tax may discourage the formulation of corporation. Government of Nepal is being unable to realize the expected income tax from personal as well as corporation. There is no proper supervision over the staff member of tax collection department corruption is the main problem of tax administration. There is no reliable and sufficient data for tax purpose. However Merchant Banks and Finance companies assist government to collect its revenue though making profit from the financial transaction by rendering service to the public and business organization and pay income tax from their taxable income.

1.3 Objectives of the Study

The main objective of the study is to analyze the income (corporate) tax collection from Merchant Banker by the government for the last five years. The other major objectives of this study are listed below.

1. To analyse the role of income tax in Nepali economy.
2. To introduce merchant banking services in Nepal and evaluate the contribution of income tax paid by selected merchant banker to the government revenue.
3. To assess the contribution of income tax paid by selected merchant banker companies on total income tax and total tax revenue of the government.
4. To forward the appropriate suggestions and recommendations for the identified issues.

1.4 Significance of the Study

For the economic development of the nation it is necessary huge amount outlay. But resources are limited. Government should identify the potential taxpayer and should given more emphasize to collect more revenue from them. For the economic development of the country, contribution of direct tax is more essential rather than indirect tax. But the whole tax structure in Nepal is dominated by indirect tax. Among the direct tax, income tax plays a significant role. It is one of the major resources that can be increase through proper correction in collection procedures and identification of potential taxpayers. So, it becomes necessary to analysis the different taxpayers under each head and income tax collected from each group of taxpayers time to time.

To increase the portion of national revenue, research and analysis should be done in the field of income tax. But the studies and research work is lacking in the area of income tax. Merchant Banks & Finance are also income taxpayers. The problems they are facing in tax paying should be corrected so they may contribute more income tax the national receipt. Merchant Banks & Finance are such institutions, which are directly linked with most other business activities. The position of business, trade and industries can be visualized through the analysis of activities of Merchant Banks & Finance. This study concern with appropriate suggestions for the estimation, correction and provide comprehensive information about income tax. Besides, this analysis may be useful to make new policies for granting various facilities to the Merchant Banks & Finance for making more taxable income in the competitive environment and legal correction, vague section of income tax can be also rectified from such analytical study.

This study is concerned with these aspects and it tries to make appropriate recommendations for the correction or problems in paying income tax by Merchant Banks & Finance. Besides, this study will also be useful to the tax planner, bankers, tax authorities and many others like teachers, students, researchers, and people who are interested on it.

1.5 Limitation of the study

As every research study is followed by some limitations, this study is also not free from limitation. The major limitations are mentioned below:

1. The study is concern only on those selected financial institutions, which are (namely pointed out) merchant banks & finance companies.
2. This study concentrates on the income (Corporate) tax realization from selected seven merchant bankers. They are;
 - (I) Ace Development Bank Ltd.
 - (II) Nmb Bank Ltd.
 - (III) Citizens Investment trust
 - (IV) Nepal Housing & Merchant Finance Ltd.
 - (V) Development Credit Bank Ltd.
 - (VI) NIDC Capital Markets Ltd.
 - (VII) Nepal Share Markets and Finance Ltd.
3. The study has covered the data from fiscal year 2003/2004 to 2007/2008.
4. Mainly secondary data has been used.