

# **Chapter I**

## **Introduction**

### **1.1 General Background**

The main objective of government of any developing country is to improve living standard of people through the development process. In order to achieve this objective every government launches different economic, social, cultural and other development activities. For this, government needs huge amount of financial resources.

Nepal is a land locked country lying between two Asian giants China and India. Both of them are able to enjoy high economic growth in the world. However, Nepal has not been able to reap the benefit of synergic development impact of encouraging growth of its neighbor. Nepal has been adopting the system of mixed economy to achieve its development goals. In spite of its planned efforts for development, overwhelming majority of its people enjoy income below the poverty line.

In order to uplift the living standard of people, Nepal has given first priority to economic development through planned efforts and the government has continued the implementation of several reform programs initiated in the past. Resource mobilization is the foundation for economic development of the nation. Since Nepal started its planned development efforts in 1956, the need for mobilization of additional financial resources has been growing in multiple folds.

The government can mobilize both internal and external financial resources to bridge its expenditure. However, the internal resources are more preferable to external one for sustainable economic development. Internal resources can be classified broadly into two groups, tax revenue and non tax revenue. Tax revenue includes direct tax on income and wealth and indirect tax

on consumption. Non-tax instruments for revenue collection are government charges, fines, dividend, royalty etc.

Income tax is categorized under direct tax on account of its property. It cannot be shifted backward or forward. Taxes on income may be levied on individual as well as business firms. The former is known as personal income tax and the later is known as corporate income tax.

Great Britain was the first country that introduced modern income tax in 1799 A. D. to collect revenue to finance Napoleonic war with France. In 1862, USA introduced income tax to finance Civil War. In India modern income tax was adopted in 1860. In Nepal income tax was introduced in 1959. Both individuals and companies were taxed in similar way during the earlier period but later on companies were levied with a flat rate and individuals with progressive rates (Poudel, 2002; 5).

First law of Nepal regarding to the income tax is Business Profit and Salaries Tax Act, 1960 then after three income tax acts has been introduced. These are Income Tax Act, 1962, Income Tax Act, 1974 and Income Tax Act, 2002. However, Income Tax Act, 2002 is in practice.

Income tax is the third largest source of total tax revenue. It is a tool of achieving minimum social and economic objectives as lay down by the constitution of Nepal. As a poor country, sources of government revenue are very limited. The domestic sources of the government revenue should be increased to escape from the condition of dependency on foreign aids and loans. Income tax may be the best way to increase government revenue internally.

## **1.2 Statement of the Problem**

Economic development is the prime concern of every nation. To fulfill this objective, every nation is accomplishing various activities. However, developing countries are facing serious problems in the process of economic development. Nepal is not exception to this condition.

Deliberate planning process began only after 1957 (2013 B.S) in Nepal. Ten (One three year and other five years) periodic plans have been already completed and Three Year Interim Plan is under operation. To fulfill the planning expenditure and for the process of economic development a lot of capital is needed.

Nepal is one of the developing and agro-based countries in the world. Its gross national income per capita is \$320 (World Development Indicator, 2008). It is the lowest in the SAARC countries and 30.85 percent of the total population lies below poverty line (Economic Survey, 2008). This scenario shows the economic condition of Nepal. So, Nepal needs huge amount of capital for economic development. Despite the various measures adopted by the government to boost revenue collection there is still a substantial resource gap between expenditure and revenue. The rate of government expenditure is exceeding the rate of growth in revenue collection, almost every year from the beginning of its development phase. The resource gap in FY 2006/07 was 45892.3 millions (Economic Survey, 2008). The sources of bridging the resource gap are internal and external borrowing. The external borrowing has playing important role to fulfill the resource gap. However, the use of external borrowing to fulfill growing government expenditure brings various problems.

The development process of a country will be possible only when the government can collect its own internal revenue. Internal revenue constitute a significant portion on government revenue of the total revenue collected in FY 2006/07, Tax and non-tax revenue account for 81.09 percent and 23 percent respectively (Economic Survey,2008). The major portion of government

revenue is covered by taxation but the tax composition of Nepal shows that the government revenue is highly dependent on indirect tax. In FY 2006/07, the indirect tax had contributed 73.31 percent of total tax revenue (Economic Survey, 2008).

In the context of Nepal's accession to WTO membership, it is a great challenge for the government to adjust tax rates accordingly without reducing present level of revenue collection. Revenue collection from direct tax is far behind low compared to indirect tax. Income tax is the major contributor of direct tax.

As the means of economic growth and social justice, income tax has not succeeded to play significant role in Nepalese tax structure. The direct tax had contributed only 26.68 percent of total tax revenue and income tax had contributed 82.87 percent of direct tax in FY 2006/07 (Economic Survey, 2008).

In developing nations, people have greater propensity to evade taxes. They have lesser or no knowledge about income tax and they have to maintain their expenditure from their limited income. Rich people are avoiding taxes by using legal loopholes and taking advantages of an inefficient tax administration.

In Nepal, the coverage of income tax is very narrow and people have low tax paying habit. Tax authorities are inefficient and ineffective in collecting tax and broadening tax base. There are no integrated programs for taxpayer's education, assistance counseling and guidance. The assessment procedure of income tax is ineffective; including delay in tax assessment not only reduces total revenue, but also brings harassment to the taxpayers (Lamsal, 2005; 8).

The coverage of income tax is very narrow in Nepal. Agriculture income is exempted from income tax. Remuneration or salary income is taxed more

heavily than the capital income. Retirement amount received by Nepalese people being retired from the service of foreign country is also exempted from income tax. Exemption of these sources provides loopholes for the evasion and complicate to the tax administration. Exclusion of agricultural income from tax net alone, cuts out about half of the GDP. The contribution of direct tax, especially of income tax is considerably low in Nepal compared to other developed countries. Administrative inefficiency, confusing definitions, corrupt bureaucracy, widespread tax evasion etc. are the reason for this state of affairs.

One of the most important tools for shortening resource gap in developing countries, efficient and effective utilization of internal resources has not been practically prioritized yet. And the potentiality of income tax to mobilize additional financial resources has not yet been recognized properly. In this juncture, it is necessary to study about the role of income tax in resource mobilization. In this study, we have tried to find out the answer of the following questions:

1. What is the structure and trend of income tax in Nepal?
2. What is the productivity and responsiveness of income tax in Nepal?
3. What are the problems and prospects of resource mobilization through income tax in Nepal?

### **1.3 Objectives of the Study**

The general objective of the study is to examine the role of income tax in resource mobilization.

The specific objectives of the study are:

1. To examine the structure and trend of income tax in Nepal.
2. To measure responsiveness and productivity of income tax yields.

3. To examine the problems and prospects of resource mobilization through income tax in Nepal.

#### **1.4 Justification of the Study**

Election of constitution assembly has completed after the successful aftermath of the Historic People's Movement and the commencement of the peace process. Now, the government has to spend huge resources for reconstruction, rehabilitation and relief to make modern, prosperous and just Nepal and to address the ambitious expectation of the people. For this purpose, government needs a huge amount of resources. In this regard, income tax can be a major source of government revenue.

Taxation is a powerful instrument for mobilizing the internal resources of any country whether it is developing or developed one. In developed countries, taxation contributes more than 3/4th to their total national revenue in which share of income tax is prominent. But case in developing countries is different; income tax has not been contributing the total revenue of country to the extent as it does in developed ones. In developing countries where financial resource gap is increasing seriously leading the economy to the state of external dependency, taxation only becomes sustainable and non-inflationary internal remedy to overcome this problem of financial resources gap and deficit financing. Because of poor internal resource mobilization capability, Nepal has been facing a serious resources gap for many years and this trend seems to be continued in future if suitable measures are not taken in time properly. For the remedy of external dependency and growing resource gap problem, internal revenue base should be strengthened through the mobilization additional financial resources internally specially through income taxation.

In the revenue structure of Nepal, the share of tax revenue and non-tax revenue were 81.09 percent and 18.09 percent respectively in FY 2006/07 which was 77.2 percent and 22.8 percent in FY 2004/05. Income tax occupies largest share in the direct tax and that the percentage share of this component in

the FY 1990/91 was 54.97 percent amounting to Rs. 746.2 million. The contribution of income tax to direct tax was highest i.e. 90.10 percent in FY 2000/01 and minimum i.e. 53.60 percent in FY 1991/92. Its contribution was reached to 82.87 percent of direct tax in FY 2006/07.

So, a study on the present and potential role of income tax to mobilize additional financial resources is must. This study has been concentrated on mobilization of additional financial resources through proper management of requirement. This study has been an attempt to explore potential rooms for additional resource mobilization through internal sources with special focus on income tax.

### **1.5 Limitations of the Study**

1. This study only covers the period of FY1964/65 to FY2006/07.
2. This study is based on secondary data and no attempt has been made to examine the reliability and validity of data.

## **Chapter II**

### **Literature Review**

In classical economics tax was taken as an extra burden to people. But now time has changed and tax has become main source of resource mobilization. Since FY 1959/60, when income tax was started in Nepal, many individuals and institutions have studied in this subject regarding legal aspect, administrative problem, historical aspect, trend and structure productiveness of income tax etc. They are as follows:

#### **2.1 Review of International Context**

Richard A. Musgrave in his book entitled "The Theory of Public Finance" (1959) has divided his study into four major parts. First part provides a general framework for an economic theory of the household, combining the functional finance of the stabilization type with other equally important objective of budget policy, including provision for the satisfaction of social wants and adjustment in the distribution of income. Application of welfare economics to the issues of budget determination, the general range of problems usually connected with incidence and effects of budget policy and the problems of fiscal policy as a means of economic stabilization have been described in part second, and fourth respectively.

Richard A Musgrave and Peggy B. Musgrave (1989) in their book entitled "Public Finance in Theory and Practice" have focused on individual income tax's provisions, structure of the tax base, problems of inclusions and deductions of income tax. They have further explained the structure and integration of corporate income tax.

B.B. Lal in his book entitled "Direct Taxes: Income Tax, Wealth Tax, Gift Tax and Tax Planning" (1990) has explained that income tax plays a very important role in the national economy. It is one of the important sources of



revenue to the government. In addition, it is also taken as a tool for achieving the social and economic objectives. Thus, he has concluded that besides, being a source of revenue, income tax has become an effective instrument to ensure balanced socio-economic growth.

Milka Casnegra de Jantcher and Richare M. Bird in their article "The Reform of Tax Administration" (1992) have suggested three main ingredients that are necessary for a successful tax administration reform in developing countries. First, the tax structure usually needs to be simplified for ease of compliance to the administration. Second, a reform strategy suitable to the specific circumstances of country must be developed. Finally and overall, there must be a strong political commitment to the improvement of tax administration and best-designed efforts will fail.

William Easterly and Sergio Rebelo in their working paper named "Marginal Income Tax Rates and Economic Growth in Developing Countries" (1992) have explained that the high income tax rate has a negative effect on the pace of economic expansion. This report has provided suitable methods for computing average marginal income tax rates that combine information on statutory rate with the amount of tax revenue collected and with data on income distribution.

Valeria De Bonis in his working paper named "Regional Integration and Factor Income Taxation" (1997) has analysed the issue of factor income taxation in the context of regional integration agreements. If Countries remove the barriers to trade and factor movement, taxation will distort the allocation of resources across borders. He has further concluded that the cross country uniformity of taxes on income from mobile factors is not necessarily an optimal outcome because the tax rate around which equalization takes place might not be the 'right' one.

Bhagawati Prasad in his book entitled "Income Tax: Law and Practice" (1999) has discussed the various aspects of income tax in India. This book is

basically designed to fulfil the partial requirement of the students of B.Com, BBA, BBM, BBS, and C.A. of Karnatak University.

## **2.2 Review of Nepalese Context**

Kedar Bahadur Amatya in his book entitled "Nepalma Aayakar Bebastha" (1965) has analysed the legal aspects of the income tax. This book is only the description of the income tax and is mainly based on Income Tax Act, 1962.

Surya Prasad Marahatta and Ananda Prasad Khatiwada in their book entitled "Fundamental of Nepalese Income Tax: with up to date Financial Directives and Regulations" (1970) have presented the legal provision as well as practical aspects related to income tax.

Narendra Lal Kayastha in his thesis named "Taxation of Income and Property" (1974) has discussed the role, importance, and historical and legal aspects of income tax. He has concluded that the reason for the very poor significance contribution of income tax to government revenue is due to the tax evasion. He has pointed out that the tax evasion is the main problem of income tax system of Nepal.

Puskar Raj Reejal in his article named "Revenue Productivity and Elasticity Aspects of Nepalese Taxation" Published by CEDA (1976) explained that Nepalese tax structure, as a whole was fairly elastic, with elasticity coefficient 1.82 and buoyancy 2.18 for the total tax revenue. This study found that the income tax to be highly elastic 4.39 which was highest among all the tax categories.

Govinda Ram Agrawal in his article named "Resource Mobilization for Development: The Reform of Income Tax in Nepal" (1978) has found that buoyancy of income tax with respect to GDP for period FY 1967/68 to FY 1975/76 is 2.18 and elasticity is 2.01. He was further identified that the main defects of the income tax administration as failure to locate new taxpayers, to

maintain the accounts, delay in assessment, poor taxpayer compliance, evasion and avoidance of tax, and defective management.

Santosh Raj Poudyal and Prem Prasad Timilsina in their book entitled "Income Tax in Nepal" (1990) have described the theoretical as well as practical aspects of income tax. This book is descriptive rather analytical.

Narayan Raj Tiwari in his book entitled "Income Tax System in Nepal" (1993) has described the legal provision related to income tax. He has described the process, provisions and methods to assess the income tax with numerical examples.

Hari Bahadur Bhandari in his thesis named "Contribution of Income Tax to Economic Development of Nepal: with Reference to Kathmandu and Pokhara Valley" (1994) has found that to increase the contribution of income to economic development of Nepal, capital gain and agricultural income should be taxed. He has also suggested differentiating the exemption limit to the family with one child and two children.

Madan Kumar Dahal in his report named "Review of Tax System" (2052) has addressed the narrow tax base, low tax elasticity, higher burden of indirect tax compared to direct tax lack of voluntary compliance, wide spread tax evasion, leakage's etc. as main constraints of Nepalese tax system. Including income from agricultural sector, income from domestic industries, social sector and electricity sector, which contributes 52% of total GDP, is exempted from income tax. This report has suggested that about 40% extra resource mobilization is possible if proposed tax policy and program are in place.

Mani Kumar Nepal in his thesis named "Structure and Responsiveness of Nepal's Tax System" (1995) has mentioned that the overall elasticity of the total revenue in Nepal's tax structure for the period FY 1968/69 to FY 1992/93 was 0.64 and Nepalese revenue structure as a whole was regressive in nature.

But, the buoyancy coefficient for the total tax revenue was 1.16 during the study period. However, elasticity of income tax was 0.48 in study period.

Govind B. Thapa in his article entitled "Nepalko Rajaswako Samrachana, Rajaswako Sthiti Ra Chunautiharu" published in Rajaswa (2000) has described that the agricultural income which contributed about 40% of GDP being tax free, about 50% of total population being below the poverty line, tax holiday for new industries, lack of political commitment are the major causes of poor resource mobilization in Nepal.

Puspha Raj Kandel in his article named "Draft of Income Tax Act, 2002. Critical Analysis" (2001) has analysed the draft on several grounds like exemption of agricultural income from tax coverage, export duties levied upon export inequality in tax rates imposed on different capital earned income and no adjustment for inflation rate in the tax act, rules and regulation

Rup Khadka in his book entitled "Income Taxation in Nepal Retrospect and Prospects" (2001) has stated that income tax is annually the third largest source of government revenue producing about 20% of tax revenue. Khadka states that although some attempts have been made in recent time to broaden the coverage, the tax base is still narrow both legally and administratively covering less than one percent of total population of Nepal.

Bishwadeep Adhikari; in his book entitled "Income Tax Law: Then and Now" (2002) has described the legal provision of new Income Tax Act, 2002. He has also described the decisions made by supremecourt about the income tax and also described the legal provisions with critical analysis.

Jayanti Poudel in her thesis named "Income Taxation in Nepal: A Study of its Structure and Productivity" (2002) has explained that within the direct tax, income tax is the largest source, which contributed more than 86% in FY 1999/00. The contribution of income tax to direct tax has increased significantly since its introduction. The elasticity and buoyancy coefficient of

income tax has been found to be 0.61 and 1.36 respectively during the period FY 1975/76 to FY 1999/00. This shows that Nepalese income tax is very inelastic and there are minimum chances for further discretionary changes.

Sankar Prasad Sharma in his dissertation named "Taxation of Income in Nepal" (2002) has explained that with the passage of time, the ancient taxation of property become both less fashionable and less productive. The relative welfare position of individuals began to measure in terms of their income and therefore tax on income become respectable both among the ranks of economists and policy makers. He has further mentioned that the internal resource mobilization as a percentage of GDP has gone up and the structure of income tax in Nepal is not much responsive.

Bidhyadhar Mallik in his book entitled "Modern Taxation System of Nepal" (2003) has presented the history of modern income tax periodically from the very beginning to Income Tax Act, 2002 with the justification of changes and amendments made in the act and regulation. The author has presented Income Tax Act, 2002 in simple and clear crystal manner with suitable examples and explanations wherever necessary.

Pushpa Raj Kandel in his book entitled "Tax Laws and Tax Planning" (2003) has presented various practical and theoretical aspects of taxation with clear and proper logics supported by theoretical explanations and practical problems, in the context of changed act, Income Tax Act, 2002.

Dharma Raj Shakya in his thesis named "A Study on Income Tax Act, 2002" (2004) has concluded that the act could be a effective means to generate more revenue from income taxation if the act is effectively implemented. The confusions and misunderstanding of different provisions made on Income Tax Act, 2002, can eliminate providing orientation to tax payers and training to tax administration.

Rajendra Dulal in his thesis named "Income Taxes in Nepal: Study of its Structure and Contribution to Revenue Generation" (2004) has explained that the contribution of income tax to total revenue was 7.8% in FY 1975/76 and in FY 1999/00 it was 14.5%. This study has explained that the income tax rates and slabs have been changed radically in recent years. Under new Income Tax Act, 2002, individual income tax is levied with low rates of 15% and 25% and the corporate income tax is levied with single rate of 25%. For bank and financial institutions the rate is 30% of taxable income.

Surendra Keshar Amatya, Bihari Binod Pokharel and Rewanta Kumar Dahal in their book entitled "Taxation in Nepal: Income Tax, Property Tax and Value Added Tax" (2004) have defined all the terms relating to income tax and value added tax. The examples that are presented in this book are very useful to reader to know more about provisions and procedures of the Income Tax Act, 2002.

Barmha Bahadur Bajgin in his thesis named "A Study on Income Tax: Trend Analysis and Projection" (2005) has concluded that the income tax which must be strong in revenue structure for economic growth of nation is very poor in Nepalese tax structure. By the trend analysis of income tax collection it can be declared that there exists so many gaps viz. gap in policy, gap in law and gap in administration has very high fluctuation.

Naba Raj Lamsal in his thesis named "Income Taxation in Nepal: Structure, Provision and Problems" (2005) has explained that the contribution of income tax to total revenue, tax revenue, direct tax and total GDP is in increasing trend. He has further explained that the income tax is the composition of corporate income tax, individual income tax and investment income tax. The corporate income tax has dominant role on income tax but it is in decreasing trend.

Rishi Ram Neupane in his thesis entitled "Income Tax as an Internal Source of Resource Mobilization in Nepal" (2005) has concluded that the

Tax/GDP ratio in Nepal is very nominal as compared to the same ratio in neighbouring SAARC and other developing countries. He has also concluded that income tax is the main component of direct tax and its contribution on direct tax and total tax revenue is 78.78% and 19.02% respectively. He has further said that for the economic upliftment of the nation, additional internal financial resource mobilization should be strengthened and generation of more revenue internally, planned development efforts, political stability and liberal economy may be the means for such mobilization.

Jagdish Agrawal in his book entitled "Income Tax, Theory and Practice" (2007) has dealt with the various aspects of income tax. He has mentioned that the new act (i.e. 2058) is a result of a great deal of efforts by some prominent figures of Nepal and some friends of Nepal. The Income Tax Act, 2058, has completely replaced the old act of 2031.

Lokendra Bhandari in his thesis named "Income Taxation in Nepal: Analysis of Structure and Problems" (2007) has explained that the contribution of income tax to the total revenue tax revenue, direct tax and total GDP is in increasing trend. Its contribution was 9.94%, 12.67%, 67.37% and 0.93% respectively in the FY 1989/90 which increased to 15.13%, 19.04%, 78.3% and 1.96% in FY 2005/06. This study has further explained that being various problems relating to income tax, revenue collection from income tax is low as compared to other developing countries like India, Sri Lanka and Pakistan.

Neelam Timsina in his article entitled "Tax Elasticity and Buoyancy in Nepal: A Revisit " (2007) has concluded that the automatic response of tax to income is low. Compared to the period FY 1975 to FY 1994, the elasticity coefficients of tax during the review period (FY 1975 to FY 2005) did not reveal significant differences. The buoyancy and elasticity of income tax during the study period was 1.37 and 0.41 respectively. This study has further concluded that only the discretionary measures cannot generate more revenue free of charge. Improvement in tax administration to control the leakage and to

broaden the tax bases in practice is important for enhancing the elasticity of the tax.

Saroj Raj Regmi in his article entitled "Income Tax Evasion is a Crime in Nepalese Legislation" (2007) has explained that the current trend of collection of income tax and the contribution of it in the national revenue is far from satisfaction. This study has also suggested to enhance some progressive reforms in current income tax law with practical solutions and well set up mechanisms.

### **2.3 Conclusion**

Since FY1959/60, when income tax was started in Nepal, many individuals and institutions have studies in this subject regarding legal, administrative, historical aspect of income tax and trend, structure and productivity of income tax. All the books are found syllabus oriented and there is no any study which consists all subject matter of this study. However, all the previous studies and books are relevant to known the different concept of tax, income tax, different methods of adjusting tax revenue series for calculating elasticity and buoyancy, problems and prospects of resource mobilization through income tax etc.



## **Chapter III**

### **Methodology**

#### **3.1 Conceptual Framework**

Resource mobilization has a crucial role in fiscal policy implementation, especially in a developing country where the demand of public funds for public expenditure is high. It is the better source of resource mobilization than other sources such as deficit financing and money creation. As tax revenue is the major source of domestic revenue in Nepal, the measurement of tax elasticity and buoyancy would be very beneficial in terms of reforms in tax structure as well as revenue administration. In addition to this, the study of tax elasticity and buoyancy is also useful for revenue forecasting.

Tax revenue may change due to various factors, such as changes in income, changes in tax rate and tax base, changes in efficiency of tax assessment and collection, among others. The responsiveness of tax revenue to such changes can be explained with the help of tax elasticity and buoyancy. Tax elasticity may be defined as the ratio of a percentage change in adjusted tax revenue to a percentage change in income i.e. nominal GDP. On the other hand, tax buoyancy refers to changes in actual tax revenues due to the changes in income as well as due to the changes in discretionary measures such as tax rates and tax bases (Mukul, 1997; 63). This distinction between the tax elasticity and buoyancy is very useful in analyzing and evaluating whether further revenues will be sufficient to meet the resource needs without changing the rates or bases of the existing tax. To measure the tax elasticity, historical tax series must be adjusted so as to eliminate the effects of tax revenue from discretionary changes. If there is no change in tax rates and tax base during the reference period, buoyancy will be the same as elasticity.

Elasticity is measured with adjusted data while buoyancy is measured with unadjusted data. If an elasticity of unity means that each one percentage change in GDP is accompanied by one percentage change in tax revenue, an elasticity of less than unity means that the percentage change in revenue will be less than the percentage change in GDP and an elasticity greater than one means that the percentage change in revenue will exceed that in GDP. A tax system is said to be elastic if the measure exceeds one and inelastic if it is less than one (Goode, 1986; 92). High tax elasticity is said to be desirable attribute because it leads to natural growth in revenue for financing the rapidly growing development expenditure without the need for politically difficult decisions to raise taxes. However, major sources of government revenue may have a low elasticity, in which case the authorities must seek additional revenue by introducing discretionary changes (Timalsina, 2007; 28). The difference between the elasticity and buoyancy coefficient of the tax is used to whether discretionary changes always siphon off additional revenue and vice versa. Because of the nature of discretionary changes they can be adopted in a particular situation to collect more revenue immediately to fulfill the current requirement but in the long run, raising elasticity is desirable and frequent discretionary changes might be intractable and may be unpopular as well.

An efficient tax system ought to give better results and be progressive; it should possess elasticity greater than one. Of course the degree of progressiveness depends upon the desired level of objectives of the economy. Generally, elasticity and buoyancy are defined as the ratio of relative change in dependent variable (tax yield in the study) to the relative change in independent variable (GDP). Mathematically, both elasticity and buoyancy have been calculated on the basis of following equation;

$$e = \frac{\Delta T}{T} \times \frac{Y}{\Delta Y} \dots\dots\dots (1)$$

Where, e = elasticity of total tax to GDP

T = change in tax revenue                      T = tax revenue (income tax)

Y = change in GDP                                Y = GDP

The income elasticity of each separate tax may be decomposed into the elasticity of tax to base and the elasticity of base to income. Thus, the base elasticity and buoyancy have been calculated on the basis of the following equation:

$$e_1 = \frac{\Delta T}{T} \times \frac{B}{\Delta B} \dots\dots\dots (2)$$

Where,  $e_1$  = elasticity of total tax to proxy base

T = change in tax revenue                      T = tax revenue

B = change in proxy base (non-agriculture GDP)

B = amount of proxy base (non-agriculture GDP)

For calculating elasticity, the adjusted revenue yields are used. This is done to eliminate discretionary changes to find out the built in flexibility where as the actual yields are used to calculate buoyancy. By calculating the difference between elasticity and buoyancy the role of discretionary changes in income tax revenue is observed.

### 3.1.1 The Adjustment Procedure

Tax revenue usually changes due to discretionary measures, for example, changes in tax rates, tax net expansion and so on. Therefore, a need to separate the changes in revenue emanating through the discretionary measures from that due automatic measures arises to estimate the elasticity. This is the way to distinguish tax elasticity from tax buoyancy.

Tax revenue series can be adjusted in four ways: constant rate procedure, the proportional adjustment procedure, divisa index procedure and the dummy variable procedure. The selection of the appropriate adjustment

method depends upon the availability of the data on tax changes and the type and frequency of such changes (*Ibid*, 78). The constant rate structure method requires disaggregated data on tax rates and tax bases; which is not easily available in Nepal. Since the tax revenues change frequently through the discretionary changes, the dummy variable procedure is not applicable. So the proportional adjustment procedure, which requires calculation of the revenue implications of discretionary measures, is applied in the study to adjust the historical tax revenue data. In this method, to remove the estimated revenue impact through discretionary measures, the annual observed data are adjusted for discretionary changes. The resulting series are converted to the first year's basis by adjusting the year to year changes by the ratio of the tax yield on the basis of the first year rates to the actual tax yields.

In Proportional Adjustment Method, it adjusts the historical revenue series for each to derive a revenue yield based on the structure of rate and exemptions for a reference year. In this method, there are several alternative methods for adjustment such as: Prest Method, Sahota Method and Chand Method.

#### **I) Prest Method**

This method begins with estimates of the effects of discretionary tax changes on the year's receipts, often prepared by treasury officials. The separation of discretionary effects is then accomplished in two steps. First, a preliminary series of adjusted tax yield for each year the estimated amount attributed to the discretionary changes in that year. Second, this adjusted series is then further refined to form a final series that excludes the continuing impact of each discretionary change on future years. The Prest formula is;

(a)  $T_1, T_2, \dots, T_t, \dots, T_n$  are actual tax yields for a series of years.

(b)  $D_1, D_2, \dots, D_t, \dots, D_n$  measures the effect of discretionary change in the  $j^{\text{th}}$  year's revenue outturn.

(c)  $T_{ij}$  indicates the  $j^{\text{th}}$  year's actual tax yield adjusted to the tax structure that existed in year  $i$ .

If  $i = 1$  is the reference year, the series  $T_{11}, T_{12}, T_{13}, \dots, T_{1t}, \dots, T_{1n}$  represents what the tax receipts would have been if the tax structure had remained as in year 1 with all discretionary changes removed from the years following year 1. It is this series that forms the basis used here for measuring the elasticity of a tax. The series is developed as follows:

$$T_{11} = T_1$$

$$T_{12} = T_2 - D_2$$

$$T_{13} = T_{23} \times \frac{T_{12}}{T_2}$$

$$T_{14} = T_{34} \times \frac{T_{23}}{T_3} \cdot \frac{T_{12}}{T_2}$$

$$T_{1j} = T_{j-1,j} \times \frac{T_{j-2,j-1}}{T_{j-1}} \dots \frac{T_{23}}{T_3} \times \frac{T_{12}}{T_2}$$

## II) Chand Method

In this method the adjusted tax yield at present year found on the basis of following year's adjusted value. The formula for adjustment is:

$$T_{nr} = T_r \times \frac{T_{r+1}}{T_{r+1} - D_{r+1}} \times \dots \times \frac{T_n}{T_n - D_n}$$

Where,  $n$  = reference years and the number of years considered.

$T_{nr}$  = adjusted or net tax yield in  $r^{\text{th}}$  year.

$D_r$  = discretionary change in  $r^{\text{th}}$  year.

$T_r$  = actual tax yield at  $r^{\text{th}}$  year.

$r = 1, 2, \dots, n.$

### III) Sahota Method

Sahota's adjustment of actual tax receipts to a series ( $I_i$ ), which he argues, excludes discretionary effects, is accomplished by:

$$I_i = \frac{T_i}{T_{i-1}}(I_{i-1})$$

Where,  $T_i$  stands for  $i^{\text{th}}$  year tax collection adjusted to rates in year  $i-1$ . This can be written in other way:

$$IT_t = \frac{AT_t \pm RT_t}{AT_{t-1}} \times IT_{t-1}$$

Where,

$IT_t$  = index of net tax receipt of the year  $t$ .

$AT_t$  = actual tax yield of the year  $t$ .

$RT_t$  = actual discretionary changes

$t$  = the  $t^{\text{th}}$  year.

$t-1$  = the one period lag.

Sahota Method is used for making adjustment to eliminate discretionary changes. It adjusts the actual figure or the current year on the basis of the adjustment figure of the previous year. Same result comes from another Prest Method also. Constant Structure Method is the best method for calculating adjusted revenue series in developed countries where previous data are easily

available but for developing countries like Nepal, Sahota method is the second best method, as it requires less data details.

### **3.2 Research Design**

This research has been an analytical and descriptive in design using historical data to assess the current role of income tax in resource mobilization internally and to explore some potential areas for additional domestic resource mobilization through income taxation to shorten the gap of resource deficit in Nepalese Finance.

This research has tried to analyze and describe the taxation system by its own procedure. Historical data of FY1964/65 to FY2006/07 has been fully taken into consideration. The main variables used in analysis are gross domestic product (GDP), tax revenue and non-tax revenue of government. Tax revenue of the government is broken down into direct tax and indirect tax. Both direct and indirect taxes are again sub divided into different subcomponents.

### **3.3 Nature and Sources of Data**

Secondary sources of data have been used for the conduct of this research. The sources of data consist of books, journals, newspapers, reports and dissertations. The major sources of secondary data are as follows:

- a. Different Publications of Ministry of Finance.
- b. Report and records of Inland Revenue Department.
- c. Published documents of NRB and NPC.
- d. Dissertations available at the central library of T.U.
- e. Dissertations available at library of CEDECON; T.U.
- f. Articles published on different journals and news magazines.

- g. Different publications of Central Bureau of statistics (CBS).
- h. Internet, e-mail.
- i. Different publications of World Bank.
- j. Different publications of IMF.

### 3.4 Variables Used in the Model

Total revenue of the government has been classified into tax and non-tax revenue. Further, tax revenue is again divided into direct tax and indirect tax. Direct tax includes income tax, the tax on land revenue and registration fees. Similarly, indirect tax in turn is divided into custom and tax on consumption and production of goods and services. The independent variable, GDP, will be regressed with income tax as the dependent variable in the study to estimate the elasticity and buoyancy coefficient of income tax.

<u>Dependent Variable</u>	<u>Independent Variables</u>
Income Tax (T)	Total GDP (Y),  Non-Agri.GDP (Y <sub>1</sub> )  Income Year (x)

### 3.5 Identification of the Model

The formula that is used to estimate elasticity as shown in the equation (1) ignores true functional relationship between the variables. Therefore, elasticity can be obtained by regressing the income with the tax yield by using following exponential form of equations as:

$$T = Y \dots\dots\dots (3)$$

Where,     measures the elasticity or buoyancy



Elasticity is defined as the automatic response of tax revenue to change in GDP and buoyancy as the total response of tax revenue including discretionary changes, associated with a given percentage change in GDP.

Least square method is used for trend analysis and projection. The equation of trend line is given as follows:

$$Y = a + bX$$

Where, Y = Income Tax

X = Income Year

a and b = Parameters

### 3.6 Specification of the Model

In this study the double log linear model is used to estimate the built-in-flexibility or elasticity with respect to adjusted revenue series is measured from the relation.

$$T_a = Y$$

Taking log on both sides;

$$\log T_a = \log \quad + \quad \log Y \dots\dots\dots (4)$$

For base elasticity,

$$\log T_a = \log \quad + \quad \log Y_1 \dots\dots\dots (5)$$

Similarly, sensitivity or buoyancy coefficient with respect to actual tax revenue series and GDP is estimated from the relation.

$$T = Y_1$$

Taking log on both sides;

$$\log T = \log \quad + \quad \log Y \dots\dots\dots (6)$$

For base buoyancy,

$$\log T = \log T_a + \beta_1 \log Y_1 \dots\dots\dots (7)$$

Where,

$T_a$  = adjusted tax revenue series

$T$  = actual tax revenue series

$Y$  = total GDP

$Y_1$  = total non-agriculture GDP

$\beta_1$  = elasticity coefficient

$\beta_2$  = buoyancy coefficient

$\beta_3$  = coefficient

Empirical test developed here is that there is good and strong relationship between respective independent variables and dependent variables. Common statistical test namely F-test has been used to test the significance of the coefficient of elasticity and buoyancy at 1 percent level of significance and to test the reliability of the model being used. The value of  $R^2$  has been calculated to see how good the relationship between the dependent and independent variables are in the equation.

The least square method of a time series analysis is used for the trend analysis and projection.

$$Y_c = a + bX$$

Where,

$Y_c$  = Estimated value of Y for any given value of independent variable X.

$a$  = Y-intercept or value of Y when  $X=0$

$b$  = slope of the trend line/ amount of change in 'Y' per unit change in 'X'

The value of 'a' and 'b' is obtained by solving the following two normal equations:

$$Y = Na + bX$$

$$\sum XY = a \sum Y + b \sum X^2$$

Where,

N: number of years

Now, substituting the value of 'a' and 'b' in equation (1), gives the equation of the trend line.

### **3.7 Tools of Analysis**

Both quantitative as well as qualitative methods have been employed for the purpose of data analysis. However, the quantitative tools have been employed widely. It has been seen as the best method for the data analysis and also to reach at the conclusion. Different statistical tools for both estimation and test have been employed as demanded by the objectives so specified above.

With regard to the model used above, following measures are carried out to check the reliability of the analysis:

#### **Coefficient of Determination ( $R^2$ )**

The R-squared ( $R^2$ ) statistic measures the success of regression in predicting the values of dependent variables within the sample. Estimate of coefficient of determination ( $R^2$ ) shows the percentage of the total variation in dependent variables explained by independent variables. The value of  $R^2$  lies between 0 and 1. The higher the  $R^2$  the greater will be the percentage of the variation of dependent variable (T) explained by the independent variable (Y) i.e. the better the 'goodness of fit' of the regression plane to the sample observations and closer the  $R^2$  to zero the worse the fit of regression plane.

## **Adjustment Coefficient of Determination ( $\overline{R^2}$ )**

This measure is also employed to get additional information about the goodness of fit. One problem with using  $R^2$  as a measure of goodness of fit is that the  $R^2$  will never decrease as more regressors are added. In the extreme case, we can always obtain an  $R^2$  of one if we include as many independent regressors as there are sample observations. The adjusted, commonly denoted as  $\overline{R^2}$  penalizes the  $R^2$  for the addition of regressors, which does not contribute to the explanatory power of the model.

### **t-test**

The t-test is based on the students' distribution. It is used to test the hypothesis about any individual partial regression coefficient. To compute the t-statistic, the standard errors for each input are computed separately. The t-ratio is the significant test of the regression coefficient of the hypothesis. Broadly speaking a test of significance is a procedure by which sample results are used to verify the truth or falsity of null hypothesis. The decision to accept or reject null hypothesis is made on the basis of value of the test statistic obtained from the data at hand. The t-statistic, which is computed as the ratio of an estimated coefficient to its standard error, is used to test hypothesis that a coefficient is equal to zero, to interpret the t-statistic given that the coefficient is equal to zero.

### **D-W test**

D-W test is the test that justifies whether there is serial autocorrelation or not in the residual terms. Moreover, it measures the linear association between adjacent residuals from a regression model.

If there is no serial correlation, the D-W statistic will be around 2. The D-W statistic will be around 2. The D-W statistic will fall below 2 if there is positive serial correlation. If there is negative correlation the statistic will lie

somewhere between 2 and 4. Positive serial correlation is the most commonly observed form of dependence. As a rule of thumb with 50 or more observations and only a few independent variables, a D-W statistic below about 1.5 is a strong indication of positive first order serial correlation.

There are three main limitations of the D-W test as a test for serial correlation. First, the distribution of the D-W statistic under the empirical test depends on the data matrix. The usual approach to handling this problem is to place bounds on the critical region, creating a region where the test results are inconclusive. Second, if there are lagged dependent variables on the right-hand side of the regression, the D-W test is no longer valid. Lastly, you may only test the empirical test of no serial correlation against the first order serial correlation. This measure will be carried out to check the autocorrelation. Since the estimation is based on the time series data, check for the autocorrelation is most.

### **F-test**

For the purpose of analysis of variance, this test is employed. The F-statistic tests that all of the slope coefficients in a regression are zero. For ordinary least square models, the F-statistics is computed as,

$$F = \frac{R^2 / K - 1}{(1 - R^2) / N - K}$$

Under the empirical test with normally distributed errors, this statistic has an F-distribution with K-1 numerator degrees of freedom and N-K denominator degrees of freedom.

The p-value denoted probability (F-statistics) is the marginal significance level of the F-test. If the p-value is less than the significance level we are testing, say, 0.01, we reject the empirical tests that all slope coefficients

are equal to zero. For the explanation above, the p-value is essentially zero, so we reject that all of the regression coefficients are zero.

## **Chapter IV**

# **Theoretical Framework and Historical Background of Income Tax**

## **4.1 Concept of Tax**

### **4.1.1 Theoretical Framework**

Tax is a compulsory contribution to government made without reference to a particular benefit received by the taxpayer. These characteristics distinguish it from a price, which is a voluntary payment for goods and services. This is politically and economically important. The absence of a perceived direct benefit causes taxation to be regarded as burdensome in a way that prices are not, even by persons who recognize that the state provides benefits for the community and who approve its policies. Generally, the amount of tax paid by a person will not affect the benefits that he receives individually, and it will be too small to have an appreciable effect on total benefit. Hence, an individual could rationally, selfishly, advocate reducing his own taxes even though he wished government services to be maintained or expanded (Goode, 1986; 75).

The primary purpose of taxation is to divert control of economic resources from taxpayers to the state or its own use or transfer to others. Taxation restrains total spending by households and enterprises but influences the allocation of economic resources, recognizes social costs that are not reflected in market prices, and affects the distribution of income and wealth.

Taxes are usually paid in money and represented as a forced surrender of purchasing power. Exceptionally, however they are collected in kind as were agricultural taxes in Japan and Korea immediately after 2<sup>nd</sup> World War and as are taxes on oil companies in a number of producing countries (Ibid; 76).

#### 4.1.2 Origin of Taxation

The history of taxation dates back to antiquity. In early days taxes were not collected in monetary terms but were collected by tribal rules, community heads, etc for communal services and at the time of emergencies (Dulal 2004; 22).

In Hindu tax system, tax was levied on the basis of welfare of the people and people were eager to pay tax because not to pay tax was taken as a great sin. According to Hindus' Holy Scripture, Vedas, the duty of king was to serve and secure people, maintain peace and carry out social works. In order to perform all those activities, the king used to collect crops and cattle from farmers and gold, silver and copper from traders. These ancient forms of taxation were expanded from time to time under the influence of various economical, political and ethical forces (Ibid; 22).

In the early Roman society, the citizens had to pay taxes even for the pulling rights. Ancient Athens used to derive its revenue from taxes like customs, sales, and pole tax on aliens and slaves. One who was taxed and failed to pay was guilty of a capital offence. After the end of Punic war in 146 B.C., they were relieved from the poll tax. They started to levy tax on the people of the captured areas instead of there citizens. At the time of Julius Ceaser, 1% sales tax was imposed to the people and he was the first ruler who started to collect taxes through governmental institutions (Ibid; 22-23)

Kautilya's '*Arthashastra*' of the fourth century B.C. has classified the tax receipt into three types (Ibid; 23)

- a) Income earned through taxes on goods produced within the country.
- b) Income earned through taxes on the capital.
- c) Income earned through taxes on imports and exports.



Land revenue was an important source of taxation in ancient India. Kautilya mentioned, “The tax system should be such as not prove a great burden on the public (Prajā), the king should act like the bee which collects economic thought was guided by social welfare concept. He suggested heavy taxation for luxuries and other articles, which were not in favor of the public welfare (Ibid; 23).

Classical writers always favored minimum interference of the government and emphasized on the least taxation. According to the classicists’ taxation is the common debt to citizens, a kind of compensation and the price of the advantages which society confers upon them. Thus tax is a quota each citizen has to pay towards cost of public services. Antonio De Viti De Marco has described the misconception of classical economists in the following words:

Taxes were regarded as a sort of hail that destroys part of crop. Therefore, the use to which tax was put after its payment was not studied at all. The consequence was that taxes were regarded, without further ado, as being accompanied by a contraction in the supply of available goods, with all the mistaken consequences of this mistaken premise (Timalsina, 2007; 41).

Until the Great Depression of 1930s, many economists regarded neutrality of tax system as ultimate goal. After the Keynesian revolution, it is generally accepted that taxation is no longer to look upon as a means of collecting the revenue for financing the government expenditure but as one of the primary weapons in the government armory for ensuring general economic stability (Ibid; 42).

As a fiscal instrument, taxation is used in mitigating the inequality in income and wealth. It is also used to check inflation to provide incentives for production, saving and investment; to influence balance of payments and the structure of economy and to achieve long term economic growth. Thus, Keynes using taxation as a fiscal instrument gave a new direction to its role (Ibid; 42)

After the great depression of 1930s, the function of government has been increased considerably. For smooth functioning, government has got various sources of revenue. Tax is an important instrument of government to mobilize the resources to achieve the objectives. Generally, tax is defined as compulsory payment to government irrespective to the benefits. There are various sector separated for taxation, if the field is income of the people then it is called income tax (Ibid; 42)

#### **4.1.3 Definition of Tax**

Many economist and scholars have expressed their views in regarding to the tax. Some of the definitions on tax given by some scholars are as follows:

According to Dalton “A tax is a compulsory contribution imposed by public authority irrespective of the exact amount of services recorded to tax payer in return and not imposed as penalty for any legal offence.”

According to Prof. Seligman “A compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred.”

From the above definitions, it is clear that tax is compulsory levy imposed to the person by the government according to the law of the country. The person whom tax is imposed must pay taxes otherwise the law punishes him/her. The government does not provide any corresponding benefit to the taxpayers for the amount of tax.

#### **4.1.4 Classification of Tax**

For the first time, Hicks (1954) preferred to classify taxes as on income and consumption. As per international classification taxes can be viewed as (Dahal, Class note):

- a) Taxes on income, profits and capital gains (Direct tax)

- b) Tax on property
- c) Tax on domestic goods and services
- d) Tax on international trade and transactions.

In modern times, taxes are broadly classified into two types. They are: direct and indirect tax. The direct- indirect classification is essentially an administrative distinction. The origin of technical classification is unknown (Ibid).

#### **4.1.4.1 Direct Tax**

A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is the same. Taxpayer can not shift the burden of tax to other persons. Examples of direct tax are: income tax, property tax, interest tax, gift tax etc.

#### **4.1.4.2 Indirect Tax**

An indirect tax is a tax imposed on one person but partly or wholly paid by another. Indirect tax is transferable. The person paying the tax and the person bearing the tax is different. Taxpayer can shift the burden of tax to other persons. People pay tax when they received or consumed goods and services. VAT, sales tax, entertainment tax, hotel tax, import and export duties, excise duty etc. are the examples of indirect tax.

### **4.2 Concept of Income Tax**

#### **4.2.1 Income**

Income means a “person’s income from any employment, business or investment and the total of that income as calculated in accordance with this act” (ITA, 2058). It includes all sort of income received for the provision of labour or capital or both of whatever form or nature in the taxable income.

Income as the economic gain received by the person during the particular period, is most, satisfactory defined by Henry Simons as the algebraic sum of items (Due and Friedlander, 1994; 256):

- A. The person's consumption during the period, and
- B. The increase in the individual's personal wealth during the period.

Symbolically,  $Y=C+W$

Where, Y=income,

C=consumption

W=change in wealth

#### **4.4.2 Income Tax**

Income tax is a personal tax imposed on the net income of individuals and corporation. In most of the countries especially the USA, Canada and other countries, income tax is defined in term of the 'flow of wealth' of receipt in money or goods from the taxpayers during the period. Inflow of wealth method, taxation is defined on a realization rather than an accrual basis, and this applies only when a transaction occurs between other persons and taxpayers (Gautam, 2006; 34).

According to the tax economists "An income tax is a levy imposes upon the tax of individuals after the exemption limit. Income tax is direct tax based on the total income of the taxpayer from all the sources and is graduated on a special system of exemption." It is very important source of revenue of each country (Ibid; 34).

### **4.2.3 Reasons in Favour of Income Tax**

The reasons in favour of income tax are given below (Timalsina, 2007; 47):

- i) Income tax is associated with the ability to pay principle of taxation. It is due to this, the poor can be let out from this sort of taxation and appropriate progressivity can be made among the taxpayers.
- ii) Although, theoretically, it can distort the work-leisure and saving-consumption choices and other decisions, the evidence suffers that unless extremely high rates are used the income tax creates relatively little substitution of leisure for work effort or other alterations of behaviour. So, it is relatively neutral with regard to allocation efficiency.
- iii) It serves as an instrument for reducing the inequality of income distribution.
- iv) By adjusting the tax burden the government can, in effect, influence the saving ratio throughout the economy and thus the growth rate. Therefore, it also works as a strong build-in-stabilizer.

### **4.2.4 Reasons against Income Tax**

In spite of all those merits, some weak points are also identified about income taxation they are given below (Ibid; 47-48):

- i) Tax burden is realized by income tax payers but not by consumption taxpayers. So, there is a tendency of tax evasion relatively higher in former case than that of later.

- ii) Consumption tax is preferable to saver and income tax to consumer. Therefore, it hampers saving attitude of taxpayers.
- iii) Income is not proper index of taxation due to monetary transfer, self-produced goods etc.
- iv) Income tax is said to involve double taxation. Any one who pays income tax upon his net income has also to pay income tax for interest income. But this sort of double taxation is lacking in consumption taxes.

The debate between commodity taxation and income taxation with their merits and demerits in their own field is never ending. But the comparative study of the tax structure of low, middle and high-income countries show that commodity tax revenue has significant share in total tax revenue in most of the developing countries and least in high-income countries with some exceptions, and reverse is the case about direct tax.

#### **4.2.5 Condition for the Success of Income Tax**

The income tax functions successfully if the following conditions were fulfilled (Goode, 1986; 102).

- Existence of pre-dominantly money income.
- A standard of living.
- Prevalence of honest and reliable accounting.
- A large degree of voluntary compliance on the part of taxpayer.
- A political system not dominated by wealthy group acting in their self-interest.
- Honest and efficient administrative structure.

#### **4.2.6 Objectives of Income Tax**

The objectives of taxation in developing countries can be classified into two categories namely growth objectives and stabilization objectives which are discussed below:

##### **1) The growth objectives**

In developing countries, it is one of the major objectives for economic development. There must be adequate capital accumulation to finance development projects and to accelerate the pace of economic growth. Economic growth is not possible if the rate of growth of population exceeds the rate of national income. In order to increase per capita income, saving and investment with the help of appropriate tax policy can increase the rate of national income. The experiences of developing countries indicate that early introduction of direct tax will be great value to the people who are living on subsistence level low literacy rate.

In developing countries, tax policy should discourage the consumption of unnecessary goods and encourage the promotion of saving income ratio. According to James Cut the role of tax policy in promoting economic growth, thus, emerges as one of the restraining increase in consumption i.e. tax policy must seek to increase the saving income ratio as national income increase.

In the developing countries, where foreign concerns are not operating at the early stage of economic development the potentiality of corporate income taxation becomes low. So, the development of corporate sector, business sector in developing counties should provide special tax concession such as tax holiday and investment credit needed for the industrial development.

##### **2) Stabilization Objectives**

In the developing economy, problem of inflation is depended on the type of expenditure incurred by the public sector on goods and big industries and

socio-economic overhead capital. In this regard, taxation can be helpful in minimizing the inflationary trend. From the economic viewpoint, they should lead to growth with stability and be consistent with national economic policies. Inflation of certain degree is helpful for increasing economic growth but it may have various other adverse effects.

In developing countries, where inflation is acute, the prices of the traditional commodities like food, raw materials etc which are used both for domestic as well as export purpose rise very much thus affecting domestic and export markets. The fall in export earnings adversely affect the process of economic growth in these countries. As a result there will be no development in the country's economic situation. Taxation of income is not advisable to check steep inflation because the potentiality of checking inflation through income tax is limited since the coverage is not wide and the propensity to consume is higher among such a section of people, which is not out of the periphery of income tax.

### **3) Equity**

The word equity refers to the reducing gap between rich and poor which is one of the most important objectives of income tax. While designing the tax policy, the widely accepted principle is the principle of equality. It implies that those with equal abilities to support government should pay equal amounts and those with unequal abilities, should pay different amounts bearing a reasonable relation to their abilities. The former aspect often called horizontal equity and the latter vertical equity. The equality aspect of taxation is directly concerned with the ability-to-pay principle which is primarily a matter of economic capacity that can be measured by income, wealth and consumption.

In favor of income as a sensible index of equity, it may be argued that a person's economic capacity and his ability to contribute depend upon his wealth and income. As a matter of historical experience, we find that the income tax has been the vehicle of progressive taxation.



In the history of 45 years of income tax, it has done a lot in the sector of taxation but it requires further improvement. However, income tax has become an important source of revenue. The income tax is essentially a unitary tax under which all of its gross income and all deductions are combined to arrive at total taxable income subjective to a single table of rates (Ibid; 50)

At present time income tax in Nepal is ranked third in the order of significant. First is VAT. It is shown by the tax structure of different countries that as the country goes on developing the contribution of income tax in total tax structure goes on expanding. It is clear from the facts that in developed countries like U.S.A., Japan, U.K., France etc. the income tax is the main source of government revenue. Mostly, the developing nations of the world rely on indirect taxes to meet the growing volume of government expenditure. In this connection Nepal is not an exception because in under developed countries the economy is not well integrated.

The developed countries of the world especially industrialized nations of the west channel collect required revenue by tapping direct taxes. In fact the revenue from direct taxes occupies a prominent place in total tax structure and total revenue of these countries, nevertheless, in their early phases of economic development they had to rely mostly on indirect taxes.

To a developing country, highly dependency on foreign aids and loans is not good. So, it would be better to reduce the foreign source of financing for development. The external financing should play only supplementary role in the national economy. But it is pity to say that the internal financing position of Nepal is very poor. It is unrealistic to expect more tax from poor Nepalese people. As regarding Nepalese economy, external source of financing has been the backbone of all the plans so far framed and implemented since 1956. In future, if the external sources decreases or stop, Nepalese economy will face disastrous consequences. To avoid such circumstances, Nepal should mobilize her own domestic financial resources adequately.

Among domestic financial resources taxation seems to be highly justified. Taxation is viewed as a powerful tool in the hand of government for the purpose of internal financial resource mobilization. Economic development depends, far more than is commonly recognized, on a carefully thought-out and well-organized tax structure.

Upward adjustment in the tax rates or even introduction of new taxes in itself does not ensure desirable increase in revenue. The ability of tax payers, tax consciousness, quality of the tax personal, efficient tax administration, enforceable tax law and policy, scientific and timely tax assessment produce etc are the factors that directly affect the collection of internal revenue.

Taxation comprises direct taxes and indirect taxes. Income tax is a part of direct tax, which is imposed upon the net income of an individual and corporation, derives from business, profession, investment, rent, remuneration and other sources. Income tax is considered to be the vital tool for the government to accumulate adequate revenue and to achieve socio-economic objectives. Its progressive feature makes it an effective instrument for reducing distributional inequalities in income and wealth. It confirms must closely to the “ability-to-pay” principle of taxation. It ensures equal taxation of persons with equal ability and increasing taxation of person with higher income.

Income tax is basically charged for two purposes namely collecting revenue to meet expenses for people’s welfare activities and to create egalitarian community by minimizing the economic gap between haves and haves not.

Income tax is based on the principle of certainty in the sense that the government has already acquired the acknowledgement about income tax and taxpayers have also already known the amount of tax that will be levied to them. It also follows the cannon of economy. It increases the civil consciousness. It is helpful for generating the concept of social responsibility

towards the nation and keeps the people vigilant to see the public money may not be misused (Saxena, 1986; 2).

### **4.3 Historical Background of Income tax**

#### **4.3.1 Income Tax in International Context**

Credit for the establishment of the first successful income tax in the world is given to Great Britain where it was first introduced in 1799 in order to finance the wars with France. The main reason for the introduction of this tax was that it was preferable as a substitute for the customs and excise duties in raising revenue. It remained more or less a temporary tax until 1860 when it got accepted as a permanent tax (Timalsina, 2007; 54).

In USA, the first income tax was introduced in 1862 to generate revenue to finance Civil war expenditure. The federal corporation income tax was introduced in 1909. In Japan, income tax was introduced in 1887. It was a general individual income tax and extended to the corporate income in 1899. In German, income tax became an effective instrument since the Persian Reform of 1891 though income tax had been levied in different forms before the unification of Germany in 1871. In India, income tax in its modern form was adopted in 1860, several experiments were made from 1860-1886 and finally the systematic income tax legislation was enacted in 1886. Income tax in Switzerland in 1840, Austria-1849, Italy-1864, New Zealand in 1891, Canada in 1892, Holland in 1892/93, Australia in 1895, Denmark in 1903, France in 1909, Sri Lanka in 1932, South Korea 1948 and in Nepal 1959 (Khadka, 2004, August 10).

After the adaptation of income tax, many countries had undergone considerable changes. Initially, income tax was limited to the income generated within the country but with the globalization taxation of worldwide income came into vogue. There have been different practices regarding the taxation of individuals and companies. Some countries initiated with the taxation of

individual and brought companies in to the tax net after a few years of the implementation of income tax. But in some countries both the individual and companies were taxed in the similar way but later on they were taxed in different ways such as companies with a flat rate and individuals with progressive rates.

Until the mid 80s, income tax was used as an effective instrument for the redistribution of income. But the intended objective could not be achieved in real life. Some stress progressive rate structure discouraged to work, invest and save more and complicated the tax administration.

Income tax has been an important element of the modern tax system. All sorts of countries have adopted this tax as an important instrument to generate revenue required to finance state activities and taxable capacity of the taxpayer.

#### **4.3.2 Taxation in Nepal**

At the ancient time, tax system of Nepal was based on Vedas, Smritis and Purans. Directives propounded by Manu, Yagya, Balak, Chanakya etc. had guided the taxation system. At that time, the principle of collection tax from the people was imposition of tax without harming the activities of people (Gautam, 2006; 35).

During the period of the Lichhabis, the main sources of government revenue were tax. There was 'Tri-Karas' system such as Bhaga (Tax on agriculture), Bhoga (tax on livestock) and Kara (tax on trade). Amsubarma, the popular king of that period imposed water tax and religious monument repair tax. Tax was payable in accordance to taxpayers ability. At that time, a tax on income of the farmers from agriculture was imposed at the rate 1/6, 1/8 and

1/12 shares of crop production depending on the land quality ( Kandel ,2004;11).

In Malla period, there were taxes related to land, trading, etc. Jayasthiti Malla, imposed taxes on cremation (Daha Sanskar) and caste purity (Ibid;11)

In Shah Period, there was continuation of the tax system of Malla period. There were different types of taxes like Walak (tax on each family), Gaddimudark, Chumawan, and Goddhawk etc (Ibid; 11).

Prithivinarayn Shah introduced Pota tax in 1772. This system of tax was based on flat system and limited on small Birta owners. In the period of Surendra Bikram Shah, excise was introduced in Nepal (Ibid; 11)

During Rana period, the main source of government revenue was land taxes, custom duties and excise. Sanads and Sawals were the laws guiding the tax system. Lagati (based on cost record) and Hasawali (not based on record) were two types of revenues. Jamna Nasodnu, Kachha Nachhodnu (Not to get total and not to leave even a single paisa) was the principle of revenue collection in Rana period (Gautam, 2006; 36).

After the dawn of democracy, the first budget, which was introduced in 2008 B.C. stated about the introduction of income tax in Nepal. But it was actually started from 1960 in the form of Business profit and Remuneration tax (Ibid; 36)

## **Chapter V**

### **Structure of Income Tax in Nepal**

#### **5.1 Introduction**

The need for mobilization of financial resources has been growing rapidly since planned development efforts began in Nepal. This need has been specially pronounced the urgency for domestic resource mobilization. If we see the details of financial outlay in various development plans the resource need has increased 194170 times being the tenth plan outlay of Rs. 64,076,000 million in comparison to the first plan outlay of Rs.330 million. This has indicated a rapidly increasing trend in financial outlays for development.

In developing nations, use of foreign aids and loans have produced bitter experiences as well as mixed consequences. The repayment of principle and interest is providing to be a net burden for many of them. It can at most occupy only a marginal and dwindling importance in the financing of development activities. Mobilization of resources from domestics source is the only viable stress needs to be placed on financing of development efforts in Nepal. Foreign aid should be taken as complement to domestic efforts not substitute for domestic source of government financing.

#### **5.2 Resource Gap in Nepalese Finance**

Scarcity of resources is constrained for the realization of development goals in developing countries. Nepal has also been facing serious and growing problem of resource gap in her finance since her first budget 1951/52. A resource gap is taken to be the difference between expenditure and revenue. The outlook of resource gap can be seen as follows:

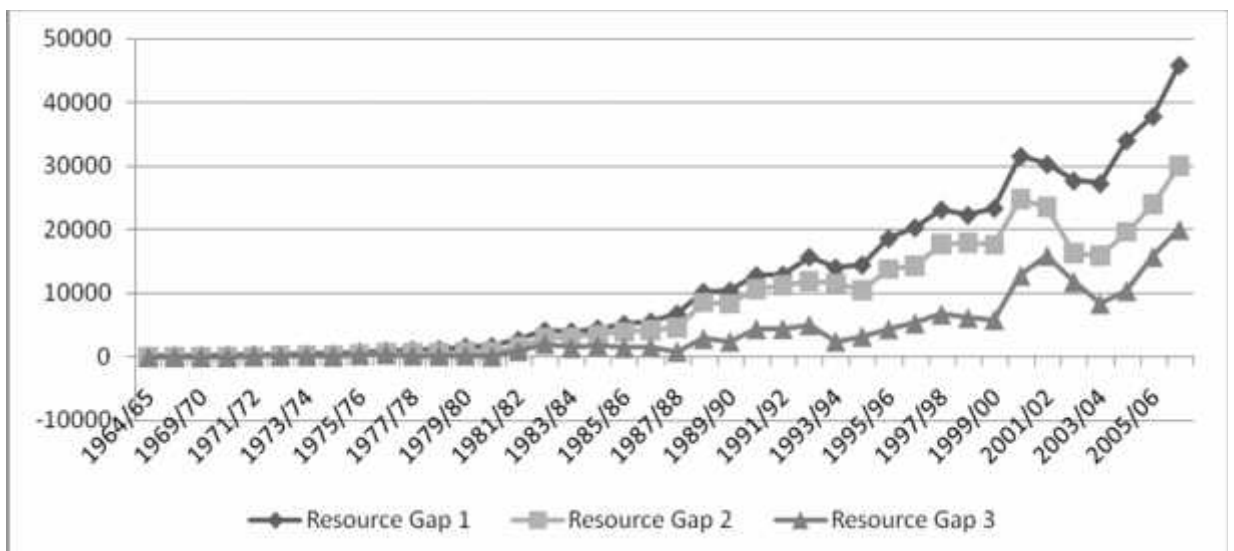
$$\text{Resource gap 1} = \text{Expenditure} - \text{Revenue}$$

$$\text{Resource gap 2} = \text{Resource gap 1} - \text{Foreign grants}$$

Resource gap 3= Resource gap 2- Foreign loans

To fill the ditch of growing resource gap, a large amount of external aids, loans and internal loans has to be borrowed but scarcity of resource seems to be never ending phenomenon in Nepal. In the first budget of Nepal there was a regular expenditure of Rs. 42 million and there was no development expenditure. A total of Rs. 30.5 million was collected as revenue and the government did not take any foreign loan and grant. This year the resource gap was of Rs. 11.5 million (Neupane, 2005; 43).

**Figure 5.1 Resource Gap in Nepalese Finance (FY1964/65 to FY 2006/07)**



Source: Table 5.3

Resource gap 1 which is the difference between total expenditure and total revenue is in increasing trend. It has increased from Rs 157.6 million in FY1964/65 to Rs 45,892.3 million in FY 2006/07 in an average of 12,201.37 million per year. This increase in resource gap indicates the poor performance of domestic resource mobilization.

Resource gap 2, which is the difference between expenditure and revenue plus foreign grants, is also in increasing trend. This type of resource gap started since the budget of FY 1956/57. In this year it was Rs 0.7 million

that rose to Rs 609.4 million in FY 1978/79 with an average annual growth rate of 2.86 percent (Neupane, 2005; 45). This gap was 10655.1 million in FY 1990/91 and reached to 30,091.5 million in FY 2006/07. This gap was minimum in FY 1969/70 under the study period. The gap was 8673.1 million in average under the study period.

The picture of resource gap 3, which is the difference between expenditure and total revenue plus foreign grants plus foreign loan, is still not promising. It was increase from 10.60 million in FY 1964/65 to 20,038 million in FY 2006/07. This gap was minimum (i.e.-31.5 million) in FY 1969/70 under the study period. This increasing magnitude of resource gap clearly indicates that there is urgent need for mobilization of additional resources even through income tax.

The increasing gap between government expenditure and revenue and high fiscal deficit have contributed economic distortion such as increasing in prices, large flow of imported goods and services, low level of domestic savings and heavy reliance on external debt, leading the economy to the state of external dependency. Increase in regular and development expenditure of government, burden of debt servicing charges, poor utilization of natural resources, poor economic growth, inadequate tax efforts, political, instability rising inflation etc. are the reason for growing resource gap in Nepalese finance.

### **5.3 Tax Effort Ratio and Per Capita Income: International**

#### **Comparison**

The success of development efforts of any country depends on its ability to mobilize additional internal resources to finance regular and development expenditure. Tax is considered safer and better means for the mobilization of additional financial resources as compared to other internal and foreign recourse as compared to other internal foreign sources of deficit financing.



Income tax is one of the major components in total tax revenue that plays a vital role in internal resources mobilization. The rate of role of total tax and income tax for additional financial recourse mobilization is analyzed on the basis of their relative contribution to the GDP.

The level of taxation is typically measured by tax revenue as a share of GDP. Comparing levels of taxation across countries provides a quick overview of the fiscal obligations and incentives facing the private sector.

Low ratios of tax revenue to GDP may reflect weak administration and large-scale tax avoidance or evasion. Low ratios may also reflect a sizeable parallel economy with unrecorded and undisclosed incomes. Tax revenue ratios tend to rise with incomes, with higher income countries relying on taxes to finance a much broader range of social services and social security than lower income countries are able to (WDI, 2007; 287).

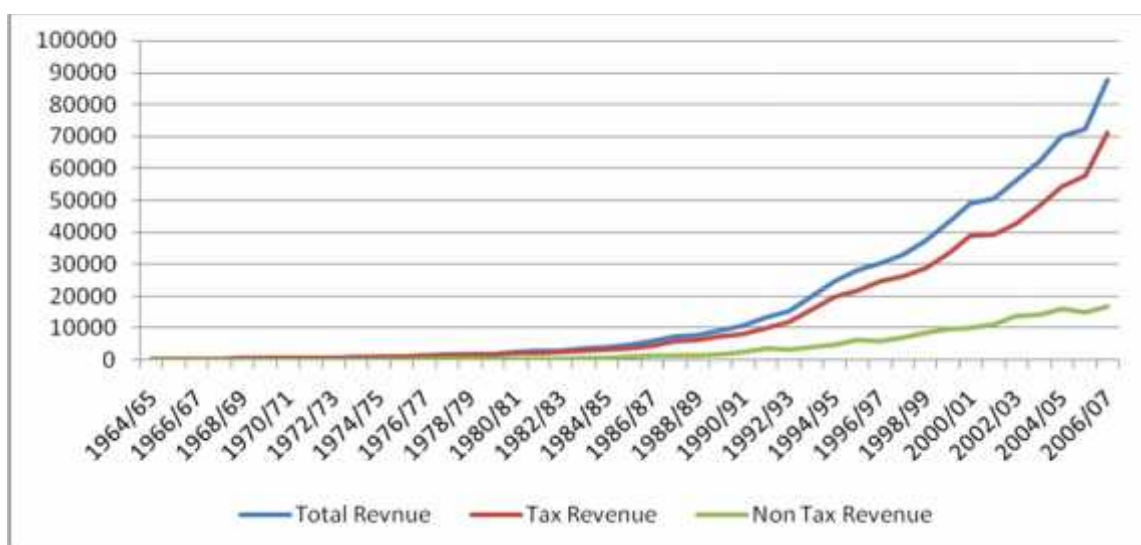
Nepal is one of the poorest countries with GDP 8,938 \$ million in 2006 and GNI per capita is 320 \$ in 2006, according to the World Development Indicator 2008. The contribution of tax revenue to GDP in 2006 was only 8.9 percent, which is the lowest in the SAARC countries. The highest GDP is of USA 13,163,870\$ million in 2006 while tax revenue as percentage of GDP is 11.90 percent. Similarly, the highest contribution of tax revenue to GDP is 28.80 percent in the case of UK. GNI per capita of Nepal is also very low and it is around 270 \$ since long time. But with regard to other countries either belongs to low-income country or lower middle-income country the GNI per capita income is comparatively very high.

## 5.4 Tax Structure of Nepal

### 5.4.1 Contribution of Tax Revenue and Non Tax Revenue in Total Revenue

When the GN presented first budget in the FY 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 latter in the late 1950s the share of non-tax revenue declined drastically, because of the increasing contribution of indirect tax on foreign trade (Timalcina, 2007; 57).

**Figure No. 5.2 Contribution of Tax Revenue and Non Tax Revenue in Total Revenue (FY1964/65 to FY 2006/07)**



Source: Table 5.3

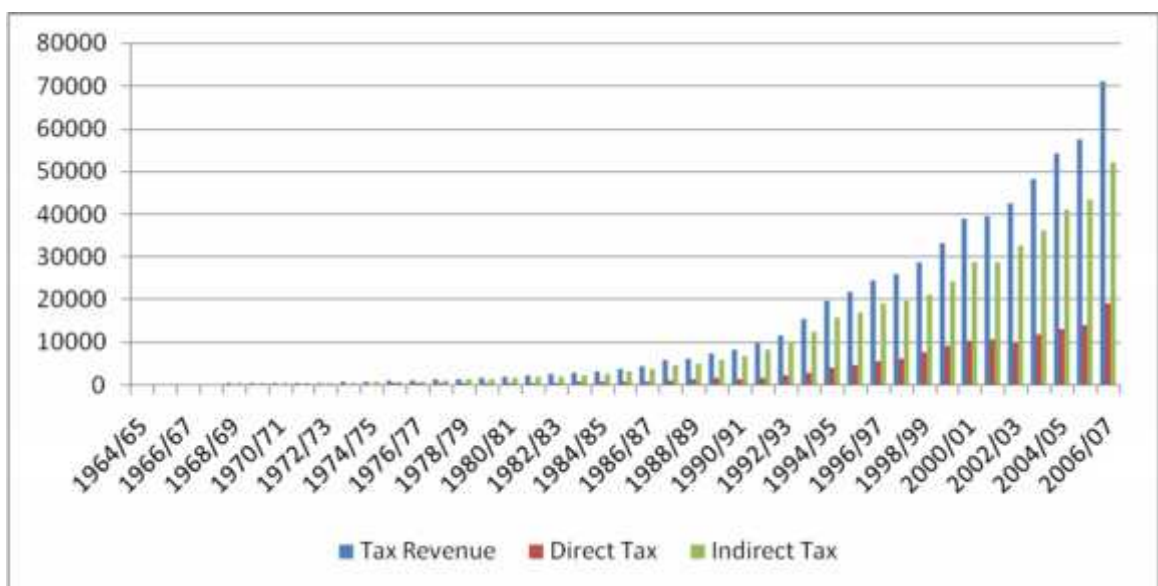
In the FY 1990/91 the share of non-tax revenue was 23.79 percent of total revenue. But it reached to the maximum 26.91 percent in the FY1991/92. The contribution of tax revenue in the total revenue is almost 80 percent of the total revenue and never declined below 75 percent except in the FY19886/87 and FY1991/92. The contribution of tax revenue and non-tax revenue to total tax revenue is 82.77 and 19.84 percent respectively in an average under the

study period. Thus, role of tax revenue in domestic resource is highly significant. The amount of total revenue has grown in increasing trend from FY 1964/65 and the tax revenue has followed the path as well.

#### 5.4.2 Composition of Tax Revenue

The contribution of tax revenue in the total revenue is significant from the very beginning.

**Figure No. 5.3 Contribution of Direct Tax and Indirect Tax in Total Tax Revenue (FY1964/65 to FY 2006/07)**



Source: Table 5.4

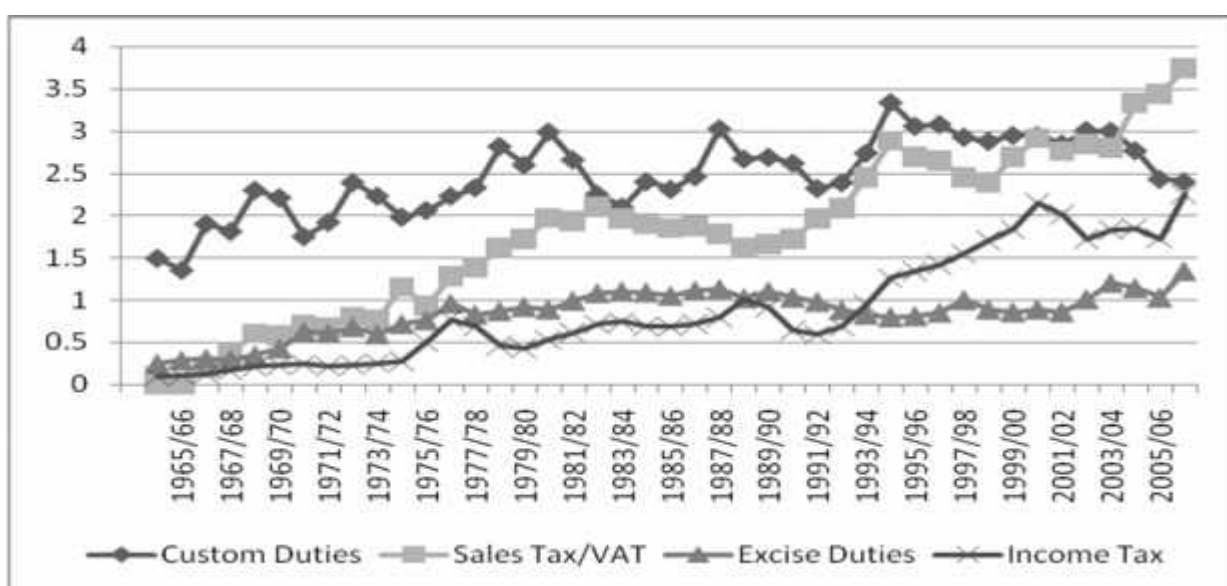
There has been simultaneous increment in both direct tax and indirect tax in absolute term during the study period. The amount of tax revenue was Rs.150.8 million in the FY 1964/65. In which the share of direct tax was 35.54 percent whereas 64.46 percent of indirect tax. From the early 80s the amount of tax revenue had grown tremendously and reached the amount of Rs.71,126.7 million in the FY 2006/07. But the share of direct tax and indirect tax vary from year to year. The figure in the table shows the share of direct tax declined from 35.54 percent in FY 1964/65 to 16.15 percent in FY 1991/92 and then reached to 26.69 percent in FY 2006/07 increasing continuously except some fluctuation in few years.

Similarly, the share of indirect tax increased from 64.46 percent in FY 1964/65 to 83.85 percent in FY 1991/92 then started to decline and reached to 73.31 percent in FY 2006/07. However, the share of indirect tax was very high before 1990 but declined after the restoration of democracy and adaptation of the liberalization policy by the nation. This has sought that country should try to mobilize the resources through direct taxation rather than indirect taxation since the country is already a member of WTO and SAFTA.

### 5.4.3 Contribution of Various Taxes in the GDP

During the study period the contribution of total revenue has increased from 3.43 percent of GDP in FY 1964/65 to 12.58 percent in FY 2006/07, this shows the increasing trend of revenue at a slower pace. Contributions of all kinds of taxes are in increasing trend though not satisfactory in some cases.

**Figure 5.4 Contribution of Various Taxes in GDP (FY1964/65 to FY 2006/07)**



Source: Table 5.5

The contribution of custom duties was about 2 percent of GDP in the FY 1974/75 and in the succeeding year its contribution was not encouraging which lay between 2 to 3 percent of GDP. In the FY 2006/07, its share in GDP was only 2.40 percent. Contribution of export duties remain about 0.1 percent of

GDP. But the contribution of land revenue and registration remained about 0.5 percent of the GDP in most of the year. Table 5.4 shows, the major taxes that contributed significantly in the revenue are sales tax/VAT and income tax during the study period. Their contribution was 1.15 and 0.28 percent of GDP respectively in the FY 1974/75 and reached 1.72 and 0.64 percent of GDP in the FY 1990/91.

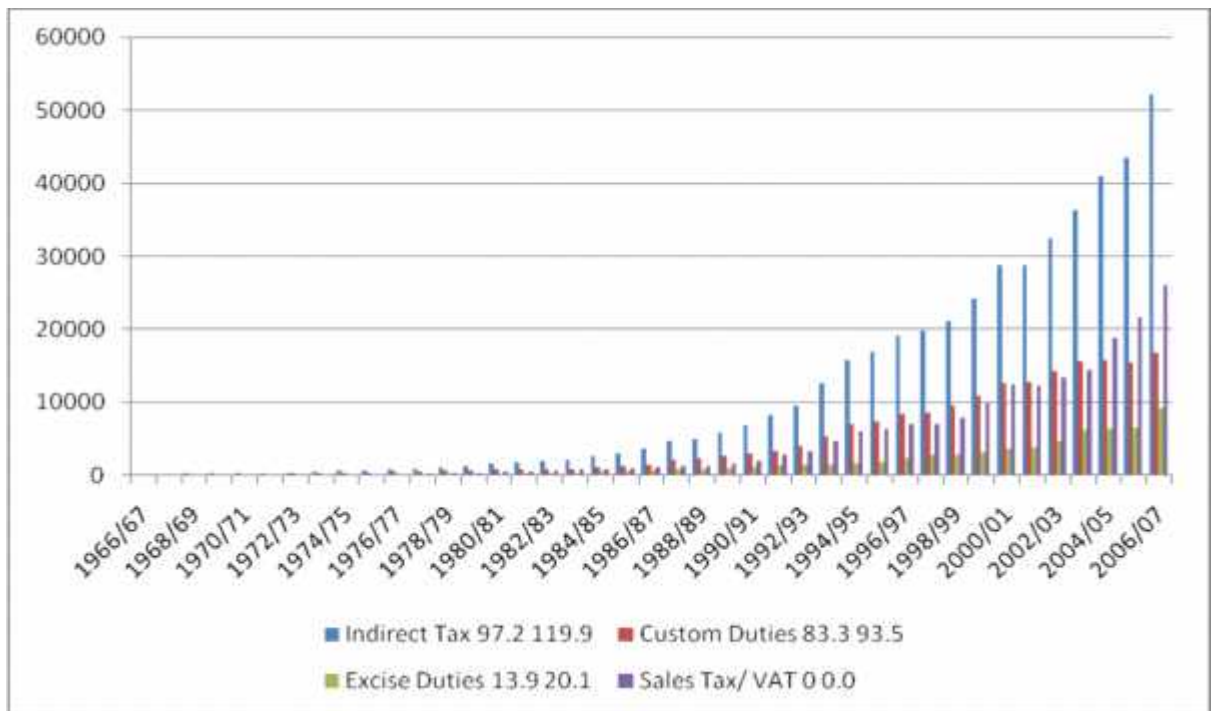
But after the restoration of democracy in 1990, Nepal adopted the policy of liberalization and the concept of open economy then the share of sales tax and income tax rose significantly. After the introduction of VAT in Nepal in 1997 the resource mobilization through VAT became the backbone of the Nepalese economy. In the FY 2006/07, the contribution of VAT and income tax reached 3.74 and 2.26 percent respectively of GDP.

#### **5.4.4 Composition of Indirect Tax**

After the restoration of democracy in 1990, Nepal adopted the policy of liberalization and the concept of open economy then the share of sales tax and income tax rose significantly. After the introduction of VAT in Nepal in 1997, the resource mobilization through VAT became the backbone of the Nepalese economy.

Nepalese tax revenue mainly depends on taxes on international trade and sales tax on goods and services supplemented by tax on income and property to some extent. Nepalese tax structure is highly dependent on indirect tax.

**Figure 5.5 Composition of Indirect Tax (FY1964/65 to FY 2006/07)**



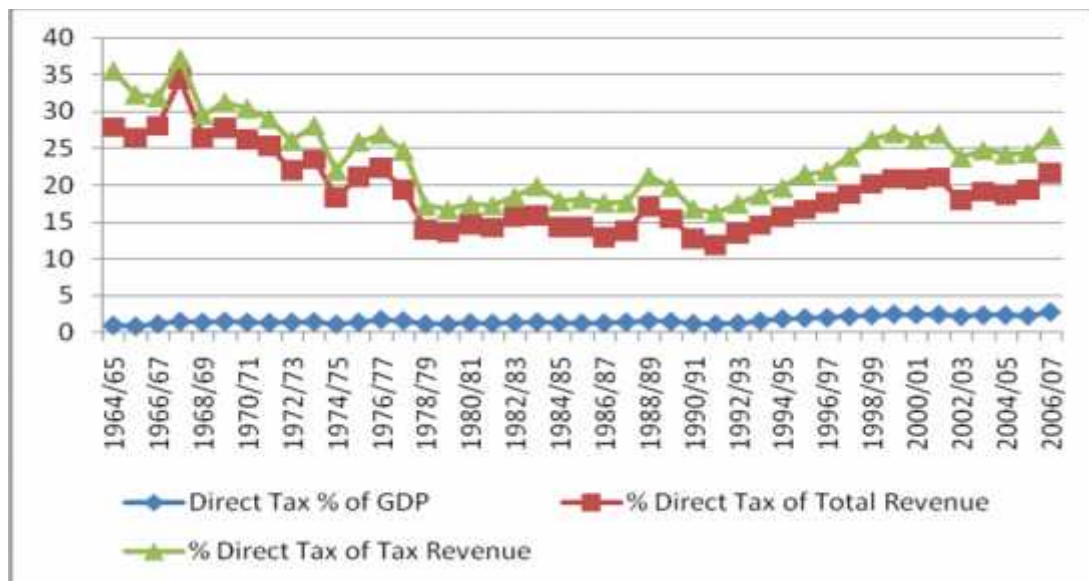
Source: Table 5.6

The contribution of custom duties in indirect tax declined from 85.70 percent in FY 1964/65 to 32.04 percent in FY 2006/07. The share of custom duty has decreased mainly due to the low tariff rate and increment of direct tax. The sales tax/VAT has become an important source of overall tax revenue with increasing trend. The contribution of sales tax/VAT was increase from 7.87 percent in FY 1966/67 to 50.04 percent in FY 2006/07. The contribution of excise duties and custom duties in indirect tax were 16.37 and 50.92 percent in an average.

#### **5.4.5 Contribution of Direct Tax**

Nepalese tax revenue is mainly dependent on the indirect taxes such as tax on international trade and sales tax/VAT on goods and services. But in the total revenue, the role of direct tax is also significant from the very beginning, which is shown below:

**Figure 5.6 Contribution of Direct Tax (FY1964/65 to FY 2006/07)**



Source: Table 5.7

In the beginning of the study period i.e. in FY 1964/65 the amount of direct tax was Rs.53.6 million. In the FY 1975/76 it increased by more than 4 times and the amount reached to Rs.236 million. Though its growth is not smooth in the early period, after FY 1991/92 the amount of the direct tax has grown significantly. In the FY 2006/07, it reached to Rs.18,980.30 million from Rs.1,369.70 million in the FY 1991/92.

Contribution of direct tax to tax revenue is varying from year to year. In FY 1964/65, direct tax had contributed 35.54 percent to the tax revenue but it declined slowly and reached to 16.15 percent in FY 1991/92 except some increment in few years. But after the FY 1991/92, it grew to 27 percent in the FY 1999/00 and again it is declined. The contribution of direct tax to tax revenue is 24.15 percent in an average.

The share of direct tax to the total revenue is also declining. In few years of the beginning it was encouraging but later it faded away. In FY 1964/65 the share of direct tax to total revenue was 27.87 percent and it increased to 34.45

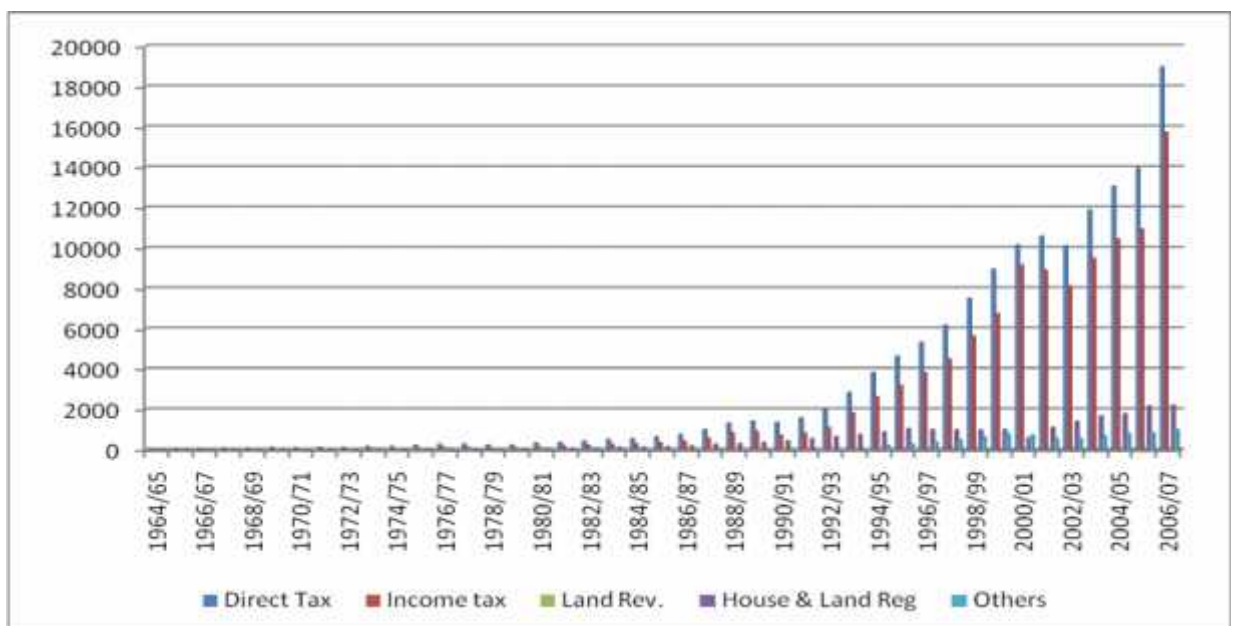
percent in FY 1967/68 and started to decline. It reached to minimum in the FY 1991/92 with 11.81 percent and again it began to increase with some fluctuation. Now in FY 2006/07 the share of direct tax to total revenue is 21.64 percent.

The contribution of direct tax to GDP is encouraging from the very beginning. In the FY 1964/95, direct tax was 0.96 percent of the total GDP and it declined to 0.83 percent in FY 1965/66 then after it has maintained above 1 percent. But after the FY 1996/97 contribution of direct tax to GDP crossed the 2 percent and is now 2.72 percent of the GDP.

#### 5.4.6 Composition of Direct Tax

In the Nepalese tax structure, the major components of direct taxes keep on changing from the beginning. But the major components of direct taxes are income tax, land tax and house and land registration tax. Until the FY 1993/94, vehicle tax was considered as a direct tax and from FY 1994/95 it has been classified under the indirect tax.

**Figure 5.7 Composition of Direct Tax (FY1964/65 to FY 2006/07)**



Source: Table 5.8



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 FY 1964/65 the amount of direct tax was only Rs.53.6 million, in which the contribution of land revenue alone was Rs.43.2 million which was 80.60 percent of the total direct tax. In the same year, the amount of income tax was Rs.5.3 million which was 9.90 percent of the direct tax. After the lapses of time the scenario changed, the amount of income tax increased tremendously. In the FY 1976/77 it increased by 25 times and reached to Rs.133.3 million which was 45.10 percent of the direct tax. Its share in direct tax has been increasing continuously. In FY 2005/06, the amount of income tax was Rs.16,726.8 million which was 82.87 percent of the direct tax.

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, changed in the latter days. In the early years of the 1990s the share of the house and land registration to direct tax highly increased and reached to 35.56 percent in FY 1991/92 but declined then after. It declined sharply again in the FY 2000/01 and then increased to 11.79 percent of the direct tax in FY2006/07.

#### **5.4.7 Share of Income Tax in the Total Revenue in Selected Countries**

Modern income tax was first introduced by Britain as a temporary instrument to generate revenue required for the war finance. Now, the tax is major source of revenue in the developed as well as developing countries.

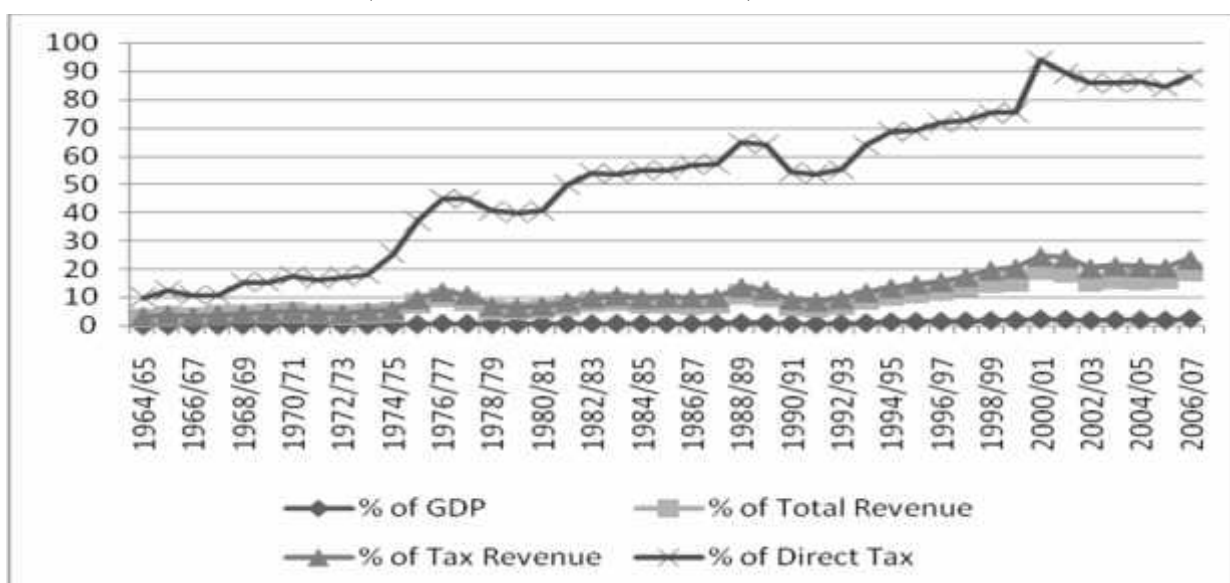
The contribution of income tax to total tax revenue in USA is highest which 57 percent of the total revenue was in 2006. Among the selected countries of the world, Nepal has the lowest contribution of income tax in the total revenue that was 11 percent in the year 2006.

In general, the bulk of the income tax revenue comes from the individual income tax in developed countries while corporate tax provides the bulk of the income tax revenue in the developing countries.

#### 5.4.8 Contribution of Income Tax

Income tax was introduced in FY 1959/60 for the first time when it generated revenue of Rs.203 thousands. In FY 1962/63, income tax revenue increased to Rs.2 millions. Income tax was initially levied only on business income and salary. In the FY 1959/60 business tax provided about 80 percent of the total income tax revenue.

**Figure 5.8 Contribution of Income Tax as Percentage of Different Heads (FY1964/65 to FY 2006/07)**



Source: Table 5.10

Before 1994/95 the major components were corporate income tax, income tax from individuals and from remunerations. The corporate income tax included income tax from public enterprises, semi-public enterprises and private corporate bodies. Then the amount of income tax grew rapidly and reached to Rs.1,824.3 million in the FY 1993/94, which was 63.89 percent of the direct tax, 11.87 percent of tax revenue and 0.95 percent of the GDP.

In the fiscal year 1994/95, the components of the income tax were again revised. They were corporate income tax, individual income tax, tax on house and land rent and the interest tax. Corporate income tax included government corporate, public limited corporate and private limited corporate where as individual income tax included the tax on the income from remuneration and business, industry and occupation. So that the amount of income tax increased to Rs.2,640.6 million in FY 1994/95 from Rs.1,824.3 million of previous year which was 68.60 percent of the direct tax, 13.43 percent of total tax revenue and 1.26 percent of the GDP.

Again in the FY 2002/03, the bases of income tax were revised. They are corporate income tax, tax on remuneration, income tax on investment, tax on windfall gain and others. The corporate income tax includes government corporate, public limited corporate, private limited corporate, personal or sole trading and other institutions. Similarly, the components of the income tax on investment are tax on lease or rent, interests, capital gains, dividends and other income from investment. In the FY 2006/07 the amount of income tax was Rs.16726.8 million which was 88.13 percent of the direct tax, 23.52 percent of the tax revenue, 19.07 percent of the total revenue and 2.40 percent of the GDP.

If we see the increasing trend of Income tax, it is most likely to surpass the custom duties in future and will be the second largest source of revenue whereas the VAT will be the first largest source. The contribution of income tax to direct tax was much lower in the early years of the study period. Income tax contributed only 9.89 percent of the direct tax in the FY 1964/65. Then after, it has been increasing continuously and rapidly. As a result, its share to direct tax has not decreased from 50 percent after 1980. In FY 2000/01, the share of income tax to direct tax was 93.97 percent while in FY 2001/02 it was 89.32 percent. This decrease in the share of income tax for the period from FY 2002/03 is due to the application of VDIS program in 2001. It had caused sharp increase in the income tax in 2001 and not in that extent after withdrawal of

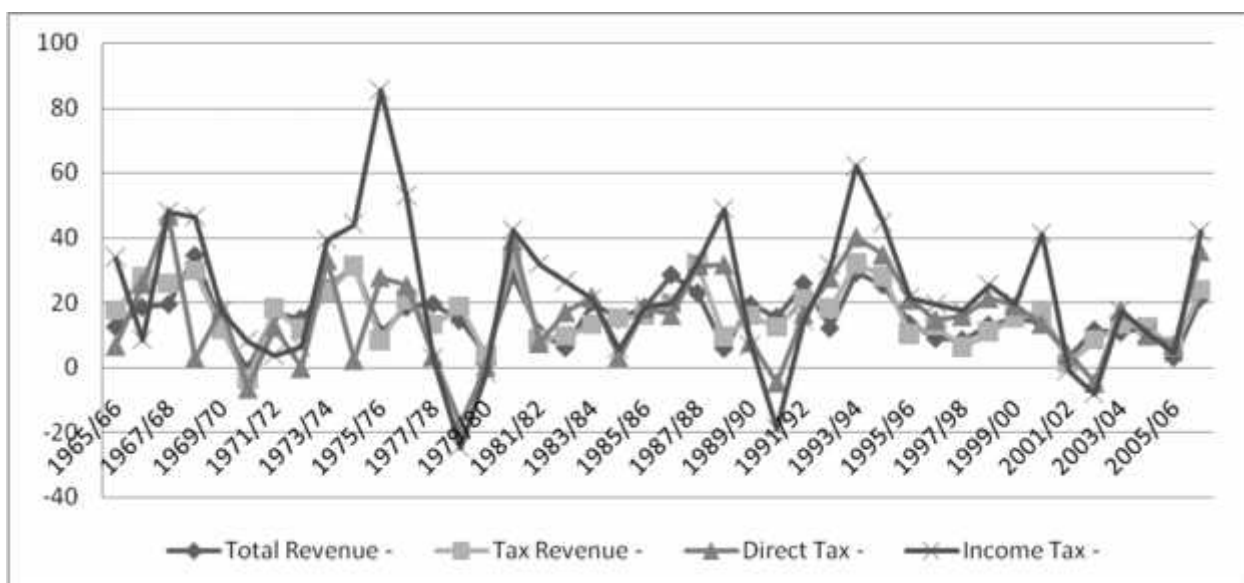
the VDIS in 2002. Also the land tax and house rent tax has been excluded recently from income tax. In the FY 2006/07 the contribution of income tax to direct tax has reached only 88.13 percent.

Recently, the income tax has been divided into corporate income tax remuneration tax, income tax on investments, and tax on windfall gains. Thus, the income tax is one of the prime sources of direct tax in Nepal. But the contribution of income tax to total tax revenue is still lower than the developed countries. The more the revenue generated from income tax, the more progressive and equitable the tax system will be.

#### 5.4.9 Growth Rates of Total Revenue, Tax Revenue, Direct Tax and Income Tax

Among all growth rate of income tax is maximum which is followed by tax revenue. In FY 1978/79, 1990/91 and 2002/03, the growth rate of both income tax and direct tax was negative.

**Figure 5.9 Growth Rates of Total Revenue, Tax Revenue, Direct Tax and Income Tax (FY1964/65 to FY 2006/07)**



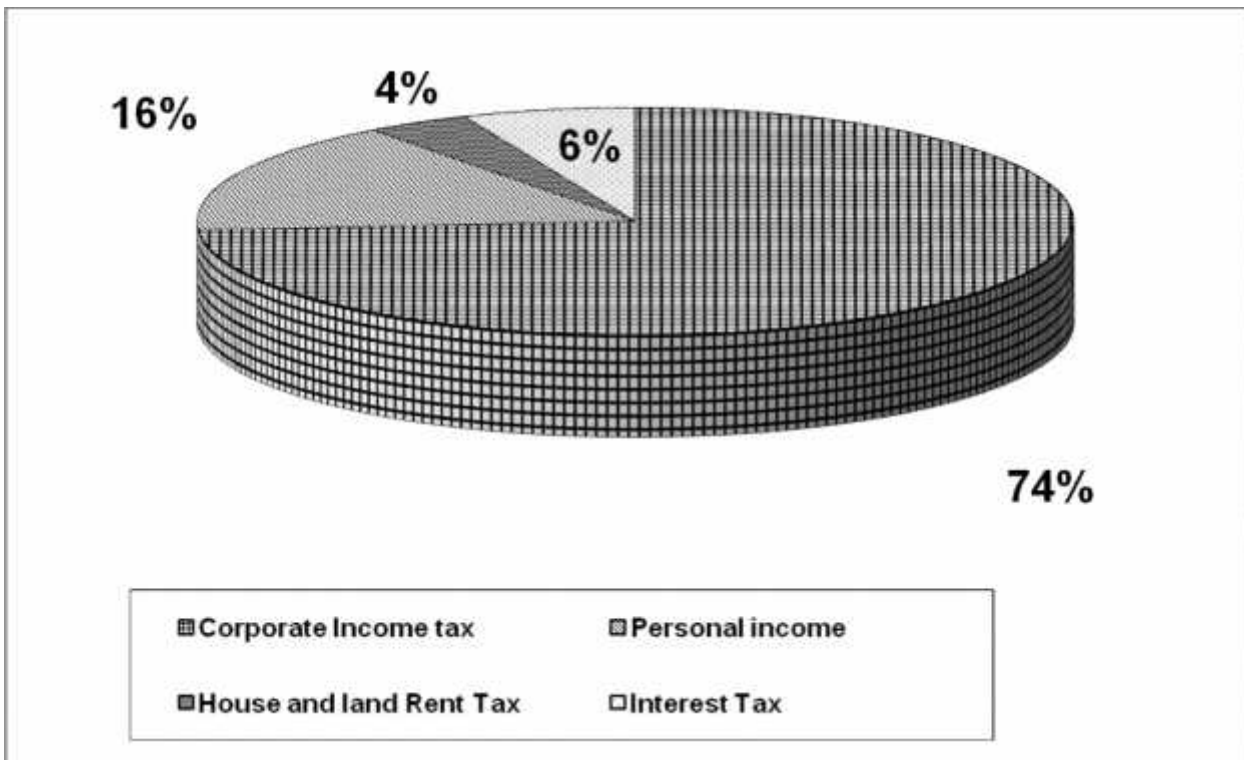
Source: Table 5.11

The growth rates of total revenue, tax revenue, direct tax and income tax from FY1990/91 to FY2006/07. The income tax increases by 23.63 percent in an average, which is maximum among all. The growth rate of income tax is followed by tax revenue, which increases by 16.50 percent in an average. Total revenue and direct tax increase by 16.36 and 16.25 percent respectively in an average under the study period.

### **5.3.11. Composition of Income Tax**

Until the FY 1993/94, income tax was divided in to corporate income tax, individual income tax and tax on remuneration. But, from the FY 1994/95, income tax revenue was divided into main four groups' viz., individual income tax, corporate income tax, interest tax and house and land rent tax. Of these taxes, corporate tax was collected from government corporations, public and private limited companies and partnership firms. Individual income tax was collected from individuals and proprietorship firms. Interest tax was collected from banks or finance companies that pay interest on all types of deposits and the house rent tax was levied on income obtained from the renting out the house and land in urban areas. Again from the FY 2002/03, it was revised and now the components of income tax are: corporate tax, tax on remuneration, tax on investment, tax windfall gain and others. The corporate income tax includes tax revenue from Government Corporation, Public Limited Corporation, Private Limited Corporation, personal or sole trading and other institutions. Similarly, the income tax on investment includes tax on lease or rent, interest.

**Figure No. 5.10 Composition of Income Tax in FY2006/07**



Source: Table 5.12

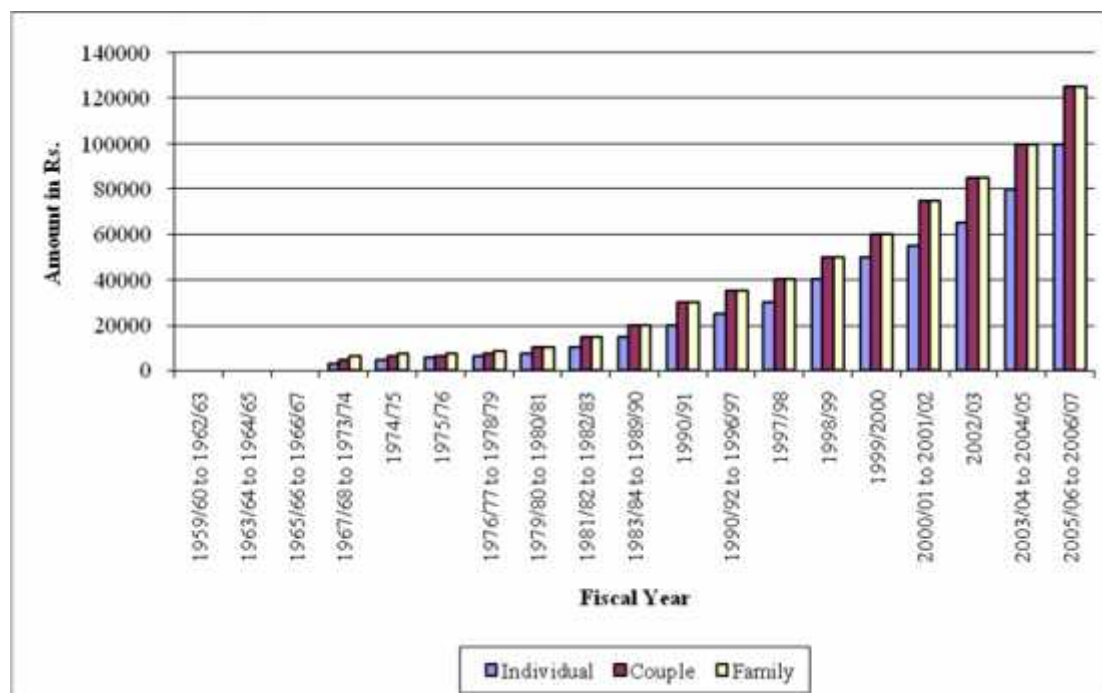
Initially, the income tax was given in gross amount but, later on, from the FY 1977/78 the category of the different heads under income tax was made. The bases of the income tax were revised twice then, in FY 1994/95 and FY 2002/03. This shows that government is trying to widen the tax base to increase the internal resource mobilization.

### **5.5 Income Tax Exemptions Limit**

Exemptions limit is an important variable while managing the income tax. Considering the situation of price escalation, to exclude the poor from income taxation and to reduce the administrative problems are main purpose of keeping exemptions limits for every year, Finance Act prescribes the exemptions limit for individuals families, couple and corporations, But exemptions limit was not allowed to corporate tax payers from FY 1965/66 non-resident taxpayers from the FY 1974/75 and partnership from the FY

1975/76, after FY 1979/80 to till 2006/07 the exemptions limit of couple and family is same.

**Figure 5.11 Income Tax Exemption Limits (FY1959/60 to FY2006/07)**



The exemption limit for all individual, couple and family is in increasing trend from the beginning of the study period. Now, the exemption limit for individual and couple or family is Rs 100,000 and 125,000 respectively.

## 5.6 Income Tax Rates

Rate structure of income tax has been changing continuously since its introduction. In FY 1959/60, net income was divided into 11 brackets. When income over Rs.7000 a year was subject to graduated rates ranging from 5 percent to 25 percent. For the personal income, the slabs have varied from a minimum of two to maximum of eight from the FY 1982/83 to 2002/2003. From the FY 1998/99, the income tax was divided in to two slabs. The rates have varied from 5 to 55 percent. For partnership firms, corporations and non-resident, the income tax rate was same as the rate of personal income from

1984/85 to 1993/94 but exemption limit is not allowed for them. After FY 1994/95, they were taxed at flat rate. The tax rate was reduced from 35 percent in FY 1995/96 to 30 percent for bank, finance companies and financial firms and 25 percent for others (including partnership firms) in FY 1999/00.

Under the new Income Tax Act 2002, individual income tax is levied with two rates of 15 percent and 25 percent. For individuals, who have Rs.120,000 incomes or Rs.1,200,000 turnovers from any kind of business in metropolitan or sub metropolitan cities, municipalities and other area in Nepal are subject to pay Rs.2,000, Rs.2,000, Rs.1,500 and Rs.1,000 as annual flat rates, respectively.

Initially corporate entities were subject to progressive rate structure as individual. Public enterprises and public limited companies listed in the Nepal Stock Exchange were subject to pay a flat corporate tax in 1986/87. This tax was extended to private limited companies in 1993/94. In the later years, it started to levy in the flat rate for its simplicity. Since FY 2001/02 to till now income tax rate for partnership firms, corporation and non residents is 25 percent of taxable income.



## **Chapter VI**

### **Productivity and Projection of Income Tax in Nepal**

#### **6.1 Introduction**

Elasticity and buoyancy are two popular concepts, which are mostly used to measure the responsiveness of taxes in a tax system. The first one measures the automatic response of revenue to the change in income i.e. revenue increase excluding the effect of discretionary change in legal bases, rates, exemptions limit, administrative reforms etc. and the second measures the total response of tax revenue to change in income i.e. revenue increase including the effect of discretionary changes. Elasticity is a static concept where as buoyancy is a dynamic one.

The elasticity refers to the total change in tax revenue excluding discretionary change, associated with a given percentage change in National Income (NI). Tax buoyancy refers to the ratio of total percentage change in the tax revenue including discretionary changes to a given percentage change in NI. If buoyancy is higher than elasticity, it signifies that discretionary changes can raise additional revenue and vice versa.

The response of tax revenue to changes in income has often been singled out as a vital ingredient in considering the criteria for a tax system in a developing country (Charles, 1972; 425). The ratio of percentage change in the income tax revenue to the percentage change in national income gives the buoyancy coefficient of an income tax under consideration. The term elasticity excludes the discretionary changes i.e. change in rates, bases, exemptions limit, administration reforms etc. The yield effects of normal improvements in administration unaccompanied by legal changes are thus included in this measurement of elasticity. Thus, elasticity is also regarded the method of measurement of automatic response of revenue to income changes.

#### **6.2 Calculation of Elasticity and Buoyancy**

Elasticity and buoyancy of income tax is calculated here including the data from the FY 1964/65 to 2006/07. Further, it is divided into two periods;

from FY 1964/65 to 1989/90 period I and from FY 1990/91 to 2006/07 period II. The year 1990 is taken here as the break even point to compare the productivity of income tax before and after the liberalization of the Nepalese economy since Nepal adopted the liberalization policy after the restoration of democracy in 1990. After this, a lots of changes were gone in economic polices.

Also, the elasticity and buoyancy of income tax is calculated with respect to non-agriculture GDP as proxy base from the fiscal year 1974/75 to 2006/07. Similarly, it has also been divided into two periods for comparison.

**Table 6.3**

**Elasticity and Buoyancy of Nepalese Income Tax**

**(FY1964/65 to FY2006/07)**

Statistics → Income Tax	Estimate	Standard Error of	R (Correlation Coefficient)	R <sup>2</sup> (Coefficient of Determination)	$\overline{R^2}$ (Adjusted R <sup>2</sup> )	F-statistics	D-W Statistics	T-statistics
Buoyancy	1.54	0.31	0.99	0.98	0.98	2422.66	0.38	49.22
Elasticity	0.69	0.30	0.96	0.93	0.93	538.11	0.35	23.20
Difference	0.85							

Source: Table 6.1

**Table 6.4**  
**Elasticity and Buoyancy of Nepalese Income Tax for Period I**  
**(FY1964/65 to FY1989/90)**

Statistics → Income Tax	Estimate	Standard Error of	R (Correlation Coefficient)	R <sup>2</sup> (Coefficient of Determination)	$\overline{R^2}$ (Adjusted R <sup>2</sup> )	F- statistic s	D-W Statistic s	T- statistic s
Buoyancy	1.76	0.07	0.98	0.96	0.96	641.47	0.52	25.33
Elasticity	0.85	0.07	0.93	0.86	0.85	141.26	0.36	11.89
Difference	0.91							

Source: Table 6.1

**Table 6.5**  
**Elasticity and Buoyancy of Nepalese Income Tax for Period II**  
**(FY1990/91 to FY2006/07)**

Statistics → Income Tax	Estimate	Standard Error of	R (Correlation Coefficient)	R <sup>2</sup> (Coefficient of Determination)	$\overline{R^2}$ (Adjusted R <sup>2</sup> )	F- statistic s	D-W Statistic s	T- statistic s
Buoyancy	1.78	0.08	0.99	0.97	0.97	494.99	0.62	22.25
Elasticity	0.83	0.09	0.93	0.857	0.85	89.73	0.53	9.47
Difference	0.95							

Source: Table 6.2

The responsiveness of any tax system directly relies of the economic structure or bases of that particular country. In this context, base elasticity is highly useful. Here base elasticity and base buoyancy of income tax is calculated taking non-agriculture GDP as the proxy base since the income from the agricultural income is out of tax net.

**Table 6.6****Base Elasticity and Base Buoyancy of Nepalese Income Tax  
(FY1974/75 to FY2006/07)**

Statistic s→ Income Tax	Estimate d	Standar d Error	R (Correlation Coefficient)	R <sup>2</sup> (Coefficient of Determinatio n)	$\overline{R^2}$ (Adjusted R <sup>2</sup> )	F- statistic s	D-W Statis tics	T- statis tics
Buoyanc y	1.21	0.03	0.99	0.98	0.98	1624.8 4	0.60	40.3 1
Elasticit y	0.50	0.02	0.97	0.93	0.93	419.99	0.75	20.4 9
Differen ce	0.71							

Source: Table 6.1

**Table 6.7****Base Elasticity and Base Buoyancy of Nepalese Income Tax for  
Period I (FY1974/75 to FY1989/90)**

Statistics → Income Tax	Estimat ed	Standard Error	R (Correlatio n Coefficient )	R <sup>2</sup> (Coefficient of Determinatio n)	$\overline{R^2}$ (Adjuste d R <sup>2</sup> )	F- statisti cs	D-W Stati stics	T- statist ics
Buoyanc y	1.14	0.07	0.97	0.95	0.94	254.05	1.12	15.94
Elasticity	0.41	0.05	0.90	0.81	0.80	60.20	1.47	7.76
Differenc e	0.73							

Source: Table 6.1

**Table 6.8**

**Base Elasticity and Base Buoyancy of Nepalese Income Tax for Period II  
(FY1990/91 to FY2006/07)**

Statistic s→ Income Tax	Estimate d	Standar d Error	R (Correlatio n Coefficient )	R <sup>2</sup> (Coefficient of Determina tion )	$\overline{R^2}$ (Adjuste d R <sup>2</sup> )	F- statisti cs	D-W Stati stics	T- statis tics
Buoyan cy	1.58	0.07	0.99	0.97	0.97	519.39	0.64	22.7 9
Elasticit y	0.74	0.08	0.93	0.87	0.86	97.41	0.51	9.87
Differen ce	0.84							

Source: Table 6.2

### 6.3 Interpretation

The calculation of elasticity and buoyancy of income tax with respect to GDP as well as base elasticity and base buoyancy of income tax with respect to proxy base (non-agriculture GDP) is given above. It consists the period of FY 1964/65 to 2006/07 and FY 1974/75 to 2006/07 respectively. For making the analysis more effectiveness, this period is further divided in to two parts. The time period from FY 1964/65 to 1989/90 is the Period I and from FY 1990/91 to 2006/07 is the Period II. While calculating base elasticity and base buoyancy from FY 1974/75 to 2006/07, the period 1974/75 to 1989/90 is taken as period I and the period from FY 1990/91 to 2006/07 as period II. The year 1990 is taken as the break even point since Nepal adapted the policy of open economy or followed the process of liberalization after the restoration of democracy in 1990. The comparative study of two periods gives the effectiveness in tax collection especially, in the sector of income tax.

The elasticity of income tax 0.69 is extremely low in comparison with buoyancy 1.54 in the period 1964/65 to 2006/07, which is shown in the Table 6.3. Thus, the income tax is less responsive to change in GDP. The buoyancy of income tax with respect to GDP is 1.54, which means that one percent change in GDP cause 1.54 percent change in income tax yield. This indicates

that the government has concentrated more on introducing various discretionary measures rather than broadening the income tax base. Such an income tax structure is not conducive to support growing development activities because it needs frequent changes in the tax rates through legislative procedures. It creates the complication of mobilizing additional revenue. It also adds uncertainty to the existing environment. Exemption of agriculture income from income tax net, continuous decreasing tax rates and more or less constant tax base, low valuation of imported goods, which further lowers the income tax, complication in identifying the income from service sectors etc. are the main reasons of low income elasticity in Nepalese tax system. The inelastic nature of income tax indicates that is still potentiality of raising the income tax through widening tax base, certain administration reforms and may be raising tax rates.

The elasticity of income tax is 0.85 and 0.83 of the study period I and II respectively. This shows the income tax is inelastic or income tax revenue is less responsive to the GDP. The buoyancy is 1.76 and 1.78 of the study period I and II respectively. This shows the income tax is highly buoyant.

The difference between buoyancy and elasticity coefficients is utilized to know how much percentage change in revenue by one percent change in GDP due to discretionary changes. The higher difference means the high possibility of raising the tax collection through discretionary changes. The difference between buoyancy and elasticity is 0.85 in the whole period and 0.91 and 0.95 in period I and II respectively. This indicates that the role discretionary changes are very high to yield the revenue from income tax, especially in the period II.

The values of base elasticity and base buoyancy of Nepalese income tax during FY 1974/75 to 2006/07 are 0.50 and 1.21 respectively, in table 6.6. This shows the income tax is inelastic with respect to proxy base also. But the values of base elasticity and base buoyancy of period I and period II are 0.41 and 1.14 and 0.84 and 1.58 respectively. The low value of base elasticity and base buoyancy coefficient of income tax to base indicates a poor relationship

between base and tax. That is change in base only cannot bring desired change in the tax revenue and some other factors are also responsible which are to be applied to bring change in the tax revenue structure.

The difference between base buoyancy and base elasticity is 0.71, 0.73, and 0.84 in whole period, period I and period II respectively. This means one percent change in income tax yield through discretionary change. It is seemed that the role of discretionary change is greater than the automatic growth in income tax revenue in all period. But it is very high in the period II. Thus Nepalese income tax system is likely to be buoyant rather than elastic.

The values of correlation coefficient (R) in all cases are more than 0.90 shows that there is strong positive relationship between related dependent and independent variables. The coefficient of determination ( $R^2$ ) measures the goodness of fit of regression. The  $R^2$  for income elasticity is 0.93 and for buoyancy is 0.98, which indicates that the association between GDP and income tax holds good. The values of  $R^2$  are also high in the period I and II. Similarly, the value of adjusted  $R^2$  in case of base elasticity and base buoyancy are also significantly high. Here adjusted  $R^2$  measures the variation in income tax revenue due to the variation in GDP. The value of adjusted  $R^2$  is comparatively greater in the case of buoyancy than in the elasticity of relevant variables.

To check whether the variation is due to variation in GDP and in GDP originating from non-agriculture sector, F-test is utilized. The tabular value of F statistics for given degree of freedom at 1 percent level of significant is less than the calculated value in all cases. Since the calculated value is highly significant, the relationship is reliable. Similarly, in case of base elasticity, the calculated value of F is significantly higher than the tabulated value of F statistics. Thus it can be confirmed that the variation in income tax revenue is mainly caused by the variation in GDP as well as GDP originating from non-agriculture sector.

The values of t-statistics, which gives the significance of parameters, are also significant at 1 percent. The value of d-statistics in all cases are less than 1, this shows that there is positive autocorrelation at given degree of freedom and significant at 1 percent level of significance.

## **6.4 Projection of Income Tax in Nepal**

Data about projection of income tax in coming year are not available. The availability of date till 2006/07 only has been major hardly in making projection.

Despite the serious gaps in availability of information for projections as attempt has been made in this study to project income to revenue of Nepal till 2016/17. Such projection should be taken as broad estimation only in view of series limitations. Additional torn effects resulting from policy changes, administrative action and changes in the behavior of taxpayers have not been disaggregated. The most important thing is that we are calculating the historical trend line of total income tax for period of past 17 years (i.e. FY 1990/91 to 2006/07) using secular trend.

### **6.4.1 Trend Analysis of Income Tax in Nepal**

It is cleared in trend of income tax there also exist cyclical variations. As per the trend of income tax, it should grow by the rate of Rs 891.89 million per year, But during the reference period 1990/91 to 2006/07, it is not found that the income tax is growing as per its growth rate. In FY 1990/91 income tax was collected amounting Rs. 746.20 million where -733.09 million should be collected.

In FY 1991/92, the income tax amounting RS. 855.10 million was collected which was Rs. 317 million more than its trend value. In FY 1993/94, 1994/95, 1995/96, 1996/97, 1997/98, 1998/99, 1999/00, there was negative collection variation. In FY 2000/01 and FY 2001/02, there was positive variation in income tax collection. There was again negative variation of



1,277.89, 646.16, 480.53 and 858.01 million respectively in FY 2002/03, 2003/04, 2004/05 and 2005/06, and there was Rs. 3,189.92 million excess collection of income tax in FY 2006/07.

#### **6.4.2 Future Projection of Income Tax in Nepal**

As per the calculated growth rate, the income tax collected will increase by Rs. 891.873 million per year. In FY 2007/08 Rs. 14,428.75 million income taxes will be collected. Likewise in FY 2011/12, income tax amounting Rs. 17,996.24 million and in FY 2016/17 income tax amounting Rs. 22,455.61 million will be collected.

#### **6.4.3 Projection of Income Tax with Average Growth Rate**

By the analysis of the data from FY1964/65 to FY2006/07, it is observed that the income tax increases at 23.63 percent in an average per year.

As per the calculated growth rate, the income tax collected will increase by 23.63 percent per year in an average. In FY 2007/08 Rs. 20,679.34 million income taxes will be collected. Likewise in FY 2011/12, income tax amounting Rs. 48,309.46 million and in FY 2016/17 income tax amounting Rs. 139,524.80 million will be collected.

## **Chapter VII**

# **Problems and Prospects of Resource Mobilization through Income Tax in Nepal**

### **7.1 Problems of Income Tax in Nepal**

Nepalese tax system is circumscribed by serious structural constraints. The major constraints existing in the tax system is that it lacks simplicity and transparency. With extremely limited tax base, low tax elasticity, relatively higher tax rates, poor voluntary compliance, ineffective tax administration, growing arbitration in assessment, rigid and incomprehensive tax laws and regulations, and numerous tax shelters, taxation in Nepal has so far been attributed to negation resulting in rampant corruption. Tax avoidance, evasion and delinquency have also increased substantially over the years. A majority of the taxpayers are ignorant of existing laws and regulations. There is apprehension that taxpayers are neither sufficiently protected by the law nor is their contribution ever recognized. A significant amount of revenue is missing before reaching treasury in between the taxpayers and tax officials. The major challenge facing Nepal's tax administration is how to identify and improve voluntary compliance (Dahal, 2004, 319).

The problems of taxation differ with respect to individual taxes. The problems of income tax are broadly categorized into three different heads viz. administrative problems, legal problems and structural problems.

#### **7.1.1 Administrative Problems of Income Tax**

In the absence of diligent execution of taxes, goals of tax policy are difficult to attain. Ineffective enforcement of existing taxes may lead to public irritation and ill feeling and may defeat even its basic purposes to impose. Prof. Colbert has rightly observed that the art of taxation consists in so plucking the

goose as to obtain the largest amount of feathers with the least possible amount of hissing. For this to achieve in practice, what is required is the diligent execution of taxes. But in developing countries, administrative tax machinery are mostly inexperienced and tax payers are usually unfamiliar with the existing tax-laws and even maintenance of proper records of their accounts are not in common practice. As a result, effectiveness of tax administration is highly constrained (Nepal, 2002; 259).

Ministry of finance is the apex of the tax administration in Nepal. The Revenue Division of the ministry is responsible for formulating tax policy and setting up the appropriate tax administration to implement the tax policy. Tax Directorate set up in 1959 is the first organized income tax administration of Nepal. In 1961/62, the Tax Directorate was named Internal Revenue Department and in 1963/64 the department was converted into the Department of Taxation. In the mid April 2001, the Department of Taxation and the Department of Value Added Tax are merged. After the merger of two departments into one organization the merger department is Inland Revenue Department (Bajgain, 2005; 36-37).

There is no separate body for the administration of income tax in Nepal. The Inland Revenue Department is responsible for the income tax administration in Nepal which is not far from its drawbacks which are explained below:

**(i) Failure to Locate New Taxpayers**

The tax administration in Nepal lacks up to-date roll of insisting as well as potential taxpayers. The major problem of locating new taxpayers is in the case of non-residence and non-citizen persons. The open border with India has compounded these problems.

## **(ii) Failure to Maintain Proper Accounts and Records**

The Inland Revenue Department is failure to maintain proper accounts and records of income tax. Nepalese tax administration does not have enough information about actually how much taxpayers are in Nepal? What is the actual income status of Nepalese people? Due to the poor database, there is greater possibility of tax evasion.

## **(iii) Assessment Delays**

Assessment refers to the calculation of tax liability by applications of governing rates to taxable income. Assessment procedure, non-maintains of financial records and accounts, lack of information etc. are the major causes of assessment delays.

## **(iv) Poor Taxpayers Compliance**

Nepalese people have tradition of paying indirect taxes. They do not seem to have accepted the payment of income tax as a normal way life. Many people still perceive income tax as an unnecessary payment. There is a general lack of income tax consciousness. Lack of taxpayer education, complicated laws and procedures, unhelpful attitude of tax personnel, poor enforcement of fines and penalties are the main reasons for poor taxpayers' compliance.

## **(v) Avoidance and Evasion of Income Tax**

Avoidance and evasion of income tax is the main problem of income tax. Taxes are compulsory payments, not voluntary contributions. So, people always look for a way to avoid and evade tax in order to minimize present tax. Corruption, illegal business activities, high tax rates, ineffective use of fines and penalties, lack of support from public etc. are the main reasons for tax avoidance and evasion.

## **(vi) Defective Personnel Management**

The human factor is the heart of effective tax administration. The effectiveness of tax administration depends on its personnel. However the personnel of tax administration of Nepal are also falling in corruption. Thus, the tax administration of Nepal is not efficient. Defective selection procedure, lack of efficiency in tax personnel, poor training opportunities, and defective organizational arrangements are the main reasons for defective personnel management.

### **7.1.2 Legal Problems of Income Tax**

Although there was tax system in Nepal in ancient time also, the concept of income tax was brought only by the first budget. The budget introduced in 1951 A.D. stated about the introduction of income tax system in Nepal. However, it was actually introduced in 1960 when the Finance Act, 1959 and Business profit and Remuneration Tax Act, 1960 were enacted (Kandel, 2004; 16).

First law of Nepal regarding to the income tax is Business Profit and Salaries Tax Act, 1960 then after three income tax acts has been introduced in Nepal. These are Income Tax Act, 1962, Income Tax Act, 1974 and Income Tax Act, 2002. However, Income Tax Act, 2002 is in practice which has certain problems and explained below:

#### **(i) Complicated Laws and Procedures**

Laws related to income tax in Nepal are complicated for average taxpayer to comprehend. They provide widespread discretionary power to tax officers. A taxpayer in Nepal cannot know for certain what his tax liabilities should be. In fact his tax liability varies with whatever the tax officer thinks it to be reasonable.

## **(ii) Difficult to Charge the Tax on Dual Used Commodity**

There are many dual used commodities, which require good judgment either brings it under the tax net or exempt it from taxation. For example, consider the example of a farmer and mini truck. If the farmer uses the truck for further income generating purpose, no doubt, he should pay tax. But if he use this trucks foe his own agricultural purpose, there would not be any income and his property should be tax-free. So, how do the government charge the tax from such kind of dual used commodities, is the great problem of income tax.

## **(iv) Deviation from the Basic Principle of Income Taxation**

The essence of a progressive income tax is that it should take into account the personnel circumstances of the taxpayers. The Nepalese income tax has deviated considerably from this principle. It treats different sources of income differently, resulting in an unequal tax burden upon taxpayers having equal tax paying capacity. Employees, particularly in the public sector, pay full tax on their income due to withholding of tax. Self-employed people who earn more money, however, are almost out of the tax net, they pay little or no tax on their income.

## **(v) Long Time Lag**

The lag in the collection of income tax is rather long. A taxpayer has to pay the final tax due within 35 days after the receipt of the notice of assessment. The taxpayer is not able to pay within the stipulated period; he must file for an extension with 35 days of the notice of assessment and after the payment of any penalties. The tax officer may allow an extension of up to 9 months. Although fees are charged for late payments, they are not adequate to deter delays in payments.

### **7.1.3 Structural Problems of Income Tax**

#### **(i) Narrow Coverage**

The base of income tax is extremely very low in Nepal. Agricultural income is exempt from income tax. Capital income is treated favourably. For example, capital gains are not taxed. Dividends are kept out of the income tax net at the shareholders' level while interest on deposits from an account with a bank or finance company is taxed highly. Although, labour income is taxed more heavily than the capital, allowances such as travel allowances, the leadership allowances, medical allowances, telephone allowances, pensions etc. granted to employees are all excluded from the coverage of income tax. In addition, a number of tax incentives have been provided to industries.

#### **(ii) Relatively Higher Tax Rates**

Different studies have shown that the large amount of illegal economic activities are prevalent in the under developing countries which are subject to out of tax net. The formally organized sectors, which are under tax net, have to compete with the sectors, which do not pay any tax. It increases the tax evasion and illegal economic activities in the economy. At present 15 percent and 25 percent tax rates are in practice for individual taxpayers. The taxable income that is taxed at 15 percent is Rs.75000, which is slighter low and more income is taxes at the higher rate of 25 percent. So the taxable income at 15 percent rate should be increased. The tax rate should be decreased in order to widen the coverage.

The presumptive tax depending on the business is relatively same over the years. But the limit of profit and transaction is increased. They should be increased proportionately for its effectiveness.

Income derived by an individual from running special industry has to pay 20 percent where as it is 25 percent for the individual taxpayer. This causes

the tax avoidance. Hence, such discrimination should be replaced by an appropriate tax rate.

### **(iii) Exemptions Limit**

The exemptions limit does not show any definite relationship with per capita GDP or with inflation rate or with poverty norms. Thus it is unscientific and policy maker should give attention in this aspect in the coming days.

The exemptions limit being equal to the remuneration taxpayers and business individuals do not seem reasonable. To bring all the sources of income including fringe as well as retirement benefit under the tax net, the exemption limit for remuneration taxpayers should be made comparatively higher

### **(iv) Deduction**

There is no transitional provision for unrelieved pre-operating expenses occurred before income tax act 2002 and there is no provision for the treatment of pre-operating expenses. Hence, the ambiguity in deducting such expenses while calculating taxable income should use, properly defined.

The cost of repair and maintenance of machinery and plant has increased in the latter years, the provision of 5 percent depreciation basis for deduction of that form the assessable income does not totally cover. It discourages the capital formation in the economy.

The tax act 2002 provides Rs.100, 000 or 5 percent of adjusted taxable income, whichever is less as deduction of donation expenses. This limit was fixed many years ago now it should be revised. If the limit is low, it restricts the businessmen from spending money in social sector.

Since Nepal has adopted liberalization policy and tried to attract FDI in different sectors. So investment friendly policy with regard to taxation should be made. The facility of carry forward of unrelieved loss for 7 years in different sides of hydro project is low because of its long gestation period.



## **7.2. Prospects of Resource Mobilization through Income Tax**

Income tax can be a major source of resource mobilization if certain pre-requisition or condition are fulfilled.

### **1. Existence of Predominately Monetized Economy**

This means that every economy activities should be monetized. Higher the economy to be monetized, greater will be the possibility to introduce new taxes. Due to the lack of predominant monetized economy developing countries like Nepal have not been able to properly mobilized resources through income tax.

### **2. A High Standard of Literacy**

If the society is highly literate, voluntary compliance will be high. They also realize why they should pay taxes.

### **3. Large Degree of Voluntary Compliance**

Voluntary compliances mean voluntarily disclosure of income and paying taxes according to the rule. If voluntarily compliance is, a great amount of resources can be mobilized through income taxation.

### **4. Reliable Record of Accounting**

In the absence of reliable records of accounting, one cannot actually calculate the income of individuals. There greater possibility of tax evasion. Therefore there should be reliable records of accounting for the proper implementation of income tax.

### **5. Absence of Wealthy or Comprador Class in the Policy Making**

If there is wealthy of comprador class, they act in their self-interest. Their activities go against the proper implementation of income tax government cannot mobilize resources through income taxation.

## **6. Honest Efficient Administration**

Honest and efficient administration is needed for any tax, but minimum acceptable standards appear to be higher for income taxes than for many other levies. Difficult as the task of establishing a satisfactory administration may be, it is probably the condition for successful income taxation that can be met most quickly. The expert, nevertheless, must guard against the assumption that a tidy organization and political staffing assure neither good administration nor can he be confident that the best attainable administration will eliminate obstacles to heavy reliance on income taxes.

## **7. Improve the Tax Administration**

In order to improve tax administration the following should be done:

- Every tax administration must get the message that honesty is honoured and rewarded, while corruption gets punished.
- Given the resources constraint, resource made available to tax department must be used in a cost efficient way.
- Taxpayer must get the message that evasion would be punished.
- In a large and growing population of tax payer it is not possible to check the returns filed by each assesses. So there is need to proceed on the basis of “self –assessment”. It means that tax authority should accept whatever taxpayers declare on their own subject to random checks. It may not be very wise to concentrate only on “large case”.
- In order to facilitate enhancement, the following need to be done:
  - Extension of the scheme of withholding over wide areas such as salary, interest, dividend and even rental incomes.
  - Adoption of presumptive approach in taxing the hard-to-tax group.

- Development of an efficient information system.

## **8. Others**

- Increase the extent of tax base.
- Rationalization of tax rates compatible with SAFTA and WTO provision.
- Self-assessment system should be made more effective.
- Improving the efficiency of the tax administration.
- Developing an effective data and information system by using new technology.
- Gradual elimination of exemption.  
Introduction of voluntary disclosure of income schemes (VDIS).

## Chapter VIII

### Findings, Conclusion and Recommendations

#### 8.1 Findings

Nepal is one of the developing countries with \$320 of per capita income and 30.85 percent of total population lies below poverty line. So, Nepal needs huge amount of resources for economic development. Despite the various measures adopted by the government to boost the revenue collection, there is still a substantial resource gap between expenditure and revenue.

Because of increasing gap between expenditure and revenue collection, Nepal has to heavily depend upon both external as well as internal debt to meet the budget deficit. Unfortunately, the dependency is still in increasing which is undesirable for the economy. This scenario emphasizes for the mobilization of financial resources through income tax.

The major findings of this study are summarized as follows:

- Resource gap is taken to be the difference between government expenditure and revenue. It has increased from Rs 157.6 million in FY1964/65 to Rs 45,892.3 million in FY 2006/07 in an average of 12,201.37 million per year. This increase in resource gap indicates the poor performance of domestic resource mobilization.
- Tax effort ratio measures the country's economic performance. In Nepal, the contribution of tax revenue to GDP was 10.1 percent and per capita income was only \$ 270 in 2005, which was lowest among the SAARC countries. In USA contribution of tax to GDP was 11.20 during the same period and its per capita income was \$ 41440. Though the tax effort ratio is to some extent equal, its amount is very high because of its high GDP.

- Government revenue is the composition of tax revenue and non-tax revenue. There is dominant share of tax revenue in Nepalese government revenue. The contribution of tax revenue to government revenue shows the fluctuating trend and it had contributed 86.77 percent in an average under the study period.
- Nepalese tax revenue is the composition of direct tax and indirect tax revenue. There is dominant role of indirect tax. The contribution of direct tax and indirect tax revenue were 24.15 percent and 78.23percent respectively in an average under the study period.
- Among the various sources of government revenue, custom duties, VAT, income tax and excise duties are the major sources of government revenue. Income tax has occupied third position at present on the basis of its contribution. The contribution of income tax in increasing trend, which shows the bright future of income tax.
- The direct tax consists of income tax, land revenue, house and land registration and others. In the FY1964/65, the income tax was Rs. 5.3 million and the land revenue was Rs.43.2 million. But in the succeeding fiscal year the amount of land revenue has declined and vanished at present. The share of income tax is appeared as the dominant source of direct tax with the amount of Rs.16726.8 million contributing 82.87 percent in the direct tax in the FY 2006/07. Income tax has contributed 23.52 percent to the total tax revenue, 19 percent to the total revenue and 2.39 percent in the GDP in the FY 2006/07.
- The contribution of income tax on total tax revenue, GDP and total revenue is in increasing trend. Its contribution was 11.76,

0.92 and 9.36 percent in tax revenue, total revenue and GDP respectively in an average under the study period.

- Income tax is the composition of corporate income tax, personal income tax, and investment income tax. Corporate income tax is collected from government corporations, public and limited, partnership firms. Individual income tax is collected from remuneration and industry, business, profession. Invested income tax is collected from dividend, interest, royalty, rent etc.
- Within the income tax there is the dominant role of corporate income tax and it is in decreasing trend and it was 74 percent of income tax in FY 2006/07. The contribution of personal income tax, house and land rent tax and interest tax was 16, 4, and 6 percent respectively.
- Tax exemptions limit has done timely change from the beginning to tap the potentiality of resource. Tax rate is also fixed according to the need. It has maintained the progressivity with less number of slabs for individual income after 1990s. At present there are only two slabs with 15 and 25 percent above the exemption limit.
- The measurement of elasticity and buoyancy of income tax gives the responsiveness of income tax in the tax system. The values of elasticity in all cases are less than unity implies that the income tax is not responsive. This shows there is still potentiality of raising the income tax through widening base, administrative reforms and may be raising tax rates.
- It is cleared in trend of income tax there also exist cyclical variations. As per the trend of income tax, it should grow by the rate of Rs 891.89 million per year, But during the reference period 1990/91 to 2006/07, it is not found that the income tax is

growing as per its growth rate. In FY 1990/91 income tax was collected amounting Rs. 746.2 million where Rs. -733.09 million should be collected.

- As per the calculated growth rate, the income tax collected will increase by Rs. 891.87 million per year. In FY 2007/08 Rs. 14,428.751 million income taxes will be collected. Likewise in FY 2011/12, income tax amounting Rs. 17,996.243 million and in FY 2016/17 income tax amounting Rs. 22,455.608 million will be collected.
- Extremely limited tax base, low tax elasticity, relatively higher tax rates, poor voluntary compliance, ineffective tax administration, growing arbitration in assessment, rigid and incomprehensive tax laws and regulations, and numerous tax shelters are the main problems of Nepalese tax system.
- The problems of taxation differ with respect to individual taxes. The problems of income tax are broadly categorized into three different heads viz. administrative problems, legal problems and structural problems. These three categories of problems are major hardly in resource mobilization through income tax.

## **8.2 Conclusion**

The study on income tax collecting the data from the FY 1964/65 to FY 2006/07 shows that the income tax is very important source of revenue. Its contribution in the total revenue is in increasing trend. The timely changes policies with respect to income tax are very important in the collection of income tax. The future projection of income tax shows the bright future of income tax in government revenue. But the calculation of elasticity and buoyancy of income tax shows the income tax is buoyant rather than elastic.

This implies that the role of discretionary power is significant in the collection of income tax.

There are still some problems of resource mobilization through income tax. However, we can solve these problems by the collective effort of people, tax officers, political parties and government. If we solve the problems of income tax in time, no one can deny the fact that income tax is the major tool of financial resource mobilization in Nepal.

### **8.3 Recommendations**

On the basis of the findings of the present study, the following specific suggestions have been recommended for a sound and effective income tax system.

#### **1) Broadening Income Tax Base**

Tax bases in Nepal are among the lowest in South Asia. Till very recently, income tax base was not broadened so as to more than offset the revenue loss caused by drastic reduction in tax rates. However, the newly enacted Income Tax Act has brought most of the sources of income under the tax net that were hitherto untaxed. With the full-fledged implementation of the Act from the next fiscal year it can be hoped that the elasticity of the Nepalese income tax will increase to a significant extent. Nevertheless there are some areas that have not been taxed to the fullest extent. Still the Act has exempted agricultural income, which contributes about 38% of GDP. Similarly, foreign sourced income has been virtually untaxed. It may be recalled that remittance from abroad covers a huge chunk of GNP of Nepal. Likewise, capital gains have been taxed only partially. Thus,

- a) The government should levy tax on agricultural income after providing certain exemption limit.



- b) Liability to pay should be based on ability to pay, which further depends on the area of land owned by the farmers and marginal productivity of the land.
- c) For the sake of neutrality as well as to broaden the tax base foreign sourced income should be taxed. If the same income is taxed abroad, taxpayers should be provided with the credit facility. To materialize this, double taxation avoidance treaty should be concluded with as many countries as possible at least with major source countries.
- d) Capital gains tax should be effectively implemented in investment for non-business purpose as well.

## **2) Reforms in Tax Administration**

More often, it is mentioned that tax administration in developing countries is tax policy, which means that until and unless policy measures are backed by corresponding administrative reforms, they are doomed to failure. This very clearly recognizes the important role of tax administration in developing countries like Nepal. Therefore, the administrative reform is critical to the success of tax policy. In view of the above and the administrative problems stated elsewhere, following measures are suggested:

- a) The tax policies, tax laws and tax administration are interrelated part of taxation. Hence, government should mobilize these aspects and consider serious attention towards its effectiveness.
- b) Tax policy should have clear-cut directive and consistent with a long term perspective of the policy. At present the tax policy should be focused on optimum resource mobilization for the purpose of the expenditure revenue gap.
- c) As the whole of information is central to the success of tax administration, information collation should be consolidated. Intra-

departmental as well as inter-departmental networking at least among the departments within the MOF should be established at the earliest. The scope of PAN should be expanded to cover such things as purchase and sale of land, vehicles etc. it should be provided to as many taxpayers as possible. Taxpayers who hesitate to come to IROs or are either unaware about it, should be provided the PANs in their doorsteps.

- d) In IRD, a separate “Research and Analysis Unit” should be established in order to find our new avenues of the taxation and to find out the lapses in tax policy persuaded by the government.
- e) Efforts need to be made, to institutionalize the recently created LTO along proper lines. Its organizational structure must be functional and it should have adequate physical facilities.
- f) Tax collection officials should be well trained, well-remunerated and reasonable and serve punishments should be well published for demonstration effect.
- g) The present system of making assessment of every return filed should be stopped. Rather, a credible system, of random sampling should be developed in which only those taxpayers who have underreported their income or inflated their expenditure substantially could be detected. Only this should give message among taxpayers that honest taxpayers are not harassed by tax administration. On the other, it would convey a message to taxpayers that if they are not to report their profit accurately, there is always a probability of being detected and punished.
- h) The terms and the procedure under the act should be simplified so that even laymen could understand easily.

- i) The tax officials also need to be reoriented to implement the new act smoothly. They should be familiarized with recent innovation in the field of public administration particularly in tax administration whereby taxpayers are treated as clients. And hence, client orientation should be the thrust of the administrative reforms.
- j) Modern taxes are implemented under the self-assessment system. It is, therefore, necessary to have a large number of tax officers who have a good knowledge of accounting and auditing. This means it should be made mandatory to have a basic degree on accounting auditing and the tax system in order to be eligible to apply for the position of tax officers.
- k) Enhancing voluntary compliance should be the ultimate goal of the tax administration. For this, the cost of non-compliance should be substantially increased and the cost of compliance should be reduced. In this regard, delinquent taxpayers should be penalized and such events should be publicized properly so that it may have sufficient deterrent effects among probable defaulters. On the other, the cost of compliance should be lowered, inter alias, by simplifying procedures, helping taxpayers in meeting their obligations and educating them in various aspects of tax administration.
- l) As the modern tax administration demands professionals who are highly qualified in the tax system, accounting, auditing, law, economics, and IT, it is necessary to create an appropriate working environment that should include among other things, higher salaries, so that competent professional can be attracted and retained in the tax administration

### **3) Raise the Income Level**

The major source of income tax is the income itself. Government should take initiative towards this. If the sufficient employment is generated by creating investment friendly environment the income level of people can be raised. Thus, the sufficient amount of revenue through income tax can be generated.

### **4) Establishment of the Standardized Accounting System**

Nepalese tax account system has been criticized for non-meeting the international standard. To regulate accounting system a separate body should be established.

### **5) Others**

The entry of personnel from another group into revenue group should be hard taking into consideration of carrier development of the personnel inside the revenue group.

The property investigation commission should act effectively to find out the illegal income and property of the revenue personnel and seize such assets without any legal source. The punishment for corrupt and irresponsible officials should be publicized so that others would be deterred from involving in malpractices. It would be a warning for others. The decision about the appeal of the taxpayer should be made timely. Tax officials who are responsible for such delay should be compensating for the loss.

## **Annexes**

## Annex 1

**Table 5.1 Resource Gap in Nepalese Finance (FY1964/65 to FY 2006/07) Amount in Rs. Million**

Fiscal Year	Total Expenditure	Total Revenue	Resource G Gap 1	Foreign Grants	Resource Gap 2	Foreign Loans	Resource Gap 3
1964/65	349.90	192.30	157.60	141.10	16.50	5.90	10.60
1965/66	427.30	216.50	210.80	175.30	35.50	2.30	33.20
1969/70	683.80	464.00	219.80	243.70	-23.90	7.60	-31.50
1970/71	769.50	459.70	309.80	270.70	39.10	32.50	6.60
1971/72	889.00	535.40	353.60	242.00	111.60	38.90	72.70
1972/73	982.80	615.80	367.00	180.30	186.70	47.40	139.30
1973/74	1,226.30	766.40	459.90	222.60	237.30	87.90	149.40
1974/75	1,513.70	1,008.40	505.30	282.80	222.50	104.00	118.50
1975/76	1,913.30	1,115.60	797.70	359.70	438.00	145.90	292.10
1976/77	2,330.40	1,322.90	1,007.50	392.60	614.90	164.30	450.60
1977/78	2,674.90	1,582.00	1,092.90	466.60	626.30	381.80	244.50
1978/79	3,020.50	1,811.90	1,208.60	599.20	609.40	390.20	219.20
1979/80	3,470.70	1,880.00	1,590.70	805.60	785.10	534.90	250.20
1980/81	4,092.30	2,419.20	1,673.10	868.90	804.20	693.30	110.90
1981/82	5,361.30	2,679.50	2,681.80	993.90	1,687.90	729.30	958.60
1982/83	6,979.20	2,841.60	4,137.60	1,090.10	3,047.50	985.80	2,061.70
1983/84	7,437.30	3,409.30	4,028.00	876.60	3,151.40	1,670.90	1,480.50
1984/85	8,394.80	3,916.60	4,478.20	923.40	3,554.80	1,754.90	1,799.90
1985/86	9,797.10	4,644.50	5,152.60	1,172.90	3,979.70	2,501.10	1,478.60
1986/87	11,513.20	5,975.10	5,538.10	1,285.10	4,253.00	2,705.80	1,547.20
1987/88	14,105.00	7,350.00	6,755.00	2,076.80	4,678.20	3,815.80	862.40
1988/89	18,005.00	7,776.90	10,228.10	1,680.60	8,547.50	5,666.40	2,881.10
1989/90	19,669.30	9,287.50	10,381.80	1,975.40	8,406.40	5,959.60	2,446.80
1990/91	23,549.80	10,729.90	12,819.90	2,164.80	10,655.10	6,256.70	4,398.40
1991/92	26,418.20	13,512.70	12,905.50	1,643.80	11,261.70	6,816.90	4,444.80
1992/93	30,897.70	15,148.40	15,749.30	3,793.30	11,956.00	6,920.90	5,035.10
1993/94	33,597.40	19,580.80	14,016.60	2,393.60	11,623.00	9,163.60	2,459.40
1994/95	39,060.00	24,575.20	14,484.80	3,937.10	10,547.70	7,312.30	3,235.40
1995/96	46,542.40	27,893.10	18,649.30	4,825.10	13,824.20	9,463.90	4,360.30
1996/97	50,723.70	30,373.50	20,350.20	5,988.30	14,361.90	9,043.60	5,318.30
1997/98	56,118.30	32,937.90	23,180.40	5,402.60	17,777.80	11,054.50	6,723.30
1998/99	59,579.00	37,251.00	22,328.00	4,336.60	17,991.40	11,852.40	6,139.00
1999/00	66,272.50	42,893.80	23,378.70	5,711.70	17,667.00	11,812.20	5,854.80
2000/01	80,483.30	48,893.90	31,589.40	6,753.40	24,836.00	12,044.00	12,792.00
2001/02	80,752.40	50,445.60	30,306.80	6,686.20	23,620.60	7,698.00	15,922.60
2002/03	83,939.90	56,229.70	27,710.20	11,339.10	16,371.10	4,546.40	11,824.70
2003/04	89,601.90	62,331.00	27,270.90	11,283.40	15,987.50	7,629.00	8,358.50
2004/05	104,184.40	70,122.70	34,061.70	14,391.20	19,670.50	9,266.10	10,404.40
2005/06	110,106.20	72,282.10	37,824.10	13,827.50	23,996.60	8,214.30	15,782.30
2006/07	133,604.50	87,712.20	45,892.30	15,800.80	30,091.50	10,053.50	20,038.00
Average			12,201.37		8,673.10		4,119.85

Source: Economic Survey, Various Issues

**Table 5.2 GDP, Per Capita Income and Tax Revenue as Percentage of GDP of Selected Countries  
in 2006**

<b>Countries with different Income Group</b>	<b>GDP in 2006 (in million of \$)</b>	<b>GNI Per Capita 2006 (in US \$)</b>	<b>Tax Revenue as % of GDP</b>
<b><u>Lower Income</u></b>			
Nepal	8,938	320	8.9
India	911,813	820	10.70
Pakistan	126,836	800	9.50
Ghana	12,906	510	22.40
<b><u>Lower Middle Income</u></b>			
Sri Lanka	26,964	1,310	15.30
Thailand	206,338	3,050	16.90
Peru	92,416	2,980	13.50
<b><u>Upper Middle Income</u></b>			
Argentina	214,241	5,150	14.20
Chile	145,843	6,810	20.70
Malaysia	150,672	5,620	--
South Africa	255,155	5,390	29.00
<b><u>High Income</u></b>			
Australia	780,531	35,860	23.70
Switzerland	380,412	43,530	10.50
USA	13,163,870	44,710	11.90
UK	2,376,984	40,560	28.80

Source: World Development Indicator, 2008

**Table 5.3 Contribution of Tax Revenue and Non Tax Revenue in Total Revenue (FY1964/65 to FY 2006/07)**

Amount in Rs. Million

Fiscal Year	Total GDP	Total Revenue	Revenue % of GDP	Tax Revenue	TR as % Total Rev.	Non-Tax Revenue	% Total Rev.
1964/65	5,602.00	192.30	3.43	150.80	78.42	41.50	21.58
1965/66	6,909.00	216.50	3.13	177.10	81.80	39.40	18.20
1966/67	6,411.00	256.70	4.00	225.80	87.96	30.90	12.04
1967/68	7,173.00	306.80	4.28	283.80	92.50	42.20	13.75
1968/69	7,985.00	413.00	5.17	368.30	89.18	44.70	10.82
1969/70	8,768.00	464.00	5.29	411.30	88.64	52.70	11.36
1970/71	8,938.00	459.70	5.14	395.70	86.08	64.00	13.92
1971/72	10,369.00	535.40	5.16	466.80	87.19	86.60	16.17
1972/73	9,969.00	615.80	6.18	521.10	84.62	94.70	15.38
1973/74	12,808.00	766.40	5.98	642.40	83.82	124.00	16.18
1974/75	16,571.00	1,008.40	6.09	841.70	83.47	166.70	16.53
1975/76	17,394.00	1,115.60	6.41	911.20	81.68	204.90	18.37
1976/77	17,280.00	1,322.90	7.66	1,100.10	83.16	222.80	16.84
1977/78	19,732.00	1,582.00	8.02	1,243.90	78.63	338.20	21.38
1978/79	22,215.00	1,811.90	8.16	1,476.80	81.51	334.90	18.48
1979/80	23,351.00	1,880.00	8.05	1,528.80	81.32	351.20	18.68
1980/81	27,307.00	2,419.20	8.86	2,035.70	84.15	383.50	15.85
1981/82	30,988.00	2,679.50	8.65	2,211.30	82.53	468.20	17.47
1982/83	33,761.00	2,841.60	8.42	2,421.10	85.20	420.50	14.80
1983/84	39,390.00	3,409.30	8.66	2,737.00	80.28	672.30	19.72
1984/85	44,441.00	3,916.60	8.81	3,151.20	80.46	765.50	19.55
1985/86	53,215.00	4,644.50	8.73	3,659.30	78.79	985.20	21.21
1986/87	61,140.00	5,975.10	9.77	4,372.40	73.18	1,602.70	26.82
1987/88	73,170.00	7,350.40	10.05	5,752.80	78.27	1,597.60	21.73
1988/89	85,831.00	7,776.90	9.06	6,287.20	80.84	1,489.60	19.15
1989/90	99,702.00	9,287.50	9.32	7,283.90	78.43	2,003.60	21.57
1990/91	116,127.00	10,729.90	9.24	8,176.30	76.20	2,553.50	23.80
1991/92	144,933.00	13,512.70	9.32	9,875.60	73.08	3,637.10	26.92
1992/93	165,350.00	15,148.40	9.16	11,662.50	76.99	3,485.90	23.01
1993/94	191,596.00	19,580.80	10.22	15,371.50	78.50	4,209.40	21.50
1994/95	209,974.00	24,575.20	11.70	19,660.00	80.00	4,945.10	20.12
1995/96	239,388.00	27,893.10	11.65	21,668.00	77.68	6,225.10	22.32
1996/97	269,570.00	30,373.50	11.27	24,424.30	80.41	5,949.20	19.59
1997/98	289,798.00	32,937.90	11.37	25,939.80	78.75	6,998.10	21.25
1998/99	330,018.00	37,251.00	11.29	28,752.90	77.19	8,494.40	22.80
1999/00	366,251.00	42,893.80	11.71	33,152.10	77.29	9,741.60	22.71
2000/01	425,454.00	48,893.90	11.49	38,865.10	79.49	10,028.80	20.51
2001/02	444,052.00	50,445.60	11.36	39,330.60	77.97	11,115.00	22.03
2002/03	473,546.00	56,229.70	11.87	42,587.00	75.74	13,642.70	24.26
2003/04	517,993.00	62,331.00	12.03	48,173.00	77.29	14,158.00	22.71
2004/05	566,579.00	70,122.70	12.38	54,104.70	77.16	16,018.00	22.84
2005/06	630,301.00	72,282.10	11.47	57,430.40	79.45	14,851.70	20.55
2006/07	696,989.00	87,712.20	12.58	71,126.70	81.09	16,585.50	18.91
Average			8.87		82.77		19.84

Source: Appendix I



**Table 5.4 Contribution of Direct Tax and Indirect Tax in Total Tax Revenue (FY1964/65 to FY 2006/07)**

Amount in Rs. Million

Fiscal Year	Tax Revenue	Direct Tax	% of TR	Indirect Tax	% of TR
1964/65	150.80	53.60	35.54	97.20	64.46
1965/66	177.10	57.20	32.30	119.90	67.7
1966/67	225.80	72.00	31.89	153.80	68.11
1967/68	283.80	105.70	37.24	178.10	62.76
1968/69	368.30	108.70	29.51	259.60	70.49
1969/70	411.30	128.60	31.27	282.70	68.73
1970/71	395.70	120.30	30.40	275.40	69.6
1971/72	466.80	135.40	29.01	331.40	70.99
1972/73	521.10	135.30	25.96	385.80	74.04
1973/74	642.40	180.20	28.05	462.20	71.95
1974/75	841.70	184.50	21.92	657.20	78.08
1975/76	911.20	236.00	25.90	675.20	74.10
1976/77	1,100.10	295.70	26.88	804.40	73.12
1977/78	1,243.90	306.20	24.62	937.70	75.38
1978/79	1,476.80	253.10	17.14	1,223.70	82.86
1979/80	1,528.80	253.80	16.60	1,275.00	83.40
1980/81	2,035.70	353.20	17.35	1,682.50	82.65
1981/82	2,211.30	379.90	17.18	1,831.40	82.82
1982/83	2,421.10	445.10	18.38	1,976.00	81.62
1983/84	2,737.00	541.80	19.80	2,195.20	80.20
1984/85	3,151.20	559.70	17.76	2,591.50	82.24
1985/86	3,659.30	661.80	18.09	2,997.50	81.91
1986/87	4,372.40	768.70	17.58	3,603.70	82.42
1987/88	5,752.80	1,010.20	17.56	4,742.60	82.44
1988/89	6,287.20	1,331.40	21.18	4,955.80	78.82
1989/90	7,283.90	1,435.10	19.70	5,848.80	80.30
1990/91	8,176.30	1,369.70	16.75	6,806.60	83.25
1991/92	9,875.60	1,595.20	16.15	8,280.40	83.85
1992/93	11,662.50	2,036.20	17.46	9,626.30	82.54
1993/94	15,371.50	2,855.30	18.58	12,516.20	81.42
1994/95	19,660.00	3,849.30	19.58	15,810.70	80.42
1995/96	21,668.00	4,655.50	21.49	17,012.50	78.51
1996/97	24,424.30	5,340.00	21.86	19,084.30	78.14
1997/98	25,939.80	6,187.90	23.85	19,751.90	76.15
1998/99	28,752.90	7,516.10	26.14	21,236.80	73.86
1999/00	33,152.10	8,951.50	27.00	24,200.60	73.00
2000/01	38,865.10	10,159.40	26.14	28,705.70	73.86
2001/02	39,330.60	10,597.50	26.94	28,733.10	73.06
2002/03	42,587.00	10,105.80	23.73	32,481.20	76.27
2003/04	48,173.00	11,894.60	24.69	36,260.40	75.27
2004/05	54,104.70	13,071.80	24.16	41,032.90	75.84
2005/06	57,430.40	13,968.10	24.32	43,462.30	75.68
2006/07	71,126.70	18,980.30	26.69	52,146.40	73.31
Average			24.15		78.23

Source: Appendix I

**Table 5.5 Contribution of Various Taxes in GDP (FY1964/65 to FY 2006/07)**

Figures are in Percentage

<b>Fiscal Year</b>	<b>Total Revenue</b>	<b>Custom Duties</b>	<b>Sales Tax/VAT</b>	<b>Excise Duties</b>	<b>Land Rev. &amp; Reg.</b>	<b>Income Tax</b>
1964/65	3.43	1.49	0.00	0.25	0.82	0.09
1965/66	3.13	1.35	0.00	0.29	0.65	0.10
1966/67	4.00	1.90	0.19	0.31	0.92	0.12
1967/68	4.28	1.81	0.38	0.3	1.22	0.16
1968/69	5.17	2.30	0.60	0.35	1.07	0.21
1969/70	5.29	2.21	0.58	0.43	1.17	0.22
1970/71	5.14	1.75	0.70	0.63	1.02	0.24
1971/72	5.16	1.92	0.67	0.61	0.97	0.21
1972/73	6.18	2.39	0.80	0.68	0.93	0.23
1973/74	5.98	2.23	0.77	0.60	0.97	0.25
1974/75	6.09	1.98	1.15	0.72	0.77	0.28
1975/76	6.41	2.06	0.93	0.76	0.78	0.50
1976/77	7.66	2.23	1.28	0.96	0.81	0.77
1977/78	8.02	2.33	1.38	0.83	0.72	0.69
1978/79	8.16	2.82	1.61	0.87	0.50	0.46
1979/80	8.05	2.60	1.72	0.92	0.52	0.43
1980/81	8.86	2.99	1.97	0.89	0.65	0.53
1981/82	8.65	2.66	1.93	0.99	0.55	0.61
1982/83	8.42	2.25	2.10	1.08	0.51	0.71
1983/84	8.66	2.10	1.96	1.10	0.54	0.74
1984/85	8.81	2.40	1.90	1.09	0.49	0.69
1985/86	8.73	2.31	1.85	1.05	0.46	0.68
1986/87	9.77	2.46	1.87	1.11	0.46	0.72
1987/88	10.05	3.03	1.78	1.13	0.50	0.79
1988/89	9.06	2.67	1.61	1.02	0.47	1.00
1989/90	9.32	2.69	1.66	1.10	0.45	0.92
1990/91	9.24	2.62	1.72	1.03	0.46	0.64
1991/92	9.32	2.32	1.96	0.98	0.44	0.59
1992/93	9.16	2.39	2.08	0.88	0.46	0.68
1993/94	10.22	2.74	2.45	0.83	0.43	0.95
1994/95	11.70	3.34	2.88	0.8	0.45	1.26
1995/96	11.65	3.06	2.69	0.81	0.45	1.34
1996/97	11.27	3.08	2.64	0.85	0.38	1.42
1997/98	11.37	2.93	2.45	1.00	0.35	1.55
1998/99	11.29	2.88	2.39	0.89	0.30	1.71
1999/00	11.71	2.95	2.69	0.86	0.28	1.84
2000/01	11.49	2.95	2.91	0.89	0.14	2.15
2001/02	11.36	2.85	2.76	0.86	0.25	2.01
2002/03	11.87	3.01	2.84	1.01	0.30	1.72
2003/04	12.03	3.00	2.80	1.2	0.33	1.83
2004/05	12.38	2.77	3.33	1.14	0.32	1.85
2005/06	11.47	2.43	3.43	1.03	0.35	1.73
2006/07	12.58	2.40	3.74	1.34	0.32	2.26
Average	8.87	2.54	1.84	0.87	0.59	0.90

Source: Appendix I

**Table 5.6 Composition of Indirect Tax (FY1964/65 to FY 2006/07)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>Indirect Tax</b>	<b>Custom Duties</b>	<b>%of Indirect Tax</b>	<b>Excise Duties</b>	<b>%of Indirect Tax</b>	<b>Sales Tax/ VAT</b>	<b>%of Indirect Tax</b>
1964/65	97.20	83.30	85.70	13.90	14.30	0.00	0.00
1965/66	119.90	93.50	77.98	20.10	16.76	0.00	0.00
1966/67	153.80	121.70	79.13	20.00	13.00	12.10	7.87
1967/68	178.10	129.70	72.82	21.50	12.07	26.90	15.10
1968/69	259.60	183.60	70.72	28.00	10.79	48.00	18.49
1969/70	282.70	193.50	68.45	38.10	13.48	51.10	18.08
1970/71	275.40	156.50	56.83	56.60	20.55	62.30	22.62
1971/72	331.40	198.60	59.93	63.60	19.19	69.10	20.85
1972/73	385.80	238.20	61.74	67.80	17.57	79.80	20.68
1973/74	462.20	286.20	61.92	77.40	16.75	98.50	21.31
1974/75	657.20	328.50	49.98	119.70	18.21	190.50	28.99
1975/76	675.20	358.50	53.10	132.10	19.56	161.90	23.98
1976/77	804.40	386.20	48.01	166.10	20.65	222.00	27.60
1977/78	937.70	458.80	48.93	164.40	17.53	273.10	29.12
1978/79	1,223.70	626.70	51.21	192.60	15.74	356.80	29.16
1979/80	1,275.00	608.00	47.69	215.20	16.88	401.20	31.47
1980/81	1,682.50	815.80	48.49	242.20	14.40	537.70	31.96
1981/82	1,831.40	825.10	45.05	305.70	16.69	597.40	32.62
1982/83	1,976.00	760.90	38.51	365.80	18.51	709.30	35.90
1983/84	2,195.20	825.90	37.62	432.10	19.68	770.70	35.11
1984/85	2,591.50	1,064.40	41.07	483.90	18.67	845.80	32.64
1985/86	2,997.50	1,231.00	41.07	558.70	18.64	985.90	32.89
1986/87	3,603.70	1,505.70	41.78	678.60	18.83	1,143.80	31.74
1987/88	4,742.60	2,214.60	46.70	825.30	17.40	1,300.50	27.42
1988/89	4,955.80	2,289.90	46.21	877.70	17.71	1,379.70	27.84
1989/90	5,848.80	2,684.90	45.91	1,097.00	18.76	1,650.10	28.21
1990/91	6,806.60	3,044.30	44.73	1,200.30	17.63	1,995.50	29.32
1991/92	8,280.40	3,358.90	40.56	1,419.30	17.14	2,835.90	34.25
1992/93	9,626.30	3,945.10	40.98	1,452.60	15.09	3,438.40	35.72
1993/94	12,516.20	5,255.20	41.99	1,592.30	12.72	4,693.20	37.50
1994/95	15,810.70	7,017.90	44.39	1,675.50	10.60	6,037.90	38.19
1995/96	17,012.50	7,327.40	43.07	1,945.90	11.44	6,431.70	37.81
1996/97	19,084.30	8,309.10	43.54	2,302.10	12.06	7,126.60	37.34
1997/98	19,751.90	8,499.90	43.03	2,886.50	14.61	7,108.70	35.99
1998/99	21,236.80	9,517.50	44.82	2,952.50	13.90	7,882.50	37.12
1999/00	24,200.60	10,813.30	44.68	3,132.70	12.94	9,850.00	40.70
2000/01	28,705.70	12,552.10	43.73	3,771.20	13.14	12,382.40	43.14
2001/02	28,733.10	12,658.80	44.06	3,807.00	13.25	12,267.30	42.69
2002/03	32,481.20	14,236.40	43.83	4,785.10	14.73	13,459.70	41.44
2003/04	36,260.40	15,554.80	42.90	6,226.70	17.17	14,478.90	39.93
2004/05	41,032.90	15,701.60	38.27	6,445.90	15.71	18,885.40	46.03
2005/06	43,462.30	15,344.00	35.30	6,507.60	14.97	21,610.70	49.72
2006/07	52,146.40	16,707.00	32.04	9,343.20	17.92	26,095.60	50.04
Average			50.92		16.37		31.16

Source: Appendix I

**Table 5.7 Contribution of Direct Tax (FY1964/65 to FY 2006/07)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>Total GDP</b>	<b>Total Revenue</b>	<b>Total Tax Revenue</b>	<b>Direct Tax</b>	<b>Direct Tax % of GDP</b>	<b>Direct Tax % of Total Revenue</b>	<b>Direct Tax % of Tax Revenue</b>
1964/65	5,602.00	192.30	150.80	53.60	0.96	27.87	35.54
1965/66	6,909.00	216.50	177.10	57.20	0.83	26.42	32.30
1966/67	6,411.00	256.70	225.80	72.00	1.12	28.05	31.89
1967/68	7,173.00	306.80	283.80	105.70	1.47	34.45	37.24
1968/69	7,985.00	413.00	368.30	108.70	1.36	26.32	29.51
1969/70	8,768.00	464.00	411.30	128.60	1.47	27.72	31.27
1970/71	8,938.00	459.70	395.70	120.30	1.35	26.17	30.40
1971/72	10,369.00	535.40	466.80	135.40	1.31	25.29	29.01
1972/73	9,969.00	615.80	521.10	135.30	1.36	21.97	25.96
1973/74	12,808.00	766.40	642.40	180.20	1.41	23.51	28.05
1974/75	16,571.00	1,008.40	841.70	184.50	1.11	18.30	21.92
1975/76	17,394.00	1,115.60	911.20	236.00	1.36	21.15	25.90
1976/77	17,280.00	1,322.90	1,100.10	295.70	1.71	22.35	26.88
1977/78	19,732.00	1,582.00	1,243.90	306.20	1.55	19.36	24.62
1978/79	22,215.00	1,811.90	1,476.80	253.10	1.14	13.97	17.14
1979/80	23,351.00	1,880.00	1,528.80	253.80	1.09	13.50	16.60
1980/81	27,307.00	2,419.20	2,035.70	353.20	1.29	14.60	17.35
1981/82	30,988.00	2,679.50	2,211.30	379.90	1.23	14.18	17.18
1982/83	33,761.00	2,841.60	2,421.10	445.10	1.32	15.66	18.38
1983/84	39,390.00	3,409.30	2,737.00	541.80	1.38	15.89	19.80
1984/85	44,441.00	3,916.60	3,151.20	559.70	1.26	14.29	17.76
1985/86	53,215.00	4,644.50	3,659.30	661.80	1.24	14.25	18.09
1986/87	61,140.00	5,975.10	4,372.40	768.70	1.26	12.87	17.58
1987/88	73,170.00	7,350.40	5,752.80	1,010.20	1.38	13.74	17.56
1988/89	85,831.00	7,776.90	6,287.20	1,331.40	1.55	17.12	21.18
1989/90	99,702.00	9,287.50	7,283.90	1,435.10	1.44	15.45	19.70
1990/91	116,127.00	10,729.90	8,176.30	1,369.70	1.18	12.77	16.75
1991/92	144,933.00	13,512.70	9,875.60	1,595.20	1.10	11.81	16.15
1992/93	165,350.00	15,148.40	11,662.50	2,036.20	1.23	13.44	17.46
1993/94	191,596.00	19,580.80	15,371.50	2,855.30	1.49	14.58	18.58
1994/95	209,974.00	24,575.20	19,660.00	3,849.30	1.83	15.66	19.58
1995/96	239,388.00	27,893.10	21,668.00	4,655.50	1.94	16.69	21.49
1996/97	269,570.00	30,373.50	24,424.30	5,340.00	1.98	17.58	21.86
1997/98	289,798.00	32,937.90	25,939.80	6,187.90	2.14	18.79	23.85
1998/99	330,018.00	37,251.00	28,752.90	7,516.10	2.28	20.18	26.14
1999/00	366,251.00	42,893.80	33,152.10	8,951.50	2.44	20.87	27.00
2000/01	425,454.00	48,893.90	38,865.10	10,159.40	2.39	20.78	26.14
2001/02	444,052.00	50,445.60	39,330.60	10,597.50	2.39	21.01	26.94
2002/03	473,546.00	56,229.70	42,587.00	10,105.80	2.13	17.97	23.73
2003/04	517,993.00	62,331.00	48,173.00	11,894.60	2.30	19.08	24.69
2004/05	566,579.00	70,122.70	54,104.70	13,071.80	2.31	18.64	24.16
2005/06	630,301.00	72,282.10	57,430.40	13,968.10	2.22	19.32	24.32
2006/07	696,989.00	87,712.20	71,126.70	18,980.30	2.72	21.64	26.69
Average					1.62	19.65	24.15

Source: Appendix I

**Table 5.8 Composition of Direct Tax Their Share in Direct Tax (FY1964/65 to FY 2006/07)**

Amount in Rs. Million

Fiscal Year	Direct Tax	Income Tax	% of Direct Tax	Land Rev.	% of Direct Tax	House & Land Reg	% of Direct Tax	Others	% of Direct Tax
1964/65	53.60	5.30	9.90	43.20	80.60	2.80	5.20	2.30	4.30
1965/66	57.20	7.10	12.40	45.10	78.85	2.50	4.37	2.50	4.37
1966/67	72.00	7.70	10.70	56.60	78.60	2.40	3.30	5.30	7.40
1967/68	105.70	11.40	10.80	83.30	78.80	4.10	3.90	6.90	6.50
1968/69	108.70	16.70	15.40	79.40	73.00	5.70	13.30	6.90	6.30
1969/70	128.60	19.60	15.20	87.70	68.20	14.50	11.30	6.80	5.30
1970/71	120.30	21.20	17.60	76.40	63.50	14.50	12.10	8.20	6.80
1971/72	135.40	22.00	16.20	83.20	61.40	17.30	12.80	12.90	9.50
1972/73	135.30	23.40	17.30	74.50	55.10	18.60	13.70	18.80	13.90
1973/74	180.20	32.60	18.10	96.90	53.80	27.00	15.00	23.70	13.20
1974/75	184.50	47.00	25.50	90.90	49.30	36.00	19.50	10.60	5.70
1975/76	236.00	87.20	36.90	94.80	40.20	40.70	17.20	13.30	5.60
1976/77	295.70	133.30	45.10	97.00	32.80	42.70	14.40	22.70	7.70
1977/78	306.20	136.80	44.70	87.00	28.40	54.10	17.70	28.30	9.20
1978/79	253.10	103.00	40.70	54.60	21.60	55.70	22.00	39.80	15.70
1979/80	253.80	101.20	39.90	56.20	22.10	65.00	25.60	31.40	12.40
1980/81	353.20	144.00	40.80	100.70	28.50	77.80	22.00	30.70	8.70
1981/82	379.90	189.80	50.00	81.70	21.50	88.30	23.20	20.10	5.30
1982/83	445.10	240.20	54.00	66.70	15.00	104.80	23.50	33.40	7.50
1983/84	541.80	290.90	53.70	77.20	14.20	135.20	25.00	38.50	7.10
1984/85	559.70	307.30	54.90	76.90	13.70	141.70	25.30	33.80	6.00
1985/86	661.80	364.40	55.10	74.20	11.20	170.10	25.70	53.10	8.00
1986/87	768.70	437.50	56.90	72.40	9.40	211.60	27.50	47.20	6.10
1987/88	1,010.20	579.00	57.30	80.70	8.00	286.20	28.30	64.30	6.40
1988/89	1,331.40	861.20	64.70	80.40	6.00	320.60	24.10	69.20	5.20
1989/90	1,435.10	919.00	64.00	74.60	5.20	377.10	26.30	64.40	4.50
1990/91	1,369.70	746.20	54.47	82.20	6.00	456.60	33.33	0.00	0.00
1991/92	1,595.20	855.10	53.60	64.90	4.06	567.30	35.56	0.00	0.00
1992/93	2,036.20	1,124.80	55.24	79.80	3.91	675.10	33.15	0.00	0.00
1993/94	2,855.30	1,824.30	63.89	63.80	2.23	769.30	26.94	0.00	0.00
1994/95	3,849.30	2,640.60	68.59	36.60	0.95	901.10	23.40	218.70	5.68
1995/96	4,655.50	3,205.40	68.85	14.20	0.30	1,065.40	22.88	300.20	6.44
1996/97	5,340.00	3,829.40	71.71	9.50	0.17	1,005.90	18.83	388.80	7.28
1997/98	6,187.90	4,499.00	72.70	3.80	0.06	1,002.90	16.20	509.60	8.23
1998/99	7,516.10	5,646.50	75.12	0.80	0.01	995.50	13.24	654.00	8.70
1999/00	8,951.50	6,755.70	75.47	0.80	0.01	1,012.50	11.31	780.70	8.72
2000/01	10,159.40	9,546.50	90.10	0.00	0.00	607.80	5.98	737.60	7.26
2001/02	10,597.50	9,465.70	84.01	0.00	0.00	1,121.30	10.58	574.10	5.41
2002/03	10,105.80	8,691.50	80.47	0.00	0.00	1,414.20	13.99	559.40	5.53
2003/04	11,894.60	10,215.10	79.90	0.00	0.00	1,697.50	14.27	700.40	5.88
2004/05	13,071.80	11,272.60	79.98	0.00	0.00	1,799.20	13.76	806.10	6.16
2005/06	13,968.10	11,787.00	78.27	0.00	0.00	2,180.30	15.60	847.60	6.06
2006/07	18,980.30	16,726.80	82.87	0.00	0.00	2,238.70	11.79	1,011.60	5.32
Average			51.50		24.68		18.64		6.79

Source: Appendix I

**Table 5.9 Share of Income Tax in the Total Revenue in Selected Countries**

<b>Country</b>	<b>Taxes on Income, Profits, and Capital gains as % of Total Revenue (2006)</b>
USA	57
Australia	20
India	39
Pakistan	20
Sri Lanka	16
Switzerland	19
Nepal	11
Thailand	36
Malaysia	47
Peru	24

Source: World Development Indicator, 2008

**Table 5.10 Contribution of Income Tax as Percentage of Different Heads (FY1964/65 to FY 2006/07)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>Income Tax</b>	<b>% of GDP</b>	<b>% of Total Revenue</b>	<b>% of Tax Revenue</b>	<b>% of Direct Tax</b>
1964/65	5.30	0.09	2.76	3.51	9.89
1965/66	7.10	0.10	3.28	4.01	12.41
1966/67	7.70	0.12	3.00	3.41	10.69
1967/68	11.40	0.16	3.72	4.02	10.79
1968/69	16.70	0.21	4.04	4.53	15.36
1969/70	19.60	0.22	4.22	4.77	15.24
1970/71	21.20	0.24	4.61	5.36	17.62
1971/72	22.00	0.21	4.11	4.71	16.25
1972/73	23.40	0.23	3.80	4.49	17.29
1973/74	32.60	0.25	4.25	5.07	18.09
1974/75	47.00	0.28	4.66	5.58	25.47
1975/76	87.20	0.50	7.82	9.57	36.95
1976/77	133.30	0.77	10.08	12.12	45.08
1977/78	136.80	0.69	8.65	11.00	44.68
1978/79	103.00	0.46	5.68	6.97	40.70
1979/80	101.20	0.43	5.38	6.62	39.87
1980/81	144.00	0.53	5.95	7.07	40.77
1981/82	189.80	0.61	7.08	8.58	49.96
1982/83	240.20	0.71	8.45	9.92	53.97
1983/84	290.90	0.74	8.53	10.63	53.69
1984/85	307.30	0.69	7.85	9.75	54.90
1985/86	364.40	0.68	7.85	9.96	55.06
1986/87	437.50	0.72	7.32	10.01	56.91
1987/88	579.00	0.79	7.88	10.06	57.32
1988/89	861.20	1.00	11.07	13.70	64.68
1989/90	919.00	0.92	9.90	12.62	64.04
1990/91	746.20	0.64	6.95	9.13	54.48
1991/92	855.10	0.59	6.33	8.66	53.60
1992/93	1,124.80	0.68	7.43	9.64	55.24
1993/94	1,824.30	0.95	9.32	11.87	63.89
1994/95	2,640.60	1.26	10.74	13.43	68.60
1995/96	3,205.40	1.34	11.49	14.79	68.85
1996/97	3,829.40	1.42	12.61	15.68	71.71
1997/98	4,499.00	1.55	13.66	17.34	72.71
1998/99	5,646.50	1.71	15.16	19.64	75.13
1999/00	6,755.70	1.84	15.75	20.38	75.47
2000/01	9,546.50	2.24	19.52	24.56	93.97
2001/02	9,465.70	2.13	18.76	24.07	89.32
2002/03	8,691.50	1.84	15.46	20.41	86.01
2003/04	10,215.10	1.97	16.39	21.21	85.88
2004/05	11,272.60	1.99	16.08	20.83	86.24
2005/06	11,787.00	1.87	16.31	20.52	84.39
2006/07	16,726.80	2.40	19.07	23.52	88.13
Average		0.92	9.36	11.76	52.41

Source: Appendix I

**Table 5.1 Growth Rates of Total Revenue, Tax Revenue, Direct Tax and Income Tax (FY1964/65 to FY 2006/07)**

Figures are in Percentage

<b>Fiscal Year</b>	<b>Total Revenue</b>	<b>Tax Revenue</b>	<b>Direct Tax</b>	<b>Income Tax</b>
1964/65	-	-	-	-
1965/66	12.58	17.44	6.72	33.96
1966/67	18.57	27.50	25.87	8.45
1967/68	19.52	25.69	46.81	48.05
1968/69	34.62	29.77	2.84	46.49
1969/70	12.35	11.68	18.31	17.37
1970/71	-0.93	-3.79	-6.45	8.16
1971/72	16.47	17.97	12.55	3.77
1972/73	15.02	11.63	-0.07	6.36
1973/74	24.46	23.28	33.19	39.32
1974/75	31.58	31.02	2.39	44.17
1975/76	10.63	8.26	27.91	85.53
1976/77	18.58	20.73	25.30	52.87
1977/78	19.59	13.07	3.55	2.63
1978/79	14.53	18.72	-17.34	-24.71
1979/80	3.76	3.52	0.28	-1.75
1980/81	28.68	33.16	39.16	42.29
1981/82	10.76	8.63	7.56	31.81
1982/83	6.05	9.49	17.16	26.55
1983/84	19.98	13.05	21.73	21.11
1984/85	14.88	15.13	3.30	5.64
1985/86	18.58	16.12	18.24	18.58
1986/87	28.65	19.49	16.15	20.06
1987/88	23.02	31.57	31.42	32.34
1988/89	5.80	9.29	31.80	48.74
1989/90	19.42	15.85	7.79	6.71
1990/91	15.53	12.25	-4.56	-18.8
1991/92	25.94	20.78	16.46	14.59
1992/93	12.10	18.09	27.65	31.54
1993/94	29.26	31.80	40.23	62.19
1994/95	25.51	27.90	34.81	44.75
1995/96	13.50	10.21	20.94	21.39
1996/97	8.89	12.72	14.7	19.47
1997/98	8.44	6.20	15.88	17.49
1998/99	13.09	10.84	21.46	25.51
1999/00	15.15	15.30	19.10	19.64
2000/01	13.99	17.23	13.49	41.31
2001/02	3.17	1.20	4.31	-0.85
2002/03	11.47	8.28	-4.64	-8.18
2003/04	10.85	13.12	17.70	17.53
2004/05	12.50	12.31	9.90	10.35
2005/06	3.08	6.15	6.86	4.56
2006/07	21.35	23.85	35.88	41.91
Average	16.35	16.50	16.25	23.63

Source: Appendix III



**Table 5.12 Composition of Income Tax (FY19974/75 to FY2006/07)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>Public Enterprises</b>	<b>Semi Public Enterprises</b>	<b>Private Corporate</b>	<b>Individuals</b>	<b>Remuneration</b>		
1974/75	47.00						
1975/76	87.20						
1976/77	133.30						
1977/78	34.60	6.70	5.90	85.00	4.60		
1978/79	27.00	5.20	0.90	61.40	8.50		
1979/80	28.10	7.60	2.20	55.70	7.60		
1980/81	41.00	0.80	1.00	91.40	9.80		
1981/82	37.40	0.30	0.20	143.70	8.10		
1982/83	53.40	1.50	0.30	173.90	11.00		
1983/84	63.70	2.20	0.80	212.50	11.70		
1984/85	93.10	1.40	0.50	196.00	16.30		
1985/86	110.80	1.80	2.00	234.50	15.30		
1986/87	120.90	1.20	0.20	284.30	30.90		
1987/88	193.20	1.90	1.90	348.60	33.40		
1988/89	216.90	2.60	0.40	597.40	43.80		
1989/90	240.90	2.40	0.00	625.00	50.70		
1990/91	162.20	2.70	0.00	531.20	49.90		
1991/92	171.10	5.30	6.50	617.90	54.70		
1992/93	255.30	2.60	9.50	800.70	56.70		
1993/94	534.10	2.10	19.70	1,184.80	83.80		
	<b>Govt. Corporate</b>	<b>Public Ltd. Com.</b>	<b>Private Ltd. Com.</b>	<b>Remuneration</b>	<b>Occupation</b>	<b>Land &amp; House</b>	<b>Interest Tax</b>
1994/95	860.20	440.10	465.50	118.40	754.80	72.80	111.60
1995/96	1,144.50	563.90	564.20	133.10	799.80	106.00	119.80
1996/97	1,231.10	858.40	603.80	168.10	967.50	140.10	154.40
1997/98	1,317.80	925.10	693.80	322.20	1239.80	187.10	212.10
1998/99	1,526.50	1,155.00	780.70	396.50	1787.80	204.20	319.50
1999/00	2,198.80	1,339.50	900.10	451.50	1865.10	251.20	414.50
2000/01	2,928.00	1,924.30	1,134.20	597.30	1804.80	261.40	463.90
2001/02	1,769.30	1,412.00	1,173.90	835.60	2897.40	348.20	467.70

<b>Fiscal Year</b>	<b>Corporate Income Tax</b>	<b>Personal Income Tax</b>	<b>House &amp; Land Rent Tax</b>	<b>Interest Tax</b>	<b>Total Income Tax</b>
2002/03	3,655.50	3,177.10	381.70	845.20	8,059.50
2003/04	4,838.60	3,539.40	403.20	733.30	9,514.50
2004/05	5,327.30	3,871.60	496.30	757.30	10,452.50
2006/07	5,395.70	4,234.60	509.00	757.00	10,896.30
2006/07	11,515.80	2,510.07	599.30	996.10	15,140.00

Source: Appendix I

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**Table 5.13 Income Tax Exemptions Limit (FY1959/60 to FY2006/07)**

Fiscal Year	Individual	Amount in Rs		
		Couple	Family	All tax payers
1959/60 to 1962/63	-	-	-	7,000.00
1963/64 to 1964/65	-	-	-	6,000.00
1965/66 to 1966/67	-	-	-	5,000.00
1967/68 to 1973/74	3,000.00	4,500.00	6,000.00	-
1974/75	4,500.00	6,000.00	7,500.00	-
1975/76	5,500.00	6,500.00	7,500.00	-
1976/77 to 1978/79	6,500.00	7,500.00	8,500.00	-
1979/80 to 1980/81	7,500.00	10,000.00	10,000.00	-
1981/82 to 1982/83	10,000.00	15,000.00	15,000.00	-
1983/84 to 1989/90	15,000.00	20,000.00	20,000.00	-
1990/91	20,000.00	30,000.00	30,000.00	-
1990/92 to 1996/97	25,000.00	35,000.00	35,000.00	-
1997/98	30,000.00	40,000.00	40,000.00	-
1998/99	40,000.00	50,000.00	50,000.00	-
1999/2000	50,000.00	60,000.00	60,000.00	-
2000/01 to 2001/02	55,000.00	75,000.00	75,000.00	-
2002/03	65,000.00	85,000.00	85,000.00	-
2003/04 to 2004/05	80,000.00	100,000.00	100,000.00	-
2005/06 to 2006/07	100,000.00	125,000.00	125,000.00	-

Source: Finance Act, Various Issues

**Table 5.14(a) Rate for Personal Income Tax in Nepal (FY1964/65 to FY2006/07)**

Amount in Rs

<b>Fiscal Year</b>	<b>Slabs (Over and above the exemption limit)</b>				
1964/65	4,000(5%)	6,000(6%)	4,000(7%)	5,000(8%)	5,000(10%)
	5,000(12%)	5,000(15%)	5,000(20%)	5,000(20%)	10,000(25%)
	10,000(30%)	10,000(35%)	20,000(40%)	Balance (40%)	
1965/66 to	5,000(6%)	5,000(7%)	5,000(8%)	5,000(10%)	5,000(12%)
1966/1967	5,000(14%)	5,000(17%)	5,000(22%)	5,000(27%)	5,000(32%)
	Balance (40%)				
1967/68	5,000(6%)	5,000(7%)	5,000(9%)	5,000(12%)	5,000(14%)
	5,000(17%)	5,000(20%)	5,000(28%)	5,000(35%)	5,000(44%)
	Balance (55%)				
1968/69 to	10,000(7%)	10,000(10%)	10,000(20%)	10,000(35%)	Balance (55%)
1974/75					
1975/76	5,000(7%)	5,000(10%)	10,000(20%)	10,000(30%)	10,000(40%)
	50,000(55%)	Balance (60%)			
1976/77 to	10,000(5%)	10,000(10%)	10,000(20%)	10,000(30%)	10,000(40%)
1977/78	50,000(45%)	Balance (51%)			
1978/79	5,000(5%)	5,000(10%)	10,000(15%)	20,000(25%)	50,000(35%)
	100,000(45%)	Balance (51%)			
1979/80 to	5,000(5%)	5,000(10%)	10,000(15%)	20,000(20%)	20,000(30%)
1981/82	30,000(40%)	Balance (50%)			
1982/83 to	5,000(10%)	5,000(15%)	10,000(20%)	15,000(25%)	15,000(30%)
1988/89	30,000(40%)	20,000(50%)	Balance (55%)		
1989/90 to	10,000(15%)	15,000(25%)	20,000(35%)	20,000(40%)	30,000(45%)
1990/91	Balance (50%)				
1991/92	10,000(10%)	20,000(20%)	20,000(30%)	20,000(40%)	Balance (50%)
1992/93 to	25,000(15%)	40,000(25%)	Balance (40%)		
2001/02					
2002/03 to	75,000(15%)	Balance (25%)			
2006/07					

Source: Budget Speech, Various Issues

**Table 5.14(b) Income Tax Rate for Partnership Firms, Corporation and Non-residents  
(FY1967/68 to FY 2006/07)**

Amount in Rs

<b>Fiscal Year</b>	<b>Slabs</b>
1967/68	1,000(7%) 5,000(8%) 5,000(10%) 5,000(13%) 5,000(15%) 5,000(17%) 5,000(20%) 5,000(32%) 5,000(37%) Balance (45%)
1974/75	10,000(15%) 15,000(25%) 15,000(35%) Balance (55%)
1975/76	10,000(15%) 10,000(25%) 10,000(40%) 50,000(55%) Balance (60%)
1976/76 to 1977/78	10,000(10%) 10,000(20%) 10,000(30%) 200,000(40%) 500,000(45%) Balance (51%)
1978/79	10,000(10%) 10,000(15%) 20,000(25%) 50,000(35%) 100,000(45%) Balance (51%)
1979/80 to 1982/83	5,000(5%) 5,000(10%) 10,000(15%) 20,000(20%) 20,000(30%) 30,000(40%) Balance (50%)
1983/84 to 1989/90	5,000(5%) 5,000(10%) 5,000(15%) 10,000(20%) 15,000(25%) 15,000(30%) 30,000(40%) 200,000(50%) Balance (55%)
1990/91	10,000(20%) 15,000(30%) 20,000(35%) 25,000(40%) 30,000(45%) Balance (50%)
1991/92	10,000(10%) 20,000(20%) 20,000(30%) 20,000(40%) Balance (50%)
1999/00	30% of the taxable income
2001/02 to 2006/07	25% of the taxable income.

Source: Budget Speech, Various Issues

**Table 6.1 Total GDP, Non-agriculture GDP, Actual Income Tax and Adjustment Income Tax Series (FY1964/65 to FY2006/07)**

Amount in Rs. Million

Fiscal Year	Total GDP (Y)	Non-agriculture GDP(Y <sub>1</sub> )	Actual Income Tax (T)	Adjusted Income Tax (T <sub>a</sub> )	Adjusted Income Tax (T <sub>a</sub> )*
1964/65	5,602.00	--	5.30	5.30	--
1965/66	6,909.00	--	7.10	7.10	--
1966/67	6,411.00	--	7.70	7.70	--
1967/68	7,173.00	--	11.40	11.40	--
1968/69	7,985.00	--	16.70	15.50	--
1969/70	8,768.00	--	19.60	18.19	--
1970/71	8,938.00	--	21.20	19.68	--
1971/72	10,369.00	--	22.00	20.42	--
1972/73	9,969.00	--	23.40	21.72	--
1973/74	12,808.00	--	32.60	27.47	--
1974/75	16,571.00	5,021.00	47.00	25.20	47.00
1975/76	17,394.00	5,783.00	87.20	37.74	70.40
1976/77	17,280.00	6,774.00	133.30	48.48	90.42
1977/78	19,732.00	7,980.00	136.80	50.62	94.42
1978/79	22,215.00	8,693.00	103.00	37.04	69.09
1979/80	23,351.00	9,668.00	101.20	37.19	69.36
1980/81	27,307.00	11,628.00	144.00	49.05	91.50
1981/82	30,988.00	13,085.00	189.80	54.64	101.92
1982/83	33,761.00	14,479.00	240.20	56.25	104.93
1983/84	39,390.00	16,619.00	290.90	61.03	113.84
1984/85	44,441.00	21,680.00	307.30	52.26	97.48
1985/86	53,215.00	26,079.00	364.40	61.94	115.53
1986/87	61,140.00	30,517.00	437.50	67.14	125.23
1987/88	73,170.00	36,415.00	579.00	88.85	165.73
1988/89	85,831.00	43,259.00	861.20	80.72	150.56
1989/90	99,702.00	49,232.00	919.00	83.79	156.30
1990/91	116,127.00	60,759.30	746.20	62.90	117.32
1991/92	144,933.00	79,777.10	855.10	72.08	134.44
1992/93	165,350.00	92,259.90	1,124.80	93.64	174.66
1993/94	191,596.00	111,007.00	1,824.30	123.40	230.17
1994/95	209,974.00	124,405.00	2,640.60	168.82	314.89
1995/96	239,388.00	142,492.00	3,205.40	178.06	332.12
1996/97	269,570.00	160,785.00	3,829.40	197.51	368.41
1997/98	289,798.00	177,303.00	4,499.00	211.84	395.14
1998/99	330,018.00	197,645.00	5,646.50	190.48	355.29
1999/00	366,251.00	221,120.00	6,755.70	217.62	405.92
2000/01	425,454.00	269,829.00	9,546.50	278.86	520.14
2001/02	444,052.00	277,962.00	9,465.70	268.56	500.94
2002/03	473,546.00	300,743.00	8,691.50	234.67	437.71
2003/04	517,993.00	331,868.00	10,215.10	259.56	484.14
2004/05	566,579.00	367,211.00	11,272.60	250.76	467.74
2005/06	630,301.00	418,596.60	11,787.00	243.29	453.79
2006/07	696,989.00	470,167.00	16,726.80	321.92	600.47

Source: i) Appendix I

ii) Budget Speech, Various Issues

Note: \* means the income tax is adjusted only from FY 1974/75 to calculate base elasticity.

**Table6. 2 Total GDP, Non-agriculture GDP, Actual Income Tax and Adjustment Income Tax  
Series for Period II (FY1990/91 to FY2006/07)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>GDP</b>	<b>Non Agriculture GDP</b>	<b>Income Tax</b>	<b>Adjusted Income Tax</b>
1990/91	116,127.00	60,759.30	746.20	746.20
1991/92	144,933.00	79,777.10	855.10	855.10
1992/93	165,350.00	92,259.90	1,124.80	1,110.90
1993/94	191,596.00	111,007.00	1,824.30	1,463.98
1994/95	209,974.00	124,405.00	2,640.60	2,002.85
1995/96	239,388.00	142,492.00	3,205.40	2,112.46
1996/97	269,570.00	160,785.00	3,829.40	2,343.31
1997/98	289,798.00	177,303.00	4,499.00	2,513.31
1998/99	330,018.00	197,645.00	5,646.50	2,259.85
1999/00	366,251.00	221,120.00	6,755.70	2,581.87
2000/01	425,454.00	269,829.00	9,546.50	3,308.39
2001/02	444,052.00	277,962.00	9,465.70	3,186.23
2002/03	473,546.00	300,743.00	8,691.50	2,784.08
2003/04	517,993.00	331,868.00	10,215.10	3,079.39
2004/05	566,579.00	367,211.00	11,272.60	2,975.06
2005/06	630,301.00	418,596.60	11,787.00	2,886.35
2006/07	696,989.00	470,167.00	16,726.80	3,819.28

Source: Appendix I

Budget Speech, Various Issues

**Table 6.9 Calculation of Trend Line of Income Tax (FY1990/91 to FY2006/07)**

Amount in Rs. Million

<b>Fiscal Year (x)</b>	<b>Income Tax (Y)</b>	<b>X= (x-1998/99)</b>
1990/91	746.20	-8
1991/92	855.10	-7
1992/93	1,124.80	-6
1993/94	1,824.30	-5
1994/95	2,640.60	-4
1995/96	3,205.40	-3
1996/97	3,829.40	-2
1997/98	4,499.00	-1
1998/99	5,646.50	0
1999/00	6,755.70	1
2000/01	9,546.50	2
2001/02	9,465.70	3
2002/03	8,691.50	4
2003/04	10,215.10	5
2004/05	11,272.60	6
2005/06	11,787.00	7
2006/07	16,726.80	8

Source: Appendix I

We have,  $a = 6,401.89$

and  $b = 891.87$

Then the trend line is:

$$Y_c = 6401.89 + 891.87 X$$

**Table 6.10 Computation of Trend Values of Income Tax (FY1990/91 to FY 2006/07)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>Income Tax (Y)</b>	<b>X</b>	<b>a</b>	<b>b</b>	<b>Trend Value (Yc)</b>
1990/91	746.20	-8	6,401.89	891.87	-733.09
1991/92	855.10	-7	6,401.89	891.87	158.78
1992/93	1,124.80	-6	6,401.89	891.87	1,050.66
1993/94	1,824.30	-5	6,401.89	891.87	1,942.53
1994/95	2,640.60	-4	6,401.89	891.87	2,834.40
1995/96	3,205.40	-3	6,401.89	891.87	3,726.28
1996/97	3,829.40	-2	6,401.89	891.87	4,618.15
1997/98	4,499.00	-1	6,401.89	891.87	5,510.02
1998/99	5,646.50	0	6,401.89	891.87	6,401.89
1999/00	6,755.70	1	6,401.89	891.87	7,293.77
2000/01	9,546.50	2	6,401.89	891.87	8,185.64
2001/02	9,465.70	3	6,401.89	891.87	9,077.51
2002/03	8,691.50	4	6,401.89	891.87	9,969.39
2003/04	10,215.10	5	6,401.89	891.87	10,861.26
2004/05	11,272.60	6	6,401.89	891.87	11,753.13
2005/06	11,787.00	7	6,401.89	891.87	12,645.01
2006/07	16,726.80	8	6,401.89	891.87	13,536.88



**Table 6.11 Trend Analysis of Income Tax in Nepal (FY 1990/91 to FY2006/07)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>Income Tax (Y)</b>	<b>Trend Value (Yc)</b>	<b>Variation (Y-Yc)</b>
1990/91	746.20	-733.09	1,479.29
1991/92	855.10	158.78	696.32
1992/93	1,124.80	1,050.66	74.14
1993/94	1,824.30	1,942.53	-118.23
1994/95	2,640.60	2,834.40	-193.80
1995/96	3,205.40	3,726.28	-520.88
1996/97	3,829.40	4,618.15	-788.75
1997/98	4,499.00	5,510.02	-1,011.02
1998/99	5,646.50	6,401.89	-755.39
1999/00	6,755.70	7,293.77	-538.07
2000/01	9,546.50	8,185.64	1,360.86
2001/02	9,465.70	9,077.51	388.19
2002/03	8,691.50	9,969.39	-1,277.89
2003/04	10,215.10	10,861.26	-646.16
2004/05	11,272.60	11,753.13	-480.53
2005/06	11,787.00	12,645.01	-858.01
2006/07	16,726.80	13,536.88	3,189.92

**Table 6.12 Projection of Income Tax in Nepal (FY 2007/08 to 2016/17)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>X</b>	<b>a</b>	<b>b</b>	<b>Y<sub>c</sub></b>
2007/08	9	6,401.89	891.87	14,428.75
2008/09	10	6,401.89	891.87	15,320.62
2009/10	11	6,401.89	891.87	16,212.50
2010/11	12	6,401.89	891.87	17,104.37
2011/12	13	6,401.89	891.87	17,996.24
2012/13	14	6,401.89	891.87	18888.12
2013/14	15	6,401.89	891.87	19,779.99
2014/15	16	6,401.89	891.87	20,671.86
2015/16	17	6,401.89	891.87	21,563.74
2016/17	18	6,401.89	891.87	22,455.61

**Table 6.13 Projection of Income Tax with Average Growth Rate (FY 2007/08 to 2016/17)**

Amount in Rs. Million

<b>Fiscal Year</b>	<b>Income Tax</b>
2007/08	20,679.34
2008/09	25,565.87
2009/10	31,607.09
2010/11	39,075.84
2011/12	48,309.46
2012/13	59,724.99
2013/14	73,838.00
2014/15	91,285.92
2015/16	112,856.80
2016/17	139,524.80

**Master Table I**  
**Total GDP, Total Revenue, Tax Revenue, Non Tax Revenue, Direct Tax, Indirect Tax and others Tax**  
**Revenue (FY1964/65 to FY 2006/07)**  
 Amount in Rs. Million

Fiscal Year	Total GDP	Total Revenue	Tax Revenue	Non Tax Revenue	Direct Tax	Indirect Tax	Custom Duties	Sales Tax/VAT	Excise Duties	Land Rev.and Reg	Income Tax
1964/65	5,602.00	192.30	150.80	41.50	53.60	97.20	83.30	0.0	13.9	46.00	5.30
1965/66	6,909.00	216.50	177.10	39.40	57.20	119.90	93.50	0.00	20.1 0	45.1 0	7.10
1966/67	6,411.00	256.70	225.80	30.90	72.00	153.80	121.70	12.10	20.00	59.00	7.70
1967/68	7,173.00	306.80	283.80	42.20	105.70	178.10	129.70	26.90	21.50	87.40	11.40
1968/69	7,985.00	413.00	368.30	44.70	108.70	259.60	183.60	48.00	28.00	85.10	16.70
1969/70	8,768.00	464.00	411.30	52.70	128.60	282.70	193.50	51.10	38.10	102.20	19.60
1970/71	8,938.00	459.70	395.70	64.00	120.30	275.40	156.50	62.30	56.60	90.90	21.20
1971/72	10,369.00	535.40	466.80	86.60	135.40	331.40	198.60	69.10	63.60	100.50	22.00
1972/73	9,969.00	615.80	521.10	94.70	135.30	385.80	238.20	79.80	67.80	93.10	23.40
1973/74	12,808.00	766.40	642.40	124.00	180.20	462.20	286.20	98.50	77.40	123.90	32.60
1974/75	16,571.00	1,008.40	841.70	166.70	184.50	657.20	328.50	190.50	119.70	126.90	47.00
1975/76	17,394.00	1,115.60	911.20	204.90	236.00	675.20	358.50	161.90	132.10	135.50	87.20
1976/77	17,280.00	1,322.90	1,100.10	222.80	295.70	804.40	386.20	222.00	166.10	139.70	133.30
1977/78	19,732.00	1,582.00	1,243.90	338.20	306.20	937.70	458.80	273.10	164.40	141.10	136.80
1978/79	22,215.00	1,811.90	1,476.80	334.90	253.10	1,223.70	626.70	356.80	192.60	110.30	103.00
1979/80	23,351.00	1,880.00	1,528.80	351.20	253.80	1,275.00	608.00	401.20	215.20	121.20	101.20
1980/81	27,307.00	2,419.20	2,035.70	383.50	353.20	1,682.50	815.80	537.70	242.20	178.50	144.00
1981/82	30,988.00	2,679.50	2,211.30	468.20	379.90	1,831.40	825.10	597.40	305.70	170.00	189.80
1982/83	33,761.00	2,841.60	2,421.10	420.50	445.10	1,976.00	760.90	709.30	365.80	171.50	240.20
1983/84	39,390.00	3,409.30	2,737.00	672.30	541.80	2,195.20	825.90	770.70	432.10	212.40	290.90
1984/85	44,441.00	3,916.60	3,151.20	765.50	559.70	2,591.50	1,064.40	845.80	483.90	218.60	307.30

1985/86	53,215.00	4,644.50	3,659.30	985.20	661.80	2,997.50	1,231.00	985.90	558.70	244.30	364.40
1986/87	61,140.00	5,975.10	4,372.40	1,602.70	768.70	3,603.70	1,505.70	1,143.80	678.60	284.00	437.50
1987/88	73,170.00	7,350.40	5,752.80	1,597.60	1,010.20	4,742.60	2,214.60	1,300.50	825.30	366.90	579.00
1988/89	85,831.00	7,776.90	6,287.20	1,489.60	1,331.40	4,955.80	2,289.90	1,379.70	877.70	401.00	861.20
1989/90	99,702.00	9,287.50	7,283.90	2,003.60	1,435.10	5,848.80	2,684.90	1,650.10	1,097.00	451.70	919.00
1990/91	116,127.00	10,729.90	8,176.30	2,553.50	1,369.70	6,806.60	3,044.30	1,995.50	1,200.30	538.80	746.20
1991/92	144,933.00	13,512.70	9,875.60	3,637.10	1,595.20	8,280.40	3,358.90	2,835.90	1,419.30	632.20	855.10
1992/93	165,350.00	15,148.40	11,662.50	3,485.90	2,036.20	9,626.30	3,945.10	3,438.40	1,452.60	754.90	1124.80
1993/94	191,596.00	19,580.80	15,371.50	4,209.40	2,855.30	12,516.20	5,255.20	4,693.20	1,592.30	833.10	1,824.30
1994/95	209,974.00	24,575.20	19,660.00	4,945.10	3,849.30	15,810.70	7,017.90	6,037.90	1,675.50	937.70	2,640.60
1995/96	239,388.00	27,893.10	21,668.00	6,225.10	4,655.50	17,012.50	7,327.40	6,431.70	1,945.90	1,079.60	3,205.40
1996/97	269,570.00	30,373.50	24,424.30	5,949.20	5,340.00	19,084.30	8,309.10	7,126.60	2,302.10	1,015.40	3,829.40
1997/98	289,798.00	32,937.90	25,939.80	6,998.10	6,187.90	19,751.90	8,499.90	7,108.70	2,886.50	1,006.70	4,499.00
1998/99	330,018.00	37,251.00	28,752.90	8,494.40	7,516.10	21,236.80	9,517.50	7,882.50	2,952.50	996.30	5,646.50
1999/00	366,251.00	42,893.80	33,152.10	9,741.60	8,951.50	24,200.60	10,813.30	9,850.00	3,132.70	1,013.30	6,755.70
2000/01	425,454.00	48,893.90	38,865.10	10,028.80	10,159.40	28,705.70	12,552.10	12,382.40	3,771.20	607.8	9,546.50
2001/02	444,052.00	50,445.60	39,330.60	11,115.00	10,597.50	28,733.10	12,658.80	12,267.30	3807.00	1,121.30	9,465.70
2002/03	473,546.00	56,229.70	42,587.00	13,642.70	10,105.80	32,481.20	14,236.40	13,459.70	4785.10	1,414.20	8,691.50
2003/04	517,993.00	62,331.00	48,173.00	14,158.00	11,894.60	36,260.40	15,554.80	14,478.90	6,226.70	1697.50	10,215.10
2004/05	566,579.00	70,122.70	54,104.70	16,018.00	13,071.80	41,032.90	15,701.60	18,885.40	6,445.90	1799.20	11,272.60
2005/06	630,301.00	72,282.10	57,430.40	14,851.70	13,968.10	43,462.30	15,344.00	21,610.70	6,507.60	2,180.30	11,787.00
2006/07	696,989.00	87,712.20	71,126.70	16,585.50	18,980.30	52,146.40	16,707.00	26,095.60	9,343.20	2,238.70	16,726.80

Source: Economic Survey, Various Issues  
A Handbook of Government Finance Statistics, 2008

**Master Table II**  
**Total Revenue, Tax Revenue, Non Tax Revenue, Direct Tax, Indirect Tax and others Tax Revenue as**  
**Percentage of Total GDP (FY1964/65 to FY 2006/07)**

Figures are in Percentage

<b>Fiscal Year</b>	<b>Total Revenue</b>	<b>Tax Revenue</b>	<b>Non Tax Revenue</b>	<b>Direct Tax</b>	<b>Indirect Tax</b>	<b>Custom Duties</b>	<b>Sales Tax/VAT</b>	<b>Excise Duties</b>	<b>Land Rev. &amp; Reg.</b>	<b>Income Tax</b>
1964/65	3.43	2.69	0.74	0.96	1.74	1.49	0.00	0.25	0.82	0.09
1965/66	3.13	2.56	0.57	0.83	1.74	1.35	0.00	0.29	0.65	0.10
1966/67	4.00	3.52	0.48	1.12	2.40	1.90	0.19	0.31	0.92	0.12
1967/68	4.28	3.96	0.59	1.47	2.48	1.81	0.38	0.30	1.22	0.16
1968/69	5.17	4.61	0.56	1.36	3.25	2.30	0.60	0.35	1.07	0.21
1969/70	5.29	4.69	0.60	1.47	3.22	2.21	0.58	0.43	1.17	0.22
1970/71	5.14	4.43	0.72	1.35	3.08	1.75	0.70	0.63	1.02	0.24
1971/72	5.16	4.50	0.84	1.31	3.20	1.92	0.67	0.61	0.97	0.21
1972/73	6.18	5.23	0.95	1.36	3.87	2.39	0.80	0.68	0.93	0.23
1973/74	5.98	5.02	0.97	1.41	3.61	2.23	0.77	0.60	0.97	0.25
1974/75	6.09	5.08	1.01	1.11	3.97	1.98	1.15	0.72	0.77	0.28
1975/76	6.41	5.24	1.18	1.36	3.88	2.06	0.93	0.76	0.78	0.50
1976/77	7.66	6.37	1.29	1.71	4.66	2.23	1.28	0.96	0.81	0.77
1977/78	8.02	6.30	1.71	1.55	4.75	2.33	1.38	0.83	0.72	0.69
1978/79	8.16	6.65	1.51	1.14	5.51	2.82	1.61	0.87	0.50	0.46
1979/80	8.05	6.55	1.50	1.09	5.46	2.60	1.72	0.92	0.52	0.43
1980/81	8.86	7.45	1.40	1.29	6.16	2.99	1.97	0.89	0.65	0.53
1981/82	8.65	7.14	1.51	1.23	5.91	2.66	1.93	0.99	0.55	0.61
1982/83	8.42	7.17	1.25	1.32	5.85	2.25	2.10	1.08	0.51	0.71
1983/84	8.66	6.95	1.71	1.38	5.57	2.10	1.96	1.10	0.54	0.74

1984/85	8.81	7.09	1.72	1.26	5.83	2.40	1.90	1.09	0.49	0.69
1985/86	8.73	6.88	1.85	1.24	5.63	2.31	1.85	1.05	0.46	0.68
1986/87	9.77	7.15	2.62	1.26	5.89	2.46	1.87	1.11	0.46	0.72
1987/88	10.05	7.86	2.18	1.38	6.48	3.03	1.78	1.13	0.50	0.79
1988/89	9.06	7.33	1.74	1.55	5.77	2.67	1.61	1.02	0.47	1.00
1989/90	9.32	7.31	2.01	1.44	5.87	2.69	1.66	1.10	0.45	0.92
1990/91	9.24	7.04	2.20	1.18	5.86	2.62	1.72	1.03	0.46	0.64
1991/92	9.32	6.81	2.51	1.10	5.71	2.32	1.96	0.98	0.44	0.59
1992/93	9.16	7.05	2.11	1.23	5.82	2.39	2.08	0.88	0.46	0.68
1993/94	10.22	8.02	2.20	1.49	6.53	2.74	2.45	0.83	0.43	0.95
1994/95	11.70	9.36	2.36	1.83	7.53	3.34	2.88	0.80	0.45	1.26
1995/96	11.65	9.05	2.60	1.94	7.11	3.06	2.69	0.81	0.45	1.34
1996/97	11.27	9.06	2.21	1.98	7.08	3.08	2.64	0.85	0.38	1.42
1997/98	11.37	8.95	2.41	2.14	6.82	2.93	2.45	1.00	0.35	1.55
1998/99	11.29	8.71	2.57	2.28	6.44	2.88	2.39	0.89	0.30	1.71
1999/00	11.71	9.05	2.66	2.44	6.61	2.95	2.69	0.86	0.28	1.84
2000/01	11.49	9.13	2.36	2.39	6.75	2.95	2.91	0.89	0.14	2.24
2001/02	11.36	8.86	2.50	2.39	6.47	2.85	2.76	0.86	0.25	2.13
2002/03	11.87	8.99	2.88	2.13	6.86	3.01	2.84	1.01	0.30	1.84
2003/04	12.03	9.30	2.73	2.30	7.00	3.00	2.80	1.20	0.33	1.97
2004/05	12.38	9.55	2.83	2.31	7.24	2.77	3.33	1.14	0.32	1.99
2005/06	11.47	9.11	2.36	2.22	6.90	2.43	3.43	1.03	0.35	1.87
2006/07	12.58	10.20	2.38	2.72	7.48	2.40	3.74	1.34	0.32	2.40
Average	8.87	7.09	1.79	1.62	5.48	2.54	1.84	0.87	0.59	0.92

Source: Master Table I

**Master Table III**  
**Growth Rates of Total Revenue, Tax Revenue, Non Tax Revenue, Direct Tax, Indirect Tax and others Tax Revenue (FY1964/65 to FY 2006/07)**

Figures are in Percentage

Fiscal Year	Total Revenue	Tax Revenue	Non Tax Revenue	Direct Tax	Indirect Tax	Custom Duties	Sales Tax/VAT	Excise Duties	Land Rev. & Reg.	Income Tax
1964/65	-	-	-	-	-	-	-	-	-	-
1965/66	12.58	17.44	-5.06	6.72	23.35	12.24	0.00	46.60	-1.96	33.96
1966/67	18.57	27.50	-21.57	25.87	28.27	30.16	0.00	-0.50	30.82	8.45
1967/68	19.52	25.69	36.57	46.81	15.80	6.57	122.31	7.50	48.14	48.05
1968/69	34.62	29.77	5.92	2.84	45.76	41.56	78.44	30.23	-2.63	46.49
1969/70	12.35	11.68	17.90	18.31	8.90	5.39	6.46	36.07	20.09	17.37
1970/71	-0.93	-3.79	21.44	-6.45	-2.58	-19.12	21.92	48.56	-11.06	8.16
1971/72	16.47	17.97	35.31	12.55	20.33	26.90	10.91	12.37	10.56	3.77
1972/73	15.02	11.63	9.35	-0.07	16.42	19.94	15.48	6.60	-7.36	6.36
1973/74	24.46	23.28	30.94	33.19	19.80	20.15	23.43	14.16	33.08	39.32
1974/75	31.58	31.02	34.44	2.39	42.19	14.78	93.40	54.65	2.42	44.17
1975/76	10.63	8.26	22.92	27.91	2.74	9.13	-15.01	10.36	6.78	85.53
1976/77	18.58	20.73	8.74	25.30	19.14	7.73	37.12	25.74	3.10	52.87
1977/78	19.59	13.07	51.80	3.55	16.57	18.80	23.02	-1.02	1.00	2.63
1978/79	14.53	18.72	-0.98	-17.34	30.50	36.60	30.65	17.15	-21.83	-24.71
1979/80	3.76	3.52	4.87	0.28	4.19	-2.98	12.44	11.73	9.88	-1.75
1980/81	28.68	33.16	9.20	39.16	31.96	34.18	34.02	12.55	47.28	42.29
1981/82	10.76	8.63	22.09	7.56	8.85	1.14	11.10	26.22	-4.76	31.81
1982/83	6.05	9.49	-10.19	17.16	7.90	-7.78	18.73	19.66	0.88	26.55
1983/84	19.98	13.05	59.88	21.73	11.09	8.54	8.66	18.12	23.85	21.11
1984/85	14.88	15.13	13.86	3.30	18.05	28.88	9.74	11.99	2.92	5.64

1985/86	18.58	16.12	28.70	18.24	15.67	15.65	16.56	15.46	11.76	18.58
1986/87	28.65	19.49	62.68	16.15	20.22	22.32	16.02	21.46	16.25	20.06
1987/88	23.02	31.57	-0.32	31.42	31.60	47.08	13.70	21.62	29.19	32.34
1988/89	5.80	9.29	-6.76	31.80	4.50	3.40	6.09	6.35	9.29	48.74
1989/90	19.42	15.85	34.51	7.79	18.02	17.25	19.60	24.99	12.64	6.71
1990/91	15.53	12.25	27.45	-4.56	16.38	13.39	20.93	9.42	19.28	-18.80
1991/92	25.94	20.78	42.44	16.46	21.65	10.33	42.11	18.25	17.33	14.59
1992/93	12.10	18.09	-4.16	27.65	16.25	17.45	21.25	2.35	19.41	31.54
1993/94	29.26	31.80	20.76	40.23	30.02	33.21	36.49	9.62	10.36	62.19
1994/95	25.51	27.90	17.48	34.81	26.32	33.54	28.65	5.23	12.56	44.75
1995/96	13.50	10.21	25.88	20.94	7.60	4.41	6.52	16.14	15.13	21.39
1996/97	8.89	12.72	-4.43	14.70	12.18	13.40	10.80	18.31	-5.95	19.47
1997/98	8.44	6.20	17.63	15.88	3.50	2.30	-0.25	25.39	-0.86	17.49
1998/99	13.09	10.84	21.38	21.46	7.52	11.97	10.89	2.29	-1.03	25.51
1999/00	15.15	15.30	14.68	19.10	13.96	13.61	24.96	6.10	1.71	19.64
2000/01	13.99	17.23	2.95	13.49	18.62	16.08	25.71	20.38	-40.02	35.50
2001/02	3.17	1.20	10.83	4.31	0.10	0.85	-0.93	0.95	84.49	-2.73
2002/03	11.47	8.28	22.74	-4.64	13.04	12.46	9.72	25.69	26.12	-8.66
2003/04	10.85	13.12	3.78	17.70	11.64	9.26	7.57	30.13	20.03	16.87
2004/05	12.50	12.31	13.14	9.90	13.16	0.94	30.43	3.52	5.99	10.01
2005/06	3.08	6.15	-7.28	6.86	5.92	-2.28	14.43	0.96	21.18	4.57
2006/07	21.35	23.85	11.67	35.88	19.98	8.88	20.75	43.57	2.68	43.87
Average	16.37	16.50	17.15	15.87	17.00	14.59	22.56	17.55	11.68	23.46

Source: Master Table I



**Organizational Structure of the Inland Revenue Department**

Source: Barshik Pratibedan, 2064/65

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