# CHAPTER ONE

# INTRODUTION

## 1.1 An Overview

Resource mobilization is exceedingly important for the economic development of any country. Government can not provide public goods unless they have necessary resources to supply them. Broadly speaking, there are two sources of internal revenue through which government can mobilize resources. They are tax revenue and non tax revenue. Tax is a compulsory contribution to the government and made without reference to a particular benefit received by the tax payer (Goode, 1984). It is personal obligation to pay tax and there is no direct relationship among tax, benefit and individual tax payers.

Taxation is a major instrument of social and economic policy. It has three goals: to transfer resource from private to public sector, to distribute the cost of government fairly by income classes (vertical equity) and among people in approximately the same economic circumstance(horizontal equity ) and to promote economic growth , stability and efficiency (Vatia,1977). These objectives are closely related to the economic development of a country. So that prime concern of the developing country is to attainment of rapid economic development. The rapid economic development requires massive governmental participation, the method of obtaining revenue to meet with such activity. The role of taxation in this connection has increased very much in the current days.

The expenditure of government is increasing day-by-day because of increasing population, insurgency, political ambition, peace maintaining and social programs. However, the revenue collection or domestic resource covers the rising expenditure of current budget. External sources of fund are foreign loans and grant. The lack of external resource to cover the capital expenditure makes deficit financing in different years. Such external sources are uncertain, inconvenient and not good for healthy development if there is heavy dependency on them. It is better to mobilize internal sources rather than expecting with beggar's eye to the donors. The experiences of developing countries show that there are negative results of increasing international aid and loan to finance the public fund is not good as it reduces the liquidity position of the government and increases the inflation. The government has to impose higher taxes to repay the principle with interest. In such condition government makes efforts to cover the amount by raising tax which will adjust deficit. It is the major sources of government revenue in all countries. However, the internal sources are more preferable to external one for sustainable development. Thus, tax revenue and non-tax revenue are the crucial revenue of the government. The tax revenue is received as compulsory payment where as the remaining are conditional. The non tax revenue includes duties and fees, penalty, fines and forfeitures, receipts from sales and rent of government property, principal repayment, donation and miscellaneous income.

In developing countries, the government might play an important part in promoting capital formation and breaking the vicious circle of poverty by mobilizing adequate resources through taxation. The role of taxation in this connection has increased very much in the current days. There are two types of tax revenue through which the government mobilizes resources. They are direct tax revenue and indirect tax revenue. Direct tax is a tax whose burden is bared by tax payer himself and indirect tax is a tax whose burden is bared by others (Hicks, 1947). In other words direct tax is imposed on income and property where as indirect tax is imposed on commodity. Sales tax, custom duties and excise duties are the forms of indirect tax. As the income level of people in developing country is lower, the direct tax has less potentiality. In developing country, the role of indirect tax is vital.

In the context of Nepal, the role of taxation has increased since initiation of planning in1956 for the purpose of economic development. However, in the earlier period the drastic change needed in improving tax structure was not felt due to the low magnitude of government expenditure. Today, government expenditure has increased by greater rate than government revenue. Fiscal policy is the border line of economics and politics. As there was political instability due to internal conflict between Maoist and government, regular expenditure became higher than development expenditure to maintain peace within the country. The problem of bridging this gap between expenditure and revenue has become the main issue regarding the fiscal affairs of Nepal.

Thus, there is greater need of resource mobilization through tax in Nepal. As a developing country, potentiality of indirect tax is greater than the potentiality of direct tax in Nepal. The Report of Economic Commission states that Nepal had to rely mainly on the indirect tax because it was difficult to raise substantial amount of revenue through the direct tax mainly due to the latter complexity in nature. More over, the administration was also not so organized and efficient. Therefore, the government had no other alternative but to remain reliant on the indirect tax to a great extent for running the general administration and meeting the government requirements of the country (Jha, 1984). Revenue collection from indirect tax has been increasing gradually. In FY 1990/91 the total amount of indirect tax revenue was Rs. 6807.7 million which increased to Rs. 52146.0 million in FY 2006/07. The share of indirect tax revenue and direct tax revenue was 73 and 27 percent respectively in the FY 2006/07 (MOF 1992; MOF 2008). Taxation in the modern world has been taken as the most effective tool for raising ratio of revenue to GDP. The total tax/GDP ratio was 7.0 percent in FY 1990/91 which increased to 14 percent in FY 2006/07(MOF, 2008). According to the World Development Report, the total tax GDP ratio in under developed country is very low. Government requires high tax/GDP ratio because mobilizing adequate resources through taxation might invest them in various development programmes.

On the whole, resource mobilization through tax is unavoidable in the sense of that if the government does not tax now and remains dependent on foreign borrowing only for meeting the normal budgetary needs of the economy it will be forced to tax in the future. As indirect tax revenue has greater potentiality, the present study is also directed towards the problems, prospects and trend of resource mobilization through indirect tax in Nepal (1990/91-2006/07).

### 1.2 Statement of the Problem

It is possible to improve the revenue mobilization from the existing structure of Nepalese tax system. However, we have some problems in the subject matter. So it is important to know the key issues that are the inherent problems in the Nepalese tax system.

According to World Development Report 2008, Nepal has 142$^{nd}$ position among 177 countries which is very back from Sri Lanka and India in the SAARC countries. Due to internal conflict and unfavorable weather condition, Nepal had -0.6 percent economic growth rate in 2002 (Dahal, 2004). This shows that Nepal still remains one of the poorest countries in the world. Despite more than five decades of planned development, the Nepalese economy is persistently suffering from general poverty and stagnation. The low income leads Nepalese people under the vicious circle of poverty. It is the worst position in Asia. It is said that economic growth rate need three times more than population growth rate (Kantipur, 2006). And this has led to several economic and social disturbances in the country. Unfortunately, instead of being solved the problems are rather deepening and worsening. This clearly implies the scarcity of resources in the development process.

The tax administration in Nepal is very weak. There is a lack of specialized revenue services while a revenue group was created within the Nepal administration service in 1992/93, there is still a long way to go in order to develop a specialized revenue office lack of physical facilities and incentives provided for revenue officials are limited .The situation of local tax administration is even worse (Dahal, 2004).

Most of developing countries like Nepal are unable to mobilize their available resources as a result they are escaping from their opportunity and being dependent to others. There is a greater prospect of development but here is a lack of capital and technology. This is why, huge manpower is going abroad and remittance has become one of the most important sources of income.

The share of development expenditure to total expenditure in 1990/91 was 67.8 percent and it began to decline continuously and reached at 34.0 percent in FY 2006/07 (MOF 1998; MOF 2008).This fact also reveals that the share of development expenditure to total expenditure has been gradually declining and hence created lack of resource for the development.

One another problem posed for the country's macro economic stability is an acute resource gap in the public sector. The ever increasing government expenditures and limited sources of revenues have led the country to severe fiscal crises over the years. The total expenditure of government in fiscal year 1990/91was 23549.8 million and it increased at Rs. 116852.3 million in the year 2006/07 (MOF, 2008). Government expenditure is increasing day-by-day while there is no an 'equivalent' increase in government revenue. The government has been increasing security expenses heavily in later days because of internal conflict. Such unbalanced growths in revenue and expenditure have resulted in massive revenue expenditure gaps or budgetary deficits in the country. The resource gap in the year 2006/07 was Rs. 30091.7 million (MOF, 2008).

Currently, Nepal has been facing a serious problem of resource gap and dependency on the foreign loan. Here, three types of question may be posed. First what is the major reason of it? Second, what may happen, if the situation is not improved? Third, what is an appropriate solution of the problem? The answer of the first question is that expenditure requirement of the government is growing at a faster rate than its ability to mobilize additional resources. Expenditure requirement of the government is increasing continuously because it is very difficult to control regular expenditure, and development expenditure should be increased for the social welfare. Similarly there is an inadequate mobilization of internal resources due to poorly designed tax structure (Bajracharya, 1993).

The answer of the second question is that if situation is not improved, it will create a huge amount of external loan (loan means repayment of principle with extra burden of interest) which can not be reliable for long term. It means government should resort to either internal borrowing or borrowing from the central bank printing of excess money. However, both of these create adverse reaction on the economy e.g. discouraging the investment of private sectors and inflation. The answer of the third question is that there are two ways of the solution: i) cutting development expenditure, and ii) mobilization of internal resources through effective tax structure. The first option is not appropriate for a country, which is just crawling towards the development. The second option is the appropriate solution of the problem because utilization of internal resources is much better than the dependency on external sources. But in context of Nepal, the situation is just opposite which has been shown in chapter five according to which external resources have played major role in the long-term economic distortion in the country. So, we should have to mobilize internal resources rather than looking with beggars eye to the donors. Indirect tax is considered as an optimal solution of resources gap and high dependency on foreign loan because tax payers do not feel burden directly paying indirect tax it has greater share in government revenue.

This has generated the strong believe among the economists that the present tax ratio in Nepal which is very low, can be increased substantially, which might be a solution of resource problem. However, what is the trend of tax/GDP ratio, what is the magnitude of tax in Nepal and what are the problems of resource mobilization through indirect tax in Nepal with their solutions will be the subject matter of our study.

### 1.3 Objectives of the Study

The major objectives of the study are:

i. To analyze the trend of resource gap in Nepal for seventeen years period 1990/91 - 2006/07
ii. To analyze mobilization of revenue through indirect tax.
iii. To provide suggestion to make indirect tax effective to mobilize resources.

### 1.4 Significance of the Study

Human nature is always curious to learn, understand or investigate about the phenomenon by raising questions like why, how, what, when and he likes to find out the answer of any problems. The study will be concentrated on structure of tax and resource mobilization through indirect tax. It will find out the answer of many questions such as: what is the role of indirect tax in total revenue? what is the trend of various components of tax?, why is so?, what are the solutions of the problems prevailed in tax system in Nepal?, Then, what is the designation of appropriate tax policy?

There is a greater need of study in improving resource mobilization in Nepal. This need becomes more appreciable when we see a higher tax ratio to GDP in developed countries. Nepal is a tiny and poor country located in South Asia. The land formation of the country is not so favorable for well economic activities. The construction of infrastructure of development is very expensive due to which the industrial and agricultural production cost is very high and are unable to compete in foreign market. As a result foreign investment has been discouraged. In such a complicated situation we bow down our head for bilateral and multilateral aid but it is not the sustainable solution of the problem because they have no certainty. It is said that knowledge is must rather than land and sea. We have to prepare such mechanism which can give us self dependency. Here, internal source is the solution of the problem. We need to mobilize such internal resource which has the canon of equity, certainty and elasticity. Income of Nepalese people is very low about 31% people are under poverty line. Non tax revenue provides low contribution. Direct tax has less potentiality. In such condition, indirect tax has dominant role in total revenue, it is vital to study its problems and prospects.

## 1.5 Limitations of the Study

The followings are the limitations of the study.

i. This study is mainly based on the published secondary data and information and no attempt have been made to examine the reliability of the data.
ii. Due to time and resource constraint this study covers only the period from 1990/91 to 2006/07.

## 1.6 Organization of the Study

The study has been divided into six chapters. Each chapter further divided into various subsections. Chapter one concentrates on introductory part of the study and helps reader to know 'what' of the study. This chapter contains general background, statement of the problem focus of the study, objectives of the study, scope or significance of the study and limitation of the study. Chapter two is concerned with literature review. This Chapter includes meaning and nature of indirect tax in different countries of the world. An attempt has been made to provide review of the literature made both in the national and international level as far as possible. Chapter three is concerned to research methodology which provides information regarding the types and sources of data used in the study. This chapter also includes introduction, sources of data, data processing method and tools to analyze the data.

Chapter four reports the tax structure, this chapter includes the current extent and importance of indirect taxation, preparation, deigns and system of indirect taxation in Nepal, types of indirect taxation. Chapter five reports the presentation and analysis of data, resource mobilization trough indirect taxation in Nepal and theoretical analysis of indirect taxation. This chapter is also concerned with resource gap in Nepal. To make clear concept about the subject tabulation and graphical descriptions have been made. Chapter six includes summary, conclusion and recommendation conceived from the study. Finally, appendixes and bibliography have also been presented after the last chapter.

# CHAPTER TWO

# LITERATURE REVIEW

## 2.1 Theoretical Review

Tax is not a price paid by the tax-payer for any definite service rendered or a commodity supplied by the government. Tax payer has no right to any benefit from the public expenditure on the ground that he is paying tax. The benefits of public expenditure may go to anyone irrespective of the taxes paid. Thus tax is the compulsory payment to the government without expectation of direct benefit.

The relation between taxation and economic development has long been a matter of concern to policy makers and students of public policy alike. The classical economists devoted substantial efforts to analyzing the effects of taxation on growth and distribution with the rise of the stability of the economy also became an important subject of analysis. These classical and Keynesian concerns constituted prominent themes in early analysis of taxation in UDCs. Subsequently, the range of concerns widened to include the effects of taxation not just on the rate of growth of national income but also on the distribution of that income by income size, class on employment, and on other objective of policy for example, lists the objectives of fiscal policy as the promotion of economic growth, the reduction of income disparities, use of transfer to others. Taxation not only restraints total spending between households and regions but also promotes the economic stability and economic efficiency, and the increasing of host country returns from natural resource endowments.

Due to dominant source of revenue, the tax system should be helpful in income redistribution and economic stability. The taxation is the function of economic development to combat inflation, reduces the gap between rich and poor, promotes the national economy, and mobilizes the domestic resource for the economic development and saves the domestic economy (Due, 1970). To analyze the effects of indirect taxation to achieve the objectives of the developing economies which are acceleration of growth, pattern of income distribution, resource allocation and price stability, J. F Due used the development model stated as:

$$\Delta Y = f(\Delta K/\Delta Y, t, r, v)$$

where,

$\Delta K/\Delta Y$ = incremental capital output ratio (ICOR) or relationship between increase in capital stock and consequent increase in output.

$t$ = rate of technological change.

$r$ = rate of increase in quantity and quality of natural resource, labor and entrepreneurial sectors.

$v$ = modification in the institutional environment.

Taxation is the most effective tool for increasing the savings-GNP ratio. Taxes as major fiscal policy tools have an important role in increasing the capital formation and achieving the economic growth without inflation. Increasing taxes may be directed to increase savings through reducing the consumption. John F (Due 1970) suggested that taxation plays the major role to mobilize the resources for economic development of a nation. Due also illustrated the attainment of objective of developing economy, indirect tax has several advantages.

a.) They make possible greater governmental revenue for financing of infrastructure and capital investment and permit a higher rate of economic growth,

b.) They restrict luxury consumption goods more effectively than other taxes,

c.) They can use to restrict importation of luxury goods ,more effectively than other taxes,

d.) They require less administrative effort for effective collection and reduce the drain of resource for these purpose,

e.) They may be less harmful to incentives than direct taxes

On the whole, tax is the compulsory payment to the government instead of which there is no hope of direct benefit by the tax payers. It is also an effective instrument to bridge up the gap between required revenue and expenditure. It brings stability in an economy, helps to economic growth, distribution of income, and capital formation.

### 2.1.1 Objectives of Tax Policy

The broad objective of the tax policy in developing countries is the promotion of development process for meeting maximum needs of the cases and improving their living standards of life. To translate the broad objectives in operational terms, the mobilization of additional financial resources has remained the predominant concern of the tax policy in developing countries (Hicks, 1948). The specific objectives of tax policy in developing countries have emerged to accelerate economic growth, equal distribution of income and wealth, equitable allocation of resources, reduce the gap between poor and rich and higher degree of economic stability **(**Hicks, 1948**)**.

(i) The first objective of tax policy is to increase the growth rate. Taxation is the primary source of revenue in all economy. It mobilizes the resources. Through the mobilization of resources, government can attain high economic growth rate. For the purpose, it should a) restrict the unproductive consumption expenditure (b) encourages investment in new capital goods (c) channalize the investment from unproductive to productive sector of the economy, and (d) increase the factor supply.

(ii) Second, to have built in flexibility and to provide maximum revenue productivity**:** This implies that tax system should be elastic. If the government were in the need of extra fund, then elastic tax system would provide it. If the tax system is elastic it is considered highly responsiveness to national income.

(iii) Through the taxation, we can reduce purchasing power and hence reduce the aggregate demand and can control the inflationary pressure in an economy. However, it is said that some degree of inflation is desirable at a initial stage of economic development because it increases the rate of capital formation by redistributing the income and wealth from poor to rich. If it is not under control, it results into hyperinflation, which is not desirable for economic development. In this time, by using appropriate tax policy, we can combat inflationary pressure in the economy.

(iv) Through the taxation, we can remove the inequality in the distribution of income and wealth in the society. For this purpose, direct tax is useful because it has the quality of progressiveness. However, we need indirect as well to mobilize the extra resources.

### 2.1.2 Principles of Taxation

Equity, efficiency, and administrative feasibility are the three major principles of tax design of any economy. For UDCs, the most important role of taxation is to mobilize the resources for development. As an instrument of resource mobilization, its principal function lies in raising the volume of public savings to be used for capital formation consistent with the growth of saving in the economy as a whole. The quantitative role of tax policy for the mobilization of development finance may be considered in two aspects: static and dynamic.

In the former case, the economy tends to stay at a stable level of under development equilibrium in which tax revenue is used mainly on the consumption purpose. In the later case, the role of tax policy consists in preventing the increment in output from being consumed by deliberately ploughing back an increasing proportion of it into the pool of investible resources of the public sector

In order to assure the objective of ploughing back the increment in output, the UDCs have to develop a tax structure that should have a large element of built-in-flexibility. This means that the tax base must grow as income grows. Since the tax rates will only be a fraction of the base, the base must grow faster than total income in order to recapture a substantial part of the increment. Such a tax structure will be one in which the marginal effective rate of taxation in terms of national income must be high.

Although such a tax structure, would be ideally suited to plough back an increasingly larger proportion of the increment in output, it may create an adverse economic effect on incentives to resources the tax structure of the UDCs, should be sufficiently diversified and should have a coverage both ‘deep and wide’. Such a tax system will be able to mobilize and to tap the tax potentials of the different sectors created because of the accelerated process of economic development (Goode,1986).

If political decisions are made by legislative majorities, a constitutional constraint requiring generality in the imposition of taxes will be economically efficient. In the absence of such a constraint, majorities will tend to impose differentially high taxes on members of political minorities, and such differentiation opens up several sources for resource waste. This argument lends support for a uniform proportional rate of tax on all incomes.

The principal necessary ingredient of a tax system designed to promote the required level of employment in a dynamic economy is flexibility, or ability to adjust quickly to changing requirements without violent overhaul (Taylar, 1974).

### 2.1.3 Direct and Indirect Taxes

There has been a long tradition in economic literature to classify taxes into these two categories. One way of distinguishing between these two has been in terms of the incidence of taxation. It is asserted that if the incidence of a tax rests upon the person who bears its impact, then it is a direct tax. If on the other hand, the incidence is passed on to others, then it is indirect tax (Bhatia, 1977).

In traditional language, if the impact and incidence of tax lies upon the same person, then it is known as direct tax, where as it is known as indirect tax when the burden is shifted impact and incidence lies upon different person. A direct tax is really paid by a person on whom it is legally imposed, while an indirect tax is imposed on one person but paid partly or wholly by another (Dalton, 1990).

Taxes which are levied on income are known as direct tax, where as taxes levied on outlays or expenditure is known as indirect tax. Those taxes, which are based on receipts of income, are termed as direct where as those levied on expenditure are termed as indirect, income tax profit tax and capital gains taxes are, therefore, direct, custom duties, excise duties, stamp duties are indirect (Hicks, 1947).

On the basis of above definition, we can say that income tax-whose impact and incidence is on a same person, is direct tax where as sales tax and custom duties are indirect tax-whose impact and incidence are on different person.

### 2.1.4 Components of Indirect Tax

This is the tax which is charged on the ultimate consumers by the tax payers indirectly. This type of tax is popular in developing countries because the people in developing countries usually don’t like to pay direct taxes because of their ignorance and so many other related factors such as it is easy to collect substantial amount of revenue without much assessment and other administrative problems. There are many components of indirect taxes such as sales/VAT taxes levied at whole sales and retail stage of sales, customs duties levied on goods entering or leaving the country and excise duties levied at the manufacturing stage of production Then there may be advalorem taxes, that is taxes based on the value and specific taxes that are based on quantity A common believe to be the resource mobilization for government activities. In spite of their common capture their way of mobilization and adjustment might not be same for all. So, their individual introduction seems to be essential. (Singh, 1982).

**a. Custom Duties:** It is a tax levied on the commodities when money in or out of the country. In other words, customs duties are the tax levied on the value of import and export trade. These taxes are levied on several purposes such as revenue mobilization productivity, compensating for devaluation of domestic currency and corrective purposes. A developed country levies this tax to protect its industry while a developing country levies this mainly for the purpose of generating revenue for development. It does not mean that developing countries never take protective measures for their industries.

**b. Tax on Consumption and Production:** Consumption may be taxed directly through a progressive expenditure tax, or indirectly through excise sales taxes (VAT) (Singh, 1982).

**i. Sales Tax/VAT:** Sales taxes are the taxes imposed on a market which are impersonal in character. Sales taxes may be imposed by various ways and techniques and at various stages of transaction. These diversified techniques and stages cause to call sales taxes by various names such as turnover tax, whole sales tax, retail tax, value added tax whose imposition may be placed at various stages of economic activity. From a traditional view point, because of shifting of incidence of sales tax it is considered as regressive type of taxes. However this traditional conclusion has been challenged recently by revisionist view point. Sales tax is also known as 'Value Added Tax' which is most scientific innovative and powerful tax with built in quality of universal application for both developed and developing economy which was first introduced in 1954 in France. The biggest merit of the value added tax is that it is revenue buoyant and highly instrumental for resource mobilization especially in an economy with an acute shortage of resources (Goode, 1986).

**ii. Excise Duties** Excise taxes are generally defined as inland taxes or duties imposed upon the domestic production of commodities for sale or consumption within the country. A study of the growth of excise taxation would bring out clearly that the main purpose of this levy has always been revenue (Singh, 2004). It is levied internally on domestic production. It is mainly levied on industrial products and on the agricultural products too. It helps to control of injurious consumption and is considered little contribution to economic development and is desirable. It speaks about the progress in the industrial status of a country. If the revenue generated from this source is high, the economy would be more industrialized and vice versa.

**iii. Other Indirect Taxes**

**Hotel Tax*:*** A certain portion is to be paid to the government by consumers on account of the use of hotel services is known as hotels tax. But this area has not been exploited till now. Only hotels on lodging facilities are taxed. So, it would definitely be better to introduce tax on feeding facilities and in small hotels too. The adopted in this regard should certainly be the progressive one (Khadka 1996).

**Contract tax:** It is levied on the contracts given by govt. institutions this type of tax is collected at the time of making payment. Usually all the contractors add up this amount in their bids. It is the govt. expenditure on the one side and revenue on the other. Hence this type of tax essentially not a sound source of revenue (Khadka 1996).

**Entertainment tax*:*** Entertainment tax is levied to control the habit of the people and entertainment consumption and to maintain security in their places. This is levied mainly on cinema and also on the exhibition of circus or similar shows which provides entertainment. People in the UK are charged entertainment tax for the service of BBC. There is provision to fix the taxes on the ticket value. There is also a provision to fix the rates considering the size of the hall. As regards the amusement machines, the rate is determined on the basis of the number of machines (Khadka 1996).

**Air Flight tax:** It is the tax levied on air passengers. Revenue generated from this charges are used for the development of airports and are not deposited into tax accounts (Khadka 1996).

**Beer Tax:** This tax is an excise levied on beer but not on alcohol- free beer. Its rate is fixed on the basis of a hector- kilo liter and some concessions are made for small and medium scale breweries (Khadka 1996).

**Beverage Tax:** This tax is levied on the sale of any alcoholic or non-alcoholic drink. The tax rate is fixed as a percentage of the retail price by each local government (Khadka 1996).

**Road and bridge maintenance tax:** It is levied on each vehicle at a graduated rate and collected at specified bridges. However, as this tax hindered the free flow of the traffic and trade, it was replaced by specific tax on imports of high-grade diesel and petrol to be used for vehicles. It was collected at customs points together with customs duty.

## 2.2 Empirical Literature Review

Agrawal (1978) has done a research on ‘Resource Mobilization for Development’ in the period between F/Y 1951/52 To 1978/79. This study shows trend of resource gap and domestic resource mobilization through various taxation of the same period. He concluded that the trend of resource mobilization through indirect taxation in Nepal would more helpful for the context of resource mobilization to meet the financial requirement of the government. But it has been very old which can not give the significant result in the present context.

Agrawal (1980) made an extensive study of Nepalese taxation covering the period of 16 year 1962/63 to 1977/78..Which implies that the income tax of Nepal is positively responsive to change in GDP. 1 percent change in GDP will bring about 2.01 percent change in total revenue due to discretionary measures.

Bajracharya (1993) has done the research on “A Study on Resource Gap, Resource Mobilization and Excise Taxation in Nepal”, has computed the need of domestic resource mobilization for financing of development work in Nepal computing secondary time series data. In her own words “Taxation is the most important means of mobilizing resources. Especially the share of excise duty has been increasing in the total tax structure of Nepal. The potential of excise duty is directly related with the growth of industrial production and extension of the coverage. From which it is hoped this excise duty may turn out to be number of source of domestic resource mobilization which may decrease the resource gap in Nepal in years to come”.

She adds the role of excise revenue increases no only in terms of its contribution to the total revenue but also as effective tool in controlling the production and consumption of socially undesirable goods like tobacco and liquor.

The conclusion of her study is that resource gap is a serious problem. Taxation especially excise duty is the measure to reduce the gap and it is very effective tool for controlling the production of harmful goods.

Baniya (1979) in his MBS dissertation ‘Excise Taxation in Nepal’ has focused on the effectiveness of excise taxes on industrial development and measuring the potentiality of excise taxation in developing countries. Among the various internal funds available to meet government expenditure, excise duty is one of the major sources. Excise duties are not levied only on collecting more revenue but they contribute in improving exports, to have controls in the overflow of harmful goods in the society and to protect and develop infant industries. However there are many problems in the collection of excise taxes such as excise duty administration, lack of effective information system and technical problems. In order to strengthen the position of excise duties in total tax revenue, he suggested the following measures.

- Excise on higher brand of ciggerettes should be increased and the excise on lower brands should be kept low.
- Excise for alcoholic and spirits should be increased.
- In every three months, price determination committee should determining price so that excise revenue should be increased.
- The government should review the incentives given to various industries.
- Proper training should be given to staffs of excise department.

His suggestions could include only excise tax. However it could not solve the problems of custom duty and sales tax which are important sources of government revenue.

Burlakoti (1995) has done a research on “Resource Mobilization through Indirect Taxation in Nepal” and has computed elasticity and buoyancy coefficient of all component of indirect tax by the Sahota method of the period between1972/73-1992/93. He expresses that taxation is not the instrument only forgetting revenue but it also considered as the medium of eliminator of undesirable effect and introducer of desirable effect in economy. Therefore taxation is considered as having two weapons in one hand. His findings were:

- Trend of different sources of taxation shows that the share of direct tax revenue has continuously declined and the share of indirect taxes have continuously increased.
- Magnitude as well as percentage contribution of traditional direct taxes ie, land tax, declined continuously while income tax and registration duty are growing continuously.
- “The share of indirect taxes on total revenue is very high on total revenue and growing continuously”.
- Therefore, Nepalese tax structure is heavily relied on indirect tax.

His study shows that the share of direct tax had been declined and the share of indirect tax had been increasing continuously. However, it is very old research it can not tell recent trend, problems and prospects of indirect tax in Nepal because it is the age of trade liberalization and globalization. SAFTA has been implemented since, 1st Jan. 2006.

Beyer (1973) has presented the paper on "Resource Mobilization for Development of Nepal". His paper is concerned to the period of 1965/66 to 1970/71. He advised the alternative course of action open to government of Nepal, on the seminar as follows: (a) Government of Nepal (GON) can postpone the policy decisions for mobilizing additional resource and continue the rapid expansion of public sectors expenditure but accept the consequences of a serious Indian currency balance of payments problems which in turn is likely to have serious implicit for Nepal's economy (b) GON can avoid both the policy decisions on resource on Indian currency balance of payments problem by modifying its national development objectives and curtailing sharply the growth of expenditure and (c) GON can avoid the destabilizing effects of deficit financing and check the gap expansion of expenditure by policy decisions.

Dhungana (1980) has done research on 'Indirect Taxation in Nepal' of the period between F/Y1964/65to 1979/80. He has computed the elasticity and buoyancy coefficient of all components of indirect taxes with using A.R.Prest method for separating automatic from discretionary revenue changes. In his own words:

● "Excise duties constitute the third largest revenue earning source in the country. Proper implementation of the excise system will be able to bring a substantial amount to the government exchequer, which is around 11.5% of total revenue".

● "Sales Taxes are becoming one of the important sources of government revenue in Nepal. It is second largest source of the development budget, which is around 19.5% of total revenue".

● "Customs Duty is one most important source of the total revenue. Since one third of total revenue is collected from this source only. HMG has to devise the policy measures with almost care and clear objectives. While levying the customs duties a part from revenue considerations several other aspect like protection to the industries, incentive for future investments and conservation of foreign exchange should also carefully examined and it is around 35% of total revenue. The elasticity and buoyancy coefficient is 0.55and 1.37, and refers that customs duties is not progressive."

The conclusion of his study is that the share of indirect tax is very large, which is around 73% on the total revenue in which custom duty occupies first largest share then after sales tax and excise duties occupy second and third position in tax revenue in Nepal.

Kayastha (1974) has done research on 'Taxation of Income and Property in Nepal' in his MA dissertation in his won words "Of the traditional taxes, customs provides another important source of government revenue which before 1951 was one of the neglected source of income while historically land revenue tax was the most important tax in the country in recent years the receipts from this tax have been overshadowed by the returns from customs and excise duties, since the volume of Nepal's import and export is increasing from 1951. The demand of the Nepalese people to a wider variety and better quality consumer goods has increased to a great extent due to the inflow of Indian and US Aids. To meet this demand as well as for feeding the development projects, imports has gone up increasing the revenue from the custom duties".

From his findings we can conclude that indirect tax has dominant role in tax revenue. Nepal has low tax GDP ratio, the share of direct tax is decreasing. Similarly, the share of custom duty and excise duty are declining. However, it is very old research which can not explain current situation. Recent condition is some different due to trade liberalization and globalization policy which needs recent research

Khadka (2000) In his book 'The overall Nepalese tax system and tax administration' has examined different steps that are taken in the process of developing tax system in Nepal. Further he recommends some measure to design the tax system that is broad based, low rated, neutral, simple, and transparent and also some essential measures for the reform of tax administration are suggested.

He identified the current issues of Nepalese tax system a) lack of coordinated long term strategy b) narrow coverage c) artificial tax base d)defective oraganizational structure weak and traditional tax administration f) traditional and complex procedure g) effective local taxes. The study concludes that the tax officials are mostly responsible for the existing problems of tax system and the hesitation of the policy makers to take hard decision is also being boundary to clean the system.

The following steps are suggested to take in order to rationalize tax system a) adopt along –term coordination approach b) broaden the tax base c) rationalize the tax rates d) reforms the tax administration e) enhance the tax compliance f) implement local taxes. Along with there existing issues and suggestions the study considering these indirect tax in Nepal, states that there is no choice other than to mobilize resources through indirect tax in Nepal to generate revenue required for improving its deteriorating macro economic performance. Thee custom duty assists to protect infant industries VAT need not to fix arbitrary or artificial values for the tax purpose, which avoids the existing problems of corruption and non transparent. Excise duty restricts to produce the goods which are socially harmful. Achievement of these good features of indirect tax depends on its implementation, which are the major issues for its succession Nepalese context.

Pradhan (2004), "An excise tax is best seen as a trace commodity tax, rather than as a transaction upon the production of a commodity and collected at the factory rather than on the actual sale of commodity". Increase of our economy, excise duties are the fourth largest source of total tax revenue. They are levied on certain goods (Tobacco, alcohol, plastic, cement, vehicles) produced in the kingdom of Nepal either on advalorem or specific rate basis.

To sum, various studies have found the heterogeneous opinion towards the tax revenue but, all of them agree on the dominant role of indirect tax in resource mobilization in Nepal. However, this review discloses the fact that there has been no research which compares the structure of tax revenue and resource mobilization through indirect tax after restoration of democracy in 1990. Under an assumption that structure changes may have occurred in the revenue generation due to the different policies adopted by government of Nepal. So, this study will be concentrated at the potentialities and problems of resource mobilization through indirect taxation in Nepal after the restoration of democracy in 1990.

# CHAPTER THREE

# RESEARCH METHODOLOGY

## 3.1 Introduction

Taxes for the purpose of present study are taken to mean any compulsory payment without any direct quid-pro-quo. Accordingly, revenue sources of the government of Nepal, are shown under the heading of custom duties, excise duties, import duties, sales tax which are considered as indirect tax whereas income tax, land tax and registration tax are taken as direct tax. Remaining sources of revenue like fees, dividend, and penalty, fine are considered as non-tax revenue.

This chapter shows the techniques used by the investigator to attain the objectives of the study. It consists of Nature and sources of data, study period, method of processing and analysis.

## 3.2 Nature and Sources of Data

This study is based on secondary data which is collected from various sources. These sources consist of 'Rajaswa' a journal, published by Department of Inland Revenue; 'Economic Survey' published by MOF; 'Statistical Pocket Book' published by Central Bureau of Statistics; 'Budget Speech' published by MOF of various fiscal years, Nepal Rastra Bank Publications and other different reports and related published materials.

## 3.3 Study Period

The empirical analysis covers seventeen years period from FY 1990/91 to 2006/07, focusing on trend and structure of taxation and resource mobilization through indirect taxation after the restoration of a Multiparty Democracy to an establishment of Federal Democratic Republic Nepal. It is the matter of concern to all of us to study the government revenue. As indirect tax has dominant role in government revenue, this study is also concentrated on trend, problems and prospects of indirect tax in Nepal.

## 3.4 Method of Processing and Analysis

The collected data have been compiled and tabulated in different headings. These data have to be graphed into different way so as to make research understandable. Different statistical tools and techniques such as percentage ratio are included to craft the collected data so as to obtain desire objective**.** The general method of our study is concerned with graphical presentation and tabulation. Attempt has been made to present the sources and trend of indirect tax during the period of review (1990/91 to 2006/7). An analysis, trend, problems and prospects give a clear view of the resource gap in Nepal. The trend and pattern are presented using simple mathematical tools like average, ratio and percentage.

### 3.5 Tools used to analyze the Data

Under this study tools such as tax/GDP ratio, percentage, table, multiple bar diagram have been used which make easier to understand the trend of movement.

(a) Revenue Effort Ratio (TER)

The total revenue tax effort ratio is also knows as total revenue effort ratio and it shows a relationship between total revenue and GDP and defined as (Prest, 1985):

$$TER = \frac{TR}{Y}$$

where,

TER = Total revenue effort ratio;

TR = Total revenue;

Y = Gross domestic product (GDP).

(b) Total Tax Effort Ratio (TTER)

The total tax effort ratio shows a relationship between tax and GDP (income) and defined as (Prest, 1985):

$$TTER = TTR/Y$$

where,

TTE= Total tax effort ratio;
TTR= Total tax revenue;
Y= Gross domestic product (GDP).

(c) Non-tax Effort Ratio (NTER)

The non –tax effort ratio shows a relationship between non –tax and GDP and defined as (Prest, 1985):

$$NTER = \frac{NTR}{Y}$$

where,

NTR= Non –tax effort ratio;

NTR= Non –tax revenue;

Y= Gross domestic product (GDP).

(d) Direct Tax Effort Ratio (DTR)

The direct tax effort ratio is the relationship between direct tax and GDP and defined as (Singh, 1982):

$$DTER = \frac{DT}{Y}$$

where,

DTER= Direct tax effort ratio;

DT= Direct tax revenue;

Y= Gross domestic product (GDP);

(e) Indirect tax Effort Ratio (ITER)

Indirect tax effort ratio is the relationship between indirect taxes and GDP and defined as (Singh, 1982):

$$ITER = \frac{IDT}{Y}$$

where,

ITER = Indirect tax effort ratio;

IDT= Indirect taxes;

Y= Gross domestic product (GDP).

(f) Sales tax Effort Ratio or VAT Effort Ratio (STER/VAT)

The sales tax effort ratio is the relationship between sales taxes and GDP and defined as

$$STER = \frac{ST}{Y}$$

where,

STER = Sales tax effort ratio;

ST = Sales taxes.

(g) Excise Tax Effort Ratio (ETER)

The excise tax effort ratio is the relationship between excise taxes and GDP and defined as (Pant, 1985):

$$ETER = \frac{ET}{Y}$$

where,

ETER = Excise tax effort ratio;

ET = Excise taxes;

Y= Gross domestic product (GDP).

(h) Custom duties effort ratio is the relationship between customs duties and GDP and defined as:

$$CDER = \frac{CD}{Y}$$

where,

CDER = Customs duties effort ratio;

CD = Custom duties;

Y= Gross domestic product (GDP).

## CHAPTER FOUR

# TAX STRUCTURE IN NEPAL

### 4.1 Evolution of Taxation in Nepal

The history of taxation in Nepal dates back to antiquity. However, modern tax system begins with the advent of democracy and manifestation of first consolidated budget comprising revenue and expenditure of the kingdom of Nepal in 1951. So, attempts were made to rationalize the structure of Nepalese tax system after the introduction of a democracy in 1951. For this, contract system of collecting taxes was gradually replaced by the system of collecting taxes directly by the tax officials. Since 1951, tariff boards had been constituted at different times to provide suggestions to rationalize the customs schedule. The Excise Act 1958, the Custom Act 1962, and the Revenue Act 1964 were introduced in order to consolidate various excise, customs duties, and land revenue laws and unity tax systems throughout the country. Modern taxes like income tax, foreign investment tax, and urban house and land tax were introduced in 1959/60. Sales tax was introduced at the retail level in 1965/66 than moved to the wholesale level in 1968, and further shifted to the import /manufacturing point in 1974. VAT was introduced in 1997, in the place of the sales tax, hotel tax, entertainment tax, and contract tax, until now, several new taxes have been included in the Nepalese tax family after 1951, a few taxes were abolished and some of the abolished taxes were reinstated over the years (Khadka, 2000).

Nepal's tax system is circumscribed by serious structural constraint. The major constraint existing in the tax system is that it lacks simplicity and transparency (Dahal, 1999). 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 regulation, and numerous tax shelters, taxation in Nepal has so far been attributed to 'negotiations', resulting in rampant corruption. Tax avoidance, evasion and delinquency have also increased substantially over the year. This is one of the critical reasons, why the number of taxpayers as of Rs. 1997/98 confined to Rs. 309,665 i.e. Just over 1 percent of the total population (MOF 2000/2001).

## 4.2 Total Revenue

The Total revenue is composed by total tax and total non tax revenue. The trend and share of tax and non tax revenue on total revenue during the period 1990/91-2006/07 has been described with the help of table 4.1.

Table 4.1: Composition of Total Revenue (1990/91-2006/07) (Rs. in Million)

| F/Y | Tax revenue | | Non-tax revenue | | Total revenue | |
|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % |
| 1990/91 | 8176.3 | 76.2 | 2553.6 | 23.8 | 10729.9 | 100.0 |
| 1991/92 | 9875.6 | 73.1 | 3637.1 | 26.9 | 13512.7 | 100.0 |
| 1992/93 | 11662.5 | 77.0 | 3485.9 | 23.0 | 15148.4 | 100.0 |
| 1993/94 | 15371.5 | 78.5 | 4209.4 | 21.5 | 19580.9 | 100.0 |
| 1994/95 | 19660.0 | 79.9 | 4945.1 | 20.1 | 24605.1 | 100.0 |
| 1995/96 | 21668.0 | 77.7 | 6225.1 | 22.3 | 27893.1 | 100.0 |
| 1996/97 | 24424.3 | 80.4 | 5949.2 | 19.6 | 30373.5 | 100.0 |
| 1997/98 | 25940.0 | 78.8 | 6998.0 | 21.3 | 32938.0 | 100.0 |
| 1998/99 | 28753.0 | 77.2 | 8498.1 | 22.8 | 37251.0 | 100.0 |
| 1999/00 | 33152.1 | 77.3 | 9741.6 | 22.7 | 42894.0 | 100.0 |
| 2000/01 | 38865.1 | 79.5 | 10028.8 | 20.5 | 48894.0 | 100.0 |
| 2001/02 | 39330.6 | 78.0 | 11115.0 | 22.0 | 50446.0 | 100.0 |
| 2002/03 | 42587.0 | 75.7 | 13642.7 | 24.3 | 56229.7 | 100.0 |
| 2003/04 | 48173.0 | 77.3 | 14158.0 | 22.8 | 62331.0 | 100.0 |
| 2004/05 | 54104.7 | 77.2 | 16018.0 | 22.8 | 70123.0 | 100.0 |
| 2005/06 | 57430.4 | 79.4 | 14851.7 | 20.6 | 72282.1 | 100.0 |
| 2006/07 | 71126.7 | 81.1 | 16585.5 | 19.9 | 87712.1 | 100.0 |

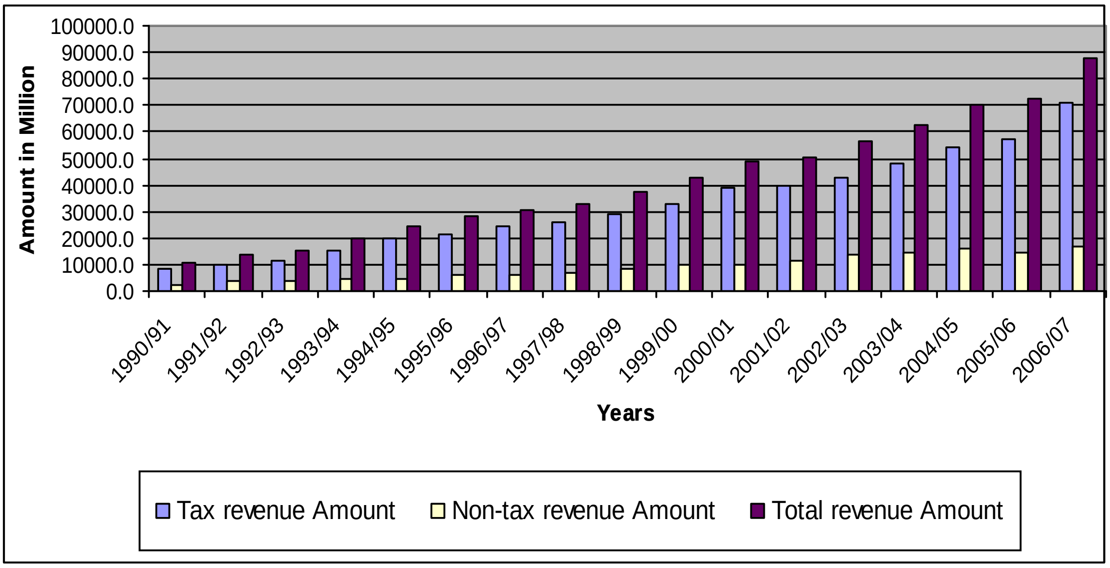
Source: MOF 1998; MOF 2008

The magnitude of total revenue as well as tax and non tax revenue is shown in table 4.1. In fiscal year 1990/91, the total revenue was Rs. 10729.9 millions in which the share of tax and non tax revenue was 76.2% and 23.8% respectively. In fiscal year 1999/2000 the total revenue was Rs. 43289.7 millions in which the share of tax and non tax revenue was 77.5% and 22.5% respectively. Similarly, in fiscals year 2006/07 the total revenue increased to Rs; 87712.1 millions in which the share of tax and non tax revenue was 81.1 and 19.9 percent respectively. Thus total revenue of government increased from Rs. 10729.9 to Rs. 87712.1 during study period. The percentage share of tax revenue on total revenue increased from 76.2 percent in FY 1990/91 to 81.1 percent in FY 2006/07.

The amount of total revenue is in increasing trend. The trend of total tax revenue on total revenue is also in slightly increasing trend because the consumption of consumers is increasing with the increase in income level of people. But the share of non tax revenue on tax revenue is very low which is in slightly decreasing trend during the study period. The table reveals that tax is the most important instrument for domestic resource mobilization.

All the matters described in table 4.1 also can be described with the help of figure 4.1 in which total amount is measured in Y axes where as year is measured in X axis.

Graph 4.1: Composition of Total Revenue (1990/91-2006/07)




Source: MOF 1998; MOF 2008

Figure 4.1 shows the amount of tax and non tax revenue in total revenue. Amount of tax, non tax and total revenue are in increasing trend. The tax revenue is higher than the of total non tax revenue.

## 4.3 Tax Revenue and its Magnitude

Total tax revenue is very important instrument mobilizing domestic resources in Nepal. Total tax revenue is composed of direct and indirect tax revenue. Indirect tax plays an important role in resource mobilization in Nepal. The trend of direct tax and indirect tax revenue on total tax revenue can be described with the help of table 4.2.

Table 4.2: Composition of Tax Revenue (1990/91-2006/07) (Rs. in Million)

| FY | Direct tax | | Indirect tax | | Total tax revenue | |
|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % |
| 1990/91 | 1368.6 | 16.7 | 6807.7 | 83.2 | 8176.3 | 100 |
| 1991/92 | 1595.2 | 16.1 | 8280.4 | 83.8 | 9875.6 | 100 |
| 1992/93 | 2036.2 | 17.4 | 9626.8 | 82.3 | 1166.5 | 100 |
| 1993/94 | 2855.3 | 18.5 | 12516.0 | 81.4 | 15372.0 | 100 |
| 1994/95 | 3849.0 | 19.5 | 15811.0 | 80.4 | 19660.0 | 100 |
| 1995/96 | 4655.9 | 21.5 | 17012.0 | 78.5 | 21668.0 | 100 |
| 1996/97 | 5340.1 | 21.8 | 19084.0 | 78.2 | 24424.0 | 100 |
| 1997/98 | 6013.1 | 23.2 | 19927.0 | 76.8 | 25940.0 | 100 |
| 1998/99 | 7516.1 | 26.1 | 21237.0 | 73.8 | 28753.0 | 100 |
| 1999/00 | 8951.5 | 27.0 | 24201.0 | 73.0 | 33152.0 | 100 |
| 2000/01 | 10159.0 | 26.1 | 28706.0 | 73.8 | 38865.0 | 100 |
| 2001/02 | 10598.0 | 26.9 | 28733.0 | 73.0 | 39331.0 | 100 |
| 2002/03 | 10106.0 | 23.7 | 32481.0 | 76.2 | 42587.0 | 100 |
| 2003/04 | 11913.0 | 24.7 | 36260.0 | 75.2 | 48173.0 | 100 |
| 2004/05 | 13072.0 | 24.2 | 41839.4 | 75.8 | 54105.0 | 100 |
| 2005/06 | 13968.0 | 24.3 | 43462.0 | 75.6 | 57430.0 | 100 |
| 2006/07 | 18980.0 | 26.7 | 52146.0 | 73.3 | 71127.0 | 100 |

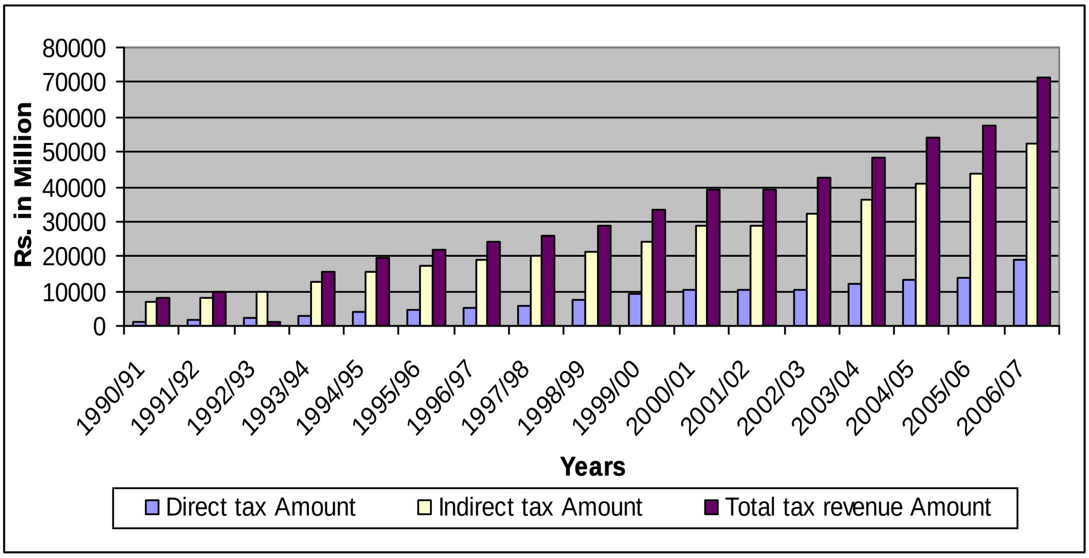
Source: MOF 1998; MOF 2008

Table 4.2 shows a composition of total tax revenue and the share of direct and indirect tax in total tax revenue. During the study period, the share of direct tax revenue in total tax revenue is increasing from 16 percent to nearly 27 percent. As shown in the table total tax revenue was Rs 8176.3 millions in 1990/91 which increased to Rs 33548.1 million in 1999/2000 and 71126.7 million in FY 2006/07. Thus total tax revenue is moving in increasing trend during the study period. From the table 4.2, the share of indirect tax on total tax revenue is significantly higher than the direct tax revenue. In FY 1990/91 the share of indirect and direct tax revenue is 83 and nearly 17 percent respectively. In FY 1997/98 the share of indirect and direct tax to total tax revenue was 77 and 23 percent respectively. Similarly in FY 1998/99, 1999/00, 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06 and in 2006/07 the share of indirect and direct tax is 74 and 26, 73 and 27, 74 and 26, 73 and 27, 76 and 24, 75 and 25, 76 and 24, 76 and 24, 73 and 27respectively.

The importance of higher share of direct tax in total tax revenue is that it is more progressive and equity is best served. Economists like Goode (1986) believes that indirect taxes, which are a major source of revenue in LDCs, tend to be regressive with respect to income for two reasons: first, total consumption of households are a declining fraction of income for successively higher income classes. Second expenditures on some heavily taxed items such as tobacco and beer often are a declining fraction to total consumption as income rises. Thus, progression is achieved only through direct taxes and the progressive tax rates are fair. Another possible cause in reduction in the share of indirect tax is liberalization policy in world trade and implementation of value added tax in Nepal.

With the help of table 4.2, a figure has been illustrated which shows the share of indirect tax and direct tax in government tax revenue.

Figure 4.2: Composition of Tax Revenue (1990/91-2006/07)




Source: MOF 1998; MOF 2008

The figure shows the composition of tax revenue according to which the amount of indirect tax revenue is quite higher than the amount of direct tax revenue. The share of direct tax is less than the share of indirect tax. The amount of direct and indirect tax is moving in increasing trend but the share of indirect tax is moving in decreasing trend.

### 4.3.1 Direct Tax and its Magnitude

Direct tax is composed of land revenue and registration, tax on profit, tax on property, and income. However, amount of direct tax, income tax, land tax, house and land and registration and others tax 1990/91-2006/07 has been described with the help of table 4.3.

Table 4.3: Direct Tax and its Magnitude (1990/91-2006/07) (Rs in Million)

| FY | Direct Tax | Income Tax (IT) | Land Tax (LT) | House & Land Registration (HLR) | Others |
|---|---|---|---|---|---|
| 1990/91 | 1370.0 | 745.9 | 82.10 | 456.6 | 85.4 |
| 1991/92 | 1595.0 | 855.4 | 64.80 | 571.2 | 103.6 |
| 1992/93 | 2036.0 | 1124.8 | 69.30 | 682.5 | 159.4 |
| 1993/94 | 2855.0 | 1824.5 | 61.00 | 772.2 | 197.3 |
| 1994/95 | 3795.0 | 2823.5 | 34.90 | 902.8 | 33.8 |
| 1995/96 | 4585.0 | 3431.4 | 18.20 | 1048.4 | 87.0 |
| 1996/97 | 5234.0 | 4123.3 | 5.90 | 1010.0 | 89.7 |
| 1997/98 | 6013.0 | 4898.1 | 3.60 | 1000.6 | 110.7 |
| 1998/99 | 7516.1 | 6170.0 | 1.40 | 1001.8 | 342.9 |
| 1999/00 | 8931.5 | 7420.6 | 0.70 | 1011.3 | 498.9 |
| 2000/01 | 10159.4 | 8650.1 | 5.10 | 607.8 | 896.4 |
| 2001/02 | 10597.0 | 8436.0 | 0.80 | 1131.0 | 1029.2 |
| 2002/03 | 10105.8 | 7102.2 | 0.00 | 1414.3 | 1589.3 |
| 2003/04 | 11912.6 | 8512.5 | 0.00 | 1697.5 | 1702.6 |
| 2004/05 | 12265.4 | 4664.3 | 0.00 | 1799.2 | 5801.9 |
| 2005/06 | 13968.0 | 5829.7 | 0.00 | 2181.1 | 5957.2 |
| 2006/07 | 18980.0 | 6254.1 | 0.00 | 2253.5 | 10482.4 |

Source: MOF 1998; MOF 2008

Table 4.3 shows the amount of income tax and land & house have been increasing but at the same time the contribution of land tax has been declining during the study period. In FY 1990/91 the amount of income tax, land tax, house and registration tax were Rs.745.9, Rs 82.1, Rs 456.6, Rs 85.4 respectively. But by the FY 2002/03 the amount of land tax is zero.

### 4.3.2 Indirect tax and its Magnitude

Indirect tax is composed of two major sources of tax in Nepal: Customs duty and tax on consumption and production. Tax on consumption and production further can be divided into VAT and excise tax. So VAT, Custom and excise duty are the component of indirect tax revenue. Table 4.4 shows the share of VAT, custom and excise duty during the period (1990/91-2006/07).

Table 4.4: Indirect Tax and its Magnitude (1990/91-2006/07) (Rs in Million)

| FY | Indirect Tax | Custom Duties | | Excise Duties | | Sales Tax/VAT* | |
|---|---|---|---|---|---|---|---|
| | | Amount | % | Amount | % | Amount | % |
| 1990/91 | 6806.6 | 3044.3 | 44.73 | 1200.3 | 17.6 | 2527.9 | 37.1 |
| 1991/92 | 8280.4 | 3358.9 | 40.56 | 1414.4 | 17.0 | 3461.7 | 41.8 |
| 1992/93 | 9626.3 | 3945 | 40.98 | 1452.8 | 15.0 | 4213.4 | 43.7 |
| 1993/94 | 12516.0 | 5255 | 41.99 | 1592.2 | 12.7 | 5551.5 | 44.3 |
| 1994/95 | 15865.0 | 7018.1 | 44.24 | 1657.3 | 10.4 | 7135.6 | 44.9 |
| 1995/96 | 17083.0 | 7327.4 | 42.89 | 1944.3 | 11.3 | 7739.8 | 45.3 |
| 1996/97 | 19191.0 | 8309.1 | 43.3 | 2298.1 | 11.9 | 8477.6 | 44.1 |
| 1997/98 | 19927.0 | 8502.2 | 42.67 | 2885.8 | 14.4 | 8364.4 | 41.9 |
| 1998/99 | 21236.8 | 9517.7 | 44.82 | 2953.2 | 13.9 | 8765.7 | 41.2 |
| 1999/00 | 24200.6 | 10813.3 | 44.68 | 3127.6 | 12.9 | 10665.0 | 44.0 |
| 2000/01 | 28705.7 | 12552.1 | 43.73 | 3771.2 | 13.1 | 12717.0 | 44.3 |
| 2001/02 | 28733.1 | 12658.8 | 44.06 | 3807.0 | 13.2 | 12570.6 | 43.7 |
| 2002/03 | 32481.2 | 14236.4 | 43.83 | 4785.1 | 14.7 | 13459.7 | 41.4 |
| 2003/04 | 36260.4 | 15554.8 | 42.9 | 6226.7 | 17.2 | 14478.9 | 39.9 |
| 2004/05 | 41839.4 | 15701.6 | 37.53 | 6445.9 | 15.4 | 18885.4 | 45.1 |
| 2005/06 | 43462.0 | 15343.6 | 35.30 | 6507.6 | 14.9 | 21613.0 | 49.7 |
| 2006/07 | 52146.0 | 16707.6 | 32.03 | 9343.2 | 17.9 | 26095.6 | 50.0 |

* VAT has been introduced form 1997 instead of sales tax

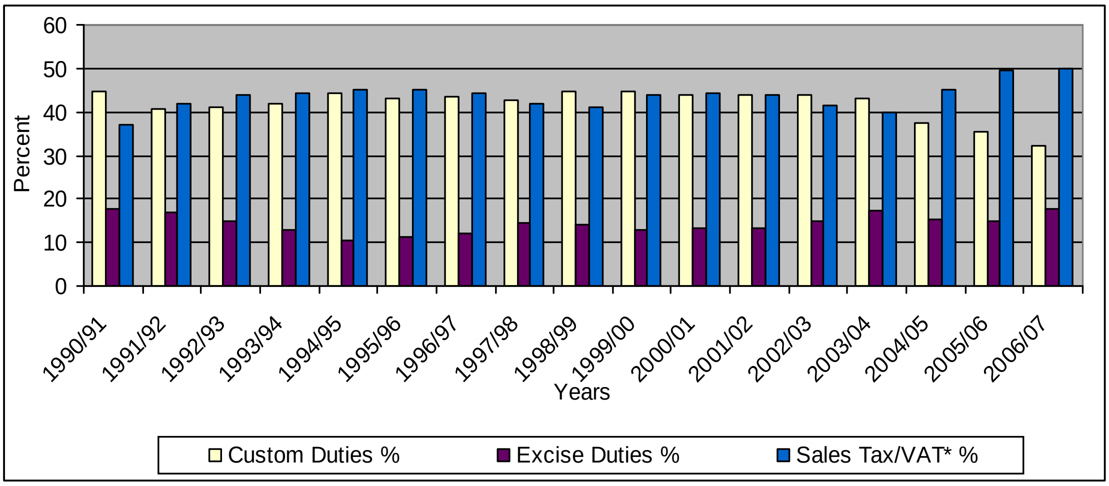
Source: MOF 1998; MOF 2008

Table 4.4 reveals that percentage share of custom, VAT and excise duties in indirect tax are 45, 18, 37 percent respectively in FY 1990/91 in which the share of custom duty occupies highest position. It reveals among custom excise and sales tax revenue, custom duty was the major source revenue in indirect tax. In FY 1994/95, the share of custom and Sales tax were 44 and 45 percent respectively which were nearly equal. The share of custom duty and sales tax revenue remained nearly equal up to FY 2001/02. Then after the share of custom duty began to decline and remained at 32 percent in FY 2006/07. Where as VAT increased and reached to 50 percent in the same year. Sales tax was converted into VAT in 1997. After the implementation of VAT, it began to lead among the share of components of indirect tax. However, the excise tax had lowest share among the components of indirect tax. It did not have any fix trend. The share of excise was nearly equal at 17 percent in FY 1990/91and

2006/07. The share of excise duty could not increase properly the possible reasons are lack of information and technical problems and lack of transparent tax administration.

As a whole, the share of custom duty in the study period is in decreasing trend. It decreased from 45 percent to 32 percent. The major cause of decline in the share of custom duty in indirect tax revenue is trade liberalization policy adopted by the government and implementation of VAT in Nepal. There is slight change in the share of excise duty during the study period. Share of VAT revenue has increased from 37 percent to 50 percent during the study period. The implementation of VAT and trade liberalization policy reduced the share of custom duty and increased the share of VAT in indirect tax during the study period. The share of VAT is highest and the share of excise duty is lowest in FY 2006/07. Figure 4.3 shows the percentage share VAT, custom and excise duty in indirect tax in Nepal.

Graph 4.3: Composition of Indirect Tax Revenue (1990/91-2006/07)




Source: MOF 1998; MOF 2008

Figure 4.3 reveals the share of custom, excise and VAT in indirect tax among which the share of VAT and custom duty are equal up to FY 2004/05 the after VAT is in increasing trend, the share of custom is in decreasing trend and share of excise is nearly constant. The share of custom duty had leading position in the beginning of the study where as the share of custom VAT played leading role in the ending of the study. In the light of liberal economic policies adopted by Nepal Government from 1992/93, and rates fixed in the line of other trading partners, Nepal have to become less dependent on customs duty and find other reliable and new source of revenue.

## 4.4 Tax and Non tax Effort Ratio

The tax effort ratio is defined as the relationship between tax and gross domestic product (Dahal, 1999). Tax-GDP ratio or average tax is defined as a simple ratio between total tax revenue to total output (GDP). In other words, it is total tax liability to total tax base. It is considered as the most straight- forward measure to compare international taxable capacity. It indicates the feasibility of change in the taxable capacity. In other words, it provides information about the capacity of countries to respond fiscal problems by raising the level of taxation. In absence of other more reliable indicator of the utilization of the taxable capacity, the ratio of tax to GDP (tax /GDP) has been used in assessing the fiscal performance in almost all the countries. It is often believed that the tax-GDP ratio generally increases with the increase in per capita income. However, it is not true in many cases as well. In Nepal, the tax–GDP ratio is increasing comparatively at very low rate as compared to the rise in gross domestic product because the income level of Nepalese is very low. On this basis, these could be interpreted that there exists substantial scope for further taxation in Nepal as the country's tax–GDP ratio is below taxable capacity (Kayastha, 1986). The tax effort ratio shows the burden of tax. In this study, various tax effort ratios have been calculated with respect to GDP

In this study, the various study of tax effort ratio has been calculated with respect to GDP. Table 4.5 shows percentage share of tax/GDP ratio, total revenue/GDP ratio and non tax/GDP ratio.

Table 4.5: Tax and Non tax Effort Ratio in Nepal (1990/91-2006/07) (Rs. in Million)

| FY | GDP | Actual Total Revenue | TR as % of GDP | Actual TTR | TTR as % of GDP | Actual NTR | NTR as % of GDP |
|---|---|---|---|---|---|---|---|
| 1990/91 | 116127 | 10729.9 | 9.2 | 8176.3 | 7.0 | 2553.6 | 2.2 |
| 1991/92 | 144933 | 13512.7 | 9.3 | 9875.6 | 6.8 | 3637.1 | 2.5 |
| 1992/93 | 165350 | 15148.4 | 9.2 | 11662.5 | 7.1 | 3485.9 | 2.1 |
| 1993/94 | 191596 | 19580.9 | 10.2 | 15371.5 | 8.0 | 4209.4 | 2.2 |
| 1994/95 | 209976 | 24605.1 | 11.7 | 19660.0 | 9.4 | 4945.1 | 2.4 |
| 1995/96 | 239388 | 27893.1 | 11.7 | 21668.0 | 9.1 | 6225.1 | 2.6 |
| 1996/97 | 269570 | 30373.5 | 11.3 | 24424.3 | 9.1 | 5949.2 | 2.2 |
| 1997/98 | 289798 | 32938 | 11.4 | 25940 | 9.0 | 6998 | 2.4 |
| 1998/99 | 330018 | 37251 | 11.3 | 28752.9 | 8.7 | 8498.1 | 2.6 |
| 1999/00 | 366251 | 42894 | 11.7 | 33152.1 | 9.1 | 9741.6 | 2.7 |
| 2000/01 | 394052 | 48894 | 12.4 | 38865.1 | 9.9 | 10028.8 | 2.5 |
| 2001/02 | 406138 | 50446 | 12.4 | 39330.6 | 9.7 | 11115 | 2.7 |
| 2002/03 | 437546 | 56229.7 | 12.9 | 42587 | 9.7 | 13642.7 | 3.1 |
| 2003/04 | 448655 | 62331 | 13.9 | 48173 | 10.7 | 14158 | 3.2 |
| 2004/05 | 461455 | 70123 | 15.2 | 54104.7 | 11.7 | 16018 | 3.5 |
| 2005/06 | 480416 | 72282.1 | 15.0 | 57430.4 | 12.0 | 14851.7 | 3.1 |
| 2006/07 | 492335 | 87712.1 | 17.8 | 71126.7 | 14.4 | 16585.5 | 3.4 |

Source: MOF 1998; MOF 2008

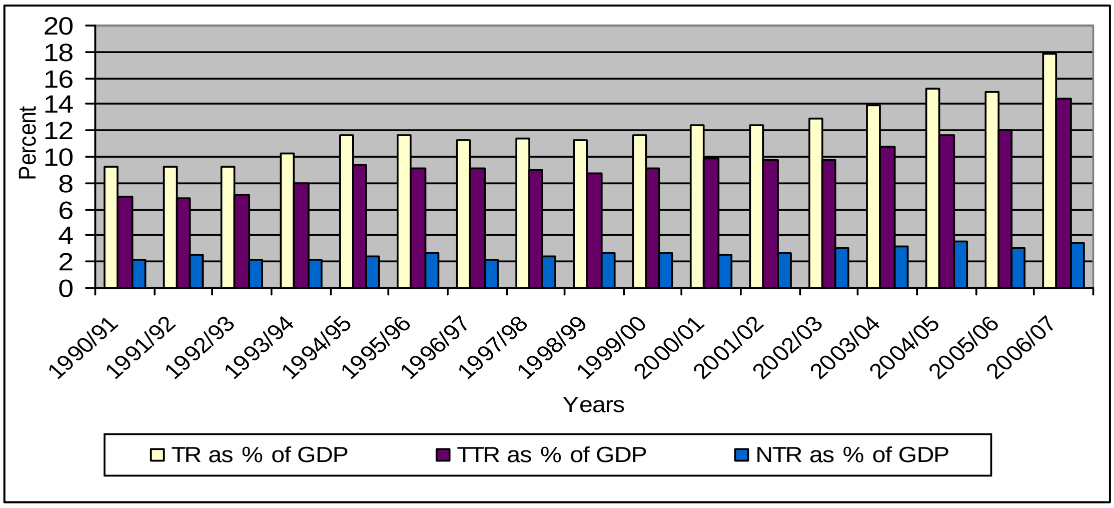
Table 4.5 shows the tax and non tax effort ratio (non tax /GDP ratio) of various years such as total revenue effort ratio, tax effort ratio direct tax effort ratio, indirect tax effort ratio of the period 17 years from FY 1990/91 to 2006/07. The total revenue effort ratio was 9 percent in FY 1990/91 it increased to 18 percent in 2006/07. 18 percent was the highest percentage share of total revenue in GDP during the study period because tax of consciousness of responsibility of paying tax. The tax effort ratio was 15 percent in FY 2004/05 but it slightly decreased at 15 percent in FY 2005/06 the possible reason were unfavorable economic environment, ineffective tax administration and trade liberalization. As a whole, total revenue/GDP ratio moved in increasing trend during the study period because of increase in income, consumption of people, public consciousness on tax paying responsibility. The non-tax effort ratio was 2.2 percent in FY 1990/01 and it slightly increased to 3.4 percent in FY 2006/07.

The share of non tax/GDP ratio is bery low because income level of people is very low.

Table 4.5 shows the tax/GDP ratio. In FY 1990/91 GDP tax effort ratio was 7 percent which increased to 14. percent in FY 2006/07. In FY 2000/01 the ratio is 9.9 which remained constant for three fiscal years 1990/91, 1991/02 and 1992/93. The share of total tax revenue is in increasing trend during the study period because of increase in consumption, implementation of VAT, people's consciousness and improved tax policy. Another possible cause is that the responsibility of the government is increasing continuously to perform her obligatory and optional function government had to collect more revenue.

With the help of table 4.5 a figure 4.4 has been illustrated to describe the tax and non tax effort ratio in Nepal.

Figure 4.4: Share of Tax and Non-Tax Revenue in GDP (1990/91-2006/07)




Source: MOF 1998; MOF 2008

It can be explained from multiple bar diagram 4.4 that the share of total revenue, tax revenue and non tax revenue in GDP is very low. Total tax effort ratio is moving in slightly increasing trend. However the non tax effort ratio is moving in almost constant trend. It also reveals that the share of tax effort ratio is higher than the share of non tax effort ratio. The possible reason is low income level people.

### 4.6.2 Direct Tax and Indirect Tax Effort Ratio

Direct tax ratio and indirect tax ratio provides vital information about the capacity of the country to respond to fiscal problems by raising the level of direct tax and indirect tax. In most of developing countries, the contribution of indirect tax has always been more than the contribution of direct tax to the total tax revenue because per capita of income in developed country is higher, they are very rich. So, they have high degree of potentiality of paying direct tax. However, the situation of developing country is just opposite. Table 4.6 shows the share of direct tax and indirect tax in GDP of the period between F/Y 1990/91 to 20006/07.

Table 4.6: Direct and Indirect Tax Effort Ratio (Rs. in Million)

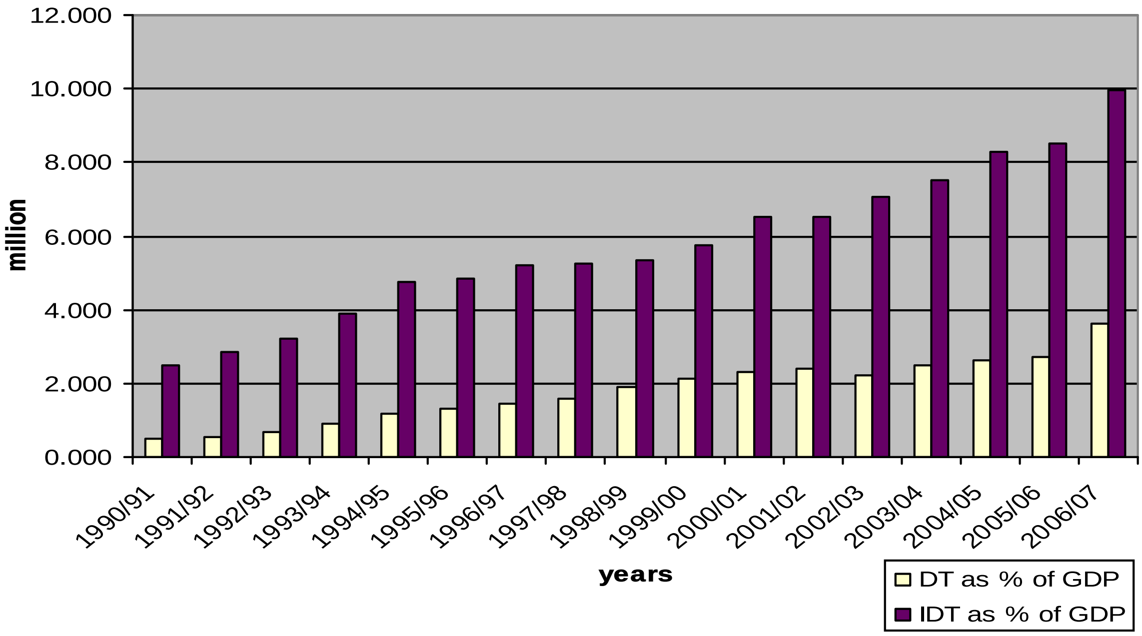
| FY | GDP | Direct tax | DT as % of GDP | Indirect tax | IDT as % of GDP |
|---|---|---|---|---|---|
| 1990/91 | 116127 | 1370.0 | 1.2 | 6806.6 | 5.9 |
| 1991/92 | 144933 | 1595.0 | 1.1 | 8280.4 | 5.7 |
| 1992/93 | 165350 | 2036.0 | 1.2 | 9626.3 | 5.8 |
| 1993/94 | 191596 | 2855.0 | 1.5 | 12516.0 | 6.5 |
| 1994/95 | 209976 | 3795.0 | 1.8 | 15865.0 | 7.5 |
| 1995/96 | 239388 | 4585.0 | 1.9 | 17083.0 | 7.1 |
| 1996/97 | 269570 | 5234.0 | 2.0 | 19191.0 | 7.1 |
| 1997/98 | 289798 | 6013.0 | 2.1 | 19927.0 | 6.9 |
| 1998/99 | 330018 | 7516.1 | 2.3 | 21236.8 | 6.4 |
| 1999/00 | 366251 | 8931.5 | 2.4 | 24200.6 | 6.6 |
| 2000/01 | 394052 | 10159.4 | 2.6 | 28705.7 | 7.3 |
| 2001/02 | 406138 | 10597.0 | 2.6 | 28733.1 | 7.1 |
| 2002/03 | 437546 | 10105.8 | 2.3 | 32481.2 | 7.4 |
| 2003/04 | 448655 | 11912.6 | 2.7 | 36260.4 | 8.1 |
| 2004/05 | 461455 | 12265.4 | 2.8 | 41839.4 | 8.9 |
| 2005/06 | 480416 | 13968.0 | 2.9 | 43462.0 | 9.0 |
| 2006/07 | 492335 | 18980.0 | 3.9 | 52146.0 | 10.6 |

Source: MOF 1998; MOF 2008

The share of direct tax and indirect tax in GDP was 1.2 and 5.9 percent respectively in FY 1990/91. It was very low share of direct and indirect tax in GDP. The possible causes are lack of feeling of responsibility of citizens to pay tax, low gross domestic production. The share of DT and IT both are moving in increasing trend in the study period and reached up to 4 and nearly 11 percent respectively in FY 2006/07. The share of direct tax and indirect tax increased because government revised tax policy several time so that, she could impose higher revenue through tax, advertisement of tax through media, Direct tax/GDP ratio is 2 percent in FY 1995/96 which slightly increased and reached to 4 percent in FY 2006/07. It is the highest percent during the study period because tax effort ratio is going increasing year by year. Direct tax effort ratio increased from 1 percent to 4 percent during the study period due to the increase in gross domestic production and public consciousness. The indirect tax effort ratio is 6 percent in FY 1990/91 and it reached 11 percent in FY 2006/07.

Direct tax and indirect tax have been moving in increasing trend. However, indirect tax effort ratio is higher than direct tax effort ratio possible causes are: i) People have low level of income. ii) Tax payer feel direct burden paying direct tax. iii) Consumption of consumers is increasing iv) Tax payers do not feel burden directly when paying indirect tax. On this basis, we can conclude that the level of direct tax and indirect tax ratio in Nepal is very low and there exists substantial scope for further taxation as the average tax ratio is below the taxable capacity. Figure 4.5 shows the share of direct tax and indirect tax in total GDP.

Figure 4.5: Direct and Indirect Tax Effort Ratio (1990/91-2006/07)




Source: MOF 1998; MOF 2008

On the basis of the figure 4.5, it can be explained that direct tax/GDP ratio and indirect tax/GDP ratio are in increasing trend but they are very low. The percentage share of direct tax is lower than the percentage share of indirect tax. The share of indirect tax is 8 percent in FY 2006/07 where as percentage share of direct tax is less than half of share of indirect tax in the same year. The possible causes of lower share of direct tax are low level income people, ineffective administration and lack of public consciousness.

From the study of Structure of tax in Nepal, it can be explained that tax and non-tax are the two major sources of revenue of government. The share of tax revenue is higher than the share of non-tax revenue in Nepal. Total tax is composed of direct tax and indirect tax in which the share of indirect tax is higher than the share of direct tax. Though the Tax/GDP ratio is in increasing trend in Nepal, it is very low which need to be increased. Being a poor and underdeveloped country, it is unable to increase the sources of revenue as it requires.

# CHAPTER FIVE

# TREND OF RESOURCE MOBILIZATION TROUGH INDIRECT TAX IN NEPAL

Indirect tax is a very powerful missile of fiscal policy in developing countries. For the better collection of indirect tax there should be sound trade transition in a country. Trade transaction helps more in indirect tax revenue collection. Indirect tax can be raised from foreign trade as well as domestic trade. Value Added Tax (VAT) is more general with indirect tax in relation to domestic trade in comparison to foreign trade. Value Added Tax is imposed only in the value added at particular stage in production and distribution. Custom duty is imposed upon the importation and export of goods. Custom duties enter the development world as supplements to the prices of imported finished products and imported inputs.

## 5.1 Historical Background:

The history of the taxation is as long as the history of man. In early days, taxes were colleted by tribe rulers and community heads. To perform these works, they used to take cattle from animal products, crops from agricultural products and gold, silver and copper from trade. According to Ancient Hindu tax system, it was based on the theory such as the water of the earth goes in the sky due to heat of the sun and latter it rains again on the earth. This is why the people were eager to pay the tax. (Agrawal, 1978), The Hindu theory of taxation is of immense importance from the constitutional point of view. Taxes had been fixed by a law and scales had been embodied in the sacred common law. The consequences was that whatever the form of government, the matter of taxation laws not an object of ruler. No friction could therefore legally arise between the crown and the people on the question of taxation.

Classical economists were against of government intervention. They adopted the Laissez Faire economy. They suggested collecting tax only for maintaining peace and security. It was regarded as a sort of hail that destroys part of the crops. Thus they were infavour of surplus budget. However, after the great depression of 1930s Keynes suggested to present big size of budget to enhance effective demand. It was possible only through government intervention (Singh, 1982).

In the context of Nepal, there was no hard and fast rule relating to taxation during the Rana Regime. The main aim of the ruler was to earn as much as they could by taxing people. The amount was always kept hidden. The chief sources of revenue in the Rana Nepal (1846-1950) were land tax, custom and excise duties, royalties on felling of trees, royalty on supply of porters and soldiers, entertainment tax and few other minor taxes. During this period, the taxes that suited the objectives, needs and whims of the prime minister were on l6 imposed and no need was felt for the development of effective revenue administration system (Agrawal, 1978).

The main source of revenue in Rana Nepal based mainly on agriculture which occupied about three-fourth of the total revenue during this period. During this period, the main sources of revenue consisted of traditional items and no need was felt for the development of effective revenue administration system.

Since 1951, tariff boards has been constituted at different times to provide suggestion to rationalize the customs schedule .The Excise Act 1958, the Custom Act 1962, and the Land Revenue Act 1964, were introduced in order to consolidate various excise, custom duties, land revenue laws, and unify tax system throughout the country. Modern taxes like income tax, foreign investment tax, urban house and land tax, were introduced in 1959/60.Sales tax was introduced at the retail level in 1965/66, then moved to the wholesale level in 1968, and further shifted to the import manufacturing point in 1974. VAT was introduced in 1997, in the place of the sales tax, hotel tax, entertainment tax, Air flight tax and contract tax. Up to now several new taxes were included in the Nepalese tax family after 1951, a few taxes were abolished and some of the abolished taxes were restarted over the year. However, various reforms have been initiated to improve the quality of services in tax administration, making the administration taxpayer friendly and increasing the revenue yield required for meeting expenses of various development activities.

The objectives of the Tenth plan (2002-07) were to increase revenue elasticity by broadening tax base, maximum mobilization of domestic resource and gradually reducing dependency on foreign assistance (Tenth plan, 2002). The quantitative targets during the plan period refers to that revenue to GDP ratio would be 14.0 percent, while the share of direct tax, indirect tax, and non- tax revenue to GDP would mark 3.5, 7.7, and 2.8 percent, respectively. The number of income tax payer will be increased to 300,000 and size of VAT registered taxpayers will reach 40,000. Non-tax revenue will be increased through reforms in dividends and loan investment. Administrative and legal reform will carry on making tax administration simple, transparent and perfect.

In recent years, government of Nepal has made tremendous efforts to mobilize internal revenue through improving tax system in various ways. There could be summarized as (a) implementation of VAT project in cooperation with DANIDA.(b) implementation of Income tax Administration Consolidation (ITAC) project in cooperation with GTZ. (c) implementation of Automated System for Custom Data and Account(ASYCUD) project in the department of custom in cooperation with(UNCTAD) .(d) enactment of local self Government Act 1999 and local self Government Regulation 1999.(e) setting up of the Revenue Advisory Board. (f) Establishment of the Local Authority Fiscal Commission (LAFC)

A majority of the taxpayers are ignorant of existing laws and regulations and various circulation frequently issued by the tax authorities. The increasing use of discretionary power by the authority for the assessment has been perennial sources of corruption. There is apprehension that the taxpayer is 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 taxpayer and tax officials. The tax administration in Nepal appears to be inefficient, indifferent, and corruption. In fact, corruption has weakened the tax base. Nepal is also considered as place for 'tax have'. The major challenge facing Nepal's tax administration is: how is identify the taxpayers that are still unrecorded and being them in to tax net, thereby improving voluntary compliance.

**5.2 Composition of Indirect Tax**

Many economists believe that indirect tax has an adverse affects on savings, investment, consumption, production and distribution of wealth. However, the fact is that in LDCs like Nepal, indirect taxes are the major sources of tax revenue. This is because indirect tax can be easily collected through the producers and sellers. It is also used in LDCs for curtailing luxury consumption (which are usually imported) and encouraging savings and capital investment. In the context of Nepal, the government generates indirect tax from custom duty and tax on consumption production as indirect tax. Composition of indirect tax from FY 1990/91 to 2006/07 has been shown in the table 5.1.

Table 5.1: Composition of Indirect Tax (1990/91-2006/07) (Rs. in million)

| FY | Indirect tax | Custom Duties | | Tax on Consumption and Production | |
|---|---|---|---|---|---|
| | | Total | Custom as % of IT | Total | As % of IT |
| 1990/91 | 6806.6 | 3044.3 | 44.73 | 3763.4 | 55.3 |
| 1991/92 | 8280.4 | 3358.9 | 40.56 | 4921.5 | 59.4 |
| 1992/93 | 9626.3 | 3945.0 | 40.98 | 5681.3 | 59.0 |
| 1993/94 | 12516.0 | 5255.0 | 41.99 | 7261.2 | 58.0 |
| 1994/95 | 15865.0 | 7018.1 | 44.24 | 8792.6 | 55.6 |
| 1995/96 | 17083.0 | 7327.4 | 42.89 | 9684.7 | 56.3 |
| 1996/97 | 19191.0 | 8309.1 | 43.3 | 10775.2 | 56.5 |
| 1997/98 | 19927.0 | 8502.23 | 42.67 | 11424.7 | 57.3 |
| 1998/99 | 21236.8 | 9517.71 | 44.82 | 11938.5 | 55.6 |
| 1999/00 | 24200.6 | 10813.3 | 44.68 | 13783.9 | 56.0 |
| 2000/01 | 28705.7 | 12552.1 | 43.73 | 16583.2 | 56.9 |
| 2001/02 | 28733.1 | 12658.7 | 44.06 | 16634.0 | 56.8 |
| 2002/03 | 32481.2 | 14236.4 | 43.83 | 18804.3 | 56.9 |
| 2003/04 | 36260.4 | 15554.8 | 42.9 | 21406.2 | 57.9 |
| 2004/05 | 41839.4 | 15701.6 | 37.53 | 26137.8 | 62.5 |
| 2005/06 | 43462.0 | 15343.7 | 35.30 | 28121.8 | 64.7 |
| 2006/07 | 52146.0 | 16707.6 | 32.03 | 35438.8 | 67.9 |

Source: MOF 1998; MOF 2008

Indirect tax is composed of two major tax headings in Nepal: custom duty and tax on consumption and production. Clearly table 5.1 shows that the custom takes very important place in the composition of indirect tax, although it is continuously decreasing due to trade liberalization policy in the world. The percentage share of tax on consumption and production is little higher than custom duty in indirect tax. Tax on consumption and production is composed by excise duty and value added tax.. The custom duty was 3044.3million in FY 1990/91 and increased to 16707.6million in 2006/07 but the percentage share of custom duty in indirect tax decreased from 45 to 32 percent of indirect taxation.

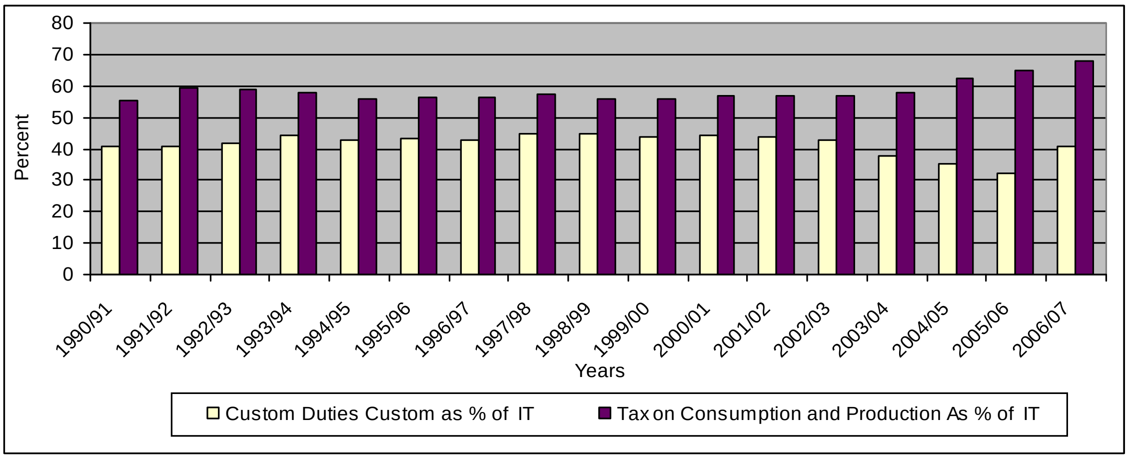
According to the table in FY 1990/91, total indirect tax revenue was Rs.6806.8 million which continuously increased and reached at Rs. 52146 in FY 2006/07 because the number of firms under VAT registration has been increased. Tax on consumption and production increased slightly and reached to 68 percent however custom duty decreased at 32 percent during the study period. However, the share of tax on consumption and production total indirect tax has increased from 55 percent to

68 percent during the study period. The major causes in increase in the share of tax on consumption and production is implementation of VAT, trade liberalization, and implementation of SAPTA and SAFTA. To increase the share of tax on consumption and production the government has to impose tax at high rate on the production of the goods which are harmful to society.

Continuous reduction in custom duty may harm the infant industries in Nepal. As Nepal has become member of WTO it has to follow its principle which may destroy native industries. Nepal may become the market of industrialist countries in future. In this situation Nepal should be conscious about the matter.

Figure 5.1 shows the percentage share of tax on consumption and the percentage share of custom duty which has been illustrated with the help of table.

Figure 5.1: Composition of Indirect Tax (1990/91-2006/07)




Source: MOF 1998; MOF 2008

Figure 5.1 shows the trends of custom duties of the period 1990/91-2006/07. The custom duty is Rs. 3044.3 million in FY 1990/91 and increased to Rs.15343.67 million in FY 2006/07. The percentage share of custom duty on indirect taxation was 32 percent at the same year. Custom duty is moving in decreasing trend however tax on consumption and production is in increasing trend which is revealed by the figure 5.1.

### 5.2.1 Custom Duties

Custom duty is one of the traditional and largest source of tax revenue in Nepal. When we come to the history of customs in our country Nepal, they were charged even in ancient times. In the middle age, trade between India and Tibet was carried through Nepal. Nepal used to levy customs on the goods and commodities traded and used to generate good revenue. This trade was recognized in the region of king Pratap Malla. In those days, the customs duty was colleted on contract basis which continued up to 2007 BS. Customs administration replaced the contract system and (Regmi, 1994). Under the Indo-Nepal Treaty 1950, Nepal had to open custom offices in different parts of the terai region and also had to adjust the custom schedule in line with Indian schedule. To manage all this, a separate Department of Custom and Excise was established in 1955. Later in 1966, a separate Custom Department was established in order to handle the collection of custom duties more efficiently and effectively. Moreover, the introduction of custom act 2019 supported to bring uniformity in custom administration of the country (Pant, 1984).

Customs duty is collected under four sub tax headings.

a) Import duties;
b) Export duties;
c) Indian Excise and other excise duties

Import Duty: The import duty is that type of tax which is levied on importation of goods. The main objective of imports duties is to restrict the importation of luxurious consumption goods and to promote the domestic infant industries.

Export Duty: The export duty is that tax which is levied on exportation of goods. The export duty is nominal and it is only collected for the official operation.

Indian Excise duty: Under the Indo-Nepal Trade and Transit Treaty 1950, as amended from time to time, Indian excise duty levied on goods that are directly imported from the Indian factories under the Application for Removal of Goods Form No.1 is refunded to Nepal government and is known IER.

We can explain the share of import, export and other duties in indirect tax during the study period with the help of table 5.2. It also shows their trend of movement.

Table 5.2: Composition of Custom Duties (1990/91-2006/07) (Rs. in million)

| FY | Total tax revenue (Rs.) | Total Indirect Tax Revenue | Custom Duties | | | |
|---|---|---|---|---|---|---|
| | | | Total Custom | Import | Export | Others |
| 1990/91 | 8176.3 | 6807.7 | 3044.3 | 2752.6 | 78.5 | 213.2 |
| 1991/92 | 9875.6 | 8280.4 | 3358.9 | 2795.2 | 114.7 | 449.0 |
| 1992/93 | 11662.5 | 9626.8 | 3945.0 | 3178.0 | 140.7 | 626.3 |
| 1993/94 | 15371.5 | 12516.2 | 5255.0 | 4356.0 | 427.0 | 472.0 |
| 1994/95 | 19660.0 | 15810.7 | 7018.1 | 5840.1 | 332.5 | 845.5 |
| 1995/96 | 21668.0 | 17012.1 | 7327.4 | 6246.5 | 149.9 | 931.0 |
| 1996/97 | 24424.3 | 19084.3 | 8309.1 | 7093.2 | 167.8 | 1048.1 |
| 1997/98 | 25940.0 | 19926.9 | 8502.23 | 7019.4 | 217.1 | 1265.7 |
| 1998/99 | 28753.0 | 21236.8 | 9517.71 | 7698.3 | 378.0 | 1441.4 |
| 1999/00 | 33152.0 | 24200.6 | 10813.3 | 8959.9 | 432.5 | 1420.2 |
| 2000/01 | 38865.0 | 28705.7 | 12552.1 | 10391.9 | 492.6 | 1667.6 |
| 2001/02 | 39331.0 | 28733.1 | 12658.7 | 9678.4 | 917.4 | 2062.1 |
| 2002/03 | 42587.0 | 32481.2 | 14236.4 | 10567.7 | 855.6 | 2813.1 |
| 2003/04 | 48173.0 | 36260.4 | 15554.8 | 10666.9 | 527.1 | 4360.8 |
| 2004/05 | 54105.0 | 41839.4 | 15701.6 | 12299.1 | 697.9 | 2704.6 |
| 2005/06 | 57427.0 | 43462.0 | 15343.7 | 11744.6 | 625.6 | 2973.8 |
| 2006/07 | 71126.7 | 52146.0 | 16707.6 | 13626.1 | 708.7 | 2372.8 |

Source: MOF 1998; MOF 2008

Table 5.2 shows the trends of imports duties of the period between FY 1990/91- 2006/07. The import duty was Rs. 2752.6 million in FY 1990/91 and increased to Rs. 13626.16 million in 2006/07. Import duty is continuously increasing trend because the demand of people is increasing. In FY 1996/97, the import duty was Rs. 7093.2 million but it decreased by Rs. 74 million in FY 1997/98 and remained at Rs. 7019.4 million because total import was decreased. Similarly, the import duty decreased in FY 2001/02, FY 2005/06 in comparison to last year. Other possible causes of decline in import duty are trade liberalization and globalization. Other duty includes also Indian excise duty which is moving at increasing trend because our trade is India dependent.

The table 5.2 also shows the trends of exports duties of the period between FY 1990/91 to 2006/07. The share of export duty is lower than the share of import duty because there is lack of medium and large scale industries in Nepal. We are heavily dependent on foreign products. It is why our import is larger than export. In FY 1990/91 export duties was Rs. 78.5 million and increased at Rs.625.6 million in FY 2006/07. Export duty increased slightly during the study period because our industrial development is very slow. Most of exports are covered by agricultural sector which are sold at lower price. The percentage share of import duty, export duty and others are shown in table 5.3.

Table 5.3: Share of Custom Duties in Indirect Taxation (Rs. in Million)

| Fy | Total tax revenue (Rs.) | Total Indirect Tax Revenue | Custom as % of IT | Import as % of IT | Export as % of IT | Others as % of IT |
|---|---|---|---|---|---|---|
| 1990/91 | 8176.3 | 6806.6 | 44.7 | 40.04 | 1.02 | 3.1 |
| 1991/92 | 9875.6 | 8280.4 | 40.56 | 33.76 | 1.38 | 5.4 |
| 1992/93 | 11662.5 | 9626.8 | 40.98 | 33.01 | 1.46 | 6.5 |
| 1993/94 | 15371.5 | 12516.2 | 41.99 | 34.80 | 3.41 | 3.8 |
| 1994/95 | 19660 | 15810.7 | 44.24 | 36.94 | 2.10 | 5.3 |
| 1995/96 | 21668 | 17012.1 | 42.89 | 36.72 | 0.88 | 5.5 |
| 1996/97 | 24424 | 19084.3 | 43.3 | 37.17 | 0.88 | 5.5 |
| 1997/98 | 25940 | 19926.9 | 42.67 | 35.23 | 1.09 | 6.3 |
| 1998/99 | 28753 | 21236.8 | 44.82 | 36.25 | 1.78 | 6.7 |
| 1999/00 | 33152 | 24200.6 | 44.68 | 37.02 | 1.79 | 5.8 |
| 2000/01 | 38865 | 28705.7 | 43.73 | 36.2 | 1.72 | 5.8 |
| 2001/02 | 39331 | 28733.1 | 44.06 | 33.68 | 3.19 | 7.1 |
| 2002/03 | 42587 | 32481.2 | 43.83 | 32.53 | 2.63 | 8.6 |
| 2003/04 | 48173 | 36260.4 | 42.9 | 29.42 | 1.45 | 12.0 |
| 2004/05 | 54105 | 41839.4 | 37.53 | 29.97 | 1.7 | 6.6 |
| 2005/06 | 57427 | 43462.0 | 35.30 | 27.87 | 1.48 | 7.0 |
| 2006/07 | 71126.7 | 52146.0 | 32.03 | 30.29 | 1.58 | 5.2 |

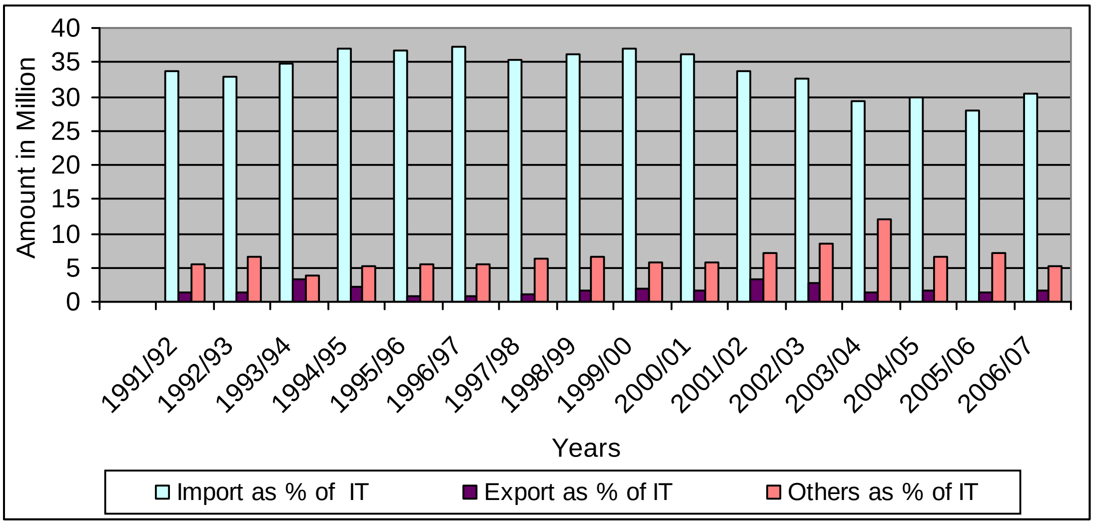
Source: MOF 1998; MOF 2008

Table 5.3 shows the trends and percentage distribution of customs duties of the period between FY1990/91- 2006/07. The share of custom duties on total indirect tax revenue was 44.7 percent in FY 1990/91. It couldn't increase and moved as fluctuation. The share of custom duty in FY 2001/02 was 44 percent which decreased slowly and remained at 32 percent in FY 2006/07. The share of custom duty is in decreasing trend due to trade liberalization policy adopted by the government.

The percentage share of import duty in indirect taxation was 40 in FY 19990/91. It declined at 34 and 33 percent in FY 1991/92 and FY 1992/93. The share of import duty on custom duty began to increase till FY 1996/97. In this FY it was 37 percent however it declined in FY 1997/98. Then after it began to decline and remained at 30 percent. On the whole import duty is moving in decreasing trend because of trade liberalization, globalization and implementation of VAT. The contribution of import duty was 28 percent in FY 2005/06. It is the lowest contribution of import duty on indirect taxation during the study period.

The share of export duty during the study period was very small. The share of export duty was 3 percent in FY 2001/02, which is the highest share of export duty in indirect taxation during the study period. The percentage share of export duty in FY 1995/96 and 1996/97 was less than one. The possible causes of low share of export duty are: i) Higher share of import ii) Lower share of export iii) Lack of large scale industries iv) Weakness of trade protection policy. With the help of table5.3 a multiple bar diagram can be illustrated. Figure 5.2 indicates the percentage share of import, export and other duty.

Figure 5.2: Share of Import, Export and Other Duties in Custom Duties




Source: MOF 1998; MOF 2008

From figure 5.2, it can be concluded that the share of import duty is going decreasing because trade liberalization policy has been adopted by the government, concept of SAPTA then after SAFTA has been implemented. The share of export duty is quite lower than the share of import duty in custom duties because there is few number of large scaled industries in Nepal due to which it is unable to export goods in huge quantity. Nepal imports capital and consumption goods in huge quantity.

From the above analysis of customs duty indicates that it has been an important source of government revenue. However it still suffers from some problems such as multiple rate structure which results in difficulty in tax administration, rates fixed in the line of other trading partners, Nepal have to become less dependent on customs duty and find other reliable and new source of revenue.

### 5.2.2 Tax on Consumption and Production of Goods and Services

Nepal government collects this tax under eight different sub-tax headings: Sales/VAT (ST), tax on industrial product or excise duty (IP) entertainment tax (ET), hotel tax (HT), air flight tax (AFT), contract tax (CT) and road and bridge maintenance tax (RBM).

#### a. Share of VAT in Tax Revenue

It has been introduced in Nepal in 1997 A.D. with a view to effectively mobilizing internal revenues by improving the existing tax system in Nepal (Khadka, 2000). In initial stage, it was taken negatively by private sector. However, now it has been considered as the important tool for reducing external dependency and minimizing budget deficit. VAT is the replacement of sales tax, making tax burden not on total value but on the value added to the main objective not to effect in the increased price. The VAT can be taken as an important domestic resource mobilization in Nepal. So it should be adopted as an important member of reforming sales tax, entertainment tax contract tax and hotel tax. Now our government is centralizing sources of revenue through VAT reducing custom duties. Including entertainment tax, hotel tax and sales tax VAT has been adopted in Nepalese economy since 1997 and has established itself as a best instrument of resource mobilization carrying out the important role in total revenue, total tax revenue and indirect tax. The contribution of VAT revenue in total tax revenue and indirect tax revenue has been shown in table 5.4.

Table 5.4: Share of VAT in Total Revenue (1990/91-2006/07) (Rs. in Million)

| FY | Total tax revenue (Rs.) | Total Indirect Tax Revenue | VAT Revenue | VAT as % of TTR | VAT as % of IT |
|---|---|---|---|---|---|
| 1990/91 | 8176.3 | 6806.6 | 2527.9 | 30.9 | 37.1 |
| 1991/92 | 9875.6 | 8280.4 | 3461.7 | 35.0 | 41.8 |
| 1992/93 | 11662.5 | 9626.8 | 4213.4 | 36.1 | 43.7 |
| 1993/94 | 15371.5 | 12516.2 | 5551.5 | 36.1 | 44.3 |
| 1994/95 | 19660 | 15810.7 | 7135.6 | 36.3 | 44.9 |
| 1995/96 | 21668 | 17012.1 | 7739.8 | 35.7 | 45.3 |
| 1996/97 | 24424 | 19084.3 | 8477.6 | 34.7 | 44.1 |
| 1997/98 | 25940 | 19926.9 | 8364.4 | 32.2 | 41.9 |
| 1998/99 | 28753 | 21236.8 | 8765.7 | 30.4 | 41.2 |
| 1999/00 | 33152 | 24200.6 | 10665 | 32.1 | 44 |
| 2000/01 | 38865 | 28705.7 | 12717 | 32.7 | 44.3 |
| 2001/02 | 39331 | 28733.1 | 12570.6 | 31.9 | 43.7 |
| 2002/03 | 42587 | 32481.2 | 13459.7 | 31.6 | 41.4 |
| 2003/04 | 48173 | 36260.4 | 14478.9 | 30.0 | 39.9 |
| 2004/05 | 54105 | 41839.4 | 18885.4 | 34.9 | 45.1 |
| 2005/06 | 57427 | 43462 | 21613 | 37.6 | 49.7 |
| 2006/07 | 71126.7 | 52146 | 26095.6 | 36.7 | 50 |

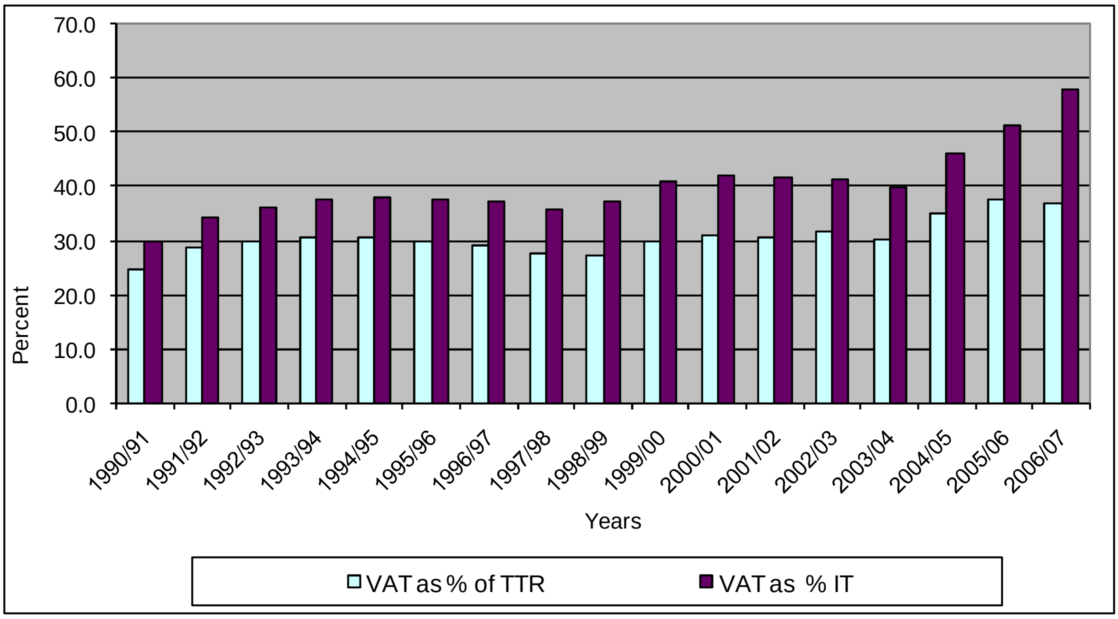
Source: MOF 1998; MOF 2008

As indicated in table 5.4 sales /VAT revenue was Rs. 2527.9 million in FY 1990/91. The amount of VAT revenue increased continuously and reached at Rs. 26095.6 in FY 200607. It increased continuously because of increase in consumption of people, public consciousness and increase in the number of firms under VAT registration.

The share of VAT in total tax revenue and indirect tax revenue were 31 and 37 percent respectively in FY 1990/91. The share of VAT revenue in total tax revenue and indirect tax revenue increased at 35and 42 percent respectively in FY 1991/92. However, share of VAT in total tax revenue and indirect tax revenue decreased in FY 1997/98 and 1998/99. The major cause of decline in the percentage share of VAT was improper implementation of VAT due to the lack of experience and also it was opposed by producers and sellers. However, since last three years VAT has been playing leading role in indirect taxation. In last year of the study 50 percent of total indirect tax revenue was collected from VAT revenue.

During the study period of 17 years, the percentage share of VAT revenue to total tax revenue was in increasing trend. The share of VAT revenue in total tax revenue was increased from 31 to 37 percent in FY 1990/91 to 2006/07. Hence the contribution of VAT in total tax revenue is more and attracting further it is in increasing Trend. The percentage share of VAT revenue in indirect tax revenue is increasing rapidly because it is scientific, less chance of corruption decreasing share of custom duty. The contribution of VAT in FY 2006/07 was 50 percent. In the beginning stage of VAT, it was taken negatively, it was opposed by tax payers but now it has been popular and major instrument for internal revenue collection. With the help of table5.4 a figure 5.3 has been illustrated which shows the share of VAT in indirect tax and total tax revenue.

Figure 5.3: Share of VAT in Total Revenue (1990/91-2006/07)




Source: MOF 1998; MOF 2008

The figure shows that the contribution of VAT in total tax revenue and indirect tax revenue. According to the figure, contribution of VAT in FY 1990/91 to total tax and indirect tax is 24.8 and 29.76 percent respectively which have been increased up to 36.7and 58 percent respectively in FY 2006/07.

Sales/VAT was the second largest source of total tax revenue after the custom duties. However, due to trade liberalization the revenue from custom duties is likely to decline and as such, VAT has become the largest source of total tax revenue in Nepal. The analysis of VAT suggests that Nepal has been successful in implementing the broad-base VAT as a major step in Nepalese tax reform after the restoration of democracy. However, inclusion of more and more products (such as agricultural and primary food stuffs) into the VAT net is one of the major challenges to increase the revenue mobilization through this tax.

**b. Share of Excise Duties**

Excise tax is levied only on a few industrial products such as liquors, beers, cigarettes and tobacco. They are levied on the domestically manufactured goods only and most of the imports are kept out of the excise net. It is the fourth largest source of revenue in Nepal. It was introduced at the time of Rana Regime. Excise duty was collected as lump sum contract payments for the grants of exclusive rights for the production and distribution. These duties which were imposed on five industrial products in 1960/61 were further extended to sixteen items by 1967/68 and to twenty two items by 1974/75. We can see that the revenue collection from excise duty in 1983/84 was Rs. 432.2 million. It was 12.7 percent of totals revenue 15.8 percent of total tax revenue. And 19.7 percent of indirect taxes (Bajracharya, 1993). so, we can conclude that this tax constitute a very reliable sources of revenue generation with advancement the process of economic development of a nation. The trend of excise duty in indirect tax and total tax can be explained with the help of table.

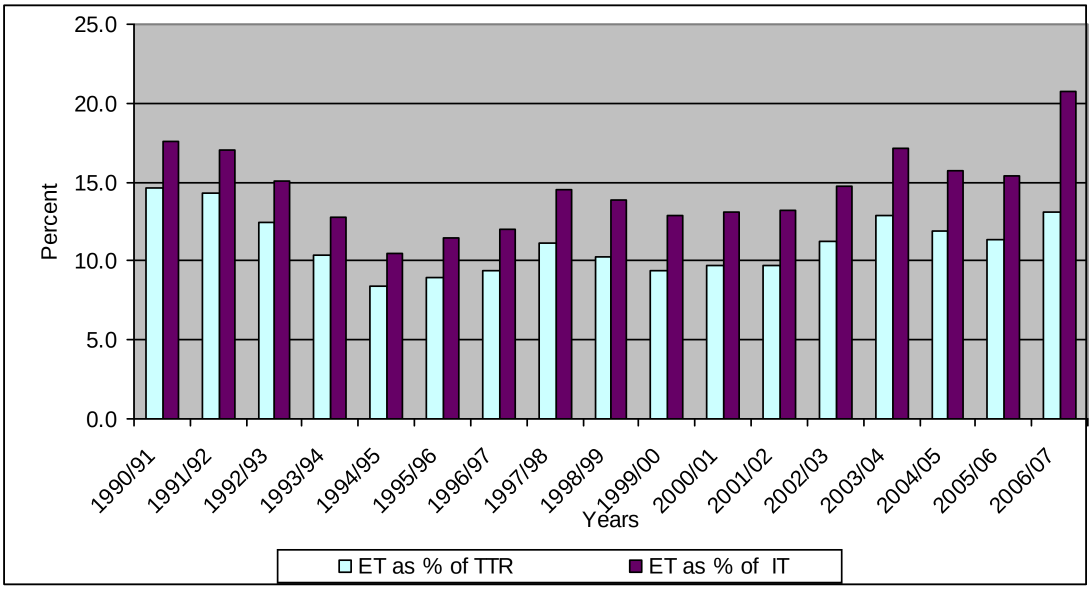
Table 5.5: Share of Excise Duty in Indirect Tax (1990/91-2006/07) (Rs. in Million)

| Fy | Total tax revenue (Rs.) | Indirect tax Revenue | Excise tax | ET as % of TTR | ET as % of IT |
|---|---|---|---|---|---|
| 1990/91 | 8176.3 | 6807.7 | 1200.0 | 14.7 | 17.6 |
| 1991/92 | 9875.6 | 8280.4 | 1414.3 | 14.3 | 17.1 |
| 1992/93 | 11662.5 | 9626.8 | 1452.8 | 12.5 | 15.1 |
| 1993/94 | 15371.5 | 12516.2 | 1592.5 | 10.4 | 12.7 |
| 1994/95 | 19660 | 15810.7 | 1657.3 | 8.4 | 10.5 |
| 1995/96 | 21668.0 | 17012.1 | 1944.3 | 9.0 | 11.4 |
| 1996/97 | 24424.3 | 19084.3 | 2298.9 | 9.4 | 12.0 |
| 1997/98 | 25940.0 | 19926.9 | 2885.8 | 11.1 | 14.5 |
| 1998/99 | 28753.0 | 21236.8 | 2953.2 | 10.3 | 13.9 |
| 1999/00 | 33152.0 | 24200.6 | 3127.6 | 9.4 | 12.9 |
| 2000/01 | 38865.1 | 28705.7 | 3771.2 | 9.7 | 13.1 |
| 2001/02 | 39330.6 | 28733.1 | 3807.0 | 9.7 | 13.2 |
| 2002/03 | 42587.0 | 32481.2 | 4785.1 | 11.2 | 14.7 |
| 2003/04 | 48173.0 | 36260.4 | 6226.7 | 12.9 | 17.2 |
| 2004/05 | 54104.7 | 41032.9 | 6445.9 | 11.9 | 15.7 |
| 2005/06 | 57427.0 | 42137.9 | 6507.6 | 11.3 | 15.4 |
| 2006/07 | 71126.7 | 44986.9 | 9343.2 | 13.1 | 20.8 |

Source: MOF 1998; MOF 2008

Table 5.5 shows the trend and percentage distribution of excise taxes of the period between FY1990/91 to 2006/07. The share of excise taxes on total tax revenue and indirect tax revenue is 14.68 and 17.62 percent respectively in FY 1990/91. The share of excise duty on total tax revenue and indirect tax revenue decreased at 8.97 and 11.42 respectively in FY 1995/96 but it increased by 13 and 20 percent on indirect and total tax respectively in FY 2006/07. Thus percentage contribution of excise duty is in fluctuation position. The share of excise duty could not increase due to following reasons. i) lack of transparent administration ii) lack of efficient administration iii) technical Problems. Other possible reasons are low production discourage to the socially harmful industries. The trend of excise duty has been shown with the help of table 5.4.

Figure 5.4: Share of Excise tax (1990/91-2006/07)




Source: MOF 1998; MOF 2008

Figure 5.4 reveals the share of excise tax on indirect and direct tax. The trend of excise tax is moving in fluctuation during study period.

The above analysis of excise duty indicates that it has been considerably rationalized from the period of its inception. However, the rates of excises are still very much higher which can distort the economic incentives, discourage further production, and encourage tax evasion.

**5.3 Resource Gap a Serious Problems**

Developing countries have been experiencing a serious and growing resource gap problem in development finance because of the growth of government expenditure vis-à-vis revenue from internal sources. Considering the present world economy situation with world wise depression and inflation too much dependency on foreign grant might lead to disastrous economic situation at home due to unreliable source of financing. It is very difficult to state anything about the trend of foreign grant. One can fairly guess that the bilateral grants likely to remain static or even may decline in the yeas to come.

Earlier the public finance was solely treated from the public revenue point of view. So, taxation received more importance than the public expenditure. However in modern times this approach has been symmetrical in nature with equal emphasis on public revenue and public expenditure. The importance of public revenue, not only in deciding the magnitude of the public sector but also to its overall performance can not exaggerate in any developing country. Many fiscal economists have examined this problem and have come out with the conclusion that government should raise at least 20 percent of GDP as its revenue in order to meet the development needs and also to produce desirable effect in the economy.

In Nepal, the major portion of the development expenditure would govern by foreign aid and foreign loans. To look at the magnitude of the resource gap one has to examine the trends of the public expenditure and the public revenue in Nepal.

### 5.3.1 Trend of Resource Gap in Nepal

Nepal has been experiencing a serious and growing resource gap in development finance because of the growth of government expenditure vis-à-vis revenue from internal sources. The Resource Gap A' shows the actual condition of economy without dependency of external sources while 'Resource gap B' shows that economy which is dependent on public revenue and foreign aid (grants) not on loans (internal and well as external) components. The table5.6 shows the trend of resource gap including and without including foreign aid.

Table 5.6: Trend of Resource Gap in Nepal Rs. In Million

| F.Y. | Total Expend. | Total Revenue | Resource Gap A | Foreign Aid (grant) | Resource Gap B | Foreign Aid (loan) | Resource Gap C |
|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4(2-3) | 5 | 6(4-5) | 7 | 8(6-7) |
| 1990/91 | 23549.8 | 10729.9 | 12819.9 | 2164.8 | 10655.2 | 6256.4 | 4398.8 |
| 1991/92 | 26418.2 | 13512.7 | 12905.5 | 1643.8 | 11261.7 | 6816.9 | 4444.8 |
| 1992/93 | 30897.7 | 15148.4 | 15749.3 | 3793.3 | 11956 | 6920.9 | 5035.1 |
| 1993/94 | 33587.4 | 19581 | 14006.4 | 2393.6 | 11612.8 | 9163.6 | 2449.2 |
| 1994/95 | 39060 | 24605 | 14455 | 3937.1 | 10517.9 | 7312.3 | 3205.6 |
| 1995/96 | 46542.3 | 27893.1 | 18649.2 | 4825.2 | 13824.0 | 9463.6 | 4360.4 |
| 1996/97 | 50723.7 | 30373.5 | 20350.2 | 5988.3 | 14361.9 | 9043.6 | 5318.3 |
| 1997/98 | 56118.3 | 32937.9 | 23180.4 | 5402.6 | 17777.8 | 11054.5 | 6723.3 |
| 1998/99 | 59579.0 | 37251.3 | 22327.7 | 4336.6 | 17991.1 | 11852.4 | 6138.7 |
| 1999/00 | 66272.5 | 43289.7 | 22982.8 | 5711.7 | 17271.1 | 11812.2 | 5458.9 |
| 200/01 | 79835.1 | 48893.6 | 30941.5 | 6753.4 | 24188.1 | 12044.0 | 12144.1 |
| 2001/02 | 80072.2 | 50445.5 | 29626.7 | 6686.1 | 22940.6 | 7698.6 | 15242.0 |
| 2002/03 | 84006.1 | 56229.8 | 27776.3 | 11339.1 | 16437.2 | 4546.4 | 11890.8 |
| 2003/04 | 89442.6 | 62331.0 | 27111.6 | 11283.4 | 15828.2 | 7629.0 | 8199.2 |
| 2004/05 | 102560.4 | 70122.7 | 32437.7 | 14391.2 | 18046.5 | 9266.1 | 8780.4 |
| 2005/06 | 110889.2 | 72282.1 | 38607.1 | 13827.5 | 24779.6 | 8214.3 | 16565.3 |
| 2006/07 | 133604.6 | 87712.1 | 45892.5 | 15800.8 | 30091.7 | 10053.5 | 20038.2 |

Source: MOF 1998; MOF 2008

Table 5.6 reveals if resource gap is considered the difference between total expenditure and total revenue of the country, it is Rs.12819.9 and 18649.2 million in FY1990/91and FY 1995/96 respectively, is shown by 'Resource Gap A' in the following table. Resource Gap A is continuously increasing from 1990/91 up to 2001/02. It decreased for two years 2001/02, 2002/03 then after again it took its continuity and reached to Rs. 45892.5 million in 2006/07. The 'Resource Gap A' shows the actual conditions of domestic economy and it is totally deficit for the nation's economy to meet the financial requirements for the government expenditure on regular as well as development sectors. The 'Resource Gap A' is a clear indication of the poor performance of resource mobilization at the domestic sector on the one hand and a higher growth of the public expenditure on the other. The 'Resource Gap A' is known as fiscal deficit in public economy.

If resource gap is considered the difference between total expenditure and total revenue plus foreign aid (grants), it is Rs. 10655.15, 13824.03and 30091.7million is shown the 'Resource Gap B' in FY 1990/91, 1995/96 and 2006/07. It is smaller than the total revenue. The foreign aid is collected through bilateral and multilateral sector. The 'Resource Gap B' is known as budget deficit in public economy.

Considering the present world economic situation with worldwide recession and inflation too much dependency on foreign grant might lead to disastrous economic situation at home due to unreliable source of foreign grant, one can fairly guess that the bilateral grant is likely to remain static or even may decline in the years too come.

If resource gap is considered the total expenditure minus total revenue plus foreign aid (loans and grants), it is Rs. 4398.75, 4360.43 and 20038.2 million in FY 1990/91, 1995/96 and 2006/07 is shown by 'Resource Gap C' in the table 5.6. The foreign aid (loans and grants) is collected through bilateral and multilateral sectors. The 'Resource Gap C' is only cover through internal loan from banking and non-banking sectors, change in cash balance and so on.

In such situation the government should rely less on foreign aid in the years to come. Therefore, the government of Nepal has no option but to rely mostly on the domestic sources for meeting the increasing public expenditure because of other two options are neither feasible nor desirable politically and economically. Therefore, the only option left the government is to strengthen the efforts of domestic resource mobilization that will avoid the inflationary consequences of deficit financing and would not require the curtailment of public expenditures.

## CHAPTER SIX

# SUMMARY, CONCLUSION AND RECOMMENDATION

### 6.1 Summary of the Result

The analysis of preceding chapter gives a clear cut picture that taxation is a primary instrument of resource mobilization in Nepal. Increasing fiscal deficit, insufficient revenue generation, inequality and weak tax administrative is the major problems of Nepalese tax system, which are the result of poorly designed or improperly functioning tax system. The resource gap is attributed to increase in government expenditure on regular and development sectors that is higher and faster than revenue growth.

Nepal, being in the process in economic development needs higher government expenditure to meet the purposed development programs. This ultimately creates a resource gap. On the other hand, foreign aid, loan and grant and domestic borrowing are not considered as the permanent solutions of resource gap. In this connection, the share of non-tax revenue is very low and to raise the revenue from these sources, one needs higher capital accumulation in comparison to its returns and government equally thinks about the welfare view. Taxation is not only the instrument of getting higher revenue but also the medium to eliminate undesirable effect in the economy and introducer to a desirable effect. These facts justified that the ultimate and permanent solution to abridge gap is only through taxation in which indirect-taxation has dominant role.

The overall trend of revenue from taxation in Nepal shows that the contribution of tax revenue to GDP has been increasing from 7.0 percent in 1990/91 to 14.4 percent in 2006/07 with some steady rate. But this ratio is seemed to be minimal as asserted by Sir Arthur Lewis that this less than 15 percent tax-GDP ratio in UDCs would have to be raised to at least 17 percent in order to satisfy the minimal requirement of a modern state. At the same time-share of direct tax to GDP increases form 1.2 percent to 3.9 percent in 2006/07 but share of indirect tax increases from 6 percent in FY 1990/91to10.6 percent in FY 2006/07.

In terms of tax revenue, the contribution of direct tax revenue has continuously declined and indirect taxes have continuously risen. In the total revenue, the share of tax revenue has been dominant role over the study period. Nepal as a developing country has low per capita income thus direct tax is considered inferior. As people do not feel burden directly when paying tax, indirect tax is considered superior.

In addition to this, the major findings of the study are.

(a) In Nepal, tax-GDP ratio is 14 percent which is almost one half of the tax effort- ratio of developed economies indicates that Nepal is one of the low-taxed country.

(b) 73 percent of total tax revenue comes from indirect tax and 27 percent tax is comes from direct tax. The percentage share of indirect tax is quite higher than the percentage share of direct tax because of trade protection policy, implementation of VAT, discouragement on the industries which are socially harmful.

(c) Share of customs duty in indirect tax is in decreasing trend due to the trade, liberalization policy of WTO and implementation of SAFTA.

(d) Percentage share of import duty is quite higher than the percentage share of export duty. The possible reasons may be trade protection policy, dependency on foreign country for requirements.

(e) Share of sales/VAT in indirect tax and total tax revenue has increasing trend. Share of sales/VAT on indirect tax increased from 30 percent to 50 percent during the study period because of implementation of VAT and trade liberalization policy.

(f) The share of excise tax in indirect tax revenue is in neither increasing trend nor decreasing trend during the study period because of uncertain production.

(g) Among the share of the component of indirect tax revenue the share of VAT is in increasing trend where as the share of custom duty is in decreasing trend because of trade liberalization policy adopted by government. The share of VAT has highest position since FY 2004/05.

(h) Resource gap problem in Nepal is increasing because government expenditure is increasing more rapidly than government revenue.

## 6.2 Conclusion

To perform obligatory and optional function, a government needs revenue. Tax is the major source of revenue. To increase the tax revenue is not an end in itself rather it is a means to meet the fiscal imbalances, reduce inequality of wealth and income, proper allocation of resources and incentive to work and invest, which would lead to increase in productivity and national income. Thus, raising revenue is only one of many goals and a tax system must be administratively feasible.

This need becomes more appreciable when we see the higher tax ratio to GDP in developed country. This has generated a strong believe among the economist that the present tax ratio in Nepal which is very low, can be increased substantially, which would be a solution of resource problem. As the income level of Nepalese people is very low, direct tax has less contribution to the tax revenue. VAT, Custom and Excise duty have first second and third position. However, some improvement appeared in the non-tax revenue and sales/VAT. In some extent, VAT has been successful to develop a stable source of revenue through broadening the tax base. Among custom duties import duty covers the huge percentage and growing every year.

This shows that Nepalese tax system heavily dependent on indirect tax and this process will be continue without drastic change in ax system.

**6.3 Recommendations**

There are many weaknesses and problems under taxation in Nepal. There are irregularities and leakages in tax administration. The greater dependence on foreign aid and loans should be minimized with a reasonable taxation system. It should be modernized by expanding the scope of taxation by increasing tax base and by making the tax structure more progressive. Moreover, the indirect taxes must remain an important source for resource mobilization in Nepal. However, its future prospective should be considered in the light of the following recommendation.

a) The share of custom duty in total tax revenue is in decreasing trend. To raise the resource mobilization through custom duty, customs duties needs control of leakage such as controlling smuggling, checking open border, revising liberal trade policy and adopting trade protection policy by Nepal government.

b) The liberal economy primarily focuses reducing on sales/VAT and excise tax rates. The degree of reduction should be lower on basic commodities but it should be raise on those commodities, which are injurious to health and social environment.

c) The government of Nepal has to bring a drastic change in tax policy to increase tax/GDP ratio. Tax policy should have a clear-cut direction and consistent with a long run perspective of the policy. The tax policy should be concentrated on optimum revenue mobilization for reducing tax revenue expenditure gap.

d) The present Nepalese tax structure depends heavily on indirect taxes. More than 73.3 percent share of indirect tax to total revenue over the study period have mentioned in the result. So the effective way for more revenue generation from direct taxes is to make them progressive supported by competent tax administration.

e) The introduction of high sales and excise tax on luxury consumption such as, liquor and tobacco which are harmful to society. This process will help to discourage the consumers to consume these injurious goods.

f) Higher revenue growth through other alternative source such as tax on excise duty, VAT, beverage tax and beer tax must be ensured because Nepal has already entered into WTO and has reduced its imports tariff since the adoption of liberal economic policies in 1992/93 and in the line with the customs tariffs reforms taking place around the world.

g) The government has to introduce high import duties except basic goods such as medicine, salt, wheat, wheel chair and stick for blind people. This process helps the domestic infant industries.

h) VAT is considered to be effective tax system for raising more resource mobilization. However this tax system needs efficiency in tax administration.

i) Develop tax consciousness and tax paying habits to the tax payers through education and effective information.

j) Strengthen the consultation process with the private sector on revenue policy matters through the Revenue Consultative Committee.

It should be designed in such away so as to bridge the gap between actual potential base since there exists a persistent feature of political instability for one and half decade, here is lack of political will and determination in the government that inhibited the emergence of an effective tax administration in Nepal.

Thus to improve the performance of indirect tax the government can change the environment by providing education, information and knowledge to the tax payers that may help increase voluntary compliance . Computerization of tax administration, motivation for public servants and possibly tax forming may be instrumental in changing the tax administration. The best way to cope with administration problems, however, is to make a change in tax law. Tax law and regulations should be simple. Too many tax shelters with series of tax exemptions and deduction must be estimated that have not only distorted the tax structures but also led to massive corruption.

It is not necessary to say that the Nepalese domestic revenue mobilization is very low in comparison to other. It is the time to take action immediately to improve the performance of domestic resource mobilization. Focus should be given on transparency, fairness and timely and quality production in administration instead of simple collection. Efforts should be given to establish functionally well organized tasks where the tasks can be carried out service-minded manner. Committed, motivated and dedicated business community civil society, tax authority are the prerequisites of the government revenue. These are building gradually, which are the sign of good shining of indirect tax in Nepal.

Appendix I: Contribution of Direct and Indirect Tax Revenue as % of Total Tax

| FY | Tax Rev | Direct Tax | | Indirect Tax | |
|---|---|---|---|---|---|
| | | Number | % | Number | % |
| 1975/76 | 911.2 | 236.0 | 25.9 | 675.2 | 74.1 |
| 1976/77 | 1100.1 | 295.7 | 26.9 | 804.4 | 73.1 |
| 1977/78 | 1243.9 | 306.2 | 24.6 | 937.7 | 75.3 |
| 978/79 | 1476.8 | 253.1 | 17.1 | 1223.7 | 82.8 |
| 1979/80 | 1528.8 | 253.8 | 16.6 | 1275.0 | 83.4 |
| 1980/81 | 2035.7 | 353.2 | 17.4 | 1682.5 | 82.7 |
| 1981/82 | 2211.3 | 379.9 | 17.2 | 1831.4 | 82.8 |
| 1982/83 | 2421.1 | 445.1 | 18.4 | 1976.0 | 81.6 |
| 1983/84 | 2737.0 | 541.8 | 19.8 | 2195.2 | 80.2 |
| 1984/85 | 3151.2 | 559.7 | 17.8 | 2591.5 | 82.2 |
| 1985/86 | 3659.3 | 661.8 | 18.1 | 2997.5 | 81.9 |
| 1986/87 | 4372.4 | 768.7 | 17.6 | 3710.6 | 84.9 |
| 1987/88 | 5752.8 | 1010.0 | 17.6 | 4742.6 | 82.4 |
| 1988/89 | 6287.2 | 1331.0 | 21.2 | 4955.8 | 78.8 |
| 1989/90 | 7283.9 | 1435.0 | 19.7 | 5848.8 | 80.3 |
| 1990/91 | 8176.3 | 1370.0 | 16.8 | 6806.6 | 83.3 |
| 1991/92 | 9875.6 | 1595.0 | 16.2 | 8280.4 | 83.9 |
| 1992/93 | 11662.5 | 2036.0 | 17.5 | 9626.3 | 82.5 |
| 1993/94 | 15371.5 | 2855.0 | 18.6 | 12516.0 | 81.4 |
| 1994/95 | 19660.0 | 3795.0 | 19.3 | 15865.0 | 80.7 |
| 1995/96 | 21668.0 | 4585.0 | 21.2 | 17083.0 | 78.8 |
| 1996/97 | 24424.3 | 5234.0 | 21.4 | 19191.0 | 78.6 |
| 1997/98 | 25939.8 | 6013.0 | 23.2 | 19927.0 | 76.8 |
| 1998/99 | 28752.9 | 7516.1 | 26.1 | 21236.8 | 73.9 |
| 1999/00 | 33152.1 | 8931.5 | 26.9 | 24200.6 | 73.0 |
| 2000/01 | 38865.0 | 10159.4 | 26.1 | 28705.7 | 73.9 |
| 2001/02 | 39330.6 | 10597.0 | 26.9 | 28733.1 | 73.1 |
| 2002/03 | 42586.9 | 10105.8 | 23.7 | 32481.2 | 76.3 |
| 2003/04 | 48173.0 | 11912.6 | 24.7 | 36260.4 | 75.3 |
| 2004/05 | 54104.7 | 12265.4 | 22.7 | 41839.4 | 77.3 |
| 2005/06 | 57430.0 | 13968.0 | 24.3 | 43462.0 | 75.6 |
| 2006/07 | 71127.0 | 18980.0 | 26.7 | 52146.0 | 73.3 |

Source: MOF 1998; MOF 2008

Note: Direct Taxes comprise Income Tax, Land Tax and House land registration. Indirect tax include Custom Duties, Excise Duties and Sales Tax i

Appendix II: Structure of Indirect Tax (1990/91 to 2006/07) (Rs. In Million)

| FY | Indirect Tax | Custom Duties | | Excise Duties | | Sales Tax/VAT* | |
|---|---|---|---|---|---|---|---|
| | % | Number | % | Number | % | Number | % |
| 1975/76 | 675.2 | 358.5 | 53.1 | 132 | 19.5 | 184.6 | 27.3 |
| 1976/77 | 804.4 | 386.2 | 48.0 | 166.1 | 20.6 | 252.1 | 31.3 |
| 1977/78 | 937.7 | 458.8 | 48.9 | 164.4 | 17.5 | 314.5 | 33.5 |
| 1978/79 | 1223.7 | 626.7 | 51.2 | 192.6 | 15.7 | 404.4 | 33.0 |
| 1979/80 | 1275 | 608 | 47.6 | 215.2 | 16.8 | 451.8 | 35.4 |
| 1980/81 | 1682.5 | 815.8 | 48.5 | 242.2 | 14.4 | 624.6 | 37.1 |
| 1981/82 | 1831.4 | 825.1 | 45.0 | 305.7 | 16.6 | 700.6 | 38.2 |
| 1982/83 | 1976 | 760.9 | 38.5 | 365.8 | 18.5 | 847.7 | 42.8 |
| 1983/84 | 2195.2 | 825.9 | 37.6 | 432.1 | 19.6 | 932.9 | 42.4 |
| 1984/85 | 2591.5 | 1064.4 | 41.1 | 483.8 | 18.6 | 1039.5 | 40.1 |
| 1985/86 | 2997.5 | 1231.1 | 41.1 | 558.7 | 18.6 | 1197.9 | 39.9 |
| 1986/87 | 3710.6 | 1505.7 | 40.58 | 678.6 | 18.2 | 1407.9 | 37.9 |
| 1987/88 | 4742.6 | 2214.7 | 46.7 | 825.4 | 17.4 | 1678.4 | 35.3 |
| 1988/89 | 4955.8 | 2289.9 | 46.21 | 877.6 | 17.7 | 1766.2 | 35.6 |
| 1989/90 | 5848.8 | 2684.9 | 45.91 | 1097 | 18.7 | 2041.4 | 34.9 |
| 1990/91 | 6806.6 | 3044.3 | 44.73 | 1200.3 | 17.6 | 2527.9 | 37.1 |
| 1991/92 | 8280.4 | 3358.9 | 40.56 | 1414.4 | 17.0 | 3461.7 | 41.8 |
| 1992/93 | 9626.3 | 3945 | 40.98 | 1452.8 | 15.0 | 4213.4 | 43.7 |
| 1993/94 | 12516.0 | 5255 | 41.99 | 1592.2 | 12.7 | 5551.5 | 44.3 |
| 1994/95 | 15865.0 | 7018.1 | 44.24 | 1657.3 | 10.4 | 7135.6 | 44.9 |
| 1995/96 | 17083.0 | 7327.4 | 42.89 | 1944.3 | 11.3 | 7739.8 | 45.3 |
| 1996/97 | 19191.0 | 8309.1 | 43.3 | 2298.1 | 11.9 | 8477.6 | 44.1 |
| 1997/98 | 19927.0 | 8502.2 | 42.67 | 2885.8 | 14.4 | 8364.4 | 41.9 |
| 1998/99 | 21236.8 | 9517.7 | 44.82 | 2953.2 | 13.9 | 8765.7 | 41.2 |
| 1999/00 | 24200.6 | 10813.3 | 44.68 | 3127.6 | 12.9 | 10665.0 | 44.0 |
| 2000/01 | 28705.7 | 12552.1 | 43.73 | 3771.2 | 13.1 | 12717.0 | 44.3 |
| 2001/02 | 28733.1 | 12658.8 | 44.06 | 3807.0 | 13.2 | 12570.6 | 43.7 |
| 2002/03 | 32481.2 | 14236.4 | 43.83 | 4785.1 | 14.7 | 13459.7 | 41.4 |
| 2003/04 | 36260.4 | 15554.8 | 42.9 | 6226.7 | 17.2 | 14478.9 | 39.9 |
| 2004/05 | 41839.4 | 15701.6 | 37.53 | 6445.9 | 15.4 | 18885.4 | 45.1 |
| 2005/06 | 43462.3 | 15343.6 | 35.3032 | 6507.6 | 14.9 | 21613.0 | 49.7 |
| 2006/07 | 52146.4 | 16707.6 | 32.0398 | 9343.2 | 17.9 | 26095.6 | 50.0 |

Source: MOF 1998; MOF 2008

i

Appendix III: GDP, Total Revenue, Revenue from Direct tax and Indirect Tax (1990/91 to 2006/07) (Rs. In Million)

| | GDP | Actual Total Revenue | Actual TTR | Actual NTR | Actual DT | Actual IT | Custom | Land Revenue/ House and Land Registration | Import | Export | Excise | Sales/VAT |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| /91 | 275700 | 10729.9 | 8176.3 | 2553.6 | 1368.6 | 6807.7 | 3044.3 | 540 | 2752.6 | 78.5 | 1200.00 | 2026.10 |
| /96 | 349819 | 27893.1 | 21668 | 6225.1 | 4655.9 | 17012.1 | 7327.4 | 1066.6 | 6246.5 | 149.9 | 1944.30 | 6431.30 |
| /97 | 367331 | 30373.5 | 24424.3 | 5949.2 | 5340.1 | 19084.3 | 8309.1 | 1015.4 | 7093.2 | 167.8 | 2298.90 | 7126.50 |
| /98 | 379588 | 32938 | 25940 | 6998.0 | 6013.1 | 19926.9 | 8502.2 | 1004.2 | 7019.4 | 217.1 | 2885.80 | 7122.62 |
| /99 | 396835 | 37251 | 28752.9 | 8498.1 | 7516.1 | 21236.8 | 9517.7 | 1003.2 | 7698.3 | 378 | 2953.20 | 7882.25 |
| /00 | 421012 | 42894 | 33152.1 | 9741.6 | 8951.5 | 24200.6 | 10813.3 | 1015.9 | 8959.9 | 432.5 | 3127.60 | 9854.91 |
| /01 | 441519 | 48894 | 38865.1 | 10028.8 | 10159.4 | 28705.7 | 12552.0 | 612.9 | 10391.9 | 492.6 | 3771.20 | 12047.76 |
| /02 | 442048 | 50446 | 39330.6 | 11115.0 | 10597.5 | 28733.1 | 12658.7 | 1131.8 | 9678.4 | 917.4 | 3807.00 | 11963.97 |
| /03 | 459488 | 56229.7 | 42587 | 13642.7 | 10105.8 | 32481.2 | 14236.4 | 1414.3 | 10567.7 | 855.6 | 4785.10 | 13459.71 |
| /04 | 481003 | 62331 | 48173 | 14158.0 | 11912.6 | 36260.4 | 15554.7 | 1697.5 | 10666.9 | 527.1 | 6226.70 | 14478.91 |
| /05 | 496026 | 70123 | 54104.7 | 16018.0 | 13071.8 | 41032.9 | 15701.5 | 1799.2 | 12299.1 | 697.9 | 6445.90 | 18885.40 |
| /06 | 509911 | 72282.1 | 57430.4 | 14851.7 | 13968.1 | 43462.3 | 15343.6 | 2181.1 | 11744.6 | 625.6 | 6507.60 | 21613.00 |
| /07 | 522666 | 87712.1 | 71126.7 | 16585.5 | 18980.3 | 52146.4 | 16707.6 | 2253.5 | 13626.1 | 708.7 | 9343.20 | 26095.60 |

Source: MOF 1998; MOF 2008

Appendix IV: Revenue expenditure pattern (1990/91 to 2006/07) (Rs. In Million)

| FY | Total Revenue | Regular. Expenditure | Development Expenditure | Total Expenditure | Revenue surplus | % rev. surplus to total rev. | % share of Dev. exp. to total revenue |
|---|---|---|---|---|---|---|---|
| 990/91 | 10729.9 | 7570.30 | 15979.50 | 23549.80 | 3159.6 | 29.4 | 148.9 |
| 991/92 | 13512.7 | 9905.40 | 16512.80 | 26418.20 | 3607.3 | 26.7 | 122.2 |
| 992/93 | 15148.4 | 11484.10 | 19413.60 | 30897.70 | 3664.3 | 24.2 | 128.1 |
| 993/94 | 19581.0 | 12409.20 | 21178.20 | 33587.40 | 7171.8 | 36.6 | 108.1 |
| 994/95 | 24605.0 | 19265.10 | 19794.90 | 39060.00 | 5339.9 | 21.7 | 80.4 |
| 995/96 | 27893.0 | 21561.90 | 24980.50 | 46542.40 | 6331.1 | 22.7 | 89.5 |
| 996/97 | 30374.0 | 24181.10 | 26542.60 | 50723.70 | 6192.9 | 20.4 | 87.4 |
| 997/98 | 32938.0 | 27174.40 | 28943.90 | 56118.30 | 5763.6 | 17.5 | 87.8 |
| 998/99 | 37247.0 | 33944.20 | 22992.10 | 56936.30 | 3302.8 | 8.8 | 61.7 |
| 999/00 | 42894.0 | 35579.10 | 25480.70 | 61059.80 | 7314.9 | 17.0 | 59.4 |
| 000/01 | 48893.6 | 45837.30 | 28307.20 | 74144.50 | 3056.3 | 6.2 | 57.9 |
| 001/02 | 50445.5 | 48863.90 | 24773.40 | 73637.30 | 1581.6 | 3.1 | 49.1 |
| 002/03 | 56229.8 | 52090.50 | 22356.10 | 74446.60 | 4139.3 | 7.3 | 39.7 |
| 003/04 | 62357.0 | 55552.10 | 23095.60 | 78647.70 | 6804.9 | 10.9 | 37.0 |
| 004/05 | 70122.7 | 61686.40 | 27340.40 | 89026.80 | 8436.3 | 12.0 | 38.9 |
| 005/06 | 72282.1 | 67017.8 | 29606.60 | 96624.4 | 5264.3 | 7.2 | 40.9 |
| 006/07 | 87712.1 | 77122.4 | 39729.90 | 116852.3 | 10589.7 | 12.0 | 45.3 |

Source: MOF 1998; MOF 2008

Appendix V: Structure of Direct Tax (1990/91 to 2006/07) (Rs. In Million)

| FY | Direct Tax | Income Tax (IT) | Land Tax (LT) | House & Land Registration (HLR) | Others | %share of Income Tax | % I |
|---|---|---|---|---|---|---|---|
| 1975/76 | 236.00 | 87.20 | 94.80 | 40.70 | 13.30 | 36.95 | |
| 1976/77 | 295.70 | 133.30 | 97.00 | 42.70 | 22.70 | 45.08 | |
| 1977/78 | 306.20 | 136.80 | 87.00 | 54.10 | 28.30 | 44.68 | |
| 978/79 | 253.10 | 103.00 | 54.60 | 55.70 | 39.80 | 40.70 | |
| 1979/80 | 253.80 | 101.00 | 56.20 | 65.00 | 31.60 | 39.80 | |
| 1980/81 | 353.20 | 144.00 | 100.70 | 77.80 | 30.70 | 40.77 | |
| 1981/82 | 379.90 | 189.80 | 81.70 | 88.30 | 20.10 | 49.96 | |
| 1982/83 | 445.10 | 240.20 | 66.70 | 104.80 | 33.40 | 53.97 | |
| 1983/84 | 541.80 | 290.90 | 77.20 | 135.20 | 38.50 | 53.69 | |
| 1984/85 | 559.70 | 307.30 | 76.90 | 141.70 | 33.80 | 54.90 | |
| 1985/86 | 661.80 | 364.40 | 74.20 | 170.10 | 53.10 | 55.06 | |
| 1986/87 | 768.70 | 437.50 | 72.40 | 211.60 | 47.20 | 56.91 | |
| 1987/88 | 1010.00 | 578.00 | 80.70 | 286.20 | 65.10 | 57.23 | |
| 1988/89 | 1331.00 | 861.20 | 80.40 | 320.60 | 68.80 | 64.70 | |
| 1989/90 | 1435.00 | 919.00 | 74.60 | 377.10 | 64.30 | 64.04 | |
| 1990/91 | 1370.00 | 745.90 | 82.10 | 456.60 | 85.40 | 54.45 | |
| 1991/92 | 1595.00 | 855.40 | 64.80 | 571.20 | 103.60 | 53.63 | |
| 1992/93 | 2036.00 | 1124.80 | 69.30 | 682.50 | 159.40 | 55.25 | |
| 1993/94 | 2855.00 | 1824.50 | 61.00 | 772.20 | 197.30 | 63.91 | |
| 1994/95 | 3795.00 | 2823.50 | 34.90 | 902.80 | 33.80 | 74.40 | |
| 1995/96 | 4585.00 | 3431.40 | 18.20 | 1048.40 | 87.00 | 74.84 | |
| 1996/97 | 5234.00 | 4123.30 | 5.90 | 10010.00 | 89.70 | 78.78 | |
| 1997/98 | 6013.00 | 4898.10 | 3.60 | 1000.60 | 110.70 | 81.46 | |
| 1998/99 | 7516.10 | 6170.00 | 1.40 | 1001.80 | 342.90 | 82.09 | |
| 1999/00 | 8931.50 | 7420.60 | 0.70 | 1011.30 | 498.90 | 83.08 | |
| 2000/01 | 10159.40 | 8650.10 | 5.10 | 607.80 | 896.40 | 85.14 | |
| 2001/02 | 10597.00 | 8436.00 | 0.80 | 1131.00 | 1029.20 | 79.61 | |
| 2002/03 | 10105.80 | 7102.20 | 0.00 | 1414.30 | 1589.30 | 70.28 | |
| 2003/04 | 11912.60 | 8512.50 | 0.00 | 1697.50 | 1702.60 | 71.46 | |
| 2004/05 | 12265.40 | 4664.30 | 0.00 | 1799.20 | 5801.90 | 38.03 | |

Source: MOF 1998; MOF 2008

Appendix I: Contribution of Direct and Indirect Tax Revenue as % of Total Tax

| FY | Tax Rev | Direct Tax | | Indirect Tax | |
|---|---|---|---|---|---|
| | | Number | % | Number | % |
| 1975/76 | 911.2 | 236.0 | 25.9 | 675.2 | 74.1 |
| 1976/77 | 1100.1 | 295.7 | 26.9 | 804.4 | 73.1 |
| 1977/78 | 1243.9 | 306.2 | 24.6 | 937.7 | 75.3 |
| 978/79 | 1476.8 | 253.1 | 17.1 | 1223.7 | 82.8 |
| 1979/80 | 1528.8 | 253.8 | 16.6 | 1275.0 | 83.4 |
| 1980/81 | 2035.7 | 353.2 | 17.4 | 1682.5 | 82.7 |
| 1981/82 | 2211.3 | 379.9 | 17.2 | 1831.4 | 82.8 |
| 1982/83 | 2421.1 | 445.1 | 18.4 | 1976.0 | 81.6 |
| 1983/84 | 2737.0 | 541.8 | 19.8 | 2195.2 | 80.2 |
| 1984/85 | 3151.2 | 559.7 | 17.8 | 2591.5 | 82.2 |
| 1985/86 | 3659.3 | 661.8 | 18.1 | 2997.5 | 81.9 |
| 1986/87 | 4372.4 | 768.7 | 17.6 | 3710.6 | 84.9 |
| 1987/88 | 5752.8 | 1010.0 | 17.6 | 4742.6 | 82.4 |
| 1988/89 | 6287.2 | 1331.0 | 21.2 | 4955.8 | 78.8 |
| 1989/90 | 7283.9 | 1435.0 | 19.7 | 5848.8 | 80.3 |
| 1990/91 | 8176.3 | 1370.0 | 16.8 | 6806.6 | 83.3 |
| 1991/92 | 9875.6 | 1595.0 | 16.2 | 8280.4 | 83.9 |
| 1992/93 | 11662.5 | 2036.0 | 17.5 | 9626.3 | 82.5 |
| 1993/94 | 15371.5 | 2855.0 | 18.6 | 12516.0 | 81.4 |
| 1994/95 | 19660.0 | 3795.0 | 19.3 | 15865.0 | 80.7 |
| 1995/96 | 21668.0 | 4585.0 | 21.2 | 17083.0 | 78.8 |
| 1996/97 | 24424.3 | 5234.0 | 21.4 | 19191.0 | 78.6 |
| 1997/98 | 25939.8 | 6013.0 | 23.2 | 19927.0 | 76.8 |
| 1998/99 | 28752.9 | 7516.1 | 26.1 | 21236.8 | 73.9 |
| 1999/00 | 33152.1 | 8931.5 | 26.9 | 24200.6 | 73.0 |
| 2000/01 | 38865.0 | 10159.4 | 26.1 | 28705.7 | 73.9 |
| 2001/02 | 39330.6 | 10597.0 | 26.9 | 28733.1 | 73.1 |
| 2002/03 | 42586.9 | 10105.8 | 23.7 | 32481.2 | 76.3 |
| 2003/04 | 48173.0 | 11912.6 | 24.7 | 36260.4 | 75.3 |
| 2004/05 | 54104.7 | 12265.4 | 22.7 | 41839.4 | 77.3 |
| 2005/06 | 57430.0 | 13968.0 | 24.3 | 43462.0 | 75.6 |
| 2006/07 | 71127.0 | 18980.0 | 26.7 | 52146.0 | 73.3 |

Source: MOF 1998; MOF 2008

Note: Direct Taxes comprise Income Tax, Land Tax and House land registration. Indirect tax include Custom Duties, Excise Duties and Sales Tax

Appendix II: Structure of Indirect Tax (1990/91 to 2006/07) (Rs. In Million)

| FY | Indirect Tax | Custom Duties | | Excise Duties | | Sales Tax/VAT* | |
|---|---|---|---|---|---|---|---|
| | % | Number | % | Number | % | Number | % |
| 1975/76 | 675.2 | 358.5 | 53.1 | 132 | 19.5 | 184.6 | 27.3 |
| 1976/77 | 804.4 | 386.2 | 48.0 | 166.1 | 20.6 | 252.1 | 31.3 |
| 1977/78 | 937.7 | 458.8 | 48.9 | 164.4 | 17.5 | 314.5 | 33.5 |
| 1978/79 | 1223.7 | 626.7 | 51.2 | 192.6 | 15.7 | 404.4 | 33.0 |
| 1979/80 | 1275 | 608 | 47.6 | 215.2 | 16.8 | 451.8 | 35.4 |
| 1980/81 | 1682.5 | 815.8 | 48.5 | 242.2 | 14.4 | 624.6 | 37.1 |
| 1981/82 | 1831.4 | 825.1 | 45.0 | 305.7 | 16.6 | 700.6 | 38.2 |
| 1982/83 | 1976 | 760.9 | 38.5 | 365.8 | 18.5 | 847.7 | 42.8 |
| 1983/84 | 2195.2 | 825.9 | 37.6 | 432.1 | 19.6 | 932.9 | 42.4 |
| 1984/85 | 2591.5 | 1064.4 | 41.1 | 483.8 | 18.6 | 1039.5 | 40.1 |
| 1985/86 | 2997.5 | 1231.1 | 41.1 | 558.7 | 18.6 | 1197.9 | 39.9 |
| 1986/87 | 3710.6 | 1505.7 | 40.58 | 678.6 | 18.2 | 1407.9 | 37.9 |
| 1987/88 | 4742.6 | 2214.7 | 46.7 | 825.4 | 17.4 | 1678.4 | 35.3 |
| 1988/89 | 4955.8 | 2289.9 | 46.21 | 877.6 | 17.7 | 1766.2 | 35.6 |
| 1989/90 | 5848.8 | 2684.9 | 45.91 | 1097 | 18.7 | 2041.4 | 34.9 |
| 1990/91 | 6806.6 | 3044.3 | 44.73 | 1200.3 | 17.6 | 2527.9 | 37.1 |
| 1991/92 | 8280.4 | 3358.9 | 40.56 | 1414.4 | 17.0 | 3461.7 | 41.8 |
| 1992/93 | 9626.3 | 3945 | 40.98 | 1452.8 | 15.0 | 4213.4 | 43.7 |
| 1993/94 | 12516.0 | 5255 | 41.99 | 1592.2 | 12.7 | 5551.5 | 44.3 |
| 1994/95 | 15865.0 | 7018.1 | 44.24 | 1657.3 | 10.4 | 7135.6 | 44.9 |
| 1995/96 | 17083.0 | 7327.4 | 42.89 | 1944.3 | 11.3 | 7739.8 | 45.3 |
| 1996/97 | 19191.0 | 8309.1 | 43.3 | 2298.1 | 11.9 | 8477.6 | 44.1 |
| 1997/98 | 19927.0 | 8502.2 | 42.67 | 2885.8 | 14.4 | 8364.4 | 41.9 |
| 1998/99 | 21236.8 | 9517.7 | 44.82 | 2953.2 | 13.9 | 8765.7 | 41.2 |
| 1999/00 | 24200.6 | 10813.3 | 44.68 | 3127.6 | 12.9 | 10665.0 | 44.0 |
| 2000/01 | 28705.7 | 12552.1 | 43.73 | 3771.2 | 13.1 | 12717.0 | 44.3 |
| 2001/02 | 28733.1 | 12658.8 | 44.06 | 3807.0 | 13.2 | 12570.6 | 43.7 |
| 2002/03 | 32481.2 | 14236.4 | 43.83 | 4785.1 | 14.7 | 13459.7 | 41.4 |
| 2003/04 | 36260.4 | 15554.8 | 42.9 | 6226.7 | 17.2 | 14478.9 | 39.9 |
| 2004/05 | 41839.4 | 15701.6 | 37.53 | 6445.9 | 15.4 | 18885.4 | 45.1 |
| 2005/06 | 43462.3 | 15343.6 | 35.3032 | 6507.6 | 14.9 | 21613.0 | 49.7 |
| 2006/07 | 52146.4 | 16707.6 | 32.0398 | 9343.2 | 17.9 | 26095.6 | 50.0 |

Source: MOF 1998; MOF 2008

Appendix III: GDP, Total Revenue, Revenue from Direct tax and Indirect Tax (1990/91 to 2006/07) (Rs. In Million)

| | GDP | Actual Total Revenue | Actual TTR | Actual NTR | Actual DT | Actual IT | Custom | Land Revenue/ House and Land Registration | Import | Export | Excise | Sales/VAT |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| /91 | 275700 | 10729.9 | 8176.3 | 2553.6 | 1368.6 | 6807.7 | 3044.3 | 540 | 2752.6 | 78.5 | 1200.00 | 2026.10 |
| /96 | 349819 | 27893.1 | 21668 | 6225.1 | 4655.9 | 17012.1 | 7327.4 | 1066.6 | 6246.5 | 149.9 | 1944.30 | 6431.30 |
| /97 | 367331 | 30373.5 | 24424.3 | 5949.2 | 5340.1 | 19084.3 | 8309.1 | 1015.4 | 7093.2 | 167.8 | 2298.90 | 7126.50 |
| /98 | 379588 | 32938 | 25940 | 6998.0 | 6013.1 | 19926.9 | 8502.2 | 1004.2 | 7019.4 | 217.1 | 2885.80 | 7122.62 |
| /99 | 396835 | 37251 | 28752.9 | 8498.1 | 7516.1 | 21236.8 | 9517.7 | 1003.2 | 7698.3 | 378 | 2953.20 | 7882.25 |
| /00 | 421012 | 42894 | 33152.1 | 9741.6 | 8951.5 | 24200.6 | 10813.3 | 1015.9 | 8959.9 | 432.5 | 3127.60 | 9854.91 |
| /01 | 441519 | 48894 | 38865.1 | 10028.8 | 10159.4 | 28705.7 | 12552.0 | 612.9 | 10391.9 | 492.6 | 3771.20 | 12047.76 |
| /02 | 442048 | 50446 | 39330.6 | 11115.0 | 10597.5 | 28733.1 | 12658.7 | 1131.8 | 9678.4 | 917.4 | 3807.00 | 11963.97 |
| /03 | 459488 | 56229.7 | 42587 | 13642.7 | 10105.8 | 32481.2 | 14236.4 | 1414.3 | 10567.7 | 855.6 | 4785.10 | 13459.71 |
| /04 | 481003 | 62331 | 48173 | 14158.0 | 11912.6 | 36260.4 | 15554.7 | 1697.5 | 10666.9 | 527.1 | 6226.70 | 14478.91 |
| /05 | 496026 | 70123 | 54104.7 | 16018.0 | 13071.8 | 41032.9 | 15701.5 | 1799.2 | 12299.1 | 697.9 | 6445.90 | 18885.40 |
| /06 | 509911 | 72282.1 | 57430.4 | 14851.7 | 13968.1 | 43462.3 | 15343.6 | 2181.1 | 11744.6 | 625.6 | 6507.60 | 21613.00 |
| /07 | 522666 | 87712.1 | 71126.7 | 16585.5 | 18980.3 | 52146.4 | 16707.6 | 2253.5 | 13626.1 | 708.7 | 9343.20 | 26095.60 |

Source: MOF 1998; MOF 2008

Appendix IV: Revenue expenditure pattern (1990/91 to 2006/07) (Rs. In Million)

| FY | Total Revenue | Regular. Expenditure | Development Expenditure | Total Expenditure | Revenue surplus | % rev. surplus to total rev. | % share of Dev. exp. to total revenue |
|---|---|---|---|---|---|---|---|
| 990/91 | 10729.9 | 7570.30 | 15979.50 | 23549.80 | 3159.6 | 29.4 | 148.9 |
| 991/92 | 13512.7 | 9905.40 | 16512.80 | 26418.20 | 3607.3 | 26.7 | 122.2 |
| 992/93 | 15148.4 | 11484.10 | 19413.60 | 30897.70 | 3664.3 | 24.2 | 128.1 |
| 993/94 | 19581.0 | 12409.20 | 21178.20 | 33587.40 | 7171.8 | 36.6 | 108.1 |
| 994/95 | 24605.0 | 19265.10 | 19794.90 | 39060.00 | 5339.9 | 21.7 | 80.4 |
| 995/96 | 27893.0 | 21561.90 | 24980.50 | 46542.40 | 6331.1 | 22.7 | 89.5 |
| 996/97 | 30374.0 | 24181.10 | 26542.60 | 50723.70 | 6192.9 | 20.4 | 87.4 |
| 997/98 | 32938.0 | 27174.40 | 28943.90 | 56118.30 | 5763.6 | 17.5 | 87.8 |
| 998/99 | 37247.0 | 33944.20 | 22992.10 | 56936.30 | 3302.8 | 8.8 | 61.7 |
| 999/00 | 42894.0 | 35579.10 | 25480.70 | 61059.80 | 7314.9 | 17.0 | 59.4 |
| 000/01 | 48893.6 | 45837.30 | 28307.20 | 74144.50 | 3056.3 | 6.2 | 57.9 |
| 001/02 | 50445.5 | 48863.90 | 24773.40 | 73637.30 | 1581.6 | 3.1 | 49.1 |
| 002/03 | 56229.8 | 52090.50 | 22356.10 | 74446.60 | 4139.3 | 7.3 | 39.7 |
| 003/04 | 62357.0 | 55552.10 | 23095.60 | 78647.70 | 6804.9 | 10.9 | 37.0 |
| 004/05 | 70122.7 | 61686.40 | 27340.40 | 89026.80 | 8436.3 | 12.0 | 38.9 |
| 005/06 | 72282.1 | 67017.8 | 29606.60 | 96624.4 | 5264.3 | 7.2 | 40.9 |
| 006/07 | 87712.1 | 77122.4 | 39729.90 | 116852.3 | 10589.7 | 12.0 | 45.3 |

Source: MOF 1998; MOF 2008

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## List of Abbreviation

| | |
|---|---|
| ARG | Annual Rate of Growth |
| CBS | Central Bureau of Statistics |
| CEDA | Center for Economic Development |
| CEDECON | Central Department of Economics |
| CD | Custom Duty |
| DT | Direct Tax |
| EJN | Economic Journal of Nepal |
| EPD | Export Duties |
| ED | Excise Duties |
| FY | Fiscal Year |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| IPD | Import Duties |
| IDT | Indirect Taxes |
| GON | Government of Nepal |
| NTR | Non-Tax Revenue |
| OCD | Other Custom Duties |
| OT | Other Taxes |
| ST | Sales Taxes |
| TR | Total Revenue |
| TTR | Total Tax Revenue |
| NRB | Nepal Rastra Bank |
| UDCs | Under Developed Countries |
| ET | Entertainment Tax |
| HT | Hotel Tax |
| AFT | Air Flight Tax |
| CT | Contract Tax |
| RBM | Road and Bridge Maintenance Tax |
| MOF | Ministry Of Finance |