

Role of Income Tax in Nepal's Tax Structure

- Govinda Ram Agrawal*

1. Introduction

Tax structure refers to the level as well as relative importance of various taxes in the composition of total tax revenue of a country. A discussion of tax structure, therefore, should deal with the balance between direct vs. indirect taxes.

The base for levying taxes may be consumption, income, and capital. Taxes on consumption are known as indirect taxes where as taxes on income and capital are known as direct as well as indirect taxes.¹

2. Indirect Taxes and Developing Nations

Heavy reliance on indirect taxes, especially consumption-based taxes, is the major feature of the tax structure of developing nations.² Customs duties, excise taxes and to a growing extent sales tax play a dominant role in their tax structure.³

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1 For a detailed analysis of Nepalese tax structure, see Bhavani Dhungana, N. Kayastha and B. P. Rai An analysis of Tax structure of Nepal (Kathmandu: CEDA, Dec. 1976)

2 See Walter W. Hellar "Fiscal policies for underdeveloped Economies" in Richard M. Bird and Oliver Oldman, Readings on Taxation in Developing countries. Op. Cit.

3 See John F. Due Indirect Taxation in Developing Economies (U. S. A.: The John Hopkins Press, 1970) P. 1.

Table I gives a comparative picture of the reliance of more than 70 countries by GNP class on indirect taxes. It is evident that smaller the per capita GNP of a country, more the reliance on indirect taxes, countries with less than US \$100 per capita GNP, including Nepal, mobilize 68 percent of their tax revenue for countries having per GNP of more than US \$800.

Similarly, an examination of fifty-five countries showed the relative importance of direct taxes in the total government revenue was markedly less in developing countries.⁴ The broad pattern emerging from the above discussion indicates that indirect taxes have been predominant in the tax structure of developing nations.

The main reasons for the heavy reliance on indirect taxes in developing nations can be enumerated as follows:

1. Deep-rooted tradition of raising indirect taxes, mainly because of the feudal or colonial heritage.⁵
2. Low per capita income of the vast majority of masses who do not possess ability to pay direct taxes.
3. Concentration of most of the income and wealth in the hands of small "Wealth groups" who possess enough political and administrative powers to block direct tax measures that threaten their positions.
4. Preponderance of small and unstable business undertakings which present tremendous difficulties in collection of a small amount of direct taxes from a multitude of low income earners. The corporate sector tends to be underdeveloped in these countries.
5. The existence of large pockets of non-monetized sectors, inhabited largely by illiterate people. These sectors may not be relevant for the immediate purposes of

4 See A. R. Prest Public Finance in Underdeveloped Countries (New York: Frederick A. Praeger, 1973) p. 27. It was found that Sudan, Guatemala, Haiti, Iran, Jordan and Thailand derived less than 10 percent of their government revenue from direct taxes whereas this percentage was more than 50 percent for USA, Canada, U. K., Netherland, Australia and New Zealand.

5 Land Tax was the most important traditional source of revenue in many developing nations, Perhaps, this was the only major direct tax of some sort.

Table No 1

Reliance on Indirect Taxes by GNP Class (1965-1969 period)

Estimated Number of per capita GNP US \$	Indirect Taxes			Customs Duties			Sales Tax			Excise Taxes		
	Number of Countries	% of Total Tax Revenue (Average)	Included	Number of Countries	% of Total Tax Revenue (Average)	Included	Number of Countries	% of Total Tax Revenue (Average)	Included	Number of Countries	% of Total Tax Revenue (Average)	Included
	Indirect	Indirect	Indirect	Indirect	Indirect	Indirect	Indirect	Indirect	Indirect	Indirect	Indirect	Indirect
100 or less	20	68	20	52	35	13	33	21	16	24	15	
101-200	11	64	11	50	32	8	21	15	9	30	17	
201-500	19	64	19	51	33	9	25	16	16	29	20	
501-800	9	50	9	38	18	4	37	19	8	36	15	
over 800	15	32	15	12	4	14	35	14	15	46	15	

Source : John F. Due Indirect Taxation in Developing Economies (The John Hopkins Press, 1970) pp. 2, 28, 60, 80.

direct taxation, but they are important in terms of their future potential for direct taxes.

6. Lack of tax consciousness and taxpaying habit on the part of the taxpayers, voluntary compliance has been a rare phenomenon in developing nations.
7. Lack of effective information base. Most of the developing nations lack reliable and up-to-date data about the various aspects of their economy. The tax information system is virtually non-existent. Cooperation and coordination between various revenue agencies is poor. Accounting standards are undeveloped and most of the taxpayers either do not maintain account at all or maintain more than one set of accounts to evade taxes.
8. Policymakers prefer indirect taxes for their revenue generation potential as well as positive psychological impact on taxpayers. Since indirect taxes are paid at source and included in the prices, most of the people are less conscious while paying such taxes. Therefore, argument is forwarded that people prefer indirect taxes to direct taxes and they are easy and cheap to collect.
9. Ineffective tax administration, which tends to be infested with inefficiency, dishonesty, corruption, discretion and incompetent personnel. Tax administrators in developing nations seem to have a limited capacity for administration of direct taxes. This is the important reason for the poor performance of direct taxes.⁶

3. Structure of Nepalese Revenue

The structure of Nepalese revenue is presented in Table 2 and 3. Tax revenue accounts for more than 83 percent of the total revenue. It has grown absolutely from Rs. 105 million in 1962-63 to Rs 1102 million in 1976-77, with an estimate of Rs. 1972 million in 1978-79. This is consistent with the average annual growth of total revenue—about 18 percent over the 1970/71-1976/77 period.

In the total revenue, the share of indirect taxes is about 63 percent and of direct taxes about 22 percent. There is an indication of declining trend in the share of direct taxes.

⁶ Also see Richard Goode The Individual Income Tax (USA: The Brookings Institution, 1964). For a discussion of the conditions in Nepal, see the last section of Chapter one.

From 1965-66 through 1970-71, revenue increased at an average annual rate of 22 percent. The share of tax revenue increased from 84 percent of total revenue in 1965-66 to 89 percent in 1970-71. However, from 1971-72 through 1976-77 revenues increased at an average annual rate of 27 percent. The current trend indicate a showing down in revenue growth to about 10 percent annually. Although comparative importance of direct tax revenue is increasing, Nepal still derives about 75 percent of its tax revenue from indirect taxes.⁷

4. Structure of Nepalese Tax Revenue

The structure of Nepalese tax revenue is presented in Table 4 in terms of consumption, income and capital based taxes. The share of consumption-based taxes has been the largest and has tended to remain at about 75 percent of total tax revenue.

The share of income-based taxes in the total tax revenue of Nepal was a stable figure of 5 percent till 1973-74. However, recently it has shown an increasing trend and was 12 percent in 1976-77.

The share of capital-based taxes (including land tax) has shown a declining trend— from 31 percent in 1967-68 to 14 percent in 1976-77. This indicates poor taxation of capital in Nepal.

Customs duties, although registering four-fold increase between 1965-66 through 1975-76, declined from a high of 51 percent of total tax-revenue in 1965-66 to 39 percent in 1975-76. Revenue from excise duties increased about seven-fold during the same period and its share in total tax revenue increase from 11 percent in 1965-66 to about 14 percent in 1975-76. Sales tax increased by twentyfive-fold over the same period and its share in total tax revenue increased from 3 percent in 1965-66 to over 20 percent in 1975-76.

Income tax has been a fast growing category of tax revenue with twelve-fold increase during the 1965-66—1975-76 period. Its share increased from 4 percent of total tax revenue in 1965-66 to about 10 percent in 1975-76.

Taxes on property rank as the lowest growing of the taxes. Their share in total tax revenue has almost halved from 26 percent in 1965-66 to 15 percent in 1975-76. Two-thirds of the revenue comes from land tax which has remained inelastic because of the lack of discretionary changes in rates and base.

⁷ See George E. Lent and Angelo G. Faria Tax Program for Nepal (Washington, D. C. IMF, Aug. 1977) pp. 8-13.

Over a ten year period (1967-68 to 1976-77) the average share in total tax revenue was consumption-based taxes 74 percent, income-based taxes 7 percent, and capital-based taxes 19 percent. The contribution of consumption-based indirect taxes is three times the combined contribution of income and capital-based taxes in the tax structure of Nepal.

Over the period 1965-66—1975-76 as a whole, about 40 percent of the growth in Nepal's tax revenue appeared to have been due to the "built-in" response to economic growth and improved tax administration. The remaining 60 percent may be attributed to discretionary tax measures. However, over the period 1971-72-1976-77, these proportions were 54 percent and 46 percent respectively, reflecting better tax administration.⁸

5. Income Tax in Nepal's Tax Structure

The role of income tax in Nepal's tax structure is presented in Table 5. It is interesting to note that the collection of income tax in absolute terms has shown a constantly rising trend—Rs 2 million in 1962-63, Rs 23 million in 1972-73, Rs 33 million in 1976-77, and as estimate of Rs 175 million in 1978-79. Its share in total revenue of Nepal, however, remained constant to about 4 percent till 1974-75. It markedly increased to 10 percent in 1976-77. In 1978-79, this share is estimated to decline at 8.6 percent. During the period 1970-71 to 1976-77, the total revenue increased at 18.1 percent, while income tax increased at the rate of 32.03 percent.

The share of income tax in total tax revenue of Nepal was about 4.5 percent till 1972-73. However, This share increased to 12.1 percent in 1976-77 but is estimated to decline to 10.5 percent in 1978-79.

The share of income tax in the tax structure of Nepal has shown a remarkable increase in recent years and contributes about 40 percent of the total direct taxes.⁹ This tax has appeared as one of the fastest growing taxes of Nepal.

The trends of income tax in selected countries for years 1970-71 are presented in Table 6 which shows that the share of income tax (individual + corporate) to total tax revenue was 56 percent in Canada, 46 percent in Japan, 41 percent in U. K., 36 percent in USA, and 36

⁸ *ibid.* p. 10-14 for calculations and further elaboration.

⁹ See Table 2-1 for calculations of income taxes as percent of direct tax.

Table-5
Income Tax in Nepal's Tax Structure

Fiscal Year	Collection in Rs in Million	Percent of Total Tax Revenue	Percent of Total Revenue
1962/63	2.00	1.91	1.54
1963/64	2.79	2.36	1.77
1964/65	5.26	3.49	2.73
1965/66	7.08	4.00	3.27
1966/67	7.73	3.42	3.01
1967/68	11.41	4.02	3.50
1968/69	16.73	4.54	4.05
1969/70	19.63	4.77	4.23
1970/71	21.17	5.35	4.61
1971/72	22.05	4.72	3.98
1972/73	23.38	4.49	3.80
1973/74	32.64	5.08	4.26
1974/75	47.00	5.57	4.66
1975/76	87.17	9.56	7.81
1976/77	133.30	12.10	10.08
1977/78@	140.00	11.27	8.86
1978/79+	175.00	10.46	8.64

@Revised Estimates; + Budget Estimates;

Source: Budget Speeches (Kathmandu : Ministry of Finance)

Table-4

Share of Consumption-Income-Capital-based Taxes in Total Tax Revenue of Nepal
(1967/68-1976/77)

	1967/68	1968/69	1969/70	1970/71	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77	Ten Year Average
A. Consumption-Based Taxes											
1. Customs Duties	129.4	183.6	193.5	156.5	198.6	238.2	286.2	328.5	358.5	386.2	
2. Sales Tax	26.9	48.0	51.1	62.2	69.1	79.8	77.4	190.5	161.9	222.0	
3. Excise Tax	21.5	28.0	38.1	56.6	63.6	67.8	77.4	119.7	132.0	166.0	
4. Entertainment Tax	1.7	1.9	2.2	2.5	2.8	3.7	5.0	5.8	7.0	8.7	
5. Hotel Tax	0.1	0.3	0.5	0.7	0.9	1.5	2.2	2.8	3.5	4.8	
6. Airflight Tax	0.3	0.4	0.5	0.6	0.6	1.3	1.3	2.3	2.7	4.8	
7. Road Cess					3.3	5.6	6.2	6.9	7.6	14.5	
8. Contract Tax	1.5	2.3	1.8	2.5	3.2	4.0	4.9	7.6	9.3	11.8	
9. Miscellaneous	1.3	0.2	0.2								
Sub. Total	182.7	264.7	287.9	281.7	342.1	391.9	381.8	664.1	682.5	818.9	4398.3
Percent of Total Tax Revenue	65%	72%	70%	71%	73%	75%	75%	72%	75%	74%	74%
B. Income-Based Taxes											
1. Income Tax	11.4	16.7	19.6	21.2	22.0	23.4	32.6	47.0	87.2	133.3	
2. House Rent Tax	0.8	0.7						0.1	1.4	1.8	
Sub. Total	12.2	17.4	19.6	21.2	22.0	23.4	32.6	47.1	88.6	135.1	419.2
Percent of Total Tax Revenue	4%	5%	5%	5%	5%	5%	5%	6%	10%	12%	7%
C. Capital-Based Taxes											
1. Land Tax	83.3	79.4	87.7	76.4	83.2	74.5	96.9	90.9	94.8	97.9	
2. Urban Property & Land Tax	0.5	0.4	0.5	0.6	0.6	0.9	1.2	1.7	3.3	4.1	
3. Vehical Tax						0.5	1.1	1.9	2.1	1.2	
4. Registration	5.1	6.4	15.6	15.8	18.9	19.9	28.8	38.0	40.6	44.6	
Sub. Total	88.9	86.2	103.8	92.8	102.7	95.8	128.0	132.5	140.8	147.8	1119.3
Percent of Total Tax Revenue	31%	23%	25%	24%	22%	20%	20%	15%	15%	14%	19%
Total Tax Revenue	283.8	268.3	411.3	395.7	466.8	521.1	642.4	843.7	911.9	1101.8	5936.8
Percent	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Budget Speeches, Ministry of Finance.

percent in France. It was 11 percent in India but only 5 percent in Nepal.¹⁰ However, in 1976-77 this share increased to 12 percent in Nepal which represents a leap forward in domestic resource mobilisation.

6. Structure of Income Tax in Nepal

The structure of income tax in Nepal is presented in table 7 which shows that individual taxpayers contribute more than half of the total income tax in Nepal and salaried taxpayers make the lowest contribution. The contribution of public enterprises has been steadily declining from 21.3 percent in 1973-74 to 17.5 percent in 1976-77. The share of semi-public corporation rose sharply from 2 percent in 1973-74 to 18 percent in 1976-77 but is estimated to decline to 10 percent in 1978-79. The share of private corporate bodies in the income tax of Nepal has shown wide fluctuations—30 percent in 1975-76, 14 percent in 1976-77 and an estimate of 3 percent in 1978-79.

The structure of income tax in Nepal reveals that the corporate sector has not been effective in making meaningful contribution to income tax.

An analysis of 1975/76 data indicates that about 95 percent of assessments were related to individuals in employment and business they accounted for 64 percent of total income assessed and 44 percent of income tax payable, the share of individual business taxpayers being 28 and 38 percent respectively. Thus, all but a small proportion of employees are excluded from income tax net because of exemptions. On the other hand, partnership and corporate taxpayers with incomes up to Rs 20,000 represent 60 percent of such taxpayers but only 10 percent of tax base and 3 percent of tax assessed while 2 percent of such top income earners account for 65 percent of tax base and 78 percent of tax assessed.¹¹

7. Structure of Income Tax Rates in Nepal

The current income tax rates in Nepal are the result of the several years of experimentation with separate and integrated rate structures. In twenty years the rates and slabs have been changed at nine occasions. The slabs have varied from a minimum of five to a maximum of twelve. The rates have varied from 4% to 60%, with a maximum of 51% since 1976/77. Same

¹⁰ For further details see UN Statistical Year Book 1972 (New York: UNO).

¹¹ For details about calculations see George E. Lent and Angelo G. Faria Tax Program for Nepal op. cit. pp. 45-52.

Table-6

Trends of Income Tax in Selected Countries

US \$ in Million

Country	Year	Total Tax Revenue	Individual Income	Percentage to the Total Tax Revenue (a)	Corporate Income Tax	Percentage to the Total Tax Revenue (a)	Percentage Total (a) + (b)
Canada	1970	15,280	6,302	41.2	2,283	15.0	56.2
	1971	16,925	7,081	42.0	2,493	14.7	56.7
Japan	1970	24,280	5,572	22.9	5,580	23.0	45.9
	1971	29,625	6,744	22.8	7,130	24.0	46.8
U. K.	1970	98,196†	37,246	37.9	3,131	3.2	41.1
	1971	104,141†	8,32	38.2	3,458	3.3	41.5
U. S. A.	1970	363,493	101,225	27.8	36,567	10.1	37.9
	1971	377,578	98,130	26.0	30,209	8.0	34.0
France	1970	29,217	5,799	19.8	3,537	12.1	31.9
	1971	31,559	6,080	19.3	3,624	11.4	30.7
India	1970	9,471	620	6.5	471	6.0	11.5
	1971	10,347	649	6.3	494	4.8	11.1
Nepal††	1970	34.3	1.6	4.7			4.7
	1971	33.0	1.8	5.5			5.5

† Capital Tax of Public Sector Included.

†† US \$ converted at the rate of N. C. Rs. 12 = US \$1.

Note: For Nepal 1970 means 1969/70 fiscal years and 1971 means 1970/71 fiscal year.

Source: U. N. Statistical Year Book 1972 (New York: UNO)
For Nepal—Budget Speeches (Ministry of Finance)

Table-7
Structure of Income Tax in Nepal

Sector	1973/74		1974/75		1975/76		1976/77		1977/78@		1978/79+	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%	Rs.	%	Rs.	%
1. Public Enterprise	7.02	21.3	5.49	11.4	12.58	13.3	23.25	17.5	31.69	22.6	33.70	19.3
(100% Government Ownership)												
2. Semi-Public Enterprises	0.66	2.0	3.97	8.2	7.85	8.3	24.49	18.5	10.40	7.4	18.50	10.6
(51% Government ownership)												
3. Private Corporate Bodies	4.34	13.2	7.90	16.4	28.30	30.0	18.56	14.0	6.51	4.7	5.50	3.1
(Public limited companies)												
4. Individuals (Private Ltd., Partnership, sole traders)	18.15	55.1	27.27	56.5	40.53	43.0	71.60	46.7	87.40	62.4	113.30	64.7
5. Salaried Taxpayers	2.75	8.4	3.66	7.5	5.10	5.4	4.43	3.3	4.00	2.9	4.00	2.3
Total Income Tax	32.92	100	48.29	100	94.36	100	132.61	100	140.00	100	175.00	100

@ Revised estimates; + Budget estimates.

Note : The Breakdown for Birgunj field office was not available for 1973-77. Therefore, this has been allocated in proportion to the ratio of rest of Nepal.

Source: For years 1973/74 to 1976/77 Department of Tax, Ministry of Finance, Kathmandu.
For years 1977/78 & 1978/79 Budget Speech, 1978/79 (Ministry of Finance.)

Table-8
Rates for Personal Income Tax in Nepal (1959/60 to 1978/79)

Year	Rupees											
	SLABS (Over and above the Exemption Limit)											
	1	2	3	4	5	6	7	8	9	10	11	12
2016 to 2019 (1959-62)	4000	4000	5000	5000	10000	15000	25000	25000	100000	100000	Balance	Balance
	4%	6%	3%	8%	9%	10%	12%	15%	20%	20%	25%	25%
2020 (1963-64)	1000	4000	4000	5000	5000	5000	5000	5000	10000	10000	20000	30000
	4%	5%	6%	7%	8%	10%	12%	15%	20%	25%	25%	30%
2021 (1964-65)	4000	6000	4000	5000	5000	5000	5000	5000	10000	10000	10000	20000+
	5%	6%	7%	8%	10%	12%	15%	20%	25%	30%	35%	40%
2022 to 2023 (1965-66)	5000	5000	5000	5000	5000	5000	5000	5000	5000	5000	5000	Balance
	6%	7%	8%	10%	12%	14%	17%	22%	27%	32%	40%	40%
2024 (1967-68)	5000	5000	5000	5000	5000	5000	5000	5000	5000	5000	5000+	5000+
	6%	7%	9%	12%	14%	17%	20%	28%	35%	44%	55%	55%
2025 to 031 (1968-75)	10000	10000	10000	10000	Balance							
	7%	10%	20%	35%	55%							
2032 (1975-76)	5000	5000	10000	10000	10000	50000	50000	Balance				
	7%	10%	20%	30%	40%	55%	60%					
2033 to 034 (1976-78)	10000	10000	10000	10000	20000	50000	Balance					
	5%	10%	20%	30%	40%	45%	51%					
2035 (1978-79)	5000	5000	10000	20000	50000	100000	Balance					
	5%	10%	15%	25%	35%	45%	51%					

Note : The above rates apply to individual, married, or family taxpayers. However, till 1973/74 the above rates applied to all types of taxpayers. Thereafter separate rate schedule was specified for firm, companies, and non-resident taxpayers.

Source; Finance Acts (Kathmandu: Ministry of Law and Justice) and Budget Speech for 1978-79 (Kathmandu: Ministry of Finance.)

Table-9
Income Tax Rates for Partnership Firms, Corporations and non-Residents
 (1967-68 to 1978-79)

	SLABS (No Exemption Limit)						
	1	2	3	4	5	6	7
2024 (1967/68)	1000	5000-8%	5000-13%	5000-17%	5000-26%	5000-35%	Balance
2025-30 (1968/75)	0%	5000-10%	5000-15%	5000-21%	5000-32%	5000-45%	45%
2031 (1974/75)	10000	15000	15000	Balance			
Non-Residents	15%	25%	35%	55%			
2032 (1975/76)	10000	15000	15000	Balance			
Non-Residents	15%	25%	35%	55%			
2033-34 (1976/78)	10000	10000	10000	50000	Balance		
Non-Residents	15%	25%	40%	55%	60%		
2035 (1978/79)	10000	10000	10000	200000	500000	Balance	
Non-Residents	10%	20%	30%	40%	45%	51%	
2036 (1979/80)	10000	10000	20000	50000	100000	Balance	
Non-Residents	10%	15%	25%	35%	45%	51%	

Notes: 1. 1967/74 Rates apply to corporate taxpayers only.

2. 1974/76 rates apply to non-resident taxpayers only.

Source: Finance Acts (Kathmandu: Ministry of Law & Justice) and Budget Speech for 1978-79 (Kathmandu: Ministry of Finance).

slabs and rates were applicable to all taxpayers till 1966/67. However, since 1967/68 higher schedule of rates have been prescribed for partnership firms, corporations and non-resident. See Table 8 and 9 for details about slabs and the rates from 1959/60 to 1978/79.¹² Also see Table 10 for exemption limit allowed over the years which has ranged from a low of Rs 3000 to a high of Rs 8500.

A married couple with three children remains outside the sphere of income tax until the income is 9 to 12 times of the average national per capita income in India, Ceylon and Malaya and 15 times in Burma and Phillipines. In Nepal, it was only 6 times in 1974/75, and in about 7 times in 1978/79. Income tax coverage begins at less than twice the average national per capita income in U. K., U. S. A., Canada, Australia and Mexico.¹³

Table 11 gives a comparative picture of maximum marginal rate of income tax along with the level of income beyond which this rate is leviable in selected countries. The maximum marginal rate 51 percent in Nepal is lower in relation to the countries compared. However, the level of income beyond which the maximum marginal rate is leviable varies considerably from country to country. In Nepal, it was only Rs 40,000 in 1973/74, Rs 740,000 in 1976/77 and Rs 1,90,000 in 1977/78.

In the case of Nepal in 1974/75, the highest rate of tax 60 percent was applicable where the taxable income exceeded Rs 46,000 for a family taxpayer but the effective rate at taxable

¹² For reference purposes the Indian income tax rates for 1977/78 are given below:

First Rs.	8000	Exempt
Next	7000	15%
	5000	18%
	5000	25%
	5000	30%
	20000	40%
	20000	50%
	30000	55%
	Balance	60%

Source: Budget Speech for the year 1977/78 of the Government of India.

¹³ See R. N. Tripathy Public Finance in Underdeveloped Countries op. it. p. 186.

Table-10

**Exemption Limit in Nepalese Income Tax
(2016-17 to 2035-36-1959-60 to 1978-79)**

		Rupees			
		All Taxpayers	Single	Married	With Family
2016-17	(1959-60)	7000			
2017-18	(1960-61)	7000			
2018-19	(1961-62)	7000			
2019-20	(1962-63)	7000			
2020-21	(1963-64)	7000			
2021-22	(1964-65)	7000			
2022-23	(1965-66)	7000			
2023-24	(1966-67)	7000			
2024-25	(1967-68)		3000	4500	6000
2025-26	(1968-69)		3000	4500	6000
2026-27	(1969-70)		3000	4500	6000
2027-28	(1970-71)		3000	4500	6000
2028-29	(1971-72)		3000	4500	6000
2029-30	(1972-73)		3000	4500	6000
2030-31	(1973-74)		3000	4500	6000
2031-32	(1974-75)		4500	6000	6000
2032-33	(1975-76)		5500	6500	7500
2033-34	(1976-77)		6500	7500	8500
2034-35	(1977-78)		6500	7500	8500
2035-36	(1879-79)		6500	7500	8500

Note : The exemption was withdrawn for corporate taxpayers from the fiscal year 1965/66, for non-resident taxpayers from 1974/75, for partnership firm from 1975/76.

Source : Finance Acts (Kathmandu : Ministry of Law and Justice)

Table-11
Income Tax Rates in Selected Countries

Country	Level of Income beyond which maximum rate is leviable Rs in Thoushnd	Maximum rate in percentage
India (1973)	278	85
(1977/78)	92	60
Japan (1973)	3176	75
U. K. (1973)	488	75
Nigeria (1971)	320	72.5
USA (1973)	1056	70
Kenya (1973)	304	70
Pakistan (1971)	221	70
Australia (1972)	537	66.7
Ceylon (1971)	89	65
France (1973)	197	60
Singapore (1971)	363	55
Nepal (1973/74)	40	55
(1976/77)	740	51
(1977/78)	190	51

Source : Branko Horvat "Anti-inflation ary. Taration" in **The Economic Times : Taxation and Development** (Special Issue Annual 1974) Times of India Press, Bombay, 1974.

income of Rs 4,46,500 Was only 51 percent. For corporate taxpayers the taxable income of Rs 3,62,500 was subject to an effective rate of 51 percent. ¹⁴

Table--12

Effective Rates of Income Tax in Nepal

1976-78				1978-79			
Personal Case		Corporate Case		Personal Case		Corporate Case	
Slab Rs.	Effective rate %	Slab Rs.	Effective rate %	Slab Rs.	Effective rate %	Slab Rs.	Effective rate %
1,00,000	28.11	1,00,000	34.00	1,00,000	26.96	1,00,000	29.50
2,00,000	33.81	2,00,000	37.00	2,00,000	35.90	2,00,000	37.55
3,00,000	36.79	3,00,000	39.77	3,00,000	40.79	3,00,000	42.03
4,00,000	38.80	4,00,000	40.63	4,00,000	43.29	4,00,000	44.28
5,00,000	40.02	5,00,000	41.50	5,00,000	44.81	5,00,000	45.62
6,00,000	40.84	6,00,000	42.03	6,00,000	45.83	6,00,000	46.52
7,00,000	41.43	7,00,000	42.50	7,00,000	46.66	7,00,000	47.16
8,00,000	42.31	8,00,000	43.34	8,00,000	47.11	8,00,000	47.64
9,00,000	43.47	9,00,000	44.19	9,00,000	47.53	9,00,000	48.01
10,00,000	44.03	10,00,000	44.87	10,00,000	48.28	10,00,000	48.31

Personal Case = Taxpayer with family.

¹⁴ The formula used to calculate the amount for which the effective rate in percent is:

$$X = \frac{PE + Yr - 100t}{r - p} \dots \dots \dots (i)$$

Where X = Amount for which effective rate is P percent

P = Effective rate

Y = Amount after which X is supposed to lie.

t = Tax upto Y

r = rate of Income tax after Y

E = Exemption limit

For corporate taxpayer E = 0, (i) reduces to

$$X = \frac{Yr - 100t}{r - p} \dots \dots \dots (ii)$$

Table 12 gives a picture of effective income tax rates for the years 1976/79. The highest rate prescribed for a taxpayer with family was 51 percent where the taxable income exceeded Rs 7,48,500. However, the effective rate for this level of income was about 42 percent. The effective rate was 44 percent for taxable income of Rs 10,00,000. In the case of corporate taxpayer, the effective rate was about 45 percent for taxable income of 10,00,000.

In the 1978/79 budget the maximum rate of 51 percent is payable where the taxable income exceeded Rs 1,98,500 for a family taxpayer, however, the effective rate at this level of income is only about 35 percent. It is about 48 percent where the taxable income is Rs 10,00,000. For corporate taxpayers, the maximum rate of 51 percent is applicable where the income exceeds Rs 1,90,000. However, at this level of income effective rate is only about 37 percent and does not exceed 48 percent even in cases where the taxable income is Rs 10,00,000.

It can be concluded that there is a significant gap between the marginal rates of income tax and the effective rates of income tax in Nepal.

8. Important Taxes as Percent of GDP

Nepal's tax structure is characterized by significant changes in the level and composition of tax revenue over the years. Over the period 1964/65-1974/75 GDP of Nepal increased by less than three times compared to a five-fold increase in the tax revenue. The rate of total taxes to GDP increased from 4 percent in 1967/68 to 5.6 percent in 1974/75.

Table 13 presents data about important taxes as percent of GDP in Nepal. The ratio of custom duties to GDP was 1.8 percent in 1967/68 but went up to 2.2 percent in 1974/75. The ratio of sales tax to GDP increased from 0.4 percent in 1967/68 to 1.3 percent in 1974/75. The ratio of excise taxes to GDP went up from 0.3 percent to 0.8 percent over the same period. Thus, indirect taxes as a whole have shown an increasing trend in terms of GDP percentage.

As regards direct taxes, the ratio of income tax to GDP increased from 0.2 percent in 1967/68 to 0.3 percent in 1974/75. Land tax had a declining trend 1.2 percent in 1967/68 to 0.6 percent in 1974/75.

The share of income tax in total GDP of Nepal, therefore, was insignificant till 1974/75. Data about GDP of recent years are not available. However, in view of the substantial growth in income tax revenue in recent years, its share in GDP should increase.

Table-13

Important Taxes as Percent of Gross Domestic Product
(Current Market Prices)

Rs. Million

Year	Gross Domestic Product (GDP)	Customs Tax		Sales Tax		Excise Tax		Income Tax		Land Tax		Total Revenue Tax	
		Rs.	% of GDP	Rs.	% of GDP	Rs.	% of GDP	Rs.	% of GDP	Rs.	% of GDP	Rs.	% of GDP
1967-68	7174	129.7	1.8	26.9	0.4	21.5	0.3	11.4	0.2	83.3	1.2	283.8	4.0
1968-69	7986	183.6	2.3	48.0	0.6	28.0	0.4	16.7	0.2	79.4	1.0	368.3	4.6
1969-70	8768	193.5	2.2	51.1	0.6	38.1	0.4	19.6	0.2	87.7	1.0	411.3	4.7
1970-71	8938	156.5	1.8	62.3	0.7	56.6	0.6	21.2	0.2	76.4	0.9	395.7	4.4
1971-72	10369	198.6	1.9	69.1	0.7	63.6	0.6	22.0	0.2	83.2	0.8	466.8	4.5
1972-73	9996	238.2	2.4	79.8	0.8	67.8	0.7	23.4	0.2	74.5	0.7	521.1	5.2
1973-74	12808	286.2	2.2	98.6	0.8	77.4	0.6	32.6	0.3	96.9	0.8	642.4	5.0
1974-75	14602	329.5	2.2	190.5	1.3	119.7	0.8	47.0	0.3	90.9	0.6	843.7	5.6

Source: 1. For GDP Figures

For years 1967/68 Rs 1968/69 **Statistical Pocket Book**, (Central Bureau of Statistics, 1974).

For years 1969/70 to 1974/75 **Progress Evaluation of Fourth Plans** (in Nepali) National Planning Commission, 1976, p. 9.

2. **Budget Speeches**, Ministry of Finance.

Table-14

Per Capita Burden of Important Taxes in Nepal
(At Current Market Prices)

Fiscal Year	Population Million	Income Tax Rs.	Land Revenue Rs.	Customs Duty Rs.	Excise Tax Rs.	Sales Tax Rs.	Total Tax Rs.	Percentage increase previous yr.
1962/63	9.61	0.21	5.51	3.89	0.96		10.89	
1963/64	9.81	0.28	4.08	6.00	1.09		12.04	11
1964/65	10.01	0.53	4.31	8.32	1.39		15.07	25
1965/66	10.22	0.69	4.35	9.15	1.96	0.61	17.32	15
1966/67	10.43	0.74	5.43	11.67	1.91	1.16	21.65	25
1967/68	10.64	1.07	7.83	12.19	2.02	2.50	26.68	23
1968/69	10.86	1.54	7.31	16.90	2.58	4.42	33.91	27
1969/70	11.08	1.77	7.91	17.45	3.44	4.61	37.00	9
1970/71	11.32	1.87	6.75	13.83	5.00	5.51	34.95	6
1971/72	11.56	1.91	7.19	17.18	5.50	5.89	40.37	16
1972/73	11.81	1.98	6.30	20.17	5.74	6.76	44.12	9
1973/74	12.06	2.71	8.04	23.73	6.42	8.17	53.27	21
1974/75	12.32	3.81	7.38	26.67	9.71	15.47	68.48	29
1975/76	12.59	6.92	7.53	28.47	10.49	12.86	72.44	6
1976/77	12.82	10.37	7.62	30.03	12.91	17.26	85.68	18
1977/78	13.14	10.65	6.93	35.05	12.18	20.55	94.52	10
1978/79	13.42	13.04	10.06	48.36	16.87	24.93	124.61	32

Notes : 1. Per Capita Burden calculated by dividing the tax amount by population.

2. Population of 1962 assumed to be the population of fiscal year 1962/63.

Source : Population of 1961 was 9,412,996 From 1961 Census. Population of 1962/63 to 1969/70 extrapolated at the rate of 2.07 per annum.
Population from 1971 is from Population Projecting for Nepal (1971-1986) CBS/NPC
May 1974, Tax Revenue from Budget Speeches.

9. Per Capita Burden of Important Taxes

The per capita burden of important taxes in Nepal over a period 1962/63 to 1978/79 is given in Table 14 which shows that Nepalese people are paying more and more taxes every year. The per capita burden of total taxes in Nepal was Rs 11 when the income tax was introduced in 1962/63, went up to Rs 17 in 1965/66 when the sales tax was introduced, increased to Rs 35 in 1970/71 and Rs 86 in 1976/77. In 1978/79, the per capita tax burden is estimated to be Rs 125.

As regards customs duties, the per capita burden has steadily increased over the years—from Rs 9 in 1965/66 to Rs 28 in 1975/76 with an estimate of Rs 48 in 1978/79. The per capita burden of sales tax has shown the highest increase from less than Rs 1 in 1965/66 to Rs 13 in 1975/76 with an estimate of Rs 25 in 1978/79. The burden of excises duties increased from Rs 2 in 1965/66 to Rs 10 in 1975/76 with an estimate of Rs 17 in 1978/79. The per capita burden of indirect tax as a whole, therefore, has shown an increasing trend over the years.

The per capita burden of income tax increased from Rs 0.2 in 1962/63 to Rs 7 in 1975/76 with an estimate of Rs 13 in 1978/79. The burden of this tax has increased significantly since 1975/76. The per capita burden of land tax remained constant at about Rs 7 till 1976/77 but is estimated to increase to Rs 10 in 1978/79 owing to the substantial increases made in land revenue rates.

It can be concluded that there is an increasing in per capita burden of taxation in Nepal. The burden of income tax has also been rising. This burden is likely to increase in years to come.

10. Conclusion

As per capita income increases, ratio of taxes to GNP increases, and that foreign trade taxation tends to decline relatively while direct taxes on personal and business income rise relatively.¹⁵ This phenomenon has been widely observed in the fiscal history of many countries. Moreover, a significant change in the tax ratio almost invariably involves or is accompanied by a shift in the composition of taxes.¹⁶

15 Harley H. Hienrich A General Theory of Tax Structure Change During Economic Development (Cambridge, Mass. Harvard Law School, 1966).

16 See Raja J. Chelliah "Trends in Taxation in Developing Countries" in Richard Bird and Oliver Oldman Readings On Taxation in Underdeveloped Countries Op. Cit., p. 106.

Multiplication of taxes may weaken the entire tax structure. The rationale of structure may be lost in the complex maze of one set of taxes imposed to adjust for the defects of another set. The rates may be pushed to such heights that the effective enforcement of taxes may not be tenable.¹⁷ Irrational tax structure may adversely affect tax compliance. Size of tax base may be eroded by increases in exemptions.

Taxation trends in Nepal have shown that the role of indirect taxes has been predominant in the tax structure. More than 60 percent of tax revenue is derived from foreign trade alone. However, since 1974/75 the role of income tax has been increasing significantly.

The design of a tax structure must take into account the tax objectives such as revenue generation, equitable distribution and stabilization etc. The tax structure of Nepal has failed to take proper account of the prevailing economic structure and patterns of income distribution. The low share of direct taxes is a clear indication of the ineffective use being made of taxes to effect equitable distribution.

The role of direct taxes must, therefore, increase in the design of tax structure of Nepal. More effective use should be made of income tax to bring about the desired structural changes. This process of fiscal transformation, however won't happen automatically. It has to be deliberately implemented.

Tax structure, at any given time, is the result of a series of policy decisions taken in the past. Sound policy decisions, therefore, are needed to make the tax structure of Nepal responsive to the needs of development.

17 See Stanley S. Surrey "Tax Administration in Underdeveloped Countries" in Richard Bird and O. Oldman Readings on Taxation in Underdeveloped Countries, Op. Cit., p. 480