

Trends and Structures of Direct Taxation and its Share in Gross Domestic Product of Nepal

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Abstract

This study tried to analyze trends and structures of direct tax in Nepal with the adoption of descriptive method. This study, based on secondary data published by the Government of Nepal covering a fiscal year between 1999/00 to 2019/20, also examined the contribution of direct tax in gross domestic product of Nepal. During the study period, direct tax seemed to be fluctuating but increasing overall by 94.44%, while the percentage sharing of all taxes to the gross domestic product was increasing even though it was fluctuating from time to time. Total direct tax was found rising by 16%, on average, over the last 20 years. However, the income tax seemed contributing significantly to both direct tax and gross domestic product during the study period.

Keywords: tax, direct tax, indirect tax, developing countries, gross domestic product

Introduction

Both direct and indirect taxes are vital to collecting adequate revenues to the state for meeting increasing public expenditures of the country—and promoting economic growth, employment, and economic stability. The direct and indirect taxes should go side by side and balance each other. In developing countries, however, direct tax has limited scope, and hence indirect tax plays a more significant role. A well-oriented system of taxation requires a combination of direct and indirect taxes in different proportions (Rahul, 2015).

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A tax is defined as an involuntary fee levied on corporate organizations and individuals and is enforced by a government entity to finance government activities. The imposition of tax—on public debt, printing of currency, sale of assets, and drawing down of cash reserve with the central bank by the government—is one of the ways that government can finance its expenditure. However, tax is a cheaper source of finance for government expenditure compared to the aforementioned alternative sources. Hence, taxation has become a popular source of government expenditure financing (as cited in Ogundana & Adetoyinbo, 2017).

Hakim (2020) examined the effect of both direct and indirect taxes on the economic growth and the collection of tax revenue in 51 developing and developed countries. The findings suggest that direct taxes have a negative and significant effect on economic growth, while indirect taxes show positive but insignificant relationship with economic growth. Additionally, this study found a mixed result regarding the significant contribution of both direct and indirect taxes to the collection of tax revenue in a country. It indicates that indirect taxes, such as consumption tax and taxes on goods and services, seem insignificant and inefficient in maximizing the collection of tax revenue due to the existence of a large informal economy related to the nontaxable sectors, especially in developing countries. In this case, the government might be unable to maximize the collection of tax revenue from indirect taxes compared to direct taxes, such as taxes on personal income, profits, and capital gains (Hakim, 2020).

Objectives

The two objectives of this study are to examine trends and structures of direct taxation and to investigate its share in gross domestic product of Nepal.

Review of Literature

The history of the evolution of direct tax in Nepal is not found to be very old. Except for land revenue, other direct taxes did not seem to be imposed on the people before the advent of political change of 1951 in the country. The nation had virtually remained an authoritarian state before 1951. Both the income and expenditure of the government were used to be a confidential matter. In actual practice, no difference existed between the private purse of the ruling Rana Prime Minister and the Government treasury (Jha, 1981).

Personal income tax, gift tax, and wealth tax would be called as direct taxes since there would be no shifting of tax burden (Srinivasan & Periyasamy,1983). Furthermore, the role of direct taxes in developing economies discourages speculative investment, controls inflation, induces agriculture sector, restricts consumption, reduces inequalities of income, and helps to achieve equality. Direct taxes like taxes on land and capital gains tax are imposed to prevent speculative investment. Direct taxes are also to be used to somewhat reduce inequalities in the distribution of income and wealth. This tax policy is likely to check unproductive investment and release a greater amount of resources available for productivity investment. Direct taxes, especially progressive taxes control inflation. Since the distinction effects of the progressive rates in the nonfunctional personal incomes are low, they would be more important in checking an inflationary pressure associated with the development expenditure. Besides, the personal income taxes can be adopted to have a built-in-flexibility during inflationary period that a higher proportion of the additional income may pass on to the government (As cited in Thapa, 2007).

Basically, tax can be categorized into two broads: direct taxes and indirect taxes. If a person has to directly pay the tax liability to the government, such tax is known as direct tax. A direct tax is really paid by the person on whom it is legally imposed. The liability of direct tax cannot be transferred to others and must be paid by the taxpayer to whom it is legally imposed. The impact of direct tax is limited within the taxpayer who is liable to pay such tax. Income tax, gift tax, interest tax, property tax, death tax, and contract tax are the typical examples of direct tax. The government collects and realizes such taxes directly from the taxpayers. Direct tax is an effective instrument to instill consciousness of the citizens as to how their contribution plays the principal role in the development of the nation as a whole. In Nepal, direct taxes contribute 21% to the tax revenue of the government (Humagain, 2008).

The tax paid by the person who is legally taxed is called direct tax. The effect and burden of this tax falls on the same person. A person, when imposed, is liable to pay taxes; hence, he or she is a real taxpayer. The direct tax is the amount of tax determined by directly assessing a person's income. In addition to taxes such as income tax, gift tax, expenditure tax, property tax, corporate taxes, and taxes paid on the proceeds of property or sales are also considered direct taxes. Because firms or organizations are also legally

like individuals, the tax levied on the firm or organization for various purposes has to be paid directly and falls under the nature of direct tax (Bista, 2011). Bista has also stated that there are some good aspects of the direct tax system; therefore, it has been widely used. Since direct tax is levied according to the ability of the taxpayer, it does not adversely affect the financial ability of the taxpayer. Direct taxes are directly related to the ability to pay. The ability to pay such taxes can be made socially and economically equitable. As the trend of direct tax is progressive, inequality in income and property can be reduced by using direct tax. Since direct tax is less costly, it is considered as a frugal tax system. It definitely contains information about the amount to be paid by the taxpayer. By increasing the direct tax rate, the government can get more revenue. As a result of the increase in the income of the people, the direct tax revenue will automatically increase; hence, there is satisfactory flexibility in this tax. Since the tax burden under direct tax is borne by the taxpayers themselves, the taxpayers are especially vigilant about the use of tax money collected by the government. This will motivate the government to spend the tax collected from the people properly.

Mill (2011) defined a direct tax as one which is demanded from the intended person who should pay it (as cited in Adhikari, 2011). Similarly, Dalton (1998) considered the direct tax as one that is really paid by the person on whom it is legally imposed (as cited in Sundharam & Andly, 1998). Under the study, the major components of direct tax are income tax, land revenue and registration, and property tax. Income tax, the major component of direct tax, also carries various subcomponents to sum up the income tax, such as income tax from public enterprises, income tax from semipublic enterprises and income tax from private cooperate bodies, tax on remuneration, individual income tax, and tax on interest. Similarly, property tax includes urban house and land tax and vehicle tax (Dangal, 2018). A direct tax is a form of tax imposed directly on tax payers who bear the tax burden. Tax burden cannot be shifted to other persons (Nguyen, 2019).

However, in last three decades, there has been a declining trend in tax revenues on basis of personal income tax, while the share of corporate income tax and social security contributions are rising. On the other hand, the share of indirect taxes is changing significantly in the direction of a higher share of taxes on goods and services, especially

value added tax. The property tax has a stable and constant trend on average of 1.8%, while tax on capital and financial transactions are the least generous in an observed group of tax forms. Viewed from this perspective, it can be noted that labour taxes are higher than capital tax which confirms a more privileged treatment of capital against labour, and it is one of the fundamental characteristics of the neoliberal concept of the economy (Todorović, Milenković & Kalaš, 2019).

Direct taxes are those levied on immediately upon the person who is to bear the burden. Direct tax is a tax paid by the person on whom it is imposed legally. Direct taxes cannot be shifted to other. It is really paid by a person on whom it is levied legally. A direct tax is one imposed upon individual person or property (real and personal property). A direct tax is paid directly by an individual or organization to an imposing entity. A taxpayer, for example, pays direct taxes to the government for different purposes, including real property tax, personal property tax, income tax or taxes on asserts. Direct taxes are based on the ability to pay principle. According to this principle, those having more resources or earning higher income should pay more taxes (Shah, 2019).

Method

To examine the trend and structure of direct tax in Nepal, a descriptive, as well as analytical, method of analysis was used. This study analyzed 20 years of secondary data from the fiscal year 1999/2000 to 2019/20. The required data were taken from Economic Surveys and Advisory Committee Report published by Ministry of Finance, Nepal. A log-lin model of simple regression was used to show the trend of total direct tax.

Result and Discussion

Nowadays, income tax, land revenue and registration, vehicle tax, and other taxes are the major sources of direct tax in Nepal. Tables 1 and 2 show the trends and structures of the direct tax and share of direct tax in gross domestic product. Besides, Figure 1 also demonstrates the trend and structure of the direct tax.

Table 1

Trend and Structure of Direct Tax in Nepal

Fiscal year	GDP	Total direct tax	Income tax	Land revenue and registration	Vehicle tax	Other taxes
1999/00	441,51	895	742	102	40	-
2000/01	459,44	1015	911	61	42	-
2001/02	492,23	1059	890	131	38	-
2002/03	49220	1104	984	61	43	16
2003/04	53680	1217	951	170	70	26
2004/05	58910	1338	1047	180	81	30
2005/06	65410	1453	1094	218	85	56
2006/07	72780	1967	1573	225	100	69
2007/08	81570	2480	1908	294	107	176
2008/09	98830	3642	2725	522	185	210
2009/10	119280	4428	3382	551	242	253
2010/11	137500	5184	4206	357	302	319
2011/12	153600	5733	5286	358	356	384
2012/13	170119	8093	6702	534	437	420
2013/14	194262	9416	7804	664	496	450
2014/15	212465	10886	8976	900	550	460
2015/16	2,253,16	10924	8834	1000	599	491
2016/17	2,674,49	10933	8733	1104	598	498
2017/18	3,044,92	11001	8605	1160	655	581
2018/19	3,458,79	12990	10552	1198	657	583
2019/20	3,767,04	16108	13619	1200	698	59

Note. The figures are measured in crore rupees. Taken from *Economic Survey 2002/03, 2010/11, 2012/13, 2017/18, 2019/20 and Revenue Advisory Committee Report 2015*, by Ministry of Finance, Kathmandu, Nepal: Government of Nepal.

Figure 1 was drawn from the columns 1 and 3 of Table 1 to show the structure and trend of total direct tax.

Figure 1

Trend Line of Total Direct Tax

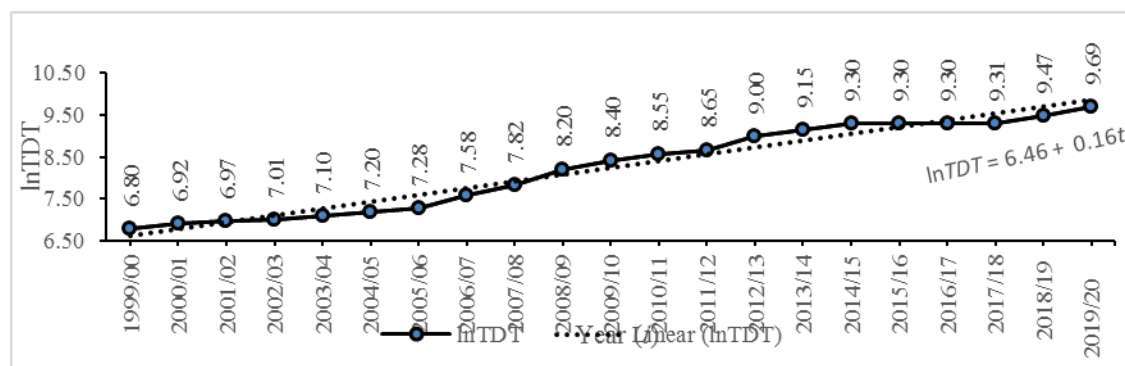


Table 1 shows the trend and structure of income tax, land revenue and registration, vehicle tax, other taxes from 1999/2000 to 2019/20. Income tax became the highest, followed by land tax and vehicle tax the lowest. Based on a log-lin model of simple regression, Figure 1 displays that total direct tax was found rising by 16%, on average, over the last 20 years. Table 2 shows their percentage share to gross domestic product.

Table 2

Percentage Share of Direct Taxes in GDP of Nepal

Fiscal year	Total direct tax	Income tax	Land revenue and registration	Vehicle tax	Other taxes
1999/00	2.06	1.68	0.23	0.09	-
2000/01	2.21	1.98	0.13	0.09	-
2001/02	2.15	1.80	0.27	0.07	-
2002/03	2.24	2.00	0.12	0.09	0.03
2003/04	2.27	1.77	0.32	0.13	0.05
2004/05	2.27	1.78	0.31	0.14	0.05
2005/06	2.22	1.67	0.33	0.13	0.09
2006/07	2.07	2.16	0.31	0.14	0.09
2007/08	3.04	2.34	0.36	0.13	0.22
2008/09	3.68	2.76	0.53	0.19	0.21
2009/10	3.71	2.84	0.46	0.20	0.21
2010/11	3.77	3.06	0.26	0.22	0.23
2011/12	3.73	3.44	0.23	0.23	0.25
2012/13	4.76	3.94	0.31	0.26	0.25
2013/14	4.84	4.02	0.34	0.26	0.23
2014/15	5.12	4.22	0.42	0.26	0.22
2015/16	4.84	3.92	0.84	0.27	0.22
2016/17	4.08	3.27	0.41	0.22	0.19
2017/18	3.61	2.83	0.38	0.22	0.19
2018/19	3.76	3.05	0.35	0.19	0.17
2019/20	4.27	3.62	0.32	0.19	0.16

Note. Calculation was based on Table 1.

From Tables 1 and 2, it can be seen that the total direct tax was observed increasing over the last 20 years from the fiscal year 1999/00 to 2019/20. This tax was Rs. 895 crores in the first year of the study and reached Rs. 16108 crores in the last year. In the 20 years of the study period, this direct tax increased by only 94.44%. In terms of percentage share, the share of these taxes seemed to be fluctuating from time to time. Similarly, the share of income tax in this tax was the highest, followed by land tax, vehicle tax and other taxes. The increase in income tax in the country means that employment opportunities were seen increasing here, indicating that the country is becoming more and more civilized. With the increase in income tax, it is obvious that the

country is moving towards a sustainable tax system. In rich countries, the proportion of direct taxes appear to be higher than that of indirect taxes, while the proportion is lower in underdeveloped countries like ours. Therefore, in most underdeveloped countries like ours, the share of direct taxes seemed weaker than that of indirect taxes, the fact that was also confirmed by Tables 1 and 2.

Conclusion

From the above analysis, income tax, land tax, and vehicle tax appear to have accounted for the largest share in Nepal's direct taxes from 1999/00 to 2019/20. The trends of these three taxes seem to be increasing; more worrisome, however, the land tax does not seem to be scientific so as to generate more revenues and to widen the tax base. Total direct tax turns out to be rising by 16%, on average, over the last 20 years (see Figure 1). In Nepal, like other underdeveloped countries, the direct tax payments tend to be increasing every year, but they do not seem to be growing as fast as they should. Similarly, the share of direct taxes to gross domestic product appears to be disappointing.

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