Contribution of Income Tax to GDP in Nepal

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Abstract

This research paper examines the contribution of income tax in revenue generation in Nepal after 2068 to 2073 B.S. The focus of the article is in the area of tax revenue collection. The results obtained from secondary data and information collected from reports, articles and journals. It is based on descriptive research design with the estimate of income tax to revenue generation. This suggests that the ratio of income tax on GDP is increasing every year since study period. Such a study is important in order to estimate contribution of income tax to GDP. The findings help to solve the problems of income Tax System of Nepal. The main conclusion drawn from this study is the contribution income tax revenue is not sufficient to generate funds of tax revenues. This article recommends that the researchers, government and policy makers who want to know the contribution of income tax revenue to GDP in Nepal.

Keywords: income tax, tax administration, tax revenue, direct tax, VAT, GDP.

Introduction

1.1 Background

Nepal is an agriculture based under developed country. The economic status of Nepal is very poor. Nepal has deficit budget and it has been making economic condition of the country very bad. In this situation, one of the main objectives of each and every nation of the world is to achieve faster economic development and Nepal is no exception to this ever-process. The Government of Nepal is trying to raise the living standard of people conducting various economic development activities. For this, our country needs to manage the various resources like, man, money, machine and materials. To obtain these particular resources government receives income through external and internal sources.

Every government has to spend a lot of money to fulfill its responsibility towards the people to carry out development activity to handle day to day administrative work, to maintain peace and security and to launch other public welfare activities. Tax is one of the major sources of revenue collections. It is a compulsory levy imposed by government on the people and institution of the country according to the prevailing laws.

Income tax can be defined as the contribution from people and business organization to the government from their income either by service or from business without taking the corresponding or direct benefit. A tax imposed on income base is called income tax and Assessment is the process of ascertaining the required tax liabilities. Generally tax can be classified into two types. They are: (a) Direct tax, and (b) Indirect tax. Direct tax which is directly paid by a person and it is legally imposed. Some of the direct taxes are income tax, property tax, health tax and the vehicle tax. Indirect tax is tax which is imposed on one person and paid partly or fully by another. Some of indirect taxes are sales tax, entertainment tax, hotel tax, passenger tax, import or excise duty and value added tax (VAT), etc.

Income tax is well known direct tax. It is considered as one of the major elements of tax revenue. Income tax is charged on person's income according to the law of the nation. It covers all the fees, additional fees, fines etc. Income includes all the incomes which are received from business, investment and employment. Income tax is superior to other business because it is imposed on the basis of paying capacity of the taxpayers.

Income Tax Act 2058 defines as, "A person from any employment, business or investment and the total of that income as calculated in accordance with this Act". Income tax reduces concentration of wealth in a few hands by imposing high rate to those persons and organizations which have high level of income and low rate to those whose income level is lower.

In early days, taxes were considered as immediate source during the scarcity. Taxes were calculated at the time of emergencies to finance wars and to provide communal services. Taxes were levied on the basis of welfare of the people. Taxes were not compulsory payment at that time. People voluntarily paid the tax because non-payment of tax was taken as sin in the Hindu system.

Great Britain was the first country in the world to introduce the income tax in 1799. It imposed income tax in order to finance war with France. Similarly, in USA the first federal tax was imposed in 1862 with the same motives of financing civil war. However, in the beginning, these countries impose income tax temporarily until 1860. Thereafter, since 1913, it was accepted as permanent tax. In this way, income tax was accepted by different countries gradually. Italy started it in 1864, and New Zealand adopted in 1891. Australian and Canada had followed the income tax in 1915 and 1917 respectively. After First World War, the income tax became an important source of tax revenue in many developed countries, by 1939; it has become the most important source of revenue in most developed countries and had made appearance in a number of developing nations (Agrawal, 1980).

In this way, Income Tax has become the regular source national income for all countries over the world. In the beginning, income tax was generally levied at a flat rate. The principal of progressive rate of income tax had been adopted by the United Kingdom and New

Zealand since 1999. Now days, a progressive rate is commonly used rather than flat rate in all over the world.

Income tax in Nepal. Nepalese ancient tax system was based on Vedas, Smritis and Purans. Directives propounded by Manu, Yagnabalka, Chanakya etc. guided the taxation system. At that time, the principle of collecting tax from the people was imposition of tax without harming the activities of the people (Kandel, 2060). In ancient Nepal, there existed irrigation tax and religious moment preservation tax in the time of the king Ansuvarma of Nepal. There was tax for purification of caste as well as cremation of the dead.

During the period of 1825-1903, the major sources of revenue were land and homestead taxes, monopolies customs transit and market duties, mines and mints, the export of forest product, bird, animals and various levies and fines. The taxes were usually collected at three levels: Royal palace, Government, Local.

Imposition and collection of taxes during the 104 year autocratic rule of the Rana family in Nepal prior to 2008 BS was the prerogative of the federal rulers. Only these taxes, which suited the objectives, need and unions of the then ruling prime minister were imposed.

The major source of the revenue in Nepal till 2007 were land tax, custom and excise duties in the form of lump sum contracts, royalties, entertainment tax, and a few other minor taxes. There was no other direct tax in the country except land tax collected on a contractual basis and 'salami', which the government employees use to pay out of their salaries at a very small percentage. The 'salami' was abolished in 2007 BS. Income tax act, 2058 is implemented form, 2058/12/19 BS. This act replaces the Income Tax act, 2031, and other acts related to income tax. There are various additional provisions in the new Act. Income Tax act, 2031 had classified income tax into five groups whereas this act divides only into four groups are as Individual income tax, Corporate income tax, Interest tax and House and Land tax.

Whatever from or nature in taxable income, the act has given the option for husband and wife as a separate nature individual until they do not accept as a couple.

The parliament of Nepal enacted Income tax act, 2058 B.S with effective from the 19th Chaitra, 2058 B.S. The government of Nepal framed Income tax rules, 2060 to clarify the act. This act consists of 143 sections along with 24 chapters. This is a forth income tax act of Nepal. It has been made to minimize the weakness of previous acts and maximize government revenue by improving collection procedure of revenue.

1.2 Research Problems

Contribution of income tax to GDP helps to fulfill knowledge about tax revenue of Nepal. This study based up on income tax structure of Nepal, following specific research question are identified:

- What is the contribution of income tax to national revenue in Nepal?

- What is the impact of income tax on GDP of Nepal?

1.3 Research Objectives

The general objective of this study is to analyze the present income tax system of Nepal and Its effectiveness of self-assessment and to provide proper recommendations to build up the nation. The specific objectives are-
- To identify the contribution of income tax to National revenue of Nepal.
- To examine the income tax on GDP of Nepal.

1.4 Limitations of the Study

The research paper has been written within the boundaries of the following limitations:
- Since the study is based on Secondary data, the results depend up on the reliability and validity of data.
- The coverage of the period is from FY2068/2069 to FY2072/73 B.S.

1.5 Significance of the Study

The outcome obtained from this study can be useful to government and policy makers to solve and frequent change in income tax act and aware people about income tax and encourage them to pay tax. Income tax is a major component of tax revenue and it will also helpful to make equitable society by equitable distribution of wealth.

1.6 Review of Literature

A review of literature helps the researcher to develop a thorough understanding and insight into previous research work that relates to the present study.

It has tried to compare the tax and non-tax revenue productivity of Nepal. The elasticity coefficient of tax and non-tax revenue for the study period were 0.98 and 1.02 respectively, while that of buoyancy coefficient were 1.77 and 1.53respectively, indicates that the discretionary changes made over tax revenue was comparatively more effective than non-tax measures, (Das,1995).

Dahal in his article entitled "Taxation in Nepal: Structure, issues and reforms" has explained that the contribution of income tax to total revenue was 7.8 percent in FY 1975/76 and in 1999/00 it was 14.5 percent. This study has explained that the income tax rates and slabs have been changed radically in recent years. Under new Income tax act, 2002, individual income tax is levied with low rates of 15 percent and 25 percent and the corporate income tax is levied with single rate of 25 percent. For bank and financial institutions income the rate is 30 percent of taxable income (Dahal, 2003).

Dahal in his article entitled " Taxation in Nepal: Structure, issues and reforms" has addressed the narrow tax base, low tax elasticity, higher burden of indirect tax compared to

direct tax lack of voluntary compliance, wide spread tax evasion, leakage etc. as main constraints of Nepalese tax system. Including income from agriculture sector, income from domestic industries, social sector and electricity sector, which contributes 52 percent of total GDP, is exempted from income tax. This report has suggested that about 40 percent extra resource mobilization is possible if proposed tax policy and program (Dahal, 2009).

Bhattrai in his entitle "A study of income tax act, 2002: Problems and Difficulties"has highlighted some problems in implementation of Income Tax Act 2002. It study based on the objectives of finding problems of income tax law, need of reform in income tax system and contribution of income tax in national economy. It finds that there is problem in rules regarding income tax. According to his study complicated tax law, illegal business activities, support of auditors in tax evasion, weak record system of tax administration, social recognition of tax evaders, no belief of people in proper use of tax, unnecessary exemptions and deductions are major problems regarding income tax law. Similarly, it suggests that income tax policy should be formulated based on the economic policy of the nation (Bhattarai,2010).

Karki in his research work "Contribution of income tax to inland revenue in Nepal" has found that tax education is most necessary in Nepal to increase the tax consciousness of tax payers. Self-assessment method is more appropriate for Nepal while assessing income tax. Similarly income tax evasion is the major problem of Nepal for income tax generation and income tax administration is not efficient for tax collection. It recommended there should be respected behavior for tax payer and quality service should be maintained to increase the contribution of income tax to inland revenue of Nepal, (Karki, 2010).

Wasti in his book entitled "Corporate income tax system and its contribution in national revenue of Nepal" has found that income tax system of Nepal is not sound and efficient, basically inefficient tax administration, practice of tax evasion and lack of awareness of tax payers. Tax education is most necessary to increase the tax consciousness of tax payers and honest tax officers. It is essential to make tax act clearer so that tax payers and tax officers may not get confused. Similarly rules and regulations are the most important factor for the effectiveness of income tax in Nepal. Lack of trained and competent tax personnel, complicated tax laws and undue delay in making assessment are the most important causes of ineffectiveness of Nepalese tax administration, (Wasti, 2010).

Bhattrai and Koirala in his book entitle "Taxation in Nepal" has presented the description of tax laws and tax planning. A simplified version of Income tax act, 2001. He has presented theoretical as well as practical aspect on taxation in this book. This book is useful to anyone who is interested in the subject of taxation. This book is also helpful to research work. The aim of writing this book is to provide the readers with basic knowledge of general principles and practices of tax law in Nepal and to develop in them basic skills to handle the tax matter in the text has been presented in a very simple and clear manner for better understanding of the law, (Bhattrai and Koirala,2011) .

Methods and Materials

This research is both qualitative and quantitative in nature. Secondary data have been used in this study. The secondary data have been obtained from economic survey, budget speech, journals and newspaper.

2.1 Research Design

This research has been analytical and descriptive in design using historical data to analyze the income tax of tax revenue in Nepalese economy.

2.2 Population and Sampling

This study is based on secondary data. To assess the structure of income tax, the data from fiscal year 2068/2069 to FY 2072/73 B.S. have taken into consideration.

2.3 Source and Types of Data

To fulfill the objective of the study, secondary data have been used. Data and information used in this study have been collected from secondary sources. The relevant data were collected from the sources: Economic Survey, Official websites of Inland Revenue department, GON: www.ird.gov.np, related text books, reference books of income tax and public finance available at national and international level and different research article.

2.4 Tools and Techniques

In order to analyze the research study, different statistical table, diagrams, graphs, pie chart, trend line etc. have been used.

Results and Discussion

This chapter deals with the analysis with the contribution of income tax to tax revenue in Nepal. The analysis of data is carried out by different figures, tables and charts. In this chapter the data and information in connection with the taxation in Nepal are presented and analyzed which are already published and trying to find out the trend and contribution of income to government revenue.

3.1 Contribution of Income Tax in Nepal

Nepal started delay in practicing of income tax. First of all income tax was imposed by pleading to the people in Nepal in the fiscal year 1959/60 as business profit and remuneration tax. Since then it has been contributing revenue to the nation. Income tax was initially levied on business income and salary income. The contribution of total income tax during the last five years given in the following table:

Table 1

Income tax contribution (Rs.in'000')

Fiscal year	2068/69	2069/70	2070/71	2071/72	2072/73
target	16869200	27087000	36298000	40242332	50813500
Achievement	19077813	27247386	33821327	41725731	52334254
Difference	+2208613	+160386	-2476673	+1483399	+1520754
Percent (%)	113.09	100.59	93.18	103.68	102.99
Growth		8169573	6573941	7904404	10608523
Growth rate		42.82	24.12	23.37	25.42

Source. IRD, 2072/73, yearly report.

While studying about the contribution of income tax in Nepal it is clear that income tax was increased. The above table clearly shows that fiscal year 2069/70 increase in income tax is higher in last five fiscal years. Frequently growth rate of income tax in fiscal year 2069/70 is 42.82%, 2070/71 is 24.12%, 2071/72 is 23.37%, 2072/73 is 25.42%. This trend shows the lowest increase in income tax in fiscal year 2071/72 is 23.37%.During Last five year trend analysis shows that in fiscal year 2070/71 cannot achieve the target and having negative growth 6.82%.

3.2 Trend of Income Tax Revenue

Income tax was imposed by pleading to the people in Nepal as business profit and remuneration tax. Since then it has been contributing revenue to the nation. Income tax was initially levied on business income and salary income. The contribution of total income tax during the last five years under different sectors given in the following table:

Table 2

Structure analysis of income tax contribution (Rs. in '000')

Particular	Fiscal year 2068/69	Fiscal year 2069/70	Fiscal year 2070/71	Fiscal year 2071/72	Fiscal year 2072/73
Institutional income	13268756	19624768	24040474	28580420	35904250
Government academy	204585	959047	1131891	1205957	1455780
Public Ltd. Company	7186458	9425132	12234469	14043883	15223330
Private Ltd. Company	3140371	4197536	6049882	7254295	11274330
Individual firm	2452345	4472091	3834350	4665138	5488220
Others agency	284997	570962	789882	1411147	2462590
Salary income	2451039	3195623	4413147	5784251	7446830
Investment income	3271475	4161963	5108691	7083112	8534160
Rent	721102	960198	897042	1151383	1527680
Interest	1087927	1685094	2466390	4169045	5376150
Capital gain	803492	761617	1043376	881123	567130
Dividend	657694	736546	674504	880105	1060240
Others income of Invest.	1260	18508	6443	1456	2960
Lottery income	19151	17380	20936	15136	35360
Others	67392	246698	249168	262477	412560
Total	19731804	27246432	33811480	41725408	52333160
Increase rate	43.88	73.19	24.09	23.40	25.42

Source. IRD, 2072/73.

   Analyzing the above table Income tax, Salary income Tax, Investment income Tax, Capital gain and Lottery gain Tax are continuously increasing. Among these, Institutional Income Tax has the great contribution. Government academy income tax has low contribution. It is due to poor management system shown by different research and survey report. Current global system focuses on salary Income tax rather than Institutions. Income Tax. But the position of Salary income Tax has the poor position. Individual income Tax collection is very weak it is due to lack of proper monitoring institutions, lack of Taxpaying habits, participation of Investment Income Tax is weak and lack of proper expansion and review of Income tax are the major causes. Review of wage rate, low income and partially loose monitoring are the other causes of low collection of Revenue. Lack of progressive Income Tax system is also another constrains. If the investment environment become fine or favor there will be also progress in income tax collection. Proper management and monitor on House Rent Income Tax and other indirect tax on huge density may increase in revenue collection in large scale.
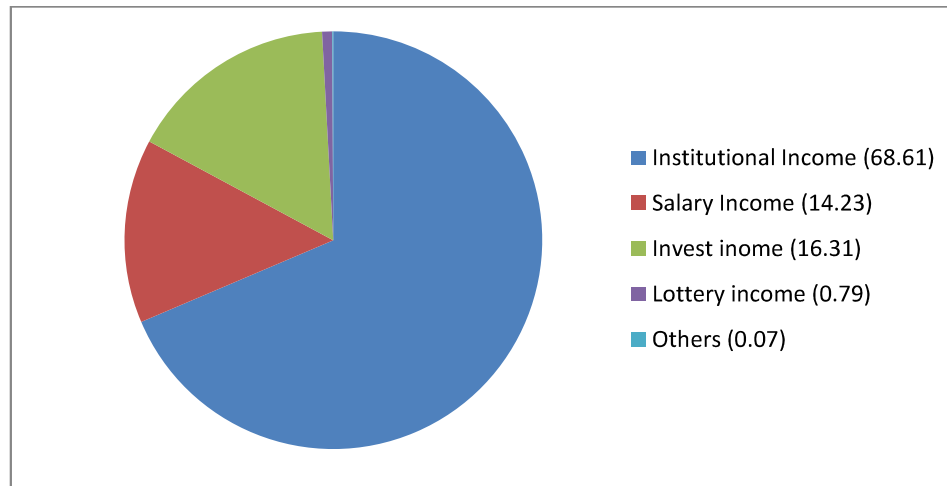
Figure 1. Analysis of income tax
Source. IRD, 2072/73 yearly report.

From the above Table and pie chart it is clear that the position of Institutional Income Tax under total Income Tax is in first position of about 68.612%. This shows that it has vital role in total Income Tax revenue and GDP as well in national budget. Above figure shows that contribution of Investment Income Tax is in second position of about 16.31%, third in Salary Income Tax of about 14.23%, forth in Lottery Income Tax and others by 0.07% is in last fifth position which takes last position in this chart.

All the trend analysis of revenue shows that the contribution of tax revenue is increasing under this income tax is also growing rapidly and expanding. Increasing of income tax shows the prosperity of national economy in gross.
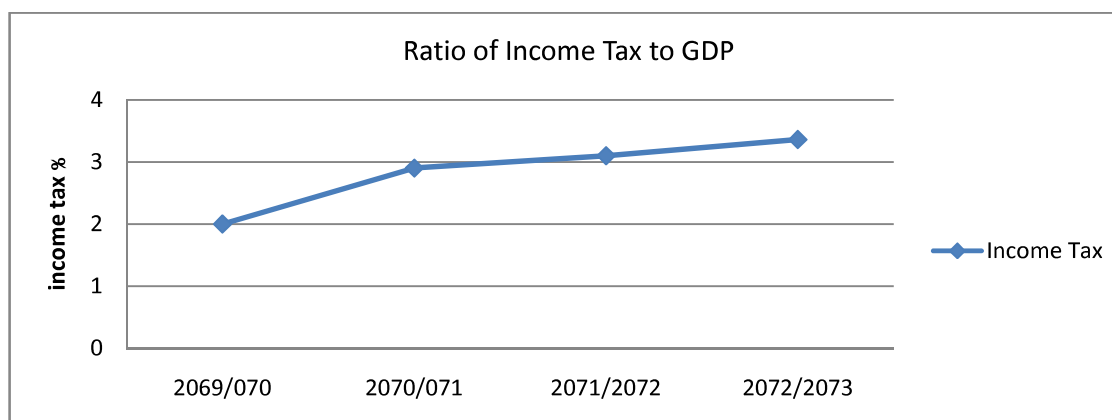
3.3 Ratio of Income Tax to GDP

The ratio income tax on GDP express as follows:

Table 3
Ratio of income tax on GDP

S.N	Fiscal year	Ratio of income tax on GDP (%)
1.	2069/70	2
2.	2070/71	2.9
3.	2071/72	3.1
4.	2072/73	3.36

Source. IRD, 2072/73.

Figure 2.Composition of income tax

From the above table and figure, it is clear that the ratio of Income tax on GDP was gradually increasing, which is clearly showed in above figure? In fiscal year 2069/70, the ratio of income tax is about 2%, in fiscal year 2070/071, ratio of income tax is 2.9%, in fiscal year 2071/072 ratio of income tax is 3.1% and In fiscal year 2072/073 ratio of income tax is 3.36%. After analyzing all the history of income tax system it is developed rapidly after new income tax act 2058.

3.4 Finding

The major findings of this research study from secondary data are summarized below:

The composition of the government revenue is internal revenue and external revenue. Internal revenue includes both tax revenue and non-tax revenue. The contribution of tax revenue shows the increasing trend which contributed.

Income Tax, Salary Income Tax, Investment Income Tax, Capital Gain and Lottery gain Tax are continuously increasing. Among these, Institutional Income Tax has the great contribution.

Income tax is the composition of corporate income tax, individual income tax and investment income tax. Corporate tax is collected from government corporations, public limited companies, partnership firms and private limited companies. Individual tax is collected from remuneration, industry and business professions etc. and investment tax is collected from dividend tax, interest tax, royalty rent tax etc.

Income Tax Administration of Nepal is not efficient due to various causes like weakness in government's economic policy, complicated tax laws and provisions, lack of public participation and lack of trained and competent employees etc.

Income Tax System of Nepal is suffering from various problems and weakness such as lack of trained employees, lack of cooperation in tax administration, increased corruption, voluntary compliance, and ambiguous provisions under the Nepalese tax Laws: limited tax base is difficult to maintain the account for tax purpose, relatively high tax rate, lack of timely adjustment of tax laws, etc.

Conclusion

 Lack of sufficient financial resource and its efficiency is the main constraints for the economic development of Nepal. Sufficient funds are required to meet the objectives of economic development. But, Nepal has not been able to collect necessary funds or revenues. Due to poor performance on internal revenue collection and its mobilization, Nepal has been heavily relying on foreign loans and grants. Thus, it is the most necessary activity to mobilize the internal fund or revenue to the optimum level.

In context of Nepal, Tax revenue is a major source of development. Trends of income tax in study period institutional income contribute 68.61%, investment income 16.31%, salary income 14.23% and total increasing rate of total income tax in 2068/2069 to 2072/2073 are 43.88%, 73.13%, 24.09%, 23.40%, 25.42% to increase the national revenue. Income tax is the most important source of government revenue which is considered as a good remedy to cure growing resource gap in Nepal. The income tax was introduced as train on business profit and the remuneration income. Income Tax is a major tools of revenue collection in Nepal. It impact on Gross Domestic Product ratio is positive It's contribution on GDP is favorable on study period. In 2072/2073, Income tax contribution is 3.36% on GDP in Nepal .This study examines the relationship between tax structures and GDP percent growth by entering income taxes namely corporate, individual and other direct taxes. which has are likely to enhance the prospects for economic growth. It is necessary to increase the share of direct tax through effective and efficient taxation system.

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