Contribution of Income tax and Effects on Revenue Generation in Nepal

Amit Yadav, Mohsin Ali, Maira Anis, Sadhana Tuladhar

Abstract— The study focuses on the structure and trend of income tax and its contribution to government revenue, composition of direct tax, ways of generating more income tax, prospect of online tax paying system, tax evasion and ways of controlling, trend of resource gap and contribution of income tax revenue to GDP. Primary data were collected through a set of questionnaire from tax administrators, tax experts and tax payers. Data analysis was performed with the use of chi-square statistical method. Findings shows that the attitude towards paying income tax have significant difference in tax experts, tax administrators and tax payers whereas attitude towards income tax rate, tax paying habit, good source of government revenue, environment of paying income tax, effectiveness of income tax act 2002 for collecting government revenue, income tax system, effectiveness of income tax system for achieving its objectives, the practice of income tax evasion, poor tax paying habit and tax evasion the crucial factor for low income tax collection, online tax paying system there is no significant difference. Finally, online tax payment system should be implemented to ease tax payer, implementing computerized system to keep track of all tax payers and tax payers should be educated sufficiently on the importance of tax.

Index Terms— GDP (Gross Domestic Product), tax administrators, tax experts, tax payers.

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1 INTRODUCTION

NEPAL is an agriculture based under developed country. The economic status of Nepal is very poor. It was listed as the 11th poorest among 121 countries. Estimates of its per capita income about $420, which is lowest in the South Asian Association for Regional Co-operation (SAARC) Countries and almost lowest in the world. Various factors contributed to the economic underdevelopment i.e. including terrain, lack of resource endowment, landlocked position, and lack of institutions for modernization, weak infrastructure and a lack of policies conducive to development. Nepal has deficit budget as level of revenue generation is comparatively very lower than the expenditure in social and economic infrastructures and it has been making economic condition of the country very bad. Resource gap of the country has been widening from the beginning to recent year.

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. Revenue mobilization also counts as the very important feature of government. The income of government is called government revenue. To finance government expenditure and to redistribute wealth which translates to financing development of the country is the main reason for taxation (Ola, 2001, Jhingan, 2004, Musgrave and Musgrave, 2004, Bhartia, 2009). The development of the country will depend on the needs of the country and countries can seek alternative sources of revenue to finance sus-

tainable development, weather the taxes collected are enough to finance (Unegbu and Irefin, 2011). Government revenue can be collected from both internal and external sources. External resources are loan, grants, bilaterally or through international institution. External resources are uncertain and guided by socio-political motives of the donor countries, such type of resources are not good for healthy development if there is highly dependency on them. Whereas internal sources include public borrowing government bonds surplus on public under taxing and taxation or in simple word we can also say that internal sources of fund are its own source derived within the country. Internal sources should be mobilized effectively and same as Nepal's government tries to mobilize internal sources for regular and development activities.

Developing countries like Nepal, having low per capita income, highly depend on the indirect tax rather than the direct tax. The share of income tax is much lower in the composition of direct tax revenue. In the initial stage of economic development, indirect tax has its own significant role similarly after a certain stage of economic development direct tax plays a vital role. To build up sound financial status and achieving social justice, economic sources should be mobilized effectively, through direct tax like income tax. It has given high preference to the developed and developing countries. The tax that has been paid by people is invested on public expenditure, although they cannot get any direct benefit from their income taxes.

Nepal still has been unable to maximize the collection of income tax. At present the contribution of income tax is insignificant. To achieve economic development, government accounts responsibilities towards their citizens, such as security, health, education, reduce social inequalities and other development activities. It needs to accumulate huge amount of revenue. Every year government spends more portion of the fund to maintain peace and security for the protection of common

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people and creation of various socio-economic infrastructures like; transportation, drinking water, electricity, communication, irrigation and launch other public welfare activities etc. To meet the growing expenditure, government has to manage fund from different sources. This study has been designed to get information on contribution of income tax to national revenue of Nepal.

The paper is organized into five parts. First parts is introduction, 2nd reviews relevant literatures, section 3rd deals with data and methodology, 4th section dwells on empirical result and analysis and section 5th provides conclusion of the paper.

2 LITRATURE RIVEW

There are very few studies which have been conducted on income tax as a source of government revenue in Nepal. Some of revenant related studies to the subject matter were reviewed below.

According to the expert group of United Nations (2000) stated that, tax revenue share considerably to development and therefore, there is the need to contour a nation tax system so as to ensure the realization of optimal tax revenue through equitable and fair distribution of the tax burden. In most of the developing country there is severe budgetary pressure due to demand for government expenditure, limited scope for raising extra tax revenues, as a result of Non-compliance with corporate persons result from technicalities and tax avoidance, poor record keeping and cash transactions. Capital goods purchased by a firm from other firm are not deductible for the tax base in the year of purchase (Khadka, 1989). The main objectives of income tax in Nepal is to raise more revenue, prevent concentration of wealth in a few hands, redistribute wealth for the common good, boost up the economy, reduce unemployment and remove regional disparities. Evasions of taxes are larger in the developed countries because the probability of being caught and the consequences of it are not the same in advanced countries (Tripathay, 1968:183). Amatya K.B (1965) mentioned that how taxable incomes are derived from different sources of income and legal aspect of income tax. Government rules and regulation is being improved on tax to make better taxation system (Kandel P.R, 2003). The governments have at their disposal many tax instruments that can be used to finance their activities (Desai, Foley and Hines, 2004). Tax revenue instability is more common in poor, more open and more inflationary economics (Bleaney, Gemmel and Greenaway, 1995).

Government revenue is the most important source of financing government expenditure and to achieve its objective government has to generate and implement various policies, planning and procedures. The revenue value of most tax expenditures rises with the marginal tax rate, as a result reducing tax rates will mechanically reduce the value of tax expenditures but is unlikely to generate net new revenues and should be distinguished from closing or curtailing tax expenditures, which typically will raise revenue. Tax expenditure reforms

have the potential to raise significant amounts of revenue. Therefore, taxation has been taken as the most effective tools for raising government revenue and mobilizing internal resources for the development of the country. The main objective of taxation is economic development. The main objective of Nepal through income tax are to raise more revenue, prevent concentration of wealth in a few hands, redistribute wealth for the common good, boost up the economy, reduce unemployment and remove regional disparities. Musgrave and Musgrave (2004) also stated that the economic burdens of tax include micro burden on the distribution of income and skillfulness of resource use as well as macro burden on the level of capacity output, employment, prices, and growth. Lack of adequate fraud control planning in our tax laws is one of that major problems encountered in income tax generation. Tax collectors fail to remit the sum to the state, if they do collect these taxes (Asada,1997; Angahar & Sani, 2012; Okpe, 1998). Tax administration and individual suffer from low manpower, fund, tools and equipment to meet the ever increasing challenges and difficulties. Political risk and instability pose the greatest business and regulatory challenges for companies during business in Nepal. Taxation build platform for income and wealth distribution accommodates that effect of taxation should be more for the rich people in the society than the poor ones, so that taxes collected are used to pay for social benefits for the less fortunate (Akintoye, 2013; Oduh, 2012; Angahar & Sani, 2012)

However, in Nepal the contribution of tax revenue had not been encouraging, thus expectations of people on development activity is cut down. Corruption, evasion, avoidance and tax haven indicators are strongly associated with low revenue and indeed, corruption functions like a tax itself (Attali, Chambas, and Combes, 2008). The more country people lack knowledge or education about taxation in the country, the greater the desire and the opportunities for tax evasion, avoidance and non-compliance with relevant tax laws (Adegbie and Fakile, 2011).

3 DATA AND METHODOLOGY

This section explains about data and analytical procedure followed in this study. Data for this study are collected from primary sources. To collect primary data, a set of questionnaire was distributed and collected through field visit to get actual, accurate, reliable information. Udeze (2005) and Uzoagulu (1998) had effected result and included all their observations, input before legal document allotted. The totals of 60 persons have been considered as a sample group i.e. tax experts, tax administrator and taxpayers are considered as total population. Out of total data 20 were tax experts (Auditor, Chartered Accountant, professor, lawyer and policy maker), 20 tax administrators (tax officers) and 20 taxpayers (Bank, Insurance Company, Finance company, trading and manufacturing companies etc.) have been considered as target group. At last data has been presented and analyzed with the help of statistical tools such as test of hypothesis.

Hypothesis test is done to show that weather there is signif-

icant difference or not between tax experts, tax administrators and tax payers views regarding them paying tax. It was developed in 1930 by Karl person.

Where, null hypothesis

Ho: There is no significant difference in the view of tax experts, administrators and tax payers.

Alternative hypothesis:

H1: There is significant difference in the views of tax experts, tax administrators and tax payers.

Test statistic: Under Ho, the test statistic is

$$\chi^2 = \frac{\sum (fe - fo)^2}{fe}$$

Where, fo = Observed frequency and
fe = Expected frequency

$$fe = \frac{Row\ Total * Column\ Total}{Grand\ Total}$$

$$df = (R - 1)(C - 1)$$

Where: df = Degree of freedom; R = The number of rows;

C = The number of columns.

If hypothesis result shows calculated χ2 > tabulated χ2 then it is significant and Ho is not accepted which means that there is significant difference in tax experts, tax administrators and tax payers views and vice versa.

4 EMPERICAL RESULTS & ANALYSIS

From above analysis we found that tabulated χ2 (5.991) remain constant and calculated χ2 varies according to opinion analysis of tax experts, tax administration and tax payers. The opinion towards attitude of paying income tax (A) is maximum in fig1 (calculated χ2= 21.176), which alternative hypothesis H1 accepted and there is significant difference in tax experts, tax administrators and tax payers. It is also clear that about 85% of the respondents that they pay income tax and 15% of the respondents accepted that they don't pay tax.

Those who don't pay tax showed the reason of high tax rate and not very aware of income tax system of Nepal and they think it's waste of money. Tax education is the must to increase the tax payers number and the government should also make the citizen to feel proud as they pay tax, therefore tax certificates or rewards should be given to regular tax payer and motivate to pay tax for new taxpayers. Whereas the opinion towards online tax paying system (K) as more convenient source of collecting government revenue is minimum in fig-1 (calculated χ2=0), which null hypothesis is accepted and there is no significant difference in tax experts, tax administrators and tax payers. It is also clear that all the respondents' thinks online tax paying system is more convenient source of collecting government revenue. 100% respondents support that

online tax paying system is getting more and more important for collecting government revenue while information technology system is getting advanced every day.

Opinion of respondents towards A, B, C, E, F, G, H, I, J re spectively accepts null hypothesis H0 which means there is no significance difference in tax experts, tax administrators and tax payers. From our analysis we also got that 73.33% of respondents responded that income tax is a good source of collecting more government revenue whereas 61.67% respondents believe that tax rate is high and those who don't pay tax showed the reason of high tax rate and not very aware of income tax system of Nepal and they think it's waste of money. Tax rate should be reduced to motivate taxpayers.
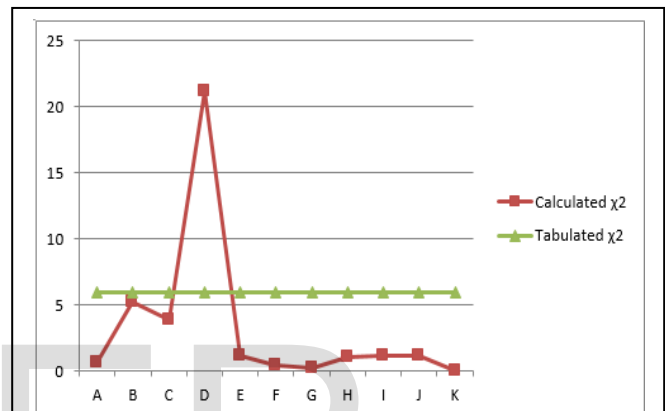

Fig. 1. Analysis of respondent's opinion

A= Income tax as a good source of collecting more government revenue, B= Attitude towards income tax rate, C= Opinion towards tax paying habit of Nepalese people, D= Attitude towards paying income tax, E= Environment of paying income tax, F= Opinion towards the effectiveness of income tax act 2002 for collecting more government revenue, G= Opinion towards income tax system of Nepal, H= Effectiveness of income tax system for achieving its objectives, I= Opinion towards the practice of income tax evasion, J= Opinion towards the crucial factor for low income tax collection, K= Opinion towards online tax paying system

Similarly, 83.33% of the respondents responded that there is a poor tax paying habit of Nepalese people, 66.76% respondents responded that the environment of paying tax is easy, 91.67% respondents responded that ITA (Income Tax Act)2002 is more appropriate, modern and effective tools to collect more government revenue, 76,67% respondents accepted that people are well informed about tax system and its purpose, 66.67% respondents responded that effectiveness of income tax system is not effective for achieving its objectives, 66.67% respondents responded that the tax evasion is most common in practice, 60% of respondents responded that the poor tax paying habit and income tax evasion are the only crucial factor for low income tax.

5 CONCLUSION

Nepal is not being able to achieve higher economic growth despite the planned development efforts. Continuous political instability and conflict has been badly affecting the country and development activities as a result internal and external investment environment is deteriorating. The sources of income tax revenue are public enterprises, private corporate bodies, individuals, remuneration and tax on interest. During the study period, all sources are increasing almost all years but revenue from individuals is increasing in higher rate than others except public enterprises. Corporate bodies are important for nations as they hold huge investment plans and essential for further development.

Therefore, to collect additional revenue, developing investment friendly environment is necessary to tap the advantage of globalization and economic development. Individuals involve in tax evasion the most and it is done through submitting false document, not maintaining proper accounts, over reporting of expenses, under reporting of incomes and maintaining different sets of invoices, operating business transaction in different names and maintaining multiple sets of bank accounts. From our study we also come to know people support on online tax paying system. They prefer online tax because according to their opinion it is more convenient source to collect government revenue, saving time, less procedural complication, easy to access, less paper work, more accurate information and safety of records. The problems can be solved to some extent by proper management of income tax system and will lead to substantial increase in revenue. Nepalese tax administration system has been attempting to modify itself to meet changes in technology and economic policies.

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