

## **Indirect Tax: Trend and Structure in Nepal**

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### **Abstract**

*This study tries to analyze the trend and structure of indirect tax in Nepal and examine the contribution of indirect tax in Gross Domestic Product of Nepal. This study has been based on secondary data published by the Government of Nepal covering a period between 2002/03 to 2019/20 fiscal year. Descriptive method of analysis has been adopted in the study. During the study period, the percentage contribution of indirect taxes to Gross Domestic Product ranges from 6.60 to 14.45. The percentage contribution is observed to be increasing along with the fluctuation trend till 2018/19 but decreased in 2019/20 as compared to earlier years.*

*Keywords:* direct tax, indirect tax, economic growth, developing countries

### **Introduction**

The taxation is categorized into two segments; direct tax and indirect tax. A direct tax is a sort of tax that is imposed directly on taxpayers who bear the tax burden. The tax burden is non-transferable to others. In the context of an indirect tax, the government collects tax from intermediaries. The taxpayer is not a fundamental bearer of economic burden. The differences in the effects of direct and indirect taxes on the economy are generated by the differences in collection methods, revenue bases, and the transfer of economic tax burden. The proper combination of indirect tax and direct tax will enhance the positive impact of tax on the economy (Todorović, Milenković & Kalaš, 2019).

Indirect tax is generally levied on one person but paid partly or wholly by another. Hence people pay tax when they receive or consume goods or services, and people do not feel the burden of the taxation like that of direct tax. Mass participation is possible because every person pays tax for the receipt of goods or services. Indirect tax can be charged at a higher rate for harmful goods, such as cigarettes and alcohol to discourage public consumption on them. Therefore, indirect tax is flexible.

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Examples of indirect taxes are value-added, customs, excise, entertainment tax, and so forth. Mill has explained indirect taxes as those that are demanded from one person in the intention and expectation that they will identify themselves at the expense of another (Adhikari, 2003).

The taxes on such goods and services are integrated with their price. Tax payers can easily shift the burden to general consumers by selling those goods and services at a higher price. (Kandel, 2003).

Indirect tax is the form of tax collected from other persons by transferring the tax liability by the taxpayers. The taxpayer partially or wholly transfers the tax burden to others in society. The burden is imposed on one person, but the incidence of the tax is borne by another person through backward and forward shifting processes. In the context of indirect tax, the person paying the tax and the person bearing the burden of tax is distinct. Value-Added Tax, excise duties, and customs duties are examples of indirect tax. (Amatya, 2004).

Tax plays a crucial role in promotion of economic development in a country which includes resource mobilization, regional development, improvement in social welfare, reduction in income inequalities, inflation control, and foreign exchange (Nzontta, 2007).

The government revenue is collected more from indirect taxes rather than from direct tax. Taxation policy must be included as an instrument for achieving development goals. (Ojha, 2009). Indirect tax transferable, and people pay tax when they consume or receive goods and services. It is shiftable, and people do not feel the burden of the lump sum. There is mass participation because every person pays tax for the receipt of goods and services. Indirect tax can be charged at a higher rate for harmful goods, such as tobacco and, alcohol to discourage them. In the context of the Nepalese revenue structure, the contribution of the indirect tax to GDP, total revenue, and tax revenue has always been significant (Dangal, 2018).

## **Objectives**

The objective of this study is to analyse the trend and structure of indirect tax along with its contribution on GDP of Nepal.

## **Review of Literature**

In the developing country like Nepal, indirect taxes are major sources of government revenue. Hence excise duties, custom duties, and sales taxes /(VAT) have played a major role in the tax structure of developing countries (Due,1970).

Due to the lack of proper mobilization of domestic resources, the development budget of Nepal still depends on foreign loans and grants. Tax has a very important role to play in the internal revenue of the country. About 80 percent of the internal revenue is contributed by tax. Customs, VAT, income tax and excise duty are the main sources of tax revenue in Nepal. The contribution of indirect tax is higher than the direct tax in total tax revenue of the nation. In recent years the indirect tax has contributed about 73 percent to the total tax revenue while direct tax has contributed about 27 percent (Dhakal, 2004).

Indirect taxes have been found to be better for the conditions in developing countries to lessen current consumption and to mobilize resources for the development because quite a large portion of national income there tends to be diverted to current consumption instead of productive investment. The average propensity to consume is much higher in such countries. Consumption must thus play an important role in the field of indirect tax. Indirect taxes raise the rate of saving and so are necessary for economic growth (Ahuja, 2006).

In developing countries, indirect taxes have become an essential source of development funds. Many growing economies that have acquired economic planning use indirect taxes as the major source of funds. These taxes are found to be better suited in developing countries because they have much broader coverage in comparison to direct taxes. Indirect taxes are paid by both rich and poor in form of commodity prices. A high rate of taxes on luxurious items will take away resources from the rich and such resources re-distributed among the poor in the form of subsidies except for taxes on the product like cigarettes, alcohol can have a valuable effect on consumption pattern. Indirect taxes are used to deflect resources from less preferred use to greater preferred ones in developing countries. Taxes on luxury goods will make them more expensive, lower their demand and profitability. This will deflect their resources from the manufacturing of these goods to more required ones (Aklani, 2010). Similarly, Aklani, 2010 concluded that both indirect and direct taxes are essential to bringing sufficient revenue to the state for meeting the rising public expenditure. Both taxes are important to promote economic growth, full employment, and economic stability. Indirect and direct taxes need to be side by side and stabilize each other. However, in developing countries, direct taxation has a finite scope and as a result, indirect taxation plays a more remarkable role. A well-oriented system of taxation requires a combination of indirect and direct taxes in distinct proportions.

The indirect tax is a tax which is collected by an intermediary from the one bearing the eventual economic burden of the tax. It can be transferred by the taxpayer to the others. An indirect tax may raise the price of goods so that consumers are paying the tax by paying more for the products (Rahul, 2015).

Indirect Taxes are primarily the taxes that are not directly levied on the income of an individual but are indirectly levied on the expense suffered by the individual. This tax is fundamentally levied on the goods seller or the service provider but in the majority of the cases, it is passed on to the end consumer and consequently, the end consumer bears this in the form of an indirect tax. To put it in another way, indirect tax is levied on the person who is making the sale but the seller can recover the same from the buyer. In several cases, the indirect tax proportion is specially mentioned in the invoice whereas in other cases – the portion of indirect tax is automatically included in the transaction value and not disclosed individually (Charteredclub.com).

Bazgan (2018) has analyzed indirect taxes will positively impact economic growth in the Romanian economy even from the first quarter of estimation of any optimistic change in the structure of indirect taxes. Although the endogenous variables presented in the VAR model are relevant to describe the analyzed econometric model, the changes in indirect and direct taxes should not be regarded as the only factors that may influence economic growth due to the fact that the macroeconomic variable of economic growth could be affected by many other decisive factors.

Dangal (2018) highlighted that the different areas of indirect tax: Customs duties, excise duties, and VAT made the average contribution of 33.95 percent, 18.86 percent, and 47.09 percent, respectively, which shows the dominance of VAT over other fields of Indirect tax. If we look at the global context, the growth of excise duties is essential, and there is a good sign of it during the study time. The growth in excise duties indicates that there is good production of domestic products in the country, less external dependency on very necessary goods, and the possibility of sustainable development has increased.

Nguyen (2019) has concluded Vietnam for the period 2003-2017. The results show that tax has a positive impact on the economic growth of Vietnam. The impacts of direct tax and indirect tax on the economy are contrasting. Indirect tax has an optimistic effect on economic growth, whereas direct tax has an indistinguishable impact on the economic growth of Vietnam. The results also indicate that there has not been enough evidence to conclude that indirect tax has more guidance on the economy as compared to direct tax. The Vietnamese tax system should be reformed to stimulate sustainable economic growth.

### **Method**

This study follows descriptive as well as analytical method of analysis based on secondary data from economic survey and revenue advisory committee report of

Ministry of Finance, an unpublished thesis/dissertation, journals and books. Simply addition, substrations, percentage and average tools are adopted.

### Result and Discussion

Based on the above literature review, data were taken from various secondary sources from 2002/2003 to 2019/ 20 has been analyzed in this subheading. At present, VAT, customs, excise, and other taxes are the major sources of indirect tax in Nepal. Tables 1 and 2 show the share of major composition of the indirect tax.

**Table 1 :** Composition of Indirect Taxes in Nepal

Fiscal year	GDP	Total indirect tax	Customs	Excise	VAT	Other taxes
2002/03	49220	3247	1423	478	1346	–
2003/04	53680	3626	1555	623	1448	–
2004/05	58910	4104	1570	645	1889	–
2005/06	65410	4346	1534	651	2161	–
2006/07	72780	5215	1671	934	2610	–
2007/08	81570	6207	2106	1119	2982	–
2008/09	98830	8275	2679	1622	3972	1.65
2009/10	119280	11472	3515	2431	5509	16.71
2010/11	137500	12432	3571	2654	6187	20.45
2011/12	153600	14461	4339	3002	7093	27.41
2012/13	170119	17753	5689	3666	8351	47.00
2013/14	194262	21498	6798	4541	10110	49.0
2014/15	212465	23924	7100	5253	11516	55.0
2015/16	225316	26678	7794	6578	12241	65.0
2016/17	267449	34519	9854	8481	16107	77.0
2017/18	304492	43192	12172	10258	20681	81.0
2018/19	345879	50009	13725	12185	24012	87.0
2019/20	376704	44663	11770	10393	22402	98.0

*Note:* The figures are measured in crore ruppees. 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.

The indirect taxes from 2002/03 to 2019/20 was seemed to be increasing and decreasing in the last year. Similarly, the customs duty has generally increased but in some years it has decreased. However, excise duty and VAT are on the rise except in the last year, but other taxes are on the rise, albeit to a lesser extent. The highest

share in indirect taxes is VAT, followed by customs and excise. In such a scenario, changes in VAT will have a major impact on indirect tax collection and will contribute significantly to reducing the budget deficit( Table 1).

**Table 2 :** Percentage share of indirect taxes in GDP of Nepal

Fiscal year	Total indirect tax	Customs	Excise	VAT	Other taxes
2002/03	6.60	2.89	0.97	2.73	–
2003/04	6.75	2.90	1.16	2.70	–
2004/05	6.97	2.67	1.09	3.21	–
2005/06	6.64	2.35	0.99	3.30	–
2006/07	7.17	2.30	1.28	3.59	–
2007/08	7.61	2.58	1.37	3.66	–
2008/09	8.37	2.71	1.64	4.02	0.00
2009/10	9.62	2.95	2.04	4.62	0.01
2010/11	9.04	2.60	1.93	4.50	0.01
2011/12	9.41	2.82	1.95	4.62	0.02
2012/13	10.44	3.34	2.15	4.91	0.18
2013/14	11.07	3.50	2.34	5.21	0.03
2014/15	11.26	3.34	2.47	5.42	0.03
2015/16	11.84	3.46	2.92	5.43	0.03
2016/17	12.90	3.68	3.17	6.02	0.03
2017/18	14.18	4.00	3.37	6.79	0.03
2018/19	14.45	3.97	3.52	6.94	0.03
2019/20	11.86	3.12	2.76	5.95	0.03

**Note:** All figures are measured in percent. Calculation was based on Table 1.

The percentage contribution of indirect taxes to GDP ranges from 6.60 to 14.45. The percentage contribution is observed to be increasing along with the fluctuation trend till 2018/19 but decreased in 2019/20 as compared to earlier years. The percentage contribution of VAT is seen to be 2.70 to 6.94. After that, the contribution of customs duty is 2.30 to 4 percent and the contribution of excise duty is 0.97 to 3.52 percent while the contribution of other taxes is negligible.

The share of VAT increased both in absolute as well as relative terms during the study period. This shows that the contribution of VAT increased, and more than 6.94 percent of GDP can be collected from VAT in recent fiscal year.

It is good that VAT is growing strong being the center of taxation. Either it is domestic production or import, VAT is collected. It is a simple taxation system being a single rate system. VAT is imposed on all the good except those for which direct VAT exemption is given. Thus, it contributes more than 48 percent to indirect tax. The beginning of VAT is a leap forward for tax reformation VAT is neutral and economy too.

Revenue from excise duties also increased in absolute term, but in relative term, it fluctuated between 0.97 percent and 3.52 percent. Because of political conflict, low growth of industrial product, and lack of security in industrial sector, relative share of excise duties was found fluctuating.

Both the total amount and percentage of tax increased during the period of the study due to the increment in the rate of tax percentage on the goods like liquor and tobacco/ cigarette, increment in the number of tax payers, and the broadened base of tax. The good aspect of this tax is that it is an alternative to the barriers on customs imposed by WTO, and it is also the sustainable source of revenue the beautiful aspect of it is that there won't be negative effect on the number of tax payers and the amount of tax collection. Similarly, although the increased tax percentage creates price climb of the goods, it doesn't decrease the number of consumers and the sale of these goods (Table 2).

## **Conclusion**

The indirect tax was seemed to be contributed more to the revenue. The larger amount of tax was collected through VAT, customs duties, and excise duties. The result shows the dominance of VAT over other fields of indirect tax.

At the preliminary stage of economic development, indirect taxes have a vital role like the Romanian. However, after a certain stage of economic development is reached, direct taxes have a significant role. In the context of economic development, indirect taxes offer several important advantages: maximization of Government revenue for financing infrastructure and capital investment; redistribution of luxury consumption more effectively permitting a higher rate of saving and investment; restriction on the import of luxury goods thus securing a good deal of foreign exchange; administrative use; and less harmful to incentives than direct taxes.

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