Tax Evasion and Avoidance: Empirical Insight from Nepal

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Abstract

Taxation is a benefit given to the government to assist the government in meeting the requirements of the people. Tax evasion, on the other hand, is the act of failing to pay taxes by illicit means. Taxation is a mandatory public contribution that is the fundamental source of government revenue. Tax evasion is an illicit conduct that causes income disparity and halts the economy, resulting in economic instability. Tax evasion is often associated with the shadow sector. Income disparity expands the tax gap or the total amount of an individual's unidentified income. This is the difference between the amount required to be reported and the amount reported. This article aims to comprehend better the relationship between government tax income and tax evasion. In contrast, the article explores the concept of tax evasion and discusses how an individual or an organization of businesses might properly use tax regulations to decrease their taxable income. Both activities fall into a category that makes a state's tax structure unfair. Furthermore, tax avoidance and evasion reduce the government's revenue sources, with the latter drastically reducing revenue income. According to the investigations, most people view paying taxes as an inconvenience, even though the amount of tax is substantially less large. This might be because taxpayers view that the taxes they pay are not being used efficiently by the government and that the tax rate is overbearing.

Keywords: Taxation, tax evasion, tax avoidance, tax reduction, tax burden, compliance failure.

Introduction

Taxation refers to the government's revenue collection as a percentage of each individual's income. Taxation, in addition to being the primary source of government revenue, is another resourcefor achieving a country's economic goals. It is seen as a significant factor in promoting economic growth and the long-term economic and social development of a country. According to Becker and Spicer (1980), there will be no advanced or contemporary state if there are no taxes, and similarly, there will be no tax evasion if there is no taxation. Furthermore, because of the presence of immeasurable and shadow economies, which carries with it tax evasion, the economy's progress may be jeopardized. Tax evasion, being an unlawful method of evading taxes, has an impact on the economy as a whole as well

as the behaviours of taxpayers(Becker&Spicer, 1980).Tax evasion refers to the "complete or significant failure to pay off budget taxes and other sums owed to the state budget, municipal budgets, government social insurance budget, and special resources"(Petre Brezeanu et al., 2011).

Taxation is the obligatory collection of funds from the general population by government agencies for public benefit. Income tax, corporation tax, property tax, customs duty, rent tax, and value-added tax are all examples of taxes that can be classed as direct or indirect. High tax rates, easily swayed tax collectors, social acceptance of tax evasion, low likelihood of tax fraud being discovered, and low moral standards were suggested as contributing factors to tax evasion in the country by researchers looking into the causes and solutions for tax evasion and corruption in the tax system (Arora, & Rank, 2010).Tax evasion in economies that are emerging can also be attributed to an inefficient tax collection mechanism. Recent research by Pantoja and Penaloza (2014)has shown that tax evasion is a growing problem that has spread over the world(Pantoja, & Penaloza, 2014).Allingham and Sandmo (1972), the first researchers to examine the elements that motivate taxpayers to cheat income tax, concluded that cheating taxes is determined by the chance of fees and penalties and the probability of detection. A portion of the hidden economy that is not declared, registered, or made public is referred to as the "shadow economy" (Allingham, & Sandmo, 1972).The term "shadow economy" refers to an illegal economy that makes earnings by violating the tax laws and regulations of a country (Feige, 1997).

In addition to being illegal and unethical, tax evasion contributes to the shadow economy. Individuals who work in the shadow economy hide their income and, as a result, do not file taxes. In addition, failing to file a tax return, hiding or not reporting actual income, filing a fraudulent tax return, claiming an unreal deduction or overstating the amount of deductions, and, most notably, making false entries in the books and keeping two books on purpose are common methods of tax evasion.

The illegal avoidance of taxes and a refusal to pay taxes is known as tax evasion. There is an enormous gap between the essential tax liability and the real tax paid.Devarajappa (2017) assessed the effects of tax evasion on government income and the level of tax evasion in the country. He discovered that the biggest amount of taxes avoided was recorded in 2008-2009, while the least amount of tax evaded was reported in 2002-2003.The use of lawful procedures to strengthen one's financial position to pay less tax, especially income tax, is known as tax avoidance. This can frequently be achieved by looking for legal and acceptable tax credits and deductions. People often confuse avoidance with evasion of taxes(Devarajappa, 2017).

Green (2009) investigated what was seriously wrong with tax evasion from a psychological and moral standpoint, as well as whether a person's underlying morals supported the process. He discovered that the public viewed non-payment of taxes as a moral violation; yet, their arguments were justifiable, such as high tax rates and the government's poor use of taxpayers'money. Tax avoidance is determined by four major variables.

a.   Age, gender, educational attainment, and employment status as demographic variables

b.   complexity, fairness, interaction with revenue authorities, compliant peers and ethics, or tax morale as cultural and behavioural variables,

c.   Legislation as Legal and institutional variables

d.   Lastly, income source, marginal tax rates, sanctions, income level, and probability of detection as economic variables. However, in a developing nation, tax morale is seen as the most significant effect(Green, 2009).

Whereas tax avoidance and tax evasion use illegal methods. Because tax avoidance is promoted, the tax code is more complicated. Looked at tax fraud and tax expenditures, and how these influence developing nations. In the study, it was shown that tax avoidance had a smaller effect on tax revenue than tax evasion. He also discovered that to close the income gap, the tax-collecting system must be effective and free of corruption (Fuest, 2009).

Tax evasion encompasses both authorized operations and purchases made according to tax rules. The primary reasons for tax evasion are high tax rates and incompetent tax administrators. They attempted to determine the connection between tax officials and tax evasion. They determined that simplifying tax regulations and closing loopholes in the legislation is the best method to prevent tax evasion(Laliwadhwa, & Pal, 2012).

The most common tax-avoidance strategy is through employer-sponsored retirement savings plans. Taxes can be avoided by using legal exclusions. Renowned economist McCulloch (1863) pointed out that the industrial revolution in France was mostly caused by tax fraud and corruption in government (McCulloch, 1863).

Taxation is a fundamental utilized by the government to rise funding to pay for all of its expenditures.Nonetheless, Nepal and other developing countries have low tax-to-GDP ratios. Because of this, emerging nations struggle to maintain even the most basic of requirements due to a lack of resources. Public finance specialists contend that taxpayer cooperation is necessary to maximise tax administration effectiveness while minimising tax evasion. Nepal, one of the world's least developed countries, is not an exception in this regard.

According to Bhoj Raj Ghimire, the joint secretary of the Nepali government at the time, "tax evasion is a part of Nepali culture," as stated in The Nepali Times (2002).As a result, practically all taxpayers are culturally driven to pay fewer taxes(The Nepali Times, 2002). Similarly, according to Gyawali (2017), the Commission for Tax Clearance of Nepal is institutionally corrupt (Gyawali, 2017)Furthermore, in December 2015, A foreign company called TeliaSonera transferred all of its shares to another foreign company called Axiata without having to pay capital gains tax to the Nepali government. This amounted to more than 33 billion rupees in tax evasion(The Himalayan Times, 2015).

Nepal went up to 110 in 2018 from 94 in 2019 on the Doing Business Comparative Report, according to the World Bank (2016).According to the report, "data changes, regulatory environment, and a decline in Nepal's business are the key causes for the dip" (World Bank, 2016).

The Kathmandu Post (2017)and Trading Economics (2017) state that corruption perception ranking ranked Nepal 117th out of 190 countries.

According to Nalishebo and Halwampa (2014), these factors might lead to an increase in the tax gap within an economy. Seven factors affecting gaps in tax collection were determined in the research (Nalishebo, & Halwampa, 2014).

Figure1: Factorsoftaxgap

Despite the lack of research in this area, tax evasion is a widespread practice, which makes the current scenario in Nepal remarkable. As a result, we made an effort to look at the issue of tax evasion, how it relates to other forms of taxes, and how it affects economic growth.
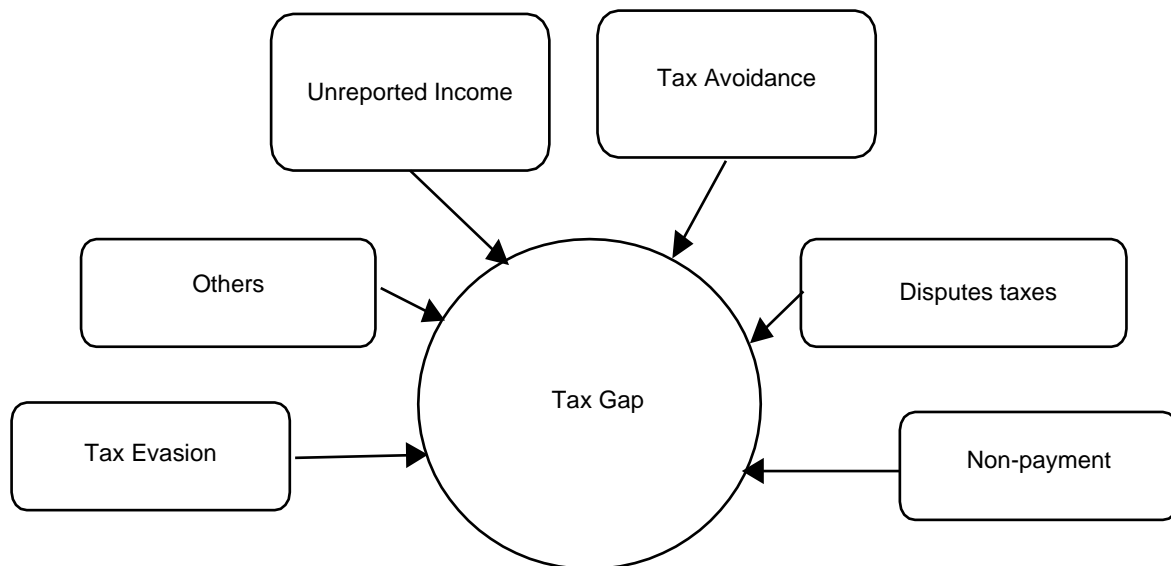
Review of literature

With a focus on a description, summary, and assessment of each review source, this part's study is a summary of earlier research and analyses. As a result, we examined and discussedthe research on tax evasion while considering other factors such as low compliance rates, psychological aspects, the design of the tax system, and the structure of taxpayer statements.

A high tax rate and a huge fine encourageevasion of tax to the individual, and as a result, people underreport their income(Friedland, Maital, & Rutenberg, 1978). To prevent future tax evasion, the government should explore both emotional and financial factors(Hasseldine, & Bebbington, 1991).Tax avoidance and evasion cannot be eliminated by changing the system of taxation. The evasion of taxation is reduced when the tax base grows(Simser, 2008).Income level, employment status, gender, age group, nationality, education level, and employment status all have significant effects on how often tax evasion arises (Devos, 2005)People who make little money, labour a lot, and are treated harshly are more likely to engage in tax evasion(Barth, Cappelen, & Ognedal, 2006)Federal tax in the US of America is noncompliant at 14%, with tax evasion varying in severity(Slemrod, 2007).Complicated income tax laws, rapid change, and poor government activities all raise tax evasion. Tax evasion is controlled by basic tax legislation and the employment of some non-legal measures(Malkawi, & Haloush, 2008).The regularity of tax-related corruption increases corporate noncompliance (Joulfaian, 2009). Personal income tax rates and tax evasion have a significant association(Uadiale, Fagbemi, & Ogunleye, 2010).Tax burdens and tax evasion are positively correlated, government size, and inflation, but taxpayer income and trade openness have a negative relationship between tax fraud(Tabandeh et al., 2012).The single most important issue impeding growth in the economy is tax evasion (Bekoe, 2012).The main issues include bribery of tax administrators through tax agents,

loopholes in the tax system, and corrupt practices (Dalu, Maposa, Pabwaungana, & Dalu, 2012).Tax evasion and avoidance have a positive relationship with personal income tax rates in developing countries(Adebisi, & Gbegi, 2013).A small tax base fosters tax evasion; hence the government should broaden the tax (Xuereb, 2015).Higher tax rates are connected to higher levels of tax evasion and economic instability, according to a study on the U-shaped relationship between tax rates and tax evasion(Mehrara, & Farahani,2016). Overall tax collection and economic growth have a very negative connection over the long term. A 1% increase in total taxation lowers GP by 1.25%(Ahmad, Sial, & Ahmad, 2016).Both the total amount of evasion and the number of evaders in the economy increase with a higher tax rate (Bethencourt, & Kunze, 2015).Tax evasion reduces tax revenue as well as economic growth(Gillman& Kejak, 2006).

According to a review of the research, tax evasion reduces tax collections, reduces economic growth, and generates social instability. The study of tax evasion fills a substantial gap in Nepalese literature. As a result, we attempted to learn more about tax evasion in Nepal.

Method

Research methodology is connected with the complete research process, beginning with the philosophical and theoretical aspects of data gathering and analysis. The primary data collected for this study is supported by secondary data obtained from books, journals, and other online sources. Because the population was too large, the current study employed a basic random sampling strategy to choose samples.

A survey was employed as the main source. The respondents individually obtained the surveys. The respondents were requested to complete closed-ended questions that had been designed. Respondents completed questionnaires with the options to strongly agree, agree, Fairly Agree, strongly disagree, and disagree. The analytical method used to examine the data that was collected for this study is the Likert Scale. To analyze data, we applied the following equations.

Likert Scale (Mean Point)=∑FX

$$N$$

Mean Point of Scale=∑X

$$N$$

Where,

(F is for frequency, X is for scale, N is for the number of scale and frequency, e is the margin of error, which is often expressed as 5% = 0.05, and the cutoff value is equal to mean + e = 3.00 + 0.05 = 3.05)

Within the Kathmandu valley, 200 randomly selected sample respondents between the ages of 20 and 60 were selected (Kathmandu, Lalitpur, and Bhaktapur). The target population for respondents consists of taxpayers, tax administrators, and tax specialists.

Empirical Result and Analysis

To collect a sample of 200 people from the population for primary data analysis, the researcher used the judgmental sampling process.There were 124 male responders (62%) and 76 female respondents

(38%) among the 200 total. The ages of the sample participants ranged from 20 to 30 years old for 21%, through 30 to 40 years old for 34%, 40 to 50 years old for 31%, and 50 to 60 years old for 14%.They were self-employed in 45% of cases, worked in the public sector in 26% of cases, and engaged in the private sector in 29% of cases.31% of them earned between Rs 5, 00,000 and Rs 10, 00,000 per year, whereas 12.7% made more than Rs 10, 00,000 per year. Of them, 52.5% earned between Rs 2, 00,000 and Rs 5, 00,000 per year.

1.   Do you also agree to file a tax return including the tax amount on time?

The Likert Scale was used to calculate the figures in Table 1 below.

Table 1

Figure computation (by applying the Likert scale)

Respondent	F	X	FX
Strongly Agreed	20	3	60
Agreed	104	5	520
Fairly Agree	74	4	296
Disagreed	2	2	4
Strongly Disagreed	0	1	0
Total	**200**	**15**	**880**

Source: *Field Survey (2022)*

The calculated mean point for responses regarding the effectiveness of taxes is 4.4, which exceeds the designated cut-off point of 3.05. According to the decision rule, this indicates a large number of the respondents agreed to file tax returns and paid their taxes on time or early.

2.   *Do you agree that a high tax rate is a hardship for taxpayers?*

The Likert Scale was used to calculate the figures in Table 2 below.

Table 2

Figure computation (by applying the Likert scale)

Respondent	F	X	FX
Strongly Agreed	92	5	460
Agreed	52	4	208
Fairly Agree	40	3	120
Disagreed	12	2	24
Strongly Disagreed	4	1	4
Total	**200**	**15**	**816**

Source: *Field Survey (2022)*

The calculated mean point for responses regarding the effectiveness of taxes is 4.08, which exceeds the designated cut-off point of 3.05. According to the decision rule, this indicates a large number of the respondents agreed a high tax rate is a hardship for taxpayers which might be caused by tax evasion.

3.Do you think that requires the assistance of an auditor/Tax lawyer/Tax consultant when filing an Income tax return?

The Likert Scale was used to calculate the figures in Table 1 below.

Table 3

Figure computation (by applying the Likert scale)

Respondent	F	X	FX
Strongly Agreed	46	5	230
Agreed	102	4	408
Fairly Agree	40	3	120
Disagreed	12	2	24
Strongly Disagreed	0	1	0
Total	**200**	**15**	**782**

Source*: Field Survey (2022)*

The calculated mean point for responses regarding the effectiveness of taxes is 3.91 which exceeds the designated cut-off point of 3.05. According to the decision rule, this indicates a large number of the respondents agreed while filing an income tax return they need the assistance of an Auditor/Tax consultant/Tax lawyer.

4.   Do you agree that there is tax evasion in Nepal?

The Likert Scale was used to calculate the figures in Table 1 below.

Table 4

Figure computation (by applying the Likert scale)

Respondent	F	X	FX
Strongly Agreed	112	5	560
Agreed	72	4	288
Fairly Agree	16	3	48
Disagreed	0	2	0
Strongly Disagreed	0	1	0
Total	**200**	**15**	**896**

Source*: Field Survey (2022)*

The calculated mean point for responses regarding the effectiveness of taxes is 4.48, which exceeds the designated cut-off point of 3.05. According to the decision rule, this indicates a large number of the respondents agreed that there is tax evasion in Nepal.

Discussion

In terms of public finances, tax evasion is a major monster that wrecks havoc on the stability of the public economy. Researchers have found that tax evasion has a wide range of detrimental economic effects.The scale of the illicit, dark, or dirty economy is not positively correlated with tax evasion (Gillman& Kejak,2006). Similarly, some economists contend that preventing tax evasion is a challenging undertaking.

The data demonstrates the unpredictability of the taxpayers' behaviour. However, empirical data indicates that a large number of taxpayers are essentially truthful and provide information. Underreporting income is essentially defined by Erard and Feinstein as taxpayer behaviour leading to purposefully constructed tax filings. Still others, though, assert that there are similarities between the behaviours of tax evaders and corrupt people (Erard& Feinstein, 1994).Corruptionis "the act of violating an established social or legal norm." He discovered some factors that encourage corruption and make tax avoidance, evasion, and corruption in tax administration simpler to do so. These factors include Insufficient efficiency and attendance, Poor morale among employees, Salary level, Limited and inadequate salary, Salary structure, Job terms in office, Cultural aspects of the society of the job holders, Pandemic workers, Discriminatory practices in actions, Friendship with party leaders of the workers (Tanzi, 2017).

Nepal faces significant issues with tax compliance and avoidance. The primary compliance challenges include:

a.   Failure to register for both income tax and VAT

b.   A significant portion of non-filers

c.   Under-billing and a sizable portion of non-billing

d.   A large amount of mismatches are present

e.   A sizable portion of VAT on false bills

f.   A massive proportion of taxes due from various organizations

g.   A large number of pending cases with the Revenue Tribunal

h.   Politicians' poor attitude toward creating a good tax compliance environment

To address these issues, a robust judicial system is essential for reducing tax evasion (Tanzi, 2017). Additionally, Bird (2015), a well-known professor, emphasized the importance of a strong legal framework, transparent communication, and uniform legislation to combat tax evasion.

According to this study report, the number of people aged 30 to 40 years and 40 to 50 years was found to be higher than the number of people aged 20 to 30 years, and 50 to 60 years. This is significantly conceivable in every part of Nepal since the average age for business people and Nepalese people employment is between the ages of 25 and 60.When few taxpayers worked in the public sector, it was revealed that most were self-employed and worked in the private sector. The private sector and self-employment employed a disproportionately large share of respondents. It might be because private sector employees get higher wages than those in other industries. Although they considered it a burden, a large proportion of respondents paid their taxes. A small number of individuals avoid paying taxes because they perceive them as burdensome. According to this, a large number of respondents paid their taxes on time or early. When individuals complain that they pay excessive taxes while also doing so, it

is viewed as a contradictory action. It is emphasised that, despite disagreements or complaints about the tax rate, people ultimately pay their taxes, possibly out of fear of getting caught in tax evasion. Also mentioned is the fact that people do require an auditor's assistance while submitting their I.T. forms. (Bird, 2015).

Conclusion

Tax evasion and avoidance are very certainly as old as taxes. It is a chronic problem not just in Nepal's economy, but also in the global economy. Authorities have been working continuously to combat the widespread problem of tax fraud. Nevertheless, their efforts to keep it under control have mostly been ineffective so far. Several significant clinical disorders have no remedies, and tax evasion is a societal problem with no right solution (Hasseldine& Bebbington, 1991).Tax evasion is the major factor contributing to the government's lack of income. Due to inept tax structures and dishonest tax collectors, tax evasion occurs in most developing nations around the world. This results in the establishment of a parallel economy and accounted money. The law governing taxes and revenue thresholds must be modified if the economy of a country is to improve. Tax relief is needed to minimize the quantity of tax evasion, and tougher penalties for tax evasion offenses are needed to make up the gap.

Tax evasion is a serious issue in Nepal, impacting both the government's and its citizens' well-being, as well as the efficiency of government actions. The Income Tax Act has several sections that are open to multiple interpretations and might be manipulated. For this reason, Nepal must establish a considerably simpler and more competitive international tax policy to eradicate tax evasion and wrongdoing.

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