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Contribution of Income Tax Revenue to Total Tax Revenue of Nepal

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Abstract

The Government is responsible for maintaining peace, security and economic stability, balancing debt management and investing in infrastructure and essential resources to foster development and cover ongoing expenses. These priorities require a robust financial system, with tax revenue as a crucial income source for the government. Therefore, it is essential to understand the dynamics between income tax revenue and total tax revenue for effective policy-making and economic management. This study explored the intricate relationship between income tax revenue and total tax revenue in Nepal, to enhance understanding and inform future research and policymakers. The study comprehensively analyzed time series data from 2009/2010 to 2021/2022 to achieve this objective. The analysis included descriptive analysis to identify the relationship between income tax revenue and total tax revenue. The study revealed a strong positive correlation between income tax and total tax revenue in Nepal. The study's findings underscored the significance of income tax policies in shaping overall tax revenue and provide valuable insights for policymakers and tax authorities in optimizing revenue generation while ensuring tax system stability.

Keywords: Economic development, policymaker, government, gross domestic product

Introduction

The Government has many duties to uphold. Its main responsibility is to ensure peace, security and economic stability while managing the overall economy and debt sustainably. Moreover, the government also puts money into infrastructure and necessary resources to aid in progress and cover continual costs. Governments also take on the role of caregivers and mediators for different aspects of society. The government depends on its financial resources to assign funds for administrative and capital expenditures (Todaro & Smith, 2006). Taxation is the primary method used by the government to raise funds for public services and administration, along with borrowing money through debt (Bhatia, 2009; Jakir, 2011). The main goal of imposing taxes is to create income for the government to support its activities while minimizing negative economic impacts (Gentry & Hubbard, 2000). A tax is a monetary obligation levied by the government on earnings, products, services and property to support public service and administrative tasks (Myles, 2000; Kandel, 2010). Taxation is essential in directing a country's economy towards prosperity and stability. It achieves this by regulating economic activities, promoting growth, ensuring a fair distribution of national income and reducing disparities among regions (Dhakal et al., 2022). Income tax is a crucial component of Nepal's taxation framework, significantly influencing the total tax revenue. Nepal needs a robust taxation system to collect internal funds for advancement as a developing country reliant on agriculture. A direct form of taxation, income tax is imposed on individuals, corporations and other entities based on their earnings, as highlighted by Yadav et al. (2015). Taxes are financial obligations that individuals and businesses must pay to the government based on their income, without receiving any immediate personal benefits in return. Taxation can be categorized into two main types; direct taxation and indirect taxation. Direct taxes are levied on income while indirect taxes are applied on expenditure (Chapagai, 2021; 2024). Gross Domestic Product (GDP) refers to the total monetary value of all goods and services generated within the geographical boundaries over a specified period (Adhikari et al., 2022).

Income tax plays a significant role in Nepal's tax system, substantially affecting the overall tax revenue. Nepal needs a robust taxation system to collect internal funds for advancement as a developing country reliant on agriculture. A direct form of taxation, income tax is imposed on individuals, corporations, and other entities based on their earnings as highlighted (Yadav et al., 2015). Taxes are monetary payments made by both individuals and businesses to the government, determined by their earnings, without guaranteeing any immediate personal benefit exchange (Adhikari, 2020). Taxation can be categorized into direct tax and indirect tax. Direct tax is levied on income, while indirect tax is levied on consumption (Chapagai, 2021; 2024). Gross domestic product (GDP) refers to the comprehensive value of all goods and services that are produced within a nation's borders during a specific period (Adhikari et al., 2022). The study study found a complex relationship between tax revenue and income inequality. The results suggest that tax revenue is essential for funding public services and reducing income inequality in the nation (Sari et al., 2022).

The significance of tax revenue as a crucial financial resource for the Government of Nepal has increased over time, especially in response to increasing government expenditures. As a result, there has been a notable shift in emphasis towards the enhancement of tax revenue. This scenario raises a critical question: is there a correlation between tax revenue and GDP in Nepal? The objective is to provide an in-depth analysis of the complex relationship between income tax revenue and total tax, addressing a gap in the current literature. The paper seeks to improve our knowledge of how income tax revenue relates to total tax within Nepal's economy, providing insights that can guide future research and policy decisions. The primary objective is to assess the impact of income tax revenue on total tax revenue in Nepal and to clarify the relationship between tax revenue and the overall economic growth of the country.

Literature Review

Previous empirical studies investigating the correlation between tax revenue and GDP have predominantly focused on diverse global contexts, including that of Nepal. Gupta (2007) found that counties that rely significantly on taxation of goods and services typically experience lower income levels, while those that prioritize taxation on income, profits, and capital gains frequently attain more favorable financial results. Shrestha and Kautish (2020), Dahal (2020), and Kharel (2021) conducted a study on the correlation between government revenue and economic growth in Nepal. The results reveal a positive correlation between government revenue and economic development. A study conducted by Alowosheble et al. (2017) revealed that the revenue generated from income tax has a considerable impact on overall economic growth. Korkmaz et al. (2019) examined the impact of taxation on economic growth in Turkey. The study revealed that indirect tax has a positive and significant effect on economic development, whereas direct tax revenue has a negative effect on economic growth. There are positive and significant relationships between tax revenue, expenditure GDP and budget deficit.

A comprehensive analysis of the factors contributing to the substantial dependence on direct tax, while also examining the relative proportions of indirect tax and direct tax revenue with the overall tax framework. The investigation revealed that the ineffectiveness of income tax administration is attributed to broader governmental inefficiencies. Moreover, the ratio of income to GDP, alongside total revenue and direct tax revenue, exhibited an upward trajectory. To facilitate a program-oriented fiscal policy, it was recommended that value-added tax should serve as a principal source of indirect tax within a liberalized economic context. For taxpayers operating on a smaller scale, it is suggested that door-to-door services be implemented. The study revealed that the fundamental nature of a clear, transparent, and progressive economic policy is the main factor contributing to the insufficient effectiveness of Nepal's income tax system. Additionally, the existing corporate tax rate has been considered unsuitable, with a recommendation for a standardized rate to be applied across all categories of corporations (Kafle, 2019).

The study discovered that in Nepal, tax revenue significantly and positively influences economic growth (Ghimire, 2019). The study showed that indirect taxes positively and significantly impact economic development while direct tax revenue has a negative effect on economic growth. In addition, there are strongly positive correlations between tax revenue, government expenditure, GDP, and the budget deficit (Anojan, 2018). The study found that direct taxes have a significant negative correlation with economic growth, whereas indirect taxes show a positive but insignificant effect on the dependent variable. Furthermore, it revealed that direct taxes make a significantly greater positive contribution to total tax revenue compared to indirect taxes (Hakim, 2020). The study demonstrated a strong and positive relationship between tax revenue and GDP in Nepal (Dangal et al., 2021). Personal income tax has a significant and positive effect on agriculture, whereas corporate tax has not been shown to have a substantial impact on the sector (Omodero, 2020).

Nguyen and Darsona (2022) study reveals that tax revenue has a negative relationship between tax revenue and GDP. Aden-Dirir Aden (2023) indicated that short-term tax policies and institutional forms do not significantly affect economic growth. However, it suggests that, over the long term, taxation, government efficiency, and institutional quality positively impact economic growth. Abata et al. (2023) examined the influence of both direct and indirect taxes on Nigeria's economic growth. Their findings indicated that direct taxes exert a considerable negative effect on economic growth, while indirect taxes contribute positively and significantly to the country's economic development. Adeyemi (2023) explored the correlation between tax revenue and economic growth in Nigeria, revealing the long-term relationship between the two variables. Furthermore, the study conducted by Irekponor and Ebieji (2023) reveals that tax revenue has a positive significant impact on GDP. Edore (2022) and Jemiluyi and Jeke (2023) reveal in their study that tax revenue positively impacts economic mobilization significantly. The taxation on remuneration plays an important role in the overall fiscal revenue of the government. Over the study periods, remuneration tax has accounted for a contribution ranging from 2 percent to 20 percent of the total tax revenue in Nepal (Basnet, 2024). The results indicate a substantial effect of taxation on the Gross Domestic Product (GDP) and venue of Nepal. Furthermore, the research elucidates the detrimental consequences of tax evasion and avoidance on the generation of revenue (Shakya & Ojha, 2024). The results indicate an affirmative trajectory in revenue mobilization, wherein tax revenue is a crucial function. The results enhance the comprehension of Nepal's endeavors in revenue mobilization and the structure of its revenue sources, thereby offering valuable perspectives on the nation's fiscal policies and financial viability (Nepal et al., 2024). The study revealed that natural resource rents have a significant negative correlation with GDP in Nepal (Dangal et al., 2021). Many studies have demonstrated a significant and positive relationship between tax revenue and a country's gross domestic product (GDP). These research including Okafar (2012), Jalata (2014), Ugwunta and Ugwuanyi (2015), Njindan Iyke and Takumah (2015), Takumah and Ikye (2017), Ali et al. (2018), Odhiambo and Olushola (2018), Oboh et al.(2018), Basher et al.(2019), Oluwatobi et al.(2021), Nguyen et al.(2021), and Zahra et al. (2021) have all supported this finding. Conversely, some studies including those by Marire and Sunde (2012), and Saibu (2015), have reported a negative correlation between tax revenue and GDP. The literature review shows a lack of detailed studies focusing on the impact of income tax revenue on total tax revenue in Nepal. This research aims to address this void by providing a thorough examination of the intricate connection between income tax revenue and total tax revenue in the Nepalese economic system.

Methods and Procedures

This study utilizes a descriptive approach to examine the role of income tax revenue in the total tax revenue of Nepal, employing data from 2009/2010 to 2021/2022. The data, primarily drawn from the economic survey conducted by the Ministry of Finance, were analyzed through ordinary least squares (OLS) regression and correlation coefficients to evaluate the relationship between income tax and overall tax revenue. The analysis was conducted using SPSS version 23, with results presented in percentages and ratios via descriptive statistics, to assess the relationship between income tax and total tax revenue. Data analysis was performed using SPSS version 23, and the findings were presented in percentages and ratios through descriptive statistics. Additionally, independent t-tests and F-test were performed to test the research hypothesis and analyze the results of the (OLS) analysis.

Model Specification

The study examines how income tax revenue and total tax revenue influences Nepal's GDP from 2009/2010 to 2021/2022. To achieve this, a statistical model was created to explain how the variables interact with each other. An examination of real-life research on income tax and overall tax revenue in different countries shows that the connection between the chosen factors adheres to a linear trend. This understanding establishes a link between income tax revenue and total tax revenue. The model presented in this study indicates that total tax revenue is influenced by income tax revenue from both micro and macroeconomic viewpoints. Thus, the definition of the model is:

Total tax revenue = f (Income tax revenue) (1)

The working model of the paper is delineated below, drawing upon the functional relationships previously discussed.

Where;

β_0= Autonomous (Intercept)

β_1= Coefficient of income tax revenue, μ = error term

The total tax revenue is anticipated to be positive, even in the absence of income tax revenue collection. Therefore, the initial expectation is that the model parameter will exhibit a positive sign.

Research Hypothesis

A review of empirical studies shows a consistent positive relationship between income tax revenue and total tax revenue in various countries. Building on this finding, the current research aims to evaluate this relationship quantitatively by proposing the following hypothesis:

H_o = There is no significant statistical relationship between income tax revenue and total tax revenue.

Results and Discussion

Linear Regression Analysis

The R-value is 0.992, this value presents a strong positive relationship between predicted values and the dependent variable, indicating a correlation between the observed and predicted values. The R squared value is 0.984, indicating that a large portion of the variance in the dependent variable can be predicted from the independent variables/ The adjusted R squared value is 0.978, which adjusted R square value based on the number of predictors in the model. A standard error of 40.60 indicates that more precise predictions are obtained with smaller standard errors. The R-squared change is 0.984, indicating that the addition of predictors has significantly improved the model's fit. The F-change is 182.84, which is significant. The D-W value is 2.329, which is slightly above ideal value of 2, indicating weak negative autocorrelation in the residuals. The P-value for the statistic is 0.000, indicating that the change in the model's fit is statistically significant at the 0.05 level. Both income tax and total tax revenue have a significant positive correlation. The regression analysis investigates the influence of income tax revenue on total tax revenue. The regression analysis examines how income tax revenue affects total tax revenue. The model exhibits a strong positive and significant (F-statistic 182.84, P< 0.001) (Table 1). Based on the regression analysis conducted, there exists a robust correlation between the total income tax and the total tax revenue. The standardized coefficient (Beta) value of 0.991 and a significant T-statistic of 25.92 (<0.001) suggest that increases in total tax revenue are directly associated with higher total tax revenue. As a result, the researcher has rejected the null hypothesis, concluding that income tax revenue significantly contributes to total tax revenue relative to GDP. The results are in line with the research studies carried out by Gupta (2007), Shrestha and Kautish (2020), Dahal (2020), Kharel (2021), Alowosheble et al. (2017), Korkmaz et al. (2019), Ghimire (2019), Anojan,(2018), Hakim (2020), Dangal et al. (2021), Omodero (2020), Nguyen and Darsona (2022), Aden-Dirir Aden (2023), Abata et al. (2023), Adeyemi (2023), Irekponor and Ebieji (2023), Edore (2022), Jemiluyi and Jeke (2023), Okafar (2012), Jalata (2014), Ugwunta and Ugwuanyi (2015), Njindan Iyke and Takumah (2015), Takumah and Ikye (2017), Ali et al. (2018), Odhiambo and Olushola (2018), Oboh et al.(2018), Basher et al. (2019), Oluwatobi et al. (2021), Nguyen et al. (2021), and Zahra et al. (2021). Howver, certain research studies, such as by Marire and Sunde (2012), Saibu (2015) and Nguyen and Darsona (2022), do not align with the results.

Based on the research methodology and the regression output presented above, the following estimated model has derived.

Total Tax Revenue = 30.035 + 3.663 (Income Tax) + μ

The regression results indicate that the autonomous component of the model is positive, suggesting that the economy would achieve a baseline total tax revenue of Rs. 30.035 in the presence of income tax revenue during the review period from 2009 to 2022. The positive coefficient of income tax (3.663) aligns with the theoretical expectation of a positive relationship between income tax revenue and total tax revenue. This implies that an increase of Rs. 1 in income tax revenue would lead to an approximate increase of Rs. 3.663 in Nepal's total tax revenue. Additionally, the t-statistic of 22.61 exceeds the critical t-value of 1.812 at a 5% significance level. This confirms that income tax revenue has a statistically significant impact on total tax revenue in Nepal over the study period. To that extent, the researcher therefore rejected the null hypothesis and accepted the alternative hypothesis, assuming income tax revenue makes signification contribution to the total tax revenue in Nepal.

Table 1

Linear Regression Analysis

Model	R	R Square	Adjusted R Square	Standard Errors of the Estimate	Change Statistic			
					R Square Change	F Change	Durbin-Watson	Significant F Change
1	.992[a]	.984	.978	40.60698	.984	182.848	2.329	.000

Model		Unstandardized coefficients		Standardized coefficients	T-test	Significant
		B	Standard error	Bata		
1	Constant	26.32	22.21		1.185	0.259
	Total income tax	3.7	1.43	.0.991	25.92	0

Sources: SPSS Version 23.0 Regression output

a. Dependent Variable: Total Tax Revenue

b. Predictors: (Constant), Investment Income Tax(I), Corporate Income Tax(C), Personal Income Tax(P)

Income Tax Revenue of Nepal

The corporate income tax revenue can vary from a minimum of Rs. 20.22 billion up to a maximum of Rs. 123.16, having a mean value of Rs. 70.47 billion. The coefficient of variation (CV) is 53.49, with a standard deviation of 37.69. Personal income tax revenue can vary from a minimum of Rs. 9.29 billion up to a maximum of Rs. 92.50, having a mean value of Rs. 37.32 billion. The coefficient of variation (CV) is 73.84, with a standard deviation of 27.56. Income tax revenue from investment varies from at least Rs. 4.32 billion up to Rs. Maximum Rs. 36.67 billion on average, at Rs. 18.48 billion. The coefficient of variation (CV) is 60.69 with a standard deviation of Rs. 11.26. The total income tax revenue varies from a minimum of Rs. 33.82 billion up to Rs, 252.19 billion with an average of Rs, 126.27 billion. The standard is 74.75, with a coefficient of variation (CV) of 59.20. The total tax revenue fluctuates from a minimum of Rs. 159.80 billion up to the ceiling of 984.33, at a mean of Rs. 492.61 billion is the sum. The value of the standard deviation is 276.79, with a coefficient of variation of 56.19. The Gross Domestic Product (GDP) varies from the lowest of Rs. 1193 billion up to the maximum Rs. 4933.70 average Rs. 2,853.76. The coefficient of variation is (CV) 41.32, while the standard deviation is 1179.13. The range of the income tax revenue to total tax revenue ratio is 21.16 to 30.46, mean at 25.05. The coefficient of variation (CV) is 8.87, while the standard deviation is 2.20. This indicates a relatively low degree of variability in the proportion of income revenue to total tax revenue across the study periods. The relatively low CV for the ratio of income tax revenue remains relatively stable, despite the variability in individual income tax components and total tax revenue (Table 2).

Table 2

Income Tax Revenue of Nepal

'Rs. in Billion'

Fiscal Year	Corporate Income Tax(C)	Personal Income tax (P)	Investment Income Tax(I)	Total income Tax(T) = C+P+I	Total Tax Revenue	Gross Domestic Product (GDP)	Income tax revenueto Total tax revenue in Nepal	Income tax revenue to GDP in Nepal
2009/010	20.2	9.29	4.32	33.82	159.8	1,193	21.16	2.83
2010/011	23.93	10.92	6.5	41.35	177.2	1,367	23.34	3.02
2011/012	30.49	12.29	8.52	51.3	211.7	1,758.40	24.23	2.92
2012/013	37.07	15.54	11.58	64.18	259.2	1,949.30	24.76	3.29
2013/014	45.42	19.43	10.76	75.61	312.4	2,232.50	24.20	3.39
2014/015	52.04	22.56	11.57	86.16	356	2,423.60	24.20	3.56
2015/016	70.97	29.96	13.2	114.13	421.1	2,608.20	27.10	4.38
2016/017	92.65	34.85	17.34	144.84	553.9	3,077.10	26.15	4.71
2017/018	87.6	41.41	25.79	154.78	659.5	3,455.90	23.47	4.48
2018/019	104.87	55	28.54	188.41	738.6	3,858.90	25.51	4.88
2019/020	123.16	57.93	32.15	213.23	700.1	3,888.70	30.46	5.48
2020/021	104.65	83.49	33.34	221.48	870.1	4352.55	25.45	5.09
2021/022	123.01	92.5	36.67	252.19	984.33	4933.7	25.62	5.11
Minimum	20.20	9.29	4.32	33.82	159.80	1193.00	21.16	2.83
Maximum	123.16	92.50	36.67	252.19	984.33	4933.70	30.46	5.48
Mean	70.47	37.32	18.48	126.27	492.61	2853.76	25.05	4.09
Std. Deviation	37.69	27.56	11.26	74.75	276.79	1179.13	2.20	0.95
CV	53.49	73.84	60.90	59.20	56.19	41.32	8.78	23.13

Source: GON, MOF, Economic Survey 2012/2013, 2022/2023

Conclusion

The study identified considerable variability in corporate, personal and investment income tax revenue as well as in total tax revenue, as reflected by the corresponding standard deviation and coefficients of variation. Nonetheless, despite this variability, the ratio of income tax revenue to total tax revenue has remained relatively stable throughout the study period, indicating consistent proportions. Furthermore, the regression analysis has underscored a strong positive correlation between income tax revenue and total tax revenue as evidenced by high R, R-squared, and adjusted R-squared values, alongside low standard errors of estimate and significant F-change statistic. This suggests that changes in income tax revenue have a substantial impact on total tax revenue with an increase in income tax positively associated with higher total tax revenue. Reject the null hypothesis and conclude that income tax revenue significantly contributes to both total tax revenue and GDP. The finding has significant implications for policymakers and tax authorities, highlighting the importance of income tax policies in shaping overall tax revenue. It emphasized the end of strategic adjustments to income rates to optimize revenue generation while maintaining stability in the tax system. Furthermore, the paper recommends that the Nepal government make a full-fledged effort to efficiently collect and effectively utilize such tax revenue by closing the door to corruption issues, which can be possible by making the income tax administrations more fashionable than ever.

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