

An Outline of Nepalese Taxes

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1. Introduction:

Nepal's¹⁾ unitary Government has two tiers: national and local. The former is known as His Majesty's Government (hereinafter referred to as HMG) while the latter consists of villages, towns and districts.²⁾ Both of these levels of Government, national and local, are empowered to levy taxes on property, income and commodities. They levy independent taxes; surcharges and revenue sharing taxes, which are widely used in many countries, but are not common in Nepal.

This paper attempts to give an outline of local as well as national taxes. The paper is divided into four sections. The introductory section is followed by a section that deals with national taxes; it traces the development and analyses the existing structure of each major tax. The third section, which focusses on local taxes, follows the same pattern as that of the preceding one. The final section contains our concluding remarks.

2. National Taxes:

HMG levies various taxes on property, income and commodities at the

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national level. Some of these taxes are very old while others are relatively young. A general description of each of these taxes is given below.

(a) **Land Revenue** (*Malpot*): Land revenue has been levied in Nepal from time immemorial. In ancient times a certain portion of the product of land had to be paid to the government by landowners. Initially payment was made in kind but gradually taxation in the form of cash came into vogue.

Attempts were made from time to time to improve the land revenue system. Completion of the cadastral survey was an important step in this direction. A very rudimentary survey was initiated during the reign of King Jayasthiti Malla and an ocular survey was completed during 1853 to 1968. A cadastral survey, however, began only in 1893. The land records in most cases were incomplete and inaccurate even after the completion of this survey. A more scientific, systematic and detailed cadastral survey was necessary. So the Land (Survey and Management) Act 1964 was enacted in order to survey land scientifically, classify land more accurately and prepare land records properly. Under this Act land has been surveyed to date in 55 districts out of 75 districts of the Himalayan Kingdom. In these districts where cadastral survey has yet to be completed there is a lack of proper record of land. As a result one does not know how far the land tax system is effective in the absence of adequate records

Another endeavour in connection with the improvement of the land revenue system was the classification of land. Land was classified into four categories, viz, *Abal*, *Doyam*, *Seem*, and *Chahar* during the reign of King Jayasthiti Malla. This classification was made mainly on the

basis of the nature of soil and its fertility. *Abal* is the highest quality land while *Chahar* is the lowest. The highest land revenue rate is levied on *Abal* land, then on *Doyam* land, *Seem* land, and finally on *Chahar* land. This system, in the main, is still in vogue.

However, urban land has been divided into six categories since 1981-82 when a separate land tax called *Bhumi Kar* was introduced on urban land in lieu of traditional *Malpot*.³

Establishment of separate land revenue offices (*Malpot Karyalaya*) in 1899 was also a notable event in the development of land revenue system. These offices, however, were not directly involved in assessing and collecting land revenue; instead they collected it through middlemen who were known as *Mukhiya* and *Zimwal* in the Himalayan and Mountain regions and *Zamindar* and *Patwari* in the *Terai*.⁴ The middlemen maintained records of land holding in their respective areas, collected land revenue from the land holders every year and deposited it in the land revenue office concerned within the stipulated time. The middlemen system gradually became a hereditary system and was advantageous for the Government in more ways than one: there was assurance of fixed amount of revenue, and no need to employ a large number of personnel to maintain records and collect revenue resulting in minimum administrative cost of collection. Besides, since middlemen were granted position of power and prestige, in addition to monetary rewards, they acted efficiently to maintain their positions not only for themselves but for succeeding generations as well. Further, as the middlemen were from the local taxing areas, they had a permanent interest in their respective areas. They assumed leadership responsibilities and involved themselves in the social and development activities in

their areas.

The middlemen system of collecting land revenue, however, had a number of drawbacks. There was always the possibility that the middleman would collect more revenue than was legally required and thereby a portion of money paid by taxpayers would go into the pockets of the middlemen rather than into the public exchequer. Also, since authority to collect tax was granted to many middlemen, methods of tax collection varied from area to area. In addition, the middlemen system "became a source of exploitation as landowners were forced to pay not only the land revenue but they also had to offer gifts in the form of *Walak*, *Salami*, or *Bethbegar*⁵⁾ to their respective *Mukhiya*, *Zamindar*, *Zimwal*, or *Patwari*."⁶⁾ At that time the *Rana*⁷⁾ rulers were not bothered about the mischief done by the middlemen; they were satisfied with the middlemen system due to the assurance of fixed amount of revenue with the minimum cost. At present the middlemen system exists only in 20 districts where the cadastral survey has yet to be completed. Land revenue offices collect land revenue directly from landowners in the other 55 districts where the cadastral survey has been completed.

The abolition of *Birta* system in 1959-60 also deserves special mention in the discussion of the land revenue system. Under the *Birta* system the right only to collect and retain land revenue was granted to some private individuals in some areas while in other, ownership of the land itself was granted to some private individuals. In the latter cases some of the owners of *Birta* land were paying a nominal amount to the Government while others were paying nothing. After the abolition of *Birta* system, land revenue was imposed on the lands which were

under the ownership of *Birta* holders under the *Birta* system. In the case of land where *Birta* landholders were granted a right only to collect and retain land revenue under the *Birta* system, landowners had to pay land revenue to the Government instead of previous *Birta* holders and all *Birta Mal Tahashil*⁸⁾ were nationalized.

Land revenue rates are fixed on the basis of a specific unit of area. The unit is the *Bigha*⁹⁾ in the *Terai* region and the *Ropani*¹⁰⁾ in other regions. As stated earlier, rates are graduated according to the type of land. There was a differential rate structure for *Terai*, the valleys and hills until 1965-66 but this was abolished in 1966-67 and it was replaced by a uniform rate structure. This rate structure continued until 1974-75. The separate rate structure introduced in 1972-73 for *Pakho* land¹¹⁾ of the Himalayan and Mountain regions where the cadastral survey had been completed was an exception, however. Again, separate rate schedules were introduced for *Terai*, valleys and hills in 1975-76. Land revenue rates were increased for specified landowners in 1978-79, i.e.; land revenue rates for landowners who held 3 to 10 *Bigha* were increased by 40 per cent and for those holding more than 10 *Bigha*, by 60 per cent. These increased rates were revoked the next year when a uniform rate structure was adopted for valleys and hills (i.e. Himalayan and Mountain Regions). As a result, rates for valleys were decreased marginally (i.e. less than 5 per cent) while rates for hills were increased, on average, by 20 per cent. Again a differential rate structure for *Terai*, valleys and hills was introduced in 1980-81 and the same practice has been continued to date. A separate schedule has been adopted for urban land since the introduction of the *Bhumi Kar* in 1981-82. As stated earlier, urban land is divided into six categories

for the purpose of *Bhumi Kar* and different rates are fixed for each category. Further, rates vary for the urban land of Kathmandu valley, the *Terai* region and the other regions. Land revenue rates have not been changed since.

However, a rebate of 50 per cent of land revenue on holdings of up to 1 *Bigha* or equivalent was granted in 1977-78, which continued until 1979-80. In 1980-81, a rebate of 75 per cent of land revenue on holdings up to 1 *Bigha* in *Terai* and 20 *Ropani* in other regions was introduced. The extent of rebate was further increased in 1981-82 when a 99 per cent rebate was granted to all landowners in those districts of the Himalayan and Mountain regions where the cadastral survey had not been completed, to those landowners who held up to 20 *Ropani* in other districts of the Himalayan and Mountain regions and 1.5 *Bigha* in districts of *Terai* region. This provision was retained until 1985-86. However, since 1986-87, for simplicity's sake a land revenue of Rupee one has been levied instead on landowners who were granted the 99 per cent rebate earlier. Thus land revenue has been used for more than a decade mainly to maintain land records rather as a revenue source. Such a policy, however, does not match with economic realities.¹²⁾

(b) **Customs Duties** (*Bhansar Mahasul*): - Like land revenue customs duties have been levied in Nepal since ancient times. These duties were used heavily during the *Rana* regime for revenue purposes. During the *Rana* regime customs duties consisted of internal and external duties. The former duties were levied at the time when goods crossed administrative boundaries while the latter duties were imposed when goods crossed a political boundary.

Like land revenue customs duties were collected through the middlemen. But the middleman system of collecting customs duties was different from that of hereditary land revenue collection system. In the case of customs duties a license for the collection of these duties in a particular area was generally granted by auction to the highest bidder who was given exclusive right to collect customs duties. In addition, contractors were given position such as *Dittha*, *Laptan*, *Subba*, and *Subedar*¹³⁾. As a result, businessmen used to be involved in such contracts even if the contract did not appear to be profitable. Pros and cons of the middleman system have already been pointed out earlier.

Attempts have been made to rationalize customs duties since the 1950s. In this context, the contract system was abolished and direct collection by Government employees was adopted instead. Similarly internal duties were abandoned because of their ruinous effects on internal trade and commerce, since they require long hold up of transport resulting in great delay and waste. A more detailed customs tariff based on Standard International Trade Classification was adopted in 1959 which later in 1980 was replaced by a new tariff based on Customs Co-operation Council Nomenclature. Tax rates have been changed from time to time and the classification system was modified.

Due to the rise in the number and the volume and value of imported goods the base of tax has expanded considerably over the years. This tax has been the largest source of tax revenue since the mid 1950s (vide Table 1). Import duties are levied on more than 1000 items and the base of this tax is the c.i.f. price which is largely determined by a central valuation committee for goods imported from countries other than India and by the regional valuation committee of the customs

officers for goods imported from India.

Rates of import duties are expressed largely on an *ad valorem* basis, with a few exceptions. There are 9 basic rates (i.e. 5, 10, 15, 20, 25, 30, 50, 70 and 100) depending upon the nature of goods. As is common elsewhere luxuries are taxed heavily and necessities lightly. In addition to the basic rates, additional import rates are levied. The additional rate is 25 per cent for items subject to 5 and 10 per cent basic import duties; 35 per cent for items subject to 15 and 20 per cent; 45 per cent for items subject to 25 and 30 per cent and 55 per cent on items subject to basic import duties of 50 per cent or above.

Exports duties are levied on a few items such as agricultural products, unprocessed materials etc. The base of tax is the f.o.b. price of exportable items and the rates are fixed on a specific or an *ad valorem* basis.

Countervailing duties have been levied since 1987-88. These duties are levied on imported goods in a similar manner to their domestically produced counterparts subject to excise duties.

(c) **Excise Duties** (*Anta Sulka*): Excise tax is one of the oldest members of the Nepalese tax family. This tax which has been levied since ancient times was imposed on opium, hasis, liquor, leather, bones and horns during the *Rana* period and was collected, like land revenue and customs duties, through the middlemen. The contract system for collecting excise from liquor still prevails in some districts. This system, however, is different than that of the contract system for collecting customs duties that has been discussed earlier. Under the contract system for collecting excise revenue from liquor, a contractor is provided a legal monopoly over the production and distribution of

liquor, but not to collect the excise revenue, in a given area for a specified period of time. A contractor may recoup the contracted amount and possibly the markup on that amount by inflating the cost of production and hence the price of the liquor.

Excise duties on industrial production such as sugar and matches have been levied since the enactment of the Excise Act in 1958. Since then excise duties have been extended to different commodities in different years, and currently the excise is levied on about 50 manufactured items: agricultural products and services have remained out of the excise net.

The base of excise duties is the volume of production and/or exfactory price which includes the cost of production including normal profit of the manufacturer, depending upon the excise rates. Tax rates are fixed on an *ad valorem* basis for some items while on a specific basis for others. For certain items excise rates are fixed on both a specific and an *ad valorem* basis and the higher rate is the effective rate. For example, in 1989-90, excise rate on low quality *Biri* (i.e. tobacco products) was Rs. 5.25 per thousand sticks or 20 per cent of the value and whichever was the higher rate was the effective rate. In other cases, both specific and *ad valorem* rates are applied. For example, in 1989-90, excise rates on soft drinks such as coco-cola was Rs. 2.50 per liter and 5 per cent of the price. Tax rates vary widely from commodity to commodity.

(d) **Income Tax** (*Aaya Kar*): The idea of introducing an income tax in Nepal was originated in the early 1950s when the first budget speech was prepared and made public in 1951-52. Attempts were made to introduce this tax in subsequent years. However, it could not be

realized until 1958-59 due mainly to political instability. Finally, the tax was adopted in 1959-60 when a democratic Government was formed, for the first time, from the members of the parliament who were directly elected by the people. The underlying reasons for introduction of income tax were to generate more revenue in order to finance development activities and to help establish social justice. Initially the tax was levied on business income and salaries. Unfamiliarity of the people with this type of tax and the lack of adequate and effective tax administration may have been the reasons for the selection of such a narrow coverage. *Prima facie*, the imposition of income tax on business income and salaries is relatively easy compared with other sources of income. In 1962-63, the basis was widened to apply to income from several other sources. Since 1974, the sources of income have been enumerated as follows :

(i) agriculture, (ii) industry, business, profession or vocation, (iii) remuneration, (iv) building or land rent, and (v) other sources. Among these sources agriculture income, however, has remained out of the tax net with a few exceptional years.¹⁴⁾

Income tax is levied both on residents and non-residents of Nepal. A non-resident individual is one who has stayed in Nepal for 180 days or less in any fiscal year. A non-resident company is a foreign company whose management and control is exercised abroad. The tax is levied on income of residents arising in or derived from Nepal and income earned or acquired abroad which is brought into Nepal. With respect to non-residents, income tax is levied on income earned or acquired in Nepal.

There are 7 progressive rates of income tax, ranging from 10 to 50

per cent. The maximum rate for salary income, however, is 40 percent. Companies listed in the Security Exchange Center and Government Corporations are subject to a 40 per cent flat rate corporate income tax.

Nepal has been adopting unilateral method to avoid double taxation. Under this method, tax paid by a resident taxpayer on income arising in a foreign country is deducted as an expense when determining his net income. Nepal has also completed its first and so far only one double taxation treaty with India on January 18, 1987 which has been put into force since the fiscal year 1989-90. The treaty relates only to central level income tax and applies to persons who are residents of one or both of the contracting states.

Although the relative position of income tax in the Nepalese tax structure has been gradually improving it is still in its infancy as compared to the status of income tax in the modern tax systems of many countries. The coverage of income tax is very narrow since important sources of income such as agriculture and capital gains have been kept out of the tax net . The assessment procedure is rudimentary since most of the income tax revenue is assessed on the basis of the best of judgement of the tax officers.

(e) **Urban House and Land Tax** (*Shahari Kshetra Ghar Jagga Kar*): Like income tax an urban house and land tax was introduced in 1959-60. This tax is imposed on houses and adjacent land in urban areas. The adjacent land is defined as the land lying within the compound of a house to which a protected peasant has no claim under the Land Act 1964. Further, according to the Land Act 1964 a house compound includes adjoining *Goth* (cattle sheds), *Bhakari* (grain silos), wells, ponds,

stables, gardens, kitchen gardens, play grounds, etc. If no compound wall is erected a maximum of four *Kattha*¹⁵ in the *Terai* region and five *Ropani* in other regions (approximately 0.6 acre) may be considered as the compound for the purpose of the urban house and land tax.

The tax is not imposed on vacant land, however. Similarly it is not levied on the private houses and compounds of His Majesty or houses and compounds owned by the Government, or foreign governments. Houses and compounds of the factories or mills where machinery and equipment are installed are kept out of the purview of the tax as well. The Government may also confer a full or partial exemption on houses and compounds devoted to philanthropic, religious and social purposes.

It should be remembered that the tax is levied only in areas as specified by the Government through gazette notification as urban areas for the purpose of this tax. It was initially levied in Bhaktapur, Biratnagar, Birganj, Butwal, Janakpur, Kathmandu, Lalitpur, Nepalganj, and Rajbiraj. The tax was extended to Bhadrapur in 1963-64, Dharan in 1964-65, Hetauda, Palpa, Pokhara, and Rupandehi in 1973-74. Similarly it was proposed to levy the tax in Bharatpur and Dhangadi from 17 July, 1981. However, the tax could not be extended to those areas as a valuation schedule was not yet prepared. The tax was extended to Bharatpur only in 1988-89 while Dhangadi is still out of the tax net.

The base of the tax is the capital value of urban house and land property. The value is fixed by an *ad hoc* valuation committee appointed by the Government for each urban area. As the capital value of house and land property depends upon the cost of the construction of the building at the time of tax assessment with a reasonable deduction on account of depreciation, the value of land and the site

value of the house, all these factors need to be considered in connection with the valuation of the house and land.

Keeping in view the rise in the value of urban house and land property as the normal tendency, the valuation once made for the purpose of the tax by an *ad hoc* committee is to be revised in every five years. This is only in principle, however; the practice is different as the valuation chart had been kept unchanged for more than five years in the past.

Of the value determined for the purpose of urban house and land tax the first specified amount is exempt from the tax; it was Rs. 25,000 in 1959-60 which increased to Rs. 50,000 in 1961-62, Rs. 100,000 in 1979-80, and Rs. 200,000 in 1988-89. The tax has always been levied on the basis of a graduated rate schedule; the rates, however, were sometimes specific while others *ad valorem*. The existing rate of this tax is Rs. 100 on the first taxable Rs. 500,000 and thereafter four progressive rates (i.e. 0.15, 0.50, 1.00 and 2.00 per cent) are levied on other higher values.

Urban house and land tax is very much neglected by the tax administration. Many of the tax offices do not have even the minimum information about potential taxpayers and the tax base and hence it is believed that many potential taxpayers have remained out of the tax net. Valuation has become an alarming problem and the exemption system rather confusing. Under the existing system, of the value assessed for the purpose of this tax, only 70 per cent of the value of house and 20 per cent that of land is considered taxable, and the first Rs. 200,000 of this amount is again exempt from the tax.

(f) **Sales Tax** (*Bikri Kar*): Sales tax is a comparatively new member of

the Nepalese tax family. The tax was introduced at the retail level in 1965. Since all retailers were brought under the tax net, their number was very high. Because most of these retailers were very small, unorganized and illiterate, they found it difficult to carry out formalities regarding sales tax. On the other hand, the tax administration was very weak and it could not keep count of the taxpayers. As a result the tax could not be implemented effectively and, therefore, was moved to the wholesale level from the retail point in 1968.

Prima facie, the wholesale stage is a convenient levy point because wholesalers are more organized and their numbers are smaller, making tax administration more easier. However, like retailers, wholesalers were also unorganized, and illiterate and also it was found to be difficult to distinguish between wholesalers and retailers. So the problems associated with the retail sales tax system persisted in the case of wholesale sales tax too. The tax was, therefore, moved to the import-manufacturing point from the wholesale level in 1974. Since then, in the case of imports, sales tax has been levied and collected along with customs duties while in the case of domestic products it is levied on the sales of manufacturers.

Sales tax is levied on a wide range of domestic and imported goods. All services but telecommunications have remained out of the purview of sales tax, however. The base of sales tax is the import value determined for the import duties plus the amount of import duties including countervailing duties in the case of imports and the sum of the ex-factory price and amount of excise duties in the case of domestic products. Tax rates have always been fixed on an *ad valorem* basis and the existing rates are 5, 10, 15 and 20 per cent,

depending upon the nature of goods.

(g) **Other Taxes** : In addition to above discussed taxes several other minor taxes are being levied at the national level. These taxes are : house and land registration fees, entertainment tax, air flight tax, hotel tax, contract tax, vehicle tax, tax on interest, local development tax, video and television tax and road-bridge maintenance tax. A brief introduction to each of these taxes is in order.

Of the other taxes, house and land registration fees (*Ghar Jagga Registration Dastur*) have the longest history. Registration is a service rendered by the government to individuals in connection with the transfer, mortgage, lease, gifts, endowments, etc. of immovable property and the Government has been levying house and land registration fees since 1922. The base of the tax is the value of the property concerned and rates are fixed on a lump sum basis (such as Rs. 200 on value up to Rs. 2000) in some cases and as a percentage of the value of the property in others. The rates for gifts and endowments are lower than the rates for other transfers of property. Further, higher rates are fixed for urban areas than the rural areas.

An entertainment tax (*Manoranjan Kar*), which has been in operation since the *Rana* period, is levied on entertainment facilities, such as cinemas, dance halls, opera, theatres, circuses, etc. Initially rates of this tax were fixed as a percentage of entrance fees charged for admission to the place of entertainment, but since 1986-87 they have been levied on a per ticket basis with the levy graduated according to the class of ticket. The existing rates for dress circle, balcony, special, first class, second class and third class tickets are 8.00, 6.75, 5.50, 3.00 1.75, and 0.50, respectively.

An air flight tax (*Hawai Udan Kar*), introduced in 1961-62, is imposed on passengers who embark on a flight from an airport in Nepal. In the beginning the tax was levied on passengers of international flight only, but later in 1974-75 was extended to the passengers of domestic flights as well. The original rate of tax was Rs. 5 per passenger which was raised to Rs. 10 in 1963-64, and Rs. 15 in 1972-73. In 1974-75 the rates of tax levied on passengers of international flights and domestic flights were Rs. 20 and Rs. 5 respectively. Rate of tax on passengers of international flights were raised to Rs. 30, Rs. 40, Rs. 100, Rs. 150, Rs. 200, and Rs. 300 in 1976-77, 1977-78, 1980-81, 1986-87, 1987-88 and 1989-90, respectively. Similarly, tax rates on passengers of domestic flight increased to Rs. 10 in 1976-77, and Rs. 15 in 1980-81. In 1982-83, these rates were graduated and revised (i.e. Rs. 15 and Rs. 25) and in 1986-87, the graduation was further refined when three rates (i. e. Rs. 10, 20, and 30) were introduced, depending upon the point of embarkation.

A hotel tax (*Hotel Kar*) was introduced in 1961-62 but discontinued in 1964-65 with the intent of promoting tourism and enhancing foreign exchange earnings. The tax, however, was reinstated in 1967-68. The base of the tax is the invoice value of the hotel. Its original rate was 10 per cent but this was increased to 15 per cent in 1963-64. The rate of this tax, however, was only 5 per cent when it was reintroduced in 1967-68 but was increased to 10 per cent in 1977-78. Since 1980-81 the rates of tax have been graduated according to the rating of hotel. At that time the rate for ordinary hotels and star hotels were fixed at 10 and 12 per cent respectively. These rates were graduated further in 1982-83 when a 10 per cent rate was fixed for ordinary hotels, 12 per cent for one and two star hotels, and 13, 14, and 15 per cent for 3, 4,

and 5 star hotels, respectively.

A contract tax (*Thekka Kar*) has been levied since 1965-66 on the value of contracts exceeding Rs. 10,000 which are negotiated with the Government or other parties for undertaking work for profit in Nepal. The initial rate of tax was 2.5 per cent but this was doubled in 1980-81. The tax is withheld at the time of each payment of the contract by the party awarding the contract.

Another addition to the national tax system was a vehicle tax (*Sawari Sadhan Kar*), introduced in 1972-73. This tax is imposed on all types of vehicles such as cars, jeeps, vans, buses, trucks, minibuses, three-wheelers, motor-cycles, etc. The rates of this tax are fixed on a per vehicle basis but are further linked to the capacity of vehicles, at least in the case of a few types of vehicles such as cars. The tax is collected from the vehicle owners.

Tax on interest (*Byaja Kar*) was introduced in 1977-78. This tax is levied on interest income earned from fixed deposits and the tax is withheld by the bank concerned at the time the interest is paid to depositors. Initially, interest income up to Rs. 1000 was exempt and four rates ranging from 5 to 20 per cent applied to higher amounts of interest income. This provision existed until 1979-80. Between 1980-81 and 1981-82, a five per cent interest tax was levied on all interest income derived from deposits with a bank. The level of individual exemption granted under the income tax was extended to taxpayers who derive income only from bank interest.

Since 1982-83 the interest tax has only been levied on interest income exceeding Rs. 5000. The tax is withheld by the bank at the time the interest is paid at a rate of 5 per cent and it is deposited in

the account of the tax office concerned. This tax is credited against the income tax payable on the total income, including interest from fixed deposits.

A local development tax (*Sthaniya Bikas Shulk*) was introduced in 1980-81 with the aim of mobilizing local resources from the agriculture sector. This tax is collected by the land revenue offices. Local development tax revenue collected from each district is to be used for development activities in that district. In 1980-81, revenue collected from each district was first deposited in a Government account and then granted to the respective district *Panchayat* office through the Ministry of Local Development. Such a process of transferring revenue proved to be not only time consuming and costly but also quite unnecessary. Consequently, a system of direct transfer of local development tax revenue from the land revenue office to the district *Panchayat* concerned was adopted in 1981-82. The tax was initially levied at the rate of five per cent of land revenue in those districts where the cadastral survey had been completed and one Rupee per landowner in other districts. The rate was increased to ten per cent in the case of surveyed districts, retaining the previous rate (i.e. one Rupee) in the case of the unsurveyed districts. This rate structure continued until 1982-83. The tax has been levied at the rate of 10 per cent of *Malpot* or *Bhumi kar* in all 75 districts since 1983-84.

Video tax (*Vidiyo Kar*) was introduced in 1980-81. In the beginning the annual rate of the tax was Rs. 1,000 per video recorder but after 1984-85 the rate on private (self used) video recorders has been Rs. 600 while on the video recorders used for public showing has been Rs. 12,000. Since 1987, a television tax (*Television kar*) at the annual rate of

Rs. 100 on black and white televisions and Rs. 300 on color televisions has been levied and combined with the video tax. These taxes are collected from video and television owners.

Road-bridge maintenance tax (*Sadakupul Sambhar Kar*), begun in 1982-83, is relatively younger than the previously discussed taxes. The tax was initially levied at a graduated rate on each vehicle and collected at specified bridges. Since 1984-85, however, the tax has been collected at customs points along with customs duties on imports of high speed diesel and petrol to be used for vehicles. The rate of tax was 10 *Paisa*^(b) per litre in 1984-85 but has been doubled since 1987-88.

Other minor taxes, once used in Nepal, but which no longer exist, include a foreign investment tax, stamp duties, a roadcess, a bank loan tax and a house construction tax. Of these taxes, the foreign investment tax (*Bideshi Lagani Kar*) was introduced in 1959-60 in order to discourage the flight of capital. It was levied on investment made by Nepalese resident abroad. The tax, however, lost its independent existence in 1969-70 when income from foreign investment was brought under the income tax net.

Stamp duties (*Tiket Dastur*) were levied for the first time in 1962-63. These were imposed on certain types of documents dealing with the transfer of immovable property, business transactions, etc., but were discontinued in 1974-75 due to the low revenue they generated. Stamp duties were reintroduced in 1985-86 with rather wider coverage than before but were revoked following year as they could not be implemented successfully.

Roadcess was introduced in 1971-72. It was initially levied on vehicles on the basis of per kilometer of road. Under this system it was

not only complicated to assess the tax but as well the system was prone to corruption or harassment of vehicle owners by the tax officials. So the tax was reformed in 1972-73, when a lumpsum tax was levied based on the length of various roads. However, as roadcess was collected at several points, it hindered the free flow of traffic and trade, so the tax was expelled in 1979-80.

A tax on bank loans (*Karja Kar*) was introduced in 1977-78 with the intention of controlling credit because of the then unwarranted rise in the money supply. Originally, the tax was levied on both lenders and borrowers; the former had to pay 0.25 per cent while the latter 0.50 per cent of the total amount of the loan. The tax was deducted by the bank at the time the loan was made and deposited in the public treasury. Since the tax increased the administrative burden of the banks, a 7.5 per cent tax on the total amount of interest earned by the bank from the loan was introduced instead in 1978-79. This tax was, however, incompatible with the growing Nepalese economy when it was necessary to expand banking activities and investment, so it too was repealed in 1980-81.

Another tax that was once introduced but expelled shortly afterwards is the house construction tax (*Ghar Nirman Kar*). This tax was levied on the construction of houses in urban areas in 1983-84. The rate of tax varied from 0.5 *Paisa* to Rs. 2.00 per square feet, depending upon the use of construction materials. The tax, however, failed to yield the expected revenue. Also it was felt that municipalities were the appropriate authorities to levy such a tax. It was abolished in 1985-86.

3. Local Taxes¹⁷⁾

Local urban bodies (municipalities) have been permitted to levy several taxes on houses, land, vehicles, businesses, professions, etc. within their area of jurisdiction since 1962. Several changes were introduced to regulate local taxes in 1965 which, more or less, continued without change until 1987. In 1988 local taxes were amended heavily. There was increases in the tax rates and the formulation of more detailed provisions relating to tax assessment and collection. In the following discussion we shall consider roof top and house rent taxes, vehicle tax, business and profession tax, octroi, *Panchayat* development and land tax (PDLT) and other taxes in turn.

(a) **Roof Top and House Rent Taxes** (*Ghar Dhuri Tatha Ghar Bahal Kar*): In 1962, municipalities were to levy a tax on house and the land occupied by the house within their area of jurisdiction. The base of the tax was the amount of rent in the case of rented house and land. The base of the tax was the income in the case of self occupied house and land; the sum of four per cent of the estimated construction cost (at the prevailing rate) of the house and four per cent of the current land value was supposed to be the income i.e. tax base. Taxpayers were the house and landowners and the tax rate was 2 per cent in the case of rented house and land and 1 per cent in the case of self occupied house and land.

The municipalities did not find the tax attractive. This might have been the result of its complicated valuation method. It was extremely difficult to find out the average cost of construction of the house and the current value of the land for tax purposes for the then infant

municipalities. So, in order to simplify the tax system, the tax law was amended in 1965. Subsequently, a roof top tax, not exceeding annual rate of Rs. 10 per house, depending upon its type and size, was enacted. In addition, a house rent tax, not exceeding 2 per cent of the rent, was levied on rented house and land. These taxes (i.e. the roof top tax and the house rent tax) were not amended for more than two decades. The tax rates, particularly of roof top tax, were extremely low and unrealistic ; at these rates the tax yield might not pay for the cost of collection. Consequently, the roof top tax and the house rent tax were of little interest to municipalities.

The roof top tax was amended in 1988. Then it was levied on each house on the basis of the size, type, structure, compound and location of the house. Houses belonging to HMG, foreign diplomatic mission or diplomats and non-profit organizations are exempt from the tax. Municipalities were classified into three categories for the purpose of fixing rates for this tax and a minimum of Rs. 3 (for all categories) and maximum of Rs. 3000, Rs. 1500, and Rs. 500 rates were fixed for category A, B, and C, respectively.

Municipalities have also been permitted to levy a house rent tax not exceeding five per cent of rent ; the corresponding figure was two per cent before 1988 amendment. This tax is levied on the rental income obtained from rental houses, shops, garage, godown, shade, factories, land or ponds.

Although the rates of roof top and house rent taxes were increased sharply to make these taxes more attractive for municipalities, reluctance to levy and/or implement effectively these taxes has been remained a common feature. This is interpreted to means that low tax

rates were not the only factors that serve to explain the general lack of interest in these taxes by municipalities. Another more important reason for general disinterest in these taxes is political. Municipal bodies, elected by local people, think that to implement these taxes might harm them politically because the burden of these taxes falls directly on their voters. Such an attitude of the public bodies like municipalities is not desirable, however. They try to convince their constituents of the need for such a tax. They should ensure the effective use of the proceeds thereby developing willingness among the local people to pay the tax.

Furthermore, municipalities in the main have not maintained the records relating to the number, size, type etc. of the houses within their area of jurisdiction. In the absence of such records, it is impossible for them to implement roof top tax properly.

(b) **Vehicle Tax** (*Sawari Kar*) :- Since 1962, municipalities have been permitted to levy a vehicle tax on specified vehicles registered within their area of jurisdiction. Initially the ceiling of the annual rate was Rs. 100 on per vehicle. Since 1963, vehicles have been classified into different groups and separate ceiling has been fixed for each type. Higher rates were set for rented vehicles than their owner-operated counterparts. This differential rate structure for rented and non-rented vehicles was, however, discontinued in 1965. Since 1988 both maximum and minimum rates are provided for various groups of vehicles in the relevant tax law. For example, minimum and maximum annual rates for bicycles are Rs. 3 and Rs. 6 respectively while on trucks Rs. 750 and Rs. 2000, respectively.

Municipalities have also been empowered, since 1966 to levy a tax on

vehicles that enter the municipal area but are not registered there. Initially tax rates were fixed on per mile basis. Under this system the amount of tax depended on the milage and was collected every time such a vehicle entered the municipal area. But the system was difficult to administer because it was difficult to know at the entry point the distance a vehicle is likely to cover in a municipal area. Under this system vehicle owners were also likely to be harassed by the municipal tax official stationed at the gates of the city to collect this tax. So the tax was simplified in 1988. Since then rates are fixed either on annual or on per entry basis. For example, minimum and maximum per entry rates on a truck which is not registered in a particular municipal area but enters that municipal area are Rs. 4 and Rs. 8 respectively while minimum and maximum annual rates on such trucks are Rs. 750 and Rs. 2,000 respectively ; whether the per entry or annual rate applies to such a truck is decided by the vehicle owner.

Vehicles registered in the name of HMG, diplomatic missions, nonprofit organizations and those passing through the municipal area on the national highway are exempt from vehicle tax.

(c) **Business and Professional Tax** (*Byapar, Byabsaya Munafa Kar*): Business and professional tax is another member of local tax family. In 1962, municipalities were authorized to levy a business and professional tax not exceeding five per cent of annual profit of the specified business and profession. Since it was difficult to determine the profit, the tax was changed in 1965. Taxpayers were classified according to business and profession for the purpose of fixing the tax rates, and flat annual rates were prescribed for different groups of business and professions. Minor changes were brought about in the tax system in

1966, 1967, 1979, but in 1988 there were major changes when the tax rates were increased significantly, and the coverage extended considerably. For the purpose of fixing the tax rates taxpayers have been classified into 22 groups. Some groups have been further divided into sub-groups mainly on the basis of capital investment, turnover or earning capacity. Tax rates vary not only from group to group but also vary for different sub-groups within a group.

(d) **Octroi (Chungi Kar)** :- Octroi was introduced for the first time in 1965. The tax was levied at the rate not exceeding 0.30 per cent of the value of goods which was later raised to 0.50 per cent in 1977. However, relevant tax law was silent regarding, *inter alia*, point of tax collection, tax base and its coverage. In practice, the tax was collected at the municipal gates, i.e., when goods enter municipal area and the coverage and tax assessment procedures varied considerably from municipality to municipality.

Various matters relating to octroi were clarified in 1988. For example, the tax is levied on goods brought into a municipal area for commercial, professional or industrial use in commercial quantities and collected at the municipal gates. Goods brought for daily consumption, raw materials, plant, machinery and equipment imported by industries classified by HMG as producing goods required for the fulfillment of basic needs and goods imported by HMG, foreign diplomatic missions, diplomats, non-profit organizations and development committees under foreign aided projects are exempt from octroi. Similarly goods passing through a municipal area to other parts of the kingdom are not subject to octroi. Municipalities, however, can ask for a deposit on such goods at the entry point and then refund the deposit when the goods leave

the town area within specified period of time.

The base of octroi in the case of imported goods is the sum of the import value determined for the purpose of import duties, the import duties and sales tax. In the case of domestic products, the tax base is the sum of the ex-factory price, excise duties and sales tax. In the case of goods that are (i) exempt from customs duties, sales tax or excise duties, (ii) subject to specific customs and excise duties or (iii) brought without proper invoice, the tax base is determined by a committee chaired by the municipal mayor. The rate of tax is one per cent of the value as obtained above.

The administration of octroi is seriously flawed. It is collected under the contract system. An exclusive right to collect octroi in a municipal area is granted to a private contractor by auction. "This affords the private contractor with an irresistible incentive to abuse collection practices. The octroi is collected more than once; deposits exacted for transit through a TP (Town *Panchayat*) are not refunded; and the valuation of the shipments taxed is arbitrarily assessed by the collectors. The business community quite rightly has come to think of the octroi as a harassment tax. Legal remedies for these abuses are not effective."¹⁸⁾ Hence the abolishment of the contract system of collecting octroi is nothing less than urgent.

(e) **PDLT** (*Panchayat Bikas Tatha Jaggā Kar*): Local Governments (village and town *Panchayats*) were permitted to levy PDLT, in place of land revenue, in 1965. The tax was introduced in the same year (i.e. 1965), in Budhabare Village *Panchayat* of Jhapa district on an experimental basis. It was introduced by the local bodies of Bhaktapur, Chitwan, Dang and Nawalparasi districts in 1977-78 and local bodies of

other 10 districts in 1978-79.

“However, because of inadequate preparation, the enforcement of the tax was very poor. It is said that the tax was levied haphazardly and the tax proceeds were not used efficiently. Therefore, the tax became unpopular at the local level and was consequently suspended in 1979-80 when the land revenue was restored in”¹⁹ those areas.

In recent years the policy of HMG was to encourage local bodies to levy PDLT. So the tax was reintroduced by two municipalities (i.e. Bhadrapur and Damak) of Jhapa district in 1989 and others were considering it before the suspension of all municipalities in April 1990.

PDLT is a tax on produce of land; the base of which is the annual production of the main crop. The tax is collected both from landowners and tenants at the following rates:

<u>Description</u>	<u>Rates</u>
1. <u>For Landowners</u>	
a) Self cultivated land	6 per cent of the yield of the main crop
b) Land cultivated by tenants	15 per cent of the landowner's share of the main crop
2. <u>For Tenants</u>	
a) Tenants receive 50 per cent or less of the main crop	3 per cent of the tenant's share of the main crop
b) Tenants receive more than 50 per cent of the main crop	5 per cent of the tenant's share of the main crop

(f) **Other Taxes**:- Other local taxes may include benefit tax (*Labh Kar*), education cess (*Shiksha Kar*), surcharge on land revenue (*Malpotma Atirikta Kar*) and entertainment tax (*Manoranjan Kar*). In 1962,

municipalities were permitted to levy a surcharge (not exceeding 10 per cent of land revenue) on land revenue in their respective areas. This provision, however, was later scrapped from the relevant law. Similarly, in 1962, municipalities were empowered to impose an entertainment tax, not exceeding 20 per cent of entrance fee, on entertainment. This tax was also abolished in 1965.

Municipalities may collect a benefit tax not exceeding 50 per cent of roof top tax from town dwellers who benefit from the construction, extension, improvement or upgrading of streets, sidewalks, drainage, sewerage and its maintenance, supervision and operation, for lighting of streets and for maintenance and cleaning of streets, sewerage and drainage and for soil waste management undertaken by municipalities. Similarly, municipalities can also impose a surcharge (not exceeding 25 per cent of the roof top tax) on the roof top tax for constructing school buildings, for improving facilities in educational institutions, for providing facilities to students, and for making primary education compulsory and free in the municipal area. These taxes, however, have remained unused to date by municipalities while these bodies were levying a number of nonlegal surcharges such as city hall construction surcharge, electricity surcharge etc. on goods entering into the municipal area and collected along with octroi at the municipal gates. These illegal charges were, however, abandoned in 1988 when the rate of octroi was raised from 0.50 per cent to 1 per cent.

4. Concluding Observations :

The foregoing gives a general idea of the development and the existing structure of the local as well as national taxes. It is seen that

several taxes were introduced since 1960s and a few of them were abolished. Some of the discontinued taxes were reintroduced but expelled again. Similarly other tax measures were introduced and abolished, meaning that tax measures have been adopted on an *ad hoc* basis without a careful consideration of revenue yield, operational aspects, and probable economic effects. So it will be necessary soon to adopt a coherent tax reform programme.

Currently both national and local Governments levy several taxes simultaneously on property, income and commodities. The tax spheres of national and local Governments are not clearly demarcated and there is overlapping in taxation. Overlapping, *inter alia*, unnecessarily complicates tax administration and increases both the administrative and compliance costs. This is because a taxpayer has to perform several formalities regarding several taxes and tax officials have to deal with the same taxpayers several times in connection with various taxes. It is, therefore, necessary to distinguish tax authority of the national and local Governments on the one hand and to widen coverage of a few major taxes, *inter alia*, by amalgamating minor taxes into relevant major taxes.

Although both the national and local Governments levy several taxes, the bulk of the revenue for both Governments comes from a few commodity taxes. For example, as shown in **Table 1**, customs duties, sales tax and excises provide more than 75 per cent of total tax revenue of the national Government while octroi alone, as indicated in **Table 2**, nets more than 85 per cent of total tax revenue of local Governments. Such a heavy reliance on commodity taxes means the Nepalese tax system is regressive since these taxes cannot be linked

Table 1 : Composition of National Tax Revenue

(RS. in Thousands)

Taxes	1951-52	1961-62	1971-72	1981-82	1988-89
Property Taxes	9,405	28,234	101,117	179,331	420,151
Land Revenue	9,405	28,234	83,170	81,746	80,555
House and Land Registration Fees	—	—	17,343	88,312	320,565
Urban House and Land Tax	—	—	604	9,273	19,031
Income Taxes	—	1,166	22,045	195,943	879,856
Income Tax	—	1,166	22,045	190,231	863,811
Tax on Interest	—	—	—	5,712	16,045
Commodity Taxes	8,200	39,149	338,733	1,833,698	4,986,608
Customs Duties	7,298	32,200	198,598	825,144	2,289,920
Sales Tax	—	—	69,080	597,377	1,384,855
Excises	902	6,949	63,591	305,679	872,552
Contract Tax	—	—	3,208	42,963	194,442
Hotel Tax	—	—	911	23,137	92,789
Air Flight Tax	—	—	560	21,867	66,820
Entertainment Tax	—	—	2,785	15,165	32,724
Vehicle Tax	—	—	—	2,357	31,045
Road-Bridge Maintenance Tax	—	—	—	—	21,463
Others	41	964	3,262	2,402	648
Total	17,646	69,513	465,157	2,211,365	6,287,263

Sources :—Budget Speeches and Comptroller General Office, Kathmandu.

Table 2 : Composition of Local Tax Revenue

(Rs. in Thousands)

Taxes	1982-83	1985-86	1988-89
1. Octroi	34,397	57,959	171,578
2. Vehicle Tax	2,596	4,179	9,857
3. Professional Tax	1,399	1,681	2,539
4. House Rent Tax	149	182	362
5. Roof Top Tax	58	75	185
6. Other Taxes	1,640	2,919	6,126
Total	40,239	66,995	190,647

Source :—Financial Situation Assessment of 33 Town Panchayats FY 2040/41-2045/46, Management Support For Urban Development Project Unit-A, (NEP/88/046), Shree Mahal, Pulchowk, 1989.

effectively to the ability to pay tax of the taxpayers *vis-a-vis* taxes based on income and property.

Moreover, many Nepalese taxes cover only a few sectors. For example, agricultural income and capital gains are out of the purview of income tax and almost all services have remained out of the ambit of commodity taxation. Similarly, gifts, inheritance or net wealth is not covered by any tax, meaning that the burden of taxation is not distributed equally on all sectors of the economy.

Besides, the enforcement of the tax laws is very poor. Under such a situation honest taxpayers have to bear heavier burden of taxation than their dishonest counterparts. Particularly property taxes are very much neglected and both the national and local Governments are inclined to generate revenue from commodity taxes which are relatively easy to collect and whose burden is not directly felt by the taxpayers.

All major commodity taxes viz, customs duties, sales tax, excises, and octroi, are collected at source (i.e. import-manufacturing point). Such a tax system is less productive and responsive since the base of the tax does not cover the value added at the wholesale and the retail levels and hence a rise in prices at these levels is not reflected in the tax revenue.

Since several taxes are levied at one point, taxpayers have to bear a higher burden at one time. This provides temptation to tax evasion and complicates tax administration. Further under the existing commodity tax system the tax tends to be pyramided on its way to the final consumers because of the application of percentage mark-ups on the tax so that consumers have to bear the burden of an amount in excess of tax. Such a tax system is less efficient since it is likely to stimulate

manufacturers to push some of their functions such as packaging, transportation etc. to their dealers, not for any economic reason but to lower their tax liability. To avoid these limitations a broad-based value added tax in place of several existing commodity taxes may be considered.

Footnotes :

- 1) Nepal is a South Asian Nation lying between China and India. Geographically, the country is divided into three main regions viz; the Himalayan Region (4,877-8,848 meters), the Mountain Region (306-4,876 meters) and the *Terai* Region (up to 305 meters). Administratively the country is divided into five development regions, 14 zones and 75 districts. Each district is divided into several villages and towns. Various administrative agencies of the national Government are located in development regions, zones and districts. Besides, autonomous local bodies exist in districts, towns and villages.
- 2) Until recently local Governments in villages, towns and districts were known as village *Panchayats*, town *Panchayats* and district *Panchayats*, respectively. They have been suspended since the restoration of multiparty democratic political system in place of partyless *Panchayat* system since April 1990.
- 3) The reason for the introduction of *Bhumi Kar* was to levy land tax differently on urban lands (i.e. land situated in urban areas) which are used for residential and commercial purposes from agricultural land of rural areas.
- 4) A *Mukhiya* is a chief of an area; a *Zimwal* is one who is responsible for a village; a *Zamindar* is a landlord; a *Patwari* is an honorary village registrar and accountant.
- 5) *Walak* is a kind of gift; *Salami* is a present to a superior; and *Beth-begar* is a compulsory service rendered without remuneration.
- 6) Rup Bahadur Khadka, "Nepal: A Survey of the Tax System", *Bulletin for International Fiscal Documentation*, Vol. 43, March, 1989, p. 135.
- 7) The *Rana* is a family which held power and established a hereditary Prime Minister from 1846 to 1950.

- 8) Private offices set up by the *Birta* owners to collect land revenue from the *Birta* land.
- 9) 1 *Bigha*=1.6 acre.
- 10) 1 *Ropani*=0.12 acre.
- 11) *Pakho* is an inferior type of land which can not generally be irrigated.
- 12) Rup Bahadur Khadka, "Nepal: An Economic Analysis of the Nepalese Tax System", *Asian-Pacific Tax and Investment Research Centre Bulletin*, Vol. 7, June, 1989, p. 251.
- 13) A *Dittha* is an honorary clerk; a *Laptan* is an honorary lieutenant; a *Subba* is an honorary senior clerk; and a *Sebedar* is an honorary junior lieutenant.
- 14) Agricultural income was brought under the purview of income tax from 1962-63 to 1965-66 and from 1973-74 to 1976-77.
- 15) 1 *Kattha*=0.15 acre.
- 16) 100 *Paisa*=1 *Rupee*.
- 17) Although rural, urban and district level Governments are empowered to levy several taxes, only urban Governments exercise their tax powers. So in this paper by local taxes we mean taxes levied by urban bodies.
- 18) Donald Stout, Rup Bahadur Khadka, Raju Tuladhar and Steven Pereira, *Town Panchayat Octroi Tax Study*, Management Support for Urban Development UNDP/WB Project NEP/88/046, Kathmandu, March 1990, p. 2.
- 19) Rup Bahadur Khadka, *A Study of Local Taxation in Nepal*, Management Support for Urban Development UNDP/WB Project NEP/88/046, Kathmandu, February, 1990, p. 4-7.