

MUNICIPAL OWN- SOURCE REVENUE COMPLIANCE AND ITS POTENTIALITY *The Case of Birendranagar Municipality in Nepal*

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ABSTRACT

Municipal citizens are the basis of own--source tax and non-tax revenues of Municipality. Tax revenue covers the major portion of municipal own- source revenues. Municipal revenue compliance is a complex procedure. Local revenue sources are more stable and consistent than external sources. The main aim of the present paper is to analyze the municipal revenue compliance and to find out the own- sources revenue potentiality of Birendranagar Municipality in Nepal. A descriptive and analytical research design was adopted among 166 respondents (33 municipal policy advisors and 133 municipal taxpayers) of Birendranagar Municipality and simple random sampling method was used to select the respondents. Majority of the citizens pay municipal revenues. The contribution of own- source revenue to total revenue has been fluctuating in a span of six years. Revenue compliance is satisfactory partially even though the tax rate is minimal. The study recommends the integrated property tax as a highly potential own- source revenue mode for the Municipality.

Keywords: Integrated Property Tax, Municipal Own Source Revenue, Potentiality, Revenue Compliance.

INTRODUCTION

Every resident is the source of municipal own- source revenues. Municipal revenues are generally classified into two categories: tax revenues and non-tax revenues. The key tax sources of municipalities are generally property taxes, enterprise taxes and rent taxes in Nepal.

Tax revenue covers the major portion of municipal own source revenues. Rent tax, house and land tax, enterprise tax, vehicle tax, property tax, entertainment tax, commercial video tax, advertisement tax etc. are the main sources of tax revenue. Parking charge, and service fee/charge, rental charge, building permit fee etc. are the main non-tax revenue sources of

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Nepalese municipalities.

Tax is an important source of local resources. The tax theory is divided into *ability to pay* and *benefit* principles. The benefit principle of taxation is suitable for local taxation whereas *ability to pay* principle is suitable for central government taxation. But, in developing countries, like Nepal, in general, there are only a few available tax bases. Therefore, the local government has been weak to levy the tax. In fact, taxes are paid as a price for the benefits received from public services. Therefore, benefit principle becomes workable only when benefit from local services can be approximately identified. (Shrestha, 2009).

Organization for Economic Cooperation and Development (2001) advocates that the categories of tax compliance are of administrative and technical nature where the former refers to complying with administrative rules of lodging and paying otherwise referred to as reporting compliance, procedural compliance or regulatory compliance and the latter refers to complying with technical requirements of the tax laws in calculating taxes or provisions of the tax laws in paying the share of the tax (Mumumba Omweri Marti, 2010, pp. 114-115). Many taxpayers pay little attention to tax matters and may not even view tax evasion as an ethical issue. Likewise, their ethical values may be much more tempered by situational exigencies than idealistic expectation. (Philip M.J. Reckers, 1994)

The fiscal exchange theory suggests that the presence of government expenditure may motivate compliance and that governments can increase compliance by providing goods that citizens demand in a more efficient and accessible manner (Cowell and Gordon, 1988; Levi, 1988; Tilly, 1992; Moore, 2004; 1998). Alm *et al.* (1992) note that compliance increases with (perceptions of) the availability of public goods and services. Within the fiscal exchange framework, we expect the probability of an individual's tax compliant attitude to be positively correlated to satisfaction with the provision of public goods and services. Kirchler *et al.* (2008) and Fauvelle-Aymar (1999) have stated that according to the political legitimacy theory, tax compliance is influenced by the extent to which citizens trust their government (Merima Ali, 2013, p. 8). Finally, we find indications that tax knowledge and awareness have a significant impact on tax compliance attitude (Merima Ali, 2013, pp. 7, 27).

Some of the reasons for tax compliance and tax non-compliance, and some of the factors for tax non-compliance were found to be: the inability to understand tax laws i.e. rates of tax, filing and paying dates etc., a feeling that they are not paying a fair share of tax, positive peer attitude i.e. a belief that your neighbours are reporting and paying tax honestly, and rewarding taxpayers i.e. giving a trophy for being best tax-payer, and motive for low profits. Some of the factors depending on how they are applied can facilitate compliance and non-compliance include: avoiding paying tax fines and penalties; the use of informants by KRA i.e. report tax evaders, aggressive enforcement efforts by KRA i.e. ensuring tax audits and prosecutions, payment of fines and penalties; high degree of being detected for no-payment of tax; high degree of risk aversion i.e. fear of tax audits; ethics and mobility i.e. a feeling that tax is an obligation and believing in no corruption; positive government image i.e. government is fighting corruption and is achieving tax objectives & harassment from KRA (Mumumba Omweri Marti, 2010, p. 9)

LEGAL PROVISIONS

Regarding non-compliance of municipal revenue by the citizen, Nepal government has made the provision under the Section 260 of Nepalese Local Self Governance Act (1999) that if any person does not pay any tax, duty or charge levied or contracted or any other amount due and payable to the Local Body, it shall be recovered by the District Administration Office as government dues. Likewise the government has mentioned the provision under the sub section 2(a &b) and 4 of section 165 of Nepalese Local Self Governance Act (1999) that if any one does not pay the taxes, fees, charges, tariffs contracted or imposed by the Municipality and any other amount due and payable to it, the Municipality may take action as follows :-

(a) If any one does not pay the taxes, fees, charges, which may be collected under this Act and other amounts due and payable to the Municipality, it may write to the concerned body to stop the transfer of ownership of the movable, immovable property of such person, may seal or lock up the trade, profession, and withhold the transactions including export and import.

(b) If the amount which the Municipality is entitled to collect under this Act could not be covered up even from the stoppage of the house, land, transaction or assets of the concerned person pursuant to clause (a), the Municipality may recover it by auctioning his house, land or other assets, if any. If any one does not pay any taxes, fees, charges, duties, tariffs and any other amount due and payable under this Act, the Municipality may stop the service provided by it, in regard to such persons.

The Department of Revenue Investigation of Nepal Government has set the preventive module for revenue compliance. The preventive strategy includes compliance of the acts and rules, mobilization of flying and emergency squad, adherence of code of conduct of investigation officials, issuance of guidelines and orders, use of Information technology etc (Nepal Government , 2014).

CHALLENGES

There are various concerns regarding the management of municipal finance in Nepal. There is no clear transparency for what the levied taxes are utilized. The taxpayers want to have better services for its taxes, but often they are not delivered by the local administration. Also, Municipalities must ensure that their job descriptions, competency requirements, advertisements, selection criteria and appointments are aligned with the requirements set out in the regulations. In most of the developing countries, budget execution and accounting processes were/are either manual or supported by very old and inadequately maintained software applications. This has had deleterious effects on the functioning of their public expenditure management (PEM) systems that are often not adequately appreciated (Khemani, 2006, p. 2).

A challenge for a study of taxpayer attitude is a lack of reliable data due to an individual's reluctance to reveal one's own non-compliance. In this paper, we use an indirect measure of individuals' tax compliance attitude to avoid direct implication of "wrongdoing" by the respondents. We use an indirectly phrased question, where respondents are asked to

state whether they think that it is wrong for people not to pay taxes that they own on their income. Respondents are provided with rank responses of “not wrong at all”, “wrong, but understandable” and “wrong and punishable”. Based on these responses, individuals are considered as having a tax compliant attitude if their response is “wrong and punishable” and a non-compliant attitude if their response is either “not wrong at all” or “wrong, but understandable”. (Merima Ali, 2013, p. 5).

Tax compliance is obviously critical for effective sub-national revenue generation. There is limited empirical evidence, but available analysis indicates that compliance can improve or deteriorate under decentralization. The effect seems to depend on economic conditions, citizen attitudes about sub-national governments, and variations in sub-national political dynamics, including the willingness and ability of sub-national governments to enforce the tax code. Local tax compliance in Tanzania was positively related to ability to pay and (perceived) probability of prosecution, but negatively related to perceptions of oppressive tax enforcement and weak satisfaction with services. (Smoke, 2013)

Moreover, this study provides some guide for future research into tax compliance behaviour. More researches are needed on moderating effect of risk preference on relationship between taxpayer’s attitude towards tax evasion and his/her compliance behaviour to check the consistency of the results produced by this study on this moderator. In addition, research studies are desired on taxpayers’ attitude towards government and the effect of individual religiosity on tax fraud as well as on other factors influencing tax compliance behaviour particularly in developing countries. (James O. Alabedi, 2013). Revenue compliance is the support of citizen or prospective tax payers to the revenue programmes implementation. It has always been an important issue in revenue administration for choosing of system of compliance that best serves the implementation of revenue policy. The knowledge for local governments about operation of an efficient tax administration is essential for local revenue improvement. In deciding the extent of compliance the determinant factor is information collection mechanism. A key consideration is relationship and trust with the taxpayers at the local level and monitoring.

LOCAL REVENUE POTENTIALITY

Internal sources of revenue are more stable and consistent than external sources. External sources of revenue are less reliable source of financing because of wide fluctuation in nature. These sources, therefore, should have supplementary support in municipal financing. Municipalities must be authorized to expand their internal revenue base and modify the tax rate according to local situation so that they can collect adequate revenue to meet their financial needs (Thapa, 2004, p. 4)

RESEARCH OBJECTIVES

The major aims of the present study are to analyze the municipal own -source revenue compliance and to find out its potentiality in Birendranagar Municipality in Nepal.

STUDY AREA

The study was conducted in Birendranagar Municipality of Surkhet district of Nepal. Figure 1 shows the location of the sample Municipality.



Figure 1: Surkhet District, Nepal

BIRENDRANAGAR MUNICIPALITY

(Map of Surkhet District, *Source*: NEKsapInfo, 2013)

RESEARCH DESIGN AND METHODS

The total number of Municipalities in the district is fifty eight. The formation processes of Metropolitan and Sub- metropolitan cities are different than municipalities. One metropolitan city and four sub- metropolitan cities are not able to be representative of all the municipalities. Therefore, these have been excluded from the study population. Out of 58, only 53 municipalities are the population of the study. In this study, non-probability (purposive) sampling technique was applied for the selection of Municipality and Birendranagar municipality was taken as a sample from the Mid-Western Development Region (Hill Ecological Belt) of Nepal. Cross-sectional method has been used for the collection of primary data and analytical and descriptive research design has been adopted to analyze the compliance of municipal own- source revenue and to find its potentiality of Birendranagar Municipality.

Municipal policy advisors and taxpayers were the respondents of the study. In total, 33 samples were taken from municipal policy advisors including different local political party members, CCI (Chamber of Commerce and Industries) members, civil society members, and others and 100 samples were taken from municipal taxpayers of Birendranagar municipality.

Self-administered questionnaires were developed in 5 point Likert Scale as well as Dichotomous and conducted survey for primary data collection and secondary information were obtained from Birendranagar municipality, Ministry of Federal Affairs and Local Development, District Development Committee Surkhet, Local Bodies' Fiscal Commission, and Urban Development Through Local Efforts (udle/GTZ). Relevant books, journals as well as published and unpublished performance or work of the related organizations working with local bodies. They were used for the macro-analysis of the study. For the secondary data analysis purpose, different analytical tables were prepared and different statistical tools were used for primary data analysis.

RESULTS

In this research, there were total 166 respondents (133 municipal taxpayers and 33 municipal policy advisors). Among them 77.7% respondents were males and female respondents were 22.3 percent. Out of 33 municipal policy advisors, 48% were local political party members, CCI members were 39.4%, government officers were 3% and few were civil society members. Likewise, more than 51% taxpayers were engaged in business activities and 30.8% taxpayers were involved in teaching. Similarly, about 8.3% and 9.8% taxpayers were involved in government service and agriculture, respectively. Both types of respondents' views have been collected to analyze the municipal tax compliance and to find out the potentiality of own sources of revenue of Birendranagar municipality. On the basis of questionnaire survey conducted in the July 2014, the scenario of municipal own-source revenue compliance and expressed reasons for non-compliance are presented and discussed as follows:

Table 1: Municipal Tax/Fee Contribution Scenario of Birendranagar Municipality.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Tax not contributed	30	22.6	22.6	22.6
	Tax Contributed: Less than Rs.1000	73	54.9	54.9	77.4
	Rs. 1000 to Rs. 2000	30	22.6	22.6	100.0
	Total	133	100.0	100.0	

(Sources: Field Survey, 2014)

The above Table shows that only 22.6 percent municipal citizens are non-taxpayers and 77.4 percent taxpayers act in accordance with the municipal revenue provisions. Out of 103 sample taxpayers, 73 taxpayers have paid the municipal revenue less than Rs. 1000/- and only 30 taxpayers have paid in between the range of one thousand to two thousand rupees per year. It indicates that most of the citizens have complied with the municipal revenues.

Table 2 : Reasons for Non-payment of Municipal Taxes/Fees by the Citizens

Reasons		Frequency	Percent	Valid %	Cumulative %
Valid	Tax rate is very high	5	3.8	16.7	16.7
	No information to pay tax	2	1.5	6.7	23.3
	No ability to pay tax	4	3.0	13.3	36.7
	Chances of tax rebate in future	19	14.3	63.3	100.0
	Total	30	22.6	100.0	
	Tax already paid	103	77.4		
			100.0		

(Sources: Field Survey, 2014)

The total number of non- taxpayers is 30 (22.6% in total), and out of them 19 (i.e. 14.3 % in total) non- taxpayers have not paid municipal tax considering the chances of tax rebate in future. As expressed by the 11 of citizens of Birendranagar Municipality, high tax rate, lack of information and ability are the reasons for non-payment of municipal taxes or fees.

Table 3: Views on Revenue Potentiality (in %)

Revenue Headings	Tax Payers' views					Policy Advisors' Views				
	No Potential	Hardly Potential	Semi-Potential	Poten-tial	Highly Potential	No Potential	Hardly Potential	Semi - Potential	Poten-tial	Highly Potential
Integrated Property Tax	0	0	11.3	27.8	60.9	0	0	6.1	15.2	78.8
Business/ Professional Tax	0	0.8	6	54.9	38.3	0	0	6.1	21.2	72.7
Rent Tax	0.8	3	33.1	34.6	28.6	0	0	9.1	42.4	48.5
Building Permit Fee	0	7.5	21.8	23.3	47.4	0	3	3	60.6	33.3
Service Charges	0	3.8	21.1	60.2	15	0	3	12.1	81.8	3
Environ-ment Pollu-tion Fee	0.8	5.3	12.8	60.2	21.2	0	12.1	12.1	69.7	6.1

(Sources: Field Survey, 2014)

Table 3 depicts the degree of potentiality of major own- sources revenue from the view point of municipal taxpayers and policy advisors. Integrated property tax is highly potential revenue source of Birendranagar Municipality from their viewpoint. From view point of municipal policy advisors, business/ profession tax and rent tax are highly potential and from the view point of taxpayers, building permit fee is highly potential. Their views on service charge and environment fee are same (i.e. potential).

Table 4: Contribution of Own Source Revenue on Total Revenue (Rs. in '000)

Descriptions	Fiscal Years						
	2007/008	2008/009	2009/010	2010/011	2011/012	2012/013	Total
Total Revenue Received (Rs.)	25016	57188	72975	81608	48408	68794	353989
Own Source Revenue Received (Rs.)	8490	13606	16542	17845	13781	18124	88388
Contribution of Own Source Revenue to Total Revenue (%)	33.94	23.79	22.67	21.87	28.47	26.35	24.97

(Source: Birendranagar Municipality Office, 2014)

The above Table reveals the contribution of own source revenue on total revenue of Birendranagar municipality in past six fiscal years. The average contribution of six years is about 26%.

Table 5: Major Own Source Revenue Collection Scenario

Major Revenue Headings	Fiscal Year-wise Collection (Rs. in '000)						
	2007/008	2008/009	2009/010	2010/011	2011/012	2012/013	Total (Rs.)
Integrated Property Tax	505	549	3041	2769	1524	2322	10710
Business/ Professional Tax	361	346	118	490	427	543	2285
Rental Tax	42	48	23	42	36	64	255
Building Permit Fee	995	1739	1500	1442	594	1180	7450
Service Charge/ Fee	254	382	365	719	272	534	2526
Total	2157	3064	5047	5462	2853	4643	23226

(Source: Birendranagar Municipality Office, 2014)

The above Table displays the own source revenue collection scenario of Birendranagar Municipality. The trend of revenue collection from above major headings is not consistent.

DISCUSSION

The numbers of municipal taxpayers are 103 (77.4%) out of 133, which means that 30 (22.6%) citizens are non taxpayers. Out of 103 taxpayers, 73 taxpayers have paid below Rs. 1000/- per year and only 30 taxpayers have paid more than Rs.1000/- to Rs.2000/-, which shows that the tax rate may be low. Municipal tax abatements should be strictly limited to areas that are truly in need of rehabilitation or redevelopment. (Boxer, 2010)

Most of the non-taxpayers (19 out of 30) express the views that the chance of tax rebate in future is the main reason for non-payment of municipal tax. The other non-taxpayers express their views that the high tax rate, lack of information and ability are the other causes for non-payment of municipal taxes or fees. When taxpayers get feedback from their governments in connection with the use to which their taxes are put, their voluntary compliance levels may increase as a result (Adafula, 2013, Sep 19, p. 56).

Integrated property tax is highly potential revenue source of Birendranagar municipality from the viewpoint of municipal taxpayers and policy advisors. Property tax is at present and will most likely continue to be an important source of revenue in urban councils (Fjeldstad, 2000). House and land tax is the second largest revenue source of all the municipalities of Nepal (Silwal, 2012). Property tax proponents have long advocated redefining the property tax so that it might come closer to realizing its potential. Many have identified specific best practices, including administrative and policy reforms that have been broadly successful (Bahl, 2009). Business/profession tax and rent tax are highly potential according to the opinions of policy advisors. From the view point of taxpayers, building permit fee is highly potential. Service charge and environment pollution fee are potential revenue sources of Birendranagar Municipality.

The average contribution of own- source revenue on total revenue of Birendranagar Municipality of past six fiscal years is more than 25%. The rate of own- source revenue contribution has been fluctuating year by year and the lowest contribution is 21.87%. According to udle/GTZ report, the performance of own- source revenue to total revenue of the fiscal year 2006/07 of Birendranagar municipality was only 28.45% which was very lower than set standard i.e.60% (udle/GTZ, 2008, pp. 10-14). On the one hand, the performance of own- source revenue to total revenue is low and on the other hand, the trend of revenue collection from major headings is not consistent. Thus, it can be hypothesized that under these conditions, tax revenues will be spent more in accordance with taxpayer preference, which in turn increases tax morale (Schneider, 2006).

CONCLUSION

The study concludes that the municipal own- source revenue compliance and its potentiality are two different matters. Most of the taxpayers have paid lower amount of taxes or fees, which

denotes that either the tax rate fixation power is low or there is lack of revenue mobilization plan and sound revenue administration. To some extent, revenue compliance is satisfactory even though the rate is minimal. The expectation of the most non-taxpayers is that there is probability of tax rebate by the municipality in future, which indicates that the municipality has practiced such type of tax rebate decisions in the past. There is no doubt the integrated property tax is highly potential own source revenue and enterprise tax, rent tax, building permit fee, service charge and environment pollution fee are potential own-revenue sources of Birendranagar municipality. Both the contribution of own-source revenue to the total revenue and the collection of major own-source revenue are not consistent within the study period, which signifies that the municipal revenue compliance and the joint effort on potential local revenue collection with revenue mobilization plan should be carried out concurrently.

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