

Political Instability and Impact on Nepal's Tax Revenue Collection

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Abstract

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Keywords: Tax revenue, political instability, economic development, weak public services.

This study examines the impact of political instability on Nepal's tax revenue collection and its broader effects on the national economy. The main objective of the study is to explore how political instability has influenced tax collection practices and economic policy implementation in Nepal. The study adopted a qualitative research design based on descriptive methodology to understand the socio-political and economic realities surrounding the taxation system. Secondary data were collected from the official website to analyze trends in tax revenue collection over recent fiscal years. The findings reveal that tax revenue collection during the past five fiscal years was a noticeable fluctuation. Frequent political changes, unstable governance, policy inconsistency, and weak administrative coordination negatively affected the efficiency of tax administration and compliance. The study further found that political instability has adversely impacted Nepal's overall economic system by reducing public investment in critical sectors such as education, healthcare, infrastructure development, agricultural modernization, and sustainable development programs. As a result, economic growth and public service delivery have been significantly constrained. The study concludes that political stability, transparent governance, and effective fiscal policies are essential for strengthening Nepal's tax system and promoting long-term economic development.

Introduction

The accounting and tax system of a country plays a vital role in economic development, public administration, and the delivery of public services. The Government introduces ambitious development plans every year, accompanied by political promises of economic transformation, infrastructure expansion, employment generation, and national prosperity. However, the everyday reality experienced by ordinary citizens presents a very different picture. Undone road projects, weak public service activities, rising issue of unemployment, and increasing economic dependency on remittance continue to challenge the nation's development process (Gnangnon, 2022).

Among the most challenges faced by developing countries today, one critical issue remains largely overlooked by both political leaders and the media, the inefficiency of the taxation system (Upadhyaya, 2025). Taxation is the financial backbone of every functioning state. With no effective revenue generation, a country building a strong institutions seems impossible, also providing quality public services, or achieving sustainable economic growth (Amin et al., 2014). In developed countries, tax revenue supports education, healthcare, transportation infrastructure, social security, and industrial development (Wagle, 2024). However, developing countries' taxation systems continue to suffer from structural weaknesses, political interference, corruption, and widespread tax non-compliance.

In the context of Nepal, several tax reforms introduced over the years, Nepal still struggles to establish a fair, transparent, and efficient taxation system. Political instability has further worsened the situation by creating policy inconsistency, weakening state institutions, and discouraging both domestic and foreign investment. As a result, the

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existing tax structure places greater pressure on honest taxpayers while allowing large sections of the economy to remain outside formal accountability. Therefore, the taxation problem in Nepal is not merely an administrative issue; it reflects a deep-rooted crisis of governance, institutional weakness, and political short-sightedness.

Developing countries often face lower tax collection compared to their target amounts due to inefficiencies in the tax collection system. In the present study, various factors affecting tax collection in Nepal have been identified (Neupane, 2024). Nepal faces significant challenges such as tax evasion, weak enforcement mechanisms, and a large informal economy (Raut et al., 2014), socio-economic factors influencing tax collection (Ahmad et al., 2016). Owing to major challenges such as political instability, weak economic development, unclear taxation policies, and inadequate institutional capacity, Nepal has not yet been able to implement an effective taxation system.

The taxation system in Nepal faces several major challenges, including relatively high tax rates, a narrow tax base, low tax elasticity, weak voluntary tax compliance, and leakages in tax collection. Additional problems include rigid provisions in the Income Tax Act, inefficient and sometimes corrupt tax administration, and the absence of a consolidated record of property such as land and buildings within the Internal Revenue Department (Dahal, 2011). The tax administration system is also affected by corruption, which exists at both petty and grand levels. Corruption refers to illegal activities carried out for personal benefit, and it weakens the foundations of national development. Like a serious disease, corruption spreads across both private and public institutions and ultimately damages the entire economy. In Nepal, the roots of corruption can be traced back to periods of weak governance, self-interested political leadership, and bureaucratic inefficiency, all of which have negatively influenced the effectiveness of tax administration and revenue collection.

Method

This study employed a qualitative research design using descriptive research methods to examine the impact of political instability on Nepal's tax revenue collection system. The study was based on secondary data collected from the official website of the Inland Revenue Department (IRD). Tax revenue data covering the fiscal years 2076/077 to 2081/2082 B.S. After collecting the data, the documents were printed and carefully compared across the five fiscal years to identify trends, patterns, and variations in revenue collection. The study conducted an in-depth comparative analysis to examine changes in tax performance in relation to the political and economic context of Nepal. For data interpretation, descriptive analysis was applied in a rigorous and systematic manner.

Results and Discussion

In the result section, I have prepared the given themes such as the *structural weakness of Nepal's tax system*, *political instability: the biggest obstacle to reform*, *the impact of economic development*, *over dependence on indirect tax*, *tax evasion has become a culture and causes reform efforts continue to fail* (Dahal, 2009).

The Structural Weakness of Nepal's Tax System

One of the root problems with the tax system in Nepal is the small number of people who pay taxes. The fact that a large portion of our economy is operating in the 'black' and is not being correctly checked which is partially the cause for this narrow tax base. Thousands of businesses which are being run illegally without any formal business identity (i.e. they are simply doing business under a personal name) and with no record of their financial activities still exist in a large number in Nepal. This informal sector has become a significant component of Nepal's economy. A number of businesses undertake a majority of their transactions in cash, especially in wholesale trade, real estate, transportation, construction and small businesses. Many business owners do not purposely provide a VAT invoice or do not use a 'double-entry' system of accounting and/or under-report their income, so that they can minimize the tax. (Bhattarai, Toya, 2024) This issue is not only associated with smaller businesses but large importers, contractors and commercial companies have also been accused of manipulating the tax system and making revenue disappear. Weakly functioning, monitoring systems and inefficient administration are permitting these illegal practices to continue for extended periods of time with no consequence.

A study published in the Economic Journal of Nepal has demonstrated that the tax administration in Nepal has failed in its attempts to extend the tax-net and formalize taxation of informal economic activities (EJON, 2020). As a

result, the government is able to tax a small number of taxpayers while many more people who are economically active do not pay the state any form of taxation. The result is an unfair burden on honest taxpayers, while tax evasion becomes financially rewarding for others, which harms both economic fairness and public trust.

Political Instability: The Biggest Obstacle to Reform

Nepal's taxation problems cannot be separated from its long history of political instability. Over the past several decades, Nepal has experienced frequent governmental changes, coalition politics, constitutional transition, and repeated shifts in economic policy direction. (Ghimire, 2026) Ministers change rapidly, policies are revised frequently, and institutional continuity remains weak. This instability has severely damaged long-term economic planning. Every new government announces new programs and reforms, but implementation rarely continues consistently after political leadership changes. Tax policies are frequently altered through annual budgets and finance acts without long-term strategic planning. Businesses and investors require stability and predictability. They need confidence that tax rates, regulations, and investment policies will remain relatively consistent over time. In Nepal, however, policy uncertainty discourages long-term investment and industrial expansion.

Political instability also weakens governance institutions. When political leaders focus primarily on coalition survival and power-sharing negotiations, structural economic reform becomes secondary creating space for corruption, political interference, and administrative inefficiency. (The Kathmandu Post, 2024). Tax exemptions, customs administration, business licensing, and revenue investigations are often influenced by political pressure rather than institutional principles. Such practices weaken fairness and encourage rent-seeking behavior. In reality, Nepal's taxation problem is deeply political. Weak institutions are not accidental; they are the result of decades of unstable governance and short-term political thinking. (World Bank Group, 2026)

The Impact on Economic Development

The effect of Nepal's weak tax system extends far beyond government taxes collection. Where a weak taxation structure directly affects national development capacity. (Maharjan, 2024) Without sufficient domestic revenue, the government becomes heavily dependent on foreign aid, loans, and remittance-driven consumption. This dependency limits Nepal's economic independence and long-term fiscal sustainability. Low revenue collection also reduces public investment in critical sectors such as: Education, healthcare, infrastructure, agriculture modernization, industrial development, and employment generation.

Simultaneously, the inequalities in tax also damages social trust. When an ordinary person feels overburdened while wealthy individuals avoid accountability, frustration and resentment increase. Economic inequality becomes more visible, and public confidence in democratic institutions weakens. (World Bank Group, 2026) Furthermore, unstable policy making discourages foreign direct investment. Investors avoid economies where taxation systems are unpredictable, institutions are weak, and corruption remains widespread. Nepal therefore remains trapped in a cycle of low industrial productivity, import dependency, youth migration, and slow economic transformation.

Overdependence on Indirect Taxes

The tax possessed by the government on various goods and services which is collected by the manufacturers or sellers of them from the consumer when they purchase an item or service and paid to the government afterwards. They are referred to as the consumption taxes, transactions taxes or excise taxes. (Pimentel, 2025). Indirect taxes are an important component of Nepal's tax revenue, including Value Added Tax (VAT), customs duties, and excise duties, while the indirect tax levies in more developed nations have typically been offset by the effective collection of direct taxes on income (Shah, 2010). Nepal does not have as many progressive taxes on property, wealth, and high-income earners as other countries. Consequently, many low-income and middle-income earners will end up paying far more indirect tax relative to their income, while wealthier individuals are able to greatly reduce their indirect tax liability through how they buy. Reliance on indirect taxation adds to rising inflation. Rising taxes on products, fuel, transportation, and necessities

all generate costs for the consumer and are particularly damaging to families and individuals in Nepal, who already face high unemployment and low purchasing power. Increased reliance on indirect taxation is another factor causing inflation. Tax increases on imported goods, fuel, transportation and essential goods will be passed down to the consumer at the end. (The Middle Class Under the Tax Regime, 2026) Due to low purchasing power and high unemployment, the increased prices will greatly affect the quality of life for all citizens of Nepal.

The majority of economists and policy analysts have pointed out that Nepal should be working to decrease its reliance on consumption based taxes, as well as instituting more direct taxation mechanisms aimed at wealth, property, speculative capital and high income earners. Otherwise, the growing gap between rich and poor will continue to widen. Tax Evasion Has Become a Culture. In many business sectors, tax avoidance is often considered a clever business strategy rather than an unethical practice. Many consumers also prefer purchasing goods without official bills to avoid paying VAT, while businesses promote such transactions to hide their actual income. This situation indicates a serious decline in civic responsibility and public trust in state institutions (Neupane, 2026). People are less willing to pay taxes when they believe public money is wasted through corruption, political favoritism, and administrative inefficiency. (Wikipedia contributors, 2025) In Nepal, many citizens do not see a direct relationship between the taxes they pay and the quality of public services they receive. Poor roads, weak healthcare systems, irregular public services, and visible corruption reduce public confidence in the state. As trust declines, tax compliance also declines.

The government's weak enforcement capacity further worsens the situation. Revenue offices often lack technological infrastructure, reliable databases, and effective audit systems. Corruption inside administrative institutions creates additional opportunities for manipulation and bribery. As a result, tax evasion continues to grow while honest taxpayers become increasingly frustrated.

Causes Reform Efforts Continue to Fail

Nepal has not ignored tax reform entirely. Several modernization efforts have been introduced over the years, including VAT implementation, PAN registration, Electronic tax filing, Customs modernization, Digital payment promotion, and so on. However, most reforms remain incomplete or weakly implemented. The main problem is that Nepal often focuses on technical reform without addressing institutional culture and political accountability. Technology alone cannot solve corruption if political interference continues. Digital systems cannot improve compliance if enforcement remains selective. Tax laws cannot become effective if public trust remains weak. Many reforms fail because they are introduced for short-term political visibility rather than long-term institutional transformation. Nepal's leaders frequently announce ambitious economic agendas, but implementation suffers from poor coordination, unstable leadership, bureaucratic resistance, and lack of continuity. Real reform requires political commitment that extends beyond electoral cycles.

Findings

The analysis of revenue mobilization and Gross Domestic Product (GDP) in Nepal from fiscal year 2077/78 to 2081/82 showed that both total revenue and tax revenue as a percentage of GDP experienced noticeable fluctuations. Although revenue collection increased gradually in some years, the ratio declined during the later fiscal years, indicating weaker revenue mobilization performance compared to earlier periods. The study found that political instability, inconsistent government policies, weak administrative coordination, and unstable governance negatively affected tax administration and taxpayer compliance. In addition, political instability reduced the government's ability to invest effectively in important sectors such as education, healthcare, infrastructure, agriculture, and sustainable development. As a result, the contribution of revenue mobilization to economic growth and public service delivery remained limited.

तालिका १: कुल गार्हस्थ उत्पादनमा राजस्व परिचालनको अनुपात

(रु. अर्बमा)

आर्थिक वर्ष	२०७७/७८	२०७८/७९	२०७९/८०	२०८०/८१	२०८१/८२
कुल गार्हस्थ उत्पादन	४३५२.५५	४९७६.६	५३४८.५३	५७०४.८	६१०७.२२
कुल राजस्व	९३८.३२	१०६७.९६	९५७.१५	१०५८.९	११७८.८२
कर राजस्व	८७०.११	९८४.१६	८६५.६२	९४४.६	१०४९.८८
कुल राजस्व/कुल गार्हस्थ उत्पादन	२१.५६	२१.४६	१७.९०	१८.५६	१९.३१
कर राजस्व/कुल गार्हस्थ उत्पादन	१९.९९	१९.७८	१६.१८	१६.५६	१७.१९

(स्रोत: अर्थ मन्त्रालयको वार्षिक प्रतिवेदन २०८१/८२)

Though Nepal's tax system has expanded in recent years, several problems and challenges still remain. Not only this, weak transparency in tax administration, tax evasion, political interference, low public trust, and the growth of the informal economy have reduced the government's ability to collect expected revenue. At the same time, many citizens felt that they did not receive direct benefits from the taxes they paid, which has increased dissatisfaction toward the government.

One of the most serious challenges in Nepal's tax system was tax evasion. Many business owners and high-income earners attempt to hide their actual income in order to pay less tax or avoid taxation completely. Moreover, many businesses operate without legal registration and remain outside the tax system. This system directly reduced government revenue collection. The risk of tax evasion is particularly high in sectors where cash transactions were more common. Another major issue was the lack of tax awareness among citizens. Many people did not fully understand that paying taxes is both a legal and social responsibility. Some people view taxes only as a financial burden rather than as a contribution to the national development system, because a strong "tax culture" has not fully developed in society, voluntary participation in tax payment remains weak.

Right now, Nepal's tax system is also considered complex and highly process-oriented. Tax laws, rules, and administrative procedures are often difficult for ordinary citizens and small business owners to understand. Excessive paperwork, complicated procedures, and unclear regulations created difficulties for taxpayers. As a result, many businesses preferred to remain in the informal sector instead of becoming part of the formal economy. Political instability has also had a serious impact on Nepal's tax system. Frequent changes in government, shifting economic policies, and the absence of long-term planning have created uncertainty for businesses and investors. Regular amendments to tax and economic policies often create confusion and weaken the investment environment. Furthermore, political interference in tax administration has affected fairness and transparency. There are allegations that tax exemptions, waivers, and investigations are sometimes influenced by political connections, which weakens public trust in the government.

Corruption was another major challenge. Irregularities in tax collection and administrative processes cause significant revenue losses for the state. When citizens feel that tax money is not being used properly, their willingness to pay taxes decreases. A lack of transparency and accountability in public administration further weakens trust between citizens and the government. A large part of Nepal's economy still operates within the informal sector. Many small and household businesses are not officially registered, which keeps them outside the tax system. As a result, the government is unable to collect the expected level of revenue, and fair market competition is also negatively affected.

Public dissatisfaction is also increasing because many citizens have not felt the direct benefits of the taxes they paid. In many rural and remote areas, access to quality healthcare services remains limited due to the shortage of hospitals, skilled medical staff, medicines, and modern treatment facilities. Similarly, the quality of government education has not improved as expected. Many families are forced to depend on expensive private schools, creating additional financial pressure on middle-class and low-income households. Even though citizens regularly pay taxes, trust in the government weakens when they do not receive quality public services in return. Nepal also faces challenges

in providing future security and social protection. In many developed countries, taxpayers receive benefits such as health insurance, unemployment support, old-age security, and social safety programs. However, in Nepal, these services are still limited and not fully effective. Programs such as health insurance and social security have not yet reached all citizens effectively. Due to unemployment, poverty, and economic insecurity, many young people are forced to seek employment abroad. The continuous migration of skilled and unskilled manpower negatively affects the country's long-term economic and social development. When citizens do not feel secure about their future despite paying taxes, the relationship between the state and the public becomes weaker.

Conclusion

The taxation problem in Nepal is not limited to revenue collection. It's a reflection of deeply rooted weakness in institutional and political systems that have been accumulated over the decades. A narrow duty base, widespread tax evasion, corruption, policy inconsistency, and overdependence on circular taxation continue to undermine financial stability. Political insecurity has boosted these problems by weakening governance, delaying reform, and discouraging long-term investment. No country can achieve any meaningful profitable metamorphosis when its taxation system remains structurally fragile. Nepal doesn't simply need advanced levies, it needs a fairer system, stronger institutions, responsible governance, and long-term policy stability.

Without these changes, profitable reliance, inequality, and institutional weakness will continue to define the country's future. But if Nepal can strengthen governance, contemporize tax administration, and rebuild public trust, taxation can come further than a source of profit. It can come a foundation for sustainable development, profitable discipline, and public progress.

In conclusion, an effective tax system is not only a means of collecting government revenue but also an important foundation for improving the living standards of citizens. If tax revenue is properly invested in healthcare, employment, infrastructure, social security, public trust and education in the government will gradually increase. Through political stability, transparency, good governance, and people-centered development policies, Nepal can build a stronger and more reliable tax system that supports sustainable economic growth and improves the quality of life of its citizens.

Suggestions

To improve Nepal's tax system, long-term and practical reforms are necessary. First, political stability is essential. A stable government with clear and consistent economic policies can strengthen tax administration and improve investor confidence. Frequent policy changes should be minimized, and long-term economic planning should be prioritized. Second, the tax system should be modernized by making it simpler, more transparent, and technology-friendly. Online tax systems, digital payment methods, and automated record management can improve efficiency, reduce tax evasion, and make the process more convenient for taxpayers.

Third, tax awareness among citizens should be increased. Tax education can help people understand the importance of taxation and its role in national development. When citizens see that tax revenue is being properly used for public welfare and development, public trust and responsibility are likely to increase. In addition, strong legal provisions and transparent governance are necessary to control corruption. Tax administration should remain free from political influence and operate in a fair, accountable, and impartial manner. Also, efforts should be made to formalize the informal economy. Small businesses should be encouraged to register legally through incentives, support programs, and simplified procedures. Therefore, Nepal must prioritize good governance, accountability, transparency, and sustainable reforms in order to build a stronger and more reliable economic system for future generations.

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