

Municipal revenue compliance and its potentiality of Damak municipality in Nepal

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Abstract

The major portion of municipal own source revenues is tax revenue. Municipal own revenue sources are more stable and consistent than intergovernmental transfers as well as other external sources. The basic objectives of the present study are to analyze the municipal revenue compliance and to expose the own sources revenue potentiality of Damak municipality. A descriptive and analytical research design was applied among 166 respondents (33 municipal policy advisors and 133 municipal taxpayers) of Damak municipality and simple random sampling method was used to select the municipality as a sample. Also, Simple random sampling method was employed to select the respondents. Most of the taxpayers (i.e. 80.4 %) have paid municipal revenues and out of them, more than 57 percent taxpayers have paid the municipal revenues below one thousand rupees. The contribution of own source revenue to total revenue has been fluctuating over the period of six years. From the view point of municipal policy making advisors, integrated property tax seems more potential source of revenue in comparison to other own sources. To some extent, tax compliance is satisfactory. Tax revenue wraps the main segment of municipal own source revenues. Service quality and local revenue collection capacity of Damak municipality are almost moderate and likely to be

strong. Service delivery fee imposed by the municipality for sanitation service is about satisfactory.

Key Words: Municipal tax revenue, Municipal revenue compliance, Own source revenue, Revenue potentiality

1. Introduction

In Nepal, the key tax revenue sources of municipalities are usually integrated property, rent, house and land, vehicle, enterprise, advertisement, and commercial video tax. Likewise, the major non-tax revenue sources are; property rental charge, building permit fee, vehicle parking charge, and service fee/charge, etc. (LSGA, 1999). Whatever method of collection is adopted the municipalities must be transparent and it should be acceptable to the taxpayers (Study Team, 2005). Decision regarding local revenue administration is crucial for municipal decision making advisors and decision makers. Revenues collected in municipalities are generally classified into two types: internal and external. Internal revenues are also commonly categorized into two forms and they are tax and non-tax revenues (Wegner, 2008).

The central Government of Nepal has positive feelings on the increasing efficiency in service delivery, but it is impeded by different aspects, including lack of regular monitoring of performance and sound procurement plans, non-performance of competitive tendering and lack of performance auditing as well.

Unwanted pressure of expenditures toward the end of the fiscal year is the main cause of these factors (Ministry of Finance, 2008, p. 16). For the local government benefit principle of taxation is more appropriate and for the central government ability to pay principle is suitable. But, the ground reality in developing countries, like Nepal, is vast difference. There are only a few tax bases in practice. Consequently, the municipality has become very weak to administer the tax. Actually, municipal taxes or fees are paid as a charge for the benefits obtained from the services. Therefore, benefit principle becomes workable only when benefit from local services can be approximately identified. (Shrestha, 2009)

Positive peer attitude, rewarding tax payers, offering a prize for best taxpayers and aim of low profits etc. are the supportive factors of municipal revenue compliance. Similarly, inability to be aware of tax laws or insufficient tax education programmes, high rates of tax and non tax revenues, complex tax administration procedures, unfairness or chances of misuse revenues etc. are the possible factors of non-compliance (Mumumba Omweri Marti, 2010). Especially in developing countries like Nepal, many researches are performed on taxpayers' attitude towards municipality and the effect of individual religiosity on tax fraud as well as on other factors influencing tax compliance behavior (James O Alabede, 2011). The fiscal exchange theory of public finance hints that the existence of government expenditures may encourage compliance and the governments can boost compliance by making available goods or services that municipal people demand more efficiently. According to the political legitimacy theory, it is shaped by the degree to which citizens believe the municipality. In conclusion, we come across some indications that tax knowledge

and awareness have a significant impression on revenue compliance point of view (Merima Ali, 2013). Tax source is an important own source revenues of municipalities. Both the benefit principle and ability to pay principle of taxation are the basic philosophies (BSBA, 2013). Revenue compliance is related to taxpayer's perceptions of value for money and fairness in the sub-national revenue system and that appropriate enforcement can be productive (Smoke, 2013). Local revenue collection strategies are varied from municipalities to municipalities. But method of revenue collection unanimously, is an important decision for each municipality. Collection through contractors or public private partnership (PPP) model and direct collection by municipalities themselves are common methods. Whatever may be the methods of revenue collection both accountability and cost effectiveness are most considerable factors for taxpayers and municipalities themselves as well.

The main aims of the present study are to analyze the municipal own source revenue compliance and to explore its potentiality regarding Damak municipality in Nepal.

2. Review of Literature

2.1 Problems of Revenue Compliance

Many taxpayers pay little attention to tax matters and may not even view tax evasion as an ethical issue. Similarly, the ethical values of them may be much more tempered by situational requirements than unrealistic anticipation (Philip M.J. Reckers D. L., 1994). In most developing countries, budget execution and accounting processes are either manual or supported by very old and inadequately maintained software applications. This has had toxic effects on the performance of their municipal expenditure

management systems, that are often not adequately appreciated (Khemani, 2006, p. 2). The type of government system appears to matter in the propensity to engage in corruption. The literature makes clear that the causes of corruption tend to be complex, but corruption thrives in the developing world because of the prevalence of weak public institutions, low levels of education attained by the majority of citizens, and the presence of an underdeveloped civil society. (Prier, 2007, p. 76). We have so many anxieties on the subject of the management of municipal finance in Nepal. Nepal government and Udlle/GTZ (development partner agency for local governments of Nepal) have clearly stated (MLD, udle/GTZ, 2008) that 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 municipal administration. Inter -agency coordination, conflicting laws, syndicating/ cartelling of interest groups, low administrative efficiency, negatively motivated local staff, low tax effort, low effort on transparency (dissemination and mass communication), political instability, non tax compliance, and non- feasible local revenue sources are the major revenue mobilization problems (Nepal Government, 2010). Lack of well defined mission and comprehensive functional role, lack of proper structure for the development process, and low quality of staff are also the reasons of ineffectiveness of municipal administration (Adams, 2012, pp. 4-13). Regarding the measurement, explanation and control of tax evasion, we still need to fulfill many gaps in our understanding although we might have learned so many matters of finance and taxation. (Alm, 2012). 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. (Merima Ali, 2013, p. 5).

2.2. Revenue Compliance in Nepal: Policy Perspective

Pertaining to the noncompliance of municipal tax 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 bodies, 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 actions. Besides the provisions stated in the section 59 of Local Bodies Resource Mobilization and Management Manual (2012) issued by the Nepal Government, the local bodies have to fulfill all the conditions of budget authority, circulars and directions issued from the concerned ministries, and the provisions of minimum conditions and performance measures (MCPM) manual (MoFALD, 2012).

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).

2.3 Municipal 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 the supplementary 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). So far the static revenue collection trend of integrated property tax does not mean that the tax potential is already achieved. For instance, the incorporation of integrated property tax into the total revenue of municipalities was 8% in the FY 2005/06. In addition, governments should strive for high collection rates for all revenues owed and keep the payment-making process simple and easy for citizens (Larson, 2007, p. 34). The Government of Sri Lanka has perceived seriously regarding revenue manuals and revenue surveys to identify information about current and potential revenue sources that can help local officials keep taxes, fees and charges at levels intended by policymakers (Ministry of Local Government and Provincial Councils, 2008, p. 36). Revenue compliance is the support of municipal people or prospective taxpayers to the revenue programs execution. It has always been an important issue in revenue administration for choosing the 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. Clearly, individual taxpayers' rights appear of greater importance. Potential

harassment of taxpayers is also of a concern (MLD, 2010).

For increasing revenue compliance, municipalities must ensure that their job descriptions, competency requirements, advertisements, selection criteria and appointments are associated with the requirements set out in the regulations. (National Treasury Republic of South Africa, 2011). Municipalities are fully responsible for formulating and executing local or municipal policies and programmes in partnership with other local governance performers and they have substantial roles in bringing local actors together to form a common vision of how to take action to issues raised in a coordinated way (MLD, 2012). Nepalese municipalities still have a revenue potential increase of almost 60%. It is the fact that there is high resistance of taxpayers and integrated property tax in many municipalities is not full-fledged. Missing revaluations of tax rates and the potential of integrated property tax in Nepal is quite obvious. The high taxpayer resistance is based on the mistrust against the local administration (MLD, udle/GTZ, 2008, p. 9). The main sources of own revenue for municipalities are usually property taxes, business licenses, market fees and various user charges. They have the potential to provide substantial and reliable revenue if well administered, but in practice all have serious drawbacks (ICTD, 2013, p. 2).

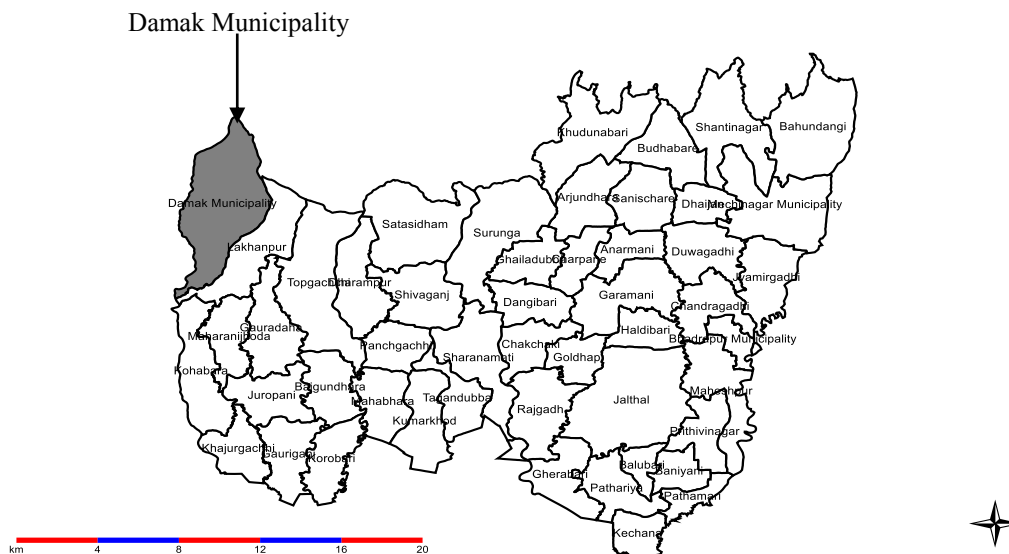
Tax compliance is obviously critical for effective municipal revenue generation. There is limited empirical evidence, but available analysis indicates that compliance can be improved or deteriorated under decentralization. The effect seems to depend on economic conditions, citizen attitudes about municipalities, and differences in municipal or local bodies' political dynamics, including the willingness

and ability of municipalities to administer the tax code (Smoke, 2013). So many researches are required for moderating effect of risk preference on relationship between taxpayer's attitude towards tax evasion and his/her compliance behavior to check the consistency of the results produced by this study on this moderator. (James O. Alabedi, 2013).

3. Research Area, Design and Methodology

3.1 Research Area

The study is closely connected to Damak municipality, so the municipality is the study population. Damak is a second oldest municipality of Jhapa. It has also been a second industrial tea estate for the last fifty years. It is situated in the eastern part of Nepal through which east-west highway from Kakadvitta (Mechi) to Mahakali is crossed. As stated in the population monograph report of CBS, Nepal (2014), Damak municipality is inhabited by approximately seventy five thousand people.



(Figure - 1, Map of Jhapa District, Source: NeKSAPInfo, 2013)

3.2 Research Design and Methodologies

In Nepal, the formation processes of Metropolitan and Sub-metropolitan cities are different than municipalities. Only fifty three municipalities are the population of the study out of fifty eight. Four sub-metropolitan cities and one metropolitan city (Kathmandu) are not able to be representative samples of all the municipalities. So, the study excluded these big five from the study population. In this study, non-probability sampling technique was applied for the selection of municipality and Damak municipality was selected as a sample from the Eastern Development Region (Terai Ecological Belt) of Nepal. Analytical

and descriptive research design has been adopted to analyze the compliance of municipal tax revenue and to find its potentiality in Damak Municipality.

Municipal taxpayers and policy making advisors were the respondents of the study and they were selected in random basis. In total, 33 samples were taken from municipal policy-making 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 (business, agriculture, and service sectors) in Damak municipality.

Dichotomous and 5 point Likert Scale self administered questionnaires were developed. A total of 216 questionnaire forms (166 of taxpayers and 50 of policy making advisors) were used, out of which 180 (144 of taxpayers and 36 of policy making advisors) were effectively returned from the respondents. The successful questionnaire return rate of taxpayers was 84.7 percent and the return rate of municipal policy making advisors was 72 percent. Thirteen (10 of taxpayers and 3 of policy making advisors) questionnaires were incomplete out of the successful returns. On the basis of first come first response, only 166 questionnaires (133 questionnaires of taxpayers and 33 questionnaires of policy making advisors) were ratified for the research study purpose out of 167 properly answered questionnaire forms.

A cross sectional method of survey was applied for collection of primary data and secondary information were obtained from Damak municipality, MoFALD (Ministry of Federal Affairs and Local Development), District Development Committee Jhapa, Urban Development Through Local Efforts (udle/GTZ) and Local Bodies' Fiscal Commission of Nepal. Relevant articles, journals, books, as well as published and unpublished materials and performance of the associated organizations working with municipalities were accepted for the macro analysis of the research study. For the analysis of secondary data, various analytical tables have been set up and different analytical tools of statistics including SPSS-20 software have been used for the analysis of primary data.

There were total 166 respondents (133 municipal taxpayers and 33 municipal policy advisors), among them 72.9 percent respondents were male and female respondents were 27.1 percent. Out of 33 municipal policy advisors, thirty (more than 90%) persons were males. Out of them, 18 respondents (54.5%) were local political party members, 9 respondents (27.3%) were CCI Members, and 6 respondents (18.2%) were civil society members and others. Likewise, more than 55 percent taxpayer respondents were engaged in business activities and about 10 percent taxpayer respondents were involved in agriculture sector. Similarly, about 35 percent taxpayer respondents were involved in government and non government services. Both types of respondents' views have been collected to analyze the municipal tax compliance and to find out the potentiality of own sources revenue of Damak municipality. On the basis of questionnaire survey conducted in March to May 2014, the scenario of municipal tax compliance, potentiality of revenue, and expressed reasons for non compliance municipal revenues are presented and discussed as follows:

4. Results

Table: 1 Tax revenue collection scenario of Damak municipality

Major Tax Headings	Fiscal Years and Collection Amount (Rs. in '000)						Total Rs.
	2007/008	2008/009	2009/010	2010/011	2011/012	2012/013	
Integrated Property Tax	2158	2518	2511	4443	6495	8174	26299
Business/ Professional Tax	401	507	757	925	1631	1507	5728
Rent Tax	35	48	778	63	45	73	1042
Other Taxes(Toll, Vehicle, Animal Market, Advertisement etc)	3819	5710	3425	3852	5460	7123	29389
Total	6413	8783	7471	9283	13631	16877	62458

(Source: Damak Municipality Office, 2014)

The above table shows the tax revenue collection scenario of Damak municipality. The trend of tax collection from above major headings is not consistent. The collection ratio of tax revenue is in increasing trend except the fiscal year 2009/010.

Table - 2 Contribution of tax revenue on own source revenue and total revenue (Rs. in '000)

Descriptions	Fiscal Years and Revenue Received Details						Total Rs.
	2007/008	2008/009	2009/010	2010/011	2011/012	2012/013	
Total Revenue Received Rs.	52845	91338	79730	142903	118350	124139	609305
Own Source Revenue Received Rs.	15675	47270	17427	21933	26281	28906	157492
Tax Revenue Received Rs.	6413	8783	7471	9283	13631	16877	62458
Contribution of Tax Revenue on Own Source Revenue (%)	40.91	18.58	42.87	42.32	51.86	58.38	39.65
Contribution of own source Revenue on Total Revenue	29.67	51.75	21.85	15.39	22.20	23.28	25.84
Contribution of Tax Revenue on Total Revenue (%)	12.13	9.61	9.37	6.49	11.51	13.59	10.25

(Source: Damak Municipality Office, 2014)

The above table reveals the average contribution of tax revenue on own source revenue

(39.65%), and on total revenue (10.25%) of Damak municipality in recent past six fiscal years.

Table -3 Annual tax contribution scenario of Damak municipality

Description	Frequency	Percent	Valid Percent	Cumulative Percent
Tax Not Contributed	26	19.6	19.6	19.6
Tax Contributed:				
Less than Rs.1000	61	45.9	46.2	65.2
Rs. 1000 to Rs. 2000	28	21.1	21.2	86.4
Rs. 2000 to Rs. 5000	12	9.0	9.1	95.5
Rs. 5000 to Rs. 10000	4	3.0	3.0	98.5
Above Rs. 10000	2	1.5	1.5	100.0
Total	133	100	100.0	

(Sources: Field Survey, 2014)

The above table depicts that most of the taxpayers of Damak municipality have paid municipal taxes below than Rs.1000/- per year. Out of 133 taxpayers, 26 taxpayers have not paid the municipal tax

by showing different causes. Besides these spoken or latent causes, the municipal policy making advisors and tax payers have expressed the possible reasons of indecision for the payment of tax and non tax revenues.

Table - 4 Consolidated views on hesitation for the payment of municipal tax

Reasons of Hesitation for Municipal Tax Payment	Tax Payers' views (%)			Policy Advisors' views (%)		
	Agree	Neutral	Disagree	Agree	Neutral	Disagree
Unusual behavior of municipal staff	18.8	39.1	42.1	21.2	24.2	54.6
Too much items of taxes and fees	23.3	26.3	50.4	21.2	21.2	57.6
Too much rates of taxes and fees	22.6	23.3	54.1	27.3	12.1	60.6
Low service quality	35.3	13.5	51.2	36.4	27.3	36.4
Collected revenues not being spent on municipal services	33.8	16.5	49.7	42.4	18.2	39.4
Low commitment of municipal staff	23.3	22.6	54.1	39.4	21.2	39.4
Taxpayer's unwillingness to pay tax	18.0	24.8	57.1	15.2	12.1	72.7
Lack of information for decision makers	29.3	33.1	37.6	51.5	21.2	27.3

(Sources: Field Survey, 2014)

The above table 4 displays the views on the possible reasons of hesitation for the payment of

municipal tax and non tax revenues by the taxpayers and municipal policy making advisors.

Table - 5 A comparative views on revenue potentiality

Major Revenue Headings	Tax Payers' views (%)					Policy Advisors' Views (%)				
	Non Potential	Hardly Potential	Semi Potential	Potential	Highly Potential	Non Potential	Hardly Potential	Semi Potential	Potential	Highly Potential
Integrated Property Tax	0	5.3	12.0	43.6	39.1	0	0	15.2	33.3	51.5
Business Tax	0	1.5	9.0	53.4	36.1	0	0	12.1	45.5	42.4
Rent Tax	1.5	18.0	18.0	33.8	28.7	0	3.0	27.3	33.3	36.4
Building Permit Fee	0	6.0	8.3	44.4	41.3	0	0	9.1	51.5	39.4
Service Fee	0.8	9.0	16.5	45.9	27.8	0	9.1	27.3	45.5	18.1
Environment Pollution Fee	10.5	16.5	27.8	33.8	11.4	9.1	21.2	24.2	39.4	6.1

(Sources: Field Survey, 2014)

Table 5 depicts the degree of potentiality of major own sources of revenue from the view point of municipal taxpayers and policy making advisors. Integrated property tax is highly potential revenue source of Damak municipality from the policy perspective.

The following figure (figure -2) depicts the taxpayers' views on three facets; local revenue mobilization capacity, human resource development programme, and average capacity of existing human resource of Damak municipality.



Figure - 2 (Integrated Views of Taxpayers of Damak municipality)

Source: Field Survey Report, 2014

The above figure shows that local revenue collection capacity and service quality of Damak municipality are almost moderate and likely to be strong. And, human resource development including training and recruitment process and capacity of existing human resources are likely to be moderate.

The figure given below reveals the integrated views of taxpayers on service delivery fees levied by municipality, service quality and the role of Damak municipality on sanitation services.

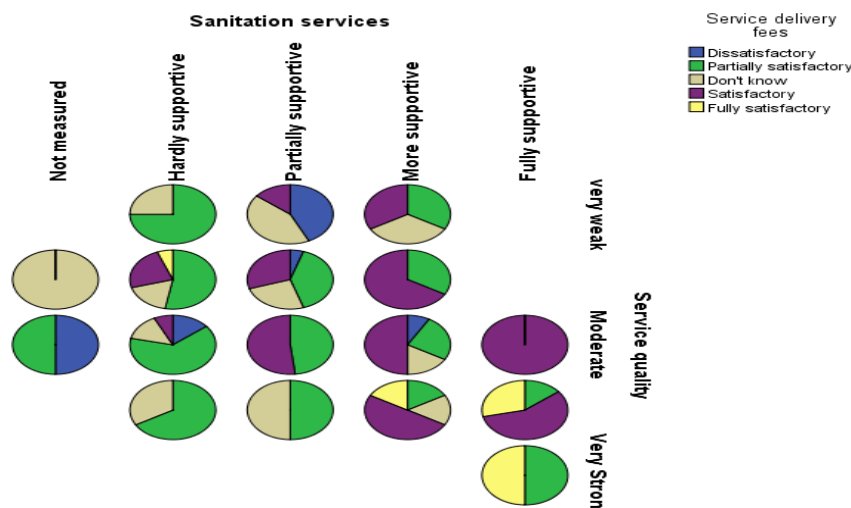


Figure - 3, Taxpayers' views on service delivery fees, sanitation services and service quality (Source: Field Survey Report 2014).

5

Discussion

The tax revenue collection scenario of Damak Municipality seems progressive except the fiscal year 2009/010. Integrated property tax has covered larger portion of the tax revenue sources within the period of the study.

The average contribution of tax revenue on own source revenue of Damak municipality of recent past six fiscal years is about 40 percent. Correspondingly, the average contribution of tax revenue on total revenue is about 10 percent only. The rate of tax revenue contribution on own source revenue

has been fluctuating year by year and the lowest contribution is 18.58%. According to the report of udle/GTZ, the performance of own source revenue to total revenue of the fiscal year 2006/07 in Damak municipality was only 25.84 percent which was much lower than set standard i.e.60 percent (udle/GTZ, 2008). The results indicate that individual moral beliefs are highly significant in tax compliance decisions (Philip M.J. Reckers, 1994, p. 9).

On the one hand, the average performance of own source revenue to total revenue of Damak municipality in the recent past six fiscal years is low

(25.84 percent), 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)

The total number of non taxpayers is 26 (19.6 percent in total), and out of them 8 (i.e. 6 % in total) non taxpayers have not paid municipal tax because of the lack of information. As expressed by 18 citizens of Damak municipality, high tax rate, secondary tax concept, chances of tax rebate in future and lack of ability to pay are the reasons for non-payment of municipal taxes. 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).

More than 30 percent taxpayers have some logics of indecisions regarding the payment of taxes, although they have refused to articulate the possible reasons. The policy making advisors have agreed upon the possible reasons for the non-payment of taxes. Their reasons are: collected revenues not being spent on municipal services (42.4 percent), low commitment of municipal staff (39.4 percent), and lack of information for decision makers (51.5 percent). In the same way, low service quality is also the another causes of hesitation for the payment of municipal revenues.

Integrated property tax is highly potential revenue source in Damak 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 to redefine 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). From the point of view of taxpayers, all the major headings of revenue are potential sources. The judgment of municipal policy making advisors, rent tax is highly potential source of tax revenue. Likewise, business tax, building permit fee, service charges, and environmental pollution control fee are also potential revenue sources of Damak municipality.

Although, human resource development including training and recruitment process and capacity of existing human resources are likely to be moderate, local revenue collection capacity and service quality of Damak municipality are almost moderate and likely to be strong. Service delivery fees levied by the municipality for sanitation services are partially satisfactory, and quality of sanitation service is moderate from the view point of municipal taxpayers.

6. Conclusion and Recommendations

Tax revenue wraps the main segment of municipal own source revenues. The study summarizes that the potentiality of municipal own source revenue and its compliance are not similar matters. Most of the municipal taxpayers have paid lower amount of tax, which indicates that either the tax administration power is low or there is lack of tax education and revenue mobilization plan. 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 clearly shows that the municipality has exercised such type of policies in the past.

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 Damak municipality. The contribution of tax revenue to the own source revenue and the total revenue is not coherent within the study period. Service quality and local revenue collection capacity are moderate and delivery fee for sanitation services is partially satisfactory in Damak municipality.

On the basis of the above conclusions, the study recommends the following:

- a. Municipal revenue education (tax education) programme should be conducted effectively.
- b. The joint effort on potential local revenue collection with revenue mobilization plan and the municipal tax compliance campaign should be carried out parallel.
- c. Tax rate should be revised regularly as well as tax administration power should be enhanced.

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