

# **PROVISION OF FINES AND PENALTIES UNDER INCOME TAX ACT 2058**

## **A THESIS**

### **Submitted By:**

**Prakash Pokhrel**

**Shankar Dev Campus**

T.U. Regd. No: 7-1-260-51-2002

Campus Roll No: 2473/2065

Exam Roll No: 390204/2066

### **Submitted To:**

Office of the Dean

Faculty of Management

Tribhuvan University

In partial fulfillment of the requirement for the Degree of

**Master of Business Studies (MBS)**

Putalisadak, Kathmandu

May, 2014

Date: .....

# VIVA-VOCE SHEET

We have conducted the Viva-Voce examination of the thesis presented by

**Prakash Pokhrel**

Entitled

**“PROVISION OF FINES AND PENALTIES UNDER INCOME TAX ACT 2058”**

We found that the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for

**Master of Business Studies (MBS)**

## **Viva-Voce Committee**

Head, Research Department: .....

Member (Thesis Supervisor): .....

Member (Thesis Supervisor): .....

Member (External Expert): .....

# **RECOMMENDATION**

**This is to certify that the thesis**

**Submitted By:**

**Prakash Pokhrel**

Entitled

**“PROVISION OF FINES AND PENALTIES UNDER INCOME TAX ACT 2058”**

has been prepared as approved by this Department in the prescribed format of Faculty of Management. This thesis is forwarded for examination.

.....  
Prof.Dr Kamal Deep Dhakal)  
Thesis Supervisor

.....  
(Prof.Dr Kamal Deep Dhakal)  
Head of Research Department

.....  
(Asso. Prof. Prakash Singh Pradhan)  
Campus Chief

.....  
(Romakant Bhattarai  
Thesis Supervisor

## **DECLARATION**

I hereby declare that this thesis work entitled “**PROVISION OF FINES AND PENALTIES UNDER INCOME TAX ACT 2058**” submitted to office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Degree of Masters of Business Studies which is prepared under the supervision of **Prof. Dr Kamal Deep Dhakal & Romakant Bhattarai**, Shankar Dev Campus.

Date: May, 2014

.....

**Prakash Pokhrel**  
**Researcher**

## **ACKNOWLEDGEMENTS**

This study was made possible through the generous contributions of many people. I am indebted to my respected supervisor **Prof. Dr Kamal Deep Dhakal & Romakant Bhattarai** of Shankar Dev Campus, who despite his busy schedule provided valuable and meaningful suggestions and comments for the preparation of this report.

I would like to express my deep gratitude towards Head of the Research Department of Shankar Dev Campus Prof. Dr. Kamal Deep Dhakal, who have immensely contributed his time to guide me for the preparation of this thesis.

I would like to express my gratitude to all the peoples and organizations that have helped to bring this report in this form. This could not be possible without the help and support of them during the research. Similarly, all the staff members of Shankar Dev Campus, Library and Central Library of Tribhuvan University who also helped me in different ways while preparing this report.

I am also indebted to my friend Rabi Bhattarai who helped me a lot by providing his valuable suggestions and co-operation to prepare this thesis. Especially, I am very much grateful to my family members who helped me in every moment to prepare this thesis, without his support this could not be possible for me.

Finally, I hope that this thesis report will be guideline to the student of business studies and to those who wish to make further research under this topic. I have tried to prepare the report errorless as much as possible but hope the possible errors would be covered by the further researchers if any.

**Prakash Pokhrel**  
**Shankar Dev Campus**

**May, 2014**

# Table of Contents

<u>Contents</u>	<u>Pages No.</u>
<i>Recommendation</i>	
<i>Viva-voce sheet</i>	
<i>Declaration</i>	
<i>Acknowledgements</i>	
<i>Table of contents</i>	
<i>List of tables</i>	
<i>List of figures</i>	
<i>Abbreviation</i>	
<b>CHAPTER-I</b>	
<b>INTRODUCTION</b>	<b>1-9</b>
1.1 Background of the Study	1
1.2 Statement of the Problems	6
1.3 Objectives of the Study	7
1.4 Significance of the Study	7
1.5 Limitations of the Study	8
1.6 Organization of the Study	9
<b>CHAPTER-II</b>	
<b>CONCEPTUAL FRAMEWORK &amp; REVIEW OF LITERATURE</b>	<b>10-38</b>
2.1 Conceptual Framework	10
2.1.1 Meaning of Taxation	11
2.1.2 Objectives of Taxation	12
2.1.3 Principle of Taxation	12
2.1.4 Origin of Tax System	15
2.1.5 Historical Background of Taxation	16
2.1.5.1 Taxation in context of Foreign Countries	16
2.1.5.2 Taxation in Ancient Nepal	18
2.1.5.3 Taxation in Nepal during Rana Regime	19
2.1.5.4 Taxation in Modern Nepal	21
2.2 Review of Related Studies	27

2.2.1 Provision of Fines and Penalties According to Income Tax Act 58	27
2.2.2 Review of Books/Reports	32
2.2.3 Review of Journal/ Article	33
2.2.4 Review of Dissertations and Thesis	34
2.3 Research Gap	39

## **CHAPTER-III**

### **RESEARCH METHODOLOGY 39-43**

3.1 Research Design	39
3.2 Population and Sample	40
3.3 Nature and Sources of Data	41
3.3.1 Primary Data	41
3.3.2 Secondary Data	41
3.4 Data Collection Procedures	42
3.5 Data Processing and Analysis Procedure	42
3.6 Weight of Choice	43

## **CHAPTER-IV**

### **PRESENTATION AND ANALYSIS OF DATA 44-86**

4.1 Analysis of Secondary Data	44
4.1.1 Government Expenditure and Sources of Financing	44
4.1.2 Resource gap in Nepal	46
4.1.3 Nepalese Government Revenue Structure	47
4.1.4 Composition of Tax Revenue	50
4.1.5 Composition of Direct Tax Revenue	52
4.1.6 Composition of Indirect Tax Revenue	54
4.1.7 Structure of Income Tax Revenue	57
4.1.8 Contribution of Income Tax to GDP and Total Revenue	60
4.1.9 Proportion of Penalties and Fines to Direct Tax	61
4.2 Empirical Analysis	63
4.2.1. Essential of Income Tax Collection for Government	64
4.2.2. Knowledge about Income Tax Act 2058	65
4.2.3. Taxpaying Habit of Nepalese Taxpayers	66
4.2.4. Effect of Fines and Penalties to improve Poor Tax Paying Habit	67

4.2.5. Familiar with Fines and Penalties Provision	68
4.2.6. Have You Ever been Penalized	69
4.2.7. Satisfactory to the Provisions of Fines and Penalty Made in Income	71
4.2.8. Effectiveness of Tax Administration to Impose Fines and Penalties	72
4.2.9. Knowledge about Fines and Penalty by not complying income tax law	75
4.2.10 Does the Provisions of Fines and Penalty Motivates and Inspires	77
4.2.11. Sufficiency &Satisfactory of Provision Made under the ITA. 2058	79
4.3 Major Findings	82

## **CHAPTER-V**

<b>SUMMARY, CONCLUSIONS AND RECOMMENDATIONS</b>	<b>87-90</b>
5.1 Summary	87
5.2 Conclusion	88
5.3 Recommendations	89

## **Bibliography**

## **Appendices**

## **List of Figures**

Figure: 4.1	Government Expenditure & Source of Financing	46
Figure: 4.2	Composition of Total Revenue Structure	49
Figure: 4.3	Composition of Tax Revenue	51
Figure: 4.4	Composition of Direct Tax Revenue	53
Figure: 4.5	Composition of Indirect Tax Revenue	56
Figure: 4.6	Structure of Total Income Tax Revenue	59

## ABBREVIATION

A.D	Anno Domini
ADB	Agriculture Development Bank
B.C	Before Christ
B.S	Bikram Sambat
BBS	Bachelor in Business Studies
CEDA	Center for Economic Development and Administration
Etc	And The Others
F/Y	Fiscal Year
GDP	Gross Domestic Product
IRD	Inland Revenue Department
IT	Income Tax
ITA	Income Tax Act
Ktm	Kathmandu
MBS	Master's of Business Studies
MOF	Ministry of Finance
No	Number
Pvt.	Private
SN	Serial Number
TU	Tribhuvan University
VAT	Value Added Tax
Vol	Volume

# CHAPTER- I

## INTRODUCTION

### 1.1 Background of the Study

Government plays an important role for rapid economic development of any nation. The government has various responsibilities to perform towards the nation such as to carryout development plans, to handle day to day administration activities, to maintain peace and security, to launch public welfare activities and to build various socio-economic infrastructures. So the government needs a lot of revenues and funds. Without adequate amount of revenue, the government cannot perform its work or they become handicapped.

The Government spends a lot of funds mainly in three types of expenditure i.e. protection, commercial, and public expenditure. The Government expenditure is increasing nowadays because of demand of time, increase in population, social progress, increase in price, security etc. Nepal has deficit budget and it has been making more bad economic condition of the country day by day. To meet the growing need of the public expenditure, the government has to maintain its funds. There are various sources from where the government can received its funds.

The Government can collect revenue from two sources i.e. external and internal sources. Foreign grants, loans, aids and donation are the external sources of funds. External sources of funds are very important for the undeveloped countries like Nepal. They are used for economic development, reconstruction, foreign exchange, to recover from crisis condition etc. There are also disadvantages of external sources of funds such as they are uncertain, inconvenient and not good for healthy development of nation because they have to be paid after a certain period of time. The continuous use of external sources of fund to raise necessary public fund is not good because it reduces liquidity position of the government. Internal sources of fund are more important not only for financing necessary funds but also for mobilization of external sources. So, it is better to mobilize internal sources of fund rather than looking beggar's eyes to the donors. Like developed countries, the developing countries try to mobilize their internal sources for regular and

development activities. Nepal is not exception for it. But Nepal has mobilized internal sources fewer than expected.

On the other hand, an internal source of fund is another import sources and government revenue. These are own sources of fund within the country. Internal sources should be mobilized effectively due to various disadvantages of external sources of funds. Internal sources which constitute tax and non-tax revenues. Tax revenues include the amounts which are compulsorily contributed by taxpayers to the government. The main objective of tax revenue is to collect more revenue for the welfare of state. Customs duty, excise duty, income tax, value added tax, property tax etc. are the form of tax revenue. Non-tax revenues are uncertain and inconvenient because they are imposed as per need of the government. The main objective of non-tax revenue is not to collect revenue but to provide goods and services to the people. The forms of non-tax revenue are administrative income, gifts and grants, business income etc.

Tax is the main source of fund for the government. Tax is a compulsory payment by the citizens to the government without the expectation of any personal benefits, which are redistributed, by the government in the nation in terms of public services, peace and security and development of infrastructure. In every country, the largest part of the government revenue is raised through taxation. It is tool of achieving maximum social and economic objective as laid down by the constitution of the nation. Taxation has been a very essential element of the government from the very beginning of the state system. In the early stage, the main objective of the taxation was to make the state sound in respect of resources. In modern days, the main objective is to maintain peace and security with economic development. But nowadays the taxation is vital instrument of social and economic policy for the government. Hence, the main function of taxation is that it ensures collective saving for the purpose of public investment and at the same time provides incentives for promoting private investment.

Tax can be classified into two types i.e. direct and indirect tax. Direct tax is a tax which is really paid by a person on whom it is legally imposed. Direct tax is levied on income and property. Direct tax consists of income tax, vehicle tax, gift tax,

interest tax, death tax etc. Indirect tax is a tax which is imposed on one person but partly or wholly paid by another person. Indirect tax is levied on the computation of goods and services. Entertainment tax, sales tax, customs duty, hotel tax, passenger tax, excise duty, value added tax etc are some indirect taxes. In Nepal, around 79% of total revenue comes from direct tax and 21% of total revenue from indirect tax in the fiscal year 2064. Direct tax is very essential for the development of the Nepalese economy. (Economic Survey: 2064/065)

Income tax is the major source of government revenue. Income tax is direct tax because it is charged to the person who earns income from different sources as employment, business and investment etc. It is popular and superior to indirect tax because it is imposed on the basis of paying capacity of the taxpayer as per the law of the nation. The person whose income is below the taxable income is free from the obligation of income tax.

Income tax plays a vital in the development of the nation economy. It is helpful to balance the regional economic development through the provision of income tax. The government should charge higher income tax on the income from the urban area and less tax on the income from remote area. The people in urban area have so many sources of income and earn more income in comparison to the rural area. Income tax holidays and incentives would help to develop the priority sector of the national economy. It has become an effective investment to ensure balanced socio-economic growth of the nation. It also helps to reduce the regional economic imbalance by providing tax concessions and holidays to businesses or industries, which is established in remote areas. It is useful to balance the economic development. The equal distribution of income is also possible through progressive income tax. Direct tax system reduces the gaps in society between the people having higher income group and poor people, imposing higher tax rate to higher income group. That is why; it is a means of equitable distribution of natural resources to all the people. It also helps in generating the concept of social responsibility towards the nation and keeps the people vigilant towards the public money and make us confirmed that the money is used in the right direction.

The contribution of income tax is much smaller to the total revenue for developing countries in comparison to developed countries and is likely to remain same for sometimes to come despite the efforts over the year so many least developed

countries to raise more revenue. There are mainly four reasons as why income tax yield is less in developing countries as compared to developed ones. They are problems of defining income, problems of assessing and measuring it, choice of rates, allowance and deduction and difficulties of tax collection.

Nepal's income tax has the features of both global and scheduler income tax system. It resembles the global tax system in that tax is levied on total income from all sources, although net income from various types of income is calculated separately. It also looks like a scheduler system in so far as a few sources of income have been made liable to separate taxes. It is being realized that contribution of income tax to the revenue of the government must be increased in Nepal. Nepal has adopted the income tax system since six and half decades ago. But Nepal's past experience shows that the government is unable to maximize the share of income tax to the public as per expectation.

In Nepal, the ancient tax system was based on Vedas, Smritis, and Puranas. Directives propounded by Manu, Chanakya, Yagnabalka etc. guided the taxation system. At that time, the principle of collecting tax from the people was imposition of tax without harming the activities of the people of the nation (Aryal & Poudel, 2004:56).

Although the concept of income tax was familiar to the Nepalese people from the very beginning. But the first budget which was introduced in 2008 B.S. stated about the introduction of the income tax system in Nepal. It was actually introduced only in 2017 B.S., when the Finance Act 2017 and Business, Profit and Remuneration Tax Act 2017 were enacted. Since the income tax was imposed only on income from business, profit and remuneration, the tax act could not cover all the sources of income and so was replaced by the Income Tax Act 2019 in 2019 B.S. After certain period, considering this act incapable of fulfilling the needs of the dynamic economic condition of the nation, it was replaced in 2031 B.S. by another act i.e., Income Tax Act 2031. This act had 66 sections which were classified into five different sources of income.

Since 19<sup>th</sup> Chaitra, 2058, Income Tax Act 2058 has been introduced in Nepal. This act was brought in Nepal to avoid the defects of the previous act as narrow base of tax, taxing only the income originated in Nepal, dispersion of tax related acts, i.e. income

tax related provisions were given in different acts, low penalty rate to tax evader, incompatible to self-assessment system, and unsuitable to modern economy (Khadka, 2001:67).

Even there are main problems related to the collection of tax amount from the people of the nation. There are various problems in income tax practices in Nepal such as narrow coverage, unscientific tax assessment, and deviation from the basic principles of income taxation, defective system from the perspective of international taxation, no adjustment for inflation, long time-lag, and no adjustment for inflation. Some people also feel tax as a penalty, leakage in tax, lack of tax consciousness of people, inability of tax administration to cover new taxpayers, delay in tax computation and collection system etc.

The Income Tax Act 2058 has 143 sections. Income Tax Regulation 2059 is also implemented under the provision of this act. This Act has many new provisions in comparison to the Income Tax Act, 2031. Within this act, the provisions of fines and penalties are also includes. It is very important to be known by all the people of the nation. It will help to collect tax revenue without any bias and measures the cleverness of the taxpayers. Fines and penalties help to collect revenue from the taxpayer in proper manner. It reduces the tax evasion and tax avoidance activities of the taxpayers. Therefore, the provision o fine and penalty of income tax system must be reviewed and immediate correction should be made if needed (Bhattarai&Koirala, 2006:34).

## **1.2 Statement of the Problem**

Every nation wants to uplift the economic condition. For this purpose, the government required a lot of revenues. Economically developed countries have so many sources of revenues, because they have more industries, more economic activities, earning more income and profit. Such high income earner can pay more tax to the government. But Nepal has very limited sources of revenue because of social, regional and geographical differences. Therefore, the Nepalese people have very low tax paying capacity. One study regarding to the income tax has stated that only 0.5% of the total population pay the income tax. It shows only a few people pay

tax. Again most of the taxpayers have very low income earners. That is why, they pay low tax. Low income group do not want to pay tax because they have little saving. Therefore Nepalese people have very poor taxpaying habits.(Inland Revenue:2069)

Income tax is the main source of revenue. The country wants to collect more and more revenue to cope up with all necessity of the nation. For this purpose, the government should impose income tax in the country and tried to implement it effectively. Nepal has also being imposing income tax, but not effectively and could not collect targeted revenue. There are so many causes of ineffective implementation of tax system. The existence of corruption in the government machinery is the main cause; lack of motivation to taxpayers as well as tax authorities is also next essential cause. Lack of responsibilities of government employee is next cause. The people are also less conscious towards their responsibility of nation. They do not want to pay tax; they feel tax as burden lay down on them by government. Either they avoid paying tax or delay to pay tax. They do not submit their statement of income or may submit false/misleading statement. They try their best to cheat the government. To avoid such problems Income Tax Act 2058 has many provisions. Among them fine and penalties is the important provision in solving such complex problems. However the tax administration of Nepal is not effective and efficient to impose the provisions of fines and penalties as per provisioned in the law because of corruption, unnecessary outside pressure, lack of information, etc.

Therefore, it is necessary to study about the income tax and its provision about fines and penalties. In this study, it is tried to find out the answers of the following questions.

1. Are the tax administrations efficient to implement the provisions of fines and penalties?
2. What are the provisions of fine and penalties in the law?
3. How much taxpayers are acquainted with the provisions of fines and penalties of the Income Tax Act?
4. What should be the provision of fine and penalties in law?

5. How much provisions of fine and penalties have become successful in collecting revenues?
6. Are the taxpayers motivated to pay tax?

### **1.3 Objectives of the Study**

The main objective of the study is to analyze the provisions of fines and penalties as per Income Tax Act. However, the following specific objectives have been set for the study:

1. To analyze the efficiency of the tax administration for implementation of the provisions of Tax Laws.
2. To find out the contribution of Income tax to GDP.
3. To measure the taxpayers' acquaintance with provisions of fines and penalties.
4. To evaluate the taxpayers attitudes towards provisions of fines and penalties.
5. To analyze the provision and practical implementation of fine and penalties based on Income Tax Act 2058.

### **1.4 Significance of the Study**

This study is tried to analyze the provisions of fines and penalties as per Income Tax Act. It is tried to present the different provisions and their practical implementation. This study will help respective tax administrators to make their program effective and it also help to taxpayers to understand the provisions mentioned on the act. It will help to make effective provisions of fines and penalties as well as effective implementation that cause good resource collection.

Studies are conducted for some purposes. If the study cannot fulfill the objectives, then it will be worthless of time, money, labor etc. Different parties may gain different benefits as per their requirements. This study also has some signification in the field of taxation of Nepal. Generally, followings are the main significance and need of the study:

1. This study will evaluate the efficiency of the tax administrators.
2. This study helps us to know the taxpayers' acquaintance with each and every provision of fines and penalties provided in the tax act.
3. This study will try to describe the provision of fine and penalties in our income tax act.
4. This study will provide reasonable suggestions and conclusion to make income tax act more effective and practical.
5. This study will focus taxpayers' attitudes towards the provision of the act.
6. This study helps us to judge the practical implementation of the provision of the act.

### **1.5 Limitations of the Study**

Every study has some limitations. The research should go ahead within the limitations of the study. In this study following are the main limitations:

1. The study, reports relating this subject are very few. So, it is tried to collect the information, data mostly from the concerned department's publications.
2. This study is mostly based on the secondary data.
3. Few information is collected by creating small sample of the Kathmandu valley.
4. Time and budget constraints are also the limitations of this study.

### **1.6 Organization of the Study**

The study is planned to organize into following five chapters, they are:

#### **1. Introduction**

This first chapter includes the introduction and background of the study, statement of the problem, objectives of the study, significance of the study and limitations of the study.

## **2. Conceptual Framework & Review of Literature**

This second chapter includes literature review. In this chapter the researcher has reviewed from books, journals, thesis and independent studies are taken into account.

## **3. Research Methodology**

This third chapter research methodology includes the research design, sources of data collection, techniques of data collection, tools for analysis of data and methods of presentation and analysis.

## **4. Presentation and Analysis of Data**

This fourth chapter includes presentation and analysis of data part. It is the main body of our study. It includes data presentation, interpretation and analysis of collected data. Major findings of the study are also included in this chapter.

## **5. Summary, Conclusions and Recommendations**

This fifth chapter includes the summary and conclusion of the research and finally suggestions and recommendations included.

## **CHAPTER- II**

### **CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE**

Review of the literature is undertaken in order to find out what works have been conducted in the area of the concerned study. It promotes greater understanding of the problem under study, and provides comparative data to evaluate and interpret the significance of the findings, and provides fruitful sources of hypothesis and conceptual framework. It is the chapter where a researcher reviews the books, journals, magazines or any other types of studies, which are related to his/her field of study. Research is a continuous process it never ends. The procedures and the findings may change but research continues.

The purpose of reviewing the literature is to develop some expertise in one's area, to see what new contribution can be made and to receive some ideas for developing design. Thus, the previous studies can't be ignored because they provide the foundation to the present study. In other words, there has to be continuity in research. This continuity in research is ensured by linking the present study with the past research studies. From this, it is clear that for analyzing the data and to something new a researcher must review the study and know if there are any studies ahead or not.

#### **2.1 Conceptual Framework**

In this chapter, meaning of taxation, objective of taxation, principle of taxation, origin of tax system, historical development of taxation, evolution and development of income tax system in Nepal are described to know the concept of taxation.

### **2.1.1 Meaning of Taxation**

Taxation is the system of levying taxes. The system is the set of principles. The principle is a scheme of ideas or body of rules by which a theory is organized. Thus, the system of levies was developed after the origin of tax.

Different persons have defined taxation in different ways. In the words of Seligman, 'Taxation is the compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred'. According to this definition given above, it can be said that firstly a tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government. The taxpayer does not have any right to receive direct benefit from the tax paid. Due to this compulsory nature, people have expressed different views in satirical ways about the taxation. Some say, "Nothing is certain in this world but death and taxes," some say, "death and Taxes are certain but death is not annual"; while others say, "Death means stopping to pay tax". Here it should be noted that all compulsory payments are not tax. For example, fines and fees are also compulsory payments without having direct benefit to the payer but it is not tax because its objective is not to collect revenue but to curb certain types of offences. Secondly, taxpayer cannot receive any quid pro quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. A tax is not a price paid by one, for which he can claim goods and services. The charge of price for goods and services by public authority is not a tax. Thirdly, the tax is paid for the government for running it. Fourthly, in case of tax, the amount is spent for common interest of the people. The tax is collected from haves and basically, spends for the interest of haves not in the society. Fifthly, a natural or an artificial person pays the tax. (Kandel, 2003: 2)

Taxation is a system used by governments to obtain money from people and organizations. The government uses collected revenue to support itself and to provide public services. In its nature, it is relatively permanent and compulsory and does not guarantees a direct relationship between the amount contributed by a citizen and the extent of governmental services provided to him (The Columbia Encyclopedia, 2006:23).

Therefore, taxation is a devise or process of imposing a tax.

Similarly, one of the famous economists delineates, “taxation is the charge levied by the state on the property or labor of the citizens, in order to provide for the public expenses”. However, it is quite different from definition of the Encyclopedia. It is a like a definition of tax though it shares some qualities, but not identical. (K.C., 2007:4)

### **2.1.2 Objectives of Taxation**

Taxation has been a very essential element of the government from the very beginning of the state system. However, the objective of taxation has been different epochs. In ancient time, the objective of taxation was strengthening the muscle of the state by providing the revenue. Till the time of Adam Smith, the objective of the taxation was to provide revenue to the government for providing security to an individual and society from violence, invasion, justice and maintaining public institutions which can never be for the interest of an individual. In modern days, the objectives of taxation have been shifted from security perception to the economic development. The modern objective of taxation is raising revenue for resource mobilization, equal distribution of wealth and income in the society, encouragement in employment, saving and investment, removal of regional imbalances and enforcement of government policy.

### **2.1.3 Principle of Taxation**

As everything is based on certain principles, in the same way taxation also has some specific principle which helps to formulate appropriate tax policies. According to Adam Smith, the father of economics has mentioned the following criteria, maxims or cannons of taxation in his book “the Wealth of Nations”.

#### **Cannon of Equality or Equity:**

The tax policy should be formulated considering the ability of public to pay taxes. For this higher tax is imposed on higher income or properties. This policy established the equitable liability to the same income group. Thus cannon of equity say that the people should contribute to the government per the benefits that they get from the government.

**Cannon of Certainty:**

Another quality of tax system is the cannon of certainty. This cannon say that a taxpayer should be informed about the rate, time and procedures of payment of tax. Furthermore fix its target of revenues that comes from taxes.

**Cannon of Convenience:**

Convenience is another quality of a good tax system. Common people do not have sufficient knowledge about the taxation nor do they have the capacity to hire the experts. That is way tax system should be such that can be easily understood and followed by ordinary people in the society.

**Cannon of Economy:**

If the expenditure of collecting tax is more than or equal to the amount of tax, such policy will not result in surplus to the public revenues and will not be beneficial to the country. This good tax policy has the quality of economy, that the low cost of collecting tax should be maintained to the possible extent so as to minimize the difference between the amount that people take out of their pocket to pay tax and the amount that actually goes to the government treasury.

Besides the above stated cannons of taxation given by Adam Smith, there are others too developed by other economists. These cannons given by other economists are as follows:

**Cannon of Productivity:**

Cannon of productivity says that every tax system should be revenue productive. It means that there should be those taxes only which provide adequate revenue. Taxes that do not provide sufficient revenue should be withdrawn.

**Cannon of Flexibility:**

Flexibility indicates two things. First, a tax system should have the characteristic of revenue elasticity. There should be built-in tie-up between the economic activity of a country and revenue mobilization. Higher the economic activity, higher the revenue. Second, the tax system should be of that type which provides revenue as per the

necessity of the situation. If there is need of higher revenue, the tax system should provide as per the needs.

### **Cannon of Diversity:**

Tax system not totally depends on one source of revenue. It is risky to the government to depend upon only one source. That means the sources of taxation should be diversified as far as possible. This principle says that tax should be levied on various stages and various sources. There should be multiple taxes in place of single tax. Similarly, a tax system should be of that type, the burden of which is diversified on the people of different walks of life.

### **Cannon of Simplicity:**

Simplicity means understandable. The tax system should be simple to understand and applicable in public life. A complex tax system creates unnecessary hassles. Simple tax system with higher tax rate induces the taxpayer to compliance.

### **Cannon of Uniformity:**

Uniformity in this context means uniformity in depreciation system, tax rate, stock valuation system, accounting method, dividend distribution system, accounting system, appeal and penalty system, method of payment of tax and time of the payment of tax. (Kandel, 2003:4)

## **2.1.4 Origin of Tax System**

With the origin of the country, king and people, the tax system was also in use in different modes. A guardian of a family has so many responsibilities towards his family person and house. Similarly, the king had also responsibility to his country and people. So, the king imposed different rules and laws for the welfare of the society. People also used to contribute their contribution in different forms. As per requirements and situation people used to help the king by contributing money, kinds or labor service. The contribution of people is the practice of tax (Kara) prevailed with the origin of king, country and people.

Hence, every civilized society had started taxation. It is also associated with the history of rise and fall of civilization. In all civilized societies, central administration used to collect portion of people's production output to use as a reserve in hand times in order to provide for the needy and to increase the wealth and power of rulers. Until the modern era, rulers and their administrators would commonly take portions of people's crops with no consideration of costs of farm works. Thus, taxes supported all early civilizations first in the Middle East and then all around the world.

In Hindu system, taxes were collected for the welfare of the people and the people were also eager to pay tax. Not paying the tax was regarded as great sin. As per holy Hindu scripture; the Vedas, the king's main duty was to serve and secure people, maintain peace and carry out social works. The king used to collect kinds and services from the people: crops and cattle from the farmers, gold, silver etc. from traders and businessman. These were the revenues of the country. These modes of tax were expanded from time to time according to the need of time and economic development.

The citizen had to pay tax even for the polling rights in the early Roman Society. Ancient Athens used to levy its revenue from taxes like customs, sales and pole tax on alien and slaves. One, who was taxed and fails to pay, was guilty of capital offences. After the public was in 146 BC, they started to levy tax on the people of the capture area instead of their citizens. Julius Creaser had imposed one percentage sales tax to the people. Later, he started to collect tapes through government institutions.

The ancient great economist, Kautilya had written "the lurching of all programs depends first and foremost on the treasury" [Kandel 2003]. So, every state needs resources. Whether to pay salary to the employees or to do developmental works, it needs huge revenues. He had also classified the taxes into three types:

- I. Tax imposed on goods produced within the country.
- II. Tax Imposed on goods produced in the capital.
- III. Tax imposed on imports and exports.(Kandel, 2003)

Kautilya had also described in his Arthashastra, "the tax system should be such as not prove a great burden on the public (praja), the king should act like the bee which collects honey without unconvincing the plant." [Lokanath 1998].

## **2.1.5 Historical Background of Taxation**

### **2.1.5.1 Taxation in context of Foreign Countries:**

Great Britain is the first country in the world to introduce modern income tax in January 9, 1799 in order to generate revenue to finance the war fought with France which was known as Napoleonic War. However it came into force on April 5, 1799. After the end of war with France, the tax was repealed on April 5, 1802. However, the Income tax was reinstated in 1803 after the outbreak of war again with France on May 18, 1803. The new Income Tax Act was enacted on August 1, 1803. As a war tax, it was abolished on March 18, 1816 after the end of the Napoleonic Wars.

Income Tax was proposed again on March 11, 1842 as a temporary measure for three years to generate revenue to enable government to avoid budget deficits while carrying out major tariffs reforms. This tax was not abolished even after the lapse of three years because of its yield and accepted as a permanent tax by the 1880s. In 1944, the Pay-Tax-As-You-Earn (PAYE) system was introduced in Great Britain. This replaced annual or twice yearly collections. The scheme was piloted by Sir Kingsley Wood. (Khadka, 2001:10).

Adams stresses that time of war; the Athenians imposed a tax referred to as eisphora. No one was exempt from tax which was used to pay for special wartime expenditures. Athenians imposed a monthly poll tax on foreigners, people who did not have both an Athenians mother and father, of one drachma for man and a half drachma for women. The tax was referred to as metoikon.

In USA also Income Tax was introduced on August 1861 to generate revenue to finance civil war. It was the first personal income tax. In 1894 Democrats in Congress passed the Wilson-Gorman tariff which imposed the first peacetime income tax. The purpose of the income tax was to make up for revenue that would be lost by tariff reduction. In 1895 the United States Supreme Court, in its ruling held a tax based on receipt from the use of property. The court held that taxes on rents, on interest and other income from property were treated as direct tax from property and therefore

had to be apportioned. This ruling was impractical and ratified by congress in sixteenth amendment in 1913. The modern interpretation of sixteenth amendment was defined in 1954 in commissioner's ruling where it tried to include all gains/incomes derived from different sources. Congress imposed federal income tax on individualist. In 1950s tax rate were at quite bearable levels and president Regan and George W, Bush made US Tax code more progressive.

In Japan, income tax was introduced in 1887 through the enactment of the Income Tax Law on March 23, 1887. It was a general individual income tax and extended to the corporate income tax in 1899.

Rangarajan (1990:19) stressed Kautilya was a master mind. Kautilya wrote a definite treatise on economic and government at a time when large part of the world were sleep in intellectual darkness.

Indian Council for Historical Research concludes that the Arthashastra was compilation made by scholar, Kautilya in 150 A.D. the Arthasatra includes different type of cash and kind taxes. Such as custom duty (sulka), transaction tax (vyaji), tax(kara) etc.(K.C. 2007:26).

In India, Income Tax in its modern form was adopted in 1860. Several experiments were made and finally the systematic Income tax Legislation was enacted in 1886.

In ancient period tax, collectors were known as scribes in Egypt. They taxed even on cooking oil to collect the adequate revenue from citizens. According to Charles Adams, Egyptians workers and framers lost their desire to work, business person moved away. Sound money disappeared as an influential inflation destroyed the capital. It is a strong evidence of taxation of ancient Egypt.

Income Tax was introduced in Switzerland in 1840, Austria in 1849, Italy in 1864, New Zealand in 1891, Sri Lanka in 1932, France in 1909, and South Korea in 1948 and in Nepal it was introduced in 1959. (Khadka. 2001:11).

### **2.1.5.2 Taxation in Ancient Nepal**

Tax has been one of primary sources of government's revenues from the ancient time. But its practice was imposed in Nepal latter than the other developed

countries. During that period taxes were levied mainly on farmers, merchants and travelers in the forms of kinds, cash and labors services. In Lichchhavi regime, direct tax was introduced for the first time in Nepal. These direct taxes were copied from Kautilya's Arthashastra which were imposed on agriculture and business income. Therefore tax which was levied on agriculture income was called 'BHOGA' (share of production) and the tax levied on the income of business was called 'KARA' which was in the form of cash. Agriculture and religious monumental preservation taxes also existed at the time of King Anshuverma of the Lichchhavi dynasty. Malla dynasties also introduced a new tax called 'POTAKA' that was received for defense contribution. It was levied on water of farmer's irrigation. There was no any act/rules of tax. So, it was not fixed and used to change as per requirements. Fixed portion of agricultural product were payable to the king as tax. Compulsory labor work from all artisan and labors were also common way of paying taxes.

After assembly and before starting of Rana regime Nepal exercise and experienced variety of taxes to generate maximum revenue of the government. During that period, government required huge revenues to fulfill the expenditure related to administration, military and other activities which increased tremendously. In the beginning, commercial taxes were levied on land, transit, market duties, mines and mints, forest product like wildlife, herbs, drugs, wax, birds and judicial fines. Minethese taxes were collected in kinds as well as cash. These taxes were mainly imposed and collected from three different levels, i.e. RoyalPalaces, Central government and local government bodies. Royal palace levies like 'Walak', 'Gadimubarak', 'Chumawan', and 'Godan'. 'Walak' was collected from each family or a regular basis and period of national celebration or festive or ceremonial occasion. 'Gadimubarak' was collected to finance for coronation ceremony of a new king. 'Chumawan' and 'Goddhawa' were collected to finance and scared thread investiture and a marriage ceremony of royal princes and princesses. 'Godan' was levied to finance funeral expenses when a reigning king died. Central government levies which included 'Darshan-bhet' which was collected from both civil and military employees at the time of their appointment and confirmation, 'Salami' was collected from local revenue collection functionaries in the terai region as an annual payment. Local levies were on forest and water source. Maximization of revenue was the prime objective of the fiscal policy during that period.

Prithivi Narayan Shah in 1772 introduced 'POTA' tax which was regarded as revolutionary measure in Nepal's fiscal system. It was not based on progressive tax. There was not taxation on income. At that time land tenure system was divided into five forms: Raikar, Birta, Gouthi, Sera and Kipat. Birta and Kipat were the main source of revenue from land (Regmi, 1971:76).

### **2.1.5.3 Taxation in Nepal during Rana Regime**

During the period of Rana regime the Nepalese tax structure had been depends over oral mechanism with willingness and desires of Ranas. In their regime, taxes were also levied and collected according to prime minister's will, willful power and order. There was not any law. They never prepared government budget. The budget of the state was budget of the prime minister. Therefore, they built palaces for them from excess revenue of the state. Their government took pleasure in public revenues and never concerned to mobilize available financial resources to develop the country.

During Rana regime, taxes were not levied according to the income. Taxes were collected in some special forms such as 'DharshanBhet', 'TikaBhet' and 'Fattemubarak' which were traditionally acquired by the royal family. 'TikaBhet' was collected by the royal families on the occasion of Vijay Dashami Festival and 'Fattemubarak' at the time of Indraajatra Festival. They levied tax upon land, custom excise, royalties, etc. during that period taxes were collected not for raising regular revenues of the state treasury but for fulfilling specific expenditure of the royal household or extraordinary expenditure of the royal household or extraordinary expenditure necessitated by war or other emergencies. Land tax was top techniques of collecting revenue up to 1950. And custom duties exercise was widely using approach of tax system during that period.

During the period of war between Nepal and Tibet in 1855-56, Jung Bahadur had imposed tax on the income of some selected groups. In 1882, Ranodip Singh also imposed 50% tax on the income made by fisherman in the Western inner TeraiDeukhuri from the sale of fish. In 1891, BirShamaher imposed a levy of 1% on the official value of 'Jagir' assignment.

The government collected revenues by state intervention on trade. State conducted the activities of buying and selling of special commodities for raising the revenue

and used to supply the scarce commodities. These activities were monopolized by the state and get high degree of return.

In that period, the Rana government had been established a government organization named 'KAUSHI TOSAKHANA', for the collection and disbursement of revenues, obtain, store, and issues supplies to the government. This unit also perform other general activities concerning to fiscal administration. Prime Minister Jung Bahadur also established new development office known as 'SADAR MULUKIKHANA' for the maintaining the government account relating the revenues. Rana Regime also introduced tax called 'SALAMI' on employment income in Nepal. However, it was collected from government employees only. But 'SALAMI' practice was abolished in 1951. Therefore there was no effective and practical tax administration system.(Regmi, 1971:106).

#### **2.1.5.4 Taxation in Modern Nepal**

In Nepal, the idea of imposing the income tax originated in the early 1950s, when the cruel Rana regime has been replaced by Democracy. The first Budget Speech was made in 1951 by then Finance Minister and said that "a proposal to levy an income tax including tax on agriculture income is under consideration". In 1954 an income tax with Rs10000 basic exemption and progressive rate structure from 5 to 25 percent was proposed, but it could not be introduced until 1958 due to political instability. In 1959, the introduced income tax as the provision laid down in Finance Act of 1959. There were only two income heads i.e. remuneration and business. The tax rates were put in order 5 to 25 percent fixing 10 brackets. It contained the concession rate of 25% to large and 50% to the small scale industries on their tax liabilities.(Regmi, 1971:56).

#### **Income Tax Act 1960 A.D. (2017)**

In 1960 a formal Income Tax Act naming '**Business Profit and Remuneration Act 1960**' was introduced in Nepal for the first time. It was introduced for avoiding unsystematic and adhoc based of tax collection it had altogether 22 sections including provision of fines and penalties. The silent features of Income Tax Act 1960 (2017) were as given below:

6. Only business profit and remuneration were subject to tax. But deductions were not specified for the purpose of calculating the taxable income.
7. Tax on remuneration was to be deducted at sources.
8. The basis for calculating the tax liability for remuneration was the income of the current year, and for business profit it was of the preceding fiscal year.
9. The tax officer was empowered to assess tax on a best judgment estimate where tax return was not filed or a false return was filed.
10. In case of default, the fines ranged Rs 500 to Rs 5000 and for information's there was a provision of 20% of total realized if the information had been proved.
11. The first court of appeal was local "Bada Hakim" or Magistrate. Thereafter appeal could be lodged at revenue court. Every appeal was to be accompanied by security deposits of guarantee for the amount of tax payable.

Profits from industries were granted a rebate of 25% and Profit from small industries were granted a rebate of 50%. In the beginning, the government servants were the main taxpayers.

In experiences of three years indicated that the 'Business Profit and Remuneration Tax Act' was rather narrow as well as vague. It was neither equitable nor fair.

### **Nepal Income Tax Act 1962 A.D. (2019)**

Due to so many drawbacks, Income Tax Act 1962 was introduced in 1962 A.D. it had tried to fulfill all the shortfalls of previous Income tax Act 1960. This act had altogether 29 sections it had defined tax terms clearly. The main objectives of this act were to reduce unequal distribution of wealth, to make impartial, to guide by fairness and to establish behavior of payment of tax.

Income Tax Act 1962 was amended in 1972 and continues till 1974; the additional features of this act were as follows:

1. Income was defined as all kinds of income including income derived from business, remuneration, profession and occupation, house and land rent, investment in cash or kind agriculture, insurance business, agency, and any other sources.

2. The personal as well as residential status of the taxpayer for tax purpose was defined.
3. The procedure for assessment and collection of income tax were clarified. Specific provisions were made for the allowable deductions. Methods are also specified for calculation of net income.
4. The basis was specified for assessing tax on the best judgment estimate of the tax officer.
5. The provision was made to constitute the net income assessment committee with five members.
6. Tax payment could be in installment as well as in advance payment.
7. Provision was made of rather exemption of income tax for new industries for a period not exceeding 10 years.
8. Carry forward of losses was allowed for a period of two years.
9. Agriculture income was brought under the scope of income tax for the first time.
10. Income tax was defined as the tax on the net earnings.

### **Income Tax Act 1974 A.D. (2031)**

Income Tax Act 1974 was the changed form of Income Tax Act 1962. In this act the sources of income were wider than the former law. Its basic framework had been derived from the Income Tax Act 1962. It had retained or amended certain provision of the old act and had added certain new one. This act had 66 sections and sub sections. Following are the some salient feature of this act, as latest amended;

1. This act had clarified certain definitions specially relating to tax. Taxpayer, income tax, income assessment year, tax assessment, tax officer, company, net income, personal status of the taxpayers, philanthropic work, nonresident etc.
2. Sources of income were classified into five categories: (a) agriculture, (b) industry, trade, profession or occupation, (c) remuneration (d) house rent and compound taxes and (e) income from other sources.
3. The taxpayers had to register their industry, business, profession, or vocations in tax office before the commencement of the work.
4. It had made the provisions for deduction of expenses relation to expenses incurred when the taxable income is generated.

5. Provision related to computing of net income by agreement in special cases is another main feature of this act.
6. This act had made the provision for self-assessment of tax for the first time and if any mistakes raise or lower tax was assessed. Tax officer might make final assessment.
7. There was additional provision of exemption from income tax than the former act as follows: income of Guthi, income of Village Development Committee, Municipalities, compensation for life insurance or after the expiry of life insurance policy, income from provided fund were the subject to tax exemptions.
8. Carry forward of losses was allowed for subsequent three years.
9. The punishment provision was specified in different headings: failure of submits particulars of the income, false particulars not maintaining the accounts, obstructions and others.
10. Provisions had made for re-assessment or additional tax assessment.
11. The process of advance payment of tax, deduction of tax at sources and refund of tax had been specified.
12. It had the provision relation to make agreement for avoidance of double taxation.
13. The Government of Nepal might form an income assessment committee consisted five members by publishing notice in the Nepal Rajapatra.

This Income Tax Act 1974 was amended in 1977 A.D., 1979, 1980, 1984, 1985, 1986, 1989 and 1992 A.D. to make effective, practical and to avoid confusion. But this act had some shortcomings such as limited tax base, lack of integration, unclear and vague, willful power of tax officer and government, inequitable among tax payers, unscientific presentation, lack of control on tax evasion and dual appeal system. Therefore, the new income tax act 2002 had been enforced in the country. In order “to enhance revenue mobilization through effective revenue collection process for the economic development of nation, it was imperative to make the laws of income tax in order to update, amend and integrate them”.

## **Income Tax Act 2002 A.D. (2058)**

With the aim of providing shape of scientific and systematic Income Tax Act 2002 was evolved in 2002 by replacing Income Tax Act 1974. Present Income Tax Law of Nepal comprises Income Tax Act 2002, Income Tax Rules 2002 with amendment and finance Act 2006. Income Tax Act came into force on April 2002 and now-a-days it has been enacting all over Nepal. Every year the parliament passes Finance Act mentioning tax rates, provision of withholding and method of payment of tax for respective year. It amends Act to some extent. The finance Act 2063 is also a continuity of this practice. Silent features of Income Tax Act 2002 can trace as mentioned below:

1. Income Tax Act 2031 had classified income tax into five heading where this act divides only into three heading.
2. When Income Tax Act 2031 was in practice, there were several exemptions spread in different in Act 2058.
3. Subject to this new act, income is defined as "a person income from any employments, business and investment in accordance with this act". It includes all kinds of income received for the provision of labour or capital or both in whatever from or nature in the taxable income.
4. The act has given the option for husband and wife as a separate nature individual until they don't accept as a couple.
5. A resident person may claim a foreign tax credit for any foreign income tax paid by the person to the extent to which it is paid with respect to the person assessable income for that year.
6. There is a provision of functional division of work among tax officers.
7. The division is to be made under the direction of HMG director general.
8. The penalties are dividing into two parts. The tax officers can levy only fines and interest and the court can levy penalties and imprisonment.
9. This act has guaranteed the rights and secrecy of taxpayer through the act and strict punishment for non- maintaining the secrecy are provided.
10. This act has determined the rate of income tax itself for the first time, which used to be determined by the finance acts in the previous years.
11. For the purpose of calculating a person's income or investment, there are provisions of deduction related overhead costs. The government allowance

for widows, elder citizens or disable individual, gifts, bequest, inheritance, scholarship, income of foreign officials, bodies and non-profit organization have been exempted from the income tax net. Amount of person privileged under bilateral or multilateral treaty, an agriculture income and income of cooperative societies based on agriculture product and dividend of such society etc, also exempted from income tax.

12. A person has defined as a resident whose place of abode is in Nepal and who present in Nepal at any time or who present Nepal for 183 days or more within the income year, or who is an employee of HMG posted aboard during the income year.
13. According to this act, accompany is liable to tax separated from its shareholders. The bonus share, loan and advance to director and shareholder, distribution made on liquidation, are also brought under the tax net in order to plug loopholes for avoidance.
14. Under this act, resident, individuals and domestic companies are taxed on their worldwide income while non-residential individual and foreign companies are taxed only in there sourced in Nepal.
15. The income of unapproved retirement fund is free is from tax. But retirement payments in the hands of employees are taxable.
16. Capital gains are taxed explicitly under this act after four and half decades of the introduction of income tax. In case of business capital gains, gains on the disposition of business property are taxed as an ordinary income and in the case of non- business capital gain; only the gain from the casual sales of real property (land and building) and securities are subject to capital; gain tax at flat rate of 5%. There is aloes a clear provision for adjusting net loss during the fiscal year.
17. The tax is based on global income tax principal and brought all the source of income in the tax in an equal manner. This act has abandoned the itemized system of deduction on expenses are taken into accounts on a global manner but not in a line-by-line basis.
18. The act has adopted a pooled system of depreciation in which assets are broadly classified in to five categories. The deprecation rates are 5%, 25%, 20% for A, B, C and D respectively which are based on diminishing balance

method of depreciation and for class E, the rate is based on straight line method.

19. This act focus on the self-assessment system and every assessment is treated as a self-assessment. The tax officer can determine only the amended tax assessment within four years, the Jeopardy assessment is essential when a person become a bankrupt is wounded-up, or goes into liquidation, a person is about to leave Nepal forever or to close down activity in any department or in Nepal. There is no time limit in the case of jeopardy assessment.
20. Presumptive tax is limited to the small taxpayers whose annual net income is up to Rs.2, 00,000 or annual turnover is up to Rs.20, 00,000 and are subject to flat annual taxes.
21. This act has introduced the concept of administrative review to correct the administrative mistakes. The Inland Revenue department should give its decision within 90 days of objection and if the department does not gives its decision within the given time limit; the taxpayer can appeal to the revenue tribunal.
22. According to this act, the Inland Revenue department is responsible for the implementation and administration of this act.(Inland Revenue Office:2070)

## **2.2 Review of Related Studies**

For the preparation of this research study, reviewing of Income tax Act 2058, various related books, different dissertations and thesis, articles as well as reports had been concerned. They were fully utilized in this thesis writing which are as following below:

### **2.2.1 Provisions of Fines and Penalties According to Income Tax Act, 2058**

Under theIncome Tax Act 2058, a penalty may be imposed upon the taxpayer for one or more faults and up to a sum indicated in the respective sections. Penalty is a punishment for breach of law where a status requires any persons to do a particular thing and he fails to do so, he renders himself liable to penalty. Similarly, when the status requires any person not to do a particular thing and he does so, he exposes himself to penalty. The nature and quantum of penalty differs from statute and from

default. The following provisions are applicable to the imposition of penalties under the Act.

### **Penalties and Appeals**

There is no essential difference between tax and penalty. The liability for payment of both is imposed as a part of the machinery of assessment and penalty is merely an additional tax imposed in certain circumstances on account of the taxpayer's conduct under the Income Tax Act, a penalty may be imposed upon the taxpayer for one or more faults upon a sum indicated in the respective sections. Penalty is a punishment for breach of law where a statute requires any person to do a particular thing and he fails to do so, he renders himself liable to penalty. Similarly when the statute requires any person not to do particular thing and he does so, he exposes himself to penalty. The nature and quantum of penalty differs from statute and from default. The following provisions are to the imposition of penalties under this Act:

#### **1. Penalty for nonpayment of tax:**

A taxpayer should be liable for payment of a fee at the rate of 15% of the tax amount due from him, if he makes default in the payment of tax within 35 days from the date on which tax assessment was relayed or within the time extended by tax officer. Such amount of tax or fee as are in arrears shall be realized by the officer or the office notified by the tax officer in the following manners.

2. By impounding or seize the movable property of the tax payer.
3. By imposing any deposit of the tax payer in any government office or corporation owned by Government of Nepal or any amount payable to him by such office or corporation.
4. By withholding in transaction of the tax payer including that of import or export trade.
5. By auctioning of the whole or part of the movable or immovable property of the taxpayer in one or several lots.

#### **6. Penalty for Failure to Submit Statement of Income:**

7. Any tax payer who failed to submit his statement of income within 3 months after the expiry of income year shall be liable to a fine up to Rs.5000 and such

amount of fine shall be kept as security. But such fine shall not exceed 10% of the taxable amount.

8. Anybody who fails to submit his statement of income within the time allowed by an order made by tax officer shall be liable to the fine equal to an amount of 15% of the tax payable annually by him.
9. For any tax payer who fails to submit statement of income within the time allowed by the tax officer may take any of the proceeding or all pending the submission of statement of income.
  - ) To impound or seize the movable property of the tax payer.
  - ) To impound any deposit of the tax payer in any government office or corporation owned by Government of Nepal or any amount payable to him by such office or corporation.
  - ) To restrain the business of the tax payer including that of import or export trade. In order to take this action it shall be necessary for the tax officer to obtain previous approval of the director.
10. Any tax payer who failed to submit statement within the time prescribed under Section 27 and 28 or whose tax has been assessed by the tax officer using his best judgment under Section 33 (2) and who has given order by the tax officer of being heard or producing any evidence in support of his statement of income shall be liable to a fine equal to an amount of 7% of the tax payable.
11. Notwithstanding anything contained on the subsection (2) and (4) the amount of fine shall be determined under the same subsections from the expiry of the time of three months after the completion of financial year and the fines payable shall not exceed the 25% of outstanding tax payable.

### **3. Penalty for Submitting False Statement of Income:**

Any person who submits or cause a false statement shall be required to pay such amount of tax which had fallen short due to the submission of such false statement and shall also be liable to fine equivalent to the amount of tax so payable or to imprisonment exceeding two years or both. But the penalty of imprisonment shall be imposed only after it has been referred to and confirmed by the Revenue Tribunal.

#### **4. Penalty for Failure to Maintain or Preserves Account:**

Any person earning or acquiring income from industry, business, profession or vocation or any other sources as may be specified by Nepal government in a notification published in the Nepal Gazette shall maintain proper accounts of his income and expenses. The method of maintaining such accounts and the language to be used shall be as specified by government of Nepal in the Nepal Gazette.

Every taxpayer shall preserve the accounts and relevant documents of his industry, business, profession or vocation for 6 years from the date on which income has been assessed. Any taxpayer, who fails to maintain proper accounts, or fails preserve any accounts and supporting documents shall be liable to a fine not exceeding 5000 rupees.

#### **5. Penalty for Obstructing Search:**

Any person who obstructs any search operation to be made under Section 46 shall be liable to a fine not exceeding Rs. 500 or to imprisonment not exceeding one month or both by an order of the local zonal commissioner.

Any person not satisfied with the order made by the zonal commissioner may appeal against such order to zonal court.

#### **6. Penalty for Failure to Deposit Tax Deducted at sources:**

According to the provision under Section 36, any person paying any remuneration, share, commission or profit or interest to any person shall at the time of such payment deduct tax, there from and the tax so deducted shall be deposited for Government of Nepal within 15 days. If any person fails to do so within the specified period he shall be liable to fine not exceeding Rs. 500.

Under section 41 (3) where any payment is made without making any deduction of tax in advance which had otherwise to be deducted under this act, the amount for deduction while computing net income of such person.

#### **7. Punishment for Breach of the Provision of the Act of Rules:**

Except for any act punishable under Sections 59, 60, 61, 62 and 63 of this act, any person, firm, company, bank, financial or other institutions responsible for any

breach of the provision of this act or the rules made there under shall be punishable by an order of the tax officer with a fine up to the thousand rupees.

#### **8. Penalty for Failure to Comply with the Duties Prescribed by the Act:**

Without prejudice to the liability for punishment under other section of this Act, the tax officer may by an order prohibit the issuance of passport to such taxpayer who is bound to comply with obligations imposed by this act until fulfillment thereof by the taxpayers.

#### **9. Penalty for Carrying Business without Registration:**

Any person carrying on any industry, trade, profession or vocation without registration shall be punishable by the order of tax officer with a fine up to Rs.500. The tax officer may withhold carrying out the business of such person until registration or impound any or all or the commodities pertaining to that business. But the tax officer has to obtain approval of the director to impose such penalty.

#### **10. Power to Imprison for Default in Payment of tax:**

In case any taxpayer, with intention of avoiding payment of tax transfer his property of business to another person after or before the assessment of tax payable by him and does not pay the amount of tax within the time specified in Sub-section (1) and (2) of section 37. Such taxpayer, notwithstanding anything mentioned in the said Section 37, may be kept in prison by the order of Government of Nepal, until he makes payment of tax, but Government of Nepal may not order the detention of such person more than 6 months.

#### **11. Department Action In case of Negligence:**

If it is found that a tax officer has with regard to any taxpayer made dishonest or negligent tax assessment and as a result of which the tax liability of such person has become excessive or reduced the Director shall initiate proceedings for departmental punishment in accordance with the provisions made in the conditions of service of such tax officer.

## **12. Penalty for not submitting Advance Payment of Tax:**

If the Tax Officer is satisfied that any taxpayer with an intention of avoidance of payment of tax changes being the name of the firm and location or business activities, any taxpayer being a non Nepali citizen or nonresident is obliged to pay income tax under the Income Tax Act or any other existing Nepal law, is likely to abscond to avoid payment of tax, he may order that the amount of tax finally assessed be deposited in advance.

### **2.2.2 Review of Books/Reports:**

**Amatya (1965)** has published a book entitled by "*Nepalma Ayakar Bayabastha*". He has analyzed the legal aspects of income taxation in this whole book. His contribution was first in this field.

**Agarwal (1980)** presented a report entitled, "*Resource mobilization in Nepal*" published by CEDA. The book had been divided in to eight chapters; the first chapter deals with special reference to Nepal. The second chapter deals with fiscal policies in developing nations and Nepal, third chapter looks at income tax in Nepal from the historical prospective the forth chapter deals with structure of Nepalese taxation. Forth chapter is related to tax structure, the writer had concluded that taxation trend in Nepal have been shown that role of indirect taxes have been predominant in the tax structure. More than 60% of tax revenue was derived from foreign trade alone. However, since 1974/75 the role of income tax has been increasing.

**Bhattarai and Koirala (2006)** published a book revised edition named "*Taxation in Nepal*". This book is based on BBS third year syllabus. tn this book, they showed the method of computation of VAT and Income Tax. They also clearly mentioned the different provision of Income Tax Act 2058. Relevant theoretical and practical aspects have been discussed in their book.

**K.C. (2007)** published a book revised edition entitled "*Tax Laws and Tax Planning: Theory and Practical*". He divided the book in four parts. In the first part, he described the conceptual foundation. In second part, he described basis concept of income taxation of Nepal. In third part, he described VAT in Nepal. In last part, he described Tax Planning. This book has presented practical as we'll as theoretical aspects. This

book is useful to students, tax administrators, auditors, as well as to others. This book is useful to research work too.

### **2.2.3 Review of Journal/ Article:**

Nepal Tax Journals published news about taxation. In this news their include lack of taxpayer education program, taxpayer should not have fully knowledge about positive aspects of tax laws. The news was stressed that taxpayers are accepting Income Tax Act 2058, as a compulsory law.

**Agrawal (1978)** in his Report "*Are Resources mobilization for development: the reform of income tax in Nepal*" the main objective of this study were to examine the problem of growing resource gap in Nepalese finance in the context of the role of income tax in Nepal including projection if income tax, to examine the ways and means for increasing tax consciousness in Nepalese people etc.

**Panta (2005)** had written an article entitled, "*Problems in Tax Administration and Their Remedies*" published in journal of finance and development 'Rajaswa', 2004, April vol. 1. In this article he had comprehensively explained about the problem and their remedies related with tax revenue and major types of practical problems and challenges, in tax administration. He had mentioned in his article that the main problems of taxation system were showing limited amount of transaction, showing low selling price, less of issuing in taking bills, lack of showing the real factory cost, commercial fraud, lack of co-operation in tax auditing, legal ambiguity and complexity in implementation and lack of co-ordination between Inland Revenue Department and revenue investigation unit. Meanwhile, he had recommended some valuable suggestion to solve the problems and to overcome the challenges. They were statistical and information system should be properly managed, fixed norms and standards should be used to assess selling price and factory cost, the billing system should be made compulsory, co-ordination between Inland Revenue Office with various entities of Nepal Government, revenue investigation and its related unit should play the important roles.

## 2.2.4 Review of Dissertations and Thesis:

**Giri (2012)** had conducted a research entitled "*A study on tax administration in Nepal*"

### The main objectives were:

- ) To analyze the structure of tax revenue.
- ) To analyze the contribution of tax and non-tax revenue to total revenue.
- ) To evaluate performance of income tax and its share in total tax revenue.
- ) To study the existing tax administration system of Nepal.
- ) To provide suitable recommendations for improving existing scenario of income tax administration.

### The major findings were:

- ) In the structure of government revenue of Nepal , VAT ,custom ,income tax and excise duty were 24.95% , 24.12%, 15.38% and 8.84% respectively for the FY 1996/97 to 2010 /11. Overall tax revenue has more than 79% contribution within the country.
- ) However there is a fluctuation in non tax revenue for several years, the contribution of it is less than 21% of total revenue.
- ) Nepalese tax system has poor performance due to mainly following reasons.
  - a) Lack of meaningful taxpayer information.
  - b) Lack of taxpayer's education.
  - c) Problem of evasion and avoidance.
- ) Income tax is not a barrier for people of higher level income.
- ) Income tax is not paying effective role to reduce the gap between rich and poor. The main reasons are:
  - a) Widespread evasion and avoidance.
  - b) Lack of tax consciousness needs.
  - c) Poor tax administration.
- ) Tax administration and its collection were found to be changed in positive ways after restoration of democracy.

**Rai (2012)** had conducted a research entitled "*Corporate tax system and investment behavior in Nepal.*"

**The main objectives were:**

- ) To examine the sensitivity of certain policy like inflation capital gain tax, dividend tax and interest tax etc. based on their impact on tax burden.
- ) To examine the invest tax system and investment behavior in Nepal.

**The major findings were:**

- ) He showed the relationship of private investment with average effective tax rate, marginal effective tax rate and tax incentives in Nepal.
- ) He found that it's for debt financed project are almost negative i.e.17 % and positive for equity financed project and debt equity project by 27 % and 19 % respectively.
- ) He had also found the impact of inflation according to him the statutory tax rate deduction had impact on private investment by 60% and 20%.

**Bhandari (2013)** had conducted a research entitled "*Tax administration and income tax system in Nepal*"

**The main objectives were:**

- ) To analyze the administrative aspects of income tax in Nepal.
- ) To identify major problems related to tax administration in Nepal.
- ) To study the structure of income tax in Nepal.
- ) To provide appropriate suggestions and recommendations.

**The major findings were:**

- ) Nepalese total revenue is composed of both tax revenue and non tax revenue. The average contribution of tax revenue and non tax revenue was 79.64% and 20.36% respectively.
- ) Nepalese tax revenue is composed of both direct and indirect tax revenue. There is a dominant role of indirect tax revenue in Nepalese tax structure. The average contribution of direct tax and indirect tax to total tax revenue was 26.03% and 73.97% respectively. Although the total amount of both taxes is increasing, there is not satisfactory growth in collection of both taxes.

- ) The average contribution of custom duties, VAT and excise duty on indirect tax revenue were 37.59%, 46.04% and 16.36% respectively.
- ) 61.66 % of total respondent their dissatisfaction regarding the tax administration system is not sound and efficient.
- ) As per opinion survey most of respondent have suggested to increase the facilities to pay tax. It helps to increase of tax payer.
- ) Clear tax acts, rules and regulation, honest tax officers, honest tax payers, effective income tax administration are most important factors for effectiveness of tax in Nepal.

**Khanal (2013)** had conducted a research entitled *“Income tax Act 2058 and its impact on revenue collection in Nepal.”*

**The main objectives were:**

- ) To review the status of revenue collection in Nepal.
- ) To examine structure of tax revenue.
- ) To examine the attitudes the attitudes of tax payers, auditors and tax administrators about income tax act.
- ) To provide suggestions and recommendations for further collection of revenue.

**The major findings were:**

- ) Tax revenue 84.52% and non tax revenue 15.48% in FY 2011/12 and 80.45 % as in FY 2005/06. The contribution of tax revenue is on increasing trends but the increments of contribution of tax revenue are not satisfactory level.
- ) Contribution of direct tax to gap was 2.35% in FY 2005/06 which reached to 4.24% in FY 2011/12.
- ) An opinion survey has been conducted in order to find out the rate of income tax in Nepal and some other aspect of income tax , from the opinion survey with tax administrator , tax exports and tax payers the following finding have been drawn.
- ) Income tax is the suitable means of raising government revenue.

- ) Public awareness programmed is necessary to increase tax consciousness and raising the government revenue.
- ) Mass poverty and low income level increasing habit of tax evasion.

**Poudel (2014)** had conducted a research entitled "*Scope of tax planning under income Tax Act 2058 in Nepal*".

**The main objectives were:**

- ) To find out how tax planning can help in the healthy growth of economy.
- ) To study in what ways the tax payer are saving are saving their earning by reducing tax liability under tax planning.
- ) To provide the comprehensive information to the managers for strategic planning, project planning and operational planning about the areas provided by the Income Tax Act 2058.
- ) To provide the appropriate suggestions.

**The major findings were:**

- ) 92.5% of the respondents believe that Tax planning is being in practice in Nepal and 7.5% of the respondents. Think that there is no tax planning in practice.
- ) 85% of populations (appro) are considering the term tax planning in their business and profession in order to reduce tax liability and 15% of the populations are not considering the term tax planning.
- ) 20% of the respondents think that tax planning in Nepal is done through illegal ways and also the remaining 80% of the respondent think that tax planning is done through legal ways and effectively.
- ) Majority of the respondent ranked to encourage the tax payer to pay regular tax as the No.1
  1. To be done in order to make tax planning more effective.
  2. To building awareness about tax planning.
  3. To provide knowledge to the people about tax planner.
  4. To increase the rebate rates a bit more.

5. To rebate should also be given to industries, factories in municipality areas.

## **2.3 Research Gap**

There is gap between the present research and the previous researchers. The findings of the previous researches were mostly based on secondary data. Most of the previous researches did not disclose what kinds of fines and penalties provisions strategies should be implemented in Nepalese environment. Thus to fill up those gap the current research is conducted. This research is a survey type of research. It is based on secondary data and primary data. This research study is based on using data 2005/06 - 2011/12 which was not included in previous studies. So, this study will be fruitful to those interested person, parties, scholar, civil society, general public, businessmen and government for academically as well as policy prospective.

## CHAPTER- III

### RESEARCH METHODOLOGY

This methodology is a way to systematically solve the research problem. It refers to the various sequential steps that are to be adopted by a researcher during the course of studying the problem with certain objectives. This chapter refers to the overall research method from the theoretical aspects to the collection and analysis of data. This study covers quantitative methodology in a greater extent and also uses the descriptive part based on both technical aspects and logical aspect.

“Research methodology refers to the various sequential steps to adopt by a researcher in studying a problem with certain objectives in view’ (Kothari, 1994: 19). Therefore, we can conclude that research methodology tries to make clear view of the method and process adopted in the entire aspect of the study. It is also considered as the path from which researcher can systematically solve the research problem.

#### **3.1 Research Design**

This study is descriptive and analytical nature. Selection of appropriate research design is necessary to meet the objectives of any study. “Research design is a plan, structure and strategy of investigation conceived so as to obtain the answer to research questions and to control the variance” (Kothari, 1994:43). A research design is the specification of methods and procedures for acquiring the information needed. It is the overall operational pattern of framework for the project that stipulated what information is to be collected, from which sources and by what procedures. Thus a research design is a plan for the collection an analysis of data. For research there exists different types of research design like; historical research, descriptive research, case study research, field research, analytical research, true experimental research and so on. This study mainly concerned with historical research. If applicable, something descriptive and analytical approach may also be used.

The main objective of this study is to focus on the provisions of fines and penalties in the light of Income Tax Act 2058 B.S. That is why it has tried to achieved the specified objectives of the study, the opinions of the various 100 respondents associated with the distinct denomination i.e. tax experts (Tax experts are for C.A, Auditors, Lectures and Layers) tax administrators and tax payers were collected through structured questionnaire. The questionnaire includes about the essential of income tax to the government, Income Tax Act 2058, roles of fines and penalties in relation to the collection of revenue, effectiveness of Income Tax Act, taxpaying habit of tax payers, necessity of provision of fines and penalties, effectiveness of tax administrators etc. similarly various information published by organizations about income tax are used for this study. In this way the research design of this study are descriptive, analytical and empirical.

### 3.2 Population and Sample

The population of this study has been composed of all people belong to income tax in Nepal. The following groups and numbers are taken as samples.

**Table: 3.1**

**Group of Respondents and Size of Sample**

S. No.	Group of Respondents	Questionnaire Distributed	Questionnaire Received
1.	Income Tax Administrators	35	25
2.	Income Tax Experts	35	25
3.	Income Tax Payers	80	50
	Total	150	100

### 3.3 Nature and Sources of Data

Data necessary for this study were collected from primary and secondary sources. The major sources of these data were as follows:

#### 3.3.1 Primary Data

The primary data were collected by distributing structure questionnaire and personally field visit, contact and interviews with related respondents. Tax administrators are selected from tax Department and Various sectors of Tax Offices in Kathmandu valley. Tax experts are lectures, auditors, charter accountant (C.A.), lawyers who have knowledge and ideas about Income Tax etc. Tax payers are selected from various sectors e.g. manufacturing company, departmental stores, trading companies, banks, finance companies, sole business and employee, etc.

**Table: 3.2**

**Respondents Schedule**

S. No.	Group of Respondents	Sample Size
1.	Income Tax Administrators	25
2.	Income Tax Experts	25
3.	Income Tax Payers	50
	Total	100

#### 3.3.2 Secondary Data

The secondary sources of data are the information received from published books, journals, newspaper, reports, dissertations, website and other unpublished thesis and term paper etc. the major sources of secondary data are as follows:

1. Economic survey and Budget Speech of various years, Ministry of Finance;

2. Reports and records of Inland Revenue Department, Ministry of Finance and Central Bureau of Statistics;
3. Various books written by Tax Officers and Scholars related to Income Tax;
4. Thesis and Dissertation reports related to Income Tax available at library of Nepal Commerce Campus and Central Library T.U.;
5. National and international newspapers, journals, souvenirs and magazines;
6. Various websites related to the study;
7. Published documents and annual reports;
8. Other articles related to the study;
9. Publication of UNO and World Bank.

### **3.4 Data Collection Procedures**

Data of this study were collected from two sources. Primary data are collected from Tax Administrators, Tax Experts and Tax payers by using structured questionnaires. First of all these sets of questionnaires were developed and distributed to the three distinct types of respondents. Distribution was done personally through field visit rather than sending by any means to get accurate and actual information in time. Secondary data were collected from published reports of different organizations.

### **3.5 Data Processing and Analysis Procedure**

Data obtained from the various sources cannot be directly used in their original form. Further, they needed to be verified and simplified for the purpose of analysis. Data, information, figures and facts related to the study has been checked, rechecked, edited and tabulated for analyzing them.

According to the nature of data, they are inserted in meaningful tables, which are shown in the annexes. Homogeneous data have been stored in one table and various tables are prepared in understandable manner. Data are analyzed and interpreted using different types of statistical tools as given below:

) Simple Percentage,

) Simple Average,

) Charts and Diagrams.

### **3.6 Weight of Choice**

The respondents are requested either to rank their answer or to give yes/no response or to write their opinion. In the case of ranking the answer the scale varies from question to question. The scale is given according to the number of probable answer. For example, if the probable answers are 5, the scale is given 1 to 5, where 1 stands for most important and 5 stands for least important. The total points get by each choice are converted into percentage of total points available to the all choice. The choice having higher percentage is ranked as most important and the choice having lowest percentage is ranked as least important.

## CHAPTER-IV

### PRESENTATION AND ANALYSIS OF DATA

Presentation and analysis of data is very important stage of research study. Its main purpose is to change the unprocessed data into understandable form. It is the process of organizing the data by tabulating and then placing that data in presentable form by using various tables, figures and source. This analysis attempts to throw light on the provision of fines and penalties related to the Income Tax Act 2058. Basically, this study has focused on empirical study. Some secondary data regarding revenue structure in Nepal are analyzed. Data and information were collected from different sources. Data relating to income tax and provision related to the fine and penalty are presented in this chapter to make research findings more meaningful. In this chapter, data gathered from different sources are presented, analyzed, compared and verified with the use of various financial and statistical tools. In fact, this chapter determines findings of the research and helps to fulfill research objectives.

#### **4.1 Analysis of Secondary Data**

Secondary data is defined as data collection either for a purpose other than the one currently being persuaded. Secondary data are often in the form of raw data and published materials. However the unpublished data such as records or statistics gathered or compiled by others prior to the study are also secondary data. In this section data collected from different sources such as IRD, CBS etc. has been presented in tabular form, diagram, chart and analysis as per our requirement.

##### **4.1.1 Government Expenditure and Sources of Financing**

Revenue mobilization is the major source of government expenditure. A minimal gap between expenditure and revenue is to be maintaining for fiscal balance.

The annual government expenditure and source of financing of this period is displaced in the table 4.1 as well as in figure also.

**Table: 4.1****Government Expenditure and Source of Financing****(Rs. in millions)**

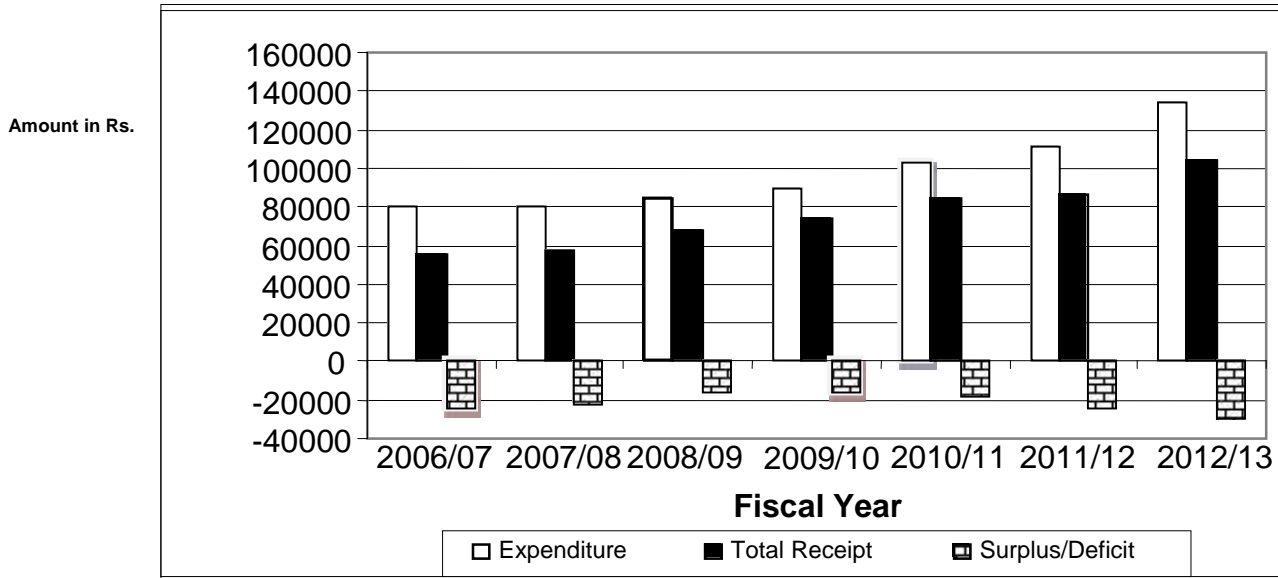
Fiscal Year	Expenditure	Receipt				Total Receipt	Surplus/Deficit
		Revenue	Percent	Grant	Percent		
2006/07	79835	48893	88	6754	12	55735	-24100
2007/08	80072	50445	88	6686	12	57219	-22853
2008/09	84006	56229	83	11339	17	67651	-16355
2009/10	89442	62331	85	11283	15	73699	-15743
2010/11	102560	70122	83	14391	17	84596	-17964
2011/12	110889	72282	84	13827	16	86193	-24696
2012/13	133604	87712	85	15800	15	103597	-30007
<b>Average</b>			<b>85.14</b>		<b>14.85</b>		

Source: Economic Survey, Ministry of Finance, Government of Nepal.

Figure: 4.1

Government Expenditure and Source of Financing

(Rs. in millions)



The table 4.1 states that the government manages its sources average 85% from revenue and 14.85% from foreign grants.

4.1.2 Resource gap in Nepal

Resource mobilization is the main challenge in the developing country like Nepal. It is due to resource constraint, mass poverty, rapid population growth, dependence on agriculture etc. the collection of resources of Nepal hardly cover the 50 percent to 75 percent of our total annual expenditure.

Due to so many development activities the government expenditure is in increasing trend. The total expenditure 20.5% in FY 2011/12 compared to the increase of 8.10% in FY 2012/13. While the trend of increase in revenue collection could not match the government trend of expenditure. The revenue increase by 21.3% in FY 2011/12 compared to that of FY 2012/13. The government revenue had finance 65.2% of government expenditure in FY 2011/12 and 65.7% in FY 2012/13.

The foreign grants also play major part of government receipts. Its portion to total government receipt is 15% in average of the study period of seven years. The government collects the deficit amount by domestic borrowings. The gap between the government expenditure and receipt is known as Resource Gap.

The table 4.1, Government expenditure and source of financing, given above describe the annual resource gap in Nepal. Nepal has received grant in increasing trend but this trend is also not sufficient to recover the gap. The government is trying to match the gap by taking more and more foreign loan which is not good to the nation. Government should try to maximize revenue collection and grant but not loan which creates burden to the nation.

#### **4.1.3 Nepalese Government Revenue Structure**

Government revenue structure in Nepal is the composition of tax revenue and non-tax revenue. These are the basic sources of government revenue. Whatever taxation is the major source of revenue in the country besides non-tax revenue. In year 1952/53, when Nepal government prepared and presented the first annual budget, the revenue structure was typically that of traditional economy, with the contribution of tax revenue to the total revenue of only 56.15% while the share of non-tax revenue was 43.84% (Dahal, 1983: 248). In 1960s the share of non-tax revenue was decline because of increasing contribution of indirect tax in foreign trade. Today the tax revenue has played significant role in the public revenue of Nepal.

The composition of revenue structure of Nepal since FY 2012/13 is presented in the table 4.2 and in figure below:

**Table: 4.2****Composition of Total Revenue Structure****(Rs. in millions)**

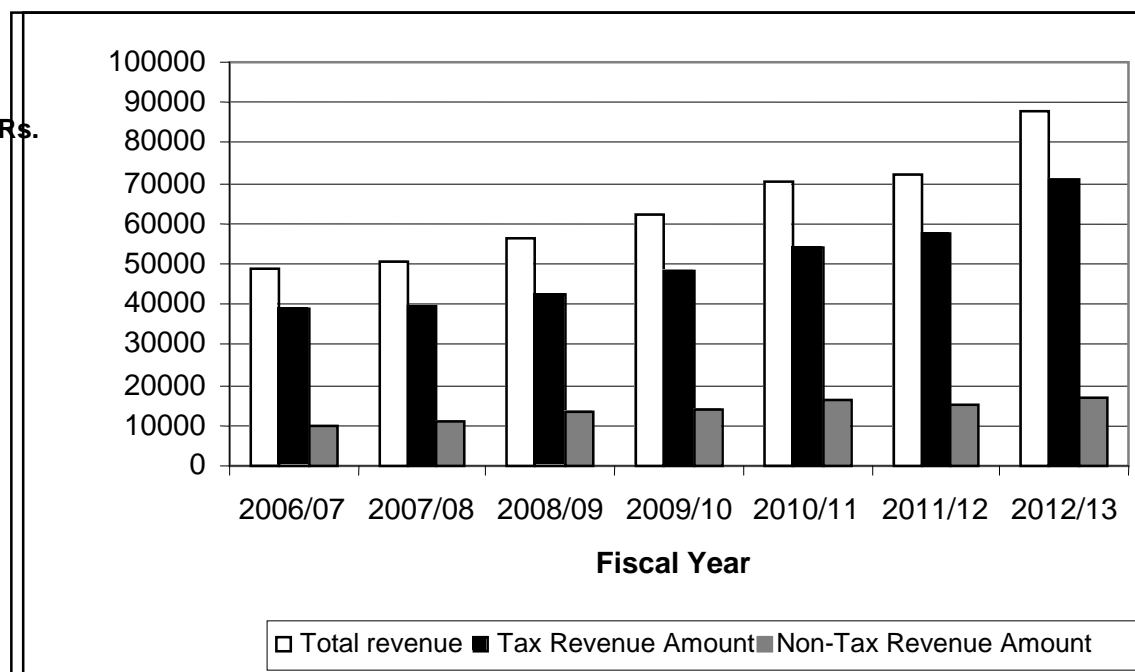
<b>Fiscal Year</b>	<b>Total revenue</b>	<b>Tax Revenue</b>		<b>Non-tax Revenue</b>	
		<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>
2006/07	48893	38865	79.49	10028	20.51
2007/08	50445	39330	77.97	11115	22.03
2008/09	56229	42587	75.74	13642	24.26
2009/10	62331	48173	77.29	14158	22.71
2010/11	70122	54101	77.16	16018	22.84
2011/12	72282	57430	79.45	14851	20.55
2012/13	87712	71126	81.1	16585	18.91
<b>Average</b>			<b>78.31429</b>		<b>21.68714</b>

Source: Economic Survey, Ministry of Finance, Government of Nepal.

Figure: 4.2

Composition of Total Revenue Structure

(Rs. in millions)



The table 4.2 states that the contribution of tax revenue is gradually increasing in every year from FY 2006/07 to FY 2012/13 amounting from Rs.38865.10 million to Rs. 71126.7 million. But there is fluctuation in percentage figure which reaches to 81.10% in FY 2012/13.

Similarly non-tax revenue also contributes in the increasing trend to the total revenue from FY 2006/07 amounting Rs. 10028.80 million to FY 2012/13 amounting Rs. 16585.50 million. According to the study period of seven years, 24.26% is the highest contribution of non-tax revenue in the FY 2008/09.due to fluctuation in percentage it drop down to 18.91% in FY 2012/13 which is the lowest contribution of non-tax revenue to total revenue.

Therefore, from the above detail it is clear that tax revenue plays a significant role in the total revenue structure of Nepal. Share of tax revenue is more than non-tax revenue in revenue structure. In average tax revenue contributes about 81% of total revenue whereas non-tax revenue about 19% of total revenue.

#### 4.1.4 Composition of Tax Revenue

Tax revenue is major source of government in Nepal. It contributes approximately 81% of total revenue mobilization. It is composed of direct tax revenue and indirect tax revenue. Direct tax includes income tax. Property tax and land revenue and registration tax whereas indirect tax includes custom duties, excise on industrial production, VAT/ sales tax, entertainment tax etc. the composition of tax revenue for last seven years is presented in table and figure below:

**Table: 4.3**

#### Composition of Tax Revenue

**(Rs. in millions)**

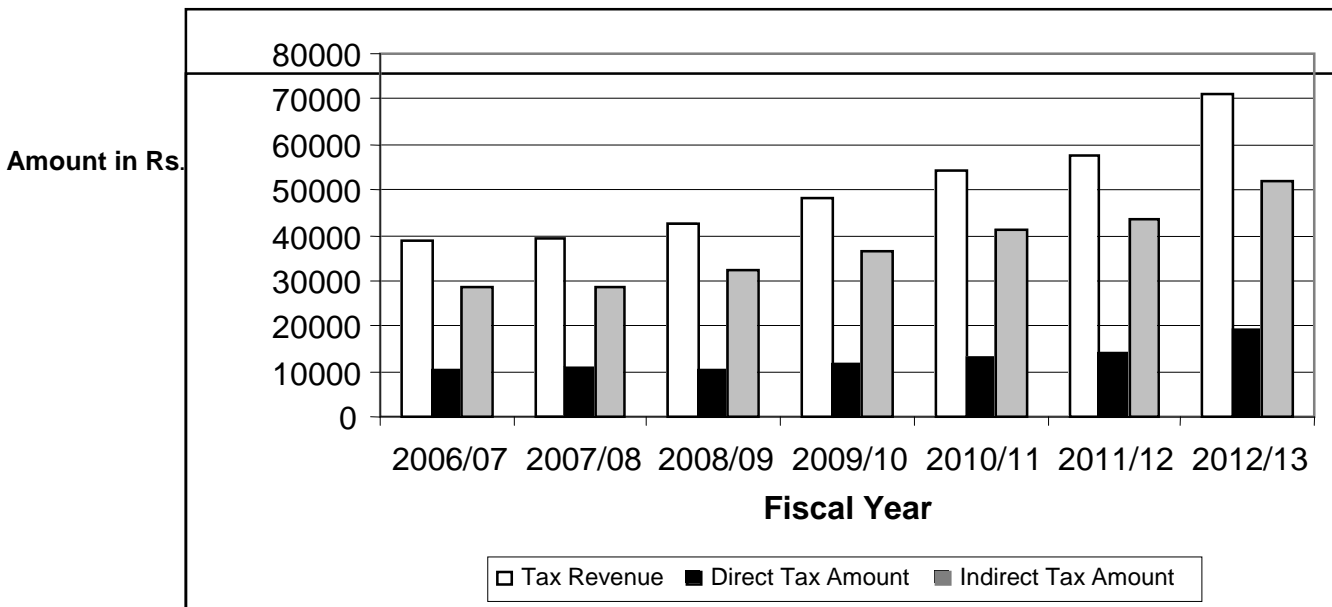
Fiscal Year	Tax Revenue	Direct Tax Revenue		Indirect Tax Revenue	
		Amount	Percent	Amount	Percent
2006/07	38865	10159	26.14	28705	73.86
2007/08	39330	10597	26.94	28733	73.06
2008/09	42587	10105	23.73	32481	76.27
2009/10	48173	11912	24.73	36260	75.27
2010/11	54104	13071	42.16	41032	75.84
2011/12	57430	13968	24.32	43462	75.68
2012/13	71126	18980	26.69	52146	73.31
<b>Average</b>			<b>27.81</b>		<b>74.75</b>

Source: Economic Survey, Ministry of Finance, Government of Nepal.

Figure: 4.3

Composition of Tax Revenue

(Rs. In millions)



From the table 4.3 the amount of direct tax revenue is Rs. 10159.4 million in FY 2006/07 which decline in FY 2009/10 and FY 2011/12 and reaches to amount Rs. 10105 million in FY 2008/09. Then after increase in the further years and reaches to Rs. 18980.3 million in FY 2012/13. But the percentage contribution of direct tax to tax revenue is fluctuating over the study period of seven years reaches to 26.69% in FY 2012/13.

The amount of indirect tax revenue is Rs. 28705.7 million in FY 2006/07. It was also increasing each year and has reaches to Rs.52146.4 million in FY 2012/13. The percentage contribution of indirect tax revenue to total tax revenue is fluctuating over the last seven years which reaches to 73.31% in FY 2012/13. Therefore it occupied a large portion in the total tax revenue than direct tax revenue. So indirect tax implies the dominant role in tax revenue.

#### 4.1.5 Composition of Direct Tax Revenue

If the person paying and bearing tax is same it is called Direct Tax. It is really paid by the same person on whom it is legally imposed. The characteristic of direct tax are equitable as per the property or income, certainty as per the process of payment, amount to be paid and time of payment, elasticity in nature etc. The major components of direct tax are income tax, property tax (urban house and land tax, vehicle tax, interest tax), land revenue, house and land registration tax and some other taxes.

In Nepalese direct tax revenue structure the contribution of direct tax and share of other components are shown in table and figure below:

**Table: 4.4**

#### Composition of Direct Tax Revenue

(Rs. in Millions)

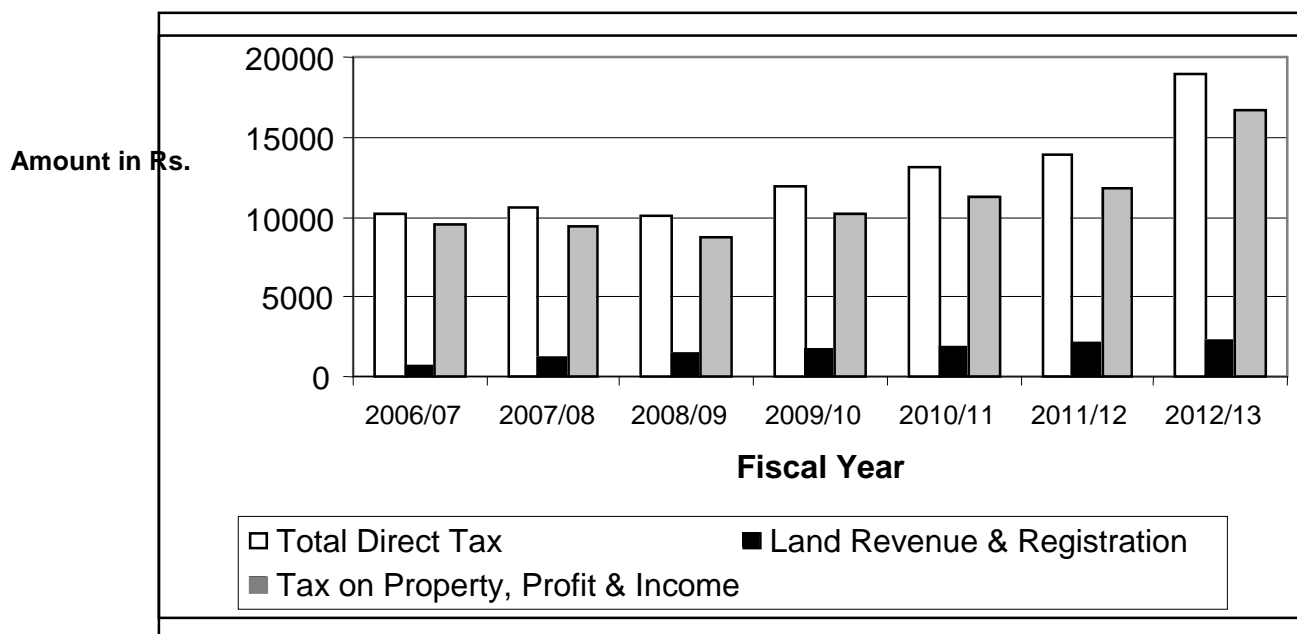
Fiscal Year	Total Direct Tax	Land Revenue & Registration				Tax on Property, Profit and Income				
		Land Tax	HouseLand Registration	Total	% of Direct Tax	Income Tax	Tax on Property	Other Tax	Total	% of Direct Tax
2006/07	10159	5.1	607	612	6.03	9114	432	0.0	9546	93.97
2007/08	10597	0.0	1131	1131	10.68	8903	562	0.0	9465	89.32
2008/09	10105	0.8	1414	1414	13.99	7966	559	165	8691	86.01
2009/10	11912	0.0	1697	1697	14.25	9245	700	268	10215	85.75
2010/11	13071	0.0	1799	1799	13.76	10159	806	306	11272	86.24
2011/12	13968	0.0	2181	2181	15.61	10373	847	565	11787	84.39
2012/13	18980	0.0	2253	2253	11.87	15034	995	697	16726	88.13
<b>Average</b>					<b>12.31</b>					<b>87.68</b>

Source: Economic Survey, Ministry of Finance, Government of Nepal.

**Figure: 4.4**

**Composition of Direct Tax Revenue**

(Rs. in millions)



According to the table 4.4 given above, direct tax is classified into two parts i.e. land revenue & registration and tax on property, profit and income. Land revenue and registration further classified into land tax, and house and land registration. The role of land tax is very nominal, contributes only Rs. 5.1 million in FY 2006/07. Then after decline to Rs 0.8 million in FY 2008/09 and reaches to nil for last 5 years up to FY 2012/13. The land revenue and registration category fully dependent on house and land registration portion. It is in incasing trend from FY 2006/07 to 2012/13 in amounting Rs. 607.8 million to Rs. 2253.5 million. Therefore the percentage of total direct tax is 6.03% in FY 2006/07 amounting Rs. 612.9 million. It is further in increasing trend after that has reached to 2181.1 million, occupying 15.61% of direct tax revenue. But in FY 2012/13 it fluctuated in percentage and reaches to 11.87%.

Other sources of direct tax revenue are tax on property, profit and income has been subdivided into income tax, tax on property and other taxes. This category of direct tax seems to be contributes 93.97 % in FY 2006/07 and it declines for next three years. It declines to 84.39% in FY 2011/12. In FY 2012/13 it contributes Rs 16726.81 million of revenue.

#### **4.1.6 Composition of Indirect Tax Revenue**

Indirect tax is levied on the spending on goods and services. This tax is not directly paid to the government by the real taxpayer. Indirect tax is that tax system where the person paying the tax and the person bearing the tax is different. An indirect tax is imposed on one person but paid partly or wholly by another. The main features of indirect tax are convenience to pay, mass participation, limited evasion, shifting of incidence etc.

Indirect tax is the main sources of government revenue. The major components of indirect tax are custom duties, excise duties, VAT/sales tax. Custom duties are composed of import, export duties and export service charge, custom duties and Indian excise refund. Excise duties levy in the industrial production and VAT has wider coverage which includes sales tax, entertainment tax, and hotel tax etc. composition of indirect tax revenue is presented in the table and figure below:

**Table: 4.5****Composition of Indirect Tax Revenue****(Rs. in millions)**

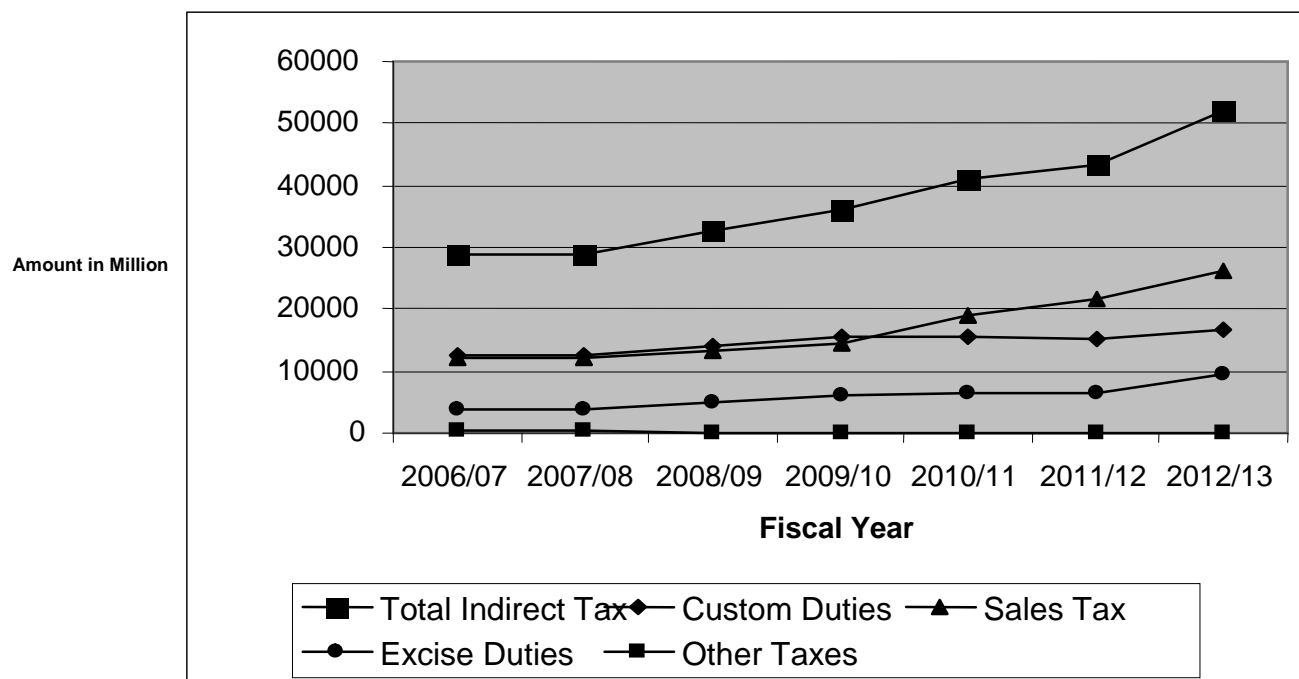
Fiscal Year	Total Indirect Tax	Custom Duties		Sales Tax(VAT)		Excise Duties		Other Taxes	
		Amount	%	Amount	%	Amount	%	Amount	%
2006/07	28705	12552	43.73	12047	41.97	3771	13.14	334	1.17
2007/08	28733	12658	44.06	11964	41.64	3807	13.25	303	1.06
2008/09	32481	14236	43.83	13459	41.44	4785	14.73	0.0	0.0
2009/10	36260	15554	42.90	14478	39.93	6226	17.17	0.0	0.0
2010/11	41032	15701	38.27	18885	46.02	6445	15.71	0.0	0.0
2011/12	43462	15344	35.30	21610	49.72	6507	14.97	0.0	0.0
2012/13	52146	16707	32.04	26095	50.04	9343	17.92	0.0	0.0
<b>Average</b>			<b>40.02</b>		<b>44.39</b>		<b>15.27</b>		<b>0.32</b>

Source: Economic Survey, Ministry of Finance, Government of Nepal.

Figure: 4.5

Composition of Indirect Tax Revenue

(Rs. in millions)



Above table 4.5 states that the contribution of custom duties to the total indirect tax is more than 32.04% in every year during the study period of 7 years. Its contribution in the FY 2006/07 is 43.73% amounting Rs.12047.8 million. It is in decreasing trend reached to 32.04% in FY 2012/13 amounting Rs.16707.6 million. Therefore, it has decreasing contribution to total indirect tax.

Contribution of VAT is fluctuation in every year is Rs. 41.97% in FY 2006/07 which reaches to 50.04% in FY 2012/13 amounting Rs. 12047.8 million to Rs.26095.6 million. The highest contribution to indirect tax was in FY 2012/13 over the study period of seven years. Amount of excise duties is also increasing each year reaches Rs. 3771.2 million to Rs.9343.20 million in FY 2012/13 with fluctuation in percentage figure and contributes only 17.92% to the indirect tax revenue.

Therefore according to the table there is fluctuation in each year in every component of indirect tax. But Sales / Vat tax contributes highest % of amount than other components over the study period of seven years.

#### **4.1.7 Structure of Income Tax Revenue**

Income tax is an important source of direct tax revenue in Nepal. Income tax revenue was divided into three types i.e. Corporate Income Tax, Individual Income Tax and Remuneration until fiscal year 1993/94. After that the income tax was divided into four groups i.e. Corporate Income Tax, Individual Income Tax, House and Land Rent Tax and Interest Tax. The Corporate income tax is collected from Government Academy, Public Company and Private Corporate Bodies. Individual income tax is collected from remuneration, and industry business, profession or vocation. House rent tax is levied on income obtained from renting house and land in urban areas. Interest tax is collected from banks and finance companies that pay interest on all types of deposits. The components of income tax revenue for last seven years are presented in table and figure below:

**Table: 4.6****Structure of Income Tax Revenue****(Rs. in millions)**

Fiscal Year	Total Income Tax		Public Enterprises		Private Company		Individual Income		Remuneration		Interest Tax	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
2006/07	9114	100	2928	32.1	1924	21.1	3200	35.1	597	6.6	463	5.1
2007/08	8903	100	1769	19.9	1412	15.9	4419	49.6	835	9.4	467	5.3
2008/09	7966	100	1251	15.7	1236	15.5	3362	41.2	1252	15.7	864	10.8
2009/10	9245	100	2056	22.2	1531	16.6	3533	38.2	1391	15.0	733	7.9
2010/11	10159	100	1332	13.1	2467	24.3	3926	38.6	1675	16.5	757	7.5
2011/12	10373	100	195	1.9	3404	32.8	4232	40.8	1764	17.0	565	5.5
2012/13	15034	100	1019	6.7	5717	38.02	523	34.82	2007	13.36	1054	7.01
<b>Average</b>		<b>100</b>		<b>15.95</b>		<b>23.46</b>		<b>39.76</b>		<b>13.37</b>		<b>7.016</b>

Source: Economic Survey, Ministry of Finance, Government of Nepal.

**Figure: 4.6**

**Structure of Total Income Tax Revenue**

(Rs. in millions)

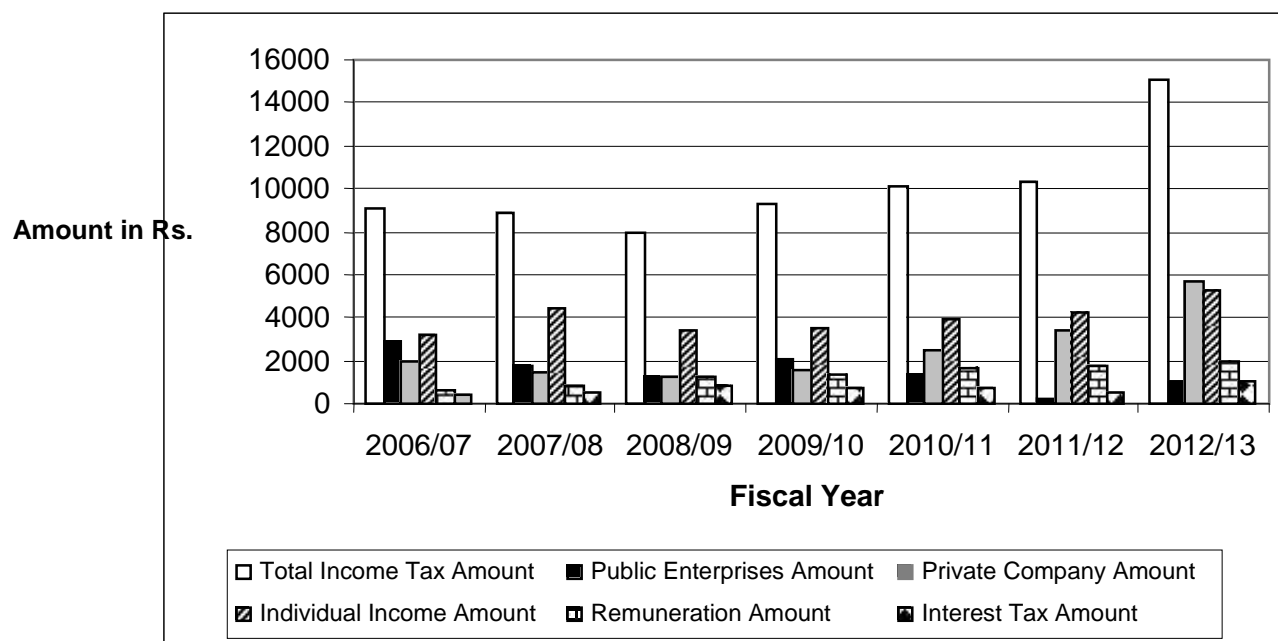


Table given above states that income tax revenue was increasing each year except FY 2007/08 and 2012/2013. In FY 2007/08 it was decreased in comparison to 2006/07. But after that it was in increasing trend reaches to Rs. 15034.01 million in FY 2012/13.

Corporate income tax is in satisfactory level as compared to other sources. The above table shows that it was gradually decreased to 1.9% in FY 2011/12. but in FY 2012/13 it seems increased to 6.7%.

Individual source of income tax also contribute reliable portion on total income tax. It seems that it is in increasing trend up to FY 2007/08 i.e. 49.6% then slightly decreased to 34.82% in FY 2012/13 amounting Rs. 5234.4 million. Performance of remuneration was also excellent which contributes 9.4% in FY 2007/08 and jumps up to 17% in FY 2011/12 and fall to 13.36% in FY 2012/13. Interest income was also in positive way but still there is lot to do. It contributes 5.1% in FY 2006/07 and reaches up to 10.8% in FY 2008/09.

#### 4.1.8 Contribution of Income Tax to GDP and Total Revenue

Revenue collection from income tax is in increasing trend but the performance is not satisfactory because we can measure the performance of income tax according to its contribution in GDP even though it is not absolute technique in developing countries. But due to lack of reliable data it is widely applicable technique. If we go through the table it shows that Income Tax GDP ratio is in decreasing trend it clear that performance is not satisfactory as desired. But the sign of hope is still left because revenue from income tax is in increasing way. The contribution of Income tax to GDP and total revenue is shown by the table given below:

**Table: 4.7**

#### **Contribution of Income Tax to GDP and Total Revenue**

**(Rs. in millions)**

<b>Fiscal Year</b>	<b>Total Income Tax Revenue</b>	<b>% of Income Tax to GDP</b>	<b>Total Revenue</b>	<b>% of Income Tax to Revenue</b>
2006/07	9114	2.34	48893	18.64
2007/08	8903	2.20	50445	17.65
2008/09	7966	1.89	56229	14.17
2009/10	9245	2.16	62331	14.83
2010/11	10159	2.27	70122	14.49
2011/12	10373	2.19	72282	14.35
2012/13	15034	3.05	87712	17.34

Source: Economic Survey, Ministry of Finance, Government of Nepal.

The table 4.6 states that the contribution of income tax to GDP. The contribution of income tax to GDP in FY 2006/07 is 2.34% which is the maximum level. It started to

decline and reaches to 1.89% in FY 2008/09. It slowly increased to 2.16% and 2.27% for following two years in 2009/10 and in FY 2010/11.

The contribution of income tax to total revenue is positively correlated with the share of 18.64% in FY 2006/07. It declined for next two years to 17.65% and 14.17% then it gradually increased in FY 2009/10 to 14.83% and again decreased to 14.49% and 14.35% from last two years. But it increased to 17.65% in FY 2007/08.

#### **4.1.9 Proportion of Penalties and Fines to Direct Tax**

Ignorance of law is not an excuse. The proverb is also equally applicable for the Income Tax Act too. Every person having an income during the year has to meet many obligations specified in the Act, Rules, circulars and notifications issued by IRD. Payment of tax is not only a sufficient fulfillment of the obligation. Besides, other duties like submission of returns, providing true and fair information, keeping records and accounts etc. also should be performed in time to avoid penalties.

Penalties and fines are of two types: one a penalty for regularly and commonly happening mistakes and irregularities; and another, for fraudulent and intentional manipulation of income and amount of taxes. The Act has named them as fines, interest and penalties. The provisions of fines and penalties play an important role to collect the tax in time and to control tax evasion culture. The amounts of penalties and fines, which are ultimately included in tax amount, have some contribution in tax revenue. The table below shows the proportion of penalties and fines towards direct tax for the last seven years.

**Table: 4.8****Proportion of Penalties & Fines to Income Tax Sector****(Rs. in millions)**

<b>Fiscal Year</b>	<b>Total Direct Tax</b>	<b>Penalties Amount</b>	<b>%of Penalty to Direct Tax</b>	<b>Fines Amount</b>	<b>% of Fines to Direct Tax</b>	<b>%of Penalties and Fines to Direct Tax</b>
2006/07	8912	26.65	0.29	2.13	0.023	0.32
2007/08	10130	18.02	0.17	2.0	0.019	0.19
2008/09	11256	28.35	0.25	23.02	0.206	0.45
2009/10	11912	24.817	0.20	5.44	0.05	0.25
2010/11	13071	16.042	0.12	2.974	0.02	0.14
2011/12	13968	48.081	0.34	49.826	0.04	0.70
2012/13	18980	15.916	0.08	8.172	0.04	0.12
<b>Average</b>			<b>0.207</b>		<b>0.056</b>	<b>0.2642</b>

Source: Inland Revenue Department

Above table shows that in the FY 2006/07 and FY 2012/13, the proportion of penalties is higher than fines to total direct tax. The amount of penalties is higher than the amount of fine since the penalties is imposed for the greater mistake. The contribution of penalties to total direct tax is 0.29% whereas as the contribution of fines is only 0.05%. The overall contribution of fines and penalties to direct tax is 0.023% in FY 2006/07 and 0.19% in FY 2007/08. But it has highest contribution to total direct tax in FY 2011/12. The contribution of fines is 0.20% and penalties are about 0.45% and overall they contribute about 0.25%. Whereas in FY 2012/13 percentage of contribution from penalties decreased and reach to only 0.08% and

finances contributes about 0.05%. The overall contribution of fines and penalties to the total direct tax is about 0.70% which is the lowest among the study period of last four years.

## **4.2 EMPIRICAL ANALYSIS**

### **Introduction**

An empirical investigation has been conducted in order to fine out various aspects of Income Tax System in Nepal from the real life experience. The major tool used for this purpose is an opinion survey through a set of structured questionnaire. A total of hundred sets of same questionnaire were distributed to three groups of respondents i.e. Tax experts, tax administrators and tax payers. The responses received from these respondents have been arranged, tabulated and analyzed in order to facilitate the descriptive analysis of this study.

The questionnaire either asked for a yes/ no response or asked for ranking of choices according to number of alternative where first choice was most important and last choice was least important. If the number of alternatives were six then the first preferred choice got six points and the last preferred choice got one point. Any alternatives, which were not ranked, did not get any point. The total points available to each choice were converted into percentages in reference to the total points available to each choice. The choice with the highest score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as least choice. The following table shows the group of respondents and code used to represent them.

**Table: 4.9**  
**Groups of Respondents and Code Used**

S. No.	Groups of Respondents	Sample Size	Codes Used
1	Tax Experts	25	A
2	Tax Administrators	25	B
3	Tax Payers	50	C
	Total	100	

#### 4.2.1. Essential of Income Tax Collection for Government

As we say that Income Tax plays a vital role in the economic development of Nepal. It is tool of achieving maximum social and economic objectives. It reduces the regional economic imbalance. Therefore as regards to above mention, a question has been asked to the respondents as to how important Income Tax is to the government. The question was “Is the collection of Income Tax essential for the government”? Table 4.9 gives the breakdown of response.

**Table: 4.10**  
**Essential of Income Tax Collection**

Responses Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	25	100	–	–	25	100
B	25	100	–	–	25	100
C	40	90	10	10	50	100
<b>Total</b>	90	90	10	10	100	100

Source: Field Survey 2014

Above table shows that 90% of total respondents agree that the government should collect income tax which is very essential element, while only 10% disagree. All the tax experts and tax administrators' respondents are in favor. But 20% taxpayers are not in favor of the above statement. Therefore it is shown that collection of Income Tax is essential for the government.

#### 4.2.2. Knowledge about Income Tax Act 2058

To know about situation of Income Tax Act 2058, two questions were asked, "How is our Income Tax Act 2058"? And if not good then why"? The responses received from the various respondents are tabulated below:

**Table: 4.11**

#### **Knowledge about Income Tax Act 2058**

Responses Respondents	Good		Moderate		Not Good		Total	
	No.	%	No.	%	No.	%	No.	%
A	15	60	10	40	–	–	25	100
B	20	80	5	20	–	–	25	100
C	10	20	25	50	15	30	50	100
<b>Total</b>	45	45	40	40	15	15	100	100

Source: Field Survey 2014

From the above table we observed that 45% of respondents agree that current Income Tax Act 2058 is good. There is no problem in it. 40% of respondents say it is moderate, it needs some improvement. But 15% of respondents i.e. taxpayers think that the current Income Tax Act is not good. From above we can conclude that the present Income Tax Act of Nepal is not bad i.e. it is satisfactory, while very few respondents from group C think that current Income Tax Act 2058 is not good.

Again from the respondents who feel that Income Tax Act 2058 is not good, they were asked a question that, "if not good then why? Choice your view from the following:"

- a. Not Scientific.
- b. It favors big taxpayers.
- c. It is not in favor of high taxpayers.
- d. Not recognized the good taxpayers.
- e. If any specify your reason.

From the total 100 respondents only 15 of them all from the group C i.e. taxpayers have view that Income Tax Act 2058 is not good. Therefore from total 15 respondents, 6 give reason that it is not scientific i.e. 40%. 2 respondents say that it favors big taxpayers and 2 say that it is not in favor of high taxpayers. Remaining respondents say it is poor which not recognize the good taxpayers and also it is not simple but is vague.

Therefore, from the above, it can be concluded that the present Income Tax Act of Nepal is not bad i.e. it is satisfactory, whereas some respondents feels that current Income Tax Act 2058 is not good so somehow it needs to be improved.

#### **4.2.3. Taxpaying Habit of Nepalese Taxpayers**

To know the taxpaying habit of Nepalese people, a question was asked, "Taxpaying habit of Nepalese taxpayers is poor". Do you agree? The responses have been tabulated below:

**Table: 4.12**

**Tax Paying Habit of Nepalese Taxpayers is Poor**

Responses	Yes		No		Total	
	No.	%	No.	%	No.	%
A	22	88	3	12	25	100
B	21	84	4	16	25	100
C	27	54	23	46	50	100
<b>Total</b>	70	70	30	30	100	100

Source: Field Survey 2014

Since 70% of respondents were agreed with taxpaying habit of Nepalese taxpayers is poor and 30% of respondents argued that there is poor taxpaying capacity, which is the reason for not paying tax.

**4.2.4. Effect of Fines and Penalties to improve Poor Tax Paying Habit**

To know the effect of legal provisions of fines and penalties to improve taxpaying habit of Nepalese people a question was asked, “Do you agree, poor taxpaying habit can be improved by effective fines and penalties provision in the Income Tax Act”? The responses received from various respondents are tabulated as follows:

**Table: 4.13**

**Effect of Fines and Penalties to Improve Tax Paying Habit**

Responses Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	21	84	4	16	25	100
B	25	100	–	–	25	100
C	15	30	35	70	50	100
<b>Total</b>	61	61	39	39	100	100

Source: Field Survey 2014

From the above table it is observed that 61% of the respondents have agreed fines and penalties related provision can improved the taxpaying habit of Nepalese people and 39% of the respondents showed their disagreement to this concept. Thus it means that it is effective to increase taxpaying habit of Nepalese taxpayers.

**4.2.5. Familiar with Fines and Penalties Provision**

To know how much the respondents are familiar with provisions related to fines and penalties of Income Tax Act 2058, a question was asked, “Are you familiar with the fines and penalties provisions in Income Tax Act 2058?” The responses received from the respondents are tabulated as below:

**Table: 4.14**

**Familiar with the Provisions Related to Fines and Penalties in Income Tax Act  
2058**

Responses Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	25	100	–	–	25	100
B	25	100	–	–	25	100
C	20	40	30	60	50	100
<b>Total</b>	70	70	30	30	100	100

Source: Field Survey 2014

From above table it is observed that 70% of respondents are familiar with provision of fines and penalties. But majority of respondents from group C i.e. taxpayers showed their ignorance about the provision. Thus, from the above study it is analyzed that the taxpayers have little/less knowledge about provisions related to fines and penalties of Income Tax Act.

**4.2.6. Have You Ever Been Penalized**

In order to know that have the respondents ever paid fines or penalties, a question was asked, “Have you ever paid Fine/Penalty?” The responses received from the various respondents are tabulated as follows:

**Table: 4.15**

**Fines and Penalties Paid by the Taxpayers**

Responses	Yes		No		Total	
	No.	%	No.	%	No.	%
A	-	-	25	100	25	100
B	-	-	25	100	25	100
C	2	4	48	96	50	100
<b>Total</b>	2	2	98	98	100	100

Source: Field Survey 2014

From the above table it is analyzed that 98% of respondents disagreed that they have ever paid fines and penalties and only few respondents confess that they have paid fines and penalties i.e. 2%. And in order to know the reason why they are penalized a question was asked with these 2% respondents, "If yes, why? Please state your cause of payment." The answers received from them are presented following:

**Reasons for Payment of Fines and Penalties:**

- ) Due to the confusion description on the clause of Income Tax Act.
- ) Due to not settlement of income tax in time.

Hence it may be concluded that due to less knowledge about the related provisions, they are being penalized. But only small percentages of respondents confess that they had paid fine and penalties.

#### 4.2.7. Satisfactory to the Provisions of Fines and Penalty Made in Income Tax Act 2058

In order to know the view of various respondents about the satisfaction of provision of fines and penalties made in current Income Tax Act 2058 a question was asked, “Do you think, the fines and penalty provision of Income Tax Act 2058 is Satisfactory?” The responses of the respondents are presented in the tabular form below:

**Table: 4.16**

#### Satisfaction to the Provision of fines and penalties

Responses Respondents	Yes		Moderate		No		Total	
	No.	%	No.	%	No.	%	No.	%
A	4	16	8	32	13	52	25	100
B	7	28	13	52	5	20	25	100
C	6	12	7	14	37	74	50	100
<b>Total</b>	17	17	28	28	55	55	100	100

Source: Field Survey 2014

Since 17% of respondents were agreed that the provision of fines and penalty made in the Income Tax Act is satisfactory. 28% of respondents say that it is moderate but 55% of respondents are not satisfied with the provision of fines and penalties of income Tax Act. Thus it can be concluded that majority of the respondents are dissatisfied with the provisions in Income Tax Act.

The respondents who gave negative responses about the satisfaction of provision of fine and penalty made in Income Tax Act were asked a question that, “If not Yes, then which area needs consideration?” and requested to write their reason for their view.

The majority of respondents disagree that the provision related to the fines and penalty made in Income Tax Act 2058 is satisfactory. Due to the weak implementation process of the provision related to the fine and penalty, there are so many problems in our income tax system. Therefore, mainly the implementation part needed to be considered by the law authorities. The reasons why the implementation part of income tax system needed to be improved have been stated below:

- J Needs to make procedures.
- J Enforcements of law and taxpayers education program needs to enhance side by side.
- J Some of the rules are not suitable to our circumstances and situation. They need to be changed as per requirement.
- J Taxpayers want benefits and facilities from the government. So they should be encouraged and motivated.
- J The government should promise to use such funds for the wellbeing of the people and nation.

Thus it is concluded that there are many reason that the present provision of fine and penalty of Income Tax Act 2058 need to be improved in various field.

#### **4.2.8. Effectiveness of Tax Administration to Impose Fines and Penalties**

In order to know the effectiveness of tax administration to impose fines and penalties in Nepal, a question was asked, " may you agree that the tax administration of Nepal is effective to impose fines and penalties as per Income Tax Act?" Table below gives a breakdown of responses.

**Table: 4.17**

**Effectiveness of Tax Administration to Impose Fines and Penalties**

Responses	Yes		No		Total	
	No.	%	No.	%	No.	%
A	10	40	15	60	25	100
B	25	100	-	-	25	100
C	-	-	50	100	50	100
<b>Total</b>	35	35	65	65	100	100

Source: Field Survey 2014

From the above table it is clear that most of the respondent i.e. 65% think that tax administration is not effective to impose fines and penalties in Nepal. Only 35% respondents think that tax administration is effective to impose fines and penalties in Nepal. Most of the tax administrators are in favor with effectiveness of tax administration to impose fines and penalties because they do not want to show their weakness. Thus, it can be concluded that the tax administration of Nepal is not effective to impose fines and penalties as per Income Tax Act.

In order to know the cause of ineffective tax administration the next question was asked. "If no,thenwhy? If more than one cause please marks your opinion by ranking." The respondents were requested to rank their answer from 1 to 6. Table 8(a) below gives the breakdown of response.

**Table: 4.17(a):**

**Reasons of Ineffective of the Tax Administration to impose Fines and Penalties**

S. No.	Reasons	Groups			Total Points	Percentage	Ranks
		A	B	C			
1	Corruption	18	0	114	132	50	1
2	Lack of information	10	0	15	25	9.46	5
3	Lack of Competency	12	0	36	48	18.18	2
4	Complicated Tax Provisions	6	0	21	27	10.23	4
5	Undue influence/pressure	8	0	22	30	11.36	3
6	No Logistic Support	1	0	1	2	0.75	6
	<b>Total</b>				264	100	

Source: Field Survey 2014

The causes of ineffectiveness of Nepalese income tax administration to impose fines and penalties as per Income Tax Act were ranked in order of the preference of the respondents were as follows:

1. Corruption.
2. Lack of competency.
3. Undue influence/pressure.
4. Complicated tax provisions.
5. Lack of information.
6. No logistic support.

It can be concluded that corruption, lack of competency, undue influence/pressure, complicated tax law and lack of information is the most important causes of ineffectiveness of Nepalese tax administration to impose fines and penalties as per Income Tax Act. But the main cause is corruption.

#### 4.2.9. Knowledge about Fines and Penalty by not complying income tax law

To know how much the respondents have knowledge that they will be punished by fines and penalties if they fail to comply income tax property a question was asked, "Do you think taxpayers know they will be penalized if they fail to comply income tax properly?" The responses received from various respondents are tabulated below:

**Table: 4.18**

#### **Knowledge about the reasons for Fines and Penalty**

S. No.	Answers	Groups			Total	Percentage
		A	B	C		
1	Do not know	9	0	24	33	33
2	All know	2	14	5	21	21
3	A few know	7	0	13	20	20
4	Most of them Know	7	11	8	26	26
	<b>Total</b>	<b>25</b>	<b>25</b>	<b>50</b>	<b>100</b>	<b>100</b>

Source: Field Survey 2014

From the above table it can be said that 33% of respondents think that taxpayers do not have knowledge that they will be penalized if they fail to comply income tax property and 20% of respondents think that only some taxpayers have knowledge and 21 % of respondents think that they all know . 26% of respondents think most of them know. Thus it is concluded that most of that taxpayers have knowledge that if

they fails to comply income tax properly they will be punished but they avoid it because they feel payment of income tax is worthless and it only a burden to them.

In order to know the reason why taxpayers do not have knowledge about the rules- they will be punished if they do not pay income tax in time a question was asked to the respondents that, "If your answer is not other than (b), what is the reason?" The answer received from the respondents is presented in tabular form below:

**Table: 4.18(a):**

**Reasons for not knowing the causes of penalties**

S. No.	Reasons	Groups			Total	Percentage
		A	B	C		
1	Lack of proper publicity.	12	2	20	34	43
2	Taxpayer do not want to know	7	9	1	17	22
3	Tax administration does not think it is necessary	2	0	15	17	22
4	The government desires to collect more revenue by fines and penalties.	2	0	9	11	13
	<b>Total</b>	<b>23</b>	<b>11</b>	<b>45</b>	<b>79</b>	<b>100</b>

Source: Field Survey 2014

The above table shows that 43% of respondents think that due to the lack of proper publicity the taxpayers do not know that they will be penalized if they do not comply income tax properly. 22% of respondents express their cause as taxpayers themselves do not want to know and similarly 22% of respondents express that tax administration does not think it is necessary. Only 13% of respondents blame the government as to collect more and more revenues by fines and penalties.

#### 4.2.10 Does the Provisions of Fines and Penalty Motivates and Inspires Taxpayers

In order to know that the taxpayers are motivated and inspired to pay the tax in time due to the provision of fines and penalties of Income Tax Act 2058, a question was asked to all the respondents that, “the provision of fines and penalties motivate and inspires taxpayers to pay tax in time and they do not conceal their real income.” Are you agreeing with this statement? The responses received from the various respondents are presented in the tabular form below:

**Table: 4.19**

#### **Provision of Fines and Penalties Motivates and inspires Taxpayers**

Responses Respondents	Yes		Yes, in some extent		No		Total	
	No.	%	No.	%	No.	%	No.	%
A	20	80	5	20	–	–	25	100
B	22	88	3	12	–	–	25	100
C	9	18	6	12	35	70	50	100
<b>Total</b>	<b>51</b>	<b>51</b>	<b>14</b>	<b>14</b>	<b>35</b>	<b>35</b>	<b>100</b>	<b>100</b>

Source: Field Survey 2014

Above table show that 35% of respondents disagree with the statement, the provision of fines and penalties motivate and inspires taxpayers while 51% express their opinion in favor of the statement. Thus the effective provisions in income tax act certainly motivate and inspire the taxpayer. And such provision helps government to collect more income tax.

To know the reason of disagreement with the statement that the provision of fines and penalties motivate and inspires taxpayers a separate question was asked to the respondents, the result of their opinion is shown below:

**Table: 4.19(a)****Reasons of disagreement**

S. No.	Answers	Groups			Total	Percentage
		A	B	C		
1	Noncompliance of provisions.	0	0	4	4	12
2	Tax administration can be influence.	0	0	20	20	57
3	Contradictory explanation.	0	0	6	6	17
4	Inefficient tax administration.	0	0	5	5	14
	<b>Total</b>	<b>0</b>	<b>0</b>	<b>35</b>	<b>35</b>	<b>100</b>

Source: Field Survey 2014

From the above table we can say that 35 out of 50 respondents from group C are not in favor of the given statement while all the respondents of group A and B are in favor. 57% of the respondents say that tax administration can be easily influence by politicians, powerful person etc. The vague and contradictory explanation in the Income Tax Act is the second main reason i.e. 17%. The third reason is inefficient tax administration which is 14% of total respondents. The fourth reason of disagreement is Noncompliance of provisions which is only 12%.

#### **4.2.11. Sufficiency and Satisfactory of Provision Made under the Income Tax Act. 2058**

In order to know the sufficiency of provision made under the Nepalese Income Tax Act 2058 a question was asked, " Do you feel, the provision made under the Nepalese

Income Tax Act sufficient and satisfactory?" The responses received on it are tabulated below.

**Table: 4.20**

**Sufficiency and Satisfactory of Provisions of Income Tax Act 2058**

Responses	Yes		No		Total	
	No.	%	No.	%	No.	%
A	5	20	20	80	25	100
B	7	28	18	72	25	100
C	32	64	18	36	50	100
<b>Total</b>	44	44	56	56	100	100

Source: Field Survey 2014

From the above table it is observed that 44% of respondents were agreed the sufficiency and satisfactory of provision made under the Nepalese Income Tax Act 2058, but 56% of the respondents were against the sufficiency and satisfactory of Income Tax Act. Thus it can be concluded that majority of the respondents were against the sufficiency and satisfactory of provisions made in the Income Tax Act 2058.

The respondents who gave negative response about the sufficiency and satisfactory of provisions made under Income Tax Act were requested to write their opinion on the blank area. A question was asked, "If not in which aspect the improvement is needed? Please give your reasons:" The reasons for the improvement of different aspects of Nepalese Income Tax Act are given below:

**Group "A" (Tax Experts)**

1. Tax Law
2. Training to staff

3. Tax administration
4. Capital gain
5. Necessary to revise
6. Tax evader
7. Suitable to modern economy and Nepalese context
8. Necessary to revise
9. In deduction
10. Filing of return
11. Clarity without dual meaning
12. Tax Rate
13. Obligation toward taxpayer
14. Stable tax structure

**Group "B" (Tax Administrators)**

1. Tax law
2. Income tax structure
3. Administration review and appeal
4. Penalty system
5. In register
6. Compulsory billing system
7. Simplify the language
8. Not match able with Nepalese contest

### **Group "C" (Taxpayers)**

1. Language
2. Tax system should be flexible
3. Tax law
4. Tax administration
5. Remuneration income
6. Incentives to industries that compete
7. Trained staff
8. Fines and penalties system

From the above listing, most of respondents suggested to simplify the language, trained staff, improve tax law and tax structure etc. they also focused to improve the administration and computerized system.

Lastly an open question was kept with respondents to express their view regarding the provision of fines and penalties in Income Tax Act 2058. The gist of their responses is given in point wise:

1. Suitable and timely amendment of the provision makes the act practical and easy implementation.
2. Provisions should be fixed in permanent law. They should not be changed yearly by financial laws as in practice.
3. Provisions in act should be clear, simple and understandable to all taxpayers even also to layman.
4. The government should adopt different methods to educate the taxpayers about the provisions through different media.
5. Fair implementation of provisions and avoid influences as well as corruption makes act popular as well as easy on effective implementation.

6. Strong and fair action to financial miscreants and social respect to genuine and honest tax payers makes income tax act authentic, indisputable, legitimate and unadulterated act.
7. Tax administrators should be trained, motivated to their duty so that they will be able to implement as the objective and the mission of the government.
8. Tax Administration should fair and equipped with necessary logistic as required for effective implementation.

### **4.3 Major Findings**

On the basis of preceding chapter and data presentation and analysis some important finding can be drawn. The major findings of this research study are summarized below:

**a) From Secondary Data:**

1. Revenue mobilization is the major source of government expenditure. Government manages its expenditure through revenue collection from general public and grants and aids from foreign countries. Comparing the fiscal year 2012/13 the contribution of revenue on total expenditure increase at an annual average rate of 9%, while the revenue mobilization increase at an annual rate of 2%. Hence, it is clear that government manages its sources average 85% from revenue and 14.85% from foreign grants.
2. Government revenue structure in Nepal is the composition of internal and external revenues. Internal revenue includes both tax revenue and non-tax revenue. Among tax and non-tax revenue, there is dominant share of tax revenue in Nepal government's revenue. It had contributed 79.49% in fiscal year 2006/07 but it was decreased to 75.74% in fiscal year 2008/09. Then after it was increased to 81.10% in fiscal year 2012/13. It shows that the contribution of tax revenue is in increasing trend.
3. Tax revenue is major sources of government revenue in Nepal. It is composition of direct and indirect tax. The contribution of indirect tax in fiscal year 2006/07 was 73.86% and in fiscal year 2012/13 was 73.31% and contribution of direct tax was 26.14% and 26.69% respectively. The percentage

contribution of indirect tax and direct tax to total tax revenue was fluctuating over the study period. It seems the dominant role of indirect tax revenue in Nepalese tax revenue.

4. Direct tax revenue is the composition of land revenue and registration and tax on property, profit and income. The contribution of tax on property, profit and income in fiscal year 2006/07 was 93.97% to the direct tax revenue but decreased to 88.13% in fiscal year 2012/13. The contribution of land revenue and registration to the direct tax was 6.03% in fiscal year 2006/07 which reaches to 11.87% in fiscal year 2012/13. Therefore, there is dominant share of tax on property, profit and income to direct tax revenue, which is also in increasing trend.
5. Indirect tax revenue is the composition of custom duty, VAT, excise duties, entertainment tax and other taxes. The contribution of custom duty, sales tax(VAT), excise duty, and other taxes were 43.73%, 41.97%, 13.14% and 1.17% respectively in fiscal year 2006/07 and contributed in fiscal year 2012/13 were 32.04%, 50.04%, 17.92% and 0% respectively. It seems that VAT/sales tax contributed large portion of shares to indirect tax revenue which is also in increasing trend.
6. Income tax structure consists of public enterprise, private company, individual income, remuneration, interest on tax. There is dominant role of private company which was in decreasing trend, contributes 21.10% in fiscal year 2006/07 but increases to 38.02% in fiscal year 2012/13 to income tax. The contribution of individual income tax is in second position and it is in decreasing trend.
7. The performance of income tax to Gross Domestic Product (GDP) is not satisfactory. It is in increasing trend. In fiscal year 2006/07 income tax-GDP ratio was 2.34% and it was 3.05% in fiscal year 2012/13. The income tax-total revenue ratio was 18.64% in fiscal year 2006/07 and then it was in decreasing trend reaches to 14.35% in fiscal year 2012/13. But in fiscal year 2007/08 it increases to 17.65%.

8. Fines and penalties also play a significant role towards the contribution of government revenue. The proportions of penalties are higher than fines to the total direct tax revenue. In fiscal year 2009/10 contribution of fines and penalties to direct tax revenues are 22% and 5% respectively and overall they contribute 27% to direct tax revenue. But in the fiscal year 2012/13 penalties contribute only 8% and fines about 4% only and over all they contribute only 13% to direct tax revenue. It shows that they contribute in decreasing trend.

**b) From Primary Data:**

1. It is essential for the government to collect income tax revenue.
2. Current Income Tax Act 2058 of Nepal is good.
3. Taxpaying habit of Nepalese taxpayer is poor.
4. Poor taxpaying habit can be improved by effective fine and penalty provisions.
5. Taxpayers are less familiar with the fine and penalty provision of Income Tax Act 2058.
6. Only small percentage of respondents had paid penalty.
7. Provision related to fines and penalties in income tax act is not satisfactory, which needed to be improved in various field.
8. Tax administration of Nepal is not effective to impose fines and penalties as per income tax act. The main reasons of ineffectiveness are corruption, lack of competent staff and complicated tax law.
9. Tax payers have knowledge they will be penalize if they fail to comply income tax properly but they deny.
10. Most of the respondent agree that “the provision of fine and penalty motivates and inspires tax payers to tax in time and they do not conceal their real income”

11. Provisions made under the Nepalese income tax act are not sufficient and satisfactory in all aspect. Improvements are need in language, competent staff, tax law, tax administration, computerized system, etc.

An opinion survey has been conducted in order to find out the role of fine and penalty to collect income tax and its related provision and some other aspects of income tax. From the opinion survey of various respondents ,i.e., Tax experts, tax administrators and tax payers the following findings has been drawn:-

1. The major goal of income taxation in Nepal is to increase the revenue of the nation. Therefore, it is essential for government to collect revenue in the form of income tax from the general public.
2. The situation of current Income Tax Act 2058 of Nepal is satisfactory.
3. The taxpaying habit of Nepalese tax payer is poor.
4. Taxpaying habit of Nepalese taxpayers can be improved by effective fine and penalty provision of Income Tax Act.
5. Tax payer has less knowledge about the provision related to fine and penalty of Income Tax Act.
6. Most of the respondents deny that they have ever paid penalties but only small percentages of respondents confess that they had paid fines and penalties.
7. The provisions of fine and penalty made in Income Tax Act 2058 are not satisfactory which are needed to be improved in various fields.
8. The income tax administration of Nepal is not effective to impose fine and penalty as per Income Tax Act. The main cause of ineffectiveness of tax administration to impose fines and penalties are corruption, lack of competency, undue influence/pressure, complicated tax provisions, etc.
9. Most of the respondents have knowledge they will be penalize if they fail to comply income tax properly but they avoid it because they feel payment of income tax is worthless and it only creates burden to their life.

10. Main reasons why the tax payer do not know they will be penalized if do not comply income tax properly are lack of proper publicity, taxpayer do not want to know, tax administration does not think it is necessary and government desires to collect more revenue by imposing fines and penalties.
11. Most of the respondent agreed that “the provision of fine and penalty motivates and inspires tax payers to pay tax in time and they do not conceal their real income”
12. Most of the respondents feel that provisions made under the Nepalese Income Tax Act 2058 are not sufficient and it does not satisfied them. Improvements are needed in language, competent staff, tax law, tax administration, computerized system of payment of tax, etc.

## CHAPTER-V

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter is the important for the research because this chapter is the extract of all the previously discussed chapters. This chapter consists of mainly three parts: Summary, conclusion and recommendation. In summary part, revision or summary of all four chapters is made. In conclusion part, the result from the research is summed up and in recommendation part, suggestion and recommendation is made based on the result and experience of thesis. Recommendation is made for improving the present situation to the concerned parties as well as for further research.

#### **5.1 Summary:**

This first chapter deals with introduction and background of the study, statement of the problem, objectives of the study, significance of the study and limitations of the study.

This second chapter deals with Conceptual Framework and review of literature. In this chapter the researcher has reviewed from books, journals, thesis and independent studies are taken into account.

This third chapter deals with research methodology includes the research design, sources of data collection, techniques of data collection, tools for analysis of data and methods of presentation and analysis.

This fourth chapter deals with presentation and analysis of data part. It is the main body of our study. It includes data presentation, interpretation and analysis of collected data. In this chapter I got the following major finding:

Most of the respondents have their views that the provided provision of fines and penalties is not satisfactory and sufficient. It needs to be improvement on language with dual and vague meaning, on provision of fines and penalties, timely correction on the provisions as well as tax law and rules, utilization of the modern information

technology on the tax administration, trained and competent staff in tax administration.

This fifth chapter means in this chapter which includes the summary and conclusion of the research and finally suggestions and recommendations included.

## **5.2 Conclusions:**

1. The percentage contribution of indirect tax and direct tax to total tax revenue was fluctuating over the study period. It seems the dominant role of indirect tax revenue in Nepalese tax revenue.
2. Income tax structure consists of public enterprise, private company, individual income, remuneration, interest on tax. There is dominant role of private company which was in decreasing trend, contributes in fiscal year 2006/07 but increases in fiscal year 2012/13 to income tax. The contribution of individual income tax is in second position and it is in decreasing trend.
3. Income tax collection in Nepal is satisfactory and the percentage of income tax to government revenue is in increasing trend.
4. The income tax administration of Nepal is not effective it can impose fine and penalty as per Income Tax Act. The main cause of ineffectiveness of tax administration to impose fines and penalties can corruption, lack of competency, undue influence/pressure, complicated tax provisions, etc.
5. There are no doubt fines and penalties must be imposed to the defective taxpayers but also to control tax evasion.
6. The success and effectiveness of income tax system entirely depends up on the implementation of provision made by the Income Tax Act, which is the major responsibility of income tax administration.
7. In order to find out the role of Income Tax in collecting revenue, different provisions of fines and penalties proposed in income Tax Act, its effectiveness etc, a set of structured questionnaire were distributed to related person, i.e. tax experts, tax administrators and tax payers.

8. Income tax system of Nepal has blamed as not efficient enough due to various problems existed in income tax. For the economic development of Nepal the problems relating to income tax system of Nepal should be solved and resources should be effectively utilized.
9. Tax payer has less knowledge about the provision related to fine and penalty of Income Tax Act 2058.
10. Most of the respondents deny that they have ever paid penalties but only small percentages of respondents confess that they had paid fines and penalties.

### **5.3 Recommendations:**

On the basis of above analysis, the following recommendations have been made regarding income tax system, its administration and effective implementation of income tax.

1. Tax revenue is in increasing trends which should be managed by the government in coming days.
2. The rate of fines and penalties should be increase. The provision of fines, penalties and punishment should be made a higher rate for income tax evaders.
3. To impose fine and penalties effectively as per Income Tax Act, tax administration should be made free from corruption, motivating them through punishment and rewards system, unnecessary outside pressure should be ignored; coordination between tax personnel and department must be established.
4. Tax personnel should be encouraged, punished and transferred on the basis of their work and experience. Regular and effective trainings, seminars, rewards, prizes and punishment system should be established for the effective personnel management.

5. Effective, efficient and two way information system between taxpayers and tax authorities should be developed and maintained. Tax administration should possess multiple source of information system.
6. The provision of rewards, prize, incentives should be introduces in the act to encourages the taxpayers to pay tax voluntarily rather than through coercive matter.
7. The tax system should be practical and effective. It should match the national economic condition. It should be equally beneficial to the taxpayers.
8. Tax laws should be clear, comprehensive and simple. It should not contain any ambiguity and should be revised frequently and reformed.
9. Computerized information system should be established to keep up to date records as well as for payment of income tax.
10. To improve the tax collection procedure, maximum penalties should be imposed for non-compliance of income tax within the due date.
11. To increase the knowledge about the provision related to fine and penalty of Income Tax Act 2058. Government should organize the different programs relating to income tax.
12. Income tax policy should be made attractive also for foreign business group.