

# CHAPTER - ONE

## INTRODUCTION

### 1.1 General Background

Nepal is one of the least developed countries which per capita income about 443 US dollars. People of Nepal depend on agriculture for their livelihood. More than 80% population of this country is dependent upon the agriculture. Nepalese economy is suffering from massive poverty, rapid population growth, hunger, diseases, unemployment, inadequate infrastructure, low income level of people, foreign dependency, unutilized resources, inadequate distribution, heavy dependency on agriculture and lack of adequate industries etc.

Now a day the prime concern of every nation of the world is rapid economic development and Nepal is no exception to this ever continuing process. Nepal aims for self reliant economic system to up grade its living standard of people. Capital plays a vital role in the economic development program to solve the various socio-economic problems.

Either to play regular expenditure, maintain peace and security, launch other public welfare activities, development work, government need to sufficient fund. The funds required by the government are normally collected from two sources: internal sources or from external sources.

External sources of government revenue are foreign loans, grants, external borrowing etc. but external sources are uncertain, inconvenient and are not good for healthy development of nation because it should be paid after a certain time period. Another source of government revenue is internal which constitute tax and non tax source revenue. Non tax sources include different revenues like gifts, grants, revenues from public enterprises, administrative revenues such as registration fees, fines and penalties. Tax sources include excise duty, VAT, income tax etc.

Tax is the main source of government revenue, which plays vital role in the rapid economic development program. A tax is a personal obligation to pay tax and there is no direct relationships between tax benefit and tax payer. The primary purpose of taxation is to direct control of economic resource from the payers to the state for its own use or transfer to others. Bringing about economic growth, elasticity in the tax structure, collection fund to the state, control of inflationary and reduction of inequality are the main objectives of the tax policy. Tax is classified into direct and indirect tax. Direct tax is tax imposed to the person who actually pays it. Direct tax can not be sifted. For example Income tax, property tax, vehicle tax, interest tax, expenditure tax, death tax etc, while indirect tax is a tax imposed on one person but partly or wholly paid by another person. For example value added tax, sales tax, hotel tax, entertainment tax, excise tax, hotel tax etc.

## **Income Tax**

Income tax is a direct tax that is imposed on the earning of individual and corporation. The underlying reason for the imposition of income tax is generating revenue to financial development activities to help in achieving social justice. Income tax helps in redistributions of economic means by the transformation of wealth from person with higher economic level to lower economic level. It should minimize gap between haves and have not. Regional economic imbalances may also be reduced by providing incentives and concessions in income tax for promoting industries in backward areas. It has become an effective instrument to ensure balanced socio-economic growth. (Siwakoti, 1987, p16)

Tax also helps to increase the consciousness of the people because the people who have paid the income tax are interested on public expenditures. Though they cannot get any direct personal benefits from their tax paying, they can observe the use of the collected fund from them in the form of income tax. It is also helpful for generating the concept of social responsibility towards the nation and keeps the people vigilant to see the public money may not be misused. Income tax is essential not for collecting government revenue but also for controlling over consumption, for promoting saving and for generating more employment. The people, whose income level is under prescribed limit, are exempted from income tax liability. Income tax is basically charged for two purposes.

- Collecting revenue to meet expenses for public welfare activities.
- To create equalitarian society by minimizing the economic gap between haves and have not.

### **1.2 Focus of the Study**

The ultimate goal of developing countries like Nepal is the rapid development for the various problems created by our population. Unemployment and low standard of living capital plays a vital role in the rapid economic development programs, more money have to be spent in various projects. So, a lot of financial resources are needed for country to success in the competitive business age.

Before 1951, government of Nepal did not have any plan and policy for the economic development of the country and income & expenditure of government was not made public due the family rule of Ranas. After the dawn of democracy first in 1951, government expenditure and revenue was declared public in the first budget speech in 1952.

In Nepal after the raise of democracy deliberate planning process began only after 2013 B.S. and the huge amount of revenue was required for the planning purpose to fulfill the planning expenditure and for the process of economic development, a lot of capital was needed. Government could get capital by two financial sources.

)Internal Sources

## )External Sources

Being a developing country, sources of public revenue are very limited in Nepal. Revenue structure of Nepal mostly depends on the foreign assistance and loan but it is unfavorable to the country. Domestic resources are reliable source to keep minimum dependency of foreign aid and loan. Taxation is a major device for mobilization of internal sources. It is considered as the most effective and reliable instrument for balanced economic development and maintain economic stability. Among various taxes, income tax plays an important role in tax revenue.

Most of the developed countries like Japan, USA, UK etc are able to collect major portion of their revenue through income tax but developing countries like Nepal still have been unable to collect adequate revenue from income tax, share of income tax to the tax structure is very low in comparison to other countries. This study is focused on analyzing the contribution of income tax and finding measures to overcome the problems associated with income tax systems so as to raise its contribution towards. This study is focused on analyzing the problem and prospects raised by ITA 2002, so that contribution of income tax in the national revenue of Nepal will certainly increase in the days to come.

Mobilization of internal sources to maximum possible extent, Nepal government has widened the scope of taxes for the rapid economic development. In keeping the policy of government mind, this study has attempted to highlight the real situations and contribution of income tax in national revenue of Nepal. More specially, this study will seek answer of the following research questions.

1. What is the share of income tax in national revenue of Nepal?
2. What is the structure of income tax in Nepal?
3. What is the trend of income tax in Nepal?
4. What are the practical & effective solutions to bring about improvement in tax administration in Nepal?

### **1.3 Statement of the Problem**

When the importance of income tax is concerned, it doesn't make much difference to either developed or underdeveloped countries. But for the underdeveloped countries whose government revenue resources are very limited, like ours the income tax will have great significance. Because of social and regional or geographical difference and lack of finance in Nepal there is no condition to utilize even potential resources which could contribute significantly in total government revenue. In such condition income tax is the revenue resource, which must have given emphasis by the government to enhance its revenue.

As we know Nepal is least developed country having poor economic growth rate. So it has been facing resources gap and fiscal gap problem. Total expenditure has exceeded revenue in each subsequent year. The government expenditure is

continually rising due to weakness and large investment in selecting development projects and regular expenditure is increasing due to result increasing burden of debt servicing and salary as well as allowances of government personnel. In other words financial resource gap is the major constraint of the Nepalese economic.

Inland Revenue Department (IRD), income tax administration of Nepal, whose role is vital in income taxation, doesn't seem effective. Because of inefficient tax personnel, lack of proper record system about the income tax payers, lack of legal provision and practices to penalize the corrupt personnel, poor supervision to tax personnel, discretionary power to tax officer, inappropriate laws regarding the administration etc, become corrupt organization.

Tax evasion and carelessness of Nepalese income tax payer seems to be another major problem. When analysis with the different prospective, lack of tax information, administrative harassment, administrative harassment, zero incentive to regular tax payers, poor enforcement of fine and penalties, complex and long legal provision and process, inappropriate rules and regulation, etc are the major causes of ineffective taxation system in Nepal. To increase its contribution to national revenue research & analysis should be done in the field of income tax. But the studies & research work is lacking in the area of income tax. So to identify the problems and to overcome them and to improve income tax study in the field of income tax is essential.

#### **1.4 Objectives of the Study**

The general objective of the study is to examine the structure & contribution of income tax and its contribution to revenue generation. The specific objectives of the study are:

1. To study and examine the Income Tax Structure and its Contribution to Revenue Generation in Nepal.
2. To analyze the volume of indirect tax & direct tax in total tax revenue.
3. To examine the problems of tax administration in Nepal.
4. To suggest and recommend on the basis of major findings of the study.

#### **1.5 Significance of the Study**

Present study aims to find out the effectiveness of income tax structure & collection of revenue in Nepal. The major areas covered by this study are as follows:

- a. Being a powerful instrument of mobilizing the internal resource, the study will show the present tax structure of Nepal.
- b. For the reduction of the external dependency, Nepal has to expand the tax revenue base. This study tries to find the potential areas for direct tax, particularly for income tax.
- c. Nepalese tax structure.
- d. Role of income tax in Nepal.
- e. Government revenue from direct & indirect tax.

- f. Role of the tax administration is the crucial thing in tax system for the underdeveloped countries like Nepal. Thus, the study will briefly analyze the situation of the tax administration.

Hence the study could be useful for further researcher, University students of new generation, Government, Professional (CA, Auditors, and Teachers etc), all other interested individuals and parties.

### **1.6 Limitation of the Study**

Every study there are so many limitations in the duration of the study. The present study is not from the limitation. The limitation of the study will be following:

- ) This study will be based on the data of 15 years (from 1995/96 to 2009/10).
- ) Most of data & information will be used from secondary sources.
- ) This study will be limited up to availability data literatures.
- ) It will be difficult to complete the study within fixed period of time.

### **1.7 Organization of the Study:**

The whole study of dissertation will categories into five different chapter which are as follows:

**Chapter-1 Introduction:** This chapter will concern on the background of the study, focus of the study, statement of the problem, objective of the study, significance of the study, limitation of the study.

**Chapter-2 Review of Literature:** This chapter will deal with review of various books, journal, old dissertation, published & unpublished reports, articles, previous newspaper etc.

**Chapter-3 Research Methodology:** This chapter deals with research design, nature and sources of data, population and sample, data gathering procedures and tools of data analyzes.

**Chapter-4 Data Presentation & Analysis:** It will be the focus of the study which represents the various statically tools to present the collected data as form of tabulation, chart, graph & diagram and analysis of data by using various methods of statistics that describe in the chapter.

**Chapter-5 Summary, Conclusion & Recommendation:** This chapter will deal with the summary of the study, relevant suggestion regarding with the income tax structure & collection revenue from income tax system in Nepal.

## **CHAPTER-TWO**

### **REVIEW OF LITERATURE**

#### **2.1 Conceptual Framework and Provision Regarding Income Tax.**

##### **2.1.1 Concepts, Meaning and Definition of Income Tax**

In the present world, income tax occupies one of the most important sources of revenue in most of the countries whether it is developed or underdeveloped. Income tax is regarded as the most important tool for mobilizing internal resources whether the contribution of income tax to the government revenue may be high or low, it has got much more importance in most of the countries of the world.

To know the term 'income tax' it is better to define the term 'Income' and 'Tax' separately. Income is generally regarded, as the best measure of ability is the sense of economic well-being, for income is the primary determinant of the level of living that a family enjoys. In the broad sense, income refers to the economic gain to a particular person during a particular period of time. It includes the person's consumption during a particular period of time as well as the net increase in the individual's personal wealth during the same period. The term 'Tax' refers a compulsory contribution from a person to the government.

According to Seligman, "Taxation is the compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred."

According to Plehn, "Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefits upon the residents of the states."(Dhakal, 2002, P2)

As per the above definition, it can be said that 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. Tax payer does not expect any return for his tax paying. In conclusion it can be said that a tax is a liability to pay an amount to the state that is spent for common interest of the people. The tax is collected from haves and basically spent for the interest of haves not in the society.

In this way, income tax as the word itself refers to a tax levied on income. In a broad sense, income tax is levy based upon the production or receipts or gain of the tax payers with in a definite period of time, from the beginning, income tax has been always regarded as a tax based on the canon of ability. The tax could be adjusted as to exempt the lowest income groups from the operation of the tax and make the richer groups bear the burden of the tax according to their income. Apart from such considerations as revenue productivity, income tax has been regarded as the ideal tax from the point of view of equity.(Andley,1964,P213)

### **2.1.2 Origin and Development of Income Tax in the Internal Context**

The history of present income tax is the story of wars, confrontation and resistance. In the history of income tax low or modern income tax, Great Britain is the first country in the world that introduced income tax in 1799 A.D as temporary instrument to generate revenue required for the war finance. Actually, it was short time war aimed tax that was imposed on it's citizen's income by United Kingdom's Prime Minister William Pitt to manage the war expenditure during the French revolutionary war and at the end of war it was dismissed in 1816. But it was re-imposed for five years to strengthen national finance by United Kingdom's Prime Minister Sir Robert Pill 1842 to improve national financial condition, which was remained up to 1860 without being dismissed and from 1860 it is being imposed through the economic act in each year. In United State (U.S.A) the federal income tax was enacted for the first time in 1862 to finance civil war expenditure. After the 6<sup>th</sup> amendment in United States constitution in 1913, the modern income tax was permanently adopted. Germany introduced income tax during 1840. It was exclusively state tax that became federal tax from 1920 to 1945. In France, the efforts were begun to enact income tax in 1870. (Shahu, 1995, P10)

Italy and New Zealand introduced income tax since 1864 and 1891 respectively. Norway introduced the income tax in 1892 and Sweden accepted modern income tax on the permanent basis in 1910. Australia adopted income tax in 1915 and Canada in 1917. After First World War, the income tax became an important source of tax revenue in many developed countries. The income tax, which was started as in war period became an essential source of revenue of almost countries all over the world after Second World War.

The importance of income tax has increased day by day and by the mid of 20<sup>th</sup> century, it has not only remained as a source of revenue for emergency but has become a regular source of national revenue. (Suwal, 1981, P2)

### **2.1.3 Development of Income Tax in Nepalese Context**

Reliable records about taxation in ancient and medieval Nepal are not available. However, tax has been one of the major sources of government revenue from the ancient time in Nepal. At that time, tax on agriculture income was called "Bhaga" and tax on business income was called "Kara". There was also irrigation and religious monuments preservation taxes during the period of king Anshuverma of Nepal.

During the 1846 to 1950 A.D., the period of the Ranas, there was not formal provision for taxation. Under the family rules of Ranas, for all practical purposes, there was no difference between the personal income of ruling Prime Minister and government's fund. The main sources of the revenue in Nepal where land tax, custom tax and excise duties in the form of lump sum contracts, royalties on forest, royalties on supply of porters and soldiers, entertainment tax and few other minor taxes. (Poudel &Timilsina)

The history of modern income tax in Nepal is not very long. The concept of modern income tax was brought only by the first budget. The budget, introduced in 2008 B.S, stated about the introduction of income tax system in Nepal. But, it was actually started from 1960(2017 B.S) in the form of “Business Profit and Remuneration Tax.” The business profit and remuneration income were subjected to tax according to “Business Profit and Remuneration Tax Act 1960”. The development of income tax in Nepal can be presented with the implementation of different income tax acts with the flow of time.

#### **2.1.3.1 Business Profit and Remuneration on Tax Act 1960(2017 B.S)**

The finance Act 1960 made provision for the taxation of business profits and remuneration. In 1960 the parliament of Nepal enacted “Business Profit and Remuneration Tax Act 1960 (2017 B.S.)”. This consisted of 22 sections. Following were the main features of Business Profit and Remuneration Tax Act 1960:

- a. Only remuneration and business profit were subjected to tax.
- b. Tax on remuneration was to be deducted at source.
- c. Deductions were not specified for the purpose of calculating the taxable income.
- d. In case of default fines up Rs. 5000 were prescribed.
- e. The basis for calculating the tax liability for remuneration was income of the current year and for business profit, it was the profit at the preceding fiscal year.
- f. Income tax was assessed on the basis of tax officer’s estimation.
- g. The tax payer had a right to appeal against the tax officer’s assessment to the local ‘Bada Hakim’. If he was not satisfied with the decision, he could appeal to the ‘Revenue and Tax Court’ after depositing fixed amount.

The experience of three years indicated that the business profit and remuneration tax act was narrow and vague. So it was replaced by the Nepal Income Tax Act 1962(2019 B.S).

#### **2.1.3.2 Income Tax Act 1962(2019 B.S)**

The main purpose of the imposition of this Act was not only to raise government revenue but also to reduce inequality of income and wealth distribution with social justice and create tax paying habit of the tax payers. The Income Tax Act 1962 had 29 sections and it was amended in 1972(2029 B.S). The main features of this Act were as follows:

- a. There were nine sources of income for tax purpose.
- b. 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 kinds, agriculture, insurance business, agency and any other sources.

- c. Provision was made for payment of tax in installment as well as for advance payment of tax.
- d. Provision was made for the exemption of income tax for new industries for certain period.
- e. Provision was made for reassessment of tax as well as rectification of arithmetic errors.
- f. Certain deductions were allowed to calculate net income.
- g. The basis was specified for assessing tax on the best judgment estimate of the tax officer.
- h. The personal as well as residential status of the tax payer for tax purposes was defined.
- i. Carry forward of losses was allowed for a period of two years.
- j. The income tax assessment and collection procedures were specified along with the method of computing net income.
- k. Agriculture income was brought under the scope of income tax for the first time.

Income tax act 1962 which was amended in 1972(2029 B.S), remained till 1974 and it was replaced by Income Tax Act 1974(2031 B.S).

### **2.1.3.3 Income Tax Act 1974 (2031B.S)**

Income Tax Act 1974 had consisted 66 sections. Its basis framework was derived from previous Income Tax Act 1962. This Act was amended for eight times to make it more effective, practical and to eliminate confusing terms. His Majesty's Government (self declared) enacted Income Tax Rules 1982(2039 B.S.) in accordance to the authority given under section 65 of the Income Tax Act 1974. Some of the selected features of this Act were as follows:

- a. This act had clarified certain definitions, especially relating to Tax, assessment of tax, income year, tax payer, non-resident tax payers, firm, company, family, philanthropic work etc.
- b. The deduction allowances for computation of net income were specified for all sources of income.
- c. The head and sources of income were classified into five categories for the assessment of income tax i.e. agriculture, industry/business/profession/ and vocation, remuneration, house and land rent and other sources.
- d. It had made provision for self-assessment of tax for the first time in Nepal.
- e. Certain types of income were exempted from income tax that was specified in section 42.
- f. Life insurance premium and donation were allowed for deduction as common deduction.
- g. Carry forward of losses were allowed for three years.
- h. The processes of assessment, reassessment, advance payment of tax, deduction of tax were clearly specified.

- i. Tax payers were required to keep accounts and records for their sources of income and preserve these records for a period of six years.
- j. Progressive rate of income tax were applied

#### **2.1.3.4 Income Tax Act 2002 (2058 B.S)**

The Income Tax Act 2002(2058 B.S) is the existing law relating to income tax administration. It consists of 143 sections. This income tax act is made effective from April 1, 2002 (chaitra 19, 2058). The objective of introducing the new Act is to enhance the revenue mobilization through effective revenue collection procedure. The main motto of this Act is to promote the economic development of the nation. This Act is broad as compared to previous act. This new Act has been made in accordance with the global standard. The Government of Nepal enacted the Income Tax Rule in 2002(2059/2/27B.S). The new Act has amended certain provision of old Act and has added certain new provisions. Some of the important features of Income Tax Act 2002 are as follows:

- a. Income tax Act 2002 has amended and integrated all the laws relating to income tax in Nepal. This act supersedes all the relevant act having provision relating to income tax.
- b. This Act has divided all the sources of income in three categories i.e. employment, business and investment.
- c. Any expenses, which are incurred in the course of earning taxable income are allowed for deduction. Such expenses should be related to income year to be spent by tax payer in relation to concern transaction.
- d. Provision for the carry forward of losses has been extended for the period of 4 years for general business and special provision of carry backward of losses for banking and insurance company is provided from the profit of last 5 years.
- e. Special incentives and rebates have been provided to special industries and project relating to infrastructure development and hydro- power.
- f. This Act has fully adopted the tax system with self-assessment of tax.
- g. Only the Finance Act has got power to amend the provisions of this Income Tax Act.
- h. The income of resident person from the employment, business or investment of the year is taxable but regarding the income of a non-resident person, only the income that has source in Nepal is taxable.
- i. Tax accounting and timing, characterization of incomes, calculation of net gain from assets and liabilities, special provision of individuals, entity, insurance and banking and retirement fund are introduced for the perfection in new tax administration.
- j. This act has shortened the of eligible deduction regarding to income from employment.
- k. This Act has specified the provision regarding to taxation on capital gain and dividends.
- l. Rights of tax payers are spelled out clearly in the act.

- m. The tax payers are given the right to appeal against tax assessment to Director General of Inland Revenue Department for administrative review, are given the right to appeal to court under Revenue Tribunal Act.
- n. Pension, gratuity, Daishain allowance, Refund of retirement fund etc are also treated as taxable income for the first time.
- o. The Act has provided a stringent fine and penalty for the defaulters.
- p. All natural person is given right to claim medical tax credit and extra exemption limit has been provided for the tax payers of remote areas.
- q. Special provisions for pollution control expenses, research and development expenses and donation have been introduced with limit for treating as expenditure.
- r. The Act has introduced a pool system of charging depreciation and it is also claimable for intangible assets for the first time.
- s. This Act has made a provision of valuation of the stock of trading goods for tax purpose.
- t. Concept of international taxation has been introduced in the new act.
- u. This Act has not included the windfall nature gains under income tax system.
- v. This Act has made a provision of relaxing the submission of income statement by a person who does not have taxable income and who has the income from remuneration only.
- w. As opposed to previous income tax acts, Income Tax Act 2002 has specified the tax rate applicable to the tax payers of different categories.

#### **2.1.4 Source of Income in Nepal under Income Tax Act 2002**

Source of income are considered as main point for tax system. Computation of taxation depends upon the type and nature of income sources. In every income tax act, sources of income should be well defined. Under “Business profit and remuneration Tax Act 1960”, business profit and remuneration were taken as source of income. But Income Tax Act 1962” had divided source of income into nine categories. Similarly, under “Income Tax Act 1974”, there were five sources of income. The new Income Tax Act 2002 has classified the tax payer’s income into three main categories for the purpose of tax assessment, which are as follows:

- (a) Income from Employment
- (b) Income from Business
- (c) Income from Investment

Each sources of income has been briefly as follows:

##### **2.1.4.1 Income from Employment**

Income from employment or remuneration is one of the important sources of income under the current Income Tax Act. Remuneration means amount given to employee against the service provided by him. In case of remuneration there used to be one getting services and other providing services. The person getting service is called

employer and the person providing service is employee. Income Tax Act 2002 has defined employment as past, present or prospective employment. Income Tax Act 2058 has specified the income from employment under section 8.

### **Income Include in Employment Income.**

As per section 8 of the Act, following payments made to the employee from the employer are included in employment income:

- a) Payment of wages, salary, leave pay, overtime pay fees, commission, prizes, gifts, bonus and other facilities.
- b) Payment of dearness allowance, cost of living expenses, rent, entertainment and transportation allowance and other personal allowances.
- c) Payments providing any discharge or reimbursement of cost incurred by the individual or an associate of individual.
- d) Payments for the agreement to any condition of the employment.
- e) Payments for termination or loss of service or compulsory retirement.
- f) Retirement contributions including those paid by the employer to a recognized retirement fund in respect of the employee and retirement payments.
- g) Other payments made in respect of employment.
- h) Other amounts as given in chapter 6 of the Act, i.e. perquisites and any gains due to change in tax accounting required to be included.
- i) Other quantified perquisites:
  - i. Availability of motor vehicle wholly or partly for private purpose. However such amount will be limited only up to 0.5 percent of his salary.
  - ii. Provision of residence to employee, however this amount is limited to only 2 percent of salary.
  - iii. The amount of expenses to be paid by the employer for following facilities of the employee as reduced by any contribution in this regard made by the employee.
    - Service of house keeper, driver, gardener or other domestic assistant.
    - Any meal, refreshment or entertainment.
    - Service provided to the residence of the employee such as installation and cost of water, electricity and telephone.
    - Under payment of interest by employee to employer for loan taken by the employee.

### **Non Taxable Income under ‘Income from Employment.’**

The following incomes are excluded in calculating the employment income of an employee:

1. Amount exempt from tax under section 10 of the Act.
  - Remuneration exempted under bilateral or multilateral agreement with foreign government.
  - Remuneration under the employment of public service of foreign government.
  - Remuneration under public services of a foreign government.
  - Remuneration provided by Nepal Government to a foreign citizen under tax exemption condition.
  - Allowance paid by Nepal Government to widows, senior citizen under or disable person.
  - Gift, bequest, inheritance or scholarship except as required to be including in calculating income under sec: 7, 8 and 9.
  - Pension received by retired army or police from public fund of foreign government.
2. Final withholding payment under section 92.
3. Meals and refreshments provided in the office on behalf of an employer to all the employees on similar basis.
4. Reimbursement of expenses incurred for the employee.
5. Payment of an amount up to Rs. 500 by the employer for petty expenses.

### **Allowable Reductions**

The following payments are allowed for reduction while driving the net income from employment of an individual:

- a) Under section 63, contribution to approved retirement fund with in the limit (Rs. 3, 00,000 or one third of assessable income whichever is lower).
- b) Under section 12, donation to an approved exempt organization is deductible up to a maximum of Rs. 1, 00,000 or 5% of taxable income or actual whichever is lower. But donation given to the institutions specified in Nepal Gazette is allowed for reduction partly or wholly.

For computation of tax liability, medical tax credit of 15% of approved medical expenses plus carried forward excess amount greater than the limit can be a adjusted. However upper limit of medical tax credit for is Rs 75 per year. The remaining balance of uncovered medical tax credit can recoup in next year.

#### **2.1.4.2 Income from Business (Sec:7)**

Business means use of capital and labor to earn income. ITA, 2058 has defined business as an industry, a trade, a profession, or the like isolated transaction with a business character and includes a past, present or prospective business. But this source does not include employment income.

### **Amounts to be Included in Business Income:**

- a) Services fees
- b) Amount derived from the disposal of trading stock.
- c) Net gain from the disposal of business assets/liabilities.
- d) Gain on sale of depreciable assets used in business.
- e) Gifts received by the person in respect of the business.
- f) Compensation received in restraint of the business.
- g) Amount received by any investment that is directly related to business.
- h) Amount required to be included due to change in accounting system.
- i) Gain due to change on exchange rate.
- j) Bad debts received.
- k) Under payment of interest on loan.
- l) Compensation received against loss of stock/profit.
- m) Any benefit or perquisites.
- n) Amount received after the cessation (closing) of a business.
- o) Amount received as per completion of work under long term contract.
- p) Deducted expenditure which is not so expended.
- q) Other incomes required to be included e.g. misc. incomes, sundry income, discount, commissions.

### **The Following Incomes are Exempted from Tax of Business Firm.**

- a) Income from Agriculture (except registered agriculture firm).
- b) Income of co-operatives registered under co-operative Act 2048 related to agriculture and forestry, saving & credit co-operative based on rural community.

### **Admissible Expenses:**

The following expenses are allowed for deduction while computing income from business.

- i. **General Deduction (sec: 13):-** Expenses related to business incurred in order to generate incomes from business are fully admissible.
- ii. **Interest on Loan (sec: 14):-** The interest incurred during the year for the debt obligation of the person shall be available for deduction to the extent that:
  - a) The borrowed money is used in that year.
  - b) If the money is borrowed for purchase of an asset, that asset is used for that year.
  - c) The debt obligation is created in the production of income from business.
- iii. **Cost of Trading Stock (sec: 15):-** Trading stock includes raw material, work in progress and finished goods etc. The cost of trading stock is derived as follows:

Cost of opening stock      xxx  
Add: purchase or production during the year xxx

Less: cost of closing stock (xxx)

Cost of trading stock xxx

The cost of trading stock should be taken at cost price or market price whichever is less.

iv. **Repair and Maintenance Expenses (Sec: 16):-** Repair and maintenance expenses cost equal to 7% of the depreciation base of respective assets is admissible, if it exceeds the limit to the balance amount is capitalized in respective groups at the beginning of the next income year.

v. **Pollution Control Cost (Sec: 17):-** ITA 2002, has allowed to deduct expenses of pollution control device used in conducting the business on same year. If the expenditure on pollution control device is more than 50% of adjustable taxable income, it will be capitalized at the beginning of the next income year under block 'D'. Adjusted taxable income means taxable profit before deducting PCC, R&D expenses and Donation.

vi. **Research & Development Cost (Sec: 18):-** Research & Development cost thought these are capital nature are allowed for deduction to an extent from the taxable income. That deduction should not be more than 50% of (taxable profit before R&D expenses plus donation plus pollution control expenses). Excess R&D cost will be capitalized at the beginning of the next income year under block 'D'.

vii. **Depreciation Expenses (Sec: 19):-** Depreciation at the prescribed rate is allowed on used depreciable assets owned by the person. The group wise details and rate of depreciation are given as follows:

Group A includes building, structures & similar works of permanent nature. Rate of depreciation for this group is 5%.

Group B includes computer, data processing equipment, furniture, fixtures & office equipment. The rate of depreciation for this group is 25%.

Group C include automobiles, buses and minibus. Rate of depreciation for this group is 20%.

Group D include construction & earth moving equipments and any tangible assets not include in above groups and portion of pollution control cost and research and development cost not absorbed. The rate of depreciation for this group is 15%.

Group E includes intangible assets like goodwill, patent rights, copyright, Trade mark, software etc. For this group, rate is calculated from original cost divided by useful life of the assets.

viii. **Donation (Sec: 12):-** Donation given to any tax exempted institutions, who have registered in the Inland Revenue Department shall be deducted from the

taxable income of the person subject to the limitation of Rs. 1,00,000 or Actual amount or 5% of taxable income whichever is less.

- ix. Bad debt expenses have been allowed by ITA 2002.
- x. Taxes paid under existing Nepal Law (except income tax).
- xi. Loss recovery (sec-20)
- xii. Other real expenses.
- xiii. Common deduction:
  - ) Contribution to approved retirement fund (for natural person).
  - ) Donation to approved exempt organization.

### **Inadmissible Expenses (Sec-29)**

- i. Any personal or domestic expenses.
- ii. Income tax paid fines & penalties.
- iii. Expenses incurred for acquiring tax free income and final withholding amounts.
- iv. Cash payment for more than Rs. 50,000 at a time having annual transaction more than Rs. 2million.
- v. Expenses not related to business.
- vi. Any Reserve, Provision or Fund.
- vii. Distribution of profit by an entity (e.g. Dividend).
- viii. Other expenditure not exempted as admissible such as capital expenditure and capital loss.

#### **2.1.4.3 Income from Investment (Sec-9)**

The investment income means income generated from the use of capital. Investment means use of capital for the purpose of getting income. According to Income Tax Act, 2002 “Investment means an act of holding or investing one or more assets, of a similar nature that are used in an integrated fashion.” But it includes the act of holding assets, other than non-business taxable assets for personal use by the person owning the assets or investing amount on such assets or employment or business related income.

#### **Amounts to be Included in Investment Income.**

- a) Any dividend, interest, rent, royalty.
- b) Gain from investment insurance, gain from unapproved retirement fund or retirement payment made by an approved retirement fund (except final withholding payment).
- c) Payment received from natural resources.
- d) Amount received in lieu of any restrictions regarding investment.
- e) Gifts received by the person in respect of the investment.
- f) Income to be included due to change in accounting methods.
- g) Net gain from disposal of non-business chargeable assets of the investment.
- h) Income received from joint investment.

- i) Compensation received in investment.
- j) Excess amounts received due to change in rate variation.
- k) Received amounts paid to other.
- l) Bad debts recovered.
- m) Under payment of interest than standard.

### **Admissible Expenses and Other Consideration**

- a) General expenses related to investment (sec 13)
- b) Interest expenses (sec 14)
- c) Repair and Maintenance cost (sec 16)
- d) Depreciation allowance (sec 19)
- e) Unrelieved loss from investment/business from current year (sec 20)
- f) Unrelieved loss from business from previous year (sec 20)

Other, common deduction (Sec 12 & 63), exemption medical tax credit (sec 15), foreign tax credit (Sec 71), final withholding payment (Sec 92) & special fee as per section 16.2 finance ordinance 2060.

### **2.1.5 Tax Rates**

- The taxable income of a resident individual for an income-year 2066/67 will be taxed at the following rates:
  - Up to Rs.160,000 - 1%
  - From Rs.160,000-upto Rs.260,000-@ 15 % plus Rs.1600
  - Above Rs. 260,000 - @ 25% plus Rs.16600.
- The taxable income of a couple, if they chose to be treated as a couple will be taxed at the following rates;
  - Upto Rs.200,000-1%
  - From Rs.200,000 – up to Rs.300,000- @ 15 % plus Rs. 2000
  - Above Rs. 300,000 - @ 25% plus Rs.17000.
- The business person who have registered own Proprietary firm should not pay above 1 (one) % tax.
- For the purposes of the Act, net gains from the disposal of non-business chargeable assets will be taxed at the rate of 10 percent.
- The taxable income of a non-resident individual is taxed at the rate of 25 percent.
- The taxable income derived by an individual from special industry or export business will be taxed at the rate of 20 percent.

- The taxable income of an entity will be taxed at the rate of 25 percent unless prescribed otherwise.
- The taxable income of a bank, or financial institution, or general insurance business, or an entity conducting petroleum work under Petroleum Act, 2040 for an income-year is taxed at the rate of 30 percent.
- The taxable Income derived by an entity engaged in an industrial enterprise or export business or derived from operating any road, bridge, tunnel, ropeway, or flying bridge. Construction business or any trolley bus or tram manufacturing business is taxed at the rate of 20 percent.
- The taxable income of an entity engaged in power generation, transmission, or distribution is taxed at the rate of 20 percent.
- The repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal will be taxed at the rate of 10 percent.
- The taxable income of a non-resident person deriving income from providing shipping, air transport or telecommunication services in Nepal will be taxed at the rate of 5 percent.
- The taxable income of an entity wholly engaged in the projects conducted by any entity so as to build public infrastructure, own operate and transfer it to the HMG/N in power generation, transmission, or distribution for an income-year shall be taxed at the rate of 20 percent.
- Special industry and an Information Technology (IT) industry providing direct employment to 300 or more Nepalese workers throughout the year are taxed at 90% of applicable income tax rate.
- Special industry providing direct employment to 1200 or more Nepalese workers throughout the year is taxed at 80% of applicable income tax rate.
- Special industry providing direct employment to 100 or more Nepalese workers throughout the year is taxed at 80% of applicable income tax rate provided that it includes at least 33% of women, dalit or disable.
- Special industry established in most undeveloped, undeveloped and underdeveloped areas is taxed at 50%, 70% and 75% of applicable income tax rate for 10 years of operation.

- The income of an organization that generates electricity or generates, transmits electricity or generates and distributes electricity or generates, transmits and distributes electricity commercially within 2075 Chaitra is exempt from tax for the first seven years and then after taxed at 50% of the rate otherwise applicable. This facility is also available for the generation of electricity from solar, wind or bio energy.

### **2.1.6 Income Tax Assessment as per Act 2002**

The term assessment means the process of determining the tax liability of the assesses. Income Tax Act, 2058 has defined the term “assessment” as an assessment of tax to be paid under this Act and it includes an assessment of interest and penalty made under this Act.

Assessment applies to the act of ascertaining and adjusting the tax due as well as to the document or record in which the details of calculation and tax are noted. The assessment requires overall appraisal of the tax payer’s income tax liability for the income year with appropriate accounting of the withholding (if not final) and installment payment.

In the income tax act 1974, the term assessment is used with different aspect in different places. Sometimes it is used as a meaning of the computation of income, onetime the determination of tax liability and sometime the whole procedure laid down in the Act for imposing liability upon the tax payer. The assessment procedure of income tax according to the Act 1974 is as follows:

- ) Submission and filling of income statement.
- ) Assessment of net income.
- ) Assessment of tax liability.
- ) Tax assessment order.

While, ITA 2002 adopts fully self-assessment system. However, there are also other types of assessment to ascertain tax payer’s tax liability for an income year.

#### **Self-Assessment (Sec: 99)**

In self-assessment, a tax payer himself assesses his tax liability or self assessment is a system under which the tax payer is required to declare the basis of his assessment to submit a calculation of the tax due and usually, to accompany his calculation with payment of amount he regard as due. This type of assessment is to be made by the tax payer’s who actually have taxable income, income not exempted from tax and income is not of that type where final withholding is made. In such assessment the tax payers should show.

- ) Tax payable by the person for the year.
- ) Amount of tax still to be paid by the person for the year being the amount shown in the return.

If in case, a person fails to file a return by the due date, the person is even treated to have made an assessment on the due date for filling the return and his assessed tax for the year will be equal to the sum of the tax withholding and tax paid in installment. The department may then proceed for an amended assessment.

### **Jeopardy Assessment (Sec: 100)**

Generally jeopardy assessment is made where there is some danger of being lost e.g. where a tax payer tries to place his assets beyond the reach of the collection machinery when an investigation into his tax affairs is initiated. The jeopardy assessment is actually made according to the best judgment base under the special circumstances as when,

- ) The person becomes bankrupt, is in over debt or goes into liquidation.
- ) The tax payer is about leave Nepal for indefinite duration.
- ) The person is about to cease the ongoing activity in Nepal or
- ) The Inland Revenue Department (IRD) otherwise considers it appropriate.

Jeopardy assessment can be made either for the whole year or for the part of the year. If the assessment is made for whole year the tax payer is not required to file the return for the year. But if the assessment is made for the part of the year then tax payer is required to file the return of income for the year on due date.

### **Amended Assessment (Sec: 101)**

Amended assessment refers to the correction and assessment on the tax payers assessment by the tax authorities. Especially it is done if an original assessment is incomplete or incorrect in any material respect. The IRD may amend an assessment made by the tax payer to adjust the assessed person's tax liability. It is done according to intention of the Act. The tax officials may amend both the self-assessment and jeopardy assessment so as to adjust the tax liability. The tax officials may amend an assessment according to the best judgment for as many times as the tax officials think appropriate within a period of 4 years. The department may amend an assessment the period of 4 years at any time where the assessment is inaccurate by the reason of fraud or any unwillful neglect by or the behalf of the assessed person.

The tax officials may not amend an assessment if the assessment has been amended or reduced assessed tax by the revenue Tribunal or a court of competent jurisdiction except where the order is responded. This provision should not be a barrier to amend in the case where a far reinvestigation is issued.

Where the Department makes amended assessment the Department shall be required to serve a written notice of the assessment to the person stating.

Tax payable by the person, tax still to be paid for the income year or the period to which assessment is made.

- ) The manner in which the assessment is calculated.
- ) The reasons why the Department has made the assessment.
- ) The date on which the assessment is payable and,
- ) Time, place and manner of objecting to the assessment.

### **2.1.7 Objectives of Income Tax in Developing Countries like Nepal**

Taxation has been a very essential element of government from the very beginning of the state system. However, the main objective of taxation has been different for different era. In ancient times the major objective of taxation was strengthening the muscle of the state by providing the resources. Till the time of Adam Smith, the chief motive of collecting the revenue was to provide resources to the government for providing security to an individual and society against violence, invasion and injustice and maintaining public institution. In modern days, the main objective of taxation has been shifted from security perception to the economic development. Income taxation is the best source of revenue generation in the hands of government for the purpose of internal resource mobilization in the developing countries. Taxation serves as major tool for transferring resources from the private to public sector.

The objectives of income taxation in developing countries can be classified into three major categories: they are growth, equitable distribution and stabilization. (Poudel, 1995, P22)

- I. **The Growth Objective:** In developing countries, it is one of the major objectives of taxation policy. For the economic development of the country, there must be adequate capital accumulation to financial development programs and for accelerating the pace of economic growth. The experience of developing countries indicates that only introduction of direct tax like personal income tax constitutes to development financing in a significant way. In developing countries, tax policy should discourage the consumption of unnecessary goods and encourage the promotion of saving/income ratio and tends people towards productive investment.
- II. **The Equitable Distribution Objective:** The equity principle states that “equal should be treated equally”(horizontal equity) and “Unequal should be treated fairly”(vertical equity). Any conceivable measure of fairness leads to progression in taxation determinants up to marginal utility of income distribution. The equity objective however may conflict with the growth objective. The current emphasis on distributive aspect in development thinking provides a significant role of taxation for reducing inequalities in income wealth, consumption and employment opportunities.
- III. **The Stabilization Objective:** the policies should lead to desired stabilization in the level of prices, employment, income and the balance of payment. They should maintain reasonable stability in terms of both short and

long-term inflationary pressure and help in correcting the imbalance that occurs in the country's balance of payment position and exchange rates.

The other specific objectives of income tax are as follows:

- ) To discourage the growing tendency to invest in unproductive real estate and levy increased taxes to property owners
- ) To promote industrial development providing tariff protection.
- ) To collect some resource from established industries.
- ) To discourage the consumption of luxury good.

### **2.1.8 Administrative Aspects of Income Tax in Nepal**

Administration is the design of implementation of government policies. Tax administration is regarded as including also some responsibility for determining the policy and programs of government related to tax. Specially, it is the planning, organizing, directing, coordinating and controlling of government organizations related to taxation.

It is the tax administration that provides feedback about the effectiveness of tax policies and laws. In the hands of incompetent tax administration, good tax policy and bad tax policy may end up looking remarkably alike. Effective tax administration paves the way for effective tax policies and laws. Improved tax administration widens the choices available to policy makers and law formulators. It is easy to advise a policy but difficult to administer it effectively.

The main objectives of tax administration should be the efficient assessment, collection and enforcement of taxes legally due, without undue cost and harassment to the government or tax payer in terms of money, time, inconvenience and mental worry. The administration should not only be fair. Efficient and responsive but should also be recognized and accepted as being such. (Agrawal; 1980. P100)

Income tax management covers the whole income tax system. It includes tax policy maker (government of Nepal), Lawmaker (Parliament) and tax administration (Inland Revenue Department and Inland Revenue office) as its lower level management. Income tax administration implements the objectives of income tax and policy into practice. In this connection, income tax administration is most important element in income tax system.

#### **Administrative Structure:**

The Ministry of Finance is at the apex of tax administration. The Ministry carries out the functions related to taxation on behalf of the Government of Nepal. the Revenue Department of Ministry is responsible for formulating tax related policies.

Inland Revenue Department is formed in 2058 B.S by merging the Department of Taxation and the Department of VAT. Tax administration includes Director General,

Deputy Director General, Chief tax officers, tax officers, other officers and other staff. The head of Inland Revenue Department is Director General, a gazette first class officer, who is assisted by two Deputy Director Generals and one liquor specialist, who are also gazette level first class officers, 20 gazette level second class officers including chartered accountants and economist and 43 gazette third class officers. There are 21 Inland Revenue Offices all over the Kingdom of Nepal.

### **2.1.9 Problems of Income Tax Administration in Nepal**

From the very beginning the contribution of income tax to the revenue of the government has been minimum. This is because the income tax system in Nepal has been facing many problems. The inefficiency of income tax administration is one of the reasons. Income tax management in developing countries like Nepal has been facing many problems. The contribution of direct tax and income tax to the public revenue is very low to meet the growing public expenditure. Nepalese government has been using deficit financing. As the consequence of this, there is significant resource gap in Nepalese budget. The problem can be avoided only when the problems of tax administration are identified and corrective actions should be taken immediately. The major problems, which the income tax administration in Nepal has been facing, can be discussed as follows: (Lamsal; 2002, P.27)

#### **1. Failure to Locate New Tax Payers:**

The tax administration could not succeed to locate new taxpayer roll of existing as well as potential taxpayers due to lack of potential taxpayer who remain outside the income tax coverage. The major problem in locating new taxpayer's is in the case of non-resident and non-citizen who remain virtually outside the income tax net. The open border with India has compounded this problem. Other potential taxpayers who have remained outside the income tax coverage are brokers, speculators, suppliers in big hotels, dealer of foreign goods, tourist guides, insurance agents and persons representing international companies. The self-employed persons especially professionals and skilled persons, have also remained outside the effective reach of income tax net.

#### **2. Failure to Maintain Proper Accounts and Records:**

There is difficulty in collecting income tax because most of the taxpayers do not maintain proper accounts for income tax purpose. In Nepal the income tax assessment is based on accounts and records but the record keeping system is very poor and not scientific. A large majority of taxpayers in the private sector, who maintain accounts, keep more than one set of books. The set presented for tax purpose generally does not give the true and fair view of the financial state of affairs of the taxpayer. The main reasons for the non maintenance of account are:

- ) The attitude of the tax officer is not conducive to the development of the habit of maintaining account of any of the taxpayers.
- ) Tax assessments by committee or best judgment method discourage the maintenance of proper accounts by taxpayers.

- ) The ineffective uses of sanctions provided in the law against those taxpayers who fail to comply with the accounting and reporting requirement of law have encouraged non-maintenance of accounts.
- ) Professional accountants, tax consultant and tax lawyers are invaluable aids in the maintenance of accounts. But such intermediaries have not received adequate encouragement and support from the tax administration.

### **3. Assessment Delay:**

Assessment delays have appeared as a serious disease in tax administration. The major reasons for delay in assessment are listed as follows:

- ) Widespread delays in filing of income tax returns,
- ) Lack of proper recording system in tax offices,
- ) Lack of meaningful information of taxpayers,
- ) Frequent changes in the identity of taxpayers,
- ) Defective assessment procedures,
- ) Filing of appeals,
- ) Procrastination by tax officer etc.

### **4. Collection Delinquency:**

The collection function of income tax in Nepal has demonstrated serious gaps and delinquencies. The main reasons for collection delinquency appear to be the following.

- ) Undue delays in assessment,
- ) Non-compliance by tax payers.
- ) Lack of collection responsibility.
- ) Reluctance to use fines and penalties,
- ) Complicated collection procedures,
- ) Failure of public sector enterprises to pay the tax, under delays in settlement of appeals,
- ) Defective accounting system in tax offices etc.

### **5. Poor Tax Payers' Compliance:**

Nepalese people have a tradition of paying indirect taxes and land taxes; they do not seem to accept the payment of income tax as a normal way of life. The sense of social responsibility in terms of tax payment is lacking. Tax administration expects that every taxpayer will automatically fulfill his obligation under the law. It does not, however, take it seriously as a duty to educate and inform the taxpayers as to their rights and duties under the law. The main reasons for lack of meaningful taxpayer compliance in Nepal can be listed as follows:

- ) Lack of tax payer education,
- ) Complicated laws and procedures,
- ) Delays in assessments,
- ) Unhelpful attitude of tax personnel,

) Lack of research in tax matters etc.

#### **6. Lack of Trained and Competent Tax Personnel:**

Regular training is essential to the personnel to increase knowledge, skill and technique of administration and improving their skill morality. Although Revenue Administration Training Center was established in 1980 with the objective of providing necessary training in revenue administration but the center is not being able to achieve the desired goal. In fact there is lack of trained and competent tax personnel in its administration.

#### **7. Lack of Motivation in Tax Personnel:**

The next problem of income tax administration is the lack of motivation in tax personnel, which causes lack of responsibility and honesty among tax officers. Tax personnel are not provided special allowance, incentives or reward for better performance. Poor state of motivation has adversely affected the initiative, moral and productivity of tax personnel. The potential of tax personnel has largely remained unutilized.

#### **8. Existence of Corruption:**

Lack of integrity and honesty in tax personnel lead to corruption that is the chronic disease of tax administration in Nepal. Corruptions reduce the revenue and distress the tax paying habit of taxpayer. The tax officials have practiced corruption in great extent but they are rarely punished.

#### **9. Complicated Tax Laws and Procedures:**

Tax laws in Nepal are complicated for average taxpayers. An average taxpayer in Nepal does not know the tax liability and the reference to the tax law.

#### **10. Instability in Government Policy:**

During the last twelve year, Nepal is facing a serious problem of political instability. During this time period, the government has been changed frequently. Each government holds different economic policies. As the result of this, the policy towards the income tax also changed with the change in the government. In such instable situation, the income tax management cannot perform effectively.

#### **2.1.10 Income Tax Evasion in Nepal**

There are different ways of reducing tax liabilities. Tax evasion is the way of reducing tax liability by illegal means. It is done through different ways like non-reporting income, under reporting of income, making fraudulent changes in account book, operating business transactions under different names, opening bank account in dummy name, over reporting of exposes, fragmentation of income etc. Tax evasion is unethical, illegal and uneconomic activity of not paying tax is against moral ethics. It

is illegal because the law does not permit to evade the tax. In the same way, it is uneconomic because it promotes black money i.e. under ground economy in a country. Such types of activities do not promote healthy economy in a country.

Tax evasion concerns illegal avoidance of taxes. It is an illegal activity in which a taxpayer seeks to hide taxable income or claim unauthorized tax deductions. In tax evasion taxpayer escapes or reduces tax liabilities in deceit way. In tax evasion, most of the taxpayers misinform or not inform to the tax authority. In a sentence, an illegal strategy to decrease tax burden by underreporting income, overstating deductions or using illegal tax shelters is tax evasion. (K.C 2007, P438)

Basically, the reasons of tax evasion can be divided into two category i.e. non tax factor and tax factors. Non- tax factors include educational background, price policies of the government, government rules and regulation, public sector salaries, government's expenditure policy and other. Tax factor include tax rate, tax base, tax structure, penalty system, probability of detection, magnitude of the strictness of penalty and possibility of applying penalty if evasion is detected. Mainly, tax factors are more concerned with the tax evasion on income from legal activities where as non tax factors are related with illegal activities.

Income tax evasion has been paralyzed all over the world, whether it is developed or underdeveloped countries. But the people of the underdeveloped countries have high practice towards tax evasion. There is widespread evasion in income tax in Nepal, especially due to poor tax paying habit, administrative difficulties and defective laws. Tax evasion is increasing day by day due to the low standard of education of tax responsibility among taxpayers. (siwakoti; 1987. P14)

Income tax evasion should be controlled effectively becomes it has serious affects to the economy. Income tax evasion affects negatively to the economic position as well as the social status of a country. If income tax evasion is not controlled, Nepal can never solve its problems of resource gap either it increase its tax rates or applies new sources of tax. (Subedi; 1982. P17)

#### **2.1.10.1 Ways of Tax Evasion:**

The important ways used in tax evasion in Nepal are as follows.

(Agrawal; 1980. P124)

- ) Concealment of source of income
- ) Concealment of income with in a source of income (i.e. understatement of income)
- ) Misrepresentation of facts and information
- ) Falsification of accounts and records (rigging of invoices, fictitious payments, payments of bills twice etc)
- ) Incorrect claim for allowances and deductions

- ) Profit shifting, cost shifting or price transfer
- ) Artificial contract for commission, discount
- ) Over and under invoicing
- ) Over statement of expenses
- ) Fraudulent transaction
- ) Fictitious transactions
- ) None reporting of income earned from illegal activities likes smuggling corrupt business practice etc.
- ) Maintenance of multiple sets of books of accounts and submitting the manipulated set for taxation purposes.
- ) Deliberate failure to maintain accounts and records and get the tax assessment done as a ‘Committee’ or best judgment basis etc.

#### **2.1.10.2 Causes of Tax Evasion**

The main causes for widespread evasion of income tax in Nepal can be listed as follows:

(Agrawal; 1980. P126)

- ) Corruption by tax officials
- ) Widespread illegal business activities
- ) Reluctance of tax payers to maintain accounts
- ) Higher marginal rates of taxes
- ) Ineffective use of fines and penalties
- ) Inadequate auditing and investigation
- ) Difficulties in locating tax payers
- ) Lack of support from public
- ) Poor development of corporate sector
- ) Poor development of intermediaries
- ) Unnecessary interference by influential persons
- ) Unlimited convertibility of Indian currency
- ) Prevalence of scheduler taxes on income

#### **2.1.11 Problems of Resource Gap in Nepalese Economy**

Nepal has been facing a serious resource gap problem in her finances from the beginning of her developmental phase to the present time. To fulfill this growing resource gap, a large amount of external aid, loan and internal loan was borrowed but the scarcity of resource seems to be never ending problem for Nepal. Scarcity of resources has constrained the realization of development programs in developing nations. Economic survey and budget speech provides a picture of the growing resources gap in Nepalese finances.

The increasing magnitude of resource gap clearly indicates that there is an urgent need for mobilizing additional sources. The main reason for the growth of resource gap is that the expenditure requirements of the government are growing at a much faster rate than its ability to mobilize additional resources. The following may be listed as the specific reason of resources gap in Nepal. (Agrawal; 1980, P9)

- Significance expansion of regular government activities,
- Significant increase in the development expenditure,
- Increasing costs of maintenance,
- Increasing burden of debt servicing charges,
- Increasing government investment in public sector enterprise,
- Government support to public and private sectors,
- Rising inflation etc.

There is need of huge amount of financial resources to fulfill the growing expenditure requirement but it is scarce in Nepal. The external resources have carried on most of the development expenditure program. Nepal should make efforts at mobilizing the internal domestic resources. For this, the following major factors have constrained domestic income mobilization in Nepal.

- Poor utilization of the natural resource base,
- Small and stagnant industrial sector,
- Poor performance of public sector enterprises,
- Poor economic growth,
- Inadequate tax effort,
- Deficient tax system,
- Lack of data base,
- Undue pressure from political and vested interest group etc.

## **2.2 Review of Related Study:**

### **2.2.1 Review of Thesis**

Padmanatha Pandey (2010), conducted a study entitled, “A Study on Income Tax Management in Nepal: A Case Study of Corporate Income Tax.” The objectives of his study were to study and evaluate the status of income tax as a major source of revenue, to examine the Nepalese income tax structure, to review and analyze the trend of income tax collection and tax revenue, to identify the factors to increase tax paying habit of income tax payers, to evaluate the problems of income tax management and provide suggestions to the concerned on the basis of study findings. Moreover he has identified that the major problems of income tax management in Nepal are: misuse of power by the tax administrator, lack of training facility to the employee, lack of sufficient power to the tax administrator, less consciousness of taxpayers. He has suggested that income tax system will be successive if the system were widening of tax coverage, tax consciousness to people, minimize the evasions

and avoidance problem, enhance the self assessment system and over staffing is to be controlled etc.

Mr. Karna Bahadur Baidawal (2009), presented a MBS thesis entitle “Effectiveness of Income Tax System in Nepal” describe the conceptual framework legal provision, composition of total revenue in Nepal, problem of resources gap in Nepal. Public awareness towards income tax system in Nepal, an empirical investigation and effectiveness of tax system in Nepal. He undertook the research work to find out the problem regarding to revenue expenditure. The main objectives of his study were to analyze the effectiveness of income tax system in Nepal, to evaluate the contribution of income in national revenue, to evaluate present income tax administration etc. he found that income tax could be used as positive collection, to develop the economic condition of Nepalese people.

Shiv Shankar Yadav (2009), presented a MBS thesis entitled “A Study Income Tax Contribution to Government in Nepal” concentrated his study mainly on the contribution of various tax as percent to GDP. The main objectives of his study were to analyze structure of revenue collection of income tax in Nepal, to examine the ratio of income tax revenue to GDP, total revenue and direct tax revenue. To access the exemption limit of income tax in Nepalese etc. His study show that the income tax revenue is increasing each year. It is positive indication for future mobilization of internal resources. Tax payer also is increasing each year that has winded the tax payer’s circle.

Mr. T. Poudel (2008), presented a dissertation entitled “Income Taxation in Nepal: A Study of its Structure and Productivity.” The objectives of her study were to analyze the structure of income tax in Nepal, to estimate the elasticity and buoyancy of income tax in Nepal, to assess the role of income tax administration in Nepal, to evaluate the success of voluntary disclosure income scheme (VDIS) program in brief and to provide the suitable recommendation for improving the scenario of income tax. She has found that overall revenue of Nepal showed and annual growth of 16%. Indirect taxation has more significant contribution in total tax revenue, income tax occupied the first rank among the direct taxes, personal income tax slabs has been changed radically from seven slabs in 1975/76 to two slabs in 1999/2000. VDIS couldn’t attract more potential taxpayers in to tax net due to lack of good planning and adequate homework of the government, working procedure of the tax administrators are still traditional and cost of administration has not been brought to the satisfactory level.

Mr. Bhisma Prasai (2007), has presented a dissertation “Revenue Collection from Income Tax in Nepal: Problem and Prospects” included focus effect of different income source of government revenue, the individual was the dominant out of other direct tax collection. Emphasized efficiency of Nepalese tax system depend upon the factors were income tax policies, income tax laws and income tax administration. And juxtaposing economic policy with tax policy is essential for achieving higher

productivity of taxation. Further he tried to show administration aspects is urgent need to be improved as well as enough concern should be given to research and development function to improve tax system or exploitation of possible sources of revenue. Widening VAT that not equity, imposing similar tax rate to resident and non-resident company, incentives package to honest tax payer and skilled persons were required to sound administration were major immediately focused to collect revenue from income tax in Nepal.

P. Bhatarai (2007), has prepared a dissertation “Contribution of Income Tax from Public Revenue of Nepal (with reference of NTC)”, with objectives to examine the effectiveness of corporate income tax imposition in Nepal and to recommend an optimum model of corporate income tax system for Nepal. In this study, he has found out that there is lack of balance between rights and duties of tax officer and tax payer. There is also frequent change in income tax act and finance act. There is lack of balanced delegation of authority, responsibility and accountability. Poor rewards and punishment system and lack of balanced delegation of authority, responsibility and accountability. Poor rewards and punishment system and lack of systematic evaluation and control mechanism are the drawbacks of the tax system. And develop job description and specification of tax personnel on the bases of specialization: encourage tax payers through tax education and awareness programmed, social reorganization and respect.

Mr. Damsi Ram Bhandari (2006) submitted a dissertation named “Taxation Knowledge of Taxpayers in Nepal.” He had pointed out the present position of taxation knowledge of taxpayer’s in Nepal. Taxpayers don’t know about the rapid change government policy etc are the main problems of the study. Similarly, he has suggested to the government and other sector to improve taxation knowledge in Nepal. His major suggestions were as follows:

- ) To increase the income tax knowledge of taxpayers’ tax related information should be published regularly.
- ) Special taxpayer education program is necessary for employees and small taxpayers.
- ) Professor, researchers, taxpayers, taxes experts should be taken while making tax policy.
- ) The school as well as campus level curriculum should be including tax related education so that taxpayer’s education program can be more effective.

Mr. Tek Raj Poudel (2006) conducted a research entitled “Role of Income Tax in National Revenue of Nepal”. The major objectives of his study were to study role of income tax in revenue of Nepal, evaluate prevailing income tax system and examine issues relating to income tax. The major findings of study were as follows:

- ) There was dominant contribution of tax revenue over non tax revenue to the total revenue of Nepal; contribution of tax revenue was in increasing trend.
- ) The Tax-GDP ratio of Nepal was not found satisfactory compare to other developing countries.
- ) Nepalese income tax system is facing problems during tax collection such as: lengthy assessment process, lack of sufficient incentives to employees, inadequate power to income tax administrators and lack of experts in tax management, more tax evasion.
- ) Tax payer were facing problem while paying tax because of misconduct of tax personnel, administrative harassment and complex tax law and rules.
- ) Reforming and controlling present taxation system, controlling open border with India, preventing illegal business, making effective administration, increasing tax coverage can contribute positively to the present tax system of Nepal.

Mr. Dharma Raj Shakya (2004), in his dissertation “A Study on Income Tax Set 2002” has tried to analyzed difference between income tax set 1974 and 2002. Similarly he described what the main provisions in the new ITA 2002 are and concerned to examine the simplification of income tax assessment procedures, effectiveness service by tax administration to the tax payers, duties and responsibilities of tax payers and tax administrators, provision regarding to minimizing corruption in the tax administration under the act.

Miss. Jayanti poudel (2002) submitted a dissertation entitled “Income Taxation in Nepal: A Study of its Structure and Productivity”. She has explained that with in the direct tax, income tax was the largest sources, which contributed more than 86% in 1990/2000. The contribution of income tax to direct tax has increased significantly since its introduction. The elasticity and buoyancy coefficient of income tax had between fund to be 0.61 and 1.36 prospectively during the period 1975/76 to 1999/2000. This shows that Nepalese income tax was very inelastic and there minimum chances far further discretionary changes.

Mr. Bharat Kumar Lamsal (2001), presented MBS dissertation entitled “A Study on Contribution of Income Tax Government revenue”. His research had mainly focused on removing and controlling income tax evasion for better resource mobilization. As has main objectives was to analyze the impact of income tax evasion in government revenue of Nepal, has set further objectives which were to identity the was and causes of income tax evasion, to estimate the volume and tendency of Nepal income tax in utilizing the source in Nepal.

Miss Binita Shrestha (2001) submitted a dissertation entitled “Revenue Collection from Income Tax in Nepal, Problem and Prospects”. She has analyzed the

effectiveness of income tax collection policy, examined the problems of revenue collection from income tax and recommended measures for improvement of income tax law and management in Nepal. She has found that the level of income tax collection has been rising. Income tax system of Nepal is suffering from various problems such as narrow tax coverage, mass poverty of Nepalese people, lack of conscious taxpayers, inefficient tax administration, instability in government policy etc.

### **2.2.2 Review of Books**

Dr. Govinda Ram Agrawal (1980) wrote a book entitled, “Resources Mobilization in Nepal”. Dr. Agrawal in his book, details explain about resources mobilization through income tax. Nepalese fiscal policy, effective tax system and tax policy, income tax system in Nepal, rule of income tax in Nepal. His main contribution from this book is concerned to the empirical investigation of factors and figures about the income tax in Nepal. Dr. Agrawal analyzed the fast growing resource gap problem in Nepalese financial and further notified that constraints for domestic resources mobilization were poor utilization of natural resources, base small and stagnant industrial sector, partial monetization of economy growth, deficiencies in tax policies, laws and administration etc. To overcome such problem of resource gap, he has recommended mobilizing additional financial resources from domestic sources to finance raising expenditure of the government. (Agrwal; 1980)

Mr. Kamal Dep Dhakal (2002) wrote his revised edition of his book, “Aayakar Tatha Ghar-jagga Kar Sambandhi Kar ra Lekha”. This book was based on Income Tax Act, 2031. This book is very much useful in getting knowledge about history of taxation and the practice under the previous Act. (Dhakal; 2002)

Mr. Ishower Bhattraai and Girija Prashad Koirala (2003) published two books named “Taxation in Nepal” and “Tax law and Tax Planning”. First book has been designed in conformity with the syllabus of BBS 3<sup>rd</sup> year and the second one has been designed based on the syllabus of MBS 2<sup>nd</sup> year. These books have been much more practical problems and solutions regarding income tax assessment from different group of income. Basically is focused on the provision, rules & regulation of ITA 2002. (Bhattraai & Koirala; 2003)

Prof. Dr. Chandra Mani Adhikari (2003) wrote a book entitled, “Modern Taxation in Nepal: Theory and Practice”. This book also has been written according to the syllabus requirement of different faculties. Especially, the BBS 3<sup>rd</sup> year syllabus of Tribhuvan University has been taken into consideration. Income Tax Act, 2058 as amended by Finance Ordinance, 2060 has also been included. Theoretical as well as practical aspects have been put in the book.

Puspa Raj Kandel (2003) wrote a book entitled, “Tax Laws and Tax Planning in Nepal”. The book is based on Income Tax Act 2058 and is published in the year 2003. Besides the Act 2058, the book included Value Added Tax also. This book is prepared

for the requirement of MBS syllabus of T.U. The book contained enough partial problems and examples to give complete knowledge of Income Tax Act (Kandel; 2003)

Mr. Bidhyadhar Mallik (2003) published a book entitled, “Nepal ko Adhunik Aayakar Parnali”. This book is very much useful to anyone who is interested in the subject of taxation. This book especially deals with thorough analysis of Income Tax Act, 2058 with example. Every section of income tax act has been clarified with suitable examples. He had written about the development of existing income tax and need and important of income tax in Nepal. The new provision made by Income Tax Act, 2058 about tax base, computation of income, tax exempt amount, deduction allowable, accounting of tax, capital gain and international taxation. And also tax auditing has been clarified precisely in his book. (Mallik; 2003)

Mr. Biswadeep Adhikari (2003) has presented a book named “Income Tax Law: Then and Now”. In this book, he has clearly presented historical aspects and development of income tax in Nepal. Similarly he has explained legal provisions of the newly implemented ‘Income Tax Act 2002’ in very simple words. He has presented both positive and negative aspect of new income tax system very clearly, which has helped a lot for conducting research study.

Mr. Surendra Keshar Amatya, Dr. Bihari Binod Pokharal and Rewanta kumar Dahal (2004) wrote a book entitled “Taxation in Nepal”. This book has been written to fulfill the course requirement of Tribhuvan University. It is based on the symbol of Bachelor level of Management/Law, CA and also for Master level of Management. This book has defined all the terms relating to income tax and value added tax. The examples presented in the book are help to reading to know more about provision and procedures of ITA 2002. (Amatya, Pokharel, Dahal; 2004)

Jit Bahadur K.C (2007) wrote his revised entitled, “Tax Laws and Tax Planning: Theory and Practical”. He has presented practical as well as theoretical aspects on taxation in this book; it inclusions and exclusions from business and investment income, deductions allowed in calculation of taxable income, basis timing and accounting issues and characterization of income. (K.C; 2007)

In this way various books, thesis, report and articles published in journals and newspaper are reviewed while preparing this thesis. Most of the books related with income tax provisions and laws, and extremely based on Tribhuvan University (T.U) syllabus requirement of T.U. Almost dissertation were written on different aspects of income taxation.

## **CHAPTER- THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter is developed to the research methodology applied in the study for the achievement of the specified objective. Both primary as well as secondary sources of data are used in the study. An opinion survey technique was adopted while collecting primary data. Questionnaires were distributed to income tax experts, income tax administrators and income tax payers so as to know their opinion towards various aspects of Income tax. Economic survey was used as the major source of secondary data. Different statistical tools are used to analyze the data.

#### **3.2 Research Design**

This study includes three types of research. They are as follow:

- a. Descriptive Research
- b. Analytical Research
- c. Empirical Research

To achieve the objective of the study, the study of Income Tax Act, Finance Act and other related acts, rules & regulations are made for descriptive & analytical research. For an empirical research, an opinion survey has been conducted. The opinion of various respondents associated with distinct denomination i.e. tax administrators, tax experts and tax payers are collected through structured questionnaire with reference to income taxation in Nepal. The questionnaire includes the specific objective of income taxation, problem relating to income taxation, duties & responsibilities of tax administration & tax payers & administration in Nepal.

#### **3.3 Population and Sampling**

All the tax experts, tax administrator and tax payers in Nepal are considered as total population. Out of them, the tax experts, tax administrator and tax payers in Katmandu valley are considered as target population. Sample size has selected from the three different groups of respondents. The following table shows the group of respondents and sample size.

### Group of Respondents and Sample Size

Group of Respondents	Sample Size
Income Tax Experts	25
Income Tax Administrators	25
Income Tax Payers	25
Total	75

### 3.4 Nature and Sources of Data

The data used in the study are taken from both primary & secondary sources. In order to achieve the real and fact full result, all the possible and useful data as far as available have been collected. The major sources of the data are as follow:

**a) Primary Source of Data:** The primary data have been collected through structured questionnaire from three groups i.e. tax administrators, tax experts and tax payers. Interview is also conducted for the collection of relevant information from related department and office.

**b) Secondary Source of Data:** Secondary data and information are obtained from various sources specified as below, which are analyzed from FY 1995/96 to FY 2009/10.

- ) Budget speech & economic survey of various years. Ministry of finance, government of Nepal.
- ) Reports and records of Inland Revenue Department.
- ) Dissertation related to income tax.
- ) Books related to income tax.
- ) National newspaper & journal.
- ) Library of different campus and central library of Kirtipur.
- ) Website of IRO [www.ird.gov.np](http://www.ird.gov.np)
- ) Website of MOF [www.mof.gov.np](http://www.mof.gov.np)
- ) Other related records and data.

### **3.5 Data Collection Procedure**

Data and information used in this study is collected from primary and secondary sources. To get accurate and actual information in time, all questionnaires are distributed and collected personally through field visit.

### **3.6 Method of Data Processing**

For the analysis, all the collected data and information of various aspects of income tax are arranged in order. Then the descriptive tools and statistical tools such as simple percentage, simple average, graphs, diagrams and rank correlation etc have been applied in the way of analysis so that the finding could be presented and interpreted properly in order and clear. In primary data analysis, some hypothesis has been tested to know whether there is significant difference between the opinion of tax administrators and taxpayers.

### **3.7 Weight of Choice**

The questionnaire asked for either to give Yes/No response or to give their opinions. Respondents were also given alternatives to rank. In this case, the first preferred choice got the highest point and the last preferred choice got the lowest point. For example if there are five alternatives, the most important ranked by the respondents gets 5 points and the least important alternative ranked by the respondents gets 1 points.

### **3.8 Statistical Tools**

Presentation style such as tables, graphs, diagrams etc are used to present the collected data. For the purpose of analysis of data, the analysis has been done by using statistical tools such as:

- i. Simple Percentage
- ii. Simple Average
- iii. Rank Correlation.

## **CHAPTER – FOUR**

### **PRESENTATION AND ANALYSIS OF DATA**

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

This chapter, data presentation and analysis is the main body part of the dissertation. It represents the all data which are relevant to study and analysis by the table, diagram and other statistical tools. So this study has been presented different data from different sub heading of fulfilling the mentioned objectives. Towards, the end of this chapter, empirical investigation based on opinion survey has been presented with relevant subtopics.

##### **4.1.1 Structure of Income Tax in Nepal**

Nepalese income tax structure is formed by combination of income tax from public enterprise, private corporate bodies, individuals, remuneration and tax on interest. Here, public enterprises include 100 percentages government ownership. Private corporate bodies' means public limited companies, individuals denote sole traders, partnership and private companies. Remuneration refers to salaries earned by government and non-government sectors employees.

The structure of Income Tax in Nepal has been presented in table no 4.1 from fiscal year 1995/96 to 2009/10. The table shows that total income tax revenue has increased in every fiscal year from 1995/96 to 2009/10. It has increased from 3431.4 million to Rs. 32982 million in the study period.

The contribution of income tax from individual has occupied first position in total income tax revenue. The trend of this tax is increasing except in the year 2002/03. It was increased from Rs. 1470.1 in year 1995/96 to Rs. 9598.7 in year 2009/10. The maximum contribution of Rs. 9877.5 million in the year 2008/09.

Income tax from private corporate bodies has occupied second position regarding its contribution in total income tax revenue of Nepal. It has also increasing trend in the every fiscal year except 2001/02 and 2002/03, from Rs. 563.9 million to Rs. 10212.3 million from fiscal year 1995/96 to 2009/10.

Income tax public enterprises is occupying third position in total income tax revenue. Except year 2001/02, 2002/03 and 2004/05, its contribution has been increasing. The maximum contribution of Rs. 9591 million in the year 2008/09.

Income tax from remuneration has occupied fourth position in total income tax revenue. It has also increasing trend in the every fiscal year of the study. The

contribution of income tax by remuneration has drastically increased from Rs. 133.1million in FY 1995/96 to Rs. 3920 million in FY 2009/10. Finally the contribution of income tax from tax on interest has occupied fifth position in total tax revenue. It is also increasing trend in the study period 1995/96 to 2009/10. The minimum contribution from this in year 1995/96 is Rs. 119.8 million and maximum contribution is Rs. 2154 million in FY 2009/10.

**Table no. 4.1**  
**Structure of Income Tax in Nepal**  
**(Fiscal Year 1995/96 to 2009/10)** **(Rs. In Million)**

Fiscal Year	Public Enterprises	Private Corporate	Individual	Remuneration	Tax on Interest	Total Income Tax
1995/96	1144.5	563.9	1470.1	133.1	119.8	3431.4
1996/97	1231.1	858.4	1711.4	168.1	154.8	4123.0
1997/98	1317.8	925.1	2120.8	322.2	212.2	4898.1
1998/99	1526.5	1155.0	2772.7	396.5	319.5	6170.2
1999/00	2198.5	1329.3	3016.4	451.5	414.4	7420.6
2000/01	2928.0	1924.3	3200.5	597.3	463.9	9114.0
2001/02	1769.3	1412.0	4419.1	835.6	467.7	8903.7
2002/03	1251.0	1236.3	3362.2	1252.6	864.0	7966.2
2003/04	2056.6	1531.3	3533.4	1391.2	733.4	9245.9
2004/05	1332.4	2467.8	3926.3	1675.9	757.0	10159.4
2005/06	1957.0	3404.3	4234.7	1764.1	774.9	10373.7
2006/07	1019.7	5717.1	5234.4	2007.9	1054.9	15034.0
2007/08	2046.0	7186.5	6381.2	2451.0	1087.9	17311.2
2008/09	9591.0	9425.1	9877.5	3195.6	1685.1	33774.3
2009/10	7097.0	10212.3	9598.7	3920.0	2154.0	32982.0

Source: Economic Survey, MOF/GON

So above analysis shows that the trend of income tax has been increasing in every fiscal year. It is better for the economic development and revenue collection for the underdevelopment country like Nepal.

#### 4.1.2 Structure of Government Revenue in Nepal

The structure of public revenue in Nepal has been presented in table 4.2(A) from FY 1995/96 to 2009/10. The table shows that the public revenue in Nepal is structured by different taxes such as custom duty, excise duty, sales tax/VAT, income tax, land revenue and registration, miscellaneous tax revenue and Non tax revenue.

Among various tax and non tax revenues sales tax/VAT, has occupied the highest position. The revenue from VAT is increased from Rs. 6431.3 million to Rs. 49668.2 million from FY 1995/96 to 2009/10. The average contribution of VAT to total revenue for last 15 years is 25.18 %.

Custom has occupied second position among the tax revenue. Revenue from custom varied from Rs. 7327.4 million to Rs. 33069.9 million from FY 1995/96 to 2009/10. The average contribution of custom to total revenue for last 15 years is 23.36%.

Similarly Non tax revenue has occupied the third position regarding its contribution to total revenue. Its contribution was Rs. 6225.1 millions in FY 1995/96 and Rs. 22683.4 millions in FY 2009/10. The mean contribution of non tax revenue over the 15 years comes to be 20.79%.

Income tax has occupied the fourth place regarding its contribution to the total revenue. It has share of Rs. 3431.4 million and Rs. 32982 millions in FY 1995/96 and FY 2009/10 respectively i.e. 12.30% contribution in FY 1995/96 and 19.27% contribution in 2009/10. The percentage contribution has been fluctuating but amount contribution in total revenue has been increasing per year except for certain years. The mean contribution of income tax in total revenue is 16.23%.

Excise duty has the fifth share in total revenue. In FY 1995/96, Rs. 1944.3 millions of total revenue was collected from excise. It has increase Rs. 1944.3 million to Rs. 22078.9 million from the FY 1995/96 to 2009/10 respectively but the percentage contribution of excise to total revenue has declined. Its mean contribution has been 9.57% of total revenue for the 15 year period.

Land revenue and registration has the sixth place to the total revenue. Its contribution in FY 1995/96 and FY 2009/10 was Rs. 1066.6 millions and Rs. 5680.9 millions respectively. Its contribution has been 4.77% of total revenue for the 15 year period.

Finally, miscellaneous tax occupied last position among the tax revenue. Its contribution in FY 1995/96 and FY 2009/10 was Rs. 1467 millions and Rs. 4943.1 millions respectively. But the percentage contribution of miscellaneous tax to total revenue has declined from 5.25% to 2.88%. Its average contribution to total revenue for the 15 years period is 2.63%.

**Table no. 4.2(A)**  
**Structure of Government Revenue in Nepal**  
**(Fiscal Year 1995/96 to 2009/10)**

**(Rs. In Million)**

Fiscal Year	Customs	Excise	Sales Tax/VAT	Income Tax	Land Revenue & Reg.	Misce. Tax	Non-Tax Revenue	Total
1995/96	7327.4	1944.3	6431.3	3431.4	1066.6	1467.0	6225.1	27893.1
1996/97	8309.1	2298.1	7126.5	4123.4	1015.4	1551.8	5949.2	30373.5
1997/98	8502.2	2885.8	7122.6	4898.1	1004.2	1526.9	6998.1	32937.9
1998/99	9517.7	2953.2	7882.2	6170.2	1003.2	1226.4	8498.4	37251.3
1999/00	10813.3	3127.6	9854.9	7450.6	1015.9	919.8	9741.6	42923.7
2000/01	12552.1	3771.2	12047.8	9114.0	612.9	767.1	10028.8	48894.2
2001/02	12658.7	3807.0	12267.3	8903.7	1131.8	582.7	11114.9	50376.1
2002/03	14236.4	4785.1	13459.7	7966.2	1414.3	725.3	13642.9	56229.9
2003/04	15554.8	6226.7	14478.9	9245.9	1697.5	969.2	14158.0	62331.0
2004/05	15701.6	6445.9	18885.4	10159.4	1799.2	1113.2	16018.0	70122.7
2005/06	15344.0	6507.6	21610.7	10373.7	2181.1	1413.3	14851.6	72282.0
2006/07	16707.6	9343.2	26095.6	15034.0	2253.5	1692.8	16585.5	87712.1
2007/08	21062.5	11189.6	29815.7	17311.2	2940.7	2835.8	22467.0	107622.5
2008/09	26792.9	16220.9	39700.9	33774.3	5223.3	3955.0	26422.6	152089.9
2009/10	33069.9	22078.9	49668.2	32982.0	5680.9	4943.1	22683.4	171106.4

Source: Economic Survey, MOF/GON

Miscellaneous taxes includes Urban House and Land tax + Vehicle tax + Other taxes

Sales/VAT tax includes Entertainment tax + Hotel tax + Flight tax +Contract tax

**Table no. 4.2(B)**  
**Structure of Government Revenue in Nepal**  
**(Fiscal Year 1995/96 to 2009/10)** **(In Percentage)**

Fiscal Year	Customs	Excise	Sales Tax/VAT	Income Tax	Land Revenue & Reg.	Misce. Tax	Non-Tax Revenue	Total
1995/96	26.26	7.00	23.05	12.30	3.82	5.25	22.31	100
1996/97	27.35	7.56	23.46	13.57	3.34	5.10	19.58	100
1997/98	25.81	8.76	21.62	14.87	3.04	4.65	21.24	100
1998/99	25.55	7.92	21.15	16.56	2.69	3.29	22.81	100
1999/00	25.19	7.28	22.95	17.35	2.36	2.14	22.69	100
2000/01	25.67	7.71	24.64	18.64	1.25	1.56	20.51	100
2001/02	25.13	7.56	24.35	17.67	2.24	1.15	22.06	100
2002/03	25.32	8.46	23.93	14.16	2.51	1.28	24.26	100
2003/04	24.95	9.98	23.22	14.83	2.72	1.55	22.71	100
2004/05	22.39	9.20	26.93	14.48	2.56	1.58	22.84	100
2005/06	21.23	9.00	29.89	14.35	3.01	1.95	20.54	100
2006/07	19.05	10.65	29.75	17.14	2.56	1.92	18.90	100
2007/08	19.57	10.40	27.70	16.08	2.73	2.63	20.87	100
2008/09	17.61	10.66	26.10	22.21	3.43	2.60	17.37	100
2009/10	19.32	12.90	29.03	19.27	3.32	2.88	13.25	100
Average	23.36	9.57	25.18	16.23	4.77	2.63	20.79	100

Source: Table 4.2(A)

Nepalese government revenue is a composition of tax and non tax revenue. The tax revenue comprises of custom duty, excise duty, value added tax or sales tax, Income tax, land revenue & registration and miscellaneous taxes.

The average contribution of customs, excise, value added tax, income tax, land revenue & registration and miscellaneous taxes to total revenue for last 15 years are 23.36%, 9.57%, 25.18%, 16.23%, 4.77%, 2.63 and 20.79% respectively.

Non-tax revenue also constitutes as major part in the structure of public revenue. Non-tax revenue has also increased Rs. 6225.1 million to Rs. 22683.4 million from FY

1995/96 to FY 2009/10. It covers the third position in the public revenue structure. The average contribution of non tax revenue to total revenue of past 15 years is 20.79%.

The average contribution of different sources of Government Revenue is shown as following Pie-chart.

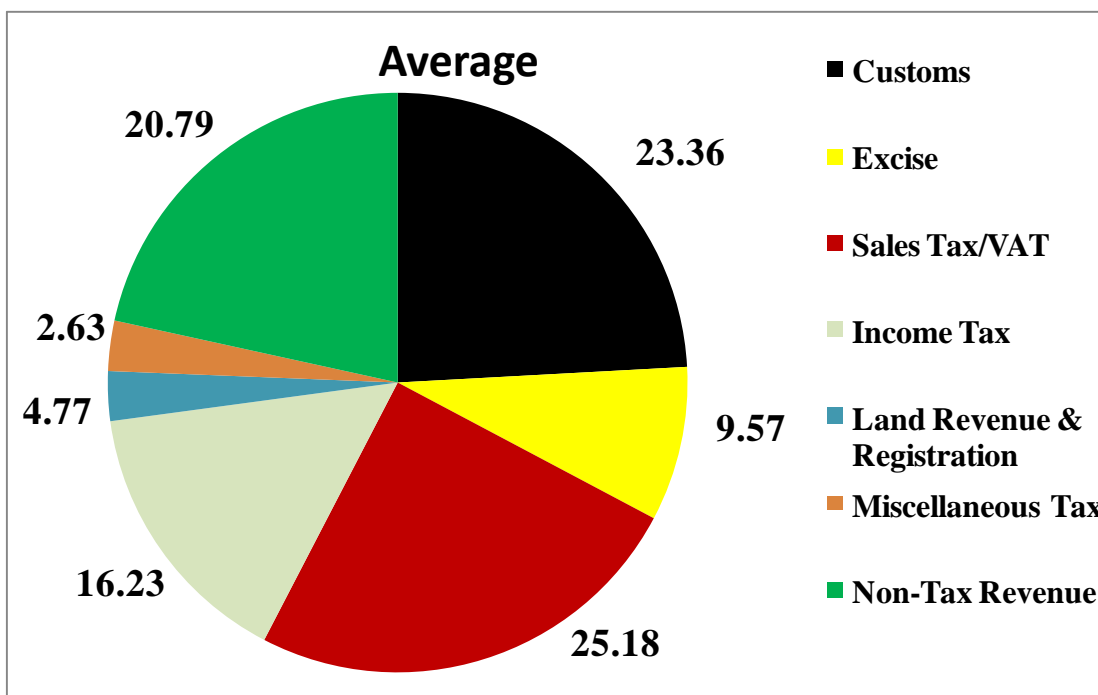


Figure no. 4.1

#### 4.1.3 Contribution of Income Tax to GDP, Total Revenue, Total Tax Revenue and Direct Tax Revenue:

Nepal is facing a serious & growing financial resource gap and her need for mobilizing additional financial resources from domestic sources through taxation has been urgent. The base for levying taxes may be consumption, income and capital. Taxes on income and capital are known as direct taxes whereas taxes on consumption are known as indirect taxes. Tax structure of Nepal is composed of both direct and indirect taxes. Income tax has been a pivotal element on direct tax and it is playing an important role to generate government revenue for the development of national economy. The following 4.3 table shows the contribution of income tax to GDP, total revenue, total tax revenue and direct tax revenue.

**Table no.4.3**  
**Contribution of Income Tax to GDP, Total Revenue, Total Tax Revenue and**  
**Direct Tax Revenue**  
**(Fiscal Year 1995/96 to 2009/10) (Rs. In Million)**

Fiscal Year	GDP	Total Revenue	Total Tax Revenue	Direct Tax Revenue	Income Tax Revenue	% of Income Tax on GDP	% of Income Tax on TR	% of Income Tax on TTR	% of Income Tax on DTR
1995/96	239388.0	27893.1	21668.0	5965.0	3431.4	1.43	12.30	15.83	57.52
1996/97	269570.0	30373.5	24424.3	6690.6	4123.0	1.53	13.57	16.88	61.62
1997/98	289798.0	32937.9	25939.8	7429.2	4898.1	1.69	14.87	18.88	65.93
1998/99	329960.0	37251.3	28752.9	8399.8	6170.2	1.86	16.56	21.46	73.45
1999/00	365465.0	42923.7	33182.1	9386.6	7420.6	2.03	17.28	22.36	79.05
2000/01	413428.7	48894.2	38865.4	10494.3	9114.0	2.20	18.64	23.45	86.84
2001/02	430396.6	50466.1	39351.2	10618.1	8903.7	2.07	17.64	22.63	83.85
2002/03	460325.3	56229.9	42587.0	10105.8	7966.2	1.73	14.16	18.71	78.82
2003/04	500699.1	62331.0	48173.0	11912.6	9245.9	1.84	14.83	19.19	77.62
2004/05	548484.7	70122.7	54104.7	13071.8	10159.4	1.85	14.48	18.78	77.72
2005/06	611118.0	72282.0	57430.4	13968.1	10373.7	1.69	14.35	18.07	74.27
2006/07	676210.0	87712.1	71127.5	18979.6	15034.0	2.22	17.14	21.14	79.21
2007/08	756756.0	107622.5	85155.5	23087.7	17311.2	2.28	16.09	20.33	74.98
2008/09	910160.0	152089.9	125667.3	42952.6	33774.3	3.71	22.20	26.87	78.63
2009/10	1102354.0	171106.4	148423.0	43606.0	32982.0	2.99	19.27	22.22	75.63

Sources: Economic Survey, MOF/GON

### **Income Tax in the Gross Domestic Product (GDP)**

The percentage contribution of income tax in GDP is presented in above 4.3 table. From the table, it is clear that the share of income tax in the GDP in Nepal is very low and it is below 4% through the period of study from the FY 1995/96 to 2009/10. Income tax revenue of Nepal as percentage of GDP is 1.43% to 2.99% with slightly fluctuation on the period of study. The minimum percentage contribution of income tax to GDP is 1.43% in FY 1995/96 and maximum contributed percentage in FY 2008/09 is 3.71%. From FY 2005/06, the trend of income tax to GDP is slightly increased up to FY 2009/10. It is better for the economic development of Nepal. The trend of income tax as percentage of GDP is presented in following figure.

## Income Tax in the Gross Domestic Product (GDP)

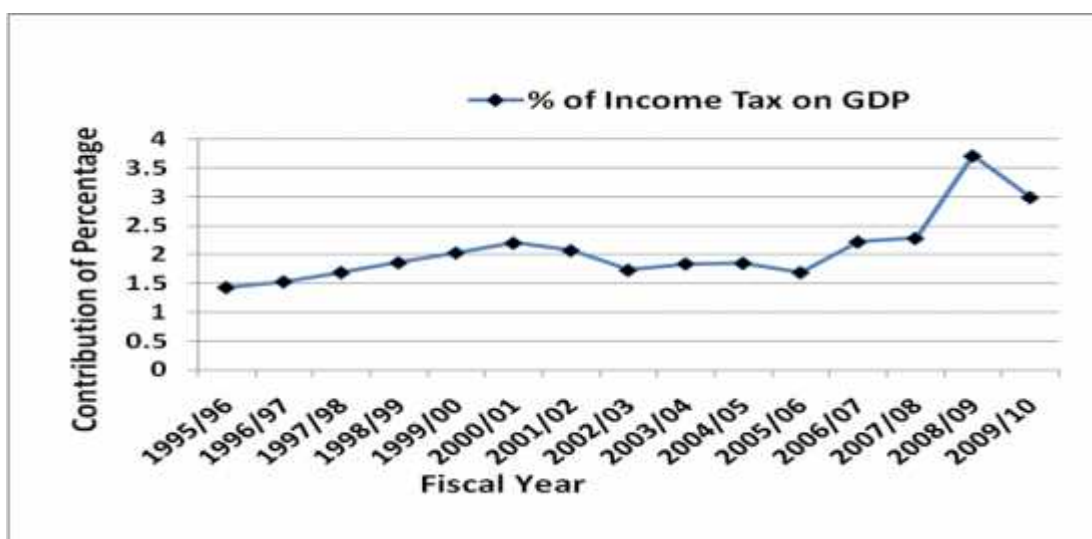


Figure no. 4.2:

## Income Tax in Total Revenue

From table 4.3 the percentage contribution of income tax to total revenue is varied from 12.30% to 19.27% from the FY 1995/96 to 2009/10. It is much fluctuating in the study period. The percentage contribution of income tax to total revenue is increasing up to FY 2000/01, after then the contribution has decreasing slightly up to 14.35 and from FY 2005/06 it is in increasing trend. It is better for development of the economy. The trend of income tax as percentage of total revenue is shown in following figure.

## Income Tax in Total Revenue

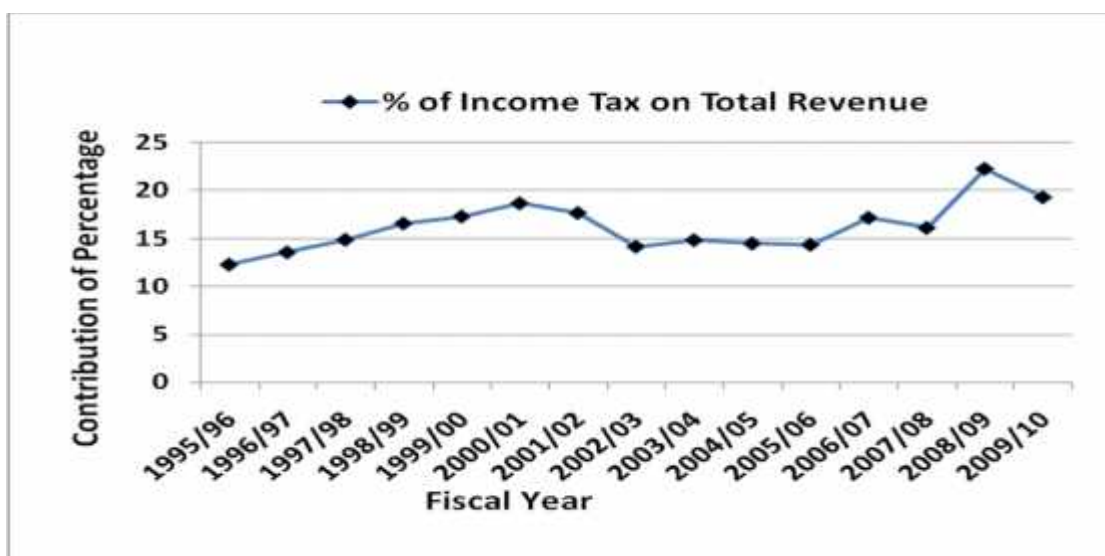


Figure 4.3

### Income Tax in Total Tax Revenue:

The contribution of income tax in Nepalese tax revenue is presented in table 4.3. The table shows that in the FY 1995/96, the minimum level of contribution is 15.83% and FY 2008/09 the maximum level of contribution is 26.87%. But it is also very fluctuating in the period of study. In the beginning period of study the trend of contribution of income tax in total tax revenue is slightly increased from 15.83% to 23.45% from FY 1995/96 to 2000/01. After 2000/01, the percentage contribution is slightly decreased up to 18.07% in FY 2005/06 and from FY 2006/07 it is in increasing trend. The contribution of income tax in total tax revenue more is better and less is harmful for the economy. The trend of the income tax in total tax revenue has shown the following figure.

### Income Tax in Total Tax Revenue

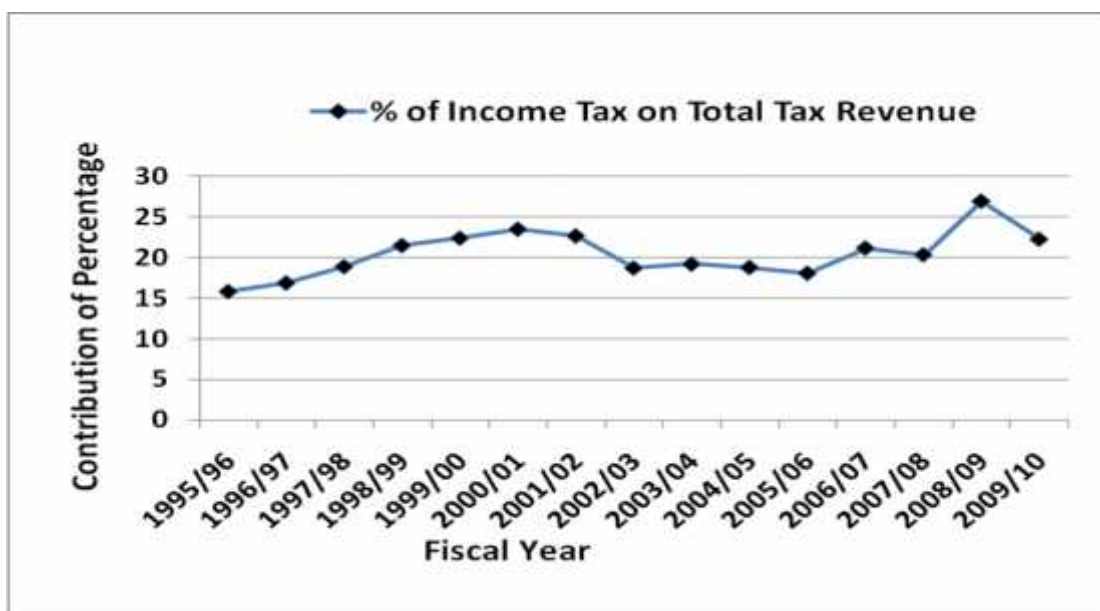


Figure no. 4.4

### Income Tax in Direct Tax Revenue

Income tax, land revenue & registration tax and other are the major compounds of direct tax. From the table 4.3, it is clear that there is substantial contribution of income tax in direct tax revenue in Nepal. In the period of study i.e. 15 year period from FY 1995/96 to 2009/10, the contribution of income tax on direct tax revenue has been 57.52% minimum in FY 1995/96 and maximum 86.84% in FY 2000/01. The trend of income tax on direct tax revenue silently increased from 57.52% to 86.84% from FY 1995/96 to FY 2001/02, after then it is decreased up to FY 2005/06 and from FY 2005/06 it is in increasing trend. It is very good for the economy of Nepal. The trend of income tax on direct tax revenue is shown in following figure.

## Income Tax on Direct Tax Revenue

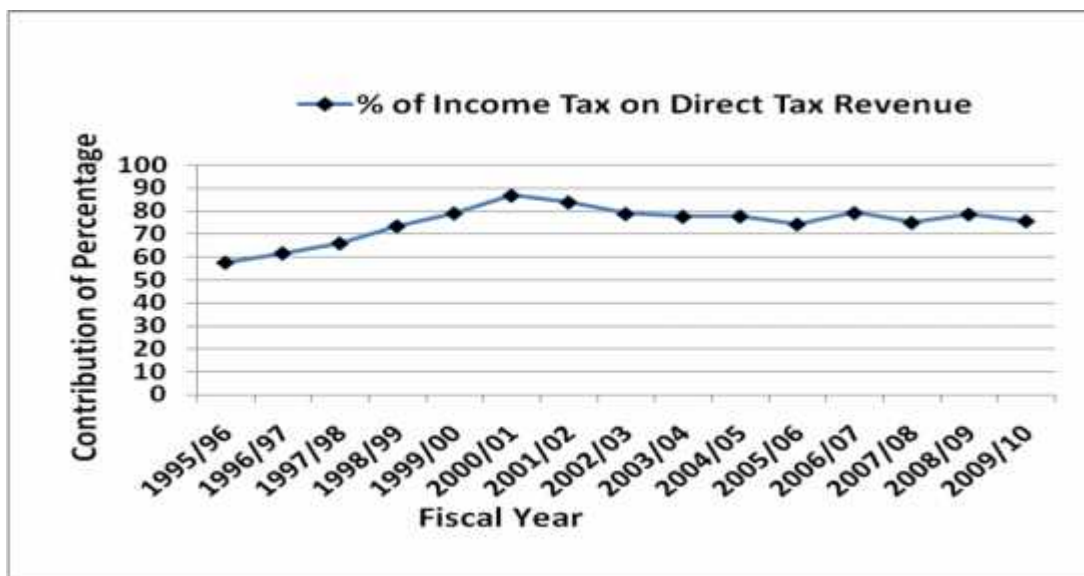


Figure no 4.5

From the above analysis it is clear that there is significant contribution of income tax in Nepal to increase GDP, public revenue, tax revenue and direct tax revenue.

### 4.1.4 Composition of Direct Tax and Indirect Tax Revenue in Nepal.

The structure of Nepalese tax revenue is presented in terms of direct tax and indirect tax. Total tax revenue consists of direct tax revenue and indirect tax revenue. Table 4.4 shows direct and indirect tax revenue of Nepalese tax revenue structure from FY 1995/96 to 2009/10. Direct tax includes income tax, land revenue & registration, urban house and land tax, property tax, vehicle tax etc. Whereas indirect tax include sales tax/VAT, customs, excise duty, entertainment tax, hotel tax, air flight tax, contract tax, road and bridge maintenance tax etc.

Table 4.4 shows that Nepalese tax structure is heavily dominated by indirect tax revenue. The average share of direct tax revenue is 25.64% in total tax revenue whereas average share of indirect tax revenue is 72.69% in total tax revenue from the FY 1995/96 to 2009/10.

The volume of direct and indirect tax was Rs. 3845.4 million and Rs. 15810.7 million i.e. 27.53% and 72.47% of total tax revenue respectively in the FY 1995/96 and 2009/10. The amount of direct tax revenue is increasing every year as it, increases from 5965 million in FY 1995/96 to Rs 43606 million in FY 2009/10. The percentage of direct tax revenue to total tax revenue is fluctuating every year. From FY 1995/96, the contribution of direct tax revenue is in increasing trend up to FY 1998/99, but from FY 1999/00 to 2005/06 the contribution of direct tax is in decreasing trend in total tax revenue, after then it is in increasing trend. The contribution of direct tax

revenue to total revenue was minimum level of 23.73% in FY 2002/03 and maximum 34.18% in FY 2008/09.

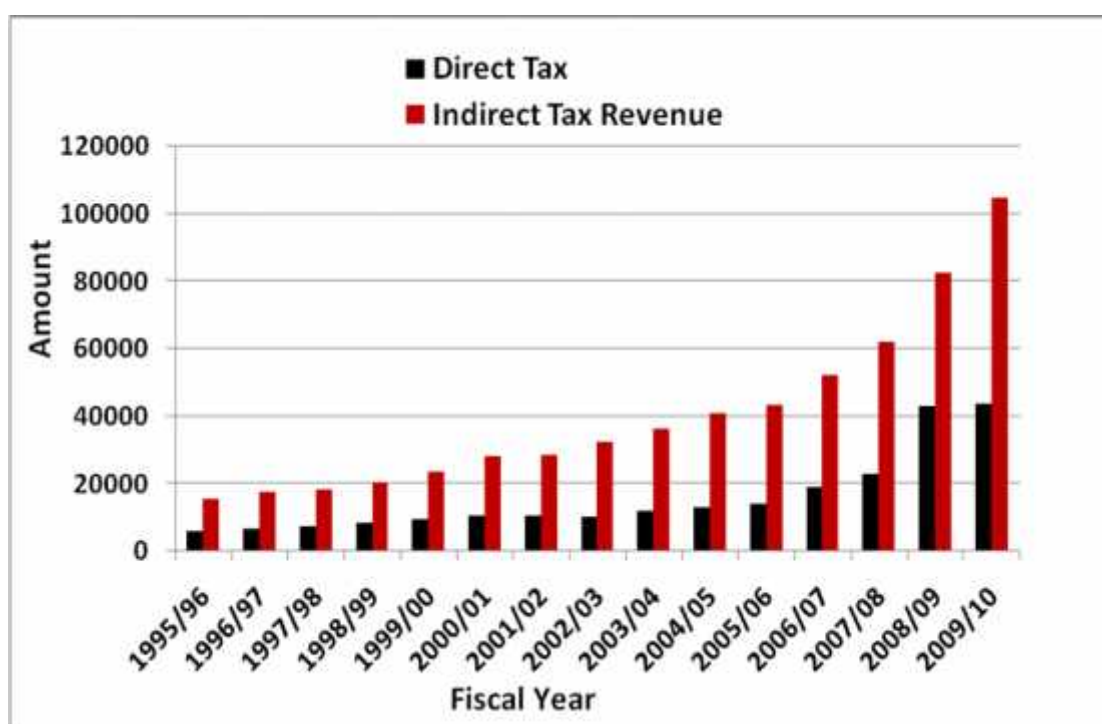
The amount of indirect tax revenue is also in increasing trend. It has increased from Rs.15703 million in FY 1995/96 to Rs. 104817 million in FY 2009/10. The percentage contribution of indirect tax revenue to total tax revenue is fluctuating in the study period. The contribution of indirect tax revenue to total tax revenue was minimum level of 70.62% in FY2009/10 and maximum of 76.27% in FY 2002/03.

**Table no.4.4**  
**Composition of Direct and Indirect Tax Revenue in Nepal**  
**(Fiscal Year 1995/96 to 2009/10) (Rs. In Million)**

Fiscal Year	Total Tax Revenue		Direct Tax Revenue		Indirect Tax Revenue	
	In Rs.	In %	In Rs.	In %	In Rs.	In %
1995/96	21668.0	100	5965.0	27.53	15703.0	72.47
1996/97	24424.3	100	6690.6	27.39	17733.7	72.77
1997/98	25939.8	100	7429.2	28.64	18510.6	71.35
1998/99	28752.9	100	8399.8	29.21	20353.1	70.78
1999/00	33182.1	100	9386.6	28.28	23795.5	71.71
2000/01	38865.4	100	10494.3	27.00	28371.1	73.00
2001/02	39351.2	100	10618.1	26.98	28733.1	73.01
2002/03	42587.0	100	10105.8	23.73	32481.2	76.27
2003/04	48173.0	100	11912.6	24.73	36260.4	75.27
2004/05	54104.7	100	13071.8	24.16	41032.9	75.84
2005/06	57430.4	100	13968.1	24.32	43462.3	75.18
2006/07	71127.5	100	18981.1	26.68	52146.4	73.31
2007/08	85155.5	100	23087.7	27.11	62067.8	72.88
2008/09	125667.3	100	42952.6	34.18	82714.7	65.82
2009/10	148423	100	43606.0	29.38	104817.0	70.62

Source: Economic Survey, MOF/GON.

## Composition of Direct and Indirect Tax Revenue in Nepal



**Figure no.4.6**

Comparison of direct tax and indirect tax revenue shows that Nepalese economy is heavily relied upon indirect taxation. To divert the economy in the channel of development, it is necessary to increase the share of direct tax. Therefore, the attention should be focused on the sufficient resource mobilization through direct taxation.

### 4.1.5 Composition of Direct Tax in Nepal

The structure of direct tax revenue is the composition of income tax revenue, land revenue and registration and miscellaneous taxes

Income tax occupies the highest rank among various taxes in direct tax revenue. The revenue from income tax varied from Rs. 3431.4 million to Rs. 32982 million of FY 1995/96 to 2009/10. The amount of income tax is in the increasing trend except in FY 2001/02, 2002/03. In FY 1995/96, out of total direct tax revenue of Rs 5965 millions, Rs. 3431.4 million has been contributed by income tax revenue in total direct tax revenue. In FY 2009/10, out of total direct tax revenue of Rs 43606 million, Rs 32982 million has been contributed by income tax revenue. The minimum contribution of income tax to direct tax is 61.63% in the FY 1996/97 and maximum contribution is 86.84% in the FY 2000/01.

Land revenue and registration occupies the second place among direct tax revenues. The trend of land revenue and registration is fluctuating. Amount collected from land revenue and registration increased from Rs. 1066.6 million to Rs. 5680.9 million from FY 1995/96 to 2009/10. But percentages contribution has been decreasing in the

recent years. Maximum percentage is 17.88% in FY 1995/96 and minimum percentage is 10.66% in FY 2001/02, which is represented the table no.4.5

Similarly, miscellaneous taxes occupy third and last position among other direct tax. The trend of miscellaneous taxes has been fluctuating. In 1995/96, Rs. 1467 millions has been collected as miscellaneous tax. It was 24.59% of total direct tax revenues. In 2009/10, Rs.4943.1 million has been collected as miscellaneous taxes out of Rs. 43606 millions of direct tax. The minimum contribution of miscellaneous tax to direct tax is 5.48% in the FY 2001/02 and maximum contribution is 24.59% in the FY 1995/96, which is represented as following table.

**Table no.4.5**  
**Composition of Direct Tax and Their Percentage Share**  
**(Fiscal Year 1995/96 to 2009/10)**

(Rs. In Million)								
Fiscal Year	Direct Tax	% of DT	Income Tax	% of DT	Land Rev. & Registration	% of DT	Misce. Tax	% of DT
1995/96	5965.0	100	3431.4	57.52	1066.6	17.88	1467.0	24.59
1996/97	6690.6	100	4123.4	61.63	1015.4	15.17	1551.8	23.19
1997/98	7429.2	100	4898.1	65.93	1004.2	13.51	1526.9	20.55
1998/99	8399.8	100	6170.2	73.45	1003.2	11.94	1226.4	14.60
1999/00	9386.6	100	7450.6	79.37	1015.9	10.82	919.8	9.79
2000/01	10494.3	100	9114.0	86.84	612.9	5.84	767.1	7.31
2001/02	10618.1	100	8903.7	83.85	1131.8	10.66	582.7	5.48
2002/03	10105.8	100	7966.2	78.82	1414.3	13.99	725.3	7.17
2003/04	11912.6	100	9245.9	77.61	1697.5	14.25	969.2	8.13
2004/05	13071.8	100	10159.4	77.72	1799.2	13.76	1113.2	8.51
2005/06	13968.1	100	10373.7	74.26	2181.1	15.61	1413.3	10.11
2006/07	18979.6	100	15034.0	79.21	2253.5	11.87	1692.8	8.92
2007/08	23087.7	100	17311.2	74.98	2940.7	12.73	2835.8	12.28
2008/09	42952.6	100	33774.3	78.63	5223.3	12.16	3955.0	9.21
2009/10	43606.0	100	32982	75.63	5680.9	13.02	4943.1	11.33

Source: Economic Survey, MOF/GON

#### **4.1.6 Composition of Indirect Tax in Nepal**

Nepalese tax structure is heavily dependent on indirect taxes, which contributed 72.47% in the FY 1995/96 and 70.62% in the FY 2009/10. Nepalese tax revenue is dependent mainly on international trade and sales tax/VAT on goods & services supplemented by tax on income and property to some extent.

The major components of indirect tax in Nepalese tax structure constitutes sales tax/VAT, customs duty, excise duty, entertainment tax, hotel tax, air flight tax, contract tax etc.

The most important compound of indirect tax is sales tax (VAT), it covers the highest contribution in indirect tax, which is shown in following table. The contribution of VAT is increasing gradually from 1995/96 to 2009/10. In 1995/96 out of total indirect tax revenue of Rs.15703 millions tax Rs.6431.3 millions has been contributed by VAT. This is about 40.95% contribution of VAT in total tax revenue. In 2009/10, out of total Indirect tax revenue of Rs.104817 million, Rs.49668.2 millions has been contributed by VAT. It is about 47.38% of the total indirect tax revenue.

Similarly the custom duty ha the second position in indirect tax. The custom duty has been decreasing gradually in the following year in percentage but the amount contribution in total indirect tax has been increasing per year. The minimum percentage of custom duty is 31.55 in year 2009/10 and maximum percentage is 46.85 in year 1996/97.

Finally excise duty occupies the third and last position in indirect tax. Excise duty has always been increasing per year than previous year. Its percentage contribution has always been fluctuating. The maximum contributed percentage of excise 21.06 in year 2009/10 and minimum percentage is 12.38 in year 1995/96.

**Table no 4.6**  
**Composition of Indirect Tax and Their Percentage**  
**(Fiscal year 1995/96 to 2009/09) (In Percentage)**

Fiscal Year	Indirect Tax	Total %	Custom Duties	As % of IDT	Excise	As % of IDT	Sales Tax/VAT	As % of IDT
1995/96	15703.0	100	7327.4	46.66	1944.3	12.38	6431.3	40.95
1996/97	17733.7	100	8309.1	46.85	2298.1	12.95	7126.5	40.19
1997/98	18510.6	100	8502.2	45.93	2885.8	15.39	7122.6	38.48
1998/99	20353.1	100	9517.7	46.76	2953.2	14.51	7882.2	38.73
1999/00	23795.5	100	10813.3	45.44	3127.6	13.14	9854.9	41.41
2000/01	28371.1	100	12552.1	44.24	3771.2	13.29	12047.8	42.46
2001/02	28733.1	100	12658.7	44.05	3807.0	13.25	12267.3	42.69
2002/03	32481.2	100	14236.4	43.83	4785.1	14.73	13549.7	41.44
2003/04	36260.4	100	15554.8	42.89	6226.7	17.17	14478.9	39.93
2004/05	41032.9	100	15701.6	38.26	6445.9	15.71	18885.4	46.02
2005/06	43462.3	100	15344.0	35.30	6507.6	14.97	21610.7	49.72
2006/07	52146.4	100	16707.6	32.04	9343.2	17.91	26095.6	50.04
2007/08	62067.8	100	21062.5	33.93	11189.6	18.03	29815.7	48.04
2008/09	82714.7	100	26792.9	32.39	16220.9	19.61	39700.9	48.00
2009/10	104817.0	100	33069.9	31.55	22078.9	21.06	49668.2	47.38

Source: Economic Survey, MOF/GON

#### **4.1.7 Composition of Tax and Non-Tax Revenue in Nepalese Tax Structure**

Total tax revenue consists of tax revenue and non tax revenue. Table 4.7 shows the composition of tax and non tax revenue in Nepalese revenue structure for the fifteen years i.e. from fiscal year 1995/96 to 2009/10. In Nepalese revenue structure; tax revenue has always been greater than non tax revenue. This means the heavy contribution of tax revenue in total revenue of Nepal. Role of tax revenue is very much important in revenue mobilization of Nepal and to meet the government expenditure.

From the FY 1995/96 to 2009/10 the amount of tax revenue found increasing every year with the amount of Rs.21668 million to Rs.148423 million but the figure in

percentage of tax revenue in the total government revenue has been found fluctuating in the different year. The contribution of tax revenue is maximum with 86.74% in FY 2009/10 and minimum up to 75.73 % in FY 2002/03.

The trend of non tax revenue collection is also fluctuating during the period from 1995/96 to 2009/10. It was Rs. 6225.1 million in fiscal year 1995/96 and reached up to Rs.22683.4 million in the year 2009/10. The contribution of non tax revenue to the total tax revenue reached to maximum level of 24.26% in the year 2002/03 whereas it is to the minimum level of 13.25% in fiscal year 2009/10.

**Table no 4.7**  
**Composition of Tax and Non-Tax Revenue in Nepal**  
**(Fiscal year 1995/96 to 2009/10)** **(Rs. In Million)**

Fiscal year	Total Revenue		Tax Revenue		Non Tax Revenue	
	In Rs.	In %	In Rs.	In %	In Rs.	In %
1995/96	27893.1	100	21668.0	77.68	6225.1	22.32
1996/97	30373.5	100	24424.3	80.41	5949.2	19.57
1997/98	32937.9	100	25939.8	78.75	6998.1	21.24
1998/99	37251.3	100	28752.9	77.18	8498.4	22.81
1999/00	42923.7	100	33182.1	77.30	9741.6	22.69
2000/01	48894.2	100	38865.4	77.49	10028.8	20.51
2001/02	50466.1	100	39351.2	77.97	11114.9	22.02
2002/03	56229.9	100	42857	75.73	13642.9	24.26
2003/04	62331.0	100	48173	77.28	14158.0	22.71
2004/05	70122.7	100	54104.7	77.16	16018.0	22.84
2005/06	72282.0	100	57430.4	79.45	14851.6	20.54
2006/07	87712.1	100	71126.6	81.09	16585.5	18.91
2007/08	107622.5	100	85155.5	79.12	22467.0	20.91
2008/09	152089.9	100	125667.3	82.62	26422.6	17.37
2009/10	171106.4	100	148423.0	86.74	22683.4	13.25

Source: Economic Survey, MOF/GOV

The trend of tax and non-tax revenue of Nepal is shown in the following figure:

## Composition of Tax and Non-Tax Revenue

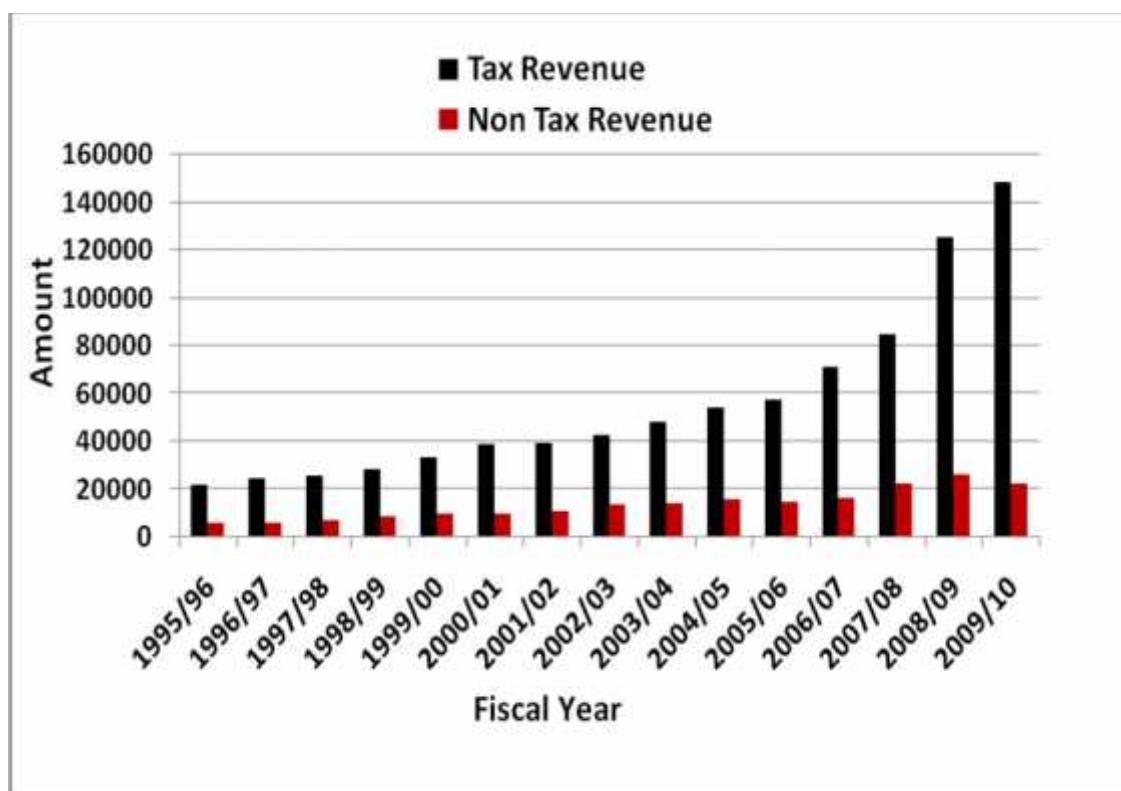


Figure no. 4.7

### 4.1.8 Problems of Resource Gap in Nepal

The resource gap in Nepal has been presented in Table 4.8 from FY 1995/96 to 2009/10. The table shows a picture growing resource gap in Nepalese finances. It is found that during the last 15 year period there was 30.31 to 41.30% resource gap in Nepal. The amount of resource gap was fluctuating during the study period. In FY 1995/96, the resource gap was 40.07% amounting Rs. 18649.3 million, which decreased to 30.31% amounting Rs.27111.6 million in FY 2003/04. From FY 2003/04, the trend of resource gap is in increasing trend up to FY 2009/10. In FY 2009/10, the resource gap is 35.48% amounting Rs. 61561.9 million.

It shows that the resource gap between revenue and expenditure from Rs. 18649.3 million in FY 1995/96 to Rs. 98647.4 million in FY 2009/10, this figure shows the poor performance of domestic resource mobilization.

**Table no 4.8**  
**Problems of Resource Gap in Nepalese Economy**  
**(Fiscal Year 1995/96 to 2009/10) (Rs. In Million)**

Fiscal Year	Total Government Expenditure(A)	Total Government Revenue(B)	Resource Gap (A-B)	% of Resource Gap to Total Expenditure
1995/96	46542.4	27893.1	18649.3	40.07
1996/97	50723.7	30373.5	20350.2	40.12
1997/98	56118.3	32937.9	23180.4	41.30
1998/99	59578.0	37251.3	22327.7	37.47
1999/00	66272.5	42893.7	23378.8	35.27
2000/2001	79835.1	48893.7	30941.2	38.75
2001/02	80072.2	50445.5	29626.7	37.00
2002/03	84006.1	56229.8	27776.3	33.06
2003/04	89442.6	62331.0	27111.6	30.31
2004/05	102560.4	70122.7	32437.7	31.63
2005/06	110889.2	72282.1	38607.1	34.81
2006/07	133604.6	87712.1	45892.5	34.35
2007/08	161349.9	107622.5	53727.4	33.29
2008/09	219661.9	143474.5	76187.4	34.68
2009/10	277973.9	179326.5	98647.4	35.48

Source: Economic Survey, MOF/GOV

The domestic resource gap pattern can be also presented in the following trend line.

## Problems of Resource Gap in Nepalese Economy

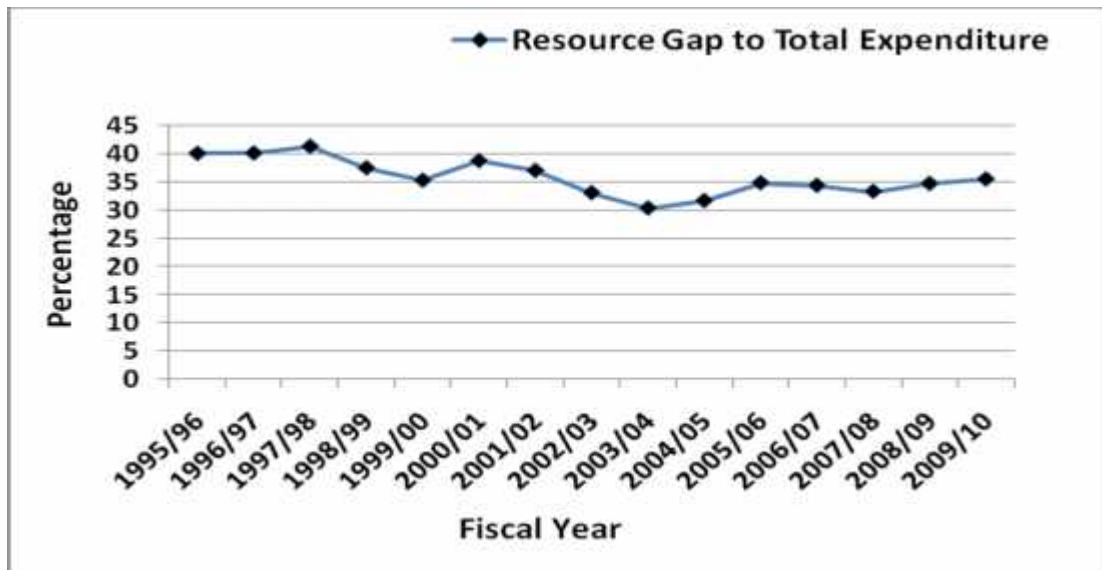


Figure no. 4.8

### 4.2 Analysis of Primary Data

The survey result has been conducted to find out the various aspects of income tax and tax administration in Nepal. For this questionnaire was developed and responses were collected from the respondents. Respondents were classified into three groups: income tax experts, income tax administrators and income tax payers. The questionnaire has covered objectives of income tax, type of income tax, income tax administration problems in Nepal (see the format of questionnaire in appendix A). The respondents were asked either to respond Yes/No to a question or for ranking of choices, the first choice was the most important and the last choice was the least important. The number of respondents in each category is equal, i.e., 25. Information received from the respondents is tabulated and analyzed in the proper way.

The following table shows the group and number of respondents.

Table no.4.9

#### Group of Respondents and Number from Each Group

Group of Respondents	Number
Income Tax Experts	25
Income Tax Administrators	25
Income Tax Payers	25
Total	75

#### 4.2.1 Income Tax as the Most Important Source of Collecting Government Revenue:

To know the respondents opinion about the role of income tax in raising government revenue, a question was asked, “Do you think income tax is an important source of collecting government revenue?” The responses received from the respondents are tabulated as follows:

**Table no.4.10**

#### **Income Tax as an Important Source of Government Revenue**

Response	Yes		No		Total	
Respondent	No	%	No.	%	No.	%
Tax Expert	25	100	--	--	25	100
Tax Administrator	23	92	2	8	25	100
Tax Payers	22	88	3	12	25	100
Total	70	93	5	7	75	100

Source : Opinion Survey

From the above table, it is clear that 100% tax experts, 92% tax administrators and 88% tax payers recognize income tax as an important source of collecting government revenue. Only 8% tax administrator and 12% tax payers did not recognize. In aggregate, 93% respondent recognized and 7% did not recognize income tax as an important source of collecting government revenue. Thus, the conclusion can be drawn out that income tax is an important source of collecting government revenue

#### 4.2.2 Need of Public Awareness Programs

To know the respondents view towards public awareness programs the question was asked, “Do you think that public awareness program is necessary in Nepal for raising the government revenue?” The opinion result is summarized in the table.

**Table no.4.11****Need of Public Awareness Programs**

Response	Yes		No		Total	
	No	%	No	%	No	%
Respondents						
Tax Experts	25	100	--	--	25	100
Tax Administrators	25	100	--	--	25	100
Tax Payers	25	100	--	--	25	100
Total	75	100	--	--	75	100

Source: Opinion Survey

From above table, it is found that all of the samples of tax experts, tax administrators and tax payers approved that public awareness programs are necessary in Nepal for raising government revenue. Cent-percent of respondents is favor of the Yes option. So it can be concluded that public awareness program is necessary for raising Nepalese government revenue.

**4.2.3 Method of Revenue Collection:**

To know the respondents view about method of collecting the revenue in Nepal, a question was asked, “Which method is better and effective for the revenue collection?” The respondent’s responses are tabulated as follows:

**Table no. 4.12****Method of Revenue Collection**

Response	Direct Tax Revenue		Indirect Tax Revenue		Non-Tax Revenue		Total	
	No	%	No	%	No	%	No	%
Respondents								
Tax Experts	10	40	15	60	--	--	25	100
Tax Administrators	11	45	14	55	--	--	25	100
Tax Payers	8	32	9	36	8	32	25	100
Total	29	38.66	38	50.67	8	10.67	75	100

Source: Opinion Survey

From the above table, in aggregate 39% respondents are in the favor of direct tax revenue, 50% are in the favor of indirect tax revenue and only 11% are in favor of non

tax revenue. Thus, it is concluded that the indirect tax revenue method is better than direct tax method for the collection of revenue.

#### 4.2.4 Income Tax Assessment Methods

To know the respondents view towards income tax assessment methods a question was asked, “Which income tax assessment method is more appropriate in Nepal?” The opinions of the various respondents are summarized as below:

**Table no.4.13**

#### **Income Tax Assessment Methods**

Response Respondents	Self Assessment		Jeopardy Assessment		Amended Assessment		Total	
	No.	%	No	%	No	%	No	%
Tax Experts	23	5.75	2	0.5	--	--	25	100
Tax Administrators	18	4.5	--	--	7	2.8	25	100
Tax Payers	25	100	--	--	--	--	25	100
Total	66	88	2	2.67	7	9.33	75	100

Source: Opinion Survey

From the above analysis 88% respondents approved self-assessment method is more appropriate to assess income, 2.67% respondents are in favor of jeopardy assessment and 9.33% in favor of amended assessment. The respondent category that is most in favor of self-assessment is tax payers. Thus, it can be concluded that self-assessment method is more appropriate while assessing income tax to collect large amount of revenue through income tax.

#### 4.2.5 Attitude Towards Problems in Paying Income Tax

To know the problem facing by the tax payers while paying income tax, the respondents were requested to rank their choice from 1 to 5 according to their preference. Here number 5 is considered as the highest priority whereas number 1 is considered as the lowest priority. The question was, “In your thinking, what types of problems are facing by the tax payer while paying income tax?” Responses received from respondents are tabulated in the table 4.14

**Table no.4.14****Problem in Tax Paying**

S. N.	Heading	Total Points Received					
		Tax Experts	Tax Administrator	Tax Payers	Total	%	Rank
a.	Consuming unnecessary time	92	76	113	281	24.98	1
b.	Expectation of illegal incentives by tax personnel	81	80	61	222	19.73	4
c.	Vague provision in income tax laws	37	58	51	146	12.98	5
d.	Lengthy process	88	70	94	252	22.50	2
e.	Lack of co-operation by tax administrator	77	91	56	224	19.90	3
	Total	375	375	375	1125	100	

Source: Opinion Survey

In Table no. 4.14, Rank 1 is given to the highest percentage and 5 to the lowest. Here lowest percentage is obtained by the problem, which is treated as the most important problem by the respondents. Ranking number 1 is considered as least major problem and number 5 is considered as a major problem. Thus, the various respondent views are responses on the basis of preference which are given below:

- a. Vague provision in income tax laws
- b. Expectation of illegal incentives by tax personnel
- c. Lack of cooperation by tax administrator
- d. Lengthy process
- e. Consuming unnecessary time

Therefore, it is concluded that the major problem facing by the tax payers while paying income tax is vague provision in income tax laws.

#### **4.2.6 Major Problem of Income Tax Collection in Nepal**

In order to know major problem of income tax collection, a question was asked “in your opinion, what are the major problem of income tax collection in Nepal?” The respondents were requested to rank their choices from 1 to 5 according to their preference. Responses are summarized in the table.

**Table no.4.15**

**Major Problem of Income tax Collection**

S. N.	Heading	Total Points Received					
		Tax Experts	Tax Administrator	Tax Payers	Total	%	Rank
a	Defective of income tax act	56	78	65	199	23.3	2
b	Mass poverty and low income level	68	45	47	160	18.6	4
c	Increasing habit of tax evasion	38	47	38	123	14.4	5
d	Inefficient income tax administration	58	49	59	166	19.3	3
e	Inappropriate rate and exemption limit	71	71	68	210	24.5	1
	Total	291	290	277	858	100	

Source: Opinion Survey

From the above analysis, the collected views of various respondents are about the major problem of income tax collection in Nepal, on the basis of ranking priority are as follows, which are highest to lowest.

- a. Increasing habit of tax evasion
- b. Mass poverty and low income level
- c. Inefficient income tax administration
- d. Defective of income tax act
- e. Inappropriate rates and exemption limit

Therefore, it is concluded that the major problem of income tax collected in Nepal is increasing habit of tax evasion.

**4.2.7 Specific Objective of Income Tax in Nepal**

To know the objective of income tax from the view of various respondents in Nepal, a question was asked, “What should be the specific objective of income tax in Nepal?” The respondents were requested to rank their choice from 1 to 5 according to their preference. Thus, the responses received from respondents are tabulated as below:

**Table no.4.16**

**Specific Objective of Income Tax**

S. N.	Heading	Total Points Received					
		Tax Experts	Tax Administrator	Tax Payers	Total	%	Rank
a.	To increase the public revenue	32	26	35	93	10.59	5
b.	To reduce the gap between have & have not	54	45	50	149	16.95	4
c.	To promote economic development	58	46	51	155	17.63	3
d.	To check inflation	94	86	71	251	28.55	1
e.	To remove regional disparities	65	80	86	231	26.28	2
	Total	303	283	293	879	100	

Source: Opinion survey

From the above analysis, the collected view of various respondents are about objectives of income tax in Nepal, on the basis of ranking priority are as follows, which are highest to lowest.

- a. To increased the public revenue.
- b. To reduce the gap between have and have not
- a. To promote economic development.
- b. To remove regional disparities
- c. To check inflation

Thus, it is concluded that the specific objective of income tax in Nepal is increasing the public revenue.

**4.2.8 Major Problem of Income tax assessment System in Nepal**

Tax assessment system is the very important part of the taxation. There are so many problems in the income tax assessment. Thus, to know the view of various respondents about these problems, a question was asked. “What are the major problems of income tax assessment system in Nepal?” The responses of various respondents are summarized in following table.

**Table no. 4.17**

**Problems of Income Tax Assessment System**

S. N.	Heading	Total Points Received					
		Tax Experts	Tax Administrator	Tax Payers	Total	%	Rank
a.	Complexity of ITA, rules & regulation	62	60	50	172	19.50	3
b.	Ineffective income tax administration	42	73	51	166	18.82	5
c.	Lack of tax education	51	61	62	174	19.73	2
d.	Lack of consciousness tax payers	59	40	69	168	19.05	4
e.	Inadequate expert in income tax management	77	62	63	202	22.90	1
	Total	291	296	295	882	100	

Source: Opinion survey

From the above table, the view of various respondents about income tax administration problem is clear on the basis of ranking. Here, ranking number 5 is considered as most serious problem and number 1 is considered as a least major problem. The various respondents rank in order to preference are as follows:

- a. Ineffective income tax administration
- b. Lack of consciousness of tax payers
- c. Complexity of ITA, rules & regulations
- d. To Lack of tax education.
- e. Inadequate expert in income tax management

Thus, it is concluded that the major problem of income tax assessment system is ineffective is ineffective income tax administration among various alternative.

**4.2.9 Problems of Income Tax Administration in Nepal**

To know the view of various respondents about the problems of income tax administration in Nepal, a question was asked, “What are the major problems of income tax administration in Nepal?” There are five alternative in the question. So, ranking on the basis of priority, the responses of various respondents are summarized as following table

**Table no. 4.18**

**Problems of Income Tax Administration**

S. N.	Heading	Total Points Received					
		Tax Expert	Tax Administrator	Tax Payer	Total	%	Rank
a.	Lack of trained and competent tax personnel	35	61	39	135	15.72	5
b.	Complicated tax laws	71	65	78	214	24.91	1
c.	Lack of proper communication	67	46	53	166	19.32	4
d.	Lack of proper direction	61	57	57	175	20.37	2
e.	Lack of co-ordination	52	61	56	169	19.67	3
	Total	286	290	283	859	100	

Source: Opinion survey

From the above table, the view of various respondents about income tax administration problem is clear on the basis of ranking. Here ranking number 5 is considered as most serious problem and number 1 is considered as least major problem. The various respondents ranking in order to preference are below:

- a. Lack of trained and competent tax personnel
- b. Lack of proper communication
- c. Lack of proper direction
- d. Lack of co-ordination
- e. Complicated tax laws

Thus, it is concluded that the major problem of income tax administration is the lack of trained and competent tax personnel.

**4.2.10 Suggestion to Improve the Income Tax Collection in Nepal**

To collect the suggestion from various respondents about improvement of the income tax, a question was asked “What action would you suggest to improve the income tax collection in Nepal?” There are five alternatives choices on the basis of ranking priority. The views of various respondents are tabulated as follows:

**Table no.4.19**

**Suggestion to Improve the Income Tax Collection in Nepal**

S.N.	Heading	Total Point Received					
		Tax Expert	Tax Administrator	Tax Payers	Total	%	Rank
a.	Education tax payers	33	51	31	115	13.90	5
b.	Simplifying tax laws	56	36	57	149	18.02	4
c.	Controlling illegal Business activities	69	52	51	172	20.80	3
d.	Assessment of tax in time	66	81	33	180	21.76	1
e.	Compulsory maintaining Account.	65	78	68	211	25.52	2
	Total	289	298	240	827	100	

Source: Opinion survey

From the above table it is clear that the most important suggestion to improve the income tax collection from the view of various respondents, on the basis of ranking from various alternatives, is educating tax payers. The preferences of respondents are as follows:

- a. Educating tax payers
- b. Simplifying tax laws.
- c. Controlling illegal business activities.
- d. Compulsory maintaining accounts.
- e. Assessment of tax in time

Thus, it is concluded that to improve the income tax collection in Nepal is educating tax payers.

To know whether the opinion about suggestion to improve the income tax collection of tax administration and tax payer are related or not, we can test by using correlation coefficient. But the views of tax expert are kept in constraint.

**Test of Hypothesis**

Null Hypothesis, H<sub>0</sub>: There is no significant relationship between the views of tax administration and tax payers with respect to suggestion to improve income tax collection

Alternative Hypothesis, H<sub>1</sub>: There is significant relationship between the views of tax administration and tax payers with respect to suggestion to improve income tax collection.

Calculation of Correlation by Formula.

Now,

$$r = 1 - \frac{6\phi d^2}{n(n^2 - Z1)}$$

Problem Error (PE):

The problem error is used to measure the relationship reliability and test significance of correlation coefficient. It is calculated by the following formula.

$$P.E = 0.6745 \frac{1 - Zr^2}{\sqrt{n}}$$

P.E. is used in interpretation whether the calculated value of 'r' is significant or not.

If  $r < P.E$ , it is insignificant or there is not correlation

If  $r > 6P.E$ , it is significant or correlation between two variables.

Let, variable x and y denotes the view of tax administrator and tax payers respectively.

**Table No.4.20**

**Calculation of Correlation Coefficient**

S.N	Suggestion	Total point(X)	Rank (R <sub>1</sub> )	Total point(Y)	Rank (R <sub>2</sub> )	d = R <sub>1</sub> -R <sub>2</sub>	d <sup>2</sup>
1.	Educating tax payers	51	4	31	5	-1	1
2.	Simplify tax laws	36	5	57	2	3	9
3.	Controlling illegal business activities	52	3	51	3	0	0
4.	Assessment of tax in time	81	1	33	4	-3	9
5.	Compulsory maintaining accounts	78	2	68	1	1	1
	Total						d <sup>2</sup> =20

Now,

$$r = 1 - \frac{6\phi d^2}{n(n^2 - Z1)}$$

$$= 1 - \frac{6 \mid 20}{5 \mid (5^2 \mid Z1)} \times 1 \mid Z \frac{120}{120} \times 0$$

Similarly,

$$P.E = 0.6745 \times \frac{1 \mid Z \mid 0}{\sqrt{n}}$$

$$= 0.6745 \times \frac{1}{\sqrt{5}}$$

$$= 0.6745 \times \frac{1}{2.236} \times 0.3016$$

$$\dots 6 \times P.E. = 6 \times 0.3016 = 1.8099$$

**Decision:**

Here r is smaller than P.E. the relationship is not significant. So null hypothesis is accepted. Thus, it is concluded that the opinion of tax administrators and tax payers regarding suggestion to improve income tax collection is not significant

**4.2.11 Role of Tax Administration in Nepal**

To know the views of various respondents about the role of tax administration in Nepal, a question was asked to respondents “What do you think about the role of tax administration in Nepal?” In the questionnaire there are five alternative choice on the basis of priority in the ranking 1 to 5. The actual views of the various respondents are tabulated as below.,

**Table No.4.21**

**Role of Tax Administration**

S.N.	Heading	Total Point Received					
		Tax Experts	Tax Administrators	Tax Payers	Total	%	Rank
a.	Collection of tax revenue	27	31	33	91	10.13	5
b.	Managing Personnel	81	82	69	232	25.83	1
c.	Policy making	67	59	65	191	21.28	3
d.	Assessment of tax	49	58	64	171	19.04	4
e.	Information collecting	77	68	68	213	23.72	2
	Total	301	298	299	898	100	

Source: Opinion Survey

According to the view of various respondents, the role of tax administration is to collect tax revenue. Above mentioned roles are arranged on the basis of ranking priorities which are as follows:

- a. collection of tax revenue
- b. assessment of tax
- c. policy making
- d. information collection
- e. managing personnel

Thus, it is concluded that the main role of tax administration is to collection tax revenue and least role is managing personnel.

To know whether the opinion about the role of tax administration of tax administrators and tax payers are related or not, we can test by using rank correlation coefficient. But the views of tax experts are kept constant

**Hypothesis**

Null Hypothesis, H<sub>0</sub>: There is not significant relationship between the view of tax administrators and tax payers with respects to role of tax administration.

Alternative Hypothesis, H<sub>1</sub>: There is significant relationship between the view of tax administrators and tax payers with respects to role of tax administration.

Now,

$$r = 1 - \frac{6\phi d^2}{n(n^2 - Z1)}$$

Probable Error (PE)

$$P.E = 0.6745 \frac{1 Z r^2}{\sqrt{n}}$$

P.E. is used in interpretation whether the calculated value of 'r' is significant or not let, variable x and y denotes the view of tax administrator and tax payers respectively.

**Table No. 4.22**

**Calculation of Correlation Coefficient**

S.N	Role	Total Point(X)	Rank (R <sub>1</sub> )	Total Point(Y)	Rank (R <sub>2</sub> )	d = R <sub>1</sub> - R <sub>2</sub>	d <sup>2</sup>
1.	Collection tax revenue	31	5	33	5	0	0
2.	Managing Personnel	82	1	69	1	0	0
3.	Policy making	59	3	65	3	0	0
4.	Assessment of tax	58	4	64	4	0	0
5.	Information collection	68	2	68	2	0	0
	Total						d <sup>2</sup> = 0

Now,

Correlation of coefficient (r) =

$$1 - \frac{6\phi d^2}{n(n^2 - Z1)}$$

$$= 1 - \frac{6 | 0}{5 | (5^2 - Z1)} \times 1$$

Again ,

$$P.E = 0.6745 \frac{1 Z r^2}{\sqrt{n}} \times 0.6745 \left| \frac{1 Z(1)^2}{\sqrt{5}} \right. \\ = 0.6745 \times \frac{0}{\sqrt{5}} \times 0$$

We know that,

- i) If  $r < P.E.$ , it is insignificant or there is not correlation
- ii) If  $r > 6P.E.$  it is significant or correlation between two variables.

**Decision:**

Here  $r$  is greater than 6 P.E. So, it means it is significant and correlation between two variable. Thus, the null hypothesis is rejected. It is concluded that the opinion of tax administrators and tax payers regarding the role of tax administration is significant.

### **4.3 Major Findings of the Study**

#### **4.3.1 Findings from Primary Data**

From the analysis of primary data, the following findings have been abstracted.

- ) Income tax is an import source of collecting government revenue.
- ) Public awareness program is necessary to increase tax consciousness and raising government revenue.
- ) Indirect tax revenue collection method is better and effective in Nepal.
- ) Self-assessment is more appropriate for Nepal while assessing income tax.
- ) Increasing habit of tax evasion is the serious problem of income tax collection in Nepal. In addition, mass poverty and low income level, ineffective income tax administration etc are also major problem.
- ) Increasing public revenue, reduce the gap between have and have not, to promote economic development etc are the specific objectives of income tax.
- ) The major problem of income tax assessment system of Nepal is ineffective income tax administration and other problems are lack of tax education, lack of consciousness of tax payers etc.
- ) Vague provision in income tax laws, expectation of illegal incentives by tax personnel, lack of cooperation by tax administrators etc are the major problems facing by tax payers while paying tax.

- J The major problem of income tax administration in Nepal is lack of trained and competent tax personnel.
- J According to suggestion of respondents to improve the income tax collection educating tax payers is necessary
- J From the opinion of respondents, the role of tax administration is to collect tax revenue

#### **4.3.2 Findings from Secondary Data**

From the research study, the following findings have been abstracted.

- J The composition of income tax structure in Nepal is income from public enterprise, private corporate, individuals, remuneration and tax on interest. The trend of income tax revenue has been increasing in every fiscal year. Within income tax, there was dominant role of individuals' contribution and it has in decreasing trend which was 42.84% of income tax revenue in FY 1995/96 and decreased to 29.10% in FY 2009/10.
- J The compositions of government revenue in Nepal are custom duty, excise duty, VAT, income tax, land revenue and registration, miscellaneous tax and non-tax revenue. Within total revenue, Sales tax/VAT has the dominant role and it has in increasing trend which was 23.05% in FY 1995/96 and 29.03% in FY 2009/10.
- J Nepalese tax revenue is the composition of direct and indirect tax. Nepalese tax structure is heavily dominated by indirect tax revenue. The percentage contribution of direct and indirect tax revenue to total tax revenue is fluctuating in the study period. The average share of direct tax revenue is 27.28% in total tax revenue whereas average share of indirect tax revenue is 72.68% in total tax revenue from the FY 1995/96 to 2009/10
- J Direct tax revenue consists of income tax, land revenue & registration and miscellaneous taxes. Among them the dominant role of income tax revenue to total direct tax revenue. The trend of income tax revenue is increased continuously from 57.52% in FY 1995/96 to 75.63% in FY 2009/10.
- J Indirect tax revenue comprise of custom duty, excise duty and sales tax/VAT (entertainment tax, hotel tax, air flight tax, contract tax etc.)The contribution of Sales tax/VAT in FY 1995/96 was 40.95% and in FY 2009/10 was 47.38%. Similarly custom duty and excise duty occupies the second and third position in total indirect tax revenue. The contribution of custom duty shows the decreasing trend. It has contributed 46.66% in FY 1995/96 and 31.55% in FY

2009/10. The contribution of excise duty is in increasing trend. It has contributed 12.38% in FY 1995/96 and 21.06% in FY 2009/10.

- J The government revenue structure of Nepal composed of two revenue resources. One of them is tax revenue where other is non-tax revenue. Tax revenue plays dominant role for total revenue. The amount of tax revenue found increasing every year with the amount of Rs. 21668 million to Rs. 148423 million from the FY 1995/96 to 2009/10. It has contributed 77.68% in FY 1995/96 and 86.74% in FY 2009/10. Remaining 22.32% in FY 1995/96 and 13.25% in FY 2009/10 to total revenue respectively is contributed by non-tax revenue
- J The tax to GDP ratio in Nepal is not found satisfactory. Tax to GDP ratio in FY 1995/96 was 9.05% and has gradually increased and reached 13.46% in FY 2009/10.
- J During the last 15 years period there was 30.31% to 41.30% resource gap in Nepal. The amount of resource gap was fluctuating during the study period. In FY 1995/96, the resource gap was 40.07% amounting Rs. 18649.3 million, which decreased to 35.48% amounting Rs. 98647.4 million in FY 2009/10.

## CHAPTER-FIVE

### SUMMARY, CONCLUSION AND RECOMMENDATION

#### 5.1 Summary

Nepal being a developing country needs lots of finance to develop the infrastructure for the country's development. Nepal has been suffering from the shortage of capital to accelerate the economic growth. The deficiency of capital to fund for the development has created a resource gap. In order to fulfill this gap the country has been depending upon foreign grants. However this dependency can be reduced if proper policies and regulation made are implemented in a fair manner.

Though the tax collection may face varieties of problem like people's disagreement to pay tax, lack of honesty and loyalty in tax administration, expectation by the people for the consideration of tax payment etc. Abide these problems government has a due responsibilities towards the people to encourage and develop a positive attitude towards the tax payment.

In the modern era, taxation has been taken as the most effective tool for rising national revenue. The government by mobilizing adequate resources through taxation might invest them in various development programs. In this way in the underdeveloped countries the government might play an important role in promoting capital formation, breaking various circle of poverty and mobilizing adequate resources through taxation.

This study shows that the share of tax revenue of the total revenue was about 86.74% while that of non-tax revenue was about 13.25% in FY 2009/10. This shows that the tax has been a major source of revenue mobilization.

Indirect tax has dominating role in composition of total tax revenue. A total amount of Rs. 104,817 million has been collected from these resources for the year 2009/10. Direct tax seems to be contribution much than to the total tax revenue, where collection is only Rs. 43,606 million as per the date of 2009/10. Among the indirect taxes, VAT and custom are the major source while income tax is one of the major sources for direct tax.

According to survey 100% of total respondents believed that taxpayer were well informed about the income tax system in Nepal. So awareness programs and tax education were to be given to the taxpayers.

Though, the tax collection has increased every year but it was not been collected in an adequately or sufficiently. Tax being most important factor of finance to the government, its collection, use should be done in a balanced way to develop the country.

## **5.2 Conclusion**

As a least developing country there are so many challenges in front of economic development of Nepal. Some of these challenges are wide spread poverty, rapid population growth, low income level of people, unemployment, inadequate resources, inequitable distribution of wealth and income, lack of adequate industries, adverse balance political instability etc.

Nepal is not being able to collect necessary government revenue to meet the development expenditure or other so many things, which are directly link to the public welfare. Due to the poor performance in internal revenue collection and mobilization, Nepal is not running in the path of economic development.

Structure of Nepalese government revenue i.e. a composition of tax revenue and non-tax revenue where tax revenue contributes 86.74% and non-tax revenue contributes 13.25%. Tax revenue includes custom duty, excise duty, VAT, income tax, miscellaneous tax etc. In this composition indirect tax playing dominating role toward direct tax.

Income tax, which must be strong in revenue structure for economic growth of a nation is very poor in Nepalese tax structure. Nepalese income tax is a composition of public enterprise, private corporate bodies, individual income tax, remuneration tax and interest tax. Within income tax, there was dominant role of individuals' contribution and it has in decreasing trend which was 42.84% of income tax revenue in FY 1995/96 and decreased to 29.10% in FY 2009/10. Due to the factors like lack of honest taxpayer, poor administration, inefficient income tax system etc, government has not been able to collect the income tax revenue, which should have been.

According to the analysis tax revenue has performing well condition. For the year tax revenue was about 86.74% and 13.25%. But it is not sufficient level of tax revenue. For the healthy development of economic condition of a country there must be more share of tax revenue in total government revenue rather than the non-tax revenue.

Nepalese tax and income tax collection performance has very high fluctuation. Nepalese income tax administration or policy level or whatever is in concern authority they must take a closer look on this variation and try to find out the root causes.

## **5.3 Recommendation**

On the basis of finding of the study for the better prospects of revenue collection from income tax in Nepal, the following recommendations are made:

- ✓ We are facing political uncertainties. Policies are well designed but very poorly implemented in Nepal. So, to promote industries, political problem should be solved at first i.e. one stable government is required at least for

coming 20 year so that they won't change the policies and implement them very minutely.

- ✓ Income Tax Act, rules and regulation should be clear and simple for all the tax payers as well as tax administrators.
- ✓ Clear provision should be made in case of deduction. All the items of deductions should be clearly defined in the act.
- ✓ Incentive and appreciation to the regular tax payer and on the other hand heavy fine and penalties to those who does not pay tax on time.
- ✓ The objective of imposing income tax must be clear. For reference it could be better to look and consider the tax policies of other developing countries as well as developed countries.
- ✓ Tax evasion and avoidance must be eradicated by effective implementation of fine & penalties and charging several actions to such people and organization.
- ✓ The personnel of Inland Revenue Department and all the tax office should be encouraged, punished and transferred on the basis of their work and experience. Regular and effective training system, reward and punishment system should be established for the effective personnel management.
- ✓ A researcher and intelligence center should be established in each tax office for proper planning and to collect the information in regarded to income tax evaders, potential new tax payers and non residents who have conducted business without registration.
- ✓ Ensure public awareness by conducting various programs.
- ✓ Illegal business activities must be controlled.
- ✓ Effective public participation is necessary to minimize the income tax evasion. Continuous efforts should be done by tax authority in order to develop the tax payers' positive attitude towards taxation.
- ✓ The members involved in formulating income tax policies must have deep knowledge about income tax.
- ✓ New sources of revenue should be found out.
- ✓ No political placement and pressure in revenue department.
- ✓ Every person having taxable income should be brought under the income tax net.
- ✓ Tax assessment under ITA 2058 are effective however there are lots of trouble during tax assessment and no clear language(dual meaningful) in this Act. The

following recommendations are made to make more effectiveness of assessment methods:

- ) Self-assessment should be carried by auditors.
  - ) Assessment must be made timely and without using discretionary power.
  - ) The tax assessment and tax collection provisions should be made clear and simple, so that tax payers would be encourage paying income tax.
  - ) Every tax return should be compulsory assessed.
- ✓ Income tax administration implements the tax laws therefore effectiveness of income tax system depends upon the income tax administration. In Nepal on of the most important reasons for unsound income tax system, inefficient and unscientific income tax administration. Following recommendations are made for improvement of income tax administration:
- ) Delay in assessment should be reduced as possible.
  - ) Computerized information system is necessary to keep up to data records of income tax.
  - ) Proper tax education should be provided to tax officials, tax inspectors and tax payers regularly.
  - ) Unnecessary outsider pressure should be avoided.
  - ) Income tax experts/profession should be increased in tax administration.

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## APPENDIX-A

### QUESTIONNAIRE

The questionnaires are conducting a research on **Income Tax Structure and its contribution to Revenue Generation in Nepal**. It would be very much appreciated if you could spend of your time for fulfilling this. Your land help and valuable suggestion are essential for the completion of the research. I would very much appreciate if you kindly spare a few minute of your valuable time in filling this questionnaire enclosed with your valuable suggestion.

Looking forward to your cooperation and support with many thanks.

Saraswati Bhatt  
Researcher, Nepal Commerce Campus

Name.....

Designation.....

Office.....

Please put tick mark ( ) against the answer of your choice or wherever appropriate put in order to preference from 1 to 5 where 1 was the least important and 5 was the most important.

1) Do you think that income tax is an important source of collecting government revenue?

a) Yes

b) No

2) Do you think that public awareness program is necessary in Nepal for raising the government revenue?

a) Yes

b) No

3) Which method do you think is better and effective revenue collection in Nepal?

a) Direct tax revenue

b) Indirect tax revenue

c) Non tax revenue

4) Which income tax assessment method is more suitable in Nepal?

a) Self assessment

b) Jeopardy assessment

c) Amended assessment

5) In your thinking, what types of problems are facing by the tax payer while paying income tax? (Ranking on the basis of priority)

- a) Consuming unnecessary time
- b) Expectation illegal incentives by tax personnel
- c) Vague provision in income tax laws
- d) Lengthy process
- e) Lack of co-operation by tax administrator

6) In your opinion, what are the major problems of income tax collection in Nepal? (Ranking on the basis of priority)

- a) Defective of income tax set
- b) Mass poverty & low income level
- c) Increasing habit of tax evasion
- d) Inefficient income tax administration
- e) Inappropriate rate & exemption limit

7) What should be the specific objective of income tax in Nepal? (Ranking on the basis of priority)

- a) To increase the public revenue
- b) To reduce the gap between have and have not
- c) To promote economic development
- d) To check inflation
- e) Remove regional disparities

8) What are the major problems of income tax assessment system of Nepal? (Rank on the priority)

- a) Complexity in Income Tax Act, rules & regulation
- b) Ineffective income tax administration
- c) Lack of tax education
- d) Lack of consciousness of tax payers
- e) Inadequate expert in income tax management

9) What are the major problems of income tax administration in Nepal? (Please rank on priority)

- a) Lack of trained & competent tax personnel
- b) Complicated tax laws
- c) Lack of proper communication
- d) Lack of proper direction
- e) Lack of co-ordination

10) What action would you suggest to improve the income tax collection in Nepal? (Please rank on priority)

- a) Educating tax payers
- b) Simplifying tax laws
- c) Controlling illegal business activities
- d) Assessment of tax in time
- e) Compulsory maintaining accounts

11) What would you think about the role of tax administration? (Please rank on priority)

- a) Collecting tax revenue
- b) Managing personnel
- c) Policy making
- d) Assessment of tax
- e) Information collection

12) In your opinion, is there any recommendation to develop income tax & total tax revenue in Nepal?

(.....)

Thank you