

INCOME TAX IN PRACTICE IN NEPAL

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RECOMMENDATION

This is to certify that the thesis

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DECLARATION

I hereby declare that the work reported in this thesis entitled "**Income Tax in Practice in Nepal**" submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master of Business Studies (MBS) under the supervision of **Prof. Dr. Kamal Deep Dhakal** and **Romakanta Bhattarai** of Shanker Dev Campus, T.U.

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ABBREVIATIONS

&	:	And
Adm.	:	Administrative
B.B.S.	:	Bachelor of Business Studies
B.S.	:	Bigram Sambata
Co.	:	Company
Dept.	:	Department
DG	:	Director General
Dr.	:	Doctor
DTAA	:	Double Tax Avoidance Agreement
e-filing	:	Electronic Filing
e-governance	:	Electronic Governance
e-PAN	:	Electronic Permanent Account Number
e-TDS	:	Electronic Tax Deducted System
Fig.	:	Figure
FNCCI	:	Federation of Nepalese Chamber of Commerce and Industries
FY	:	Fiscal Year
GAAP	:	Generally Accepted Accounting Principle
GDP	:	Gross Domestic Product
GoN	:	Government of Nepal
Govt	:	Government
H.L.P.	:	House, Land and Property
HMG/N	:	His Majesty Government of Nepal
i.e.	:	That is
IMF	:	International Monetary Fund
IRD	:	Inland Revenue Department
IRO	:	Inland Revenue Office
IT	:	Income Tax
ITA	:	Income Tax Act

ITR	:	Income Tax Revenue
JBR	:	Jung Bahadur Rana
Ltd	:	Limited
LTO	:	Large Taxpayers Office
M	:	Million
M.B.S.	:	Master of Business Studies
MoF	:	Ministry of Finance
No.	:	Number
Nos	:	Numbers
Np	:	Nepal
OACG	:	Office of the Controller of Auditor General
OECD	:	Organization for Economic Cooperation and Department
Org	:	Organization
PAN	:	Permanent Account Number
Prof.	:	Professor
Pvt	:	Private
RAS	:	Revenue Accounting System
RCC	:	Revenue Consultation Committee
Rs.	:	Rupees
S.N.	:	Serial Number
TU	:	Tribhuvan University
UK	:	United Kingdome
UN	:	United Nation
VAT	:	Value Added Tax
VDIS	:	Voluntarily Declaration of Income Sources
WTO	:	World Trade Organization
www	:	World Wide Web

CHAPTER - I

INTRODUCTION

1.1 Background

The prosperity of a country largely depends upon its economic growth rate, pace of industrial development, quality and competency of its manpower, geographical landscapes etc. These factors also determine the capacity of resource mobilization of the nation. If the circle of income, employment, investment, surplus (saving) and consumption are managed skillfully, the outcome of financial mobilization will be the high. A sound public financing also can perform this.

According to Dalton, “Public finance is a science concerned with income and expenditure of public authorities.” Public finance is a field of enquiry that relates of income and out go of governments. In modern time, this includes four divisions: Public revenue, Public expenditure, Public debt, and certain problems of the fiscal system as a whole, such as fiscal administration and fiscal policy (*Pant & Joshi, 2000:213 & 214*).

Revenue mobilization, foreign grants and loan, domestic borrowings and change in cash reserves are used as fiscal instruments for financing government expenditures. Of the fiscal deficit of Rs. 49804.6 million in the fiscal year 2008/09, Rs. 9968.9 billion (20%) was financed through foreign loan, Rs. 18417.1 million (37%) through domestic borrowing and remaining Rs.21418.6 million (43%) through the change in cash reserves (*Economic Survey: 2009/10*).

The major responsibilities of a government in a country is to carryout development plans, handle day to day administration to maintain peace and security, launch public welfare activities, fulfilling the basic needs of the people such as health, education, communication, drinking water and other public utilities and facilities, develop socio-economic infrastructures, maintain foreign affairs, etc. In Nepal, Government of Nepal classifies total expenditures under three heads i.e. recurring expenditure, capital expenditure and principle payment. Recurring expenditure is the general expenditure related to day to day administrative expenses, capital expenditure is related to

developmental expenditure and principle payment is related to government financing. According to Economic Survey of 2008/09, the actual total expenditure of government of Nepal is Rs. 161.34 billion and revised estimate of expenditure in Fiscal Year 2009/10 is Rs. 265.33 billion (*Advance Budget Speech: 2010/11*).

The government needs a huge amount of fund to discharge above responsibility which can be derived from various sources. The sources of revenue of the government can be classified into two sources i.e. tax revenue and non-tax revenue. Tax revenue can be classified into four components in broad sense. These are customs, tax on consumption and production of goods and services, land revenue and registration fees, income, profit and property tax. Non-tax revenue can be classified into five categories. These are charges, fees, fines and forfeiture, receipts from sales of government commodities and services, dividends from public corporations, royalty and sales of government fixed assets, and principle and interest payment from company and corporations.

Government receipts can be classified into internal and external sources. Internal sources are derived by mobilizing available resources of a country and internal borrowings. Internal resources play a vital role to make a country an economically independent. However, the developing country like Nepal has limited sources of internal funds. Most of the development activities, therefore, depend upon external sources of financing. The external sources of finances are foreign grants and foreign loan including both bilateral and multilateral. According to the Revised estimate of expenditure of FY 2008/09, external sources of financing (including grants and loans) is Rs.44.98 billion while total expenditure is Rs.213.58 billion. (*Budget Speech: 2009/10*) In FY 2008/09, total revenue is Rs.143474.488 million. The constraints in domestic resource mobilization are poor utilization of natural resources, small industrial sector, and poor rate of economic growth, inadequate tax efforts and deficiencies in tax policies, laws and administration (*Agrawal, 1978: 102*).

Tax Revenue is a major component of internal resources of finance. In FY 2008/09, tax revenue is 81.58 percent of total revenue. Hence, tax revenue is a major source of internal

financing. 54.8 percent of public expenditure has been financed through tax revenues in FY 2008/09 (*Office of the Controller of Auditor General*).

Tax is a permanent instrument of collection revenue. Taxes are withdrawn from persons (individual and entities) without leaving the government with a liability to the payee. It is a major source of revenues in the developed countries as well as developing and underdeveloped countries like Nepal. It has been appearing as a major source of revenues in Nepal since past few years. It has been as instrument of socio-economic development for the government (*Bhattarai & Koirala, 2004:2*). Tax is, therefore, a tool for achieving social and economic objectives as laid down by the government.

Taxes are withdrawn without leaving the government with a liability to the payee. Borrowings involve a withdrawal made in return for the government promise to repay with interest at a future date. Use of borrowing to raise the necessary fund is not good for economic development of a nation. It reduces liquidity position of the government and increase the inflation. Government has to impose higher taxes to repay the interest and the borrowed sum too. Hence, as a source of public revenue, taxes are better than borrowings because it is merely transferring of funds to public treasures. Borrowing, therefore, is likely to be meaningful only when if it is complement to domestic effort rather than substitute for it. External sources of revenues and domestic borrowings are uncertain, inconvenient and not good for healthy development of nation because they are to be paid after a certain period. Therefore, internal sources of revenues (especially tax) are more important not only for financing necessary funds but also of mobilization of internal sources. It is better to mobilize internal sources rather than looking with beggar's eyes to the donors.

The mobilization of tax revenue should be guided by the constitution of the state. Interim Constitution of Federal Democratic Republic of Nepal clearly states that 'No taxes shall be levied and collected except in accordance with the law.' This provision is based on 'No taxation without Representation'. This implies only the elected representation of people i.e. legislature parliament can formulate taxation laws. In the beginning of every

year, the Finance Minister tables the Fiscal bill in the parliament, which includes the budgeted revenues and expenditure for that fiscal year. It is the document of government's financial proposal. This bill determines tax rate, the procedure of collecting revenues and imposing taxes, tax policies and their objectives. Three different bills are presented and passed to implement the budget *i.e. Aarthic, Biniyojan and Rastra Rin Uthaune Bidheyak*. In this way the role of taxes in Nepal has developed dramatically to make enable the government implement its fiscal policies in order to become more independent. Now it has been an inevitable instrument of social and economic policy for the government. Now tax has been an inevitable instrument of social and economic policy for the government. It generates more revenues, it prevents concentration of wealth in a few hands, and it boosts up the economy as a whole.

Tax revenues are the composition of direct and indirect taxes. A direct Tax is tax paid by a person on whom it is legally imposed. An indirect tax is a tax imposed on one person but partly or wholly paid by another. The ratio of direct and indirect tax in FY 2008/09 is 3.43:8.27. It shows that indirect tax revenue is more than direct tax.

In direct tax, the person paying and bearing tax is the same. It is the tax on income and property. Nepal's budget system classifies the direct tax as income tax which includes corporate tax, remuneration tax, and income tax on investment, tax on windfall gain and others and house, land and other property which includes house and land registration fees and vehicle tax. Direct tax is equitable as it is imposed on person as per the property or income. It is also elastic. The government can change tax rate with the change in the level of property or income. It enhances the consciousness of the citizen. Tax payers feel burden of tax and so they can insist the government to spend their contribution for the welfare of the community. However, it is expensive for the government to collect tax individually. It gives mental pinch to the taxpayers as they have to curtail their income to pay to the government and tendency to evade tax may increase to avoid tax burden. In FY 2008/09 contribution of direct tax to total revenue is 23.92 percent.

In indirect tax, the person paying and bearing the tax is different. It is the tax on consumption or expenditure. Nepal's Budget system classifies the indirect tax as commodity tax based on foreign trade which includes import duties, Indian excise refund, export duty, other income of costumes etc. and internal commodity tax based on goods and services which includes VAT on production, import, sales and distribution, contract and consultancy, tourism industry etc, excise duty on cigarettes, bidi, liquor, beer, foreign employment service fees, health service fees and education fees. Indirect tax is convenient as the tax payer doesn't have to pay a lump sum amount of tax. There is mass participation because each and every person getting goods or services has to pay tax. There is less chance of tax evasion and the government can check on the consumption of harmful goods by imposing higher taxes (*Bhattarai & Koirala, 2006:4*).

However, it is regretful as the tax burden to the rich and poor is the same. It has bad effect on consumption, production and employment because higher taxes will reduce all of them and tax amounts are included in the price of goods or services. As a result, tax payers do not know how much tax they are paying to the government. Indirect tax is one of the biggest sources of public revenue. Its contribution to total revenue is far more than direct tax revenues. In FY 2008/09, contribution of indirect tax to total revenue is 57.66 percent.

Income Tax is a major component of direct tax revenue. Income tax means a liability to pay an amount to the government, which is a compulsory contribution to the national revenue from person's taxable income from any employment, business or investment and the total of that income as calculated in accordance with ITA, 2058 B.S.

Income tax is levied on consideration payment made for the provision of labor (employment income), or capital (investment income) or combination of both (business income). Income Tax Act, 2058 has excluded casual receipts such as prizes, lotteries, etc. (except those received in connection with employment, business or investment) from the definition of income for the purpose of income tax. These receipts can't be considered as consideration since receipts don't pay anything for these items. They are not considered

as economic activities and creation of wealth but are simply transfer of wealth. They are subject to a casual tax at a specified rate but not income tax.

Income tax is one of the major sources of direct tax revenue. It is also recognized as good financial tool to make narrow the inequality in income. The income tax is appearing as major sources of internal financing in Nepal. In FY 2008/09 19 percent of total revenue are income tax revenue and income tax bears 12.75% of total expenditure in FY2008/09. Major portion of direct tax is occupied by income tax. Income tax reduces the regional economic imbalance by providing tax concessions and tax holidays to the business and industries, which are, established in remote and backward areas the country. It will be possible to reduce the gap in income by imposing higher rate to those who are having higher income and from that collected amount providing necessary assistance to the people with very poor economic condition. The government can charge higher income tax on the income from urban areas and less on the income from remote areas. Business exemptions and concessions, income tax holidays and various incentives would help to develop the priority sector of a national economy. Hence, income tax has become an effective instrument to ensure balanced socio-economic growth (*Lal, 1997: 675*).

1.2 Statement of the Problem

In Nepal, the new modern Income Tax Act, 2058 was enacted from 01, April 2002(19, Chaitra, 2058 B.S.) to enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation. It was enacted to avoid the many defects of previous ITA, 2031 that had narrow tax base, global incomes of residents were not brought into net tax, fines and penalties imposed by the Act were very low, weak mechanism to control the tax avoidance scheme of taxpayers. Due to above drawbacks, ITA, 2031 could not be effective to collect expected revenues.

The goodness of income tax is that only a capable tax payer has to pay tax. Furthermore, only those tax payers will pay tax whose income is above the exemption limits. The study of Nepalese budget indicates that there is a significant resource gap. The estimated budged of FY 2009/10 has Rs. 109.43 billion budget deficit before foreign grants while it

was Rs. 71.37 billion as per revised estimate of FY 2008/09. The actual budget deficit of FY 2007/08 was Rs 30 billion (www.mof.gov.np). It shows the high rate of increasing trend of budget deficit. The sources of filling up the resource gap are internal and external borrowings. Though, external borrowing is not desirable for healthy economy, it has been playing a dominant role in Nepal. This may be because the tax revenue is not playing significant role to reduce budget deficit as expected.

Income tax system in Nepal has been facing serious managerial problems. The income tax administration in Nepal has been blamed that it is not so efficient. Since the government expenditure is growing, the sources of government revenue must be increased. But it can't be seen increased proportionately.

People in developing nations tend to have greater propensity to evade tax. This is because they have lesser knowledge about income tax, and they have to maintain their livelihood from their limited income. The rich people avoid tax by legal loopholes and taking advantage of an efficient tax management. The tax management personnel are provided with many discretionary powers, which encourage them to corrupt. The income tax management has become unable to widen the income tax coverage. In developed countries 30% to 40% of total population pays income tax (*Agrawal, 1978:144*).

However, in Nepal, the coverage area of income tax is very low. The number of taxpayers is just 370,000 (in FY 2009/10) which is 1.5% of the total population. Tax avoidance, evasion and delinquency have increased substantially over the years. This is one of the critical reasons, why the number of taxpayers is so low.

In developing economies, the tax system suffers from structural constraints with tremendous administrative and procedural complexities that lack simplicity and transparency. The tax system is said to be perfect and successful when additional revenue is mobilized without creating burden to the taxpayers with no change in the tax rates and legal bases and with modest discretionary changes attributing to improving efficiencies in tax administration. A prime concern of tax policy in underdeveloped countries is how best to produce adequate revenue to finance the public sectors. Therefore, the revenue

mobilization is a challenging proposition in developing countries where majority of people is in abject poverty and the people engaged in economic activities have extremely limited taxable capacity (*Shamshere JBR, 2010*).

In terms of tax revenue ratio, the contribution of direct taxes to total tax revenue is conspicuously less as compared to the contribution of indirect taxes. Since tax structure is massively dominated by indirect taxes, there is a need to move towards direct taxes i.e. income tax to mobilize internal resources at much higher level. The performance and contribution of direct tax is signal to advancement of greater scale of development. The increase in custom duties and VAT is not a reflection of success syndrome. The major challenge to Nepalese tax system is how to accelerate tax effort ratio (TER) to maximize the meeting minimum requirements for development. The TER is estimated to be 14.8% in FY 2008/09 in Nepal.

An elastic tax system is highly advantageous for compliance and strengthening tax administration. But there is no so elastic tax system in Nepal. There is no improvement in technical support for strengthening physical facilities in Nepal.

The tax authorities seem to be inefficient and ineffective in enforcement. There is no integrated program for taxpayer's education, guidance and counseling. Tax offices are looked upon as heaven for corruption, inefficiencies, delays, unfair dealings, harassments and incompetent personnel. The assessment procedure of income tax is not effective. Undue delay in tax assessment not only reduces the total revenue but also brings harassment to the taxpayers.

Within the boundaries of above general problems prevailed in present income tax system in Nepal, there may be many specific problems. The major source of income of the country is income as other sources. However, the collection of tax is very hard task to the government. The main inquiries are:

- What is the relative importance of income tax during the study period?
- What relationship is between direct and indirect tax and direct and income tax during the study period.

- What is the structure of direct and income tax during the study period?
- What is the trend of growth rate of income tax during the study period?
- What is the relationship of income tax to its components during the study period?
- What are the fluctuations between budgeted, revised estimate and actual income tax?

The main empirical questions are: whether there is significantly difference in the view of respondents on the fact that there is poor taxpaying habit of Nepalese people, suggestions of FNCCI about exemption limit and imposing tax on three layers, effectiveness of ITA, 2058, contribution of income tax Nepalese economy and what are the view of respondents on above queries. What is the major cause and reason of poor taxpaying habit of Nepalese people and existing corruption in tax administration as ranked by the respondents? In addition, what are the correlation between ranking on major causes and reasons of poor taxpaying habit of Nepalese people and corrupt practice in tax administration by respondents?

1.3 Objectives of the Study

The main objective of the study is to analyze the income tax in practice in Nepal. The following specific objectives have been set for the study:

- To study and evaluate the status of income tax as major source of revenue;
- To explore current issues in income tax management;
- To show and analyze relative importance of income tax revenue;
- To study the trend of growth rate of income tax revenue;
- To analyze the views of respondents on different issues of income tax; and
- To find out major problems of income tax faced by Nepalese tax administration and prescribe the required suggestions.

1.4 Focus of the Study

The importance of income tax can't be minimized in the public finance of a nation. Developing countries like Nepal can fulfill its financial needs by increasing its through income tax. Revenue from income tax can be maximized either by imposing taxes at

higher rate or introducing new taxes or collecting income tax properly within existing portfolios. Increment in income tax may be more burdensome to the people. Moreover, the poor people cannot bear the incident of more tax. Introduction of new taxes and properly collection of tax depends on good income tax system. Unfortunately, Nepal's income tax system is not free from problems and inefficiencies. Though this field is of high importance, sufficient, insight, timely and genuine researches are not being carried out in this field so far. It seems only the repetition of the same content. The knowledge of income tax system is required for all the parties concerned i.e. general people, businessperson, investors, personnel etc. Therefore, the focus of the study is real income tax practice and current issues in income tax system in Nepal.

1.5 Significance of the Study

Nepal is an agro-based developing country with low pace in industrialization process. There are only a limited number of corporate bodies, their economic performance is very small, and tendency of paying tax is low. So there is need to grow and develop corporate sectors. In Nepal, the government needs huge amount of funds to spend on daily expenses as well as development activities. Every year Nepal has been presenting deficit budget. There is a continuous increment in resource gap. Most of development activities have been depending upon bilateral and multilateral loans and grants. Internal resources are not enough even to meet the general expenses. In this context, the easy and long lasting way to increase revenue is to strengthen the internal sources is through tax revenue in which income tax is one of the major components. Thus a study of *Income Tax in Practice in Nepal* has been chosen as a topic for the study. This study has may depict what the real income tax is in practice.

This study may be useful to economic Planners, tax officers, tax administrators, government and other interested persons about significance of income tax, its contribution to national economy etc. It also may provide information about trends and projection of income tax and current issues of income tax in Nepal.

1.6 Limitations of the Study

This study will be based on both primary and secondary data. However, it depends more upon secondary sources of data as it is quantitative study. In spite of my great attempt, not all subject matter related to income tax may have been compiled. The scope of income tax in this study is limited. All the data are derived from government and non-government sources. This study has following limitations:

- This study is confined to the income tax in Nepalese context only.
- This study covers only the last eight years' data.
- Only 40 samples of tax officers and taxpayers have been taken.
- Primary Data were collected only from Kathmandu Valley so it may not represent the country as a whole.

1.7 Organization of the Study

This study has been organized into five chapters. They are as follows:

Chapter - I: Introduction

This is the introductory chapter, which will cover background of the study, problem statement, objectives of the study, and focus of the study.

Chapter - II: Review of Literature

This is second chapter and this will include conceptual framework i.e. theoretical analysis and review of related different studies. This chapter also will consider that how this study is different from the previous studies.

Chapter - III: Research Methodologies

This chapter will describe research methodologies employed in course of the study. This chapter will deal with research design, population and sample, sources of data, data collection techniques and data analysis tool (financial and statistical) and methods of analysis and presentation.

Chapter - IV: Presentation and Analysis of Data

This chapter will include primary and secondary data presentation, analysis, interpretation, testing of hypothesis, comments and suggestions of respondents and major findings.

Chapter - V: Summary, Conclusion and Recommendation

This last chapter will state summary, conclusion of the whole study and recommendation for improvement. The bibliography and Appendices will be incorporated at the end of the study.

CHAPTER - II

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1 Conceptual Framework

2.1.1 Concept, Meaning and Definition of Tax

The government of a country requires sufficient revenues to carry out developmental plans, handle day-to-day administration, maintain peace and security and launch other public welfare activities. In order to carry out such activities, the government collects revenues from various sources such as tax revenues from public enterprises and corporate institutions, special assessment, fees, fines, grants and assistance, etc. Among them, tax is the main source of government revenue.

Tax simply means a liability to pay an amount to the government. It is a compulsory contribution to the national revenue from the taxpayers according to the law. Tax payers get no direct and quid pro quo for the payment of tax. The tax fulfills the required expenditure of the government for public welfare. Its objectives are social justice and equal distribution of income. The tax is classified based on its structure, nature, merits, quantity, volume or form and procedure, etc. However, taxes are direct and indirect (*Adhikari, 2003:5*).

To understand more about the tax, here are given some definitions. According to Dalton, “A tax is a compulsory contribution imposed by public authority irrespective of the exact amount of service rendered to the tax payers in return and not imposed as a penalty for any legal offences.” According to the New Webster’s Dictionary, tax is “A charge imposed by government authority upon property, individual or transaction to raise money for public purposes”.

From the above definitions, it can be concluded that:

- Tax is a compulsory levy imposed by the government;
- Tax is levied on persons as per the prevailing laws;

- Those who pay tax do not get corresponding benefit from the government;
- Tax amount is spent for common interest of the people;
- Tax is calculated from haves for the interest of have not's in the society.

We, therefore, can define tax as a compulsory contribution made by taxpayers to the government without having any direct personal benefits. The tax is the major government's internal sources for public expenditure. To derive optimum economic stability, the tax is considered to be guided by the following public finance principles:

- i. Optimum choice of freedom,
- ii. Optimum ideal living-earning,
- iii. Optimum rate of economic growth,
- iv. Proportional distribution of income, etc.

To achieve the above objectives government have to collect taxes. The following points are to be considered while collecting the tax:

- Tax revenue should be used for public welfare,
- Tax should be imposed on the basis of tax payer's paying capacity and family environment with business,
- Tax should be productive, and
- Attention should be given on the rights and problems of tax payers, etc.

2.1.2 Types of Tax

Tax can be classified into two broad categories: Direct and Indirect Taxes. A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax the person paying and bearing tax is the same. It is the tax on income and property. The government of Nepal classifies the direct tax as: Income Tax, Remuneration Tax, Income tax on Investment, Tax on Windfall Gain and House, Land other Property Tax. The Government of Nepal classifies direct tax as follows with their respective code numbers:

1.1.03.00: Income Tax

1.1.03.10: Corporate Tax

1.1.03.11: Government Corporations

- 1.1.03.12: Public Limited Companies
- 1.1.03.13: Private Limited Companies
- 1.1.03.14: Personal/Sole Trading Firms
- 1.1.03.19: Other Institutions

1.1.03.20: Remuneration Tax

- 1.1.03.21: Remuneration Tax

1.1.03.50: Income Tax on Investment

- 1.1.03.51: Lease of Rent
- 1.1.03.52: Interest
- 1.1.03.53: Capital Gain
- 1.1.03.54: Dividends
- 1.1.03.59: Other income from investment

1.1.03.90: Others

1.1.04.00: Tax on House, Land and Property

- 1.1.04.30: House and Land Registration
- 1.1.04.50: Vehicle Tax

(Source: www.mof.gov.np/publication)

Direct tax is equitable as it is imposed on person as per the property or income and time, procedure and amount of tax to be paid is known with certainty. Direct tax is elastic. The government can change tax rate with the changes in the level of property or income. Direct tax enhances the consciousness of the citizens. Taxpayers feel burden of tax and so they can insist the government to spend their contributions for the welfare of the community. However, direct tax gives mental pinch to the taxpayers, as they have to curtail their income to pay to the government. Taxpayers feel inconvenience as the government imposes tax progressively. In direct tax, tendency to evade tax may increase to avoid tax burden and it is expensive for the government to collect tax individually.

An indirect tax is a tax imposed on one person but partly or wholly paid by another. In indirect tax, the person paying and bearing the tax is different. It is the tax on

consumption or expenditure. The government of Nepal classifies the indirect tax as follows with their respective code numbers:

1.1.01.00: Commodity Tax based on Foreign Trade

1.1.01.10: Import Duties

1.1.01.30: Indian Excise Refund

1.1.01.40: Export Duty

1.1.01.60: Other income of Customs

1.1.01.70: Agriculture improvement Grants

1.1.02.00: Internal Commodity Tax based on Goods and Services

1.1.02.10: Value Added Tax (VAT) on

1.1.02.11: Production

1.1.02.12: Import

1.1.02.13: Sales and Distribution

1.1.02.14: Contract and Consultancy

1.1.02.15: Tourism Industry

1.1.02.19: Other Services

1.1.02.20: Excise Duty

1.1.02.21: Cigarettes

1.1.02.22: Bidi

1.1.02.23: Liquor

1.1.02.25: Beer

1.1.02.26: Other Industrial Production

1.1.02.27: Excise on Import

1.1.02.28: Foreign Employment Service Fees

1.1.02.29: Health Service Tax

1.1.02.30: Education Fees

(Source: www.mof.gov.np/publication)

Indirect tax is convenient, as the taxpayer does not have to pay a lump sum amount for tax. There may be mass participation. Each person getting goods or services has to pay tax. There is less chance of tax evasion as the taxpayers pay the tax collected from

consumers. The government can check on the consumption of harmful goods by imposing higher taxes. However, indirect tax is uncertain. As demand fluctuates, tax also will fluctuate. It is regretful as the tax burden to the rich and the poor is same. It has bad effect on consumption, production and employment. Higher taxes will reduce of all them. Most of the taxes are included in the price of goods or services. As a result, tax payers do not know how much tax they are paying to the government.

2.1.3 Concept, Meaning and Definition of Income Tax

We can understand income tax if we first define the term ‘Income’ and ‘Tax’ separately. Income is generally regarded as the best measures of ability in the sense of economic well-being and primarily determines the level of living standard. In broad sense, income refers to the economic gain to a particular person during a particular period. 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 period.

Henry Simons, defined income as the sum of two items saying “income, as economic gains received by the person during the particular period” of:

1. The person’s consumption during the period, and
2. The net increase in the individual’s personal wealth during the period;

Symbolically,

$$Y = C + \Delta W$$

Where,

$$Y = \text{Income}$$

$$C = \text{Value of consumption}$$

$$\Delta W = \text{Net increase of personal wealth during the period.}$$

According to above definition, therefore, income is the sum of consumption and change in wealth during the period. Income can consist of three broad items:

1. The total amount of income received from the person less the expenses directly incurred in gaining this amount,

2. The value of goods enjoyed by person which are owned by him such as the use of value home owned, hence produced goods such as vegetables etc, and
3. The increases in the value of assets hold during the period.

The term 'Income' as defined by the Income Tax Act, 2058, Sec. 2 Ja: is 'person's income from any employment, business or investment and the total of that income as calculated in accordance with this Act.' It includes all sorts of income received for the provision of labor or capital or both of whatever form or nature in the taxable income. The person may be an individual or an entity. Tax is a compulsory contribution to the national revenue from the taxpayer according to the law. Findlays Shirras defined tax as 'a compulsory contribution to public authorities to meet the general expenses of the government which have been incurred for the public goods without reference to special benefits.' Hence, we conclude that income tax means a liability to pay an amount to the government, which is a compulsory contribution to the national revenue from person's taxable income from any employment, business or investment and the total of that income as calculated in accordance with ITA, 2058 B.S.

Income tax is levied on consideration payment made for the provision of labor (employment income), or capital (investment income) or combination of both (business income). Income Tax Act, 2058 has excluded casual receipts such as prizes, lotteries, etc. (except those received in connection with employment, business or investment) from the definition of income for the purpose of income tax. These receipts can't be considered as consideration since receipts don't pay anything for these items. They are not considered as economic activities and creation of wealth but are simply transfer of wealth. They are subject to a casual tax at a specified rate but not income tax.

2.1.4 Advantages of Income Tax

Income tax plays vital role in the national economy. Income tax is looked upon as a tool for achieving the social and economic objectives laid down in the national planning. It has been identified as a good financial mean to narrow the disparities in income. Regional imbalance is also being reduced by providing incentives and concessions in

income tax for starting new industries in backward and remote areas of the country. Thus, income tax is not only government revenue but also an effective instrument to ensure balanced economic growth. The absence of sound tax system leads to the economic backwardness and economic backwardness to all other forms of backwardness.

Income tax is one of the major sources of direct tax revenue. It is also recognized as good financial tool to make narrow the inequality in income. The income tax is appearing as major sources of internal financing in Nepal. Major portion of direct tax is the contribution of income tax. Income tax reduces the regional economic imbalance by providing tax concessions and tax holidays to the business and industries, which are, established in remote and backward areas the country. It will be possible to reduce the gap in income by imposing higher rate to those who are having higher income and from that collected amount providing necessary assistance to the people with very poor economic condition. The government can charge higher income tax on the income from urban areas and less on the income from remote areas. Business exemptions and concessions, income tax holidays and various incentives would help to develop the priority sector of a national economy. Hence, income tax has become a effective instrument to ensure balanced socio-economic growth (*Lal, 1997: 675*).

Income tax will also help to increase the consciousness of people because the people who have paid the income tax will be interested on public expenditure. Though they cannot expect any direct benefit from their tax paying, they can observe the use of collected fund from them in the form of income tax. Hence, income tax is helpful on generating the concept of social responsibility towards the nation and leaves the people vigilant to see that public money may not be misused.

As a poor and undeveloped country, sources of government revenue in Nepal are very limited. The domestic sources of revenue of the government should be increased to escape from the condition of depending on foreign aid and loan. Tax should impose on progressively and should widen the coverage of tax area to increase the domestic resources. However, the effect of higher taxation should be taken into care.

The effect of higher taxation may:

- Reduce the purchasing power of the tax payer,
- Tax payers may feel burden and other kinds of inconvenience,
- Consumption may reduce, and
- Reduce in incentives for work in order to earn more income

Nevertheless, there is no option of imposing tax as required and as per the laws.

2.1.5 Income Tax in International Context

Income Tax was first introduced in Great Britain in 1799 in order to finance war with France. Only in 1980, it was accepted as a permanent tax. In United States of America, first Federal Income Tax was imposed in 1862 to finance civil expenditure. However, it became a permanent feature only in 1913. In neighbor country India, at first income tax was introduced in 1860. After introducing Income Tax Act 1886 in 1886 it was imposed permanently. Italy adopted income tax in 1864, New Zealand in 1891, Australia in 1915 and Canada in 1917. After First World War, the income tax became important sources of tax revenue in many developed countries. By 1939, it has become the most important sources of revenue in most developed countries and had made appearance in a number of developing nations (*Agrawal, 1978:113*).

From the First World War decade, income tax has shown as an important source of revenue in developed countries. In the beginning of introducing time, it was generally levied at flat rate. Only after 1909, the principle of progression was introduced from the United Kingdom and New Zealand.

2.1.6 Taxation in Ancient Nepal

In ancient Nepal, taxes were levied in the form of kinds, cash and labor services. Special portions of agricultural products were payable to the then King as tax. There also existed tax payable in gold. Fixed taxes were levied in the villages. Compulsory manual work from all artisans and laborers were also a common way of paying taxes. In the Lichhavi Period the main sources of revenue was tax. At that time taxes were known as *Trikar* which means three kinds of taxes i.e. *Bhaga*, *Bhoga* and *Kara*. The *Bhaga* tax was levied

on agriculture, the *Bhoga* tax was on animal and the *Kara* tax on business income. Irrigation tax and religious monuments preservation tax also existed at the time of King Anshuvarma of Nepal.

2.1.7 Income Tax in Modern Nepal

Although the taxes were collected in various forms in ancient era, the history of modern income tax is not very old in Nepal. The idea of introducing income tax in Nepal originated in the early 1950s when a multi-party democratic political system was introduced. In 1951, the then Finance Minister in his budget speech declared the intention of the government to levy an income tax.

Attempts were made to introduce income tax in subsequent years. In 1954, an income tax with Rs.10,000 basic allowance and progressive taxes ranging from 5 to 25 percent was proposed. Due to political instability, it could not be introduced until 1958. The first elected government in 1959 finally introduced *Business Profits and Salaries Tax Act 1960* in Nepal. At that time, income tax was levied on only business profits and salaries. After about three years experience of income tax, the government replaced the prevailing tax Act by *Income Tax Act, 1962*. The coverage was extended in the Act. In 1974, *Income Tax Act, 1974 (2031)* was enacted. The Act remunerated income sources into five groups (a) Agriculture (b) Industry, Trade, Profession or Occupation (c) Remuneration (d) House and Compound Rents (e) Other Sources. However, agricultural income was kept outside the tax net except few years through the Finance Act.

To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend and integrate the laws relating to Income Tax, the Parliament of Nepal enacted *Income Tax Act, 2058 (2002)*. This Act has replaced Income Tax Act, 2031 (1974), which was amended for eight times and existed for a period of 28 years. The then HMG/Nepal framed an *Income Tax Rules, 2059* to help clarifying the Act.

2.1.8 Income Tax Law

Legal support is necessary to impose tax on the public. The Interim Constitution of Federal Democratic Republic of Nepal, 2063 B.S. has made a clear provision about it. It says, ‘No taxes shall be levied and collected except in accordance with the law.’ Present provision of income tax is associated with the following legal considerations:

- The Interim Constitution of Federal Democratic Republic of Nepal, 2063 B.S.,
- Income Tax Act, 2058 B.S.,
- Income Tax Rules, 2059, updated, 2065
- Finance Act of the Current Year.

2.1.9 Income Tax Policy

Income tax policies are the broad objectives and ways of doing in the matter of income tax. It plays a supportive role of income tax law. The main tax policy of Nepal was to collect revenue before FY 2043/044 B.S. There were not any specific objectives. There was narrow tax base. The Adjustment Program enacted in FY 2043/044 B.S. took the following steps:

- To clarify specific objectives of the tax,
- To widen the tax coverage area,
- To attempt to form the Revenue Board, etc.

After the advent of multi-party democracy in 2047 B.S., the Revenue Committee formed in chair of Bhuwaneswor Khatri in 30, Phalgun, 2047, has suggested the following income tax related policies to widen the tax base:

- To develop Property Tax to reconcile the income tax,
- To reduce income tax rate to increase tax coverage area, etc.

Tax revenue has not supporting in nation building to the extent as it is expected due to the existing unscientific and unsystematic tax system in Nepal. This is due to not identifying new areas of tax, traditional tax system which is burdensome and defective tax collection.

The income tax policies of Government of Nepal are short-term, mid-term and long-term. Short-term income tax policies are specified every year by passing the Finance Act and a

concept paper of the Periodic Plan specifies Mid-term and Long-term policies. The major Income Tax policies of Government of Nepal are as follows:

- To widen the contribution of tax in resource mobilization considering the capacity of the economy i.e. to widen the coverage of tax,
- To assess the tax on the basis of declared transaction, value and self-assessment making transparency the direct and indirect taxes,
- To put an end to self-intention right in tax assessment,
- To lessen the heavy dependency upon indirect tax,
- To widen the tax coverage on the basis of proportional and equality,
- To aware and train the taxpayers about the procedure of tax system,
- To specify low tax rate so that lower-class people and low-income earners can get relief, and
- Tax administration will be made sound, clear and simple, etc.

2.1.10 Income Tax Programs

Finance Minister declares Income Tax Programs every year through the Finance Act. These programs are short-term especially for a year. According to the Budget Speech of FY 2009/10, internal sources will be increased and external dependency will be reduced for the sake of huge investment required to achieve high economic growth rate. Investment friendly environment will be created for the promotion of private sector investment by removing all kinds of policy and infrastructure oriented obstacles. Revenue mobilization will be increased significantly by increasing the tax net and administrative capacity. The Budget has adopted the following income tax programs and activity to achieve the above objective:

- “Our tax contribution for our own development and for the creation of modern and prosperous Nepal.” This slogan will be used to observe fiscal year 2009/10 as “Tax Compliance Year” for developing taxpaying habit. All income earners and advance tax payers (TDS payers) will have to get PAN members compulsorily.
- Income earners involved in different employments, occupations or investments without PAN numbers, who have not paid or only partially paid taxes (people like consultants, doctors, engineers, lawyers, artists, commission agents) will, if they get

PAN numbers within the last day of Magh 2066 (mid Feb-2010) and submit the tax returns of the fiscal years 2007/08 and 2008/09 and pay the tax, will be exempt from submitting the tax returns of the previous year and enjoy exemption on payment of tax, charge, interest and penalty on it. Those who don't file tax returns and pay tax within this exemption period will be subjected to the payment of all taxes, charges, interest and penalty from the time they got involved in income generation.

- Considering the commercial use of houses and lands in different cities including those of Kathmandu valley and other urbanized village development committees, arrangement has been made to levy capital gain tax on such house and/or land transaction exceeding five million rupees with a view to bringing them into the tax net.
- Arrangement has been made for hiring the services of tax graduates or university students willing to do internship as volunteers in Inland Revenue Offices or other Revenue Offices so as to effectively implement tasks like bringing people into tax nets.
- Arrangement has been made not to look into the income source of manufacturing industries using more than 50 percent indigenous raw material, employing more than 300 national workers or those of national importance such as hydro electricity projects, international airports, tunnel ways, roadways or railways until mid April, 2019.
- Arrangement has been made to levy only 90 percent income tax on special industries and information technology industry, which directly employ 300 or more Nepalese all the year round. Similarly, industries which directly employ 1200 or more Nepalese nationals all the year round or which provide direct employment to more than 100 Nepalese nationals including 33 percent women, dalits (the downtrodden) or the handicapped will have to pay only 80 percent tax on their income of the particular year (*Budget Speech:2009/10*).

2.1.11 Income Tax Management

Income tax management covers the whole income tax system. Income tax management includes tax lawmaker, policy maker and tax administrator as its lower level management. Income tax management implements the objectives and programs of income tax law and policies into practice. Income tax management is the most important element in income tax system. Imposing tax on a person's income is very difficult task because it is the process of picking money from the person's pocket. The objectives of income tax management may be collection of maximum revenue for development, reduce inequality of income and wealth distribution among people, promotion of private sector investment, etc. In conclusion the overall objective of income tax management is to maximize revenue for achieving the goal of income tax system.

Every management has to perform some tasks to achieve desired goal. The functions of income tax management are no different from the functions of other management sciences. The functions of income tax management may be to find out tax payers, net income of tax payers, make timely assessment of income of a taxpayer, collect taxes in an efficient and secured way in a minimum cost, and to make rules of taxes simple, clear, and effective, etc.

Each work needs efficient management system for the fulfillment of desired goals. For the purpose of income tax management, there are mainly four components i.e., the Legislature Parliament, Ministry of Finance (Nepal Government), Inland Revenue Department and Tax Offices.

2.1.12 An Overview of Income Tax Act, 2058 B.S.

The concept of income tax was introduced in 2017 B.S. The Income Tax Act, 2031 was in existence before prevailing present ITA, 2058. The ITA, 2031 was not efficient due to legal constraints. Income tax related various Acts governed matters. Dispersions of tax related Acts had arisen confusion in the effective implementation of the Act. There was need various laws such as Finance Act of current year, Industrial Enterprise Act, Labor Act, Bonus Act etc in addition to Income Tax Act to assess the tax of a person.

The norms of present Revenue Policy is to mobilize revenue by widening the tax coverage area not by increasing tax rate. Under these norms, the ITA, 2058 has brought all the income derived through labor or capital or labor plus capital or flow of resource and assets under tax net.

Income Tax Act, 2058 is based on Modern Concept of Income Tax. Income of a person may not be confined within a geographical landscape due to prevailing World Economic System where the capital and technology also may not be confined within the boundaries of a country, the norms of World Trade Organization and Liberal and Competitive Economic System. The ITA, 2058 has adopted *Residence Principle of Income Tax*. According to this principle, the global income of Nepalese residents is taxable.

The ITA, 2058 has made provision on filling the return of income. Hence every taxpayer should file at the place prescribed by the Department a return of incomes not later than three months after the end of each income year. This is based on the principle *Pay as you Earn*. From this, there happens simultaneously assessment of income tax as well as payment of tax of a person. This discharges the person from the tax liability and makes the government collect the revenue in time. There is also provision of Tax Deducted at Source (TDS) while payment to natural person. These TDSs are final withholding payments. So the tax payers need not attend to the tax office to pay tax.

Income Tax Act, 2058 has many salient features. It is based on modern principle and norms. In our context, it is latest and with new presentation. It has been a decade since ITA, 2058 been effected. On this duration, it has many ups and downs in respect to its implementation. There has also been issued the *Income Tax Manual-2066* to give uniformity to the provisions prevailing in the Rules of ITA, 2058 by uniting all the provisions in a simple and practical manner. This manual also have interpreted and clarified the provisions made on the Act and the Rules, where necessary.

2.1.12.1 Objectives of ITA, 2058

The main objectives of Income Tax Act, 2058 are as follows:

- To bring all income generating activities into tax net,
- To harmonize tax rates and concession on equity grounds,

- To widen the tax base,
- To confine all the income tax related matters within the Act,
- To make income tax elastic and revenue productive,
- To reduce the scope of discretionary interpretation of the tax authorities,
- To minimize tax avoidance and tax evasion:
- To make tax payers most responsible by enforcing tax self assessment system,
- To integrate Nepalese tax system with the tax system of foreign countries.

2.1.12.2 The Special Features of ITA, 2058

ITA, 2058 has been enacted with wide perspective. Various new concepts are introduced in this Acts as compared to ITA, 2031. Many of the concepts put forward in this Act were not prevailing at Nepalese tax culture before. This Act contains 143 sections. The special features of the Act are:

- The Act has broadened the tax base. Tax rates are spelled out in the Act itself and the tax rates and concessions are harmonized on equity grounds.
- A full-fledged self-assessment system is implemented and the presumptive taxation and current year taxation system are strengthened.
- The scope of discretionary interpretation of the tax administration is drastically reduced ensuring simplicity, uniformity and transparency. The Acts has also defined the power and authority of the tax administrators.
- The Act has separated administrative and judicial responsibility by distinguishing civil liabilities of the taxpayers form criminal liabilities.
- The appeal system is further streamlined by making it mandatory for the taxpayers to file an objection with the IRD for administrative review before appealing to the Revenue Tribunal. (www.ird.gov.np/income tax)

2.1.12.3 Tax Administration

Income tax is administered directly by the IRD. It is responsible for the implementation and administration of the Act. Nepal Government is the higher authority of the tax administration. The Act has empowered Government of Nepal to establish tax offices of the Department and prescribe their jurisdiction by notification in the Nepal Gazette to

facilitate the Department in fulfilling its responsibilities. The following officers and other staff may be deputed in the Department:

- A Director General
- Deputy Director General in the numbers as may be required
- Chief Tax Administrator
- Directors
- Chief Tax Officers
- Tax Officers
- Other Officers and
- Others Staff

The Ministry of Finance is the apex of tax administration. The Ministry carries out the functions related to taxation on behalf of Government of Nepal. The revenue Department of Ministry is responsible for formulating tax related policies and coordinating the activities of all Revenue Departments. Inland Revenue Department was formed in 2001 by merging the Department of Taxation and the Department of VAT. Currently there are 22 Inland Revenue Offices all over Nepal. A Director-General, a gazette first class officer, heads Inland Revenue Department.

2.1.12.4 Permanent Account Number (PAN)

The Provision for Permanent Account Number (PAN) has been made in section 78 of ITA, 2058. For identifying the person, the Department issues a person with a number, which is known as 'PAN'. The Department has made a compulsory to state PAN in any return, statement or other documents used for the tax purposes.

PAN is a permanent unique identifying number given to every taxpayer. It is never changed after once taken by the taxpayers though the same taxpayers change their business or business site or the nature of business or other transactions. Hence it is called PAN. It is useful for the persons to pay tax and store the individual information. It is also identifying number for business, employment and investment. The number created through the computer system may be such as 100362557. PAN is necessary because the

government of Nepal has made to get PAN members compulsorily. It is necessary to mention PAN number on the transaction, invoices used for banking transactions, ledger, documents and returns of income and other tax related documents by industries, professionals, trade, business (including entrepreneurs). It also facilitates the taxpayers to do own business and to pay tax. It brings transparency in transactions. PAN is also mandatory to whom who have taken Income Tax Registration Certificate earlier before the PAN system. PAN members also can be got through the internet by applying on www.ird.gov.np. However, the PAN should take from IRD. There is subject to fine of Rs.5, 000 to 30,000 according to ITA, 2058, article 119 ka: who violate the compulsory provision of the Act. The following persons are necessary to get the members of PAN:

- Persons giving house on rent to government and semi-government institutions, and private entities,
- Doctors, Engineers, Lawyers, Auditors, Personal Consultants, Insurance Agents, Artists and Commission Agents,
- Persons having transaction of share exceeding Rs.1 million,
- Individual having taxable income from employment exceeding Rs.1, 60,000 and couple having taxable income from employment exceeding Rs.2, 00,000.
- Natural person-owner of vehicles.

Natural persons and companies should take different PAN. However it is created by the same unique numbering system. The same PAN number is given for income tax and VAT. Individual (both single and couple) having employment income are compulsorily to be taken PAN number since FY 2009/10.

E-PAN is the provision of getting PAN through the internet by authorized institution of IRD without going to apply in the IRD. It can be issued through www.ird.gov.np by receiving the application form and filling by the taxpayers. E-PAN is of two types: Personal e-PAN and Business e-PAN. Personal e-PAN can be converted into Business PAN by registering the business i.e., company and applying to the office concerned with the certificate of company registration. There can be only one PAN in the life of a person.

The PAN, therefore, facilitates in transaction, in export and import, to take loan from the bank, etc.

2.1.12.5 Tax Rates in FY 2009/10)

The taxable income of a resident individual for the income year 2066/067 will be taxed at following rates:

- Up to Rs.1,60,000-1 percent
- From Rs.1,60,000 up to 2,60,000@15% plus Rs.1600
- Above Rs.2,60,000@25% plus Rs.16,600

Taxable Income of a couple, if they choose to be treated as a couple will be taxed at the following rates:

- Up to Rs.2,00,000-1 percent
- From Rs.2,00,000 up to Rs.3,00,000@15% plus Rs.2,000
- Above Rs.3,00,000@25% plus Rs.7,000
- The business person who have registered own proprietary firm should not pay above 1(one) percent tax.
- For the purpose of the Act, net gains from the disposal of non-business chargeable assets will be taxed at the rate of 10 percent.
- The presumptive tax for individuals conducting small business (who have a turnover of Rs.2 million or an income of Rs.2,00,000) in the metropolitan or sub-metropolitan municipalities and anywhere else in Nepal amount to Rs.5,000, 2,500 and 1,500 respectively.
- The taxable income of a non-resident individual is taxed at 25 percent.
- The taxable income of an entity will be taxed at the rate 25 percent unless prescribed otherwise.
- The taxable income of 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.
- Gain from lump sum retirement payment made by an approved retirement fund or Government of Nepal is taxed at the rate of 5 percent as a final withholding tax.

- 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 derived by an entity engaged in an industrial enterprise, export business, or derived from operating any road, bridge, tunnel, ropeway, or flying bridge is taxed at 20 percent.
- The taxable income of an entity engaged in power generation, transmission, or distribution is taxed at rate of 20 percent.
- The repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal will be taxed at 10 percent.
- The taxable income of an entity wholly engaged in the projects conducted by any country so as to build public infrastructures, own operate and transfer it the Government of Nepal in power generation, transmission, or distribution for an income year shall be taxed at the rate of 20 percent. (www.ird.com/incometax)

2.1.12.6 Tax Accounting and Timing

Tax Accounting is the accounting of incomes and expenses for tax purposes as prescribed by the Act. ITA, 2058 has specified the method of tax accounting in sec. 22 when a person derives an income or incurs expenses is done according to the Generally Accepted Accounting Principle (GAAP). The tax accounting should be based on accounting standards prevailing in the country. In the absence of such standard, any prevailing international principals specified by the Department should be followed. The following are the use of tax accounting as specified by the Act:

Table 2.1
Tax Accounting and Timing

Person	Income Head	Accounting Method
Individual or Couple	Employment/Investment	Cash Basis
Sole Trader/Proprietorship	Business	Cash or Accrual Basis
Company	Business/Investment	Accrual Basis
Other entity	Business/Investment	Cash or Accrual Basis

Cash basis of accounting method treats an amount as income only when payment is received and as expenses when the payment is made. Accrual basis of accounting method

treats an amount as income when the person becomes entitled to the payment and as expenses when the person is obliged to make a payment.

Bad debts are allowed to be written off if a debt claim of a bank or financial institutions has become bad debts as determined in accordance with the prescribed standards. Inclusions and deductions under long-term contract are calculated according to the percentage of the contract completed during the year. It is important to note the difference between financial and tax accounting. Financial account is prepared based on Generally Accepted Accounting Principle (GAAP) whereas tax accounting is mainly governed by prevailing tax laws. For example, in financial accounting, depreciation is charged for each asset separately using diminishing balance method, straight-line method or any other methods. But ITA, 2058 has followed the pooled system of depreciation.

2.1.12.7 Capital Gain Tax

Capital gain (loss) is defined as a gain (loss) realized from the disposal of capital assets by a taxpayer. It is the difference between the purchase price (outgoings) and selling price (incomings) of capital assets. Earlier, income tax laws had not made any specific provision regarding taxation of capital gains (losses). As a result, items of similar nature were treated differently. Capital gains except from disposal of business assets of an individual were not brought into tax net. In case of other taxpayer, capital gains were included under the heading of other sources of income. On the other hand, capital losses of similar nature were not allowed for deduction. Such diverse treatments has arisen confusion. Income tax act, 2058 had avoided these much confusion. However, the Act does not provide the definition of capital gains. The act has treated depreciable assets, business assets and non-business chargeable assets as capital assets and gains realized from disposal of such assets as capital gains. The Act, therefore, does not cover all the gains except the above three.

The tax is imposed on the net gains, which are the total gains minus the total losses including unrelieved losses for the current income year and those from a previous income year, which thus can be carried forward forever. Gains are defined as the difference between incoming and outgoing for the asset or liability.

2.1.12.8 International Taxation

For taxation purposes, all payments and gains need to be considered based on source country of the payment. Details of the circumstances under which the source rules are defined are given in the Act. Tax is imposed on repatriated income of a foreign permanent establishment of a non-resident person, situated in Nepal. A resident person carrying on a business of character or air transport operator is fixed at flat rate on their amounts derived from carriage of passenger, mail or goods, which embark in Nepal.

A tax credit may be claimed for any foreign income tax paid with respect to foreign source income. The tax credits are calculated separately for assessable foreign income sourced in each country and will not exceed the average rate of Nepal income tax applied to the assessable foreign income.

Nepal has Tax Treaties with 10 countries. The purpose of the treaty is to relieve double taxation and prevent fiscal evasion and to ensure reciprocal administrative assistance in the enforcement of tax liabilities. In case, existing income tax law contradicts the treaty, the provisions of the treaty will prevail.

2.1.12.9 Return of Income and Assessment

The term 'assessment' means the process of determining the tax liability of assesses. ITA, 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. There are three types of assessment system (i.e., self-assessment, jeopardy and amended assessment). Self assessment is done by assesses himself at the time of submission or filing return of income and jeopardy and amended assessments are the assessment based on judgment of the Department.

In general, every taxpayer should file a signed return of income not later than three months after the end of each income year. Unless explicitly requested by the Department, no return are required from taxpayers who have not tax payable for the year or are resident individuals who have income exclusively from an employment having a source

in Nepal, who have only one resident employer at a time during the year and who don't claim a deduction of their taxable income by gifts to exempt organizations.

Unless an assessment has been emended or reduced by order of the Revenue Tribunal or of a court, the Department may amend an assessment within 4 years in order to adjust the assessed person's liability to tax in such manner as, according to the Department's best judgment, is consistent with the intention of the Act. An assessment may be amended at any time in cases of fraud. Where the department makes a jeopardy or amended assessment, it will serve a written notice on the taxpayer.

Returns of income can be of two types: interim returns (i.e., statement of estimated tax payable) and final returns of income. ITA, 2058 has treated every assessment as self-assessment. Even if a person fails to file a return by the due date, the person is treated to have made an assessment on the due date for filling the return, his assessed tax for the year will be equal to the sum of the withheld, and tax paid in installment. The Department may, then, proceed for an amended assessment.

2.1.12.10 Administrative Review and Appeal

A taxpayer may not be satisfied with the assessment made by tax offices in such a cases, he may lodge an objection against the assessment with the Director General (DG) or Revenue Tribunal. In order to ensure justice or impartiality, it is necessary to establish a sound appeal system. ITA, 2058 has made provisions for two types of appeal system: first to the IRD for an administrative review and second is to Revenue Tribunal.

A taxpayer who is aggrieved by a reviewable decision may file an objection within 30 days after the decision is made. In doing so, such taxpayer has to deposit 50 percent of due amount. The Department may stay, amend, or do necessary corrections with regard to these reviewable decisions. If the Department fails to serve a taxpayer may elect to treat the Department as having refused his objection and appeal to the Revenue Tribunal.

2.1.12.11 Penal Provisions

It is necessary that all the taxpayers comply with the tax Act voluntarily. Some tax payers may try to remain out of the tax net, some may not maintain proper accounts, some may not submit tax returns, and some may not pay tax and so on. Therefore, it is necessary to take action against those who do not comply with the Act. Penal provisions are made in the form of penal interest and penalties. Interests are charged on delinquent taxes so that taxpayers may not delay tax. Penalties are fixed to correct the misbehavior of the taxpayers. If penalties are not levied on the tax payers who violate the Act, there may be a tendency not to follow rules and non-compliance will increase. ITA, 2058 has two types of penal provisions:

Interest and Penalty

The Act has provided rights to tax offices to impose interest and penalty. The circumstances in which tax offices impose interest penalty are pointed out below:

- Interest for understating estimated tax payable by installment (sec. 118),
- Interest for failure to pay tax (sec. 119),
- Penalty for failure to maintain documentation or file statements or return of income (sec. 117),
- Penalty for making false or misleading statements (sec. 120),
- Penalty for aiding or abetting another person to commit such offences (sec.121),

Offences

Offences are dealt with in the Act in a sense of criminal offences of taxpayers as well as tax administrators. They lead to punishment in the form of fines and imprisonment on conviction. The Act has provided no rights to tax offices to impose offences. So offences are imposed by the courts. The offences attracting the imprisonment include:

- Offences for failure to pay tax (sec.123),
- Offences for submitting false or misleading statement (sec. 124),
- Offences for obstructing and coercing tax administration (sec. 125),
- Offences made by authorized and non-authorized person (sec. 126),
- Offences for aiding or abetting (sec. 127),
- Offences for failure to comply with Act (sec. 128).

Administrative Review, therefore, is review of reviewable decisions made by Inland Revenue Department so as to correct mistakes made by tax administrators internally. Revenue Tribunal is the last fact-finding body. A taxpayer who is aggrieved by a decision on an objection may appeal to the Revenue Tribunal in accordance with the Revenue Tribunal Act 2031.

2.1.13 Current Issues in Nepalese Income Tax Management

2.1.13.1 Inland Revenue Department

Inland Revenue Department was formed in 2001 by merging the Department of Taxation and the Department of VAT. Inland Revenue is currently responsible for the enforcement of Tax Laws and administration of the following taxes: Income Tax, Value Added Tax, Excise Duty, Vehicle Tax and certain fee and duties like Entertainment fee (Film Development Fee), Special fee, etc. Likewise, the Department is also responsible for monitoring the non-tax revenue such as dividends, royalties etc. of the Government. IRD is centrally located in Kathmandu. There are 22 field offices throughout the nation including a Large Taxpayers Office located in Kathmandu. IRD and its district offices are totally running on functional line. Major functions include Taxpayer's service, Audit and Collection. A Director-General, a gazette first class officer, heads Inland Revenue Department. The ultimate destination of IRD is to increase the tax compliance by making tax administration sound, skilled, effective and modernizing by developing globally compatible taxpayer friendly tax administration. IRD is working as making optimum mobilization of internal resource to accelerate economic development. The main role of IRD is to implement the policy of increasing self-tax compliance by widening base and coverage of tax and through excellent service, delivery by broadening tax coverage area and base not by increasing the rate of tax. At the same time, IRD's responsibility is to reduce the tax collection cost and implementing favorable policy to expand and promote economy. IRD is playing a main role in developing taxpaying habit in the society and discourage to revenue leakage by identifying potential area of revenue leakage areas. The IRD is committed in applying a wide e-governance and making it tax-friendly with the changing time. The reforms in tax administration and tax system are a regular and

continue process. There may be many policy, process, structural reforms in tax area. It's only possible by the help of private sector and civil society.

Functions

IRD carries out the following functions:

1. Tax Administration (Income Tax and VAT)
2. Tax Policy
3. Taxpayer Services
4. Registration, Revenue Collection
5. Tax Audit
6. Tax Enforcement and investigation
7. Review and Appeal
8. Tax Refund
9. Advance Ruling
10. Tax Treaty and International Taxation
11. Excise and Liquor Administration
12. Monitoring of non-tax

Vision

To increase voluntarily tax-compliance by developing Globally Compatible Taxpayer Friendly Tax Administration

Mission

Making and implementing tax policy with slogans of “our tax contribution for our own development for the creation of modern and prosperous Nepal.” And optimum mobilization of Revenue by developing credibility, neutrality, efficient, transparent tax system and making investment friendly tax system.

Major Norms

The major norms are taxpayer friendly faire treatment to all, professionalization, and guarantee of excellent service, implementation capacity with positive mission, commitment to the state policy, good conduct and transparency.

Major Objectives

Making tax system equity, sound and transparent, economy, skillful and modernized with latest technology, provoking the policy of economic expansion, reducing the tax compliance cost and time of taxpayers and tax collection cost of the government, promoting voluntarily tax- compliance and providing excellent service to the taxpayer, protecting the right of taxpayer, strengthening the organizational capacity for forced tax audit and investigative tax audit of who don't come into tax net or come less, increasing internal revenue mobilization, and intensifying in tax reforms efforts in compared to neighboring countries.

Strategies to be Adopted for Good-Tax System

The major strategies adopted by IRD for good tax system are: Increasing tax coverage area by increasing tax base not by rate, making a firm and wide base for revenue growth, facilitate in the process of business from starting to close, creating investment friendly environment for economic growth, guarantee the good conduct of service provider, reducing business cost of taxpayers by e-governance, making tax payers efficient in discharging formalities of taxpaying process through taxpayers' education, professionally organizational structure, mission and working style, and eliminating the revenue leakage forcefully by identifying its potential area.

Major Commitments

“Efficiency, Neutrality, Transparency, Economy, Promptness, Dynamic and Taxpayer-friendly”

2.1.13.2 Taxpayers Rights and Assurances

In addition to the specific rights and assurances provided in the concerned Acts, taxpayers in general are assured of the following rights. These assurances will be strictly adhered to. The Taxpayers rights, among others, include:

- Each taxpayer is treated with due respect and honor.
- Each taxpayer will get an immediate receipt of return submission whilst a receipt of other correspondences is to be provided in ONE hour.

- Each taxpayer willing to seek an advance ruling may apply either in the Department or through concerned Inland Revenue Office. There is a legal provision that a decision should be made within 45 days after the request is made.
- Each taxpayer can represent or make any correspondence by an authorized person including legal assistants and the accounts specialist or auditors just in case if he/she is unable to represent or make any correspondence.
- Each taxpayer is to get refund of his excess input tax (VAT) and other taxes. The exporter will get refund generally within 15 days in IROs and 30 days in IRD upon receiving application for refund.
- Each taxpayer is to get copies of the documents related with him/her or submitted to the IRO or documents or decisions affecting her/him generally in TWENTY-FOUR hours of his/her request in the concerned IRD.
- Each taxpayer is to get certificate/renewal of Excise/Liquor business generally within TWENTY-FOUR hours after the request is made.
- Each taxpayer is to get sales and purchase books certified by the Tax Officer generally within TWENTY-FOUR hours after the request is made.
- Each taxpayer is to get Permanent Accounts Number (PAN) or the Certificate generally within 3 days after the request is made, and
- Each taxpayer is to get Tax Clearance Certificate generally within TWENTY-FOUR hours after the request is made.

www.ird.gov.np/information

2.1.13.3 Major Functions Performed by IRD in FY 2008/09

There is a good collection of revenue in FY 2008/09 due to the achievement of effective implementation of government's tax policy and its desired results. The process of making tax system modernized is being improved. There has reduced the tax collection cost and tax compliance cost and time by displacing traditional working system by electronic system. There has also been the base and coverage area of tax wide. The schemes brought into are also has been effective and result-oriented. The Major functions performed by IRD are as follows:

Voluntarily Tax-Compliance

One of the tax policies is to increase voluntarily tax payers. As result, 71 educational consultancies have registered in VAT under the new provision of finance Act, 2065. PAN registration has been conducted as campaign. There has been organized many trainings programs to educate the taxpayers. There also have been published and broadcasted many public awareness programs on radio, TV, and newspapers.

Widening Tax-Coverage

There have been some achievements under the strategy to increase tax coverage not tax rate. The coverage of tax has been broadened by mobilizing volunteers (4 months) to widen the house rent, VAT and income tax. Under Tax-Coverage Expansion Program, 65,944 new taxpayers have come under tax net in FY 2008/09. To simplify complex provisions of the Act, IRD has published so many brochures such as: Tax Payment and Collection Procedure-2008, TDS-2008, ‘Let’s take PAN and conduct business confidently-2009’, Tax Exempted Amounts-an introduction- 2008, etc.

Use of e-Governance to facilitate in Service Delivery

The IRD has introduced e-TDS in income tax and PAN can be registered through online. IRD’s target is to conduct all the activities through e-governance in five years. The Oracle 8i, installed in 1998, has been converted into Oracle 10g which increases data safety and storing capacity. The department has started making comprehensive plan and programs of e-governance master plan, and associating personal e-PAN with e-TDS in current year by expanding use of e-system in revenue administration. There has been sample trial of e-filing of Debit-01 and Debit-02 returns of income. About 1, 86,102 income tax payers have filled their return of income. 1, 00,477 returns have been entered in the computer out of filled returns of income. 2,752 e-PANs have been e-filled in FY 2008/09, which has reduced tax compliance cost. The e-TDS system has achieved a great result in this year. 18,000 advance tax returns have been verified. As a result, 4,140 million revenues could be collected.

2.1.13.4 Analysis of Tax Collection Cost for Operating Efficiencies

The total collection cost of income tax, VAT and excise duty for FY 2008/09 is Rs.275.133million, which is Rs.107.168million less than previous year. However, revenue collection is increased by Rs.13809.023 million than the previous year. The total tax collection cost is Rs. 5.61 per thousand. This is very low cost of tax (*Account Department: IRD, MoF*).

2.1.13.5 Different Schemes Conducted by IRD in FY 2008/09

1. Declaration of House-Rent income
2. Self-Assessment of Income
3. VDSI (Voluntarily Declaration of Source of Income) Campaign
4. Tax-Audit to encourage Tax-Compliance
5. Investigative Tax-Audit of Non-Compliance or Less Compliance
6. Billing Enforcement for increasing Tax-Compliance

2.1.13.6 Revenue Collection

VAT and Custom duty would take the first and second position in Nepalese internal revenue mobilization. However, in FY 2008/09, the second position had taken by income tax. This indicates that the tax base is being widened and sustainable management of revenue mobilization. The contribution of internal revenue is increasing in total revenue. In the FY 2008/09, it is 59.26 percent out of total revenue. The contribution of internal revenue to the estimated total GDP (Rs.9600920 million in current price) is 8.86 percent in FY 2008/09. This is 1.53 percent greater than FY 2007/08. Out of it contribution of VAT, income tax (including house rent and interest) and excise duty is 4.14, 2.84 and 1.69 percent respectively on GDP. It was 3.79, 2.11, and 1.27 percent respectively in FY 2007/08.

Revenue Status as of mid-March of FY 2009/10

A total Revenue of Rs. 10546.3 million has been collected by mid-march of the fiscal year 2009/10. Total revenue of Rs. 84,203.2 million was collected in the same period of the previous fiscal year. Thus, the rate of revenue growth has been 25.2 percent till mi-

March of the fiscal year 2009/10 as compared to the same period of the previous fiscal year. Of the total revenue collection, Rs. 93,080.5 million came from the tax revenue, and Rs. 12,383.8 million from non-tax revenue. the tax revenue growth rate registered 36.7 percent till mid-March of the current fiscal year 2009/10 as compared to the same period of the previous fiscal year, while non-tax revenue grew by 23.2 percent more than in the previous period. (*Economic Survey: 2009/10*)

Revenue Status as of Mid-July (End of Ashad) of FY 2009/10

The Ministry of Finance said on 20, July, 2010 that revenue collection surpassed the target by Rs.3.4 billion to reach Rs.180 billion in the last fiscal year 2009/10 against the target of Rs. 176.50 billion. The fiscal year 2008/09 saw revenue collection of Rs. 143.47 billion compared to the projected Rs.141.72 billion. In the previous year, the government took in Rs.107.67 billion against the target of Rs.103.67 billion. In fiscal year 2006/07, revenue collection was Rs.87.71 billion against the target of Rs.85.38 billion. Out of the total revenue collected last year, the country received an estimated Rs.56.75 billion in value added tax, Rs.33.75 billion in income tax, Rs.35 billion in customs and Rs.24.25 billion in excise duty. Likewise, the government collected Rs.5 billion in registration fees, Rs.2.25 billion in vehicle tax and Rs.23 billion from non-tax measures.

Among the various revenue sources, the government has exceeded the target in most of the revenue components except income tax and registration fees. The targeted income tax was 36.3 billion. It also could not meet the revised estimate made in mid-six month's review by Ministry of Finance. The revised estimate of total revenue was Rs.189.6 billion while the budgeted revenue was Rs.176.5 billion. This is due to decrease in real estate business and it has effect in vehicle tax. However, revenue growth rate was 25.5 percent in FY 2009/10 compared to FY 2008/09. Income tax was affected due to load shedding and labor conflict in industries, which made worse performance in industrial sectors. The targeted and overall monthly revenue collection in FY 2009/10 can be shown in the following table:

Table 2.2
Monthly Revenue Collection in FY 2009/10

(Rs. in millions)

Month	Target	Collection	Remarks
Shrawan, 2066 (July-August, 2009)	Up to 9780	11740	
Bhadra (August-September)	Up to 19070	22550	
Ashwin (September-October)	Up to 28630	34320	
Kartik (October-November)	Up to 41330	46690	
Mangsir (November-December)	Up to 54860	58600	
Poush (December-January, 2010)	Up to 74970	79680	
Magh (January-February)	Up to 90410	94280	
Phalgun (February-March)	Up to 105170	105580	
Chaitra (March-April)	Up to 122820	126530	
Baisakh, 2067 (April-May)	Up to 137350	138590	
Jesth (May-June)	Up to 150830	153590	
Ashadh (June-July)	Up to 176500	179910	

Source: Ministry of Finance, GON

2.1.13.7 Nepal in International Taxation

Doing Business has studied 183 countries in 2010 in its seventh edition from starting of business to its close, process, time taken, and delayed. In its study Nepal's status is weaker than previous year; however, Paying Tax Indicator is improving.

Doing Business did the study with joint effort of World Bank and International Financial Corporation (IFC). The study is based on 10 different indicators such as doing business, starting a business, dealing with construction permits, employing workers, registration property, getting credit, protecting investors, paying taxes, trading across boarder, enforcing contract and closing business. On the base of above indicators, Business Doing Project studied, focused form 1, June 2008 to 2, June 2009 period. According to the classification, Middle East & North Africa have low tax rate. Largest tax rate is in Sub-Saharan Africa where Average tax rate is 67 percent. In OECD Region, business has to pay tax 13 times but in Eastern Europe and Central Asia, they have to pay 46 times in a year. In Asia, business has to pay tax 31 times in year. Similarly time to be spent on paying tax, least is in OECD with 194 hours and most in Latin America and Caribbean

with 385 hours. In South Asia, it is 285 hours. Maldives is in the first position on paying tax position among 183 countries of the world and Belarus is in the least. In Maldives onetime tax paying in a year is enough. But in Ukren it is 146 times paying of tax in a year which is the highest times in the world. In Maldives it takes 0 hour to pay tax, and in Brazil it takes 2,600 hour in a year which is most time consuming.

Table 2.3
Nepal's Position in Tax Payment

S.N.	Activity	Position	
		2009	2010
1	Times of Tax Payment (in year)	34	34
2	Time taken in payment of tax (hour in a year)	408	338
3	Rate of tax to be paid (percentage of profit)	34%	38.1%
Rank		124	124

Source: Doing Business Project Report-2010

According to above classification, Nepal's time taken in payment of tax is reduced from 408 hours to 338 by 70 hours, which indicates the time of tax payment has been reduced due to improvement in service flow of tax administration. Nepal's position in South Asia is in forth position with 124 ranks. Nepal is in higher position than India, Pakistan and Shree Lanka.

2.1.13.8 Double Taxation Avoidance Agreement (DTAA)

DTAA protect the right of taxpayer of the both parties of agreement in one hand and on the other hand, it checks tax evasion in both countries by exchanging information. It internationalizes the national taxation and prepares bases for information and capacity development. DTAA is done with objectives to facilitate international trade, reduce foreign investment interference, reduce the complexities in taxation, avoid double taxation in the same income, neutralize the tax system, and to interpret and implement tax exemption and facilities of agreeing countries and to increase revenue collection, income employment and investment in long run.

Nepal has signed in the agreement with different countries to avoid double taxation and prevent of fiscal evasion. The agreement was UN-design. However, in recent year it has followed OECD design. In Double Tax Avoidance Agreement, it also can be applied Tax Exemption, Tax Credit, Tax Sparring Method. However, Nepal has applied Tax Credit method.

In this context, ITA, 2058, Article 73 has made Provision for DTAA. Based on this legal provision, Nepal has signed with 10 countries of the world with agreement in Double Tax Avoidance and Prevention of Fiscal evasion till fiscal year 2009.

Table 2.4
The countries with Double Tax Avoidance Agreement

S.N	Countries	Date of Agreement	Remarks
1	Republic of India	18 January, 1986	
2	Kingdom of Norway	13 May, 1996	
3	Kingdom of Thailand	2 February, 1998	
4	Democratic Socialist Republic of Sri Lanka	6 July, 1999	
5	Republic of Mauritius	3 August, 1999	
6	Republic of Australia	15 December, 2000	
7	Islamic Republic of Pakistan	25 January, 2001	
8	People's Republic of China	14 May, 2001	
9	Republic of Korea	5 October, 2001	
10	Qatar	15 October, 2007	

Source: International Tax Department, IRD, MoF

Similarly, Director General of IRD of Nepal and Joint Secretary of Revenue of India have signed on agreed minutes of revision of DTAA between Nepal and India. Currently, the procedure is forwarded to make DTAA with Oman and Bahrain.

Articles in DTAA

The common articles of DTAA are: personal scope, taxes covered, general definition, permanent establishment, income from immovable property, business profit, air or cargo transport, associate enterprises, dividends, interest, royalties, independent personal

service, dependent personal service, director's fee, income earned by entertainers and athletes, remuneration and pension in respect of government service, non-government pension and annuities, payments received by students and apprentices, payment received by profession, teacher and pension schemes, other income, elimination of double taxation, non-discrimination, mutual agreement procedure, exchange of information, diplomatic agents and consular officers and termination (*DTAA Treaties with different countries*).

2.1.13.9 Tax Deducted at Source (TDS)

ITA, 2058, article, 17 has provision of TDS to bring the persons having taxable income into tax net and collect tax regular. The provision of withholding tax at the time of payment is called TDS. TDS is imposed on the payment made to income earners. Every resident employer is required to withhold tax at normal rate from a payment with a source in Nepal that is subject to be included in calculating income of an employee from the employment. TDS system is also known as Pay as You Earn. In this system remaining income is paid to income earners by Withholding Agent after withholding tax at source income from investment, dividends, remuneration income, service fees, contract, etc. This system makes the government collect revenue in advance and also more taxpayers involve into tax net. Tax compliance cost also reduced. Especially this type of provision is imposed on Hard to Groups. This group is organized sectors and persons with passive income. There are two parties in TDS system, i.e. withholding agent and withholdee. Withholding agent is as person required withholding tax as the time of payment for employment, investment return, service fees or contract. Withholdee is a person receiving or entitled to receive a payment for employment, investment return, service fees or contract for which tax is required to withhold. ITA, 2058, sec. 86, 88(ka), 89 (ka), 89 (Kha) have detail provision of TDS system. There are two types of TDS, i.e. final TDS and advance TDS.

e-TDS Provision

IRD has introduced web based e-TDS statement to reduce tax compliance cost and tax collection cost and to make tax system simplified and transparent. It was introduced in

FY 2006/07 first time in Nepal. According to IRD, 16 percent of total income tax has been collected through e-TDS. Therefore, e-TDS is considered as important tools for working efficiently and simplifying service. The special features are: taxpayers can entry their TDS amount from anywhere through internet, withholder can get online posting TDS through the internet based on transaction number with their name, no need to give statement by withholder to withholdee and withholders need not go to IRD to verity their TDS written in PAN.

2.1.13.10 Return of Income: Forms

Annex-1: Calculation of Tax for Individuals (IT-D-10-03-0162)

- i) Annex-2: Collection of Tax for Entities (IT-D-03-0162)
- ii) Annex-5: Income from Business (IT-D-15-02-0860)
- iii) Annex-6: Income from Employment (IT-D-16-02-0860)
- iv) Annex-7: Income from Investment (IT-D-17-02-0860)
- v) Annex-8: Income from Non-Business Chargeable Assets (IT-D-18-02-0860)
- vi) Annex-9: Repatriated Income (IT-D-19-01-0262)
- vii) Annex-10: Tax Credit Claim (IT-C-01-03-0162)
- viii) Annex-11: Medical Tax Credit Claim (IT-C-02-03-0102)
- ix) Annex-12: Foreign Tax Credit Claim
- x) Installment Tax Return Form
- xi) Income Tax Revenue (presumptive taxpayers only) (IT-D-01-03-0162)
- xii) Taxable Income Statement (sec. 70) (IT-D-05-01-0262)
- xiii) Annual Remuneration Return
- xiv) Income Tax Return (simplified) (IT-D-02-02-0860)
- xv) Income Tax Return (general) (IT-D-03-02-0860)

(www.ird.income tax/forms)

D-01 type Return Form: It is for resident natural person taxpayers having income source in Nepal from business with annual turnover up to Rs.1.5million or having annual taxable income source in Nepal up to Rs.1, 50,000.

D-02 type Return Form: It is for natural resident person taxpayers having income source in Nepal from business and employment with less turnover than Rs.1.5million professionals such as doctor, engineer, lawyer, auditor etc, and for entrepreneurs having employment income or other less than Rs.10million annual turnover.

D-03 type Return Form: It is for the taxpayers having income from employment, business and investment.

2.2 Review of Related Studies

Many books, dissertations, articles and reports are published and different individual and institutions concerning to income tax have conducted researches. Many individuals and institutions have studied on the various aspects relating to administrative problems, legal aspects and trends of income tax system. These studies are useful in the field of income tax. Some of the books, articles, and dissertations that are reviewed during the study are as follows:

2.2.1 Review of Books

Adhikari (2003), wrote a book named “*Modern Taxation in Nepal (Theory and Practice)*”. This book has been written especially to fulfill the requirement of the Bachelor and Master’s level courses of Tribhuvan University. This book has been organized in four parts. Part-I discusses on Theoretical concept of taxation and income tax in Nepal. Part-II discusses on property tax/house and compound tax in Nepal. Part-IV discusses on Windfall Gain Tax and other Provisions. This book has also included Income Tax Act, 2058 (with amended version), Value Added Tax Act, 2052 as references. This book has given the method of calculating Taxable income, tax rate, and other special provisions of ITA, 2058. This book has interpreted the theoretical review/concept of VAT, role of VAT in Nepalese Tax Structure, Administrative Review and VAT and Income Tax administration in Nepal.

This book has a detail interpretation of taxation, income tax in Nepal such as head and sources of income, employment or remuneration income, retirement fund and

contribution, tax on pension income, loss set-off adjustment, return filing, international taxation, tax administration and rights of tax administration etc. This book also deals with property tax in Nepal. Concept, origin and evaluation of property tax system in Nepal, provisions regarding property tax and administration of house and compound tax, tax expected property, rights duties of taxpayers, provision of penalty are the major provisions. This book has included lots of numerical and practical illustrations and problems. However, this book has not analytical interpretation of the subject matter. So it has not analyzed the importance of income tax, problems and defects of present Income Tax system, and importance of exemption and deductions in income. This book is useful because it is comprehensive. The writer has compiled all tax related subject matters, Acts and Rules within a book.

Bhattarai & Koilrala (2004), wrote a book named *Tax Laws and Tax Planning*. This book has been written to fulfill the Master's course of T.U. This book has been organized in 20 Chapters. In this book, the writers have described the provisions related to the income tax assessment and tax planning. They have also presented an overview of relevant tax laws, Income Tax Act, 2058 and Value Added Tax Act 2052. They have also included numerical problems also in regard to income tax assessment. This book is informative and descriptive rather than analytical.

2.2.2 Review of Reports and Articles

Revenue Consultation Committee (2001) has studied the overall taxation situation in depth. It highly emphasized to simplify the tax policy to increase voluntary compliance. This report recommended for written communication between taxpayers and tax administration rather than the informal relation. This report suggested to widen the income tax base by including all kinds of taxpayers and income and to find out the taxpayers of new sectors. For this, the report suggested making the actions more transparent and clear in order to attract foreign and domestic investors. It was further suggested to increase income tax exemption limit with considering purchasing power and inflation rate.

Revenue Consultation Committee (2008), *The Revenue Consultation Committee-2065 (2008)* presented its suggestions to Government of Nepal in Bhadra. The major suggestions relating to income tax presented therein are: not to impose tax on the payment of individual accident insurance, to increase the tax exemption limit. It has concluded that there is a progress in revenue collection in FY year 2064/65. To continue this trend only those existing taxpayers are not sufficient, so it suggested to the tax administration to make special campaign to widen the tax coverage area. The main sectors of widening tax coverage are academic sectors such as private primary, secondary, +2 institutions, colleges conducting bachelor and master's degree, education training and consultation institutions, vocational and technical institutions etc. Likewise the health sectors such as private hospitals, clinics, nursing homes, real estate agents. It has also suggested defining clearly the term 'service' in the Act. It is also suggested that to deduct the expenses such as residence facility, life insurance, medical facility, education and training expenses incurred for long term interest of the workers and personnel of industries from the taxable income of industries, not to deduct tax at sources who are registered in VAT, to recognize the related actual expenses of the industries and business, to remove additional tax of 1.5 percent imposed after income tax, to minimize the house rent tax, etc.

Shamshere JBR (2010) has published an article entitled "*Tax Policies in Nepal (Formulation, Implementation and Regulation)*". In his article, he has suggested transparency, simplicity, and moderately low tax rates and antidote to corruption in taxation. He depicts the facts that tax structure is massively dominated by indirect taxes, (so) there is a need to move towards direct taxes to mobilize internal resources at a much higher level. He suggests an elastic tax system is highly advantageous for compliance and strengthening tax administration. He points out the requirement of improvements in tax system in different aspects which included tax administration being given technical support for strengthening physical facilities. All types of logistic support should be provided. Since data arrangements have been poor, it is imperative to develop and expand the net working of database and information system at all levels. In addition, information campaign should be intensified through opening websites, organizing seminars, symposia

and training programs and advertising in the media. There is an urgent need of support for manpower development. More training is required for customs valuation and for efficient administration. Manpower development should be prioritized in the sector of Information Technology (IT), tax laws, auditing accounts, Revenue Consultation Committee must be replaced by 'Revenue Board' with dynamic of power along with legal status. Similarly, he has suggested strengthening the Inland Revenue Department (IRD) by making it well-equipped for policy design, implementation and research on fiscal issues.

2.2.3 Review of Dissertations

Kafle (2008), has prepared a master's thesis entitled "*Income Tax Contribution from Nepalese Enterprises with Special reference to Nepal Electricity Authority*" in 2008. The main objective of the study was to study the contribution of income tax from public enterprises to public Revenue of Nepal. The specific objectives are to show and evaluate the comparative contribution of income tax from public enterprises in different years to the total revenue of the country and find out major problems faced by public enterprises, which have made its condition deteriorating. He has conducted an empirical investigation about various aspects of Public Enterprise's income tax imposition in Nepal. He has taken 75 persons as sample. Tax experts, taxpayers, tax administrators, and Nepal Electricity Authority's Officers are the sample of his study.

His major findings about the tax structure are the composition of government revenue where the tax revenue contributed 77 percent in FY 2006/07. In total tax revenue, indirect tax constituted 73.32 percent in FY 2006/07. The share of income tax to direct tax revenue has been fluctuating significantly. The contribution of income tax from Public Enterprises in Nepal was not sufficient. He has suggested that income tax system will be succeeded if the system have widening of tax coverage, tax consciousness to people, minimize the evasions and avoidance problem, enhance the self-assessment systems and reform in income tax assessment and administration system.

Neupane (2008), has presented a master's level thesis entitled "*A comparative Study on Contribution of Direct & Indirect Tax to National Revenue of Nepal*". The main objective of this research is to analyze the contribution of direct and indirect tax to national revenue of Nepal. Other specific objectives are to analyze the structure of direct and indirect tax, analyze the contribution of corporate tax to national revenue of Nepal, to find out the most important factor for effectiveness of income tax in Nepal and to provide suggestions for effective collection of direct and indirect tax in Nepal.

The major findings of the study are contribution of tax revenue is dominantly high Nepal in total revenue, the education is the most necessary to increase the tax consciousness of taxpayers, and self-assessment method is appropriate in Nepal while assessing income tax. Income tax evasion is the major problem of Nepal for income tax generation. Main reason for tax evasion is due to defective tax administration. Income tax administration is not efficient to collect tax, etc.

Sharma (2009) has presented a master's level thesis entitled "*Study on the Scope of Tax Planning under Income Tax Act, 2058 in Nepal*". The main objective of study is to identify the scope/area of Tax Planning under ITA, 2058 and the specific objectives are to find out how tax planning can help in the healthy growth of economy, study in what ways the taxpayers are saving their earnings by reducing tax liability under tax planning.

The findings of the study are there is very less people who are planning their tax by the legal ways. Almost 50% of the respondents agree with the fact that illegal tax planning is being done due to the widespread illegal business. More than 40% of the respondents pointed out that respondents are reducing their tax liability by changing their size of business under long term tax planning. About 55% of respondents are enjoying loopholes of the Act by transferring income to their wife or minor child. 95% of the respondents agree with the fact that tax planning can help in productive investment. 20% of respondents said that it is possible to help in healthy growth of economy by healthy tax planning.

Shrestha (2009), has presented his Master's Level thesis entitled "*Revenue collection from Income Tax and its Practical Difficulties in Nepal*". The main objective is to find out the difficulties in tax collection to the government. The specific objectives are to find out the revenue collection from the different years, review the tax collection system, find out the problem in tax collection system and provide the effective tax collection.

The major findings of the study are government expenditure is in increasing trend, the government expenditure is more than government revenue so there is deficit budget, increment in the number of taxpayers is very much essential in order to broaden the tax base, income tax is the suitable means of raising government revenue, and exemption and deduction should be increase to promote the special industry and export. Likewise self assessment method is the appropriate method while assessing the income tax to increase voluntarily compliance by taxpayers. Length process, vague provision in the Act, consuming unnecessary times is the major problems faced by the taxpayers while paying the tax.

Pandey (2010), has presented a master's thesis entitled "*A study on Income Tax Management in Nepal (A Case Study of Corporate Income Tax)*". The major objective of study is to analyze the system of income tax in Nepal. The specific objectives are to study and evaluate the status of income tax as major sources of revenue, examine the Nepalese income tax structure, identify the factors to increase taxpaying habit of income taxpayers.

The major findings are: Major portions of income tax are covered by corporate sector. There is poor administration/implementation of income tax, law, rules and regulation. Government officers and offices themselves are neglecting for the effective implementation of ITA, rules and regulation. The performance of tax administration office and revenue tribunal is doubtful. Effective check and balance and monitoring system are to be implemented for better administration of income tax laws, rules and regulation. He has identified many problems such as failure to locate new taxpayers, failure to maintain proper accounts and records, defective assessment procedure, serious gaps and delinquencies in the collection of income tax, poor taxpaying habit among the

Nepalese taxpayers, tax evasion and avoidance, lack of appropriate organizational structure, and instability in government policy. He has applied a descriptive analytical research design based on secondary data. National Revenue is a population and corporate income tax is selected as a sample. Modern innovation and technologies help tax officers to monitor effectively in the tax related activities.

2.3 Research Gap

There is gap between this research and the previous researches. Most of the previous researches have focused the only contribution of various incomes in the government revenue, structure of the government revenue and income tax, etc. They have found that the contribution of income in government revenue is significant and it should be mobilized for economic development of Nepal. Almost all of them have indicated that the tax administration is inefficient and there is high level of tax evasion. Most of researches have suggested improving the tax administration and widening the tax coverage to increase the contribution of income tax in resource mobilization. But they had not studied a real income tax practice existed in Nepal. Their researches are based more on theoretical basis. They seemed to be the photocopy of each other. This thesis is different from other researches in the following terms:

- A detail and relevant presentation of accurate and up to date (latest) data and reports of income tax revenue as far as possible,
- A fully insight into real income tax practice in Nepal.
- An exploration of current issues in income tax in Nepal.

I have tried to make this thesis as complete outcome of the research on mentioned topic from the best of my effort and knowledge. I want to prove this research is an original one. It should be the foundation for the future researchers to know about the real income tax practice (being practiced) in Nepal.

However, this thesis is not complete research in itself in income tax field. It is only a foundation for future study. Many facts are yet to be depicted on income tax practice in Nepal. This thesis is a little attempt to study the income tax system in Nepal.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Research Design

For this study a descriptive e Research Design has been followed. It involves the systematic collection, presentation and interpretation of data regarding income tax revenue to give a clear picture of income tax in practice in Nepal. This study has a attempt to obtain a complete accurate description of income tax system and collection of income tax revenue in Nepal. This study is also based on historical research design, it is, therefore, mainly concerned with past secondary data. The details of past eight years' (since FY 2001/02 to 2008/09) data have been collected and evaluated systematically and objectively to reach a conclusion. This study also based on opinion survey. Opinions of various respondents associated with tax i.e. Tax Officers and Taxpayers have been collected through survey. The study, therefore, can be termed as survey cum analytical descriptive historical research design.

3.2 Population and Sample

Since this study is based on survey cum descriptive research design, there is two different sets of population and samples. The first population of descriptive research design is the whole national economy i.e. government's revenue and the sample is income tax revenue. The income tax revenue represents whole national income for this study. For this purpose, income tax revenues since FY 2001/02 to FY 2008/09 have been collected. The second population for the survey study is all tax related persons i.e. tax officers and administrators, income taxpayers (individual, private and public limited companies, corporation, cooperative, partnership and others) and tax experts (economists, auditors, accountants, lawyers, teachers etc). Among them, Tax Officers and Taxpayers have been taken as sample. 50 pre-designed questionnaires were distributed among them and 20 Tax Officers and 20 Taxpayers have been selected as sample. The sample size is as below:

Table 3.1
Sample Size

Group of Respondent	Sample Size (in number)
Tax Officers	20
Taxpayers	20
Total	40

3.3 Sources of Data

Since this research is based on descriptive research design and empirical investigation both the secondary and primary sources of data have been used.

3.3.1 Primary Sources of Data

Primary Data are collected through a schedule of self-structured set of questionnaire, informal dialogue, discussion and interview with Tax Officers of IRD and Taxpayers of different places i.e. FNCCI Office, Lalitpur Chamber of Commerce, Nepal, etc. A self-structured set of questionnaire have been distributed randomly to Tax Officers and Taxpayers and their view on the research subject have been compiled.

3.3.2 Secondary Sources of Data

The secondary data have been collected from laws, rules, and regulation, policies and programs related to income tax and books related to public finance and taxation, different websites of government of Nepal i.e. Ministry of Finance (www.mof.gov.up), Inland Revenue Department (www.ird.gove.np), Nepal Rastra Bank (www.nrb.gov.np), different libraries, articles published in the newspapers, journals, reports and publications of Government of Nepal and deferent commercial and non-commercial institutions i.e. FNCCI, different books, brochures, annual report of IRD, Central Statement of Office of Controller of General Audit, dissertations, and various numerical data and information have been collected as per the objectives of the study and research questions.

3.4 Data and Information Collection Procedure

Various numerical data and information are collected as per the objectives of the study and research questions. Firstly, laws, rules and regulation, policies and programs related

to income tax were collected to get preliminary knowledge about income tax including books related to public finance, taxation in Nepal, etc. Secondly different websites of government of Nepal were consulted and numerical and information has been collected. Different year's budget speeches, economic surveys, and reports have been collected. Lastly various journals, national newspapers are reviewed and a self-structured questionnaire are designed and distributed among samples (tax experts and taxpayers) that are selected at random basis from the population.

3.5 Data Analysis Procedure

The collected data have been classified and tabulated under different table forms and figures. Some statistical analysis also has been carried out. Simple, average and percentage have been applied where necessary. The results are expressed in the form of description and analytical way.

3.6 Presentation and Analytical Tools

Various tools are applied while completing this study and those are table, charts, percentage, average, time series analysis, chi-square test, and rank-correlation.

3.6.1 Table

Various tables are formulated to tabulate the data.

3.6.2 Charts and Diagrams

These tools are used for visually description of the data, trend line, bar diagrams and Pie-Charts are used for this purpose

3.6.3. Time Series Analysis

The value of different phenomena such as income, sale price, share profit, population, temperature etc. can be recorded over different time. This means the value of the variable may have been changing or fluctuating round a constant value over the change of time. The arrangement of statistical data chronologically (according to occurrence of time) is known as time series and statistical analysis of these chronological variations is termed as

time series analysis. A time series depicts the relationship between two variables on them being time (t) another being the variable value (y_t) under consideration (*Sthapit, 2008:319*).

For example, the income tax revenue (y_t) in Nepal in different year (t).

Hence, a time series can be considered as functional relationship.

$$y_t = f(t)$$

Where,

y_t = value of Phenomena (or variable) under consideration in time (t)

Time series sufficiently helps in forecasting the value of the variables, especially in business and economic activities, forecasting or future prediction. It helps to know the past behavior of data in certain span of time interval. On the basis of these past trends, one can make plan in forthcoming days

Least Square Method

This is the most popular and widely used mathematical method of measuring trend. This is frequently used to describe the given data but for this study, only the fitting of linear trend by the least square method has been applied to predict the actual income tax revenue for the next period.

Let us consider the equation for a linear trend as,

$$Y = b_0 + b_1t \dots\dots\dots (i)$$

Where,

y = The given value of the variable in time series. It is a dependent variable.

b_0 = Intercept of the trend line i.e. y-intercept

b_1 = Slope of trend line. This measures the increasing or decreasing rate of Y in time series.

t = Time variable i.e. Deviation taken in time

Where,

$$b_0 = \frac{\sum y}{n} \text{ and } b_1 = \frac{\sum ty}{\sum t^2}$$

The best fit of straight line trend is obtained by substituting the value of b_0 and b_1 in equation (i), we get,

$$Y_e = b_0 + b_1t$$

3.6.4 Chi-square Test

Chi-square Test is applied to such frequency of outcome as against the expected ones without reference to population parameter, which were being done in significance testing (*Sthapit, 2007:333*).

The chi-square derived by Greek letter χ^2 is one of the simplest and most widely used non-parametric in statistical work. The test was given by Karl Pearson in 1930. The quantity of chi-square describes the magnitude of the discrepancy between theory and observation. It is defined as,

$$\chi^2 = \frac{\sum(O-E)^2}{E}$$

Where,

O = Observed frequency

E = Expected Frequency $(E = \frac{RT \times CT}{N})$

(RT = Row Total, CT = Column Total and N = Number of Observations)

The number of data that are given in the form of a series of variables in a row or column or frequencies that are put in cells in a contingent table and which can be calculated independently are called the degree of freedom and is denoted by v .

The chi-square test is used to see that the principles of classification of attribute are independent. In this test, the attributes are classified into a two-way table or a contingency table as the case may be. The observed frequency in each cell is known as cell frequency. The total frequency in each row or column of the two-way contingency table is known as marginal frequency. This test shows whether there is any association or relationship between two or more attributes.

3.6.5 Rank Correlation Coefficient

Correlation may be defined as the degree of linear relationship between two or more variables. Correlation analysis is defined as the statistical technique which measures the variable which lies between +1. If the value of correlation is nearer to +1, this relationship is said to be perfectly positive correlated and vice-versa.

Ranks are assignments of orders or priorities according to their status or important. There are some variables like beauty, knowledge, intelligence, honesty etc. which cannot be measured quantitatively. These types of variables can be measured by assigning ranks or some sorts of rating are known as rank correlation. There are some methods used to measure rank correlation. One of these methods is Spearman's Rank Correlation Coefficient. He developed a method of measuring random correlation coefficient. It is denoted by r_s

The formula for Rank Correlation is

$$r_s = 1 - \frac{6 \sum d^2}{n(n^2-1)}$$

Where,

n = the number of items or individual being ranked

$d = R_1 - R_2$

R_1 = The value of items with respect to one variable

R_2 = The value of items with respect to second variable.

3.7 Test of Hypothesis

Hypothesis means the resumption or quantitative statement of the population parameter which may be true or false. In order to make proper decision about the quantitative statement of the population, hypothesis is an assumption about unknown result while testing of hypothesis, an assumption is made about the population parameter to test whether the assumption is right or not, a sample is selected from the population, sample statistic is obtained, observed the difference between the sample mean and the population hypothesized value and test whether the test is significant or insignificant.

The following hypotheses have developed for this research study:

First Set of Hypothesis

Null Hypothesis (H_{01}) There is no significant evidence of difference between the views of tax officers and taxpayers on becoming 'Tax Compliance Year-2009' a success.

Alternative Hypothesis (H_{11}) There is significant evidence of difference between the views of tax officers and taxpayers on becoming 'Tax Compliance Year-2009' a success.

Second Set of Hypothesis

Null Hypothesis (H_{02}) There is no significant evidence of difference between the view of Tax Officers and Taxpayers on the suggestion of FNCCI to the government about tax exemption limit for natural person.

Alternative Hypothesis (H_{12}) There is significant evidence of difference between the view of Tax Officers and Taxpayers on the suggestion of FNCCI to the government about tax exemption limit for natural person.

Third Set of Hypothesis

Null Hypothesis (H_{03}) There is no significant evidence of difference between the views of Tax Officers and Taxpayers on the suggestion of FNCCI to the government about imposing tax in three layers on natural person.

Alternative Hypothesis (H_{13}) There is significant evidence of difference between the views of Tax Officers and Taxpayers on the suggestion of FNCCI to the government about imposing tax in three layers on natural person.

Forth Set of Hypothesis

Null Hypothesis (H_{04}) There is no significant evidence of difference between the views of Tax Officers and Taxpayers on the effectiveness of ITA, 2058.

Alternative Hypothesis (H_{14}) There is significant evidence of difference between the views of Tax Officers and Taxpayers on the effectiveness of ITA, 2058.

Fifth set of Hypothesis

Null Hypothesis (H_{05}) There is no significant evidence of difference between the views of Tax Officers and Taxpayers on the contribution of income tax to national economy.

Alternative Hypothesis (H_{15}) There is significant evidence of difference between the views of Tax Officers and Taxpayers on the contribution of income tax to national economy.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with the data presentation and analysis. The data collected through primary and secondary sources are organized systematically, presented in the table, and analyzed through different measures such as average, percentage, figure and various statistical tools. This chapter has been divided into six sections.

4.1 Descriptive Presentation & Analysis of Secondary Data

4.1.1 Number of Taxpayers

In Nepal, the coverage area of income tax is very low. The number of taxpayers is just 370,000 (in FY 2009/10) which is 1.5% of the total population. The total number of taxpayers since FY 2006/07 to 2008/09 and their comparative study are presented below:

Table 4.1

Number of Total Taxpayers

Fiscal Year	No. of Taxpayers	Increase	Percentage
2006/07	2,56,210	-	-
2007/08	2,87,958	31,748	12.4
2008/09	3,53,902	65,944	23

Source: Annual Report-2008/09, IRD, MoF

Above table depicts the number of total taxpayers till FY 2008/09. In the FY 2006/07, total number of taxpayers was 2, 56,210 and it reached 2, 87,059 by increasing 12.4 percent or 31,748 than previous year. It reached 3,53,902 in FY 2008/09 by increasing 23 percent than previous year. The increased number of taxpayers is 65,944.

4.1.2 Classification Taxpayers

The whole taxpayers can be classified as Individual, Private Limited Company, Public Limited Company, Corporation, Cooperative, Partnership and other based on taxpayers' form. The classification of total taxpayers have presented in the following table:

Table 4.2
Classification of Taxpayers

F.Y.	Individual	Private Ltd.	Public Ltd.	Corporation	Cooperative	Partnership	Others	Total
2006/07	2,05,595	30,458	572	244	1,298	4,804	13,239	2,69,449
2007/08	2,26,092	36,536	655	283	2,141	5,543	16,708	28,7958
2008/09	2,77,130	44,270	786	330	4,448	6,579	20,358	3,53,902

Source: Annual Report: 2008/09, IRD, MoF

According to above table, in the FY 2006/07, out of total taxpayers the number of individual taxpayers were 2,05,0595 while private limited & public limited company, cooperative, partnership and other were 30458, 572, 244, 1,298, 4804 and 13,239 respectively and it reached to 36,536, 655, 283, 2,141, 5,543 and 16,708 respectively in FY 2007/08. The number of individual taxpayer in this year is 2, 26,092. In the FY 2008/09, individual taxpayers increased substantially and reached to 2, 77,130. Private Ltd, Public Ltd, Corporation, Cooperative, Partnership and Other reached 44,270, 786, 330, 4,448, 6,579 and 20,358 respectively.

Table 4.3
Classification of Taxpayers in FY 2008/09

(No. in percentage)

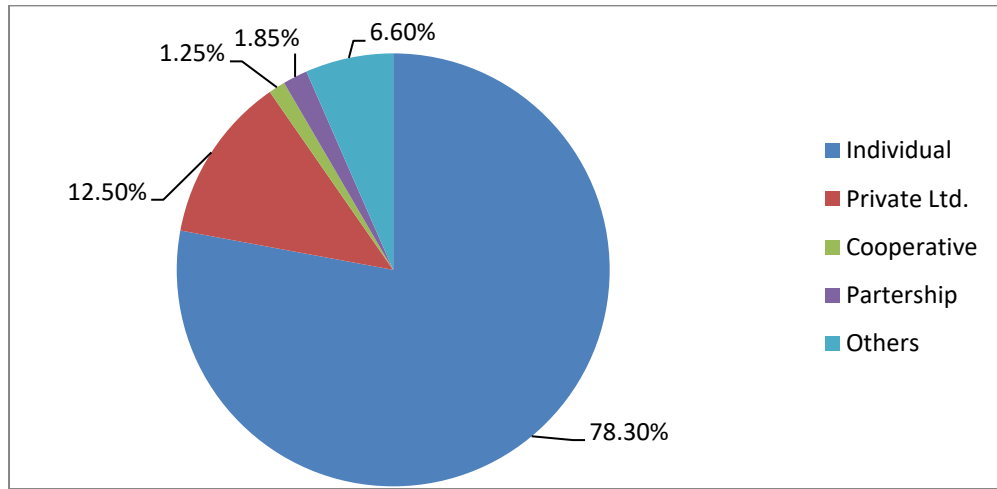
Taxpayers	Total	Individual	Private Ltd	Cooperative	Partnership	Others
Number	3,53,902	2,77,130	44,270	4,448	6,579	21,474
Percentage	100	78.3	12.5	1.25	1.85	6.6

Source: Annual Report: 2008/09, IRD, MoF

(Note: The number of Public Ltd Co. And Corporation have been included into others due to their very small figure)

The above table can be shown in Pi-chart for analysis purpose:

Figure 4.1
Classification of Taxpayers in FY 2008/09



Above figure depicts that 78 percent of total taxpayers in the FY 2008/09 are individual taxpayers, 12.5 percent are private limited companies, and 1.25 and 1.85 percent are cooperatives and partnership firms. Other taxpayers occupy 6.6 percent in which public limited companies and corporations also have been included due to their very small figure.

4.1.3 Numbers of Return of Income

In general every taxpayer should file a signed return of income not later than three months after the end of each income year. The overall number of return of income and their comparative study since FY 2006/07 to 2008/09 have presented below.

Table 4.4
Number of Return of Income

FY	Total	D-01	Percentage	D-02	Percentage	D-03	Percentage
2006/07	1,02,506	58,200	56.78	21,483	20.96	22,823	22.27
2007/08	1,30,852	71,024	54.28	26,141	19.98	33,684	25.74
2008/09	1,74,208	91,541	52.55	31,780	18.24	50,885	29.21

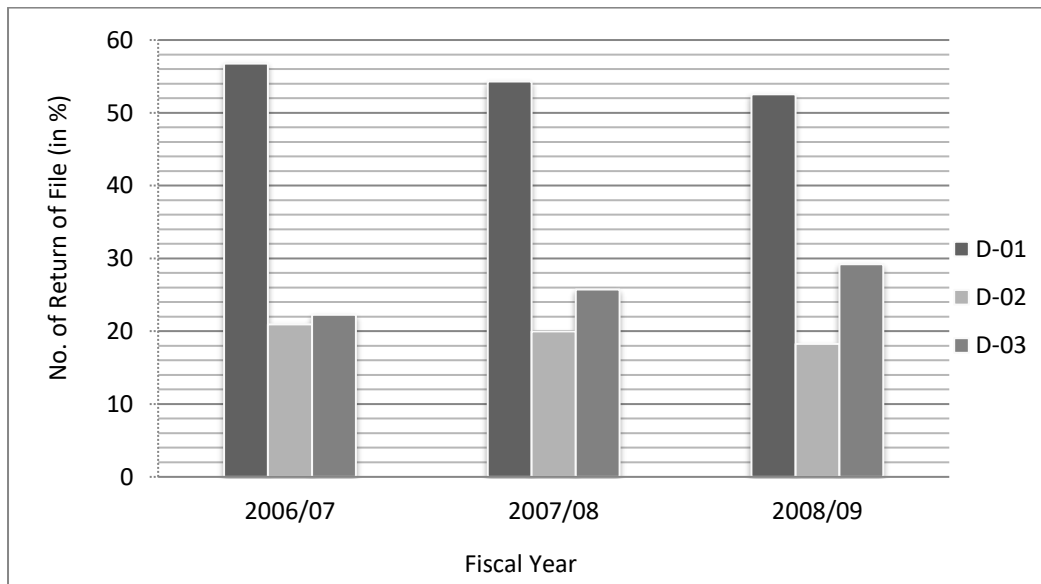
Source: Annual Report: 2008/09, IRD, MoF

According to above table 1, 02,506 Returns of Income were received in FY 2006/07 in which D-01 format were 58,200, D-02 format were 21,483 and D-03 format were 22,823.

In the FY 2007/08, it was total 1,30,852 in which D-01, D-02 and D-03 format were 71,024, 26,141 and 33,684 respectively. In the FY 2008/09, total number of Returns Income submitted by taxpayers reached 1,74,208 in which D-01 is 91,541, D-02 is 31,780 and D-03 is 50,885.

The above table can be presented in chart also to analyze more realistically:

Figure 4.2
Number of Returns of Income



According to above figure, 56.78 percent of total Returns of income in FY 2006/07 were of D-01 format. D-02 and D-03 were 20.96 and 22.27 percent respectively. In the FY 2007/98, the percentage of D-01 type statement reduced to 54.28 percent while D-03 type Returns of Income increased to 25.74 percent. D-03 type statement also had been decreased to 19.98 percent. Again in FY 2008/09 D-01 and D-02 type Returns of Income decreased to 52.55 and 18.24 percent respectively while D-03 type of statement again increased to 29.21 percent.

4.2.4. Relative Contribution of Income Tax Revenue

Income Tax plays a vital role in national revenue. It is the major component of direct tax. The comparative and relative contribution of income tax to Gross Domestic Product, total revenue, total tax revenue, and expenditure are presented as below:

Table 4.5
Relative Importance of Income Tax Revenue

(Rs. in'000')

Particulars/FY	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
GDP	-	-	-	504101000	582950000	670588700	820814000	960012000
Total Revenue	50445491	56229791	62331028	70122700	71733127	87711208	107622480	143474489
Total Tax Revenue	39330588	42586935	48172982	54104700	57430400	711227000	85155457	117051906
Total Expenditure	80072291	84006081	89442593	102560471	110889158	133604606	161349894	213578374
Income Tax	8903693	8131893	9514487	10466226	10933520	15731804	19077813	27247386
Income Tax to GDP (in pct)	-	-	-	2.08	1.88	2.35	2.23	2.84
Income Tax to Total Revenue	17.65	14.46	15.26	14.93	19.04	17.94	17.73	19
Income Tax to Tax Revenue	22.64	19.09	19.75	19.34	19.04	22.12	22.4	23.28
Income Tax to Total Expenditure	11.11	9.68	10.64	10.2	9.86	11.77	11.82	12.76

Source: Budget Speech of Different years and Central Statement: 2009, Office of the Controller of Auditor General

According to above table, there can be seen a clear picture of contribution of Income Tax to different income variables and expenditure. Contribution of income tax to GDP was 2.08 percent in FY 2004/05. It decreased to 1.88 percent in FY 2005/06. However, it increased to 2.35 percent in FY 2006/07. Again, it decreased to 2.23 percent in FY 2007/08. In FY 2008/09, the contribution of income tax to GDP increased to 2.84 percent, which is the highest till the date. Similarly, contribution of income tax to total revenue was 17.65 percent in FY 2001/2002. It decreased to 14.46 percent and increased to 15.26 percent in FY 2002/03 and 2003/04 respectively. Again, it decreased to 14.93 percent in FY 2004/05. It increased substantially in FY 2005/06 to 19.04 percent. However, it decreased in FY 2006/07 and 2007/08 to 17.94 and 17.73 percent respectively. In fiscal year 2008/09, the contribution of income to total revenue again increased to 19 percent. Analyzing whole trend in increase and decrease, there is average fluctuations, the highest contribution was 19.04 percent in FY 2005/06, and least contribution was 14.46 in FY 2002/03. Similarly, 22.64 percent of total tax revenue was the contribution of income tax in FY 2001/02. It continued decreasing in subsequent fiscal years, 2002/03 to 2005/06 to 19.05, 19.75, 19.34 and 19.04 percent respectively. But it started to increase substantially and reached to 22.12 and 22.4 percent in FY 2006/07 and 2007/08 respectively. In the FY 2008/09, again it increased to 23.28 percent. The fluctuation is normal, the highest contribution of income tax to total tax revenue remained in FY 2008/09, and the least one remained in FY 2005/06. Similarly, 11.11 percent of total expenditure had funded from income tax revenue in FY 2001/2002. However, it decreased to 9.68 percent in FY 2002/2003. In FY 2003/04 and 2004/05, it increased to 10.64 and 10.2 percent respectively. But it again decreased in FY 2005/06 to 9.86. In later period, it started to increase and 11.77, 11.82 and 12.76 percent respectively in FY 2006/07, 2007/08 and 2008/09 respectively. The overall contribution is normally fluctuating. The highest contribution is in FY 2008/09 and the least was in FY 2002/03.

4.1.5. Contribution of Direct and Indirect Tax to Total Tax Revenue

Total tax revenue is the summation of direct and indirect tax revenue. In tax structure, it can be seen that indirect tax is playing a dominant role. The comparative contribution of

direct and indirect tax to total tax revenue since FY 2001/02 to 2008/09 is presented as follows:

Table 4.6
Relationship between Direct and Indirect Tax Revenue

(Rs. in '000')

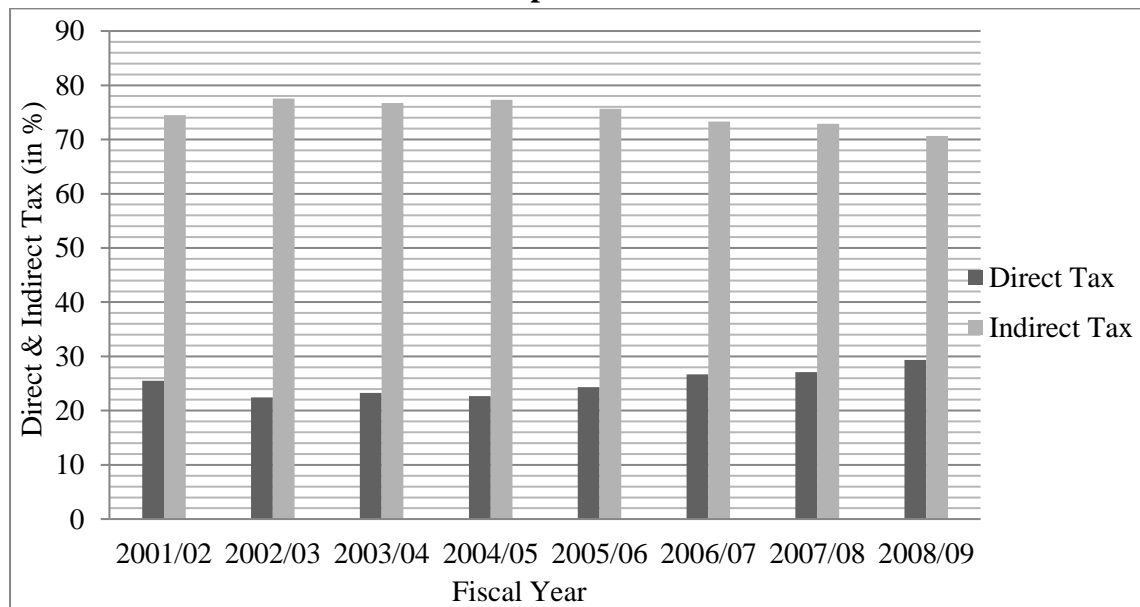
FY	Tax Revenue	%	Direct Tax	%	Indirect Tax	%
2001/02	39330588	100	10037805	25.52	29292783	74.48
2002/03	42586935	100	9546230	22.42	33040705	77.58
2003/04	48172982	100	1121197	23.27	36961012	76.73
2004/05	54104770	100	12265398	22.67	41839381	77.33
2005/06	57426995	100	13961476	24.31	43465519	75.69
2006/07	71128728	100	18980298	26.68	52146430	73.32
2007/08	85155458	100	23087759	27.11	62067699	72.89
2008/09	117051906	100	34320739	29.32	82731167	70.68

Source: Budget Speech of Different Years and Central Statement: 2009, Office of the Controller of Auditor General

The above data in the table also can be presented in charts to understand more precisely and analyze more deeply. The chart is presented as below:

Figure 4.3

Relative Relationship between Direct and Indirect Tax



From the above table and figure, we can conclude that there are two components of tax revenue i.e. direct and indirect tax. Indirect tax plays a dominant role in the composition

of total tax revenue. In the beginning fiscal year 2001/02, 74.48 percent of total tax revenue is the contribution of indirect tax. It has increased to 77.58 percent in FY 2002/03 while direct tax revenue reduced to 22.42 percent. This fluctuation continued up to FY 2005/06 where contribution of indirect tax is 75.69 and direct tax is 24.31 percent respectively. After FY 2005/06, contribution of indirect tax to total tax is gradually decreasing. It has reduced to 73.32 percent in FY 2006/07 resulting direct tax contribution increased to 26.68 percent and it reached to 27.11 in FY 2007/08. This growth continued in FY 2008/09 also and reached to 30.54 resulting decrease in indirect tax to 69.41 percent. In average, contribution of indirect and direct tax in total tax revenue is 74.68 and 25.32 percent respectively. In conclusion, the contribution of direct tax total tax is in increasing trend in later fiscal year, which is the result of increase in income tax.

4.1.6 Components of Direct Tax Revenue

In total tax revenue, the contribution of direct tax is 25.32 percent in average. Total tax is the composition of direct and indirect tax. Direct tax also consists of income tax and house, land and property tax i.e. vehicle tax. The overall position of income tax and house, land and property tax are present below since FY 2001/02.

Table 4.7
Components of Direct Tax Revenue

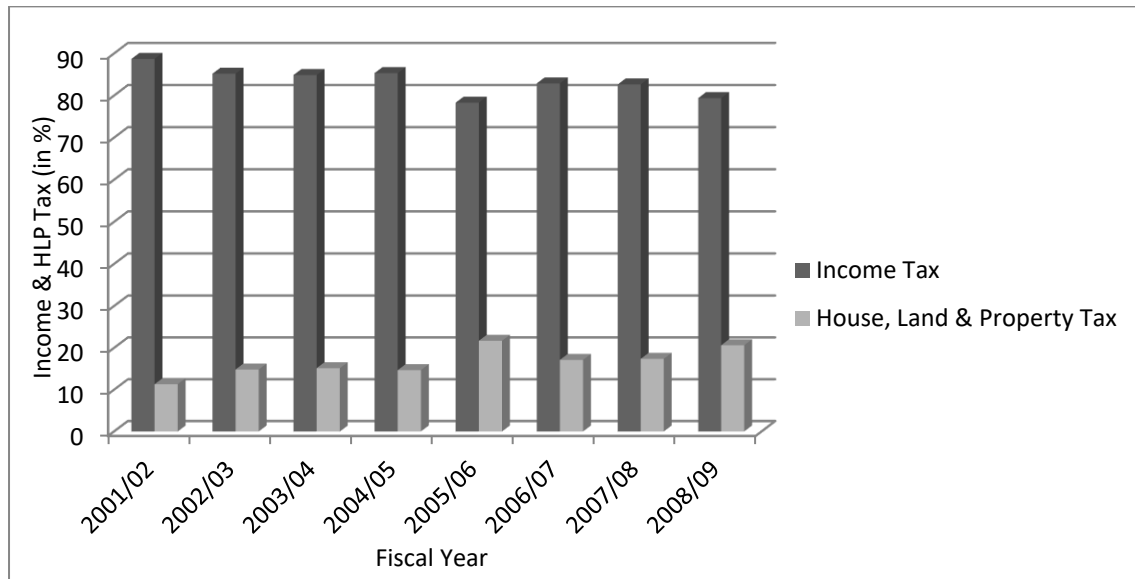
(Rs. in '000')

FY	Direct Tax	%	Income Tax	%	Tax on House, Land & Property	%
2001/02	10037805	100	8903693	88.7	1134112	11.3
2002/03	9546230	100	8131893	85.18	1414337	14.82
2003/04	1121197	100	9514487	84.86	1697483	15.14
2004/05	12265398	100	10466226	85.33	1799172	14.67
2005/06	13961476	100	10933520	78.31	3027956	21.69
2006/07	18980298	100	15731804	82.88	3248494	17.12
2007/08	23087759	100	19077813	82.63	4009946	17.37
2008/09	34320738	100	27247386	79.39	7073352	20.61

Source: Budget Speech of different years and Central Statement: 2009, Office of the Controller of Auditor General

According to above table, Rs.8903693 was income tax out of total direct tax revenue in FY 2001/02. But it decreased to Rs.8131893 in FY 2002/03 while tax on house, land and property increased to Rs.1414337. From FY 2003/04 to 2008/09 the portion of income tax is gradually increasing and reached Rs. 27247389 in FY 2008/09 while tax on house, land and property is Rs. 7073352.

Figure 4.4
Relative Components of Direct Tax Revenue



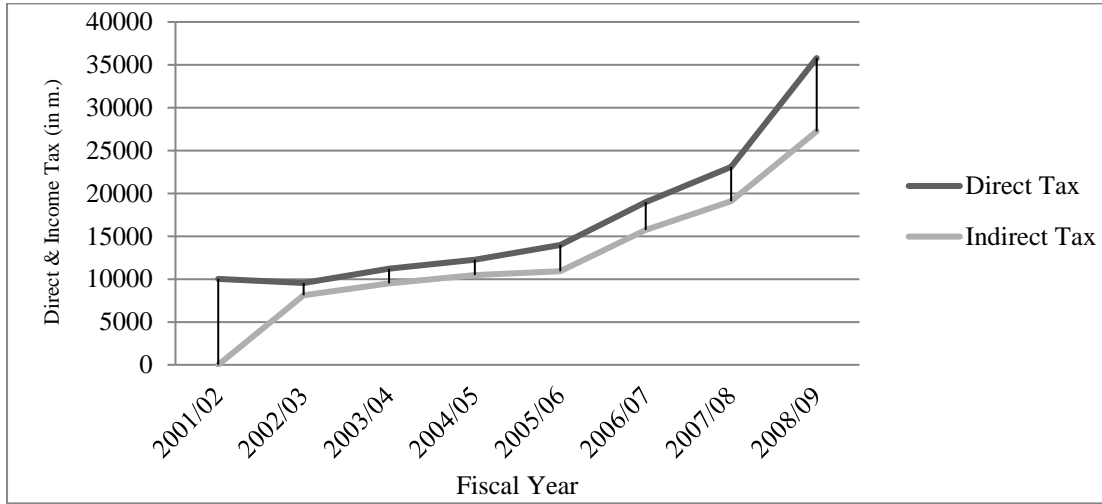
According to above figure, in the beginning FY 2001/02, the contribution of income tax to direct tax was 88.7 percent. However, it decreased to 85.18 percent in FY 2002/03 while tax on house, land and property increased to 14.82 percent than previous year. It decreased to 78.32 percent in FY 2005/06. However, it increased to 82.88 percent in FY 2006/07 but again it started to decline and reached to 79.39 percent in FY 2008/09 while the contribution of tax on house, land and property is 20.61 percent. In conclusion, portion of income in direct tax is in decreasing trend.

2.1.7 Direct and Income Tax Revenue

Income tax is a major component of direct tax revenue. Here are given a comparative relationship between direct and income tax revenue since fiscal year 2001/02 to 2008/09. What was the trend of their relationship during the study period is the focal point. The relationship of income tax contribution to direct tax is presented in graph below:

Figure 4.5

Relationship between Direct & Income Tax Revenue



According to above figure, both direct and income tax revenues are in increasing trend since FY 2002/03. However, there is decreasing trend in FY 2001/02. Direct tax is proportionately increasing with income tax revenue. It shows massively dominantly role of income tax in direct tax structure. If income tax increases, direct tax also increases proportionately and vice versa. Income tax is followed by direct tax. In conclusion, income tax leads the direction of direct tax.

4.1.8. Relationship between Income Tax Revenue and its Components

Income Tax consists of corporate tax, remuneration tax and income tax on investment and other taxes. Other taxes consist of windfall gain tax and other taxes. Contribution of corporate, remuneration, investment and other taxes since FY 2001/02 to 2008/09 are comparatively given in the following table:

Table 4.8
Components of Income Tax Revenue

(Rs. in '000')

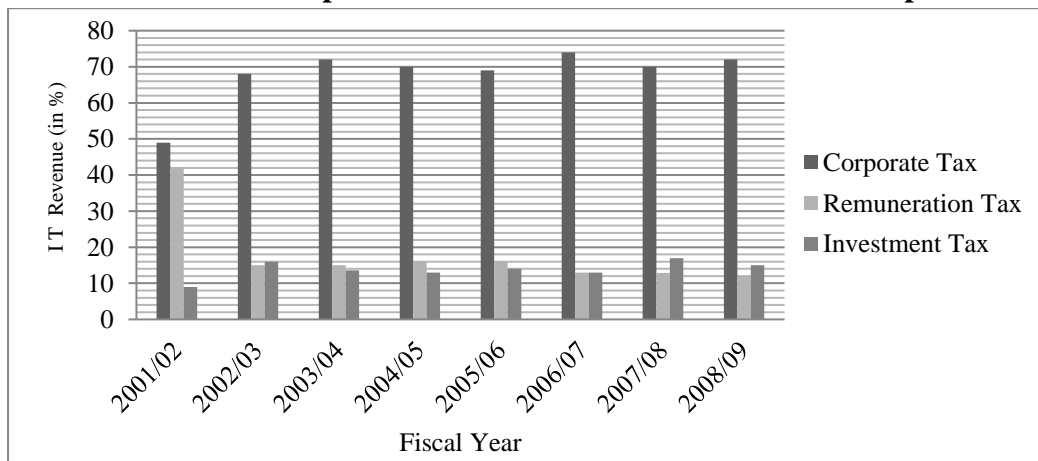
FY	Income Tax	%	Corporate Tax	%	Remuneration	%	Investment	%
2001/02	8903693	100	4355197	49	3732600	42	8158960	9
2002/03	8131893	100	5549786	68	1252597	15	1321818	16
2003/04	9514487	100	6816869	72	1391189	15	1292225	14
2004/05	10466226	100	7345003	70	1675861	16	1424770	13
2005/06	10933520	100	7576530	69	1771129	16	1546555	14
2006/07	15731804	100	11605600	74	2007934	13	2080024	13
2007/08	19077813	100	13268756	70	2451039	12.8	3271475	17
2008/09	27247386	100	19624768	72	3195623	12	4162977	15

Source: Budget Speech of different years and Central Statement: 2009, Office of the Controller of Auditor General

(Note: Income Tax from Other Sectors has excluded in above table due to their very small figure)

According to above table, out of Rs. 8903.693 million income taxes in FY 2001/02, the contribution of corporate tax is Rs.4355.197 million. Remuneration and Investment tax is Rs. 3732.6 and 8158.96 million respectively. In FY 2008/09, contribution of corporate tax reached to Rs. 19624.768 million out of total income tax. Similarly, remuneration and investment tax contributes Rs. 3195.623 and Rs. 4162.977 million respectively.

Figure 4.6
Relative relationship between Income Tax Revenue & its Components



According to above figure, in the beginning FY 2001/02, 49 percent of income tax was collected from corporate sectors. 42 & 9 percent of income tax was from remuneration and investment sectors respectively. In the later fiscal years, contribution of corporate tax to income tax is substantially increased while remuneration tax has been decreased. In the FY 2002/03, corporate tax increased to 68.25 percent while remuneration tax decreased to 15 percent. Investment tax also increased to 16 percent. The increasing trend of corporate tax continued even in FY 2003/04 and increased to 72 percent. But it continued decreasing in later two fiscal years and reduced to 69 percent in FY 2005/06 while remuneration and investment tax increased to 16 and 14 percent respectively. In FY 2006/07 corporate tax increased to 74 percent resulting decrease in remuneration and investment tax. Again, corporate tax reduced to 70 percent in FY 2007/08. Again, corporate tax increased to 72 percent in FY 2008/09 while remuneration and investment tax contribution reduced to 12 and 15 percent respectively. In conclusion, it can be mentioned that corporate tax is dominantly high since the beginning fiscal year till the date. More than 50 percent of income tax is the solo contribution of corporate sectors.

4.1.9 Relationship between Budgeted, Revised Estimate & Actual Income Tax Revenue

Fluctuation in Income Tax Revenue is analyzed in terms of Budgeted Income Tax Revenue, Revised Estimate of Income Tax Revenue and Actual Income Tax Revenue. In Nepal, there is a system of making a revised estimate of last year's budget in mid-six months' review period and actual realization of preceding of last year budget in the current fiscal year. The fluctuations in those cases are presented in the following table:

Table 4.9

Relationship between Budgeted, Revised and Actual Income Tax Revenue

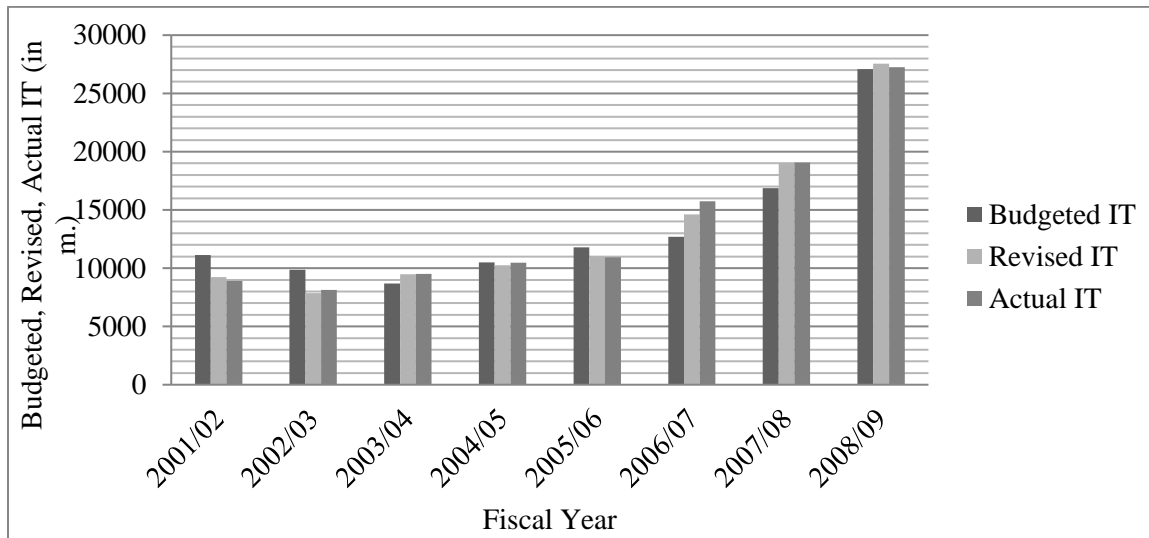
(Rs. in '000')

FY	Budgeted	Revised Estimate	Actual	Budgeted-Actual	%	Deviation
2001/02	11140000	9247500	8903693	2236307	80	20
2002/03	9862500	7852500	8131893	1730607	82.45	17.55
2003/04	8697500	9483700	9514487	816987	109.4	-9.4
2004/05	10500000	10250000	10466226	33774	99.68	0.32
2005/06	11800000	10999600	10933520	86648	92.66	7.34
2006/07	12682000	14607448	15731804	-3049804	124	-24
2007/08	16869200	19026224	19077813	-2208613	113	-13
2008/09	27087000	27547790	27247386	-160386	100.6	0.6

Source: Budget Speech of different years and Central Statement: 2009, Office of the Controller of Auditor General

Figure 4.7

Relative relationship between Budgeted, Revised & Actual Income Tax Revenue



According to above table and figure, there is no huge deviation between budgeted, revised and actual income tax revenue. In the beginning FY 2001/2002 and 2002/03, actual budget is less than revised estimate and revised estimate is less than budgeted income tax i.e. Rs.11140, 9247.5 and 8903.693 million respectively in FY 2001/02. This means budgeted income tax could not be realized. But in the FY 2003/04, actual income

tax is more than revised and revised income tax is more than budgeted income tax Rs.9514.487, 9483.7 & 8697.5 million respectively. In the FY 2004/05, revised estimate is less than budgeted but actual is more than revised. In the FY 2005/06, actual income tax is less than revised and revised is less than budgeted income tax i.e. Rs.10933.52, 10999.6 & 11800 million respectively. But in the FY 2006/07 actual income tax is more than revised and revised is more than budgeted income tax, i.e. Rs. 15731.804, 14607.448 & 12682 million respectively. This trend has continued up to FY 2008/09 where budgeted income tax is Rs.27087 million but revised estimate is Rs.27547.79 million and actual income tax realized is Rs. 27247.386 million. Analyzing deviation between budgeted and actual income tax revenue only, 80 percent of budgeted income tax has been realized in FY 2001/02. In FY 2002/03, it reached to 82.45 percent. In the FY 2003/04, 109.4 percent of budgeted income has been realized which more than budgeted one. But it reduced to 99.68 percent in FY 2004/05. It again decreased to 92.66 percent in FY 2005/06. In the FY 2006/07, 124 percent of budgeted income tax revenue could be realized which is the highest realization of budgeted figure till the date. In the fiscal year 2007/08, however, it decreased to 113 percent furthermore in FY 2008/09 it reduced to 100.6 percent only. In average until the date, cent percent budgeted income tax revenue has been collected. It shows a good sign in income tax administration.

4.1.10. Growth Rate Trend of Income Tax Revenue

Income tax revenue in FY year 2001/02 was Rs.8903.693 million. In FY 2008/09, it has reached to Rs.27547.79 million. During this period, there is not steady growth rate. There is much fluctuation in the growth rate of income tax, which is shown in the table below:

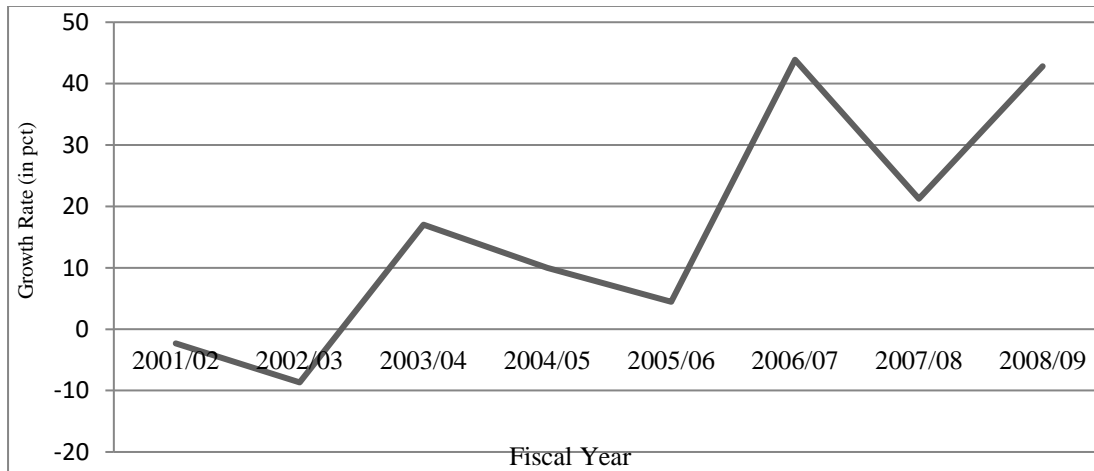
Table 4.10
Growth Rate of Income Tax

(Rs. in '000')			
FY	Income Tax	Increase (Decrease)	Growth Rate (in %)
2000/01	9113914	-	-
2001/02	8903693	(210221)	(2.31)
2002/03	8131893	(771800)	(8.67)
2003/04	9514487	1382600	17
2004/05	10466226	951739	10
2005/06	10933520	467294	4.46
2006/07	15731804	4798284	43.89
2007/08	19077813	3346000	21.27
2008/09	27247386	8169573	42.82

Source: Budget Speech of different years and Central Statement: 2009, Office of the Controller of Auditor General

According to above table income tax in FY 2000/01 was Rs.9113.914 million. It decreased to Rs.8903.693 million in FY 2001/02. Again it decreased to Rs.8131.893 million in FY 2002/03. From FY 2003/04 it started to increase and reached Rs.27247.79 million in FY 2008/09 resulting an increase of Rs.8169977 million than previous year. The highest growth can be seen in FY 2006/07 where Rs.4798.284 million has been increased than previous year. The least increase can be seen in FY 2005/06 where Rs.467.294 million decrease than previous year.

Figure 4.8
Trend of Growth Rate of Income Tax Revenue



According to above figure, we can see the growth trend of income tax revenue since FY 2001/02. In FY 2001/02, income tax has been decreased by 2.31 percent than previous year and this trend continued even in FY 2002/03 where 8.67 percent of income tax has decreased than previous year. Since FY 2003/04, it started to increase. In FY 2003/04 and 2004/05, 17 and 10 percent of income tax has been increased than their respective previous years. 4.46 percent growth rate maintained in FY 2005/06. There is highest growth rate in FY 2006/07 where it is 43.89 percent than previous year. The growth decreased to 21.27 percent in FY 2007/08 but it increased to 42.82 percent in FY 2008. In conclusion, overall growth trend is satisfying however there are big fluctuations in the growth rate.

4.1.11. Forecasting Actual Income Tax Revenue for FY 2009/10

Income tax revenue was Rs.9514.487 million in FY 2003/04 and it reached to Rs.27247.386 million in FY 2008/09. During this period there have been happened many growth rate fluctuations. Based on past data of income tax growth trend, actual income tax for future period i.e. for FY 2009/10 can be estimated.

We have, straight-line trend equation,

$$Y = b_0 + b_1 t \dots\dots\dots (i)$$

Where, Y = Income Tax Revenue

t = Deviation taken in time

Table 4.11

Calculation for Trend Line and Trend Values

FY	t = 2(X-3.5)	t ²	Income Tax (Y) (Rs. in millions)	tY	Trend Value (Y _e)
2003/04 = 1	-5	25	9514.487	(47572.435)	6973.953145
2004/05 = 2	-3	9	10466.226	(31398.678)	10382.45429
2005/06 = 3	-1	1	10933.52	(10933.52)	13790.95543
2006/07 = 4	1	1	15731.804	15731.804	17199.45657
2007/08 = 5	3	9	19077.813	57233.439	20607.95771
2008/09	5	25	27247.386	136236.93	24016.45886
Total	∑t = 0	∑t ² = 70	∑Y = 92971.236	∑tY = 136236.93	

For even number of years,

$$t = \frac{2(X - \text{A.M. of two middle years})}{\text{Interval of Time}}$$
$$= 2(X - 3.5)$$

Since, $\sum t = 0$,

$$b_0 = \frac{\sum Y}{n} = \frac{92971.236}{6} = 15495.206$$

And,

$$b_1 = \frac{\sum tY}{\sum t^2} = \frac{119297.54}{70} = 1704.250571$$

The best fit of straight-line trend is obtained by substituting the value of b_0 and b_1 in (i),

We get,

$$Y_e = 15495.207 + 1704.250571 \dots\dots\dots (ii)$$

Calculation of Trend Values by putting the value of t in (i), are as follow:

$$\text{For } t = -5, Y_e = 15495.206 + 1404.250571 (-5) = 6973.953145$$

$$\text{For } t = -3, Y_e = 15495.206 + 1404.250571 (-3) = 10382.45429$$

$$\text{For } t = -1, Y_e = 15495.206 + 1404.250571 (-1) = 13790.95543$$

$$\text{For } t = 1, Y_e = 15495.206 + 1404.250571 \times 1 = 17199.45657$$

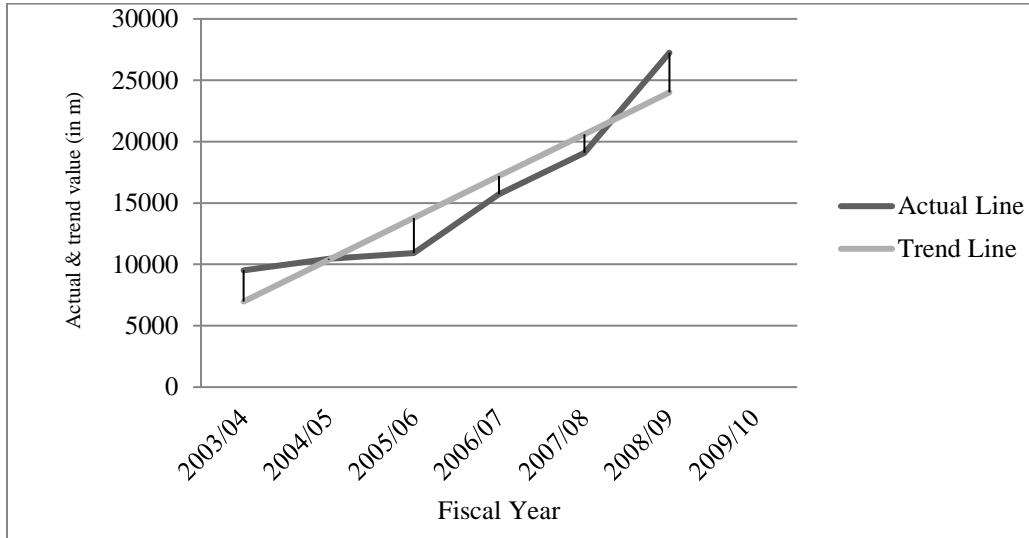
$$\text{For } t = 3, Y_e = 15495.206 + 1404.250571 \times 3 = 20607.95771$$

$$\text{For } t = 5, Y_e = 15495.206 + 1404.250571 \times 5 = 24016.45888$$

Based on above actual data and trend value calculated, we can draw a trend line as:

Figure No. 4.9

Actual and Trend Line of Income Tax Revenue



Above figure shows an increasing trend of income tax revenue collection since the value of b_1 is positive. The exact increasing rate of income tax per year will not be 1704.250571 million because $t = 2(X-3.5)$. Hence, the exact increasing rate of income tax per year is $\text{Rs. } 2 \times 1704.250571 = \text{Rs. } 3408.501142$ million.

Therefore, t for FY 2009/010 = $2(X-3.5) = 2(7-3.5) = 7$

$$Y_{2009/10} = 15495.206 + 1704.250571 = \text{Rs. } 27424.96 \text{ million.}$$

However, this may not be true picture of forecasting. According to Ministry of Finance, preliminary estimation of collection of income tax in FY 2009/10 is Rs.33750 million.

4.1.12. Composition of Income Tax Revenue in FY 2008/09

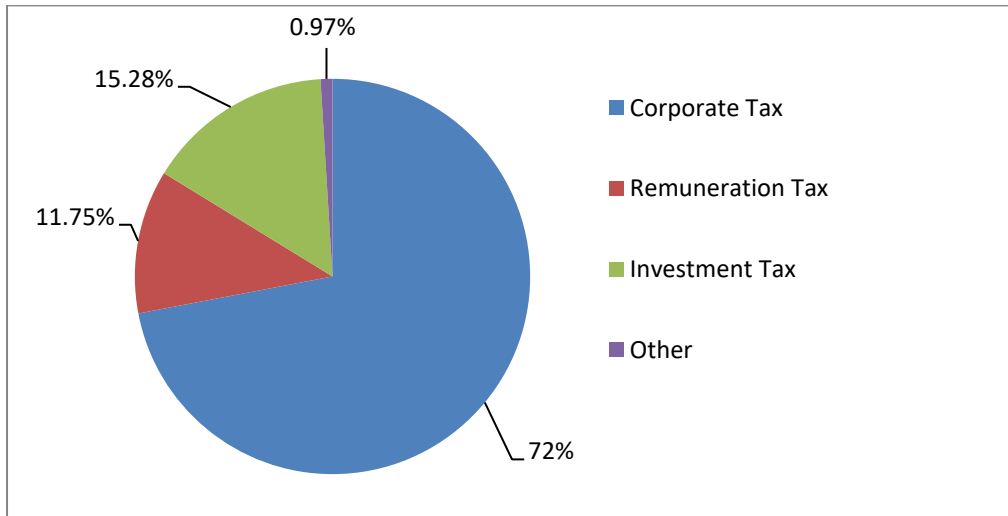
Income Tax is the sum of corporate, remuneration, income tax on investment and others. The actual income tax revenue of FY 2008/09 is classified into their respective share of contribution as:

Table 4.12
Composition of Income Tax Revenue

Tax	Amount (Rs. in '000')	Percentage
Corporate Tax	19624768	72
Remuneration Tax	3195623	11.75
Income Tax on Investment	4162917	15.28
Others	264078	0.97
Total	27247368	100

Source: Central Statement: 2009, Office of Controller of Auditor General Audit

Figure 4.10
Relative composition of Income Tax Revenue



According to above table and figure, 72 percent of income tax is the solo contribution from corporate sectors. 15.28 & 11.75 percent are the contribution investment tax and remuneration tax respectively. Other income's contribution is 0.97 percent only. Other income includes windfall gain tax also.

4.1.13 Component of Corporate Tax in FY 2008/09

Corporate income tax consists of tax paid by the government corporations, public limited companies, private limited companies and personal or sole trading firms. The contribution of corporate tax is dominantly high in corporate tax structure. Actual

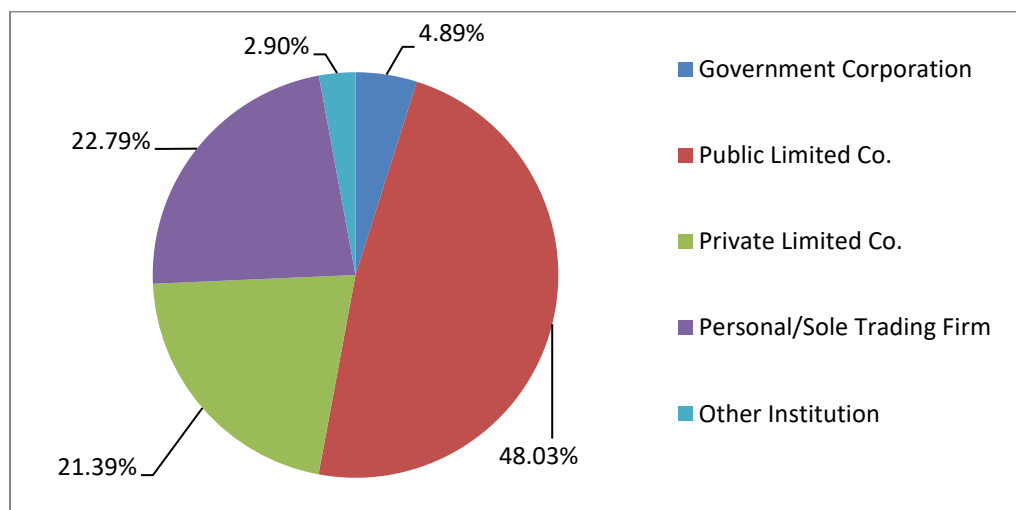
corporate tax and contribution of each of components of corporate income tax in FY 2008/09 can be shown as follows:

Table 4.13
Composition of Corporate Tax

Tax	Amount (Rs. in '000')	Percentage
Government Corporation	959047	4.89
Public Limited Company	9425132	48.03
Private Limited Company	4197536	21.39
Personal/Sole Trading	4472091	22.79
Other Institutions	570962	2.9
Total	19624768	100

Source: Central Statement: 2009, Office of Controller of Auditor General

Figure 4.11
Relative Composition of Corporate



Above table and figure depicts the existing components of corporate tax revenue in FY 2008/09. Out of total corporate tax revenue of Rs.19624.768 million, the contribution of public limited companies is Rs.9425.132 million that is 48.03 percent of total corporate tax revenue. 22.79 or Rs.4472.091 million is the contribution of personal or sole trading firms. Similarly, private limited companies contribute Rs.4197.536 or 21.39 percent. Government corporations' contribution is 4.89 percent in corporate tax revenue, which is Rs.959.047 million. Other institutions' contribution is only 2.9 percent. It is Rs. 570.962.

In conclusion, public limited companies' contribution is the highest in the corporate tax revenue.

4.1.14 Component of Income Tax on Investment in FY 2008/09

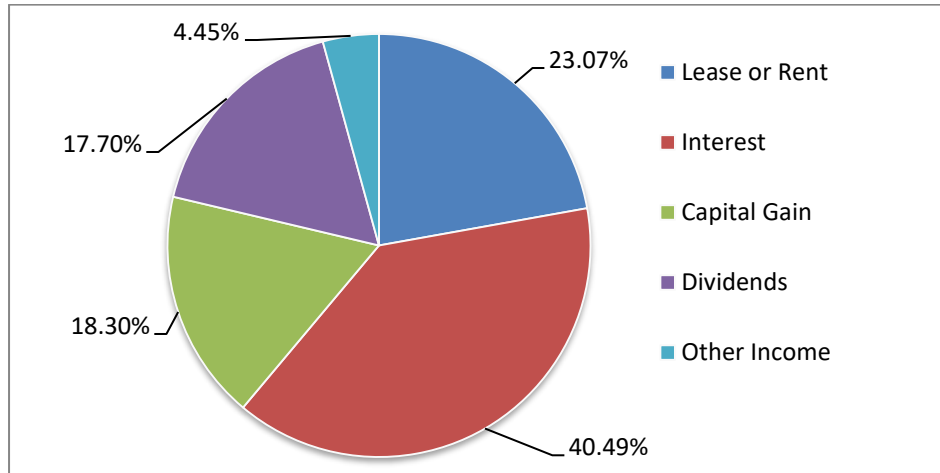
Income tax on investment is the sum of tax on lease or rent, interest, capital gain and dividends. Income tax on interest is the dominantly high in investment tax structure. Actual income tax on investment and contribution of each of its components in FY 2008/09 are present below:

Table 4.14
Composition of Income Tax on Investment

Tax	Amount (Rs. in '000')	Percentage
Lease or Rent	960198	23.07
Interest	1685094	40.49
Capital Gain	761617	18.3
Dividends	736546	17.7
Other Income from Investment	18508	4.45
Total	4161963	100

Source: Central Statement: 2009, Office of Controller of Auditor General

Figure 4.12
Relative Composition of Income Tax on Investment



Above table and figure, reveal the composition of tax revenue on investment in FY 2008/09. Out of total investment tax revenue Rs.4161.963 million, the contribution of

interest is Rs. 1685.094 million that is 40.49 percent. The contribution of lease or rent is 23.07 percent, which is Rs.960.198. Capital gain, and dividends contribute Rs.761.617 and 736.546 million, which is 18.3 and 17.7 percent respectively. The contribution of other income from investment is 4.45 percent, which is Rs.18.508 million. In conclusion, interest contributes the highest in the investment tax structure.

4.1.15. Budgeted Income Tax Revenue in FY 2009/10

Finance Minister Mr. Surendra Pandey presented the annual budget of Revenues and Expenditure for FY 2009/10 in the Legislature Parliament through a Finance Act. According to the budget speech, total revenue is estimated to be 176503.75 million. Out of it total tax revenue is estimated to be Rs.150245.64 million. Out of total revenue direct and indirect tax is estimated to be Rs.45798 and 104447.64 million respectively. And out of direct tax income tax is estimated to be Rs.36298 million which is the composition of two sources: collection from existing sources will be Rs.32532.7 and from tariff and administrative reforms will be Rs.3765.3 million respectively. The budgeted contribution of each component of income tax is present in the following table:

Table 4.15
Budgeted Income Tax Revenue-FY 2009/10

(Rs. in '000')

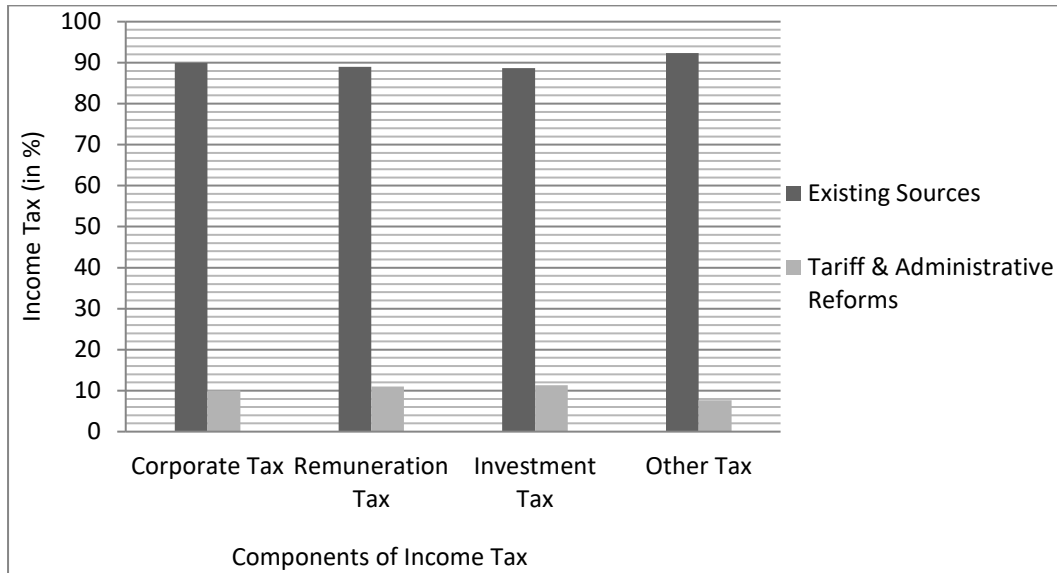
Tax	Total	%	Existing Source	%	Tariff & Adm. Reforms	%
Corporate Tax	25768000	71	23173200	89.9	2594800	10.06
Remuneration Tax	4180000	11.5	3720400	89	459600	11
Investment Tax	6121000	16.9	5427600	88.6	693400	11.33
Other	229000	0.6	211500	92.35	17500	7.64
Total	36298000	100	32532700	89.63	3765300	10.37

Source: Budget Speech, FY 2009/10, Annex-5

According to above table, out of budgeted income tax of Rs. 36298million for FY 2009/10, the contribution of corporate tax is the highest, which is Rs. 25768million or 71 percent while investment tax is Rs.6121million, which is 16.9 percent of total income tax revenue. Remuneration tax is Rs.4180million, which is 11.5 percent. For further analysis, above table can be presented in chart also:

Figure 4.13

Relative Composition of Income Tax Revenue & Its Sources



According to above figure, it is clear that more than 80 percent of budgeted income tax will be collected from the existing source. 89.93 percent of corporate tax will be collected from existing sources and remaining 10.06 percent from tariff and administrative reforms. Out of total remuneration and investment tax 86 and 88.67 percent will be collected from the existing sources respectively and remaining from tariff and administrative reforms. Other income tax consist windfall gain also and 92.35 percent will be collected from existing source. In total 89.63 percent of budgeted income tax will be collected from the existing sources and remaining 10.37 percent from the tariff and administrative reforms.

4.2 Descriptive Presentation & Analysis of Primary Data

An empirical investigation was conducted to find out various aspects of income tax practice from the experience of the real world. The major tools used for this study is an opinion survey. Total 50 questionnaires were distributed to the respondents and 40 respondents selected for this study were Tax Officers and Taxpayers. The study is based on contemporary issues in income tax in Nepal. The views of the respondents were collected from Kathmandu valley only. Information collection from the respondents have

tabulated into the separate format and been expressed in terms of percentage of total numbers, where necessary. It has been analyzed in descriptive way.

Table 4.16
Responses by Group

	Group of Respondent	Sample Size	Percentage
1.	Tax Officers	20	50
2.	Taxpayers	20	50
	Total	40	100

Source: Opinion Survey

4.2.1. The success of ‘Tax Compliance Year-2009’

The Government of Nepal has observed F.Y. 2009/10 as “Tax Compliance Year” for developing taxpaying habit with the slogan, “Our tax contribution for our own development and for the creation of modern and prosperous Nepal.” In this context, a question was asked, “will the tax compliance year be a success?” The responses received from the respondents are tabulated as follows:

Table 4.17
Responses on the success of Tax Compliance Year

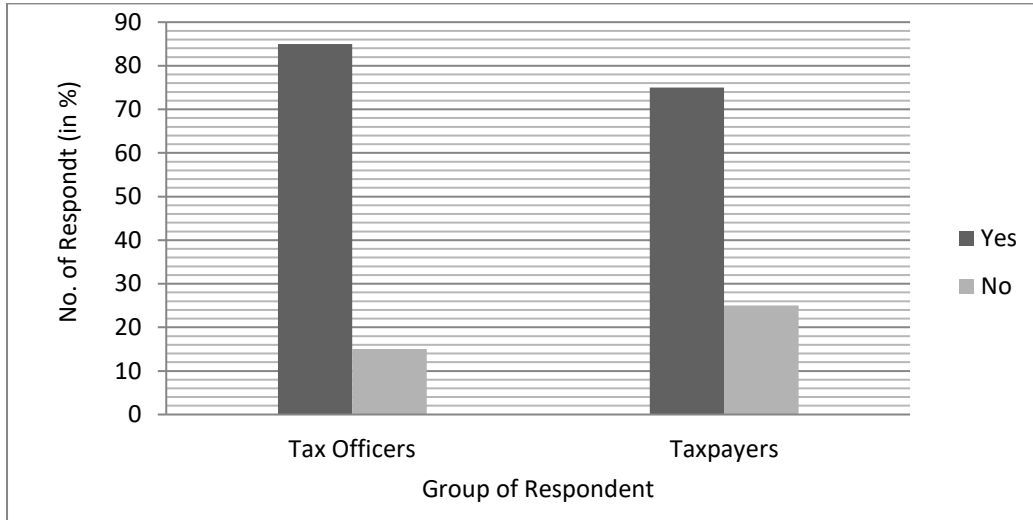
Respondent Group	Yes		No		Total	
	Nos	%	Nos	%	Nos	%
Tax Officers	17	85	3	15	20	50
Taxpayers	15	75	5	25	20	50
Total	32	80	8	20	40	100

Source: Opinion Survey

From the above table, it is clear that 17 Tax Officers believe in the success of ‘Tax Compliance Year’ and only 3 disagree with it. Similarly 15 Taxpayers believe in the success of the program and remaining 5 don’t agree with it.

Figure 4.14

Percentage of Responses on Success of Tax Compliance Year



According to above figure, it can be seen that 85 percent of Tax Officers are agree to the success of the program and 75 percent of Taxpayers believe in success of the program. In average, 80 percent of total respondents believe in the success of the program and remaining 20 percent don't believe in the success of the program.

4.2.2. FNCCI's Suggestion on the Exemption Limit of Tax on Natural Person

Federation of Nepalese Chamber of Commerce and Industries has suggested the government of Nepal to exempt in taxable income of an individual up to Rs.2, 00,000 and of couple up to Rs.3, 00,000 respectively from FY 2010/11. Currently this exemption limit is Rs.1, 60,000 and Rs.2, 00,000 respectively. The respondents were asked whether they agree or don't agree with this suggestion. The responses are presents as follows:

Table 4.18

Opinion on the Proposed Exemption Limit

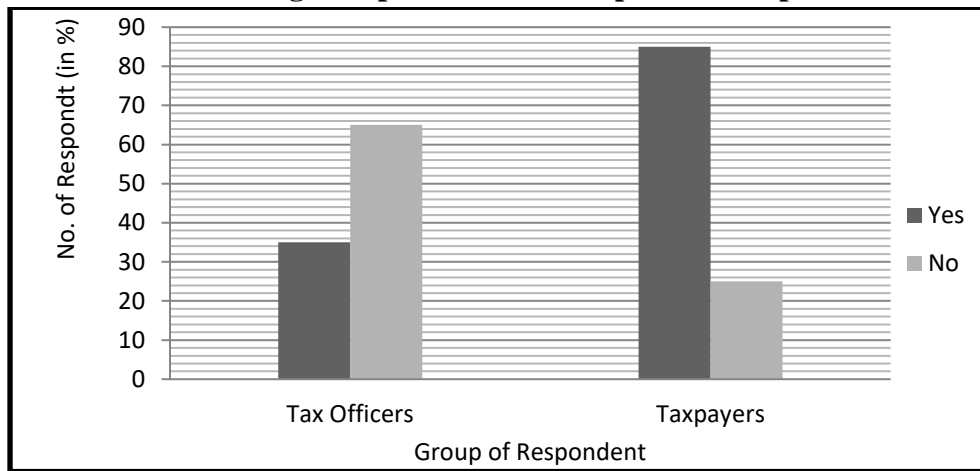
Respondent Group	Yes		No		Total	
	Nos	%	Nos	%	Nos	%
Tax Officers	7	35	13	65	20	50
Taxpayers	17	85	3	15	20	50
Total	24	60	16	40	40	100

Source: Opinion Survey

From the above table it is clear that 13 Tax Officers do not agree with the proposed exemption limit. But 17 Taxpayers support the proposed exemption limit. In total 24 respondents, are positive and 16 respondents are negative to the proposed exemption limit of FNCCI.

Figure No. 4.15

Percentage of opinion on the Proposed Exemption Limit



According to above figure, 65 percent of Tax Officers rejected the proposed exemption limit; however, 85 percent of Taxpayers approved the proposal. Only 15 percent of Taxpayers rejected the proposal. In average, 60 percent of total respondent approved the proposal of FNCCI regarding the exemption limit of natural persons.

4.2.3 FNCCI’s Suggestion on Imposing Natural Person Tax in Three Layers

FNCCI has also suggested the government to impose income tax on natural persons in three layers i.e. individual, couple and family. The respondents were asked about its practicability, feasibility and cost effectiveness. The responses received are presented as below:

Table 4.19
Opinion on the Proposed Income Tax Layers

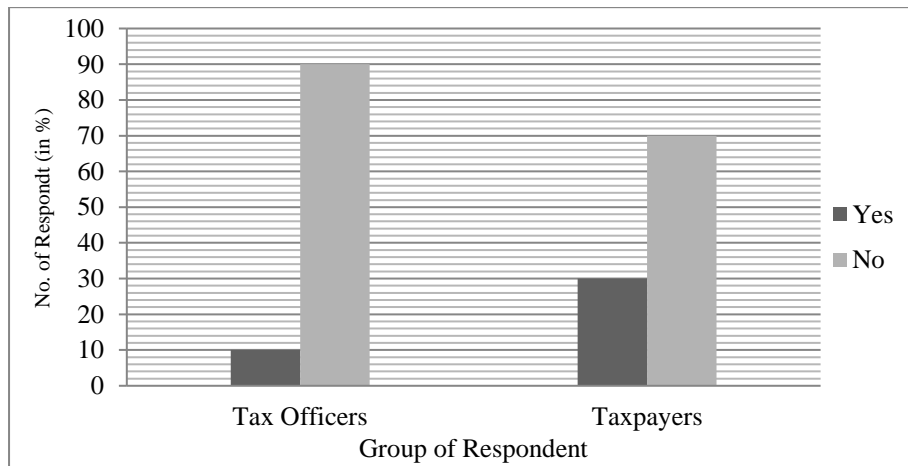
Respondent Group	Yes		No		Total	
	Nos	%	Nos	%	Nos	%
Tax Officers	2	10	18	90	20	50
Taxpayers	8	30	12	70	20	50
Total	10	25	30	75	40	100

Source: Opinion Survey

According to above table, most of Tax Officers didn't agree with FNCCI's suggestions to impose income tax on natural person in three layers. Only 2 Tax Officers agreed upon it. Taxpayers are also not positive to the proposal. 8 taxpayers approved it and the rest rejected it. In average, 10 respondents agreed and 30 respondents disagreed upon it.

Figure 4.16

Percentage of Opinion on Proposed Income Tax Layers



According to above figure, it can be concluded that only 10 percent of Tax Officers agreed upon the suggestion of FNCCI to impose income tax on natural person in three layers and rejected by 90 percent. However, 30 percent of Taxpayers approved it and remaining 70 percent rejected it. In average, 25 percent of total respondents were found to be positive to the proposal and rest 75 percent rejected it.

4.2.4. Effectiveness of Income Tax Act, 2058 B.S.

The respondents were also asked about the effectiveness of ITA, 2058 than the previous Act, 2031. They registered their answer in given questionnaire and the results are shown as:

Table 4.20
Opinion on the Effectiveness of ITA, 2058

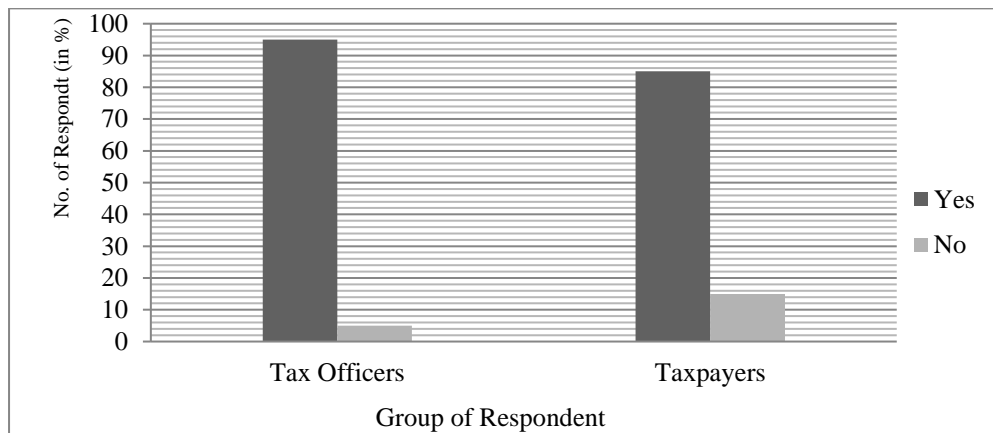
Respondent Group	Yes		No		Total	
	Nos	%	Nos	%	Nos	%
Tax Officers	19	95	1	5	20	50
Taxpayers	17	85	3	15	20	50
Total	36	90	4	10	40	100

Source: Opinion Survey

According to above table, 19 Tax Officers are confident in the effectiveness of ITA, 2058 than the previous Act and 17 Taxpayers gave their consent over this arguments. In average, 36 respondents are fully felt the effectiveness of ITA, 2058 and only 4 respondents didn't favor on the effectiveness of the current Act.

Figure 4.17

Percentage of opinion on the Effectiveness of ITA, 2058



According to above figure, 95 and 85 percent of Tax Officers and Taxpayers believed in the effectiveness of Income Tax Act, 2058. Only few percent of Tax Officers didn't believe in the effectiveness and 15 percent of Taxpayers didn't agree with the effectiveness. In average, 90 percent of total respondents believed in the effectiveness and rest 5 percent didn't.

4.2.5. Contribution of Income Tax to National Economy

The respondents were also asked whether the contribution of income tax to national economy is satisfying or not. The responses received are presented in table as follows:

Table 4.21

Opinion on Contribution of Income Tax to National Economy

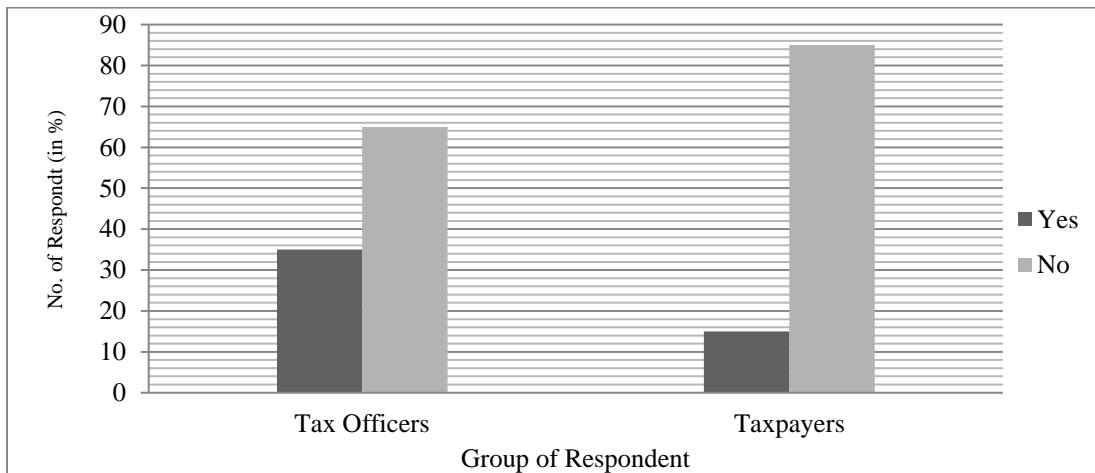
Respondent Group	Yes		No		Total	
	Nos	%	Nos	%	Nos	%
Tax Officers	7	35	13	65	20	50
Taxpayers	3	15	17	85	20	50
Total	10	25	30	75	40	100

Source: Opinion Survey

According to above table, only 7 Tax Officers were agreed upon the contribution of income tax to National Economy is satisfying and rest 13 Tax Officers were not agreed upon. Three Taxpayers were found satisfied with the contribution. Remaining 17 Taxpayers seemed to have been dissatisfied. In total, 10 respondents were positive and rest whole 90 percent is negative to the statement that income tax contributes a lot to the national economy.

Figure 4.18

Percentage of opinion on Contribution of Income Tax to National Economy



According to above figure, 35 percent of Tax Officers were not satisfied with the contribution of income tax to national economy. Only 15 percent of Taxpayers did the same as Tax Officers. 65 and 85 percent of Tax Officers and Taxpayers dissatisfied with it. In total, 25 percent of total respondent were found to be agreed upon the contribution of income tax to national economy is satisfying and rest 75 percent disagreed upon it.

4.2.6. Poor Taxpaying Habit of Nepalese People

The respondents were also asked another question in the questionnaire that whether there is poor taxpaying habit of Nepalese people. They gave their responses and it is presented in the table as below:

Table 4.22

Opinion on Poor Taxpaying Habit of Nepalese People

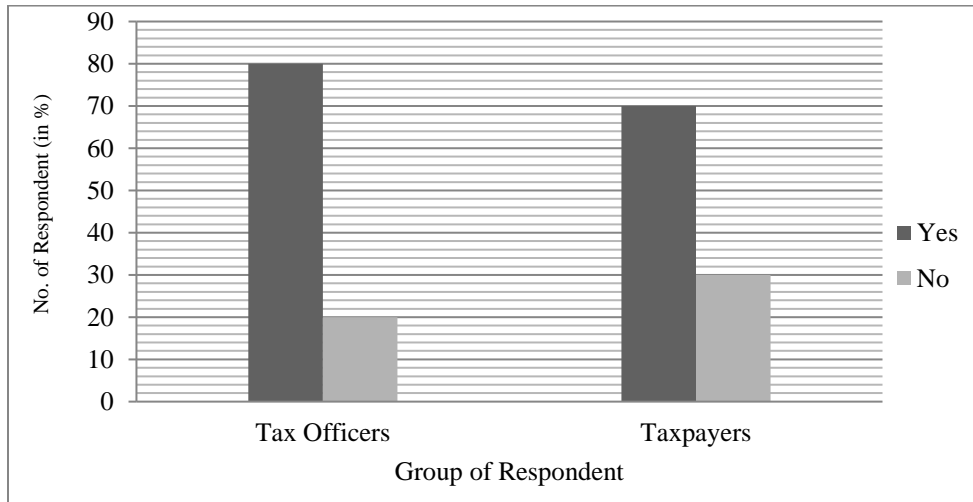
Respondent Group	Yes		No		Total	
	Nos	%	Nos	%	Nos	%
Tax Officers	16	80	4	20	20	50
Taxpayers	14	70	6	30	20	50
Total	30	75	10	25	40	100

Source: Opinion Survey

Above table depicts 16 Tax Officers and 14 Taxpayers saw a poor taxpaying habit of Nepalese people and rest 4 and 6 Tax Officers and Payers did not agree to this fact. In total 30 respondents are feeling poor taxpaying habit and rest 10 are not.

Figure 4.19

Percentage of opinion on Poor Taxpaying Habit of Nepalese People



According to above figure, 80 and 70 percent of Tax Officers and Taxpayers agreed upon the poor taxpaying of Nepalese people and 20 and 30 percent did not agree upon this fact respectively. In total 75 percent of respondents have approved the fact that there is poor taxpaying habit of Nepalese people and rest 25 percent found not agreed upon it.

4.2.7 Major Causes Behind Poor Taxpaying Habit

Most of the respondents voted that there is poor taxpaying habit of Nepalese people. To rank the major cause of poor taxpaying habit, the respondents were requested to rank in the potential reasons laid down in the questionnaire according to their important as felt by the respondent. The respondents were requested to rank their answer from one (most important) to six (least important). For analysis purpose, choice was assigned weights according to the number of alternatives. Here are six alternatives, hence, the first preferred choice gets six points and the least preferred gets one points. Second preferred choice gets five and so on. The total points available to each choice were converted into percentage in reference to total points available for all choice. The choice with the highest score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as last choice. For our convenience, let us suppose, Tax Officers be X and Taxpayers be Y:

Table No. 4.23

Major Causes of Poor Taxpaying Habit of Nepalese People

S.N.	Major Causes	Group of Respondent		Total Points	%	Rank
		X (in points)	Y (in points)			
1	Little Knowledge of tax	107	105	212	25.24	1
2	Complexities of Tax laws	71	65	136	16.19	3
3	Lack of effective programs	60	59	119	14.17	4
4	Poverty of People	58	34	92	10.95	6
5	Defective Tax administration	47	71	118	14.05	5
6	No provision for incentives	77	86	163	19.4	2
	Total	420	420	840	100	

Source: Opinion Survey

According to above table, the respondents have ranked ‘Little Knowledge of Tax and its Importance’ as the first cause for poor taxpaying habit of Nepalese people. Similarly, ‘No Provision for incentives’ ranked as the second major causes. Complexities of tax laws, lack of effective programs and defective tax administration have been ranked as the third,

fourth and fifth causes of poor taxpaying habit respectively. The respondent ranked poverty of people as least causes.

4.2.8. Major Reasons of Corrupt Practice in Nepalese Tax Administration

In order to know the major causes of corrupt practice existed in the tax administration in Nepal, the respondents were asked what the major reason was for it. The respondents were requested to rank their answer from one to five scales. Point one is the most important and five is the least one. For analysis purpose, choices were assigned weights according to the number of alternatives. Here are five alternatives, therefore, the first preferred choice gets five points and the least choice gets one point and so on. The total points available to each choice were converted into percentage in reference to total points available for all choice. The choice with the higher score of percentage was ranked as the most important choice and vice versa.

Table 4.24

Major Reasons for Corrupt Practice in Nepalese Tax Administration

S.N.	Major Causes	Group of Respondent		Total Points	%	Rank
		X (in points)	Y (in points)			
1	Dishonest Personnel	33	61	94	15.67	5
2	Lower Remuneration of Staff	71	62	133	22.17	2
3	Impunity	70	53	123	20.5	3
4	Political Protection	86	69	155	25.83	1
5	Weakness of Acts and Rules	40	55	95	15.83	4
	Total	300	300	600	100	

Source: Opinion Survey

According to above table, the respondents have ranked 'Political Protection' as the root cause of existing corrupt practice in Nepalese tax administration. They ranked 'Lower Remuneration of Personnel' as the second cause. Impunity has got third rank. Weakness of the Acts and Rules and Dishonest Personnel are ranked as fourth and fifth respectively.

4.3. Test of hypothesis based on Empirical Investigation

First Set of Hypothesis

Opinion on Success of 'Tax Compliance Year'

Responses	Tax Officer (X)	Taxpayers (Y)	Total
Yes (in numbers)	17	15	32
No (in numbers)	3	5	8
Total	20	20	40

Source: From the table 4.17

Is there evidence of a significant evidence of difference between the views of Tax Officers & Taxpayers on becoming 'Tax Compliance Year' a success?

Null hypothesis: H_{01} : There is no significant evidence of difference between the views of Tax Officers and Taxpayers on becoming 'Tax \compliance Year-2009' a success. That means there is no different view with respect to the program.

Alternative hypothesis: H_{11} : There is significant evidence of difference between the views of Tax Officers and Taxpayers on becoming 'Tax Compliance Year-2009' becoming a success.

Test statistic under H_0 is,

$$\mu^2 = \frac{(O-E)^2}{E}$$

Where, O = Observed Frequency

E = Expected Frequency

RT = Row Total

CT = Column Total

N = Total number of observations

Table 4.25
Calculation of μ^2

O	$E = \frac{RT \times CT}{N}$	O-E	(O-E) ²	$\frac{(O - E)^2}{E}$
17	$32 \times 20 / 40 = 16$	1	1	0.0625
15	$32 \times 20 / 40 = 16$	-1	1	0.0625
3	$8 \times 20 / 40 = 4$	-1	1	0.25
5	$8 \times 20 / 40 = 4$	1	1	0.25
$\sum O = 40$				0.625

Calculated $\mu^2 = \frac{(O-E)^2}{E} = 0.625$

Degree of Freedom = (r-1) (c-1) = (2-1) (2-1) = 1

Tabulated value of μ^2 at 5 percent level of significance with 1 degree of freedom (df) is 3.84.

(Note: Level of significance is supposed to be 5 percent)

Since calculated value of μ^2 is less than tabulated value of μ^2 , the null hypothesis H_0 is accepted and hence alternative hypothesis H_1 is rejected. Therefore we conclude that there is no significant evidence of different between the views of Tax Officers and Taxpayers on the success of tax compliance year. This means both respondents have same view on the program.

Second Set of Hypothesis

Opinion on Proposed Exemption Limit

Responses	Tax Officer (X)	Taxpayers (Y)	Total
Yes (in numbers)	7	17	24
No (in numbers)	13	3	16
Total	20	20	40

Source: From the table 4.18

Is there evidence of a significant evidence of difference between the views of Tax Officers & Taxpayers on the suggestion of FNCCI about the proposed natural persons' tax exemption limit?

Null hypothesis: H_{02} : There is no significant evidence of difference between the views of Tax Officers and Taxpayers on the suggestion of FNCCI regarding new tax exemption limit. That means there is no different view with respect to the proposed exemption limit.

Alternative hypothesis: H_{12} : There is significant evidence of difference between the views of Tax Officers and Taxpayers on FCCI' suggestion regarding new tax exemption limit.

Test statistic under H_0 is,

$$\mu^2 = \frac{(O-E)^2}{E}$$

Where, O = Observed Frequency

E = Expected Frequency

RT = Row Total

CT = Column Total

N = Total number of observations

Table 4.26
Calculation of μ^2

O	$E = \frac{RT \times CT}{N}$	O-E	$(O-E)^2$	$\frac{(O-E)^2}{E}$
7	$24 \times 20 / 40 = 12$	-5	25	2.08
17	$24 \times 20 / 40 = 12$	5	25	2.08
13	$16 \times 20 / 40 = 8$	5	25	3.125
3	$16 \times 20 / 40 = 8$	-5	25	3.125
$\sum O = 40$				10.41

Calculated $\mu^2 = \frac{(O-E)^2}{E} = 10.41$

Degree of Freedom = $(r-1)(c-1) = (2-1)(2-1) = 1$

Tabulated value of μ^2 at 5 percent level of significance with 1 degree of freedom (df) is 3.84.

(Note: Level of significance is supposed to be 5 percent)

Since calculated value of μ^2 is greater than tabulated value of μ^2 , the null hypothesis H_0 is rejected and hence alternative hypothesis H_1 is accepted. Therefore we conclude that

there is significant evidence of different between the views of Tax Officers and Taxpayers on the suggestion of FNCCI to the government of Nepal on the exemption limit for natural persons. This means both respondents have different view on the program or their views contradict to each other.

Third Set of Hypothesis

Opinion on Proposed Natural Person Tax Layers

Responses	Tax Officer (X)	Taxpayers (Y)	Total
Yes (in numbers)	2	8	10
No (in numbers)	18	12	30
Total	20	20	40

Source: From the table 4.19

Is there evidence of a significant evidence of difference between the views of Tax Officers & Taxpayers on the suggestion of FNCCI to the government to impose natural person tax in three layers?

Null hypothesis: H_{03} : There is no significant evidence of difference between the views of Tax Officers and Taxpayers on the suggestion of FNCCI regarding imposition of natural person tax in three layers. That means there is no different view with respect to the proposed tax layers.

Alternative hypothesis: H_{13} : There is significant evidence of difference between the views of Tax Officers and Taxpayers on FNCCI' suggestion regarding imposition of natural person tax in three layers.

Test statistic under H_0 is,

$$\mu^2 = \frac{(O-E)^2}{E}$$

Where,

O = Observed Frequency

E = Expected Frequency

RT = Row Total

CT = Column Total

N = Total number of observations

Table 4.27
Calculation of μ^2

O	$E = \frac{RT \times CT}{N}$	O-E	$(O-E)^2$	$\frac{(O-E)^2}{E}$
2	$10 \times 20 / 40 = 5$	-3	9	1.8
8	$10 \times 20 / 40 = 5$	3	9	1.8
18	$30 \times 20 / 40 = 15$	3	9	0.6
12	$30 \times 20 / 40 = 15$	-3	9	0.6
$\sum O = 40$				4.8

$$\text{Calculated } \mu^2 = \frac{(O-E)^2}{E} = 4.8$$

$$\text{Degree of Freedom} = (r-1)(c-1) = (2-1)(2-1) = 1$$

Tabulated value of μ^2 at 5 percent level of significance with 1 degree of freedom (df) is 3.84.

(Note: Level of significance is supposed to be 5 percent)

Since calculated value of μ^2 is greater than tabulated value of μ^2 , the null hypothesis H_0 is rejected and hence alternative hypothesis H_1 is accepted. Therefore we conclude that there is significant evidence of different between the views of Tax Officers and Taxpayers on the suggestion of FNCCI to the government of Nepal on the imposition of income tax on natural person in three different layers. This means both respondents have different views on propose of FNCCI or their views contradict to each other.

Forth Set of Hypothesis

Opinion on Effectiveness of ITA, 2058

Responses	Tax Officer (X)	Taxpayers (Y)	Total
Yes (in numbers)	19	17	36
No (in numbers)	1	3	4
Total	20	20	40

Source: From the table 4.20

Is there evidence of a significant evidence of difference between the views of Tax Officers & Taxpayers on the effectiveness of ITA, 2058 than ITA, 2031 B.S.?

Null hypothesis: H₀₄: There is no significant evidence of difference between the views of Tax Officers and Taxpayers on the effectiveness of ITA, 2058 than the previous Act. That means there is no different view with respect to the effectiveness of ITA, 2058.

Alternative hypothesis: H₁₄: There is significant evidence of difference between the views of Tax Officers and Taxpayers on effectiveness of ITA, 2058 than previous Act.

Test statistic under H₀ is,

$$\mu^2 = \frac{(O-E)^2}{E}$$

Where, O = Observed Frequency

E = Expected Frequency

RT = Row Total

CT = Column Total

N = Total number of observations

Table 4.28
Calculation of μ^2

O	$E = \frac{RT \times CT}{N}$	O-E	(O-E) ²	$\frac{(O - E)^2}{E}$
19	$36 \times 20 / 40 = 18$	1	1	0.55
17	$36 \times 20 / 40 = 18$	-1	1	0.55
1	$4 \times 20 / 40 = 2$	-1	1	0.5
3	$4 \times 20 / 40 = 2$	1	1	0.5
$\sum O = 40$				1.11

Calculated $\mu^2 = \frac{(O-E)^2}{E} = 1.11$

Degree of Freedom = (r-1) (c-1) = (2-1) (2-1) = 1

Tabulated value of μ^2 at 5 percent level of significance with 1 degree of freedom (df) is 3.84.

(Note: Level of significance is supposed to be 5 percent)

Since calculated value of μ^2 is less than tabulated value of μ^2 , the null hypothesis H_0 is accepted and hence alternative hypothesis H_1 is rejected. Therefore we conclude that there is no significant evidence of different between the views of Tax Officers and Taxpayers on the effectiveness of ITA, 2058 than the previous Act. This means both respondents have different views on effectiveness of ITA, 2058 or their views contradict to each other.

Fifth Set of Hypothesis

Opinion on Contribution of Income Tax to National Economy

Responses	Tax Officer (X)	Taxpayers (Y)	Total
Yes (in numbers)	7	3	10
No (in numbers)	13	17	30
Total	20	20	40

Source: From the table 4.21

Is there evidence of a significant evidence of difference between the views of Tax Officers & Taxpayers on the contribution of income tax revenue to national economy?

Null hypothesis: H_{05} : There is no significant evidence of difference between the views of Tax Officers and Taxpayers on the contribution of income tax revenue to national economy. That means there is same view with respect to the contribution of income tax to national economy.

Alternative hypothesis: H_{15} : There is significant evidence of difference between the views of Tax Officers and Taxpayers on contribution of income tax to national economy.

Test statistic under H_0 is,

$$\mu^2 = \frac{(O-E)^2}{E}$$

Where,

O = Observed Frequency

E = Expected Frequency

RT = Row Total

CT = Column Total

N = Total number of observations

Table 4.29
Calculation of μ^2

O	$E = \frac{RT \times CT}{N}$	O-E	$(O-E)^2$	$\frac{(O-E)^2}{E}$
7	$10 \times 20 / 40 = 5$	2	4	0.8
3	$10 \times 20 / 40 = 5$	2	4	0.8
13	$30 \times 20 / 40 = 15$	-2	4	0.26
17	$30 \times 20 / 40 = 15$	-2	4	0.26
$\sum O = 40$				2.13

$$\text{Calculated } \mu^2 = \frac{(O-E)^2}{E} = 2.13$$

$$\text{Degree of Freedom} = (r-1)(c-1) = (2-1)(2-1) = 1$$

Tabulated value of μ^2 at 5 percent level of significance with 1 degree of freedom (df) is 3.84.

(Note: Level of significance is supposed to be 5 percent)

Since calculated value of μ^2 is less than tabulated value of μ^2 , the null hypothesis H_0 is accepted and hence alternative hypothesis H_1 is rejected. Therefore we conclude that there is no significant evidence of different between the views of Tax Officers and Taxpayers on the contribution of income tax to national economy. This means both respondents have different views on the contribution of income tax revenue to national economy or their views contradict to each other.

4.4. Spearman Rank-correlation Coefficient

4.4.1. Correlation Coefficient on Major Causes of Poor Taxpaying Habit

Major Causes of Poor Taxpaying Habit of Nepalese People

Causes	Total Points (X)	Total Points (Y)	Re-Rank (R ₁)	Re-Rank (R ₂)	d = R ₁ -R ₂	d ²
Little Knowledge of Tax	107	105	1	1	0	0
Complexities of Tax Laws	71	65	3	4	-1	1
Lack of effective programs	60	59	4	5	-1	1
Poverty of People	58	34	5	6	-1	1
Defective Tax Administration	47	71	6	3	3	9
No provision for incentives	77	86	2	2	0	0
Total	420	420			∑d = 0	∑d ² = 12

Source: From the table 4.23

Now, Spearman rank correlation coefficient,

$$r_s = 1 - \frac{6 \sum d^2}{n(n^2 - 1)}$$

Where, n = The number of items being ranked

$$d = R_1 - R_2$$

R₁ = The rank of items with respect to Tax Officers

R₂ = The rank of items with respect to Taxpayers

$$\begin{aligned} \text{Now, } r_s &= 1 - \frac{6 \times 12}{6(36 - 1)} \\ &= 1 - \frac{72}{210} = 1 - 0.34 = 0.66 \end{aligned}$$

Therefore, $r_s = 0.66$. This shows that there is high positive correlation between Tax Officers and Taxpayers' ranking regarding the major causes of poor taxpaying habit of Nepalese people.

4.4.2. Correlation Coefficient on Major Reason of Corrupt Practice

Major Reasons for Corrupt Practice in Nepalese Tax Administration

Causes	Total Points (X)	Total Points (Y)	Re-Rank (R ₁)	Re-Rank (R ₂)	d = R ₁ -R ₂	d ²
Dishonest Personnel	30	61	5	3	2	4
Lower Remuneration of Staff	71	62	2	2	0	0
Impunity	70	53	3	5	-2	4
Political Protection	86	69	1	1	0	0
Weakness of Tax Laws	40	55	4	4	0	0
Total	300	300			∑d = 0	∑d ² =8

Source: From the table 4.24

Now, Spearman rank correlation coefficient,

$$r_s = 1 - \frac{6 \sum d^2}{n(n^2-1)}$$

Where, n = The number of items being ranked

$$d = R_1 - R_2$$

R₁ = the rank of items with respect to Tax Officers

R₂ = the rank of items with respect to Taxpayers

$$\begin{aligned} \text{Now, } r_s &= 1 - \frac{6 \times 8}{5(25-1)} \\ &= 1 - \frac{48}{120} = 1 - 0.4 = 0.6 \end{aligned}$$

Therefore, $r_s = 0.6$. This shows that there is high positive correlation between Tax Officers and Taxpayers' ranking regarding the major reasons for existing corrupt practice in Nepalese tax administration.

4.5. Comments and Suggestions from the Respondent

An open Question was asked to the respondent to know their comments on major problems of income tax administration in Nepal and suggestions for improvement. The

major problems point out by respondents, comments and suggestions received from the respondents are presented below:

4.5.1 Major Problems

1. Narrow tax coverage Area
2. Donors' and International agencies' interference is high in forming income tax laws and policy making (especially high pressure from World Bank and International Monetary Fund)
3. Less reform of tax administration
4. Less public awareness about the tax
5. Less diversification of income tax area
6. Unawareness of legal provisions to taxpayers
7. Existence of more informal business
8. Political instability
9. Unfavorable ecology
10. Weak enforcement
11. Lack of political commitment and support
12. Less motivated personnel
13. Less taxpaying culture
14. Less public awareness.
15. Negative perception of tax prevailing in public
16. Poor recording system of transaction of the taxpayers

4.5.2 Comments

1. Increase DTAA treaties.
2. Do correct practice by all.
3. Taxpaying culture should be encouraged.
4. There is no sufficient tax rebates and no encourage for taxpayers.
5. Tax administration and practice of the Act is poor.
6. Inconsistent tax policies due to the long transition period of the country.

7. There is poor implementation of rules and regulation of the tax due to unstable and coalition government.
8. Tax evasion exists.
9. There is lack of effective training and motivation to the tax personnel as well as taxpayers.
10. There is less proper utilization of collected tax revenue.
11. There is weak reward and punishment system to both tax personnel and taxpayers.
12. ITA, 2058 is based highly on educated taxpayer and developed nation i.e. less appropriate to our income situation.
13. This Act's provisions can't reduce all illegal business activities, tax evasion and avoidance.

4.5.3 Suggestions

1. Low tax rate and diversification of income tax area i.e. for agriculture and service sectors.
2. Widen tax coverage area.
3. DTAA treaties should be expanded.
4. Neutralize donors' pressure and international agencies' interference.
5. There should be aggregate administration reforms i.e. whole bureaucracy, not particular income tax administration.
6. New technology should adopt and new generation of employee should appointed.
7. Publicity about tax should intensify through different media to raise public awareness.
8. There should be realistic reward and punishment system.
9. Attitude, behavior and culture of tax administrators should be improved.
10. Both taxpayers and personnel should be honest.
11. Right information about tax rate, exemption, concession, new income tax provision should be given to taxpayers in time.
12. The people should be informed about the utilization of tax amount they paid in the nation's development (where and how).
13. Wide use of e-governance

14. Increase more participation in tax system from all corners.
15. Firm political commitment and support.
16. There should be stable politics.
17. Personnel should be motivated.
18. Simplified procedure and standards of the Acts and Rules, etc.
19. Increase public awareness and pressure against corruption.
20. More tax exemption in agriculture and undeveloped areas.
21. Develop role model leader in practice.
22. Identify and motivate to real and regular taxpayers.
23. Strict enforcement.
24. Performance based incentives should be applied.
25. Income tax Act should be compatible with international practice.
26. Tax administration should run on electronic system.
27. Free from political interference.
28. Strong commitment by major political leaders which should reflect in result.
29. Hard penalties are needed or tax related fraud and corruptions.
30. Private organizations and civil societies are to be supportive to better tax compliance.
31. Tax system should be scientific and progressive.
32. Sound tax policy and simplified procedure.
33. Improve the recording system.
34. All the individuals should be in the tax net by broadening tax net.
35. Improve the income tax management system.
36. Develop ethnicity in auditor.
37. Effective implementation of code of conduct issued by IRD for its personnel.

4.6 Major Findings

4.6.1 Major findings based on Secondary Data

Based on data presentation and analysis of secondary data, some important findings of the study are summarized below:

1. There are two sources of financing the government expenditure in Nepal i.e. internal sources and external sources. Internal sources of financing include total revenues, principle refund and domestic borrowings. External sources of financing include foreign grants and loan. The ratio of internal and external sources of financing in fiscal year 2008/09 is 4:1.
2. Total revenue includes tax revenues and non-tax revenues. Total revenue collection in FY 2008/09 is Rs.143474.488 million that is 101.24 percent of budgeted total revenue for the year. Out of it, tax revenue collection is 81.58 percent and non-tax revenue is remaining 18.42 percent. Tax revenue is massively high in total revenue.
3. Total tax revenue includes direct and indirect tax revenue. Total tax revenue collection for FY 2008/09 is Rs. 117051.906 million that is 100.42 percent of budgeted tax revenue. Out of it, indirect tax occupies 70.68 percent and direct tax occupies 29.32 percent. It shows indirect tax is dominantly high compared to direct tax.
4. Direct tax included income tax and tax on house, land, and property. Total direct tax collection in FY 2008/09 is Rs. 34320.739 million which is 96.99 percent of budgeted direct tax. This is 79.39 percent contribution of income tax remaining 20.61 percent contribution of tax on house, land and property. Income tax is leading total direct tax.
5. Income tax includes corporate tax, remuneration tax, investment and other income tax. In FY 2008/09, total income tax collection is Rs. 27247.387 million that is 100.59 percent o total budgeted income tax for the year. The contribution of corporate tax is 72 percent. Contribution of investment and remuneration is 15.28 and 11.73 percent respectively. Other income tax is 0.97 percent. Corporate sector is leading income tax revenue.
6. Total corporate tax revenue collection in FY 2008/09 is Rs. 19624.768 million that is 104.76 percent of budgeted corporate tax revenue. Out of it, contribution of

public limited companies is 48.03 percent. Contribution of personal/sole trading firms, private limited companies government corporations are 22.79, 21.39, and 4.89 percent respectively. Contribution of other institution is 2.9 percent. Public limited companies leading the corporate tax.

7. In FY 2008/09, total tax collection from investment income is Rs.4162.917 million that is 83.89 percent of budgeted investment tax. Out of it, contribution of income tax on interest is 40.48 percent. Income tax on lease or rent, capital gain and dividends are 23, 18.30, and 17.69 percent respectively. Other income from investment is 0.47 percent.
8. Remuneration tax collected in FY 2008/09 is Rs. 3195.623, which is 97.30 percent of budgeted remuneration tax for the year.
9. Other income tax collection in FY 2008/09 is Rs. 264.078 million that is 218.25 percent of budgeted figure. Other income includes windfall gain tax also.
10. Total numbers of taxpayers in FY 2006/07 were 256210. In FY 2007/08 it reached 2,87,958 by increasing 12.4 percent and in FY 2008/09, it increased to 3,53,902 by increasing 23 percent.
11. Out of total taxpayers, 2,05,595 were individual taxpayers in FY 2006/07. It increased to 2,26,092 and 2,77,130 in FY 2007/08 and 2008/09. Number of public limited companies, private limited companies and cooperatives were 572, 30,458, and 1,298 respectively in FY 2006/07 respectively and it increased to 655, 36,536, 2,141 respectively in FY 2007/08. And it is 786, 44,270, and 448 respectively in FY 2008/09. The number of corporation, partnership and other are 244, 4804, 13239 in FY, 2006/07, 283, 5543, 16,708 in FY 2007/08 and 330, 6,579 and 20,358 respectively in FY 2008/09. Above data reveals, individual taxpayers are substantially high in compared to other types of taxpayers.
12. Total numbers of return of income filled by taxpayers in FY 2006/07 were 1,02,506 in which D-01 was 58,200 (56.78%), D-02 was 21,483 (20.9%) and D-03 was 22,823 (22.27%). It increased to 130852 in FY 2007/08 in which D-01 were 71027 (54.28%), D-02 were 26,141 (19.98%) and D-03 were 33,684 (25.74%). In reached to 1,74,208 in FY 2008/09 in which D-01, D-02 and D-03 are 91,541 (52.55%),

31,780 (18.24%) and 50,885 (29.21%) respectively. D-01 type return of income is highest in number than D-02 and D-03.

13. Contribution of income tax on GDP was 2.08 percent in FY 2004/05. It decreased to 1.88 percent in FY 2005/06 but increased to 2.35 percent in FY 2006/07. Since FY 2007/08, it started to increase and reached 2.54 percent in FY 2008/09. The increment and contribution is satisfying.
14. Contribution of income tax revenue on total revenue was 17.65 percent in FY 2001/02. It continued to decrease in subsequent fiscal years and reduced to 14.93 percent in FY 2004/05. However, in FY 2005/06, it increased to 19.04 percent. Again, it decreased 17.73 percent in FY 2007/08 and reached 19 percent in FY 2008/09. There can be seen a greater fluctuation in the contribution of income tax to total revenue.
15. Contribution of income tax on total tax revenue was 22.24 in FY 2001/02. It continued to decreased and reached 19.04 percent in FY 2005/06. Since FY 2006/07, it increased gradually and reached 23.28 percent in FY 2008/09.
16. Contribution of income tax revenue on total expenditure was 11.11 percent in FY 2001/02 and reduced to 9.68 percent in FY 2002/03. It was 10.64 and 10.20 percent in FY 2004/05 and 2005/06 respectively. Since FY 2006/07, it gradually increased and reached 12.76 percent in FY 2008/09.
17. Contribution of direct tax on total tax revenue was 25.52 percent in FY 2001/02. It reduced to 22.67 percent in FY 2004/05. After Y 2005/05, it gradually started to increase. It was 24.31 percent in FY 2005/06 and reached 29.32 percent in FY 2008/09 whereas the contribution of indirect tax is remaining 70.68 percent. In average the contribution of direct and indirect tax on total tax revenue are 25.16 percent and 74.84 percent respectively.
18. Contribution of income tax on direct tax was 88.7 percent in FY 2001/02. It decreased to 85.18 and 84.86 percent respectively in subsequent two fiscal years 2002/03 and 2003/04. But in FY 2004/05 it increased to 85.33 percent. Again, it decreased to 78.31 percent in FY 2005/06. It increased to 82.88 percent and 82.62 percent in FY 2006/07 and 2007/08. In FY 2008/09, the contribution of income tax on direct tax is 79.39 percent and remaining 20.61 percent of tax on house, land and

property. In average income tax contribution is 83.41 and house, land and property tax is 16.59 percent respectively.

19. Income tax revenue collection has decreased by 2.31 percent than previous year in FY 2001/02. Further decrease rate increased to 8.67 percent in FY 2002/03. From fiscal year 2003/04, it started to grow the income tax collection and remained 17 percent growth rate in FY 2003/04. In FY 2004/05, it became 10 percent and 4.46 percent growth rate in FY 2005/06. 43.89 percent growth rate maintained in FY 2006/07. But it remained 24.27 and 42.84 percent in FY 2007/08 and 2008/09 respectively.
20. Contribution of corporate tax on income tax was 48.91 percent in FY 2001/02. It increased to 68.25 percent and 71.65 percent in FY 2002/03 and 2003/04 respectively. it decreased to 70.18 and 69.28 percent in FY 2004/05 and 2005/06 respectively. But it increased to 73.78 in FY 2006/07. It was 69.55 percent in FY 2007/08 and it is 72 percent in FY 2008/09.
21. The contribution of investment tax on total income tax was 9.17 percent in FY 2001/02. It tremendously increased to 16.25 percent in FY 2002/03. it was 13.58 and 13.62 percent respectively in FY 2003/04 and 2005/06. It increased to 14.16 percent in FY 2005/06. It was 13.22 and 17.15 percent in FY 2006/07 and 2007/08 respectively. It is 15.28 percent in FY 2008/09.
22. The contribution of remuneration tax on income tax was 41.92 percent FY 2001/02. It substantially decreased to 15.4 percent in FY 2002/03. It was 14.62 percent in FY 2003/04. 16 percent remained in FY 2004/05 and 2005/06. In FY 2006/07 and 2007/08, it was 12.76 and 12.85 percent respectively. In FY 2008/09, it decreased to 11.73 percent.
23. Actual income tax collection was less than revised estimate, revised estimate was less than budgeted income tax revenue in FY 2001/02, and 80 percent of budgeted income tax could be collected. In FY 2002/03, though actual collection was more than revised estimate, revised estimate was less than budgeted figure. 82 percent of budgeted figure could be realized. Actual and revised estimate was more than budgeted figure in FY 2003/04, and 109.4 percent was realized. In FY 2004/05, revised estimate was less than budgeted figure, but actual income tax was more than

revised figure. 99.68 percent of budget was could be realized. In FY 2005/06, both revised and actual income tax revenue was less than budgeted figure. In FY 2006/07 and 2007/08, actual revenue was more than revised and revised was more than budgeted figure and 124 percent of budgeted figure could be collected. In FY 2008/09, actual collection is less than revised estimate but revised estimate was more than budgeted figure. 100.58 percent of budgeted figure has been achieved in this fiscal year.

24. Forecasted income tax collection for FY 2009/10 is to be Rs.27424.96 million based on past growth trend of six years. However, based on later growth rate of FY 2008/09 (42.84%), it is forecasted to be Rs.38914.71669 million.
25. Budgeted income tax revenue for FY 2009/10 is Rs.36298 million. Out of it corporate tax is Rs.25768 million which will be raised 89.93 percent from the existing sources and remaining from the tariff and administrative reform. Remuneration tax is Rs.4180 and investment income tax is Rs.6121 million which will be raised 89 percent and 88.67 percent from existing sources and remaining from tariff and administrative reforms respectively. in total, 89.63 percent will be raised from the existing sources and remaining from tariff and administrative reforms.
26. The Finance Ministry said on 20, July, 2010 that revenue collection surpassed the target by Rs.3.4 billion to reach Rs.180 billion in the last fiscal year 2009/10 against the target of Rs. 176.50 billion. Out of the total revenue collected last year, the country received an estimated Rs.56.75 billion in value added tax, Rs.33.75 billion in income tax, Rs.35 billion in customs and Rs.24.25 billion in excise duty. Likewise, the government collected Rs.5 billion in registration fees, Rs.2.25 billion in vehicle tax and Rs.23 billion from non-tax measures. The revised estimate of total revenue was Rs.189.6 billion while the budgeted revenue was Rs.176.5 billion. The revenue growth rate was 25.5 percent in FY 2009/10 compared to FY 2008/09. Income tax has affected due to load shedding and labor conflict in industries, which made worse performance in industrial sectors.

4.6.2 Major findings based on Primary Data

Based on presentation of empirical investigation presented in this study, some important findings of the study are summarized below:

1. 85 and 75 percent of tax officers and taxpayers believe in the success of tax compliance year. In total 80 percent of respondents vote for the success. 35 and 85 percent of tax officers and taxpayers agree with the suggestions of FNCCI to the government on the exemption of limit of tax. In total, 60 percent of respondents agree to it. 90 and 60 percent of tax officers and taxpayers disagree with the suggestions of FNCCI to the government about imposing income tax on natural person in three layers. In total 75 percent of respondent rejected it. 80 and 70 percent of tax officer and taxpayer agree with the poor taxpaying habit of Nepalese people. In total, 75 percent of respondent found to be agreed with this fact. 95 and 85 percent of tax officer and taxpayers vote for effectiveness of ITA, 2058. 90percent of respondents are positive to it.
2. **75** percent of responding is not positive to the contribution of income tax to national economy. Out it 65 percent are tax officers and 85 percent are taxpayers.
3. ‘Little knowledge of tax and its importance to the people’ has been ranked as the major cause for poor taxpaying habit of Nepalese people. And ‘political protection’ has been ranked as the major reason behind existing corrupt practice in Nepalese tax administration. There is high positive correlation between the ranking major causes behind poor taxpaying habit of Nepalese people by tax officers and taxpayers. There is low positive correlation between the ranking regarding major reasons behind corrupt practice in tax administration by tax officers and taxpayers.
4. There is no significant evidence of difference between the views of tax officers and taxpayers on the success of tax compliance year. The view of respondents on the suggestions of FNCCI to the government about exemption limit, contradict to each other. The respondents have the same view on the suggestion of FNCCI to the government about imposing natural person tax in three layers. Both groups of respondents’ views are found to be the same on the effectiveness of ITA, 2058. Both group of respondent have a same vive on the contribution of income tax revenue to national economy.

Major portion of income tax is covered by corporate sector. People in individual normally do not pay tax though they earn very handsome amount of money because of negligence, poor administration and implementation of income tax laws, rules and regulations. Modern and innovative and technologies help tax offices to monitor effectively in the tax related activities. So tax offices should have such facilities. Honest and loyal taxpayers are to be rewarded time and again and they are to be advertised through TV, newspapers, radio etc as the brand ambassador to motivate other taxpayers to pay their income tax.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

The prosperity of a country largely depends upon its economic growth. Economic growth can be achieved by effective mobilization of resources. The mobilization of financial resources by the government is called public finance. The government of a country needs sufficient revenue to finance recurring (general) expenditure, capital (development) expenditure and principle payment. The government finances these expenditures through two major sources i.e. internal and external resources. Internal resources consist of total revenue and domestic borrowings and external resources consist of foreign grants and loans. Internal resources play a vital role to make a country economically independent. The ration of internal resource to external resources is 4:1 in fiscal year 2008/09. Total tax revenue consists of tax revenue and non-tax revenue.

Tax is permanent instrument of collecting resource. It a major sources of revenue in Nepal. It has been an instrument of social and economic development for government. Tax, therefore, is a tool of achieving social and economic objective laid down by the government. Tax is s charge imposed by government authority upon property, individual or transaction to raise money for public purpose. Tax is two types i.e. direct and indirect tax. A direct tax is a tax paid by a person on whom it is legally imposed. Direct tax is classified as income tax and tax on house, land and property. Direct tax is equitable, elastic tax rate; however, taxpayers feel burden and tendency to evade tax may increase. An indirect tax is a tax imposed on one person but partly or wholly paid by another. Indirect taxes are commodity tax based on foreign trade and internal commodity tax based on goods and services. It is convenient, induces mass participation, less chance of evasion. However, it is uncertain, fluctuates with fluctuation in demand and it is not equitable.

Income tax is the major sources of direct tax revenue. Income tax means a liability to pay an amount to the government, which is compulsory contribution to the national revenue

from person's taxable income from any employment, or business, or investment and total of that income as calculated in accordance with ITA, 2058. Income tax reduces the regional economic imbalance by providing tax concession and tax holidays to the business and industries, which have established in remote and backward areas of the country. It will be possible to reduce the gap in income by imposing higher rate to those having higher income and from that collected amount providing necessary assistance to the people with very poor economic condition.

Income tax system in Nepal has been facing managerial problems. Income tax administration has blamed that has not so efficient. There is great propensity of evading tax. Rich people avoid tax by legal loopholes and taking advantage of an efficient tax management. The tax management are provided with many discretionary power which encourage them corruption. Government of Nepal has not enlarged its assurance to the public to pay the tax for nation building. People think that tax collection mechanism is very weak and tax revenue has not used for nation building. In developing economies, the tax system suffers from structural constraints with tremendous administrative and procedural complexities that lack simplicity and transparency. A prime concern of taxpaying in underdeveloped country is how best to produce equate revenue to finance the public sector. Therefore, the revenue mobilization is a challenging proposition in developing countries where majority of people is in abject poverty and people engaged in economic activities have extremely limited taxable capacity.

On the ground of above general problem statement, the specific problems have been identified and a study on Income tax in practice in Nepal has has carried out. The main objectives of the study have been set to be exploring and analyzing the current practices and issues in income tax management in Nepal. Therefore, the focus is concentrated on the income tax revenue collection sectors. Due to the study is mainly based on descriptive historical research design, secondary sources of data have been used to analyze. However, an empirical investigation also has been carried out with 40-sample respondent of two groups comprising each of 20. Responses of these groups are primary sources of data. For this study, mainly books, reports, articles, dissertations have been consulted.

The collected data have been organized, tabulated, presented in graphs, charts and trend lines. The statistical tools used for analyzing and forecasting purposes are time series analysis, chi-square test and rank-correlation coefficient.

Income tax was first introduced in Great Britain in 1799. In India at first income tax has introduced in 1860. After the First World War, the income tax became important sources of tax revenue in many developed countries. In the beginning, it was generally levied on flat rate. Only after 1909, the principle of progression was introduced from the UK and New Zealand. In ancient Nepal, taxes were levied in the form of kinds, cash and labor services. In Lichchhabi Period, tax was known as *Trikar*.

In modern Nepal, income tax was imposed by first Parliamentary Government in 1909. In 1962, income tax Act 1962 was enacted which replaced Business, Profit and Remuneration Tax Act of 1909. The income tax act 1962 was replaced by income tax act 1974, which was amended for eight times and existed for a period of 28 years. The ITA, 1974 and all the income tax related provisions made under other special enactment has been repealed and the existing ITA, 2058 became effective since Chaitra 19, 2058 (01 April, 2002)

The act governs all income tax matters. Interim Constitution of Nepal, Finance Act of the current year and ITA Rules 2089 (updated in 2065) and ITA, 2058, guide income Law. Major tax policy in Nepal is to maximize revenue collection through widening tax base and expanding coverage area not by increasing tax rate. Major theme of government income tax program is mobilizing revenue through significantly increasing the tax net. Income tax management covers the whole income tax system. The objectives of income tax management is the collection of maximize revenue for achieving the goal of income tax system. The structure of income tax in Nepal has been classified as income tax and tax on house, land and property and other.

ITA, 2058 is based on Modern Concept of Income Tax. It has adopted Resident Principle of Income Tax. It has many salient features. The main objectives of ITA, 2058 is to

enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation. There are some special provisions. ITA, 2058 has introduced capital gain tax. The tax is imposed on the net gains, which are the total gains minus the total losses including unrelieved losses for the current income year and those from previous income year, which thus can be carried forward forever. Gains are defined as the difference between incomings and outgoings for the asset or liability.

The 'term' assessment means the process of determining the liability of the assesses. There are three types of assessment i.e. self-assessment, jeopardy, and amended assessment. Return of income is of two types; i.e. interim return and final return. ITA, 2058 has treated every assessment as self-assessment. Every taxpayer should file a signed return of income not later than three months after the end of each income year.

ITA, 2058 has specified the method of tax accounting as individual or couple should keep tax account on cash basis, companies on accrual basis and sole trading or proprietorship firms and other entities on cash or accrual basis.

ITA, 2058 has made provision about penal provision, which are divided into two parts: interest and penalties and offences. Interest is charged on delinquent taxes and tax penalties are fixed to correct the misbehavior of tax payers.

ITA, 2058 has introduced a concept of administrative review. There is provision for two types of appeal system: first to the IRD for an administrative review and the second to Revenue Tribunal. Administrative review is the review of reviewable decisions made by IRD so as to correct mistakes by tax administrators and Revenue Tribunal is the last fact finding body.

There is a special provision of international taxation in the Act. For taxation purpose, all payments and gain need to be considered based on source country of the payment. Details of the circumstances and rules are defined and given in the Act. Nepal has DTAA treaties with 10 countries till FY 2008/09. The purpose of the treaty is to relieve double taxation

and prevent fiscal evasion and to ensure reciprocal administrative assistance in the enforcement of tax liabilities. In case, existing income tax law contradicts the treaty, the provision of the treaty will prevail.

There is provision of PAN in se. 78 of ITA, 2058. PAN is a permanent unique identifying number given to every taxpayer. It is useful for the persons to pay tax and store individual information. Even individual (single or couple) having employment income is compulsory to take PAN numbers since FY 2009/10. PAN are of two types i.e. personal PAN and business PAN. e-PAN is the provision of getting PAN through the internet without going to applying in the IRD from the authorized institution of IRD.

There is the provision of TDS in article 17 of ITA, 2058. Every employer is required to withhold tax at specified rate from payment made to employee with source in Nepal. The withholding agent withholds TDS on income from investment, dividend, remuneration income, service fees etc. There are two types of TDS i.e. advance and final TDS. IRD has introduced the system of e-TDS which has reduced the tax compliance and collection cost. It was introduced in FY 2006/07 first time in Nepal.

There are some current issues in Nepalese income tax practice. It is the responsibility of IRD in Nepal to administer income tax, VAT, excise duty, education service fees and health service tax. Ministry of finance is the apex body of IRD. Ministry of Finance, on behalf of Nepal Government, exercises the management function of tax administration. The ultimate destination of IRD is to increase the tax compliance by making tax administration sound, skillful and efficient, effective and modernizing by developing taxpayer friendly tax system of international standard. IRD has set its mission, main target, major norms, objectives and strategies to be adopted for good tax system. The major commitments of IRD are efficiency, neutrality, transparency, economy, promptness, dynamic, and taxpayer friendly polity. The major functions performed by IRD in FY 2008/09 are voluntary tax compliance, campaign for widening tax coverage area, use of e-governance to improve its service delivery. Different schemes conducted

by the department are: declaration of house-rent income, self-assessment of income, VDIS, tax audit, investigative tax audit and billing enforcement.

Doing Business, a project, in its seventh edition in 2010, has ranked Nepal's position in international taxation is weaker than previous year. However, paying tax indicator is improving. Nepal's overall rank is 124. Nepal's time of tax payment in a year is 34 times, time taken in payment of tax is 338 hours and rate of tax to be paid in percent of profit is 38.1 in 2010 as studied by Doing Business.

Summary of Revenue Collection in FY 2008/09

The ratio of internal resource and external resources is 4:1. Total revenue collection is Rs.143474.448 million which is 101.24 percent of budgeted. Out of it 81.58 is tax revenue. Total tax revenue Rs. 117051.906 million. Direct tax is 29.32 percent which is Rs.34432.739. out of it income tax is 79.39 percent which is Rs.27247.387 million. The contribution of corporate tax, investment and remuneration tax on income tax are 72, 15.28, and 11.33 percent respectively. Total corporate tax is Rs. 19624.768 million. This is the composition of public limited companies, private limited, personal/sole trading and Government Corporation with 48.03, 21.39, 22.79, 4.89 percent respectively. Total investment tax income is Rs. 4162.917 million. This is the composition of tax on interest, lease or rent capital gain and dividend with 40.48, 23, 18.3, and 17.69 percent respectively. Total remuneration collection is Rs.3195.623 million that is 97.30 percent of budgeted figure for the year.

Total number of taxpayers in FY 2008/09 is 3, 53,902 while it was 2, 87,958 and 2, 56,210 in FY 2007/08 and 2006/07 respectively. The total of FY 2008/09 is the composition of individual, private limited, corporation, cooperative and partnership numbering 2, 77,130, 44,270, 786, 330, 4,448, and 6,579 respectively. This number was 2, 05,595, 30,458, 572, 244, 1,298 and 4,804 respectively in FY 2006/07.

The total number of return of income in FY 2008/09 is 1,74,208. This is total of D-01, D-02 and D-03 with 52.55%, 18.24%, and 29.21% respectively. It was total 1,02,506 in FY 2006/07 with D-01 (56.78%), D-02 (20.9%) and D-03 (22.27%).

The contribution of income tax on GDP in FY 2008/09 is 2.84 percent. It was 2.08% in FY 2005/06. The average contribution during the study period is 2.28%. The contribution income tax to total revenue is 19% in FY 2008/09. It was 17.05% in FY 2001/02. The average contribution is 17%. The contribution of income tax to total tax revenue in FY 2008/09 is 22.64 percent. It was 23.28% in FY 2001/02. The average contribution during the study period is 18.2%. The average contribution of income tax on expenditure is 10.98% during the study period. Average contribution of direct tax to total tax and income tax to direct tax is 25.16% and 83.39% respectively during the study period.

There is a great fluctuation in the growth of income tax. It has negative growth rate in beginning two fiscal years. The average growth rate is 23.24% since FY 2003/04. The average contribution of corporate tax, investment tax, and remuneration tax during the study previous has been found to have been 67.95%, 17.68% and 16.38% respectively.

The trend of realization of budgeted income is satisfying except in beginning two fiscal years. The highest realization of budgeted income tax revenue during the study period was in FY 2006/07 with 124% realization.

Forecasted actual collection of income tax revenue for FY 2009/010 based on past data is to be Rs.27424.96 million. But based on the growth rate in FY 2008/09 (42.84%), it can be forecasted to be Rs.38914.71669 million.

Budgeted income tax revenue for FY 2009/10 is Rs.36298 million. This is composition of corporate tax, investment and remuneration tax with 71%, 16.86%, and 11.52% respectively. In total 89.63 of total budgeted income will be raised from existing sources and remaining from tariff and administrative reforms.

Summary of Findings from Empirical Investigation

80% of respondents vote for the success of tax compliance program. 60% of respondents agree with the suggestions of FNCCI about exemption limit. 75% of respondents reject the proposal of FNCCI about tax layers. 90% of respondents voted for effectiveness of

ITA, 2058. 75% of respondents are found to be agreed with fact that there is poor taxpaying habit of Nepalese people. 'Little knowledge of tax and its importance' and 'Political Protection' are ranked as the most important causes and reason for poor taxpaying habit of Nepalese people and existing corrupt practice in tax administration. There is high correlation between the respondents' ranking regarding major causes of taxpaying habit and low positive correlation on the reason of corrupt practice in Nepalese tax administration. There is no significant evidence of difference between the view of taxpayers and tax officer on the success of tax compliance year, effectiveness of ITA, 2058 and contribution of income tax to national economy and there is significant evidence of difference in view on suggestion of FNCCI about tax exemption limit and imposing tax in three layers.

5.2 Conclusion

From the study of Income tax in practice in Nepal, it can be concluded that income tax revenue can play a significant role in national economy. In Nepalese tax revenue structure income tax is taking the second position after VAT, earlier this position was taken by custom duty. The contribution of income tax to budgeted revenue is increasing in recent years. However, it is not satisfactory. Nepalese revenue is massively guided by non-tax revenue. This is due to low mobilization of tax revenue. Even in tax structure, indirect tax is playing a dominant role. This is due to lower contribution of income tax since direct tax is led by income tax. This means, if income tax increased, total direct tax revenue increases proportionately and vice versa. It can, therefore, be mentioned that contribution of income tax to the national revenue must be increased to achieve the goal of national development and equal economic distribution. The goal can be achieved only if the government of Nepal takes steps for making the income tax management/administration efficient.

In recent years, it is seen the government of Nepal is trying to raise more revenue from tax. IRD is leading this responsibility. Different schemes have been conducted. New technologies have been updated and being adopted. But it has introduced it a little bit late. If this type of improvement and campaign had been introduced before some years, it has been achieved earlier.

FNCCI suggested the government of Nepal to impose natural person tax in three layers i.e. individual, couple and family. Most of tax officers view was imposing tax in three layers is not scientific and practical baseless. It needs further effective record system and consumes more labor. It is burdensome in administrative point of view since it is difficult to manage and there is difficult to identify and verify individual, couple and family. As a result, it increases administrative cost of revenue collection.

ITA, 2058 is quite advanced since it accordance with international standard, however, some analysts are saying the Act is the photocopy of the Act of the United Kingdom. In formulating tax law and policies, the interference of World Bank and International Monetary Fund is highly found. Donors' are playing dominant role, as if the Act is prepared to fulfill their stakes. Nevertheless, ITA, 2058 can be effective means to generate more revenue from income tax if the Act is effectively implemented since the Act has many salient features, which are first time introduced in Nepalese context. This Act is based on modern and scientific concept. If taxpayers react positively toward their duties and rights, and the tax administrators becomes liable to fulfill the responsibility provided the law to them can achieve objectives of the Act. If the government has been effective in its revenue collection by income tax and other resources, the amount of foreign loans would have been increased less rapidly. So to increase the huge internal resource, the revenue administration of the country must be systematic and the people of the country must have general knowledge of income tax and its importance to national economy, rules, regulations and provisions. If people are assured about proper utilization of tax revenue, the prospect of revenue collection from income tax will be higher from internal resources mobilization.

Income tax reduces the regional economic imbalance by providing the concession and tax holiday to the business and industries, which have established in remote and backward areas. It reduces the gap in income by imposing higher rate to having higher income. But in developing economies like in Nepal, tax is suffering from administrative and procedural complexities that lack simplicity and transparency. Therefore, the revenue mobilization is a challenging proposition in developing countries where majority of

people is an abject poverty and the people engaged in economic activities have extremely limited taxable capacity. The major problems of income tax in Nepal are found as high tax rate, narrow coverage area, less administrative reforms, less diversified and less taxpaying habit etc. Moderately low tax rate but progressive, firm and stable government policy, campaign on tax compliance and diversification of tax areas, can solve it.

The contribution of income tax to GDP has not increased significantly since FY 2005/06 to 2008/09. This is not a good sign. This is the result of less tax reforms and different schemes and campaigning on tax compliance. This has not been reflected in GDP. Most of the corrupt officers are protected by political leaders. This increased the corrupt practice in bureaucracy. From these honest personnel' moral can't boost up. It is found that political protection is the first reason behind the corruption in tax administration.

The challenges behind the income tax system to how to develop taxpaying habit of Nepalese people, how to bring them into tax net. Less tax compliance is not only due to poverty of people. Even so many rich and businessperson who have taxable income are still out of tax net. Tax evasion is also burning issues. Big business house and man are manipulating the account and evading tax. Auditors verify it in their influence. Fast service and simple procedure are lacking. There are so many formalities in paying tax. The tax service centers are not enough to serve the taxpayers. Taxpayers have not easily access to the service centers. The act has complex provisions, which are difficult to easily understand by general public. There is no stable income tax growth rate and higher fluctuation.

Finance Minister Surendra Pandey presented Special Budget (advance budget) in the Legislature Parliament on 11 July, 2010 (28 Ashad, 2067 B.S.) of Rs. 110.21 billion tabling 'Bill Empowering Government to Withdraw money from consolidated Fund' to carry out Appropriation Bill-2010. Nepal has been experiencing advance budget for past two consecutive fiscal years due to transition period of peace process and political instability. Delay in full-fledged budget will hit the growth rate of revenue collection and delay in investment and expansion plans of the private sector. As no changes can be made in tax structure, revenue collection will be hit.

At last, in conclusion, it can be mentioned that so many problems and challenges should be taken as opportunities to improve and reform the tax administration, they should be managed timely, and the laws implemented properly. The shortcomings prevailing in income tax management should be identified and avoided. If the problems are solved in some extent and shortcomings are avoided in theme, income tax will lead to substantial increase in the total revenue. The Nepalese tax administration has been attempting to modify itself to meet the pressing challenges brought by change in technology, economic policies, and changing need and aspiration of people. In the way, income tax management in 21st century must address many dimensions simultaneously to cope with changing and dynamic economic, political, social and global issues and ultimate to achieve the objectives of revenue collection.

5.3. Recommendation

To achieve the result as we expected from income tax, it is essential to change our attitude, and behavior toward income tax, both tax personnel and taxpayers should be honest to their duty and rights and tax administration should be reformed. Considering our culture and economic situation, we should adopt the international taxation and technology. We are facing political uncertainties. We are passing through a long peace process and transitional phase. Policies are well designed but very poorly implemented in Nepal due to instable government. So to promote industries and business, forest and foremost, political stability should be maintained. From the study, the following suggestions are recommended in overall:

1. To continue the schemes conducted in FY 2009/10 even in FY 2010/11 which is income earners involved in different employment or occupations or investments without PAN numbers, who have not paid or only partially paid tax (people like consultants, doctors, engineers, lawyers, auditors, artists, commission agents), if, they get PAN numbers within the specified time and submit the tax return of the fiscal years 2008/09 and 2009/10, and pay the tax, should be exempted from submitting the tax returns of the previous years and enjoy exemption on payment of tax, charge, interest and penalty on it. Those who don't file tax return and pay tax within the specified exemption period should be subjected to the payment of all

taxes, charges, interest and penalty from the time they got involved in income generation.

2. New sources of income tax should be found out and should bring into tax net those areas who have not come into tax net but have taxable income such as educational sectors: primary, secondary, and higher secondary schools, colleges conducting bachelor's and master's degree conducted by private sectors, education consultancy centers and vocational training institutions and natural persons involving in these sectors, health sectors: hospitals, nursing homes, health clinics, pathology centers conducted by private sectors and natural persons involving in it, networking business having door to door marketing, persons involved in fair, expo, and book fair in different occasions, and natural person involving in real estate business.
3. The confused should be avoided in tax deducting at source income of courier service provider, transport, internet service provider due to unclear definition of the term 'service'. The receipt of above sectors shouldn't be termed as 'fee'. Fee implies as membership fee, management fee and technical fee.
4. Inventory valuation of forest products and agriculture products should be based on Net Realizable Value, not on market price or book value whichever is less.
5. Tax should not deduct at source of income of persons who have registered in VAT.
6. Provision should be made to impose 10 percent tax on Hydro Power sectors for 10 years. This will increase total revenue by attracting private sector investment and increasing the projects.
7. Depreciation on civil structure of Hydro Power project should be 5 percent and on machinery equipment 10 percent.
8. The corporate tax rate of bank and financial institutions should be 25 percent.
9. Information Technology industries should be tax holiday for five years.
10. Every persons having taxable income should be brought under tax net.
11. Effective tax collection tribunal should be established.
12. No political placement and pressure in revenue department.
13. Over-staffing should be controlled.
14. Illegal business activities should be controlled.

15. There must be created a sound business environment by stopping Band (general strike) and ensuring security in business sectors.
16. There should create a investment-friendly environment so that capital should not go outside country.
17. Tax evasion and avoidance must be eradicated by effective implementation of the fine and penalties and charging severe actions to such people and entities.
18. Provide effective training to the personnel to update with changing environment.
19. Every tax return should be compulsory assessed.
20. Management assessment procedure should be clearly defined.
21. DTAA treaties should be expanded.
22. Extensive use of e-governance.
23. More tax exemption on agriculture sectors.
24. Simplify the taxpaying process avoiding too much official formalities and a clear interpretation of tax law, ruses and polices issuing manual.
25. Service Centers should be increased to increase the access of general taxpayers.
26. Intensify the publicity about income tax through different media i.e. TV, newspapers, radios, etc. and raise public awareness about tax and its importance.
27. Observe Fiscal Year 2010/11 as 'Tax Enforcement Year'.
28. Reduce Load-shedding in industrial areas and corridors and create investment friendly industrial and business environment.
29. Declare the Industrial Estate free of strike (the banda).