

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Tax is the main source of financing government activities. In every country the largest part of government revenue is raised through taxation. Tax may be imposed on a person's income or wealth. According to Dalton, "a tax is a compulsory contribution imposed by a public authority irrespective of exact amount, service rendered to the tax payer in return, and not imposed as a penalty for any legal offense (Kandel, 2052). Income tax pays a very important role in national economy. It is one of the important sources of revenue to the government.

Every government has to spend a lot of money to fulfill its responsibilities towards the people. The responsibilities either for security, health, education or other developmental activities. In each country, a lot of fund is spending by the public authority for the protection of common people and for the creation of various socio-economic infrastructures. Protection expenditure includes the purchase of arms and ammunitions, army and police expenses and administration of jails. Commercial expenditure is also incurred by the government for operating transportation and public enterprise which are undertaken by the government for the public interest. The other type of public expenditure is development expenditure. This is the expenditure incurred for providing education, health and public utilities to the community (Vanish & Agarwal,1992). So, the government expenditure are increasing day by day because of demand of time, increase in price and national income, increase in population, social progress, and so on. The government needs more money to run it successfully. The money that is so much important to the government is called public revenue. It is received from different sources. There are external and internal sources.

Internal source of fund is own source within the nation. Internal source of fund includes both tax and non-tax revenue. Continuous use of external source of fund to raise necessary public fund is not good because it reduces the liquidity position of the government, increases over dependence upon other countries and increase the inflation, so internal sources are more important not only for financing necessary funds but also for proper mobilization of external sources.

External sources of fund are foreign grants and loans. This kind of fund is received from foreign countries and international organization. External source of fund is more important for undeveloped and underdeveloped countries. It is used for economic development, reconstruction and foreign exchange, to recover from crisis condition for productive uses (Sharma & Luitel). But it is uncertain, inconvenient and not good for healthy development of nation because they have to be paid after a certain period. So it is better to mobilize internal sources rather than looking with beggar's eyes to the donors (Panta,1996). Like developed countries, developing countries try to mobilize their internal resources for regular and developmental activities. Nepal is not expectation for it.

In other hand, sources of public revenue can be classified into two type:

- i) Tax revenue and
- ii) Non-tax revenue

Tax income includes the amount which are compulsory contributed by tax payer to the government.

Non-tax revenue includes fees and charges gifts, fine and penalties, sales commodities, Royalty, dividend and special assessment etc. Non-tax sources are uncertain and inconvenient because they are imposed according to the necessary of government. Therefore, tax is the better sources of public revenue.

"Tax is a compulsory contribution from a person to the government to defray the expenses in common interest of all without special benefit conferred."(Dhakal,2059,p-2) Generally, taxes are classified into two types on the basis of form. One is direct and another is indirect tax. "Direct tax is really paid by a person whom it is legally imposed while an indirect tax is imposed on one person but partly or wholly paid by another(Dhakal,2059,pp 2-3)" property tax, vehicle tax, interest tax, gift tax, other (expenses tax, death tax) are example of direct tax. Entertainment taxes, Hotel tax, Sales tax, Custom duty, Exise Duty, others (passenger tax) are the examples of indirect tax. Income tax is the most popular tax. It is considered as one of the major elements of tax revenue.

Within the income tax system, deduction and exemption are more important for knowing about the tax because they are used continuously and treated differently year to year. To make up to date knowledge about income tax system, it should be known. By knowing it, we can compute net income and tax liability. Income tax (law) of every nation must clearly mention about the inclusion of income and deduction of expenses. Income tax plays a very important role in the economic development of Nepal. It is a tool of achieving maximum social and economic objectives as laid down by the constitution of Nepal.

It is also recognized as a good financial tool to make narrow the inequality in income. It reduced the regional economic imbalance by providing tax concession and holidays to the business or industries which are established in remote and backward areas. Income tax is essential not only for collecting government revenue but also to control over consumption to reduce inequalities of income and wealth, to promote saving and investment and to accelerate development process(Joshi,2055). It is no doubt that income tax is the main source of government revenue. It is also usable in the balance economic development. Nobody can doubt that the distribution of income is also possible through progressive income tax. It is being realized that contribution of income

tax increased in Nepal. Nepal has also been adopting the income tax system since the last four decades. It is assessed on yearly basis.

Although, the legal provision has been made and timely, there are many problem about income tax practices in Nepal such as, leakage in tax, feeling of people about tax as a penalty, delays in computation and collection, lack of accuracy and unity in accounting system, lack of consciousness of people mobility of tax administration to cover new tax payer (Khadka, 1994). In the other hand raising more revenue is the main objective of taxation but it also affects the pattern of consumption, production and distribution in the economy. Because of all these things deduction and exceptions of income tax system must be reviewed and immediate correction should be made. In collection of revenue, the exemptions and deductions and plays important role.

## **1.2 Statement of Problem**

Economic development is the prime concern of every nation of the world. To achieve this objective, every nation of the world is accomplishing various activities. Nevertheless, underdeveloped countries are facing serious problems in the process of economic development. Nepal is not expectation to this condition. People in developing nation's trend to have greater propensity to evade taxes. This is because, they have lesser knowledge about income tax and they have to maintain their livelihood from their limited income. Rich people are avoiding taxes by using legal loopholes and taking advantages of an inefficient tax administration. A recent notice of authority misuse investigation commission has proved that there is a corrupt bureaucracy in tax office.

In Nepal the coverage of income tax is very low. Only 0.5 percent of total population pays the income tax. There is poor income tax paying habit of Nepalese people. The tax authorities are inefficient and ineffective in enforcement. There are no integrating programs for the payer's education, assistance, guidance and counseling. The offices are looked upon as heaven for corruption, harassment 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 tax payers.

So, the coverage of income tax is very narrow in Nepal. Agricultural income is exempt from the income tax. Labor tax is taxed more heavily than capital income retirement amount received by Nepalese people being retired from the service by army or policy of foreign country is also exempted from income tax. Exemptions of these sources provided loopholes for tax evasion and complicates to the tax administration. In the other hand, exclusion of agricultural income from the tax net alone cuts cut about half of the GDP. Some exemptions granted to achieve certain objectives are not effective. Tax incentive is one of the examples of this. Tax incentive or concession encourages the establishment of industries in certain area but they gains or change names ownership or place the business when the tax concession period expires.

At present the exemption limit to an individual has been provided into two distinct categories in Nepal. The present act and rule classify persons into an individual and the family according to the personal status. Thus classification does not recognize the various sizes of the dependent family members. There is no discrimination between a tax payer having only spouse and tax payer with a spouse, parent and children. Therefore this limit is the Nepalese context neither shows any specific or definite relationship with per capita GDP nor with the rate of inflation nor with property norms. Income tax act has clearly mentioned about the expenses, which are allowed for deduction and not allowed for deduction. But they are not adequate and systematic. In Nepal, 10 percent of gross profit is allowed as a deduction against net income on account of expenses related with technology or product and efficiency improvement. This is not enough. There is no any provision for deduction of necessary expenses like newspaper expenses, higher education expenses made by the tax payer or his dependent etc.

There are various problems of income tax and exemptions and deductions specifically, this study has been carried out to answer the following research questions.

- ) Are the current deductions of expenses adequate?
- ) What kind of expenses should be prioritized for deduction?
- ) Are the exemption items of income sufficient?
- ) What kind of income should be prioritized for exemption?
- ) Is the tax administration of Nepal stout?
- ) Should the agricultural income be taxed?
- ) Should the exemption limit be adjusted according to the inflation?
- ) Is the current exemption limit appropriate?
- ) How much rupee should be exemption limit for an individual, a couple and a family?
- ) Are the provision made under the Nepalese Income Tax Act profuse in all respect? etc.

### **1.3 Objective of the Study**

The main objective of the study is to gain insight into the deductions and exemptions of present income tax and give appropriate suggestions to improve the tax system so that the government can collect more revenues and use than in the process of national development. The study does not only help the government to collect more revenue but also make the concerned people aware about the exemption of income and deduction of expenses. Being an opinion survey, it analyze the exempted income which are provided by the income tax act, and if also analysis the deduction of expenses, which are provided by Income Tax Act 2058. So, the specific objectives of the study will be as follows:

- ) To analyze the deduction of expenses which are allowed by the Income Tax Act.

- ) To review the provision of deduction and exemption system of Nepal in context of its contribution to the total tax revenue and total government revenue.
- ) To analyze the exemption of income and expenses which are provided by the tax Act.
- ) To analyze the exemption limit of the tax Act.
- ) To provide suggestions and recommendations for making the deduction and exemption provision is higher effective and efficient in Nepal.

#### **1.4 Scope of the Study**

This study tries to cover the major constituents of income tax system of Nepal. It aims to find out the exemption and deduction provided by tax act, problem and weakness, loopholes in income tax system, contribution of income tax to the government revenue. It also tries to suggest some possible areas for confirm. Especially, income tax deduction and exemption is discussed in detail. The study is covered the following aspects of income tax system of Nepal.

- ) Deductions and exemptions which is provided by Income Tax Act.
- ) Structure of government revenue in tax.
- ) Administration aspect of income tax in Nepal.
- ) Contribution of income tax to the government revenue and GDP.

#### **1.5 Importance of the Study**

The world is stepping toward the 21<sup>st</sup> century. In this situation, every country should apply the scientific as well as convenient system in every field of life. Developing countries like Nepal requires higher magnitude of financial resources for the developmental programmed. Domestic resources have more significant role than the external resources for the development programmed. Among the domestic resources, income tax plays a significant role. But it is a matter of great up pleasures to quote that the contribution of income tax to the

national revenue is very low in Nepal. To increase the contribution of income tax in the national revenue, problems faced by the income tax system should be researched and analyzed objectively. But it is pity to say that the study and research works in the areas works in the areas of income tax have been lacking in Nepal. Within income tax, the intensive study on tax deduction and exemptions has not been done in Nepal. Even though several scholars doing research on income tax has studied tax exemption and deductions a minor topic. In the context, need and significance of this study can be known easily.

## **1.6 Limitation of the Study**

The study is based on exemption of income and deduction of expenses in Nepalese income tax. It is not complete study of income tax system in Nepal. The present study is not free from some limitation. The main limitations of this study are as follows:

1. It is based on exemption and deduction of expenses but not as the complete study of income tax system.
2. The study was fundamentally based on secondary data and information. However, some primary data will also collect and analyzed.
3. This study has been performed in limited time and resources.
4. Due to lack of time, and resource constraint the opinion survey is kept limited to Kathmandu valley.

## **1.7 Organization of the Study**

The whole study has organized into five chapters which are:

- i) Introduction
- ii) Review of Literature
- iii) Research methodology
- iv) Data Presentation and Analysis
- v) Summary, Conclusion and Recommendation

In the first chapter of the study contains background information, statement of problem, objective of the study, need of the study, scope of the study and organization of the study.

The second chapter will about the review of the literature. Some books, dissertations, reports and articles have been viewed for this study.

The third chapter will be about research methodology. In this chapter, research design, population and sample, nature and sample of data, data gathering procedure, data processing procedure and analysis of data, weight of choice and weight of respondent have been described.

The fourth chapter is major part of the study that will be presentation and data analysis. This chapter aims to make the critical analysis of income tax system of Nepal with assistance of authoritative data and opinion survey. In it, tax structure of Nepal, deduction and exemption of income tax system and an opinion survey has been analyzed. On the basis of an analysis, it has tried to find out whether the income tax in Nepal is satisfactory or not. It describes the problems and weakness of tax administration also.

The last chapter will be concerned with findings, summary, conclusion and recommendation and suggestions.

Appendix and bibliography will be presented in the last part of the study.

## **CHAPTER TWO**

### **REVIEW OF LITERATURE**

#### **Income Tax**

If a person's income exceeds the certain amount fixed by the government, then the person has to pay certain amount for the excess of income at certain rate fixed by the government. The income which is not taxable is called the allowances and the income above the allowances is called a taxable amount. The money which is paid as tax for the excess of income is called the income tax. The income tax rates are fixed by the government for each fiscal year in the budget presents by the finance minister.

#### **Exemption and Deduction**

An amount of income allowed by law as tax free is exempt amount of income. Such amount of income is not included in total income while calculating the net income of a person. The expenditure related to such income is also not deducted while calculating the assessable income of a person [sec 21(1) (c) ]. Accordingly no amount is deducted at source while making the payment of such amount Deduction means expenses pertaining to business or investment which have been described in the act being allowable while computing income from business investment.

Many books, dissertation, articles and reports had been reviewed for performing this research study. While reviewing the books it was found that must of the books were syllables oriented and some of them had described the problems and prospects of income tax system and a path for reform of income tax similarly many dissertations, articles and reports had described the income tax law provisions, structure of income tax, problem and prospects of income tax and path for reform of income tax. There were no detail studies made on the topic of income tax exemptions and deductions. All the researchers who made

research were concise study on the deductions and exemptions. Nevertheless, some books are more important and relevant or these studies which are as follows:

■ In 2047, Mr. Santosh Raj Poudyal and Prem Prasad Timisina had presented a book of income Tax named "Income Tax in Nepal" They described the theoretical as well as practical aspects of income tax. The book has fully based T.U. syllabus prescribed for B.Com. They had not described the problem of income tax and structure of Nepal. The book was descriptive rather than analytical.

■ In 2051, Mr, Rup Bahadur Khadka has published a book named "Nepalese taxation: path for reform." In his book, he had described the economic policy of Nepal and VAT as a long-term tax for Nepal, income tax from a rough to a refined system, property taxes as the main source of local revenue, improving tax administration, tax reform strategy. He had shown the composition of tax revenue from 2008/2009 to 2048 to 2049.

About the income tax, He has described the introduction, development existing structure, main problem, and possible direction of reform. His book was based on analytical study of income tax. He had identified the major problems of income tax as narrow coverage, unscientific tax assessment, deviation from basic principle of income taxation. He had not only identified the major problems of income but also had identified the possible direction for reform; they were

- I. Extension of coverage,
- II. Improvement in tax assessment,
- III. Use of presumptive method,
- IV. Extension of withholding tax,
- V. Inflation adjustment,
- VI. Introduction of current year payment basis.

## VII. Tax treaties with the major trading partners of Nepal etc.

Similarly he had identified the major problems of the administration, they were:

1. Weak tax administration,
2. Inadequate tax training,
3. Imbalance and inadequate organizational pattern,
4. predominance of low level non-technical posts,
5. Inadequate physical and other facilities,
6. Debatable scope of revenue investigation department,
7. Lack of adequate information system,
8. Lack of coherent tax policy etc,

He had also suggested some suggestions for administrative reforms. They were:

1. Strengthening the revenue service provision of existing tax training,
2. Reorganizational and expansion,
3. Developing an integrated information system,
4. Research on taxation etc,

His book is very useful to know the various aspects of income the legal provisions relating to income tax. Although, he had not shown any numerical illustration and not mentioned tax. So his book was analytical rather than descriptive.

■ In 2027, Mr. Surya Prashad Marahattha and Mr. Ananda Prasad Khatiwoda had published a book named, "Fundamental of Nepalese Income tax with up to date financial directives and regulation". In this book they had presented the legal provisions relating to income tax and practical aspects. They had described the income Tax Act 2020. But at present due to the changes in laws, this book is not so beneficial to further study. They had

emphasized on the legal provisions rather than analytical study. They had not described the problems of income tax systems and contribution of income tax to national revenue; writers were fully based on the campus level syllabus.

■ In 2059 B.S., Mr. Bishowdeep Adhikari had published a book named "Income tax law: then and now". He had described the legal provisions of new income Tax Act 2058. He also had described the decisions made by Supreme Court about the income tax. He had described the legal provisions with critical analysis. His book was very useful to know the new Income Tax Act 2058 but had not analyzed the role of income tax and income tax structure.

■ In 2050 B.S., Mr. Narayan Raj Tiwari had published a book named "Income Tax System in Nepal". He had described the legal provisions relating to income tax. He had described the process, provisions and methods to assess the income tax with numerical examples. The book was fully based on campus level syllabus. He had not shown the role of income tax in economic development of Nepal. He also had not identified the problems of income tax system. His book was descriptive of legal provisions rather than analytical.

■ In 2050 B.S., Mr. Pavan Kumar Ojha had published book on titled "Taxation law". He had described the different acts and law of income tax. He had taken many tax cases into consideration to describe legal terms. His book may be beneficial to understand income tax laws. But he had not analyzed the role of income tax.

■ In 2056 B.S. Mr. Kamal Deep Dhakal published a book named, "Income tax and House of compound tax law and practical with VAT". He had described the legal provisions relating to income tax with numerical examples. This book is very useful to know about the legal provisions of income Tax ACT 2058. The book was fully based on the syllabus of BBS and MBS prescribed by T.U. This book was informative or descriptive rather than

analytical. He had not analyzed the role of income tax and the structure of income tax.

Some dissertations were reviewed for this study. They are as follows:

■ In 2050, Mr. Ram Bahadur Thapa had presented a dissertation entitled "Income tax assessment procedure in Nepal and analytical study". This study was basically concerned with an income tax assessment procedure. These findings about the problems of income tax assessment procedure were: ambiguities in tax assessment, undue delay in tax assessment and lack of adequate accounting skills which are considerable at present. He had conducted an opinion survey of income tax assessment procedure. He had taken 23 people as a sample. About the exemption limit 8 were negative attitudes and 9 were indifferent about the exemption limit.

Out of them, who gave the negative response, had suggested increasing the exemption limit. He suggested adjusting the exemption limit according to the inflation of the country. He had also suggested giving tax holiday to new industries as investment allowance. He also had suggested taxing the agricultural income. His topic was about income tax assessment procedure but he had described only about the income tax assessment method and fine fees and penalties. He had not mentioned the assessment procedure legal provision relating to income tax and items of exemption and deduction.

■ In 2038, Mr. Rojalin Singh Suwal had presented a dissertation named: "Income Tax System in Nepal". He had described the concept of Income tax, Importance of Income tax, objectives of income tax, role of income tax in process of economic development, problems of income tax structure of income tax.

His findings about the main reasons of income tax evasion were:

I. Absence of a clear and comprehensive definition of income,

II. Lack of tax consciousness of Nepalese people, loopholes, widespread illegal business activities, open boarder, high tax rates, corruption etc.,

Similarly, his finding about the problems of income tax in Nepal was:

1. Lack of account and records of income tax payers,
2. Delays in tax administration,
3. Lack of responsibility and honesty among the tax officers,
4. Tax evasion etc. which are more relevant at now also,

His suggestions about the income tax in Nepal were:

- I. Income tax laws should be clear and precise,
- II. Application of scientific methods for the purpose of accounting assessment and collection of income tax,
- III. Widening the tax coverage etc. But he had not mentioned the methodology/ uses in research.

He also had not mentioned the legal provisions relating to income tax, numerical example and exemption and deductions. He also had not conducted any empirical investigation.

■ In 2036, Mr. Gagan Kumar Tuladhar had presented a dissertation named, "Role of income tax in the mobilization of domestic resource in Nepal." He had described the trends of revenue from income tax, structure of income taxes as percentage of GDP, per capita burden of income tax, agricultural income tax, elasticity and buoyancy of income tax. He had presented the role of income tax in the mobilization of domestic resources for the economic development had been increasing significantly. The growing share of income tax to the total tax revenue had indicated that the tax would be the major source of revenue in future. According to him, tax efforts in Nepal had seemed quite insufficient. In 2031/1975, Nepal had realized only 5.6 percent of GDP which was quite low in compare to other developing countries. He further added that consistent efforts should be made to mobilize resources for development through taxes.

To calculate the elasticity and buoyancy of income tax, he had used formulae i.e.  $\log y_t = \log a + b \log y_{t-1} + vt$ . For the period of 1966/1967 to 1975/1976 elasticity of income tax was 2.20, which mean that a rupee changes in gross domestic product causes a change of Rs. 2.20 in income tax revenue. Similarly buoyancy of income tax was 2.41 for the period of 1966/1967. Here the elasticity and buoyancy of income tax was greater than one, which showed the income tax had positive response to change in GDP. The difference between buoyancy and elasticity was 0.21, which showed that the vigorous discretionary changes, especially the improvement of tax administration were needed to mobilize additional resources from income tax.

He had suggested widening the income tax base, income tax holiday to new industries, simple and easy tax law, reformation of income tax administration, research in income tax. But he had not mentioned the legal provisions relating in income tax. He had not accounted the exemptions and deduction also.

■ In 2040 Mrs. Naina Nepal had presented a dissertation named "A Study on the Problem and Prospects of Income Tax in Nepal." She had described the fiscal system of Nepal, tax structure of Nepal and an opinion survey of the problems and prospects of income tax in Nepal. Her findings about the problems of income tax were:

- I. Lack of account keeping by the tax payer,
- II. Narrow tax coverage,
- III. Lack of cooperation between tax payer and departments.
- IV. Lack of tax deduction, assessment deficiency etc. which are considerable at now.

She had mentioned that the future income tax is good because it is rowing year to year. She had taken an opinion survey of 10 tax officers and 15

tax payers about the different aspects of income tax. About the different aspects of income tax, about the exemptions and deductions, she had taken an opinion survey of exemption limit. She had conducted an opinion survey of the appropriateness of exemptions limit. Out of 10 tax officers, 9 were in positive response and 1 was in negative response about the appropriateness of exemptions limit. Similarly out of 25 tax payers, 23 were in positive response and 2 were in negative response about the appropriateness of exemptions limit. Similarly out of 25 tax payers, 23 were in positive response and remaining two were in negative response. She had also taken an opinion survey of adjustment of exemption limit according to the inflation. Out of 10 tax officers, 8 were agreed to adjust and 2 were disagreed. About tax payers, 23 were agreed to adjust and 2 were disagreed. On the widening the percent income tax coverage, all total (10) tax officers were agreed and all total (25) tax payers were agreed.

Her suggestions about the tax rate and exemption limit were.

- i) It should be elastic scientific and progressive.
- ii) The exemption limit should be separated to the couple and family. But only the increase in exemption limit will not create benefit.
- iii) If exempted income is spent in luxurious consumption, it will hamper saving and investment.

She had not mentioned the legal provisions relating to income tax, exempted incomes and deduction of expenses.

■ In 2041, Mrs. Rosani Shrestha had presented a dissertation named "Income tax in Nepal". She had described the structure of income tax, per capital burden of income tax, problem in income tax in Nepal. Her finding about income tax was the percentage share of income tax was shown an increasing trend. Income tax had contributed 7 percent in 1982/1983 in the overall tax structure. She also found that the evasion of income tax is a serious problem of tax. Reasons for tax evasions were:

- ❖ Low tax paying capacity of Nepalese people,
- ❖ Absence of clear and comprehensive definition,
- ❖ High tax rate,
- ❖ Wide spread illegal business activities,
- ❖ Corruption,
- ❖ Lack of system of heavy punishment etc. which are more relevant and considerable at present also found that the tax administration is not efficient because lack of trained and skill personnel, lack of sources for separate income tax revenue lack of proper incentive and low salary of tax officers.

Her suggestions about income tax were:

- I. Income tax law should be broader,
- II. Scientific method should be applied for the collection of tax,
- III. Its according and assessment, income tax administration should be made efficient,
- IV. Tax evasion and avoidance should be minimized,
- V. Loopholes should be plugged.

Although she had not mentioned the legal provision relating to income tax empirical investigation had not conducted and had not accounted exemption of deductions.

■ In 2043, Mr. Shambhu Nath Regmi had presented a dissertation named "The role of income tax in Nepal". In this study, he had described the conceptual framework of income tax structure of income tax, income tax and resources mobilizations, problems of income tax. He had described the objective of income tax. They were growth objectives and stabilization objectives. He had more concentrated on the study of tax structure of Nepal. In his study, he had found that the share of indirect tax was more than 70 percent of total tax revenue in 2038/1982. The share of direct tax about 30

percent of total tax revenue in 2038/1982. Within direct tax, the share of income tax was 17.29 percent in 1972/1973 which was increased to 35.68 percent in 2038/2040. He had identified the problems of income tax. They were:

- I. Lack of maintain the record of taxpayers,
- II. Assessment delays,
- III. Lack of responsibility and honestly among the tax officers,
- IV. Lack of responsibility and honestly among the tax payers,
- V. Tax evasion, corruption,
- VI. Lack of coordination between the various revenue and other non-revenue departments,
- VII. Leakage in personal income tax collection.

His suggestions about the income tax were:

- I. Income tax law should be clear and precise,
- II. Widening the tax coverage,
- III. Application of scientific assessment method,
- IV. Simple and easy procedure of tax payment,
- V. Honest and efficient staffs,
- VI. Coordination between staff and departments,
- VII. Establishment of research unit,
- VIII. Tax holidays to new industries.

Although he had not mentioned the legal provisions related to income. His topic is about the role of income tax but he had not shown any numerical example and had no shown or mentioned exemption and deduction.

■ In 2044 Mr. Chudamani Siwakoti had presented a dissertation named "Analytical study of income tax in Nepal". T.U. He had described the role of income tax, income tax in Nepal's tax structure, personnel management aspect of tax department, present legal aspects of Income Tax Act 2031, and problems of income tax administration in Nepal. He had identified the role of income tax

as economic growth, equitable distribution and stabilization growth. He had found that the share of income tax to total tax revenue was 1.9 percent in 2039/2040 and 9.8 percent in 2042/2043. Regarding the personnel management aspect, he had found that the department had not well trained and expert personnel, there was no any training and development opportunity to the personnel and the work load was uneven distribution.

He had identified the major problems of income tax system as defective personnel management. Lack of to date role of existing as well as potential tax payers, lack of public information, delays in the tax assessment nominal role of income tax. Some of the problems are relevant at now. He also had found the major problems in Income Tax Act 2031, they are:

- I. Complicated language,
- II. High use of best judgment assessment method for the assessment of tax,
- III. No compulsion of auditing of account of all type of business,
- IV. Assessment delays,
- V. Ineffective use of fine and penalties,
- VI. No provision of tax review commission,
- VII. Silent about scientific research,
- VIII. No provision of sales promotion outside the country,
- IX. Lack of weighted deduction,
- X. No provisions of any kind of allowance,
- XI. No provision about illegal business.

Some of them are more relevant and are considerable. His suggestions about the income tax administration were:

- I. Income tax act should be made honest efficient and effective,
- II. Tax departments should keep up to date information regarding existing and potential tax payers,
- III. Research unit should be established,

- IV. Delays in tax assessment should be reduced,
- V. Scientific equipments should be used in the tax offices,
- VI. Training and counseling should be given to the personnel.

He had also suggested about the income tax Act. They were:

- I. Language should be simple and clear.
- II. Penalties should be established to taxpayers who do not maintain account;
- III. There should be provision in act for weight deduction and.
- IV. Provisions for illegal business assessment time limit should be reduced.

He had more emphasized on the legal provisions relating to income tax. He had not used any numerical examples in his study. He had only analyzed the Income Tax Act 2031. To analyze the Income Tax Act 2031 he had not conducted any empirical investigation.

■ In 2046, Miss Shanti Baral had presented a dissertation named "Income tax in tax structure of Nepal". In her study, she had explained the historical review of tax system, structure of government revenue, contribution of income tax to total tax revenue and total revenue, share of income tax on GDP, total tax revenue.

She had found that the share of income tax to total government revenue was increasing i.e. 1.54 percent in 2039/2040 and 7.78 percent in 2044/2045. But the share of tax revenue of total revenue was 80.79 percent in 2039/2040 which was slightly decreased to 78.89 percent in 2044/2045. The income tax from individual had the highest contribution of Nepalese income tax structure. The ratio of income tax to GDP was 0.094 in 2041/2042 which was increased to 0.76 in 2043/2044. Similarly, the ratio of income tax on total revenue was 1.54 in 2039/2040 which was increased to 7.78 in 2039/2040. So the ratio of income tax to GDP, total revenue and fulfill tax revenue had an increasing

trend but the increasing rate was low as compare to other countries. She had identified the reasons of tax evasions which were:

- I. Lack of clear and comprehensive definition of income,
- II. Lack of punishment to tax evaders,
- III. Tax paying capacity and the consciousness among the tax payers was low,
- IV. Lack of efficient tax administration,
- V. Lack of scientific method of tax collection etc.

She had suggested that;

- I. The tax administration should be honest and efficient,
- II. Tax evaders should be punished,
- III. Scientific method should be used tax in collection,
- IV. Administration cost should be minimized research unit should be stabilized,
- V. Delays in tax assessment should be reduced and,
- VI. Corruption should be stopped.

She had described the tax structure in comprehensive. But she had not identified the major problem of income tax system. She had not mentioned to legal provisions relating to the income tax and numerical examples. She had found the reason of tax evasion but she had not described how can stop the tax evasion.

■ The dissertation named "contribution of income tax to the economic development of Nepal with reference to Kathmandu and Pokhara Valley submitted by Mr. Hari Bahadur Bhandari in 2051, concentrated mainly on the contribution of income tax to public revenue. He had conducted an opinion survey of different aspect of income tax system. In his study he had found that to increase the contribution of tax to economic development on Nepal, capital gain and agricultural income should be taxed. In his opinion survey he had

taken 20 persons as a sample. About the perception regarding to exemption limit 4 were positive, 12 were negative and 4 were indifferent. All the respondents had requested increasing the exemption limit. In his investigation, he has mentioned to revise and restructure the exemption limit. According to the inflation, he had found that the Nepalese taxpayers has positive attitude towards 10% of total house and rent need industries in Periodic base. He had suggested not exempting the agriculture income of high class farmer. He also had suggested differentiating the exemption limit to family with one kid and two kids. Although he had not mentioned the legal provision related to income tax and problem of income tax system.

■ Mr. Sanjay Acharya, in his dissertation "Income Tax in Nepal: A Study of Its Structure, Productivity and Problem" in 2051, had described the structure of income tax, productivity of income tax and problems of income tax system. He had shown some numerical and diagram of structure and productivity of income tax. His study about income tax was not so detailed because he had not explained the provision relating income tax system and his study was more concentrated on the problem of income tax system. Although his findings about the problem of exemption limit and allowance were considerable and accountable.

He had shown the problems of exemption limit as follows:

- I. Exemption limit being equal to remuneration tax payers and business individuals does not seem reasonable. The exemption limit for remuneration tax payers should be comparatively high than the business individuals.
- II. The exemption in the Nepalese context neither has shown any definite relationship with per capita GDP now with the rate of inflation nor with poverty line so it seems to be unscientific,
- III. Fifteen percent depreciation allowance for corporate tax payers seems to be inadequate,

- IV. Private boarding schools running nowadays at basically inclined with profit. They are excluded from income tax, which is not reasonable,
- V. One and two percent deduction of the total income from trade, industry, profession and vocation for advertisement and guest hospitality, preoperatively seems to be low,
- VI. Allowance for remuneration taxpayers is not scientific in specifying the figure in absolute term also. Only the proportional figure is recommended, otherwise these should be frequent adjustment in income tax act, which is not so practical,
- VII. Additional allowances are looking for specific industries provided that they are feasible in the Nepalese economy. Tourism industries co-operative organization in rural sector etc. in this category and should be encouraged. On the other hand, the special allowance for export income in industries doesn't seem essential, such as for carpet of government industries; it is because those small business investors are unable to export their products.

■ Mr. Daya Raj Tripathi, in his dissertation "Income System of Nepal and some potential areas for reforms" in 2052, had described about the government revenue of Nepal, income tax revenue of Nepal, income tax administration, personal in tax administration, efficiency in Nepalese income tax administration, income evasion, tax assessment and application of best judgment assessment, income tax facilities for industries, efficiency of income tax system. He had more emphasized on the income tax administration and tax evasion. He had conducted an opinion survey about the sufficiency of tax incentive and tax holiday to the industries. He had taken a sample of 26 people, out of them 16 persons were in positive response and 10 persons were in negative response about the sufficiency of tax incentives and holidays according to the respondents following reformatory activities should be performed.

- I. The industries, which invest Rs. 5 lacks or more should be defined as employment oriented industries.
- II. There should be prize system which may be as the form of tax incentives or tax holidays to the payers.
- III. The period of the tax holidays should be extended for industry, which utilizes Nepalese raw materials and produces handicraft. The period of tax holiday should be extended to ten, eight and five years instead of existing period of seven, five and two years respectively.
- IV. For the expansion of industry additional incentives should be provided,
- V. The items of reduction should be added.

He had suggested to increase the exemption limit of Rs. 25000 to Rs. 30000 for an individual, Rs. 35000 to Rs. 40000 for a couple and Rs. 35000 to Rs. 50,000 for a family. He writes these provisions may exclude the number of tax payers whose income is not so meaningful for income tax purpose but include many tax payers with meaningful tax payers. In his opinion, the exemption limit not appropriate with consumer price.

His suggestion about the deduction of expenses of remuneration tax payers were as follows:

- I. Expenses for better education of their children not exceeding the amount of Rs. 10,000 per annum.
- II. House rent allowance not exceeding Rs. 12000 per annum.
- III. Education expenses for the payers himself if he is studying in an educational institution. His dissertations very useful to further study about the income tax purpose but he had not included the exempted items of income and business expenses. He had not mentioned about the legal provision relating to income tax system.

■ In 2053, Mr. Prameshwore Pant had presented a dissertation named "A Study on Income Tax Management". He had described the role of income tax

in national economy and income tax management in Nepal. He had conducted an empirical investigation of income tax management in Nepal. His finding of the major problem of income tax in Nepal was lack of managerial efficiency, which is more important aspect as present also he had highlight on management aspect. He had suggested to provide exemption limit of Rs. 40,000 to Rs. 50,000 for a couple and Rs. 60,000 or more for family. He had suggested to treat the agricultural income and capital gain as a subject of income tax. But he had not explained the legal provisions relating to income tax. He had not explained a little bit about the expenses also.

■ In 2054, Mr. Raj Kumar Bhattarai had presented a dissertation named "Effectiveness of corporate income tax in Nepal". He had described the history of income tax and corporate income tax, legal provisions relating to income tax, administration aspect of income tax, tax structure and government mechanism. He had conducted an empirical investigation taking 50 persons and companies as a sample. In his study, he had found that the share of tax revenue to the total tax revenue was 78 percent in average, the share of the direct tax to the total tax revenue was 20 percent in average whereas the share of indirect tax to the total tax revenue was 80 percent in average, the share of income tax to the total direct tax was 67 percent in average. As substantial share of income tax in total tax revenue. There was strong contribution of corporate income tax in total income tax revenue.

He had found that the government policies, acts, regulations, concerned with the corporate income tax were not effective in increasing tax paying habit in Nepal. Although there was substantial contribution of corporate income tax in the revenue of Nepal since a long period. He had pointed a major problem of tax administration as a corruption was weakness of act, rules and regulations in theory as well as in practice of income tax.

About the exemption and deduction he had questioned as:

- I. Do you have any income, which should be tax free? and
- II. Expenses, which should be allowed for deduction?

The response about the question was that the promotional expenses, guest hospitality, donation prizes and grants should be also used for deduction as expenses. About the income, income from foreign exchange rate, grants received, all compensation received should be tax free.

He had suggested to prepare separate income tax Act, rule and regulations considering income tax Act, rule and regulations considering the element of the system and maintain stability design and develop electronic information and communication networking among the government and non-government organization, encourage the tax payers through tax education and awareness program, control the forwards and backwards shifting of corporate income tax rate to 17 percent as expected by tax payers, and make tax officers more responsible and accountable and honest.

His study was fully based on the study of corporate income tax. So had not accounted anything about the other income tax. He had pointed a problem of tax administration as a corruption but he had not identified other problem and weakness of tax system. His study is very useful to know about the corporate income tax rather than other taxes.

■ In 2058, Mrs. Binita Shrestha had presented a dissertation named, "Revenue collection from Income Tax in Nepal, Problems and Prospects" she had described the conceptual framework and legal provisions, structure of income tax in Nepal, income tax administration in Nepal, an empirical investigation and problems and prospects of income tax in Nepal. Her findings about the structure were: There was the domination share of tax revenue in Nepalese government revenue. But the contribution of tax revenue showed the decreasing trend as it had contributed by 80.46 percent in 2055/56. The tax and GDP ratio of Nepal had fluctuate cyclically between 6.81 percent to 9.36

percent for the period of 2050/2051 to 2055/2056. There was the dominant role of indirect tax revenue such as 17.76 percent and 82.24 percent in 2050/2051 of direct tax and indirect tax whereas 26.14 percent and 73.86 percent in 2040/1999 of direct and indirect tax respectively. The contribution of individual income tax was greater and increasing year to year.

The share of income tax from individual was Rs. 196 million in 2050/1985 which is increased to Rs. 2772.7 Million in 2046/47. Her finding about the problem of Nepalese income tax system was narrow coverage. Income tax system was narrow coverage, mass poverty of Nepalese people, lack of conscious of tax payers, widespread evasion and avoidance of income tax, unscientific tax assessment procedures, inefficient tax administration, and instability in government policy. She had also found the various weak point of Nepalese tax administrations. Major weak points were:

- I. Failure to locate new tax payers,
- II. Failure to maintain proper account and records,
- III. Defective selection of personnel,
- IV. Undue delay in making assessment,
- V. Lack of motivation to tax personnel,
- VI. Existence of corruption which are more relevant and considerable at present.

She had conducted an empirical investigation about the different aspects of income tax system. She had taken 60 persons as a sample. About the soundness of Nepalese income tax system, most of the respondent i.e. 97 percent of respondents recognized it unsound and unscientific. She had conducted an opinion survey of inclusion of agriculture and capital gain as a taxable income. About the agriculture income 57 percent of the respondents were positive to tax. She had used the correlation coefficient to prove the hypothesis on the problem of income tax system.

Her suggestions about the income tax system were as follows:

- I. Extension of tax coverage,
- II. Tax consciousness to people,
- III. Minimizing the problems and weaknesses of tax administration,
- IV. Reform in tax assessment,
- V. Reform income tax administration.

Although, she had not mentioned the future prospects of income tax. She had taken an empirical investigation but she hadn't taken any investigation about the exemption of deductions.

■ In 2058, Mrs. Bibha Pradhan had presented a dissertation named "Contribution of Income Tax from Public enterprises to public revenue of Nepal". T.U. she had described the public revenue, and share of NTC, conceptual framework of income tax, contribution of income tax to the public revenue and share of NTC to the income tax structure of Nepal and the share of NTC to the tax structure of Nepal.

Her findings about the tax structure were.

- I. Composition of government revenue,
- II. Tax revenue contributed 77 percent,
- III. In total tax revenue, indirect tax, constituted 74 percent.

The contribution of tax revenue on GDP was lowest other than SAARC countries except Bangladesh. The contribution of income tax from NTC in total revenue was 2.37 percent. The share of income tax to direct tax revenue had been fluctuating. The average share was 11.1 percent. The share of income tax from NTC on income tax revenue was about 15.06 in average. These figures were in 2055/2056.

Her suggestions about the income tax system were:

- I. Promotion and rewards to efficient and honest personnel,
- II. Tax education to tax-payers and officers,
- III. Motivation to personnel,
- IV. Strict action to corruption,
- V. Settlement of tax commission,
- VI. Increase the public participation and,
- VII. Reduction of delays in tax assessment.

Although, she had more concentrated on the study of NTC. She had not mentioned the legal provision relating to income tax and exemption. She had not accounted the future prospective of Nepalese income tax system.

■ In 2059, Mrs Jayenti paudyal and presented a dissertation entitled "Income tax in Nepal, a study of its structure and productivity" TU. She had described the income tax in its historical perspectives, income tax structure, elasticity and buoyancy of income tax, voluntary discloser of income schemes role of tax administration in Nepal.

She had more emphasized on income tax structure of Nepal. She had described the contribution of income tax. She had mentioned the contribution of indirect tax is about twice then direct tax. Similarly within the direct tax is the largest source of revenue. About the tax administrate of Nepal. She had found that the working procedures were, traditional and the cost of administration had not been brought to the satisfactory level

She had suggested to broadening in come tax base, reform of tax administration successful implementation of VAT, establishment of standardized accounting system. But she had not mentioned the problem of in come tax. System and exemption and deduction. She had not clarified the role of income tax administration.

■ In 2059, Mr. Basanta Kumar Singh had presented a dissertation entitled "A study on application of best judgement on income tax assessment with reference to income tax Act, 2031." He had described about the following:

1. Type of assessment,
2. Use and type of best judgment in income tax assessment,
3. Necessary conditions for best judgment assessment,
4. Legal remedies role of best judge cent assessment in income tax assessment in Nepal.

He had also conducted an opinion survey about the best judge cent assessment. He had found that the income tax assessment in Nepal was mainly performed by committee. Above to percent of the total income tax assessment was occupied by committee assessment. Best judgment assessment had occupied second. The most appropriate and reliable method of income tax assessment was on the best of account. But in Nepal, very few income tax assessments were performed on the basis of accounts that were only 3.98 percent in 2056/57. The assessment process is often delayed in Nepal. One of the main reasons, the publication of best judgment in income tax assessment was taxpayer's tendency to evade or avoid the incidence of tax. Nepalese tax administration is very poor, because of:

- I. Lack of scientific equipment,
- II. Lack of coordination between concerned department,
- III. Lack of adequate efficiency and knowledge in tax personnel,
- IV. Lack of motivation to employers,
- V. Lack of tax education of personnel,
- VI. Lack of application of principles which are required for the use of best judgment assessment,
- VII. Delay in assessment of tax,
- VIII. No provisions of compensation to taxpayers,
- IX. No provisions of compensation to the tax payer etc.

He had found the major factors, which are responsible for making best judgment assessment unsatisfactory. They were:

- I. Income tax should be assessed on the basis of accounts,
- II. II. Supervisory committee should be established for the review of tax rules and equitation to tax payers and tax personnel,
- III. Tendency of corruption,
- IV. Misutilization of power by tax officers and inter corruption from outsides,

He had recommended some recommendation. They were:

- I. Income tax should be assessed on the basis of accounts,
- II. Supervisory committee should be established for the review of the assessment,
- III. Principles of natural justice should be implemented in practice,
- IV. Income tax administration should be recruited with efficient,
- V. Honest, trained and qualified tax personnel.
- VI. There should be compulsory provisions of submitting income statement within the due date,
- VII. The time of assessment in general condition should be reduced to three months from one year,
- VIII. The provision of auditing of accounts should be made compulsory,
- IX. Rewards and punishment system should be really and strictly implemented in practices,
- X. An integrated information should be developed,
- XI. The number of legal officers should be increased,
- XII. Beside small tax payers there should be made compulsory provision of maintaining accounts and performing self assessment for all other taxpayers.

He had more emphasized on the study of application of best judgment assessment. He had not mentioned legal provisions relating to income tax and tax structure of Nepal. His study is more beneficial to know the application of best judgement assessment not the whole income tax system.

Some reports and articles have been reviewed for performing this study. Some of them are as follows:

■ In 2035, Govind Ram Agrawal, in his study of "Resource mobilization for development, the reform of income tax in Nepal". CEDA, T.U., had described the different concepts of income tax. He had described the sources mobilization through income tax, fiscal policy role of income tax, legal provisions relating to income tax, legal aspect of income tax, administration aspects of income tax etc. Various mathematical calculations had been shown per capital income, burden of income tax, buoyancy coefficient of income tax, elasticity and co-efficiency of income tax etc had been calculated.

He had identified the major problems in income tax system as inefficiency of tax administration and tax evasion. He observed that the tax authorities were insufficient in enforcement of law; there were no integrated programs for the payers' education, assistance, guidance and counseling. Tax offices were looked upon as heaven for corruption. Insufficiency, delays, unfair, dealings, harassment and incompetent personnel the major problems of tax administration. He further added "it is increasingly being felt that the potential of income tax in Nepal has been very much under realized and reforms are urgently needed in this tax. In Nepal, income tax efforts have been constrained by hastily formulated policies, ambition laws, poor coverage, poor enforcement as well as compliance and bad image of tax administration. It's potential as remained under utilized. A comprehensive study for reform of income tax in Nepal therefore has become necessary."

About the exemption and deductions, he had suggested to increase the exemption limit to the range of Rs. 8000 to 12000. When he made the study the income tax exemption limit was Rs. 65000 for an individual and Rs. 7500 for a family. He also suggested for providing additional deduction to the salaries taxpayers for educational expenses, medical expenses and house rent. He favoured for more progressive rates of income tax.

This study is very useful to find out the really about the income tax in Nepal. This study is a comprehensive and included various aspects of tax system of that period; all things mentioned in it are not fully relevant today. But some of the problems identified in it are still in existence. He had described various aspects of income tax but he had not described business expenses. He had not conducted any research on business expenses and exempted income also.

■ In 2050, Mr. Bhimeshwar Ghimire had presented the article entitled "principles of direct tax and provision of direct tax". He had described the classification of tax, relation of capital and income, base of income or expenditure tax, base of tax in Nepal, procedure of computing income, weaknesses of traditional accounting system classification of tax rate index, index of income tax in Nepal, contribution of income tax to national revenue, errors of past provisions briefing of income tax improvement, some steps of administration improvement etc. He found that the income tax only 7 percent of total revenue that was very low as compare to neighboring countries. For this, he had identified the following causes.

- I. No taxation agricultural income,
- II. Narrow base of income of retail business,
- III. High exemption limit on remuneration income etc.

He had also identified some errors of provisions relating to income tax. They were.

- I. Progressive tax had not played an effective role for equal distribution of income,
- II. Unproductive tax concession holidays and rebates,
- III. Provisions of low additional fee as compare to market interest rate,
- IV. Deduction given to record keeping tax payers and timely paying tax payers had not played an effective role etc.

He had conducted the improvement made for income tax like;

- I. Expansion of corporate tax on private limited company by 5 percent on flat rate,
- II. Minimum 40 percent rate of individual income tax,
- III. Provision of tax collection at source,
- IV. Provision of self assessment of tax,
- V. Provision of self assessment of tax, increase in additional fee to remove tax evasion etc.

He also conducted the some steps of administrative improvement. They were

- I. Provision of income assessment committee,
- II. Flat rate of tax to small tax payers,
- III. Establishment of tax offices etc.

### **Research Gap**

Various dissertation, books, reports and articles available to my best of knowledge have been reviewed while preparing this thesis. To be rank all the books have been written professionally and this is natural too. Earlier that is before introduction of income tax<sup>2058</sup>. There were very limited books available in the market designed to meet the student requirements for their academic purpose. But now number of books can be found and seen in the market based on income tax act according to the syllabus of T.U. and reviewing them in details is time consuming and hence reviewing of the books is done briefly. In fact, there one type of wave in the market in writing books and taxation and this is good in one aspect that the trend at least has enhanced

the principle of choice to the students and readers. This also shows that there has been increasing trend of professional, student and interest keeper in the field of taxation.

Dissertations, written on different aspect of taxation are found in the libraries and reviewing dissertation are from and within the income tax topic while reviewing the thesis, not even the single thesis was found written income taxation under two acts even when the previous income tax acts were introduced. In other word, such comparative study of the two acts [either previous or now] under business taxation has not been done so far for academic purpose by students. Furthermore, introduction of new act has not crossed even some years. Such efforts to bring to act at a place and to study for the purpose of dissertation has not presented in else where to my best knowledge till this was being done. Hence I am petty sure that this research work is completely new, unique, genuine and authentic one.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

This chapter is devoted to research methodology applied in the study for the achievement of desire objective. Primary as well as secondary data were used for the study. Opinion survey technique is adopted to collect the primary about the different aspects of income tax. While conducting opinion survey, questionnaires were distributed to different groups who were related to income tax. They were income tax payers' income tax. They were income tax policy maker income tax administrators, income tax experts, accountant, auditors, lawyer officers etc.

The collected data were tabulated into the separate format and tables. Some statistical tools such as average and percentage were used where necessary. The results were expressed in the form of descriptive and analytical.

#### **3.1 Research Design**

This study attempted to analyze the present exemptions and deductions of income tax act 2058, opinion of 60 respondents associated with the income via income tax policy makers, administrators, experts and payers are collected through questionnaire. The questionnaire included the problems of income tax administration, soundness of income tax administration, exempted incomes, exempted level, deduction of expenses, sufficiency of provisions etc. Similarly various publication of income tax of different organizations was used for this study. Hence the research methodology followed in this study can be termed as survey can descriptive research design.

#### **3.2 Population and Sample**

The population for this study comprised all the persons belonging to income tax of Nepal. 60 samples from Kathmandu Valley have been taken to fulfill the objectives of the study. The respondent had been divided into three

groups. The following table shows the groups of respondents and size of sample.

**Table No. 3.1**  
**Groups of respondents and size of samples from each group**

S.N.	Groups of respondents	Sample Size
1.	Income tax experts	10
2.	Income tax administrators	20
3.	Income tax payers	30
Total		60

Source: Primary Survey

### **3.3 Nature and Source of Data**

The data used for this study are both primary and secondary. The primary data are collected from primary source. The primary sources of data are the opinion survey through questionnaire. Field visit and information received from the respondents.

The secondary data are collected from secondary sources. The secondary sources of data are the information received from books, journals, newspapers and reports etc concerned with the study. The major sources of secondary data are as follows:

1. Economy survey of various years, Ministry of Finance, Government of Nepal,
2. Reports and records of department of taxation,
3. Books related to VAT and sales TAX,
4. Thesis, dissertation submitted at central library, T.U.,

5. Research studies centre for economic and development and administration concerning the income tax and VAT.

### **3.4 Data Gathering Procedures**

The data of the study collected from two sources. Primary data are collected by using questionnaires method. A set of questionnaire was developed and distributed to the selected respondents in order to get actual and accurate information. Some of the information is also collected from interview with the respondents. The secondary data are collected according to the organization of different publication, book of dissertations.

### **3.5 Data processing procedure of analysis of data**

Collected data from primary and secondary sources are firstly tabulated into separate format in systematic manner. The data are tabulated into various tables according to the subject in order. Then simple statistical analysis such as percentage and rank were calculated where necessary and they were presented and analyzed in descriptive way. Graph and charts are also presented to interpret.

### **3.6 Weight of Choice**

The respondents are requested either to rank their answer or to give yes/no response or to write their opinion. In the case of ranking the answer the scale varies from question to question. The scale was given according to the number of probable answer for e.g. if the probable answer is 6, the scale is given to 1 to 6 where 1 standard most important and 6 is least important. The total points get by each choice were converted into percentage of total points available to all choice. The choice having higher percentage was ranked as most important and the choice having lowest percentage was ranked as least important.

## **CHAPTER FOUR**

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

#### **4.1 Tax Structure of Nepal**

Modern economic development of Nepal had started with the initiation of first economic planning in 2013. Since then; Taxes have been raised for the achievement of national economic goals. So taxes play vital role to the economic development of Nepal. To know about the taxes the tax structure should be known. The tax structure refers to the level as well as relative importance of various taxes in the composition of the total tax revenue of a country. The tax structure of any country is composed of both direct and indirect taxes. The total tax structures of Nepal from the fiscal year 2051/2052 to 2064/2065 are given below:

##### **4.1.1 Composition of Total Revenue**

In Nepal, the total revenue is composed of tax revenue and non tax revenue. When the first national budget was presented in 2008/2009, the revenue structure was typically that of traditional economy with 73 percent of government receives coming from non tax revenue was 43 percent. In 1960'S the shares of non tax revenue was declined drastically because of the increasing contribution of indirect tax on foreign trade. In 2060/2061 the share of non tax revenue was 22.61 percent of total revenue as compared to 20.10 percent in 2051/2052. On the other hand the share of tax revenue of the initial period of the study [FY2051/2052] was 79.90 percent of the total revenue and has been declined to 83.59 percent in fiscal year 2064/2065, as shown in the following table:

**Table No. 4.1.1**  
**Composition of Total Revenue**

Rs. In million

Fiscal Year	Total Revenue	Total tax Revenue	Tax Revenue as % of Total Revenue	Total Non tax Revenue	Non Tax Revenue as % of Total Revenue
1	2	3	4	5	6
2051/2052	24605.10	19660.10	79.90	4945.00	20.10
2052/2053	27893.00	21668.00	71.34	6225.00	20.49
2053/2054	30374.90	24425.20	74.16	5949.70	18.06
2054/2055	32937.90	25939.82	69.86	6998.08	18.85
2055/2056	37133.86	28752.94	67.03	8380.93	19.54
2056/2057	42893.78	33152.18	67.80	9741.60	19.92
2057/2058	48893.56	38865.00	77.04	10028.56	19.88
2058/2059	50445.49	39330.55	71.19	11114.90	20.12
2059/2060	55250.00	42616.90	68.49	12633.10	20.30
2060/2061	62227.00	48155.20	77.39	14071.80	22.61
2061/2062	70122.7	54104.7	77.16	16018.00	22.84
2062/2063	72282.1	57430.4	79.45	14851.70	20.55
2063/2064	87712.2	71126.7	81.09	16585.50	18.91
2064/2065	60892.3	50898.8	83.59	9993.50	16.41

Sources Apendex-3

From the above table, it can be concluded that the source of tax revenue on total revenue is fluctuating from 71.34 percent to 83.59 percent. This indicates that the signification role of tax revenue in total revenue.

#### **4.1.2 Composition of Total Tax Revenue**

Tax revenue is composed of total direct tax and total indirect tax. There has been simultaneous increased in total direct tax, total indirect tax and the total tax revenue in absolute term. In 2051/2052, their amount was Rs.3795.10

million, Rs.15865.00 million respectively and during the period of 14 year, these amount became Rs. 37133.86 Million, Rs 24605 Million and Rs50898.8 Million. The basic reasons for the increment were due to the expansion of the tax bases and tax rates both wide and deep.

Despite the absolute increment of direct tax during the study period, It's share in total tax revenue is shrinking continuously from 19.30 percent amounting Rs.3795.10 million in 2051/2052 to 25.52 percent amounting to Rs.10037.81 million in 2058/2059. The contribution of total indirect tax in 2051/2052 was 80.70 percent amounting to Rs.15865.00 million and decrease to 74.48 percent amounting to Rs.29292.78 million in 2058/2059 and increased to 74.41 percent amounting to Rs.37757.70 million in 2058/2059. This implies the significant role in tax revenue as indirect tax is considered regressive in nature, the tax structure of Nepal is not justified on equity ground and progressiveness. From the following table, we can see that there is greatest reliance on indirect tax making our tax system regressive in nature and it's needs to shift towards direct tax.

**Table No. 4.1.2**  
**Contribution of Total Direct and Total Indirect Tax to Total Tax Revenue**

Rs. In million

Fiscal Year	Total Tax Revenue	Total Direct Tax	% of Direct Tax to Total Revenue	Total Indirect tax	% of Indirect Tax to Total Revenue
1	2	3	$4=3/2 \times 100$	5	$6=5/2 \times 100$
Fiscal Year					
2051/2052	19660.10	3795.10	19.30	15865.00	80.70
2052/2053	21668.00	4585.00	21.16	17083.00	78.84
2053/2054	24425.20	5234.00	21.43	19191.20	78.57
2054/2055	25939.82	6012.92	23.18	19926.90	76.82
2055/2056	28752.94	7296.73	25.38	21456.21	74.62
2056/2057	33152.18	8555.02	25.81	24597.17	74.19
2057/2058	38865.00	9729.75	25.08	29135.25	74.97
2058/2059	39330.59	10037.81	25.52	29292.78	74.18
2059/2060	42616.90	9452.50	22.18	33164.40	77.82
2060/2061	48155.20	10397.50	21.59	37757.70	78.41
2061/2062	54104.70	13071.80	24.16	41032.90	75.84
2062/2063	57430.40	13968.90	24.32	43462.30	75.68
2063/2064	71126.70	18980.30	26.69	52145.80	73.31
2064/2065	50818.80	24815.6	48.75	38216.20	79.08

#### 4.1.3 Composition of Total Indirect Tax

Nepalese tax revenue is dependent mainly on tax on international trade and sales tax/VAT on goods and services supplemented by taxes on income and property to some extent. Nepalese tax structure is heavily dependent on total indirect taxes. This contributed 79.08 Percent of total tax revenue in 2064/2065.

The major components of indirect tax in Nepalese tax structure constitutes custom duty, excise duty, sales tax/VAT and contract tax. Custom duty has been classified mainly into import duty and export duty. Other components of indirect tax like Entertainment tax, hotel tax. Air flight tax and other tax contribute nominal share even zero because they are included in VAT in 2054. The others of indirect tax include remission of Indian excise duties, road, bridge, repair tax and other taxes. The compositions of indirect taxes are given in the following table:

#### **4.1.4 Composition of Total Direct Tax**

In Nepalese tax structure, the measure components of direct tax are income tax, land tax and house and land registration tax unit. Until the fiscal year 2050/2051 Vehicle tax was considered as a direct tax and since 2051/2052 budget speech, it has been classified under the indirect tax. On the other hand, interest tax and urban house and land rent tax were included under the income tax since 2051/2052. Thus the contribution of income tax has become larger than the other taxes. The share of the measure component of the direct taxes is given the following table:

**Table No. 4.1.4**  
**Component of Direct Tax and Their Percentage Share**

Rs. In Million

Fiscal Year	Direct Tax	Income Tax	% share to DT	Land Tax	% share to DT	House And Land Reg.	% share to DT	Other	% share to DT
1	2	3	4=3/2 ×100	5	6=5/2 ×100	7	7/2× 100	9	10=9/2 ×100
2051/2052	3795.10	2823.50	74.40	34.90	0.92	902.90	23.79	33.80	0.89
2052/2053	4585.00	3431.40	74.84	18.20	0.40	1048.40	22.87	87.00	1.90
2053/2054	5234.00	4123.30	78.78	5.90	0.11	1009.50	19.29	95.30	1.82
2054/2055	6012.92	4898.06	81.46	3.59	0.06	1000.60	16.64	110.68	1.84
2055/2056	7296.73	6170.26	84.56	1.35	0.02	1001.79	13.73	123.33	1.69
2056/2057	8555.02	7420.61	86.74	4.61	0.05	1011.30	11.82	118.50	1.39
2057/2058	9729.75	9113.91	93.67	5.11	0.05	607.79	6.25	2.94	0.03
2058/2059	10037.81	8903.69	88.70	0.82	0.01	1131.00	11.27	2.29	0.02
2059/2060	9452.50	7852.50	83.07	0.00	0.00	1600.00	16.93	0.00	0.00
2060/2061	10397.50	8147.50	78.36	0.00	0.00	1700.00	16.35	550.00	5.29
2061/2062	13071.80	9402.40	71.93	0.00	0.00	1799.20	13.76	306.70	2.35
2062/2063	13968.90	9598.10	68.71	0.00	0.00	2181.10	15.61	565.70	4.04
2063/2064	18980.30	13979.10	73.65	0.00	0.00	2253.50	11.87	697.80	3.68
2064/2065	24815.6	8604.40	34.67	0.00	0.00	1348.10	5.43	1101.40	4.44

Source Appendix-4

Income tax occupies largest share in the direct tax and that the percentage share of this component in the fiscal year 2051/2052 was 74.40 percent amounting to Rs.3795.10. It increased to 74.84 percent in 2052/2053. After the insurance of interest and urban house and land rent tax in income tax, it started to increase and reached 73.65 Percent in 2063/2064.

Land tax, which composed 0.92 percent of direct tax even in 2051/2052, contributed only 0.05 percent in 2057/2058 and zero in 2064/2065. The share of land tax was decrease sharply in the mid 3795.10' due to the raise in the relative importance of indirect taxes and income tax and large exemptions

granted under the land revenue system. Since 2052/2054, land revenue collection authority has been transferred to total government and has ceased to become revenue sources of control government. Thus, land tax has been a negligible contribution to the revenue structure of Nepal. The share of house and land registration is fluctuated year to year. Its share in 2051/2052 was 23.79 percent and was 11.87 percent in 2064/2065.

#### 4.1.5 Contribution of Total Direct Tax

The most serious gap, which the tax structure exhibits, was in the share of direct tax. Its share of tax structure and total revenue was 48.75 Percent and 40.75 Percent respectively in the 2064/2065 as against 19.30 percent and 15.42 percent in 2051/2052, which is given in the following table:

**Table No. 4.1.6**  
**Contribution of Direct Tax**

Rs. In Million

Fiscal Year	Direct Tax Revenue	Total Tax Revenue	DT as % Of Total Tax	Total GDP	DT as %Of GDP	Total Revenue	DT as % Of Total Revenue
1	2	3	4=2/3×100	5	6=2/5×100	7	8=2/7×100
2051/2052	3795.10	19660.10	19.30	209974.00	1.81	24605.10	15.42
2052/2053	4585.00	21668.00	21.16	239388.00	1.92	27893.00	16.44
2053/2054	5234.00	24425.20	21.43	269570.00	1.94	30374.90	17.23
2054/2055	6012.92	25939.82	23.18	289798.00	2.07	32937.90	18.26
2055/2056	7296.73	28752.94	25.38	329960.00	2.21	37133.86	19.65
2056/2057	8555.02	33152.18	25.81	365465.00	2.34	42893.78	19.94
2057/2058	9729.75	38865.00	25.03	393566.00	2.47	48893.56	19.90
2058/2059	10037.81	39330.59	25.52	405632.00	2.47	50445.49	19.90
2059/2060	9452.50	42616.90	22.18	435531.00	2.17	55250.00	17.11
2060/2061	10397.50	48155.20	21.59	472424.00	2.20	62227.00	16.71
2061/2062	13071.80	54104.70	24.16	496026.00	2.64	70122.70	18.64
2062/2063	13968.90	57430.40	24.32	514459.77	2.71	72282.10	19.33
2063/2064	18980.30	71126.70	26.68	530890.11	3.56	87712.20	21.64
2064/2065	24815.60	50818.80	48.83	555850.24	4.46	60892.30	40.75

Sources Appendix - 4

From the above table, the contribution of direct tax on total tax revenue was decrease until 2048/2049 by 0.40 Percent more than 2047/2048 after 2048/2049 it is slowly increasing. The share of direct tax on total tax revenue was 19.30 percent in 2051/2052 after than it is increased slowly up to 25.52 percent in 2058/2059 and remains constant to 21.59 till2060/2061.The main reason of this constant of direct tax in Nepal is the exemption of income from agricultural sector.

The share of direct tax on GDP is very low. Its share in 2051/2052 was only 1.81 percent. Its share started to increase and reached 4.46 percent in 2064/2065. In the other hand the share of direct tax on total revenue in 2051/2052 was 15.42 percent and in 2064/2065 was 40.75 percent.

#### **4.1.6 Contribution of Total Income Tax in Nepal**

Nepal has late started in practicing of income tax. First of all income tax was imposed in Nepal 2016/2017 AD as business and remuneration tax. Since then it has contributed revenue to the nation. In the beginning of this tax, it had contributed Rs.203 thousand as revenue in 2016/2017. Income tax was initially levied on business income and salary. In 2019 the first income tax act was enacted which replaced the business, profit and remuneration tax of 2016. After the introduction of new act, the share of income tax was ten-fold increase within four years. The contribution of salary tax and business tax to total income tax during the first four years after the introduction of income tax is given in the following table:

**Table No. 4.1.6**  
**Income tax Revenue Collection from 2016/2017 to 2019/2020**

Rs in million

Heading	2016/2017	2017/2018	2018/2019	2019/2020
Business	162.00	339.00	1031.00	1767.00
Salary	41.00	67.00	135.00	169.00
Total	203.00	406.00	1166.00	1936.00
Foreign invest Mint tax	-	-	1.00	140.00
Grand Total	203.00	406.00	1167.00	2076.00

Sources: Budget speech and economic survey of various fiscal years, Ministry of Finance.

The contribution of income tax on various revenues for the study period is given in the following table:

**Table No. 4.1.7**  
**Contribution of Total Income tax On Differe4nt Revenue Heads**

Rs. In Million

Fiscal Year	Income tax Revenue	Direct Tax Revenue	It as % Of DT	Total Tax Revenue	It as % Of Tax revenue	Total Revenue	It as% of Total Revenue	Total GDP	It as % of Total GDP
2051/2052	2823.50	3795.10	74.40	19660.10	14.36	24605.10	11.48	209974.00	1.34
2052/2053	3431.40	4585.00	74.84	21668.00	15.84	27893.00	12.30	239388.00	1.43
2053/2054	4123.30	5234.00	78.78	24425.20	16.88	30374.90	13.57	269570.00	1.53
2054/2055	4898.06	6012.92	81.46	25939.82	18.88	32937.90	14.87	289798.00	1.69
2055/2056	6170.26	7296.73	84.56	28752.94	21.46	37133.86	16.62	329960.00	1.87
2056/2057	7420.61	8555.02	86.74	33152.18	22.38	42893.78	17.30	365465.00	2.03
2057/2058	9113.91	9729.75	93.67	38865.00	23.45	48893.56	18.64	393566.00	2.32
2058/2059	8903.69	10037.81	88.70	39330.59	22.64	50445.49	17.65	405632.00	2.20
2059/2060	7852.50	9452.50	83.07	42616.90	18.43	55250.00	14.21	435531.00	1.80
2060/2061	8147.50	10397.50	78.36	48155.20	16.92	62227.00	13.09	472424.00	1.72
2061/2062	9402.40	13071.80	71.93	54104.70	17.38	70122.70	13.41	496026.00	1.90
2062/2063	9598.10	13968.90	68.71	57430.40	16.71	72282.10	13.28	514459.77	1.87
2063/2064	13979.10	18980.30	73.65	71126.70	19.65	87712.20	15.94	530890.11	2.63
2064/2065	8604.40	24815.60	34.67	50818.80	16.93	60892.30	14.13	555850.24	1.55

Source: see Appendix

Income tax was increased about 11 folds in 2064/2065 against in2051/2052. Total tax in 2051/2052 was 2823.50 million increases to Rs 8604.4 Million in2064/2065. Income tax was the fifth source of revenue in2016/2017. It exceeded land in 2017/2018 and excise duties in 2050/2051 and since then it has been the third largest share of tax revenue in Nepal.

The share of income tax to total direct tax was only 74.40 percent in 2051/2052. It was the lowest contribution during the study period. The share of income tax to total direct tax was increased 64.67 percent in 2064/2065. The share of income tax to total tax revenue was 14.36 percent in 2051/2052. It had increased considerably up to study period in 2064/2065 by 16.93 percent. Similarly, its share in total revenue and total GDP was 11.48 percent and 1.34 percent respectively in2051/2052.

From the above table, we can say that the income tax is one of the main and prime sources of direct tax in Nepal. But the contribution of income tax to the total tax revenue is still lower than the developed countries. Nevertheless, income tax is most likely to surpass the custom duties in future and will be the second largest sources of revenue and the first largest source will be VAT.

#### **4.1.7 Income Tax Rate**

Rate structure of income tax has been changing continuously since its introduction in 2016/2017. Since 2016/2017 to till now, there are national records of highest and lowest income tax rate. In 2020/2021 the highest income tax rate was 60 percent, which are not repeated till now. From the introduction of income tax, tax rate is charged slabs. In 2032/2033, the income tax rate for personal income was 10 percent to 60 percent for 7 different slabs. From 2055/2056 to till now, the income tax rate for personal income is 15 percent and 25 percent for two slabs. It shows that there is a trend of reducing the number of slabs and tax rates.

Under new income tax 2058, individual income tax is levied with two rates of 15 percent and 25 percent. For the individuals, who have Rs.100000 income or Rs.10 lack turnover from any kind of business in metropolitan or sub-metropolitan cities, municipalities and other area in Nepal are subject to pay Rs.2000.Rs.1500 andRs.1000 as an annual flat rate respectively?

The income tax rate for partnership firms, corporation and non- resident was 15 to 60 percent for 5 different slabs in 2032/2033 which decreased to 30 and 30 percent for total taxable income.

For every year, finance acts prescribed the exemption limit for individual, family and couple. Above the exemption limit, different income tax rate have been levied. The exemptions limit in different years is show in the following table:

**Table No. 4.1.7**  
**Exemption Limit in Nepal (2016/2017 to 2064/2065)**

In Rs. Million

Fiscal Year	Individual	Couple	Family	All Taxpayers
2016/2017 to 2019/2020				
2020/2021 to 2021/2022				7,000.00
2022/2023 to 2024/2025				6,000.00
2024/2025 to 2030/2031	3,000.00	4,500.00	6,000.00	
2031/2032	4,500.00	6,000.00	6,000.00	5,000.00
2032/2033	5,500.00	6,500.00	7,500.00	
2033/2034 to 2035/2036	6,500.00	7,500.00	8,500.00	
2036/2037 to 2037/2038	7,500.00	10,000.00	10,000.00	
2038/2039 to 2039/2040	10,000.00	15,000.00	15,000.00	
2040/2041 to 2046/2047	15,000.00	20,000.00	20,000.00	
2047/2048 to 2048/2049	20,000.00	30,000.00	30,000.00	
2049/2050 to 2053/2054	25,000.00	35,000.00	35,000.00	
2054/2055	30,000.00	40,000.00	40,000.00	
2055/2056	40,000.00	50,000.00	50,000.00	
2056/2057	50,000.00	60,000.00	60,000.00	
2057/2058	55,000.00	75,000.00	75,000.00	
2058/2059	55,000.00	75,000.00	75,000.00	
2059/2060	65,000.00	85,000.00	85,000.00	
2060/2061	80,000.00	1,00,000.00	1,00,000.00	
2061/2062	80,000.00	1,00,000.00	1,00,000.00	
2062/2063	1,00,000.00	1,25,000.00	1,25,000.00	
2063/2064	1,00,000.00	1,25,000.00	1,25,000.00	
2064/2065	1,00,000.00	1,25,000.00	1,25,000.00	

Sources: Finance Acts of various Years, Nepal Government, MOE, Budget speech.

The above table shows that there was only one Exemption limit for all individual taxpayers from 2016/2017 to 2023/2024. After 2024/2025, individual tax payers were categorized into 3 heads i.e. individual, couple and family. From the fiscal year 2024/2025 to 2035/2036, exemption limit was different for each category. But after 2036/2037 to till now, the exemption limit of couple and family is same. This shows that the exemption is given only for two categories, i.e. individual and family or couple. Above the exemption limit of individual income, individual sets of tax rates are charged for different slabs. The following table shows the rates for personal income of Nepal.

**Table No. 4.1.8**  
**Rates of Personal income tax in Nepal (2032/2033 to 2064/2065)**

**In Rs Million**

Fiscal year	Slabs(Over Exemption Limit)							
	1	2	3	4	5	6	7	8
2032/2033	5,000.00 7%	5,000.00 10%	10,000.00 20%	10,000.00 30%	10,000.00 40%	5,000.00 55%	Balance 60%	
2017/2018	5,000.00 5%	5000.00 10%	10,000.00 15%	20,000.00 20%	20,000.00 30%	30,000.00 40%	Balance 50%	
2042/2043	5,000.00 10%	5,000.00 15%	10,000.00 20%	15,000.00 25%	15,000.00 30%	30,000.00 40%	2,00,000 50%	Balance 55%
2047/2048	10,000.00 15%	15,000.00 20%	20,000.00 35%	25,000.00 40%	30,000.00 45%	Balance 60%		
2052/2053	40,000.00 10%	25,000.00 20%	Balance a)30% a)33%					
2057/2065	75,000.00 15%	Balance 25%						

Sources: Finance act of various years, GN, MOE

From the above table, it is clear that the rates for personnel income tax in Nepal are different for different slabs. In 2032/2033, the tax rate for personal income was 7 to 60 percent for 7 different slabs. After 2032/2033, the slabs

were increased to eight slabs in 2042/2043. But, after 2042/2043, the number of slabs, rate of personnel income tax decrease till now. In 2064/2065, there was 15 percent rate of 75000 and 25% for balance.

Similarly, income tax is charged for partnership firms, corporation and non residents. In the case of these, exemption limit is not given. Tax is charged on the income after deducting expenses. The rates and slabs approved for different years are given below:

**Table No. 4.1.9**  
**Income Tax Rates for partnership firm, corporation and non-resident (2032/2033 to 2064/2065)**

In Rs Million

Fiscal Year	Slabs (Over Exemption Limit)							
	1	2	2	4	5	6	7	8
2032/2033	10,000.00 7%	1,000.00 25%	10,000.00 40%	50,000.00 55%	Balance 60%			
2037/2038	5,000.00 5%	5,000.00 10%	10,000.00 15%	20,000.00 20%	20,000.00 30%	30,000.00 40%	Balance 50%	
2042/2043	5,000.00 10%	5,000.00 15%	10,000.00 20%	15,000.00 25%	15,000.00 30%	30,000.00 40%	200,000.00 50%	Balance 55%
2047/2048	10,000.00 15%	15,000.00 20%	20,000.00 35%	25,000.00 40%	30,000.00 45%	Balance 50%		
2052/2053	33% in total							
2057/2065	(a) 30% (b) 25%							

Sources: Finance Act of various years, MOE

a = Bank, finance, companies, financial firm

b = other partnership firms

The above table shows that the income tax rates for partnership firms, corporation and non-resident were different for different slabs in the earlier years. But after 2052/2053, the rate and slab is only one. This shows the

progressive tax in earlier year and flat in recent year. The income tax rate for 2032/2033 was 15% to 60% for 5 slabs. But in 2064/2065, the tax rate was only 30 for bank, finance companies and financial firms and 25% for other partnership firms at a flat rate on taxable income.

## **4.2 An analysis of Exemption & Deduction**

Income Tax Act 2031 has been replaced by Income Tax Act 2058. Income Tax Act 2058 has classified the income heads into following. Three heads.

- a. Business
- b. Employment and
- c. Investment

The Act has defined the income heads as follow:

- a. Business: Business means any industry, a trade, a profession, or the like
- b. Isolated
- c. Transaction with a business character and includes a past, present or prospective business.
- d. Employment: Employment includes a past, present, or prospective employment.
- e. Investment: Investment means an act of holding or investing one or more assets of a similar nature that are used in an integrated fashion but excludes-
  1. Act of the holding of assets, other than non-business Chargeable assets primarily for personal use by the person owning the asset or investing amount on such asset: or

### **4.2.1 Income from an Employment**

Income Tax Act 058, section 8, has clearly mentioned the incomes or amounts, which are includable in computing income from employment. An individual's income from an employment of the individual for the year. For the

purpose of computing income from an employment the following amounts (incomes) received by him in respect of any employment of services rendered by him any year of income shall be included –

- a. Any wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts, bonuses and other facilities.
- b. Any personal allowance, including any cost of living, dearness, subsistence, rent, entertainment, and transportation allowance.
- c. Any payments for reimbursement of costs incurred by the individual or an associate of the individual.
- d. Any payments for the individual's agreement to any conditions of the employment.
- e. Any payments for redundancy or loss or termination of the employment.
- f. Retirement contributions, including those paid by the employer to a retirement fund in respect of the employee, and retirement payments.
- g. Other payments made in respect of the employment.
- h. Other amounts includable on tax accounting or quantification allocation and characterization of amounts.

In the above provisions, there is a provision of loss of employment. But the provision has not clarified the meaning of loss of employment. In the other hand, retirement contributions are nothing else than the product of sacrifice of oldness of employments. These are the bases for living standard of oldness of employees. Therefore, it does not give good information to the taxpayers / employees. Dearness allowance is given to meet the living standard of employees. It is not lawful to taxable income.

### **Non – includable amounts on employment income**

The following amounts are not includable in computing the net income from employment.

- a. Amount exempt under section 10 and final withholding payments.

- b. Meals or refreshments provided in premises operated by or on behalf of an employer to employer's employee that are available to all the employees or similar terms.
- c. Any discharges or reimbursement costs incurred by the individual –
  - i that serve the proper business purpose of employer or
  - ii. That is or would otherwise be deductible in calculating the individual's income from any business or investment.
- d. Payments of prescribed small amounts, which are so small and thus unreasonable or administratively impractical to make accounting for them. (Only up to Rs. 500 at once – expenses may be stationery, box is gift, tea/ coffee expenses, emergency medical expenses and pointed by department)

### **Employment or business**

For the calculation of net income of three 3 income heads, act has clearly mentioned the income or amounts, which are taxable & non- taxable (exempted) and expanses, which are allowed for deduction & not allowed for deduction. For computation of act has made the following provisions:

#### **4.2.2 Income from a business**

Income Tax Act 058, section 7, clearly mentioned the income or amounts which are includable in computing the income from business. They are:

- I. A person's income from a business for an income years is the person's profits and gains from conducting the business for the year.
- II. There should be included in calculating a person's profit and gains from conducting a business for an income year, the following amounts derived by person during the year:
  - a. service fees,

- b. amounts derived from the disposal of trading stock,
- c. net gains from the disposal of the person's business assets or liabilities of the business,
- d. amount of excess depreciation on the disposal of the person's depreciable assets of business,
- e. gifts received by the person in respect of business,
- f. amounts derived as consideration for accepting a restriction on business operation,
- g. amounts derived that are effectively connected with the business and that would otherwise be included in calculation the person's income from an investment.
- h. other amount required to be included on tax accounting or quantification, allocation and characterization of amount.

In the above provisions, there is a provision of loss of employment. But the provision has not clarified the meaning of loss of employment In the other hand, retirement contributions are meaning else then the product of sacrifice of employees. So it dose not give good information to the taxpayer/ employees. Dearness allowance is given to meet the living standard of employees. It is not lawful to include in taxable income.

Non- includable amounts on profit and of business.

The following amount are excluded in calculating a person's profits and gains from conducting an business

- a exempt amounts under section 10.
- b taxation of dividends under section 54.
- c dividends distributed by a controlled foreign entity at the end of the year under section 69 and
- d final withholding payment.

### **4.2.3 Income from an Investment**

Section 9 of Income Tax Act 2058, has defined the income received from an investment for income tax purpose. For the purpose of computing

income of any person from an investment for an income year is the person's profits and gains from conducting the investment for the year and there shall included.

- a Any dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from an unapproved retirement fund interest, or retirement payment made by an approved retirement fund or retirement payment from approved retirement fund
- b Net gains from the disposal of the person's non – business enlargeable assets of investment.
- c Excess amount of incomings over the depreciation basis including outgoings on the disposal of depreciable assets of the investment of the person. (Depreciable basis includes the deprecation amount, expenses made on the depreciable Assets)
- d Gifts received by the person in respect of investment.
- e Retirement contributions, including those paid to a retirement fund in respect of the person, and retirement payments in respect or investment.
- f Amounts derived as consideration for accepting restriction on the capacity to conduct the investment.
- g Other amounts required to be included in tax accounting or quantification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business.

In the above provision, act has included the amounts derived as consideration for accepting a restriction on the capacity to conduct the investment: it is fruit full to the investors who receive the compensation against the restriction. But it will not be possible to implement, if the act does not clarify the nature of restriction, cause of imposing restriction, process of compensation competing and entity, which give compensation.

### **Non- includable amounts on Investment Income**

The act has mentioned the amounts, which are excluded in computing income from an investment under section 9 (3). They are:

- a Exempt amount under section 10,

- b Taxation of dividends under section 54
- c Dividends distributed by a controlled foreign entity at the end of the year under section 69 and final withholding payments , and
- d Amounts that are included in calculating the person's income from any employment or business.

#### **4.2.4 Exemption from Income Tax**

Income Tax Act 2058, has mentioned the amounts, which are exempt and other concessions. They are described in the following section.

##### **1. Exempt Amount**

The following amounts are exempted from tax under section 10, Income Tax Act 2058.

- a. Amounts derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between His Majesty's Government and a foreign country or an international organization.
- b. Amounts derived by an individual from employment in the public service of the government of foreign country.

Provided that-

- i. The individual is a resident person solely by reason of performing the employment or is a non- resident person and
- ii. The amount are payable from the public funds of the country.
- c. Amounts derived from public fund of the foreign country by an individual who is not a citizen of Nepal as referred to in paragraph or by a member of the immediate family of the individual.

- d. Amounts derived by an individual who is not a citizen of Nepal from employment by His Majesty's Government on terms of tax exemption.
- e. Allowances paid by His Majesty's Governments to widows, elder citizens, or disabled individuals.
- f. Amounts derived by way of gift, bequest, inheritance or scholarship (which are including exception of business, employment or investment income)
- g. Amounts derived by an exempt organization by way of-
  - I. Gift, donation
  - II. Other contributions that directly relate to the organization's function to in paragraph (s) of the definition of exempt organization in section 2, whether or not the contribution is made return for consideration provided by the organization.
  - III. Amounts earned by Nepal Rastra Bank as its objectives.
- h. pension received by a Nepali citizen retired from the army or police service of a foreign country provided the amounts are payable from the public fund of that country.

In the above section, pension's amount retired from the army or police service of a foreign country is exempted from income tax. It restricts the objective of raising more revenue of government.

**Exempt organization:**

Exempt organization means the following entities:

- i) a social, religious educational or charitable organization of public character register without having profit motive.
- ii) an amateur sporting association formed for the purpose of promoting social or sporting amenities not involving the acquisition of gain.
- iii) a political party registered with the Election Commission.

- iv) a village development committee, municipality or district development committee,
- v) Nepal Rastra Bank.
- vi) His Majesty's Government.
- vii) the prescribed entity that has been issued with a personal ruling under section 76 stating that it is an exempt organization.

Income Tax Act has mentioned the organization, which are tax-free (exempt organization). Act has exempted a social, religious, educational or charitable organization of a public character registered without having profit motive, in the case of non-transparent private business like boarding schools, NGO's or other entities, where profits are earned, but for the sake of tax planning, is called retained earnings or something else. So they are tax-free it is not good symptom of tax administration.

## **2. Business Exemptions and Concessions**

The following business exemptions & concessions are mentioned in section 11 of Income Tax Act 2058.

- a. An agricultural income derived from sources in Nepal during an income year by a person, other than the income from an agriculture business derived by a registered firm, or partnership, or a corporate body, or thought the land about the holding ceiling as prescribed in the land Act 2021, exempt from income tax.
- b. Incomes derived by cooperative societies, registered under cooperative Act 2048, from business mainly based on agriculture and forest products such as sericulture and silk production, horticulture and fruit processing, animal husbandry, dairy industries, poultry farming, fishery, tea gardening and processing, coffee farming and the processing, herb culture and herb processing, vegetables seeds Processing, bee keeping, honey production, rubber farming, floriculture and production and forestry related business such as lease-hold for Forestry, cold storage of established for the stores of vegetables and business of agricultural seeds, insecticide, fertilizer and agricultural tools (other

than machine operated) and rural community based saving and credit cooperatives are exempt from tax. Dividends distributed by such societies are also exempt from tax.

- c. Income derived from sources in Nepal during an income-year by a person from a special industry is follows:
  - I. in case, the industry provides direct employment to six hundred or more Nepali citizens during the year, at 90 percent of rate is applicable to that income.
  - II. In case the industry is operated in a remote undeveloped or underdeveloped area at 70, 75 or 80 percent respectively, of the rate is applicable for the period of ten years commencing from and including the year in which the operation commences.
- d. A person who is entitled to concession under subsections a, b or c shall calculate the income referred to in those subsections as though the income was the only derived by a separable person.
- e. Where a person qualifies for more than one concession under subsection (b) I or II with respect to the same income, the person shall only be entitled to one concession with respect to income but shall be entitled to select which concession applies.
- f. Notwithstanding subsection (c), where a person uses assets to conduct an activity of the type referred to in paragraph II of the subsection, then for the purposes of calculating the time limit under that subsection the time during which any other person previously conducted a similar activity using substantially the same asset shall be counted.

Clarification- for the purpose of this section-

- ) Agricultural business' means the business of production crops from public or private land or deriving rent from a tenant using land.
- ) 'Remote area', 'underdeveloped area' and 'underdeveloped area' have the meaning in annex -3 of Industrial Enterprises Act 1992
- ) 'Special industry' means a manufacturing industry as categorized in section III of the Industrial Enterprise Act 1992, other than an industry

producing cigarettes, bide, cigar, chewing tobacco, khaini, or other goods of a similar using tobacco as the basic raw material, or alcohol, beer, or other goods of a similar nature.

In the above section, there is a prevision of exemption of tax from an agricultural income other then income from an agricultural business derived by a firm, or company, or partnership, or a corporate baby, or through the land above the holding ceiling as prescribed in land Act 2021. But the provision of taxing on agricultural income of agriculture business is not clear on itself. In the other hand, exclusion of agricultural income from the tax net alone cuts out about half of the GDP.

There are various provisions about exemption and concessions. Some concessions granted to achieve certain objectives are not effective. Tax concessions encourage the establishment of industries in certain areas but they vanish, change names, ownership, or place the business when the tax concessions period expires. In the other hand, the concessions or incentives provided to special industries are not energetic. For this kind of concession, no body will be encouraged to open the industry in remote area. For the purpose of industrial development of remote area, a separate incentive should be provided. But the new act is unable to do so.

### **3. Donation gifts to exempt to exempt organizations:**

Section 12 of Income Tax Act 2058 has mentioned the provisions of donation gifts to exempt origination. The provisions are:

- a. a person may claim to have their taxable income for an income year reduced by donation gifts made by the person during the year to an exempt organization, that are approved for the purposes of this section by the department.
- b. notwithstanding subsection (a), reductions allowed to a person under subsection (1), for an income-year shall not exceed Rs. 1,00,000 or 5 percent of the person's taxable income for the year calculated without a deduction for gifts referred to in subsection (a) and ignoring the limitations in 17 (2) and 18 (2) whichever is lower.

c. notwithstanding subsection (a) and (b), His Majesty's Government may prescribe, by a notification in the Nepal Gazette, as to allow full or partial deduction at the time of assessing a person's income of the expenses incurred for special purpose, or the expenses of gift given by the person.

From the above provision (a), it is clear that the donation given to political parties is allowed for deduction but it is not able to solve the voice of people of 'transparency of donation amount given by businessman to political parties.'

Similarly, in the above provision (c), there is a provision of special purpose. But the act has not defined 'what is the special purpose?'

#### **4.2.5 Deduction allowed**

Chapter 5 of income tax act 2058 has provided the provisions relating to expenses, which are allowed for deduction and not allowed for deduction expenses, which are allowed for deduction, are discussed from 13 to 20 sections under chapter 5. They are discussed or analyzed in the following section.

##### **1. General deductions:**

For calculating a person's income from an income year from any business or investment, there shall be deducted all actual costs to the extent incurred during the year, the by the person and the production of income from the business or investment.

##### **2. Interest:**

For the purpose of calculating the income of a person from an income-year from a business or investment, there shall be deducted all interest incurred during the year by the person under a debt obligation of the person that the debt obligation was incurred in borrowing money, used during the year

or was used to purchase an asset is used during the year or in any other case the debt obligation was incurred.

But the total amount of interest that an exempt-controlled resident entity may deduct under the above case for an income year shall not exceed the sum of; all the interest derived by the entity during the year that is to be included in calculation of the entity's taxable income for the year, and 50% of the entity's taxable income for the year, calculated without including any interest derived by the entity or deduction of any interest by the entity.

Any interest for which a deduction is denied as a result of the above cause may be carried forward and treated as incurred during the next income year.

It is an unlawful step for a businessman not to get the deduction of full amount of interest. It does not fulfill the objective of industrial/economic development. There is a controversial condition between the law of banking and law of income tax because according to the law of banking-interest must be paid to bank but according to the law of income tax- there is a provision of not to get the deduction of full amount of interest for an income year.

### **3. Cost of trading stock**

For the purpose of calculating a person's income for an income year from any business, no deduction is otherwise allowed for the cost of trading stock except the allowance determined by subtracting the amount of closing value of trading stock of business from the opening value of trading stock plus the cost of trading stock of the business acquired by the person during the year.

The opening value of trading stock of business for an income year is the closing value of trading stock of business at the end of the previous income year. The closing value of trading stock of business is the lower value of the cost of trading stock of the business at the end of the year.

The cost of trading stock of a business at the end of a person is determined by using the prime-cost or absorption-cost method in the case of a person accounting for tax purposes on a cash basis in calculating income of the business and using the absorption-cost method in the case of a person

accounting for tax purposes on an accrual basis in calculating income of the business.

In the case where absorption-cost method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which the cost of trading stock is equal to the sum of direct materials costs, direct labor costs and variable factory overhead costs. In the case where the prime-cost method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which the cost of trading stock is equal to the sum of direct material costs, and variable factory overhead costs.

Where trading stock is a person's business is not readily identifiable, the person may elect that the cost of trading stock be determined according to the first in first out (FIFO) method and average cost method. Once chosen the method may only be changed with the written permission of the Department.

In the case where average cost method is followed, the cost of trading stock is determined as per the generally accepted accounting determined as the weighted average cost of all trading stock of that type and held by the business. In the case where FIFO (first-in –first-out) method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which trading stock valuation is based on the assumption that trading stock is disposed of in the order of its acquisition.

For the purpose of this section "Direct labor costs" means labor costs directly related to the production of trading stock, "Direct material costs" means the cost of materials that are or become an integral part of the trading stock, "Factory overhead costs" means the total costs incurred by the person in manufacturing trading stock except direct material costs and "variable manufacturing overheads costs" means those factory overhead costs that vary directly which changes in volume of trading stock manufactured.

#### **4. Repair and improvement costs**

For the purpose of calculation a person's income for and income year from any business or investment, there shall be deducted all cost to the extent

incurred during the year in respect of the repair or improvement of depreciable sets owned and used by the person during the year in the production of the person's income from the investment or business.

But the deduction allowed under the above case with respect to all depreciable assets in a particular pool of depreciable assets of the person shall not exceed 5% of the depreciation basis of the pool at the end of the income-year and the deduction shall be allowed with respect to costs in order in which they are incurred. Any excess cost, or part thereof, for which deduction is not allowed as a result of this limitation, shall be added to the depreciation basis of the pool to which it relates in accordance with paragraph 2(5) of schedule 2.

The provision of adding any excess costs or part thereof to the depreciation basis amount is not contextual and lawful provision because it shows that the repair or improvement cost of a depreciable asset has not got full approval. In other hand, the tendency of carrying forward of this cost will increase the income tax revenue of government in some context but it will not bring the cordial relationship between the taxpayer and government.

### **5. Pollution control costs**

For the purposes of calculating a person's income for and income-year from any business, there shall be deducted pollution control costs to the extent incurred by the person during the year in conducting the business.

But the deduction allowed to a person for an income year with respect to all businesses conducted by the person shall not exceed 50% of the person's taxable income calculated without a deduction for pollution control costs... any excess costs or part thereof, for which deduction is not allowed shall be capitalized and may be depreciated in accordance with schedule2.

For the purpose of this section, "Pollution control costs" means costs incurred by a person with respect to a process or and asset that seeks to control population or otherwise protect or sustain the environment.

Government has a will of controlling pollution and then protection of environment has a will of controlling pollution and then protection of environment but has not spent a little bit money on it. In the other hand, all the

expenses made by the businessmen to control pollution are not allowed for deduction and has made a standard limit for it. So, it is not a good symptom of pollution control.

## **6. Research and Development costs**

For the purpose of calculation a person's income for and income-year from any business, there shall be deducted research and development costs to the extent incurred by the person during the year in conducting the business. But the deduction allowed to a person for and income-year with respect to all businesses conducted by the person shall not exceed 50% of the person's taxable income calculated without a deduction of research and development cost. Any excess, or part thereof, for which deduction is not allowed shall be capitalized and may be depreciated in accordance with schedule 2.

Research is and infrastructure of development. For successful industrial development, research and development is more important and must be expended on it. Expenses made on it must be approved and should be allowed for deduction or tax purpose. But the provision of income tax has not given full deduction on it. It is a myopic vision of government.

## **7. Depreciation Allowances**

For the purpose of calculation a person's income for and income for an income-year from any business or investment, there shall be deducted in respect of depreciation of depreciable assets owned and used by the person during the year in the production of the person's income from the business or investment, the allowances granted to the person for the year under schedule-2.

But the following provision shall be applied in respect of depreciation of th machines, equipment and other machinery installed in the electricity projects that are involving in building power station, generating and transmitting electricity and in the projects conducted by any entity son as to build public infrastructure, own operate and transfer to the HMG,

) In case where the old machines, equipment and other machinery that are already installed require replacement in any income year as they are out of order due to being too old, the balancing value of the old machines,

equipment and other machinery remained after cost shall be allowed as expenses for the year.

- ) At the time of transfer of other assets to HMG except of old assets replace in accordance with above paragraph, the balancing value if remained, after subtraction the depreciation up the year of the transfer from their cost shall be allowed as expenses.

Rates of depreciation are far from reality because there is not specific estimation provision of real age of assets and depreciation rate in Nepal. In the other hand, there is on any specific provision of depreciation of assets, which are taken in lease and installment payment basis. It shows a weak point of new income tax act.

### **8. Losses from a Business of Investment**

For calculating a person's income from an income-year from any business or investment, there shall be deducted any unrelieved loss of the year incurred by the person from any other business and any unrelieved loss of the previous four income-year incurred by the person from any business, In the case of electricity projects involving in building power station, generation and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own, operate and transfer to His Majesty's Government, any unrelieved loss of the previous seven years shall be deducted.

For the purpose of calculation the income of a person for and income-year from a investment, there shall be deducted any unrelieved loss of the year incurred by the person from any other investment. But a person may deduct and unrelieved loss with a foreign source only in calculation the person's foreign source income and an unrelieved loss incurred in deriving non-taxable income only in calculation the person's non-taxable income.

Where a person incurs a loss, or has an unrelieved loss available for carry forward under the above case during the income year in which a long-term contract of a person's business is completed or otherwise disposed of by the person, that is attributable to the long-term contract, the Department may, by notice in writing, allow to be carried back to a preceding income-year years,

and treated as an unrelieved loss of that years or year in an amount not exceeding the amount by which inclusion in calculation the income from the business to which the long term contract relates for that the business to which the long-term contract relates for that year or years exceed deductions relating to the contract.

The following loss incurred by a person during an income-year is attributable to long-term contract or contracts of the person-loss incurred from the long term contract or contracts relate to business, and loss for each such contract that is incurred due to the deductions in calculation the income from the business for the year that relate to the contract exceed inclusions that relate to the contract.

Where a person may deduct and unrelieved loss in calculation the person's income for and income-year from more than one business or investment, the person may prioritize in which calculations the loss or part of the loss is deducted.

Loss of an income-year incurred by a person from any business or investment is calculated as the excess of amounts deducted in calculation the person's income from the business or investment over amounts included in calculation such income ignoring the operation of this section.

Carry forward of losses for 4 years in not sufficient as compared to other countries. It is not sufficient to encourage the business for taking risk. The provision of carry backward is also thoughtful because the accounting system of Nepal is not so standard to apply this provision.

#### **4.2.6 Expenses not allowed for Deductions**

For the purpose of calculating the income of a person for an income year from any business, employment, the following expenses are not allowed for deduction under section 21 of Income Tax Act 2058.

- I Expenses of domestic or personal nature,
- II Income Tax,

- III Expenses to the extent to which they are incurred by a person in deriving amounts exempt under section 10 or final withholding payments,
- IV Expenses for payment made by a person whose annual turnover for an income year exceed Rs.20,00,000 is not allowed a deduction for a cash payment in excess of Rs.50,000 incurred at once other than in specified conditions,
- V Distribution of profits by an entity,
- VI Any other amount to the extent to which a deduction is not denied by above program i, ii, iii, iv or v except as provided for by this chapter 6, 7, 10, 11, 12 or 13.
- VII Expenses of a capital nature and
- VIII Foreign income tax.

A person whose annual turnover for an income year exceeds Rs.20,00,000 is not allowed for deduction for an a case payment in excess of Rs.50,000 incurred at once other than in the following condition by the person during the year:

- i) Payment is made to Nepal Government, a contribution body, a corporation owned by Nepal government or a bank or financial institution,
- ii) Payment is made to a farmer or producer for producing primary agricultural products even in the case where the product is primarily processed by the farmer himself,
- iii) Payment is a retirement contribution or retirement payment,
- iv) Payment is made in an area where banking services are not available,
- v) Payment is and necessarily be made in cash or on a day when banking service are closed or
- vi) Payment is made into a bank account of the payee, etc.

It means that the payment made with ignorance will not get full approval as expenses. For the purpose of tax calculation, these amounts should be added back.

Any other amount, to the extent to which a deduction is not denied by the section 21, (1); (f) has not defined and clarified the amounts. This kind of provision will provide a loophole for both tax administration and taxpayers.

**Clarification:-**

For the purpose of this section:

- I “Expenses of a domestic or personal nature” means the following expenses
  - a) Expenses incurred for an individual and the following expenses including interest incurred with respect to money borrowed to the extent to which is used for personal purpose:
    - ) Expenses incurred in maintaining the individual, including in providing shelter as well as meals, refreshment, entertainment or other leisure activities,
    - ) Expenses incurred with respect to the individual traveling, other than traveling in the course of conducting a business between the individual’s home and a place at which the business or investment is conducted,
    - ) Expenses incurred in acquiring clothing for the individual, other than clothing that is not suitable for wearing of work and
    - ) Expenses incurred in education and training provided that the deduction of the expenses incurred for education that is directly relevant to a business or investment conducted by the individual and which doesn’t lead to a degree or diploma is allowed.
  - b) Where a person makes a payment to an individual, expenses incurred in making the payment, including expenses incurred in favor of a third person except in and to the extent of the following conditions:
    - ) The payment is included in calculating the income of the individual,]
    - ) The individual makes a return payment of an equal market value to the person as consideration for the first mentioned payment or



way. The following table shows the groups of respondent and code used to present them.

**Table No.4.3.1**  
**Groups of respondents and code used**

S.N.	Groups of respondents	Sample size	Code used
1	Tax Experts	10	A
2	Tax Administrators	20	B
3	Tax Payers	30	C
	Total	60	

#### 4.3.2 Sufficiency of Exempted Items of Income Tax

Income Tax has provided exemptions to the various incomes. The exemptions had provided to different items of income. Act has pointed the exempt organization, which are tax free organization. To know the sufficiency of exempted items of income, a question was asked, “Do you think that the exempted items of income are sufficient?. The responses were as follows:

**Table No 4.3.2**  
**Sufficiency of exempted items of income**

	Group			Total No.	Percentage (%)
	A	B	C		
Yes	3	16	14	33	55
No	7	4	16	27	45
Tota 1				60	

Sources: opinion survey

There was hundred percent responses received from respondents, 33 respondents (55 percent) were agreed that the exempted items of income are

sufficient. But this was the cause of tax administrations because majority of tax administrations fell that they do not want to make bias against government.

As who gave negative response about the sufficiency of exempted items of income were asked a question. If no, what kind of income should be exempted?. The respondents were requested to write in the blank numbers. Most of the respondents did not response about it. Only three responses of tax expert, 12 responses of tax payers and two responses tax administrators were received. The responses were classified according to the code used in number wise.

#### Tax Experts

- I Provident fund
- II Export earning
- III Remote area allowance
- IV Life insurance premium
- V Interest received from government bank
- VI Scholarship
- VII Awards and Rewards

#### B Tax Administration

- I Life insurance premium
- II Citizenship Investment fund contribution

#### C Tax payers

- i) Overtime allowance
- ii) Retirement benefit
- iii) Income of foreign Employee
- iv) Medical Allowance
- v) provident fund
- vi) Employee's gratuity
- vii) Life insurance

Because of the majority of remuneration taxpayers, the responses of group C were related with employment income.

### 4.3.3 Opinion on Providing Exemption and Agriculture Income

From the commencement of Income tax Act, agriculture income has been treated as taxable income in some time and exempted income in some time. The new Income tax Act has exempted agriculture income tax other than the income, a firm, or company or partnership or a corporate body, through the land above the holding ceiling a prescribed in Land Act 2058, to know the opinion on it one question was asked, “In your opinion, should agricultural income be exempted?”. The responses were:

**Table No. 4.3.3**  
**Exemption on Agriculture Income**

	Group			Total No.	Percentage (%)
	A	B	C		
Yes, it should be exempted	7	14	24	45	75
No, it should be treated as other income	3	6	6	15	25
Total	10	20	30	60	100

Sources: Opinion survey

On the question asked, 75 percent of respondents were in support to exempt the agriculture income whereas 25 percent of the respondents were against the exemption of agricultural income. The respondents who gave negative response about the exempted agricultural income asked a question, “If no what should be done?” All the respondents choose the specify option. The respondents who specified their responses as other were given the following suggestion.

- ) Based on substance farmer and commercial farming, for the first, it should be exempted.

- ) The partial arrangement for taxing agriculture should be formulated, for example, be based on the size of land holding.
- ) Commercial agricultural income should be taxed as other income.
- ) It should be added on other income.

On the personal discussion with the respondents, some of the respondents said that it is impossible or difficult on taxing agriculture income because there is a condition of not collecting land tax or revenue. On the condition, how can collect the agricultural income tax?

#### 4.3.4 Revision of Current Income Tax Exemption Limit

Finance Act of Nepal nearly prescribes the tax rate beginning of income tax, tax rate and exemption limit are changing year to year. To know the respondent's view about the current exemption limit, a question was asked, "The current income tax exemption limit to family, couple and an individual needs revision?" The responses were as follows:

**Table No 4.3.4**  
**Revision of Current Income Tax Exemption Limit**

	Group			Total No.	Percentage (%)
	A	B	C		
Yes	8	13	30	51	85
NO	2	7	-	9	15
Total	10	20	30	60	100

Sources: Opinion Survey

From the above table it is clear that current income tax exemption limit should be revision.85 percent of the respondents were against the revision of current exemption limit whereas 15% of the respondents were for the revision of current against limit. Respondents who were against the revision of current

exemption limit asked, If Yes, how much be for an individual, family or couple? The responses were as follows:

**Table No. 4.3.5**  
**Exemption limit for an individual**

	Group			Total No.	Percentage (%)
	A	B	C		
Rs1,00,000	4	4	1	9	17.30
Rs1,50,000	4	8	24	36	69.23
Rs2,00,000	-	2	4	6	11.53
2,50,000	-	-	1	1	1.92
<b>Total</b>					<b>100</b>

Sources: opinion survey

On the response about the exemption limit of an individual, it was found that 69.23 percent of the respondents in favor of Rs 1,50,000. 17.30 percent of the respondents suggested that the exemption limit should be Rs 1,00,000. 11.53 percent of the respondents suggested that the exemption limit should be Rs 2,00,000 and 1.92 percent of the respondents suggested that the exemption limit should be Rs 2,50, 000. From the above table, it is clear that the exemption limit for an individual should be Rs 1,50,000.

Similarly a question was raised on the topic of exemption limit for an family and couple as, “How much exemption limit should be for family and couple?” The responses were given the following table:

**Table No.4.3.6**  
**Exemption limit for a family and couple**

	Group			Total No.	Percentage Approximate
	A	B	C		
Rs1,00,000	-	-	-	-	-
Rs150000	3	4	6	13	25
Rs2,00,000	5	8	18	31	59.62
Rs2,50,000	-	2	6	8	15.38
Total					100

Sources: opinion survey.

From the above table it is clear that the most of the respondent, i.e.59.62 percent suggested for Rs2,00,000, an exemption limit for a family and couple.25percent of the respondents were suggested for Rs1,50,000. Similarly, 15.38 percent were for Rs2,50,000.On the personal discussion with the respondents, the researcher found that more people were in support to provide income tax exemption limit equivalent to annual remuneration income of a government employee section offices.

Similarly, one question was asked. “Do you feel that exemption limit should be adjusted according to the inflationary situation of the country?” The responses were:

**Table No.4.3.7**  
**Exemption limit according to the inflationary situation of the Country**

	Group			Total No.	Percentage (%)
	A	B	C		
Yes	10	19	28	57	95
No	-	1	2	3	5
Total					100

Sources: opinion survey.

The above table shows that 95 percent of the respondents were agreed to adjust the exemption limit according to the inflationary situation of the country. So, it can be concluded that the exemption limit of a family and an individual should be adjusted according to the inflationary situation of the country.

#### **4.3.5 Soundness of Income Tax Administration of Nepal**

In order to know the respondent's opinion about the soundness of income tax administration of Nepal, a question was asked, "Do you considered that the income tax income tax administration in Nepal is sounded?" The responses received from the respondents are tabulated as following:

**Table No.4.3.8**  
**Soundness of Income Tax Administration of Nepal**

	Yes		No		Total	
	No	%	No	%	NO	%
A	4	40	6	60	10	100
B	10	50	10	50	20	100
C	5	16.67	25	83.33	30	100
Total	19	31.66	41	68.33	60	100

Source: opinion survey.

The question received from 100 percent response as 32 percent of total respondents agree that the income that administration of Nepal is sound and 68 percent of total respondents do not agree about the soundness of income tax administration of Nepal. Most of the respondents of code A and code C were disagreed about the soundness of income tax administration of Nepal. 48 percent of tax administrators were against the soundness of tax administration. From this, it can be concluded that the income tax administration of Nepal is unsound. In order to know the cause of unsound income tax administration, the next question was asked, "If no, what are the causes, which are responsible for

the creation of unsound tax administration?” the respondents were requested to rank their answer from 1 to 6 . The respondents ranking are as follows:

**Table No. 4.3**  
**Causes for the creation of unsound Income Tax Administration**

S.N.	Causes	Group			Frequency	Percents	Rank
		A	B	C			
1	Defective Income Tax Act	2	3	5	10	9	5
2	Lack of trend participation	7	8	13	28	25	2
3	Facilities of organizational structure of tax administration	5	8	12	25	22	3
4	Lack of trained employee	7	7	16	30	26	1
5	Weakness in government’s economic policy	3	4	8	15	13	4
6	Other( if any; specify)	1	3	2	6	5	6
	Total	25	33	56	114	100	

**Source: opinion survey**

In the above table, percentage was calculated according to the total frequency obtain by each causes. For ranking purpose percentage of each cause was matched with each other and assigned first rank to the highest percentage. According to the respondent’s point of view, the main cause for the certain of unsound income tax administration of Nepal was ranked as follows:

- I. Lack of trained employees.
- II. Shortage of income tax experts /professional in tax administrator.
- III. Lack of public participation.
- IV. weakness in government policies
- V. Defective income tax
- VI. Other (if specify)

Lack of public awareness, public tendency not to pay tax but get some thing from the state the difficulties, payment system of tax are some of the cause stated by the respondents.

From the above in overall, it can be concluded that the main cause for the creation of unsound tax administration of Nepal is lack of trained employees in the tax administration. In separate view of each group of respondents, Group A (tax expert) and group C (Taxpayers) were prioritized the lack of the trained employees as the main cause of unsound income tax administration. Group C (tax payers) were prioritized the shortage of income tax expert/ professional in tax administration also. In the other hand, Group B (tax administrators) were prioritized the lack of public participation as the main cause of unsound tax administration. In overall, most of the respondents of each class were agreed main causes of unsound tax administration are lack of trained employees, shortage of income tax experts/ professionals in tax administration and the lack of public participation.

#### **4.3.6 Opinion in Current Income Tax Rates**

In order to know the opinion on current income rates, respondents were requested to tick one among the three alternatives (High, Medium, low). The question was asked “What is your opinion about the current income tax rate?” The income tax rate is, “The responses received are tabulated below:

**Table no. 4.3.10**  
**Opinion and current income tax rates**

S.N	Tax rate	Group			Total No	Percent (%)
		A	B	C		
1	High	1	2	17	20	33.89
2	Medium	5	11	10	25	42.37
3	Low	4	7	2	13	22.03

Source: opinion survey

Out of the hundred percent respondents, 42.37 percent of the respondents were agreed that the current income tax rate is medium, 33.89percent of the respondents agreed on high and remaining respondents

agreed on low tax rate. From the above table, it can be concluded that the current income tax rate is medium. Some respondents feel that the rate is not higher in absolute terms but it is higher as compare to paying capacity of Nepali people.

#### 4.3.7 Problem and Weakness of Nepalese Income Tax System

Income tax system of Nepal has been blamed that it is not efficient enough. To know the cause of problems and weakness of Nepalese income tax system, a question was asked, “What are the major problems and weakness in Nepalese income tax system?” The Respondents were requested to rank their answer from 1 to 9. But most of the respondents were ticked mark. For ranking purpose, the alternative, which got many more tick mark, was arranged as most important and ranked as first.

**Table no 4.3.11**

#### **Major problems and weakness of Nepalese income tax system.**

S.N.	Problems and Weaknesses	Group			Total No.	Percentage	Rank
		A	B	C			
1	Voluntary compliance	6	15	9	30	13.33	3.5
2	Relatively high tax rate	4	5	7	16	7.11	8
3	Difficult to maintain the account for tax purpose	5	8	7	20	8.89	-
4	Limited tax base	7	14	1	22	9.78	6
5	Lack of cooperation in tax administration	9	10	15	34	15.11	2
6	Ambiguous provision under the Nepalese income tax law	7	9	7	23	10.22	5
7	Lack of trained employees	9	16	12	37	16.49	1
8	Lack of timely adjustment of tax laws	5	5	3	13	5.78	9
9	Increased corruption	8	9	13	30	13.33	3.5
	Total	60	91	74	225	100	

Source: Opinion survey

The major problems and weaknesses of the Nepalese income tax system of Nepal were ranked in order of the preference of the respondents as follows: (see above table for details)

- 1 Lack of trained employees
- 2 Lack of cooperation in tax administration
- 3 3.5 voluntary compliance
- 4 3.5 increased corruption
- 5 Ambiguous provision under the Nepalese income tax system
- 6 Limited tax based
- 7 Difficult to maintain the account for tax purpose
- 8 Relatively high tax rate
- 9 Lack of timely adjustment of tax laws

The other problems stated by the respondents were as follows:

- A Lack of motivation
- B Lack of progressive taxation
- C The evasion (which comes in to voluntary compliance)

From the view of respondents of each group, Group A (tax experts) and Group C (taxpayers) had ranked first rank to lack of cooperation in tax administration as the major problems and weakness of income tax system, whether Group B (Tax administration) had ranked first rank to the lack of trained employees as the major problem and weakness of Nepalese income tax system. In overall, all these respondents were agreed on the tax administration as the cause of problem and weakness of Nepalese income tax system. After the unsound tax administration, they were agreed on voluntary compliance and increased corruption as the major problem and weakness of income tax system.

In the personal discussion with respondents, most of the tax payers said that increased corruption is the major problem and weakness of Nepalese income tax system; one respondent gave the example of increased corruption of his industry. From the above ranking in overall, it can be concluded that the major problem and weaknesses of Nepalese income tax system are lack of trained

employees, lack of cooperation in tax administration, voluntary compliance and increased corruption.

#### 4.3.8 Prioritization of expenses for deduction

To know that respondents view about the priority of expenses for deduction, a question was asked, "in your opinion what kind of expenses should be prioritized for deduction?" The respondents were requested to response in blank area. Most of the respondents did not response on this question, only five respondents of group A, 11 respondents were respondents as it. The responses of each group have been shown in the following paragraph.

##### Group A [tax experts]

S.N.	Response	No. of respondents
1.	All expenses related to income earning	2
2.	Cost of trading stock Life insurance premium Interest on loan Depreciation Repair and maintenance	1
3.	Medical expenses Donation	1
4.	Purchasing of news paper Paying of life insurance premium Fixed percentage of salary for traveling expenses Paying of fees of students [certain percent] For children	1

### Group B [Tax administrations]

S.N.	Response	No. of respondents
1.	All expenses related to taxable income	7
2.	Cost of goods sold Rent Salary Depreciation Interest	1
3.	Cost of trading stock/ purchase Repair and maintenance and improvements Interest on Loan Research and development Depreciation	1
4.	Life insurance premium expenses Interest of retirement payments	1
5.	Depreciation Staff overhead Maintenance Advertisement Transportation	1

### Group C [Tax Payers]

S.N.	Response	No. of respondents
1.	Related with taxable income	2
2.	Medical expenses Traveling expenses	2
3.	Expenses of food Expenses of health Expenses of education Expenses of house rent Expenses of cloth	2
4.	Insurance premium Education expenses up to [+2]	1

	Entertainment expenses	
5.	Machinery expenses Salary	1
6.	Tax on bank interest	1
7.	Capital Loss Entertainment Donation	1
8.	Staff expenses eg. Uniform, other allowances Advertisement expenses Business promotion expenses Subsidy Production Losses	2
9.	Insurance premium Medical expenses Tax on Life insurance premium	1

From the above listing, most of the respondents responded to prioritize the expenses, which are related with taxable income that may be business expenses, or employee, so they were suggested to prioritize the expenses, which are related to employment income. Businessman or investors were suggested to prioritize their income earning expenses. The respondents who did not give response were agreed to prioritize the expenses which are expended on income earning that may be business or investment or employment. It was the response of personal discussion with respondents. So, it can be concluded that the expenses, which are related to taxable income, should be prioritized for deduction. Related with the above question, one more question was asked as; “What are the need for deduction these expenses?” Respondents were given full options for the writing the response in their own words. One tax experts, six tax administrators and four tax payers gave the response. These responses are listing in the following sections:

### Group A [Tax experts]

S.N.	Response	No. of respondents
1.	To calculate the taxable income To verify the position of the entity	1

### Group B [Tax Administrators]

S.N.	Response	No. of respondents
1.	To calculate the net income	1
2.	To calculate the taxable income To verify the position of the entity To analyze various matters	1
3.	To identify real profit and loss	1
4.	For invoices and documents	1

### Group C [Tax Payers]

S.N.	Response	No. of respondents
1.	To calculate the tax liabilities	1
2.	To maintain relation with the suppliers and Government To know the actual expenses To maintain good relation between government And suppliers	1
3.	Because per capita income of Nepalese people is very low.	1
4.	Because of wear and tear of machinery and tools Because of barred of debt Because not specification of entertainment expenses	1

From the above listing, it can be concluded that the need for deduct the expenses were: To calculate the tax liabilities, evidence and accuracy. to identify profit and loss, being very low per capita income of Nepalese people. One respondent of group C [in S.N. 4] has given the deducting depreciation, bad debts and entertainment expenses.

#### **4.3.9 Suggestion of Respondents to Improve Tax Management**

Income tax management of Nepal is considered as ineffective. So tax management should be improved. To improve it, there may be so many ways. To get the suggestion from respondents for improving tax management, a question was asked, “What is your suggestion to improve tax management?” In this question, 5 alternatives were provided and the respondents were requested to rank their suggestion according to the performance. The responses about it were:

According to the respondent’s point of view, the main suggestion among the alternatives were ranked as follows [according to higher percentages]

1. Providing appropriate training to personnel[27.21]
2. Participation of civil society in the process of tax collection[22.45]
3. Providing incentives to employees [19.73]
4. Increasing moral of the personnel [17]
5. Separate tax section to be set up by the companies [13.61]

Hence, most of the respondents were of the view that appropriate training to the employees was the main factor to improve tax management. They also focused on participation of civil society and incentives to the employees.

#### **4.3.10 Opinion Regarding the Pool System of Depreciation**

Income Tax Act, 2058 has made new provision of pool system of depreciation. In this regard one question was asked to all respondents for their view on the system. Almost all the respondents have responded this question.

All the respondents are found in favour of new provision of depreciation under new Act. They were asked to choose one options as reason, which they think is the best, however they were also allowed to express any other best reason by writing in others. Their view has been tabulated as below:

**Table No. 4.3.12**  
**View on the Pool System of Depreciation**

S.N.	Options	No.	%
1.	New Act has made easier to classify the assets and has avoided the confusion	48	78%
2.	Grouping of Intangible assets is logical	0	0%
3.	Depreciation rate is scientific	12	22%
	Total	60	100%

Source: Opinion Survey

From the table 4.3.12, it can be concluded that most of the respondents think that new provision of depreciation has made under easier in classifying the assets and it has included all type of depreciable assets. the percentage of this view is nearly 78 percent that is more than the depreciation rate under the new act is scientific. The percentage of such respondents is 22. But none of the respondents are in the brief that the provision is good because of intangible assets have also been grouped under block E. Some of the respondents have also written that the single method (diminishing balance method) to follow the depreciation is also clear than previous act's option for both straight line and diminishing balance method. It is to be noted here that present act has provisioned straight line method of depreciation to the intangible assets under block E.

### 4.3.11 Opinion on the Appropriateness of New Provision on Interest Expenses

Income Tax Act 2058 has made different process to follow while calculating the interest expenses as admissible expenses. In this regard, one question was asked to all respondents that whether or not the new provision regarding the interest expenses is appropriate than previous one. The respondents profile has been presented in table no. 4.3.13.

Hence from the table no. 4.3.13, it is seen that a high percentage of respondents as a whole are feeling comfortable with the provisions regarding interest in new tax Act. The percentage of consents is seen 85, where as small number of respondents 15 percent have stood themselves in against of the provisions and have said that better provision was in previous Act. And mainly because they have said that controlled entity case has created confusion otherwise it is appropriate. They have also given an example of Garmin Bikash Bank that is functioning under the controlled entity of Nepal Rastra Bank. If we look in Micro level same percent of tax administration and 80 percent of tax experts have said that the provision is appropriate than previous one.

**Table No. 4.3.13**  
**Appropriateness of New Provision of Interest Expenses**

	Yes		No		Total No.	%
	No.	%	No.	%		
Tax payers	23	80	7	20	30	100
Tax Administration	20	100	0	0	20	100
Tax experts	8	80	2	20	10	100
Total	51	85	9	15	60	100

### **Findings of Empirical Investigation:**

- 1] Income tax administration of Nepal is considered as unsound. Main causes of unsound income tax administration are lack of trained employees, shortage of income tax experts / professionals in tax administration and lack of public participation.
- 2] Income tax rates of Nepal are considered as medium. Most of the tax experts and tax administration were agreed that the income tax rates are medium whereas most of the tax payers were agreed on high income tax rate.
- 3] Exempted items in Nepal are sufficient.
- 4] Current exemption limit is not appropriate according to the income, most of the respondents were suggested to provide Rs 175000 and Rs 200000 as exemption limit for individual and a family respectively.
- 5] Family exemption limit must be provided according to the number of dependents.
- 6] Agriculture income should be exempted from income tax.
- 7] Exemption limit should be adjusted according to the inflationary situation of the country.
- 8] Average respondents were suggested for itemized deduction and average respondents were agreed on that there is sufficiency of itemized deduction.
- 9] All expenses, which are related to earning income, must be prioritized for deduction.
- 10] Most of the respondents were familiar with the present depreciation system.
- 11] Main problems and weaknesses of Nepal income tax system are lack of trained employees, lack of cooperation in tax administration.
- 12] are not sufficient in all respects. Improvement is needed in language, law, tax administration exemption limit, depreciation etc.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.1 Summary**

On the basis of preceding chapters some important finding can be drawn. The major findings of this research are summarized bellow:

- 1] Government revenue is the composition of external revenue and internal revenue. Internal revenue includes both tax and non tax revenue. There is dominant share of total tax revenue in Nepalese government revenue. But the contribution of total tax revenue tax shows the decreasing trend as it had contributed 81.73 percent in 2032/2033 on total revenue but it was increased to 83.59 percent in 2064/2065.
- 2] Nepalese total tax revenue is the composition of total direct and total indirect tax revenue. There is dominant role of total indirect tax revenue in Nepalese total revenue. The contribution of total direct tax and total indirect tax revenue were 19.30 percent and 80.70 percent respectively in 2051/2052, which become 48.75 percent and 79.08 percent in 2064/2065.
- 3] Income tax has been considered as a major source for the collection of government revenue and mobilizing internal resources. It may enhance the revenue of government, promote distributive justice and encourage private sector investment.
- 4] In Nepal, the coverage of income tax is very low. Agricultural income is exempted from income tax. Exclusion of agricultural income from the tax net alone cuts out about half of the GDP. In other hand, labor tax is taxed more heaving than the capital income. Retirement amount received by Nepalese people being retire from the service by army/

police of foreign country is also exempted from income tax. Exemption of these sources provided loopholes tax evasion

- 5] Some exemptions granted to achieve certain objectives are not effective. Tax incentive is one of the examples of this. Tax concessions encourage the establishment of industries in certain area but they vanish or change names, ownership or place the business when the tax concession facility expires.
- 6] For the purpose of calculating the income of person for an income year from a business or investment all the interest are allowed for deduction. But in the case of an exempt – controlled resident entity, it may deduct the amount of interest but not exceeding the some of all the interest derived by the entity during the year that is to be included in calculating the entity’s taxable income for the year, and 50 percent of entity’s taxable income for the year calculated without including any interest derived by the entity or deducting any interest by the entity. It is an unlawful step to business not to get the deduction of full amount of interest. Here a controversial condition exists between the law of banking and law of income tax does not give the deduction of full amount of interest for an income year.
- 7] For the purpose of calculating a person’s income for an income year from any business, no deduction is otherwise allowed for the cost of trading stock except the allowance determined by subtracting the amount of closing value of trading stock of the business from the opening value of trading stock plus the cost of trading of the business acquired by the person during the year.
- 8] For the purpose of calculating the income of a person for an income year from any business, employment or investment, the following expenses are not allowed for deduction:
  - ) Expenses of domestic or personal nature,
  - ) Income tax,

- ) Expenses made on deriving amount exempt under section 10 or final withholding payments,
- ) Distribution of profit by an entity,
- ) Expenses of capital nature,
- ) Foreign income tax and any other amount
- ) Any other amount to the extent to which a deduction is not denied by the above paragraph, has not defined and clarified the amount.

This kind of provision will provide loopholes for tax administration and tax payers. A person whose annual turnover for an income year exceed Rs 2000000 is not allowed a deduction for a cash payment is excess of rs 50000 incurred at once other than in the following condition by the person during the year:

- ) Payment made to NG,
- ) Corporation owned by NG,
- ) A bank or financial institution,
- ) A retirement contribution or retirement payment,
- ) A farmer or a producer producing primary agricultural products even in the cash were the product is primarily process by the farmer himself,
- ) In an area where banking services are not available,
- ) In cash or on a day when the banking service are closed of into a bank account of the payee. It means that the payment made with ignorance will not get full approval as expenses,
- ) For the purpose of tax calculating these amounts shall be added back.

10] Income tax administration of Nepal is not sufficient enough due to various cases. Major causes are:

Lack of trained employees,

- ) Shortage of income tax experts/ professional in tax,
- ) Lack of public participant,
- ) Faulty organizational structure of tax administration,

- ) Weakness in government economic policy,
  - ) Defective income tax act etc.
- 11] Income tax system of Nepal is suffering from various problems and weakness such as:
  - ) Lack of trained employee,
  - ) Lack of cooperation in tax administration,
  - ) Increased corruption,
  - ) Voluntary compliance,
  - ) Ambiguous provision under the Nepalese Income Tax Laws,
  - ) Limited tax base,
  - ) Difficult to maintain the account for tax purpose,
  - ) Relatively high tax rate,
  - ) Lack of timely adjustment of tax laws etc.
- 12] An opinion survey has been conducted in order to find out the various aspects of income tax. From the opinion survey of various respondents, the following conclusions have been drawn:

Income tax administration of Nepal is considered as unsound. Main causes of unsound income tax administration are:

- a. Lack of trained employees,
- b. Shortage of income tax expert/professional in income tax administration and
- c. Lack of public participation.
  - ) Income tax rates of Nepal are considered a medium,
  - ) Exempted items of incomes are sufficient,
  - ) Current exemption limits of an individual and family are not sufficient and appropriate,
  - ) Family exemption limit must be provided according to the inflationary situation of the country.
  - ) Agricultural income should be exempted from income tax.

- ) Half of the respondents were suggested for itemized deduction and were agreed on sufficiency of itemized deduction.
- ) All the expenses, which are related to earn income, must be prioritized for deduction.
- ) Most of the respondents were familiar with present depreciation system.
- ) Lack of trained employees, lack of cooperation in tax administration, voluntary compliance and increase corruption are the major problem and weakness of Nepalese income tax system.
- ) Provision made under the Nepalese income tax is not sufficient in all respects. Improvement is needed in language, laws, and, tax administration, exemption limit etc.

## **5.2 Conclusion**

Developing countries like Nepal are facing serious problems in the process of economic development. Lack of sufficient financial resource is the main constraint for economic development of Nepal. A lot of funds are required to meet the objective of the economic development. But the Nepal is not being able to collect necessary fund. Due to poor performance on internal revenue collection and mobilization, Nepal has been heavily relying a foreign loan and grants. The dependence is increasing which is not desirable for any economy. Thus, it is more essential to mobilize the internal fund to the optimum level.

To increase the government revenue, Nepal government is trying to extract money from people through taxation. Within tax, income tax is the most important source of government revenue. It is considered as a good remedy to cure growing resource gap problem in Nepal. In Nepal, the history of income tax is not so long. It is started only on late fifties. The income tax was introduced as a trial on business profit and the

remuneration income. The first elected government levied the first income tax and no specific act was made to define and to treat income tax. The first income tax was made only in 1956/60 since then four income acts has been implemented. From the very beginning the concept of exemptions, deductions and other forms of tax relief an income tax have emerged in Nepal. All incomes of an individual can not be taxable because the minimum cost required for subsistence can not be taxed. The exemptions, deduction and other forms of tax relief are essential to encourage and individual to work more. The tax relief works as an incentive to an individual. So the concept of exemption, deductions and tax reliefs were emerged in Nepal from the very beginning of income tax. Currently, income tax system of Nepal encompasses four taxes i.e. corporate income tax, individual income tax, house rent tax and interest tax. Among them, contribution of corporate sector is highest. Exemption limit and the rate of income tax is determined according to the income level and sector wise but it is not adjusted according to the inflationary situation of the country and number of dependents.

Income tax system of Nepal has been blamed as not efficient enough. Being various problems relating to income tax , revenue collection from income tax is low as compared to other developing countries like India, Srilanka, Pakistan etc. Nevertheless, if we analyze the data relating to it we can find out that it is neither bad nor worse but it is continuously improving. However income tax laws and administration in Nepal are to be deeply scrutinized and properly implemented. The provisions made on act to be mentioned clearly and language has to be made clear. Some reforms in tax administration are needed. If the problems relating to income tax system in Nepal can be solved and resources are effectively utilized those only the prospects of revenue

collection from income tax will be bright and the economic development of Nepal will be achieved.

### **5.3 Recommendation**

There are various problems regarding to income tax of Nepal. The major problems of Nepalese income tax system consist problem relating to income tax policies, income tax law and income tax administration. The major problem observed in present day is the problem of the efficient tax administration. In the opinion survey it was noticed that all the respondents were dissatisfied with the tax administration. The study did not look heavily in to the problems that are not related to exemption and deduction. So, the recommendation made for other than exemption and deduction and the deductions may be considered as the general recommendations. Hence, the research of this study has made the following recommendations on tax exemptions and deductions.

#### **Exemption**

- 1 To increase the income tax revenue, the present tax base must be widened by including the income from agricultural sector; retirement amount received by Nepalese people being retired from the services by army or police of foreign country and currently exempted other sources of income.
- 2 In the agricultural income, there must be some exemption limit and the income above this limit must be taxed.

The present level of income tax exemption is not appropriate. It must be raised to a minimum of Rs 1,75,000 for an individual. The recommendation is based on the assumption that the remuneration

income of section officer in a government institution must not be taxed.

The present provision of family exemption is not appropriate and fair. The government has to provide the family tax exemption in such a way that it would consider the number of family members. It should be raised to a minimum of Rs 2,00,000 for a family. The researcher recommends for providing this exemption limit for a maximum of two dependent children and the dependent parents.

The exemption limit must be adjusted according to the inflationary situation of the country on yearly basis.

There are many provision relating tax exemptions and concessions. Some concessions granted to achieve certain objectives are not effective. Tax concession encourages the establishment of industries in certain area but they vanish or change names, ownership or place the business when the concession facility expires. The incentives provide to special industries are not energetic. For this kind of concession, nobody will be encouraged to open the industry in remote area. So, the provision of investment allowances in the form of accelerated depreciation should be introduced, the investment allowances should be 25 percent per annum of the depreciable capital asset on straight line basis. Similarly, for the purpose of industrial development of remote area, a separate special package should be introduced.

10 percent of tax rebate should be provided to the taxpayers who submit true income statement within the specified period of time.

Income tax on total export amount is not appropriate because income tax must be based in income not the total amount. So, the provision of taxing on exports income should be introduced. Similarly, export fee on export transaction must be eliminated or exempted.

Double taxation on dividend must be eliminated.

Income tax Act has mentioned the organization, which are tax fee [Exempt organization]. Act has exempted a social, religious, educational or charitable organization of a public character registered without having profit motive. In the case of non-transparent private business like boarding school. NGO's or other entities, there profit are earned, but for the sake of tax planning, is called retained earning or some thing else. So, they should be taken into tax net.

retirement contributions are nothing else than the product of sacrifice of present earnings. So, they should be excluded from income tax.

Dearness allowance is given to meet the living standard of employees, it is not lawful to include in taxable income. So is should be fully exempted from income tax.

The income tax rate slab should be increase from 2 to 10 because the provision of little number of slabs in against the principle of ability to pay. The proposed slab and rate are as follows:

Slabs: (After exemption limit)

50,000	1,00,000	2,00,000	3,00,000	5,00,000
5%	10%	15%	20%	25%
7,00,000	8,00,000	9,00,000	10,00,000	balance

30%

35%

40%

50%

55%

This provision is based on equity and ability to pay principle. It may also reduce the gap between rich and the poor.

14 The provision of special fee must be eliminated.

## **Deduction**

1 Deduction allowed from an employment income is not sufficient. So, the following deduction should be provided to the tax payers whose sources of income is only the remuneration

Expenses for better education of their children.

Medical expenses made by tax payer.

Expenses made for house rent

Educational expenses for tax payers himself if his still studying in an educational institution.

Life insurance premium of tax payers.

2 Donation given to the political party registered with the election commission is allowed for deduction. But it is not able to solve to voice of people of transparency of donation amount given by businessman to political parties. So, donation amount given to political parties must be transparent.

3 Clear provisions should be made in the case of deduction. All the items of deductions should be clearly defined in the act.

4 deductions allowed from business or investment incomes are not sufficient. So, the following deduction should be provided to the tax payers whose source of income is business or investment.

- ) In the case of exempt controlled resident entity, full deduction of interest expenses is not allowed. It is not lawful step to the businessman who operates the business with loan/ debt amount. So, it should be fully allowed for deduction within an income year.
- ) The provision of adding any excess cost or part there of repair and improvement costs to the depreciation basis amount is not contextual and lawful provision because it shows that the repair and improvement cost of a depreciable asset has not get full approval of deduction. So, it should be fully allowed for deduction within an income year.
- ) To control pollution and than protection of environment, research and development is more essential and must be expended on it, expenses made on it must be approved and should be fully allowed for deduction within an income year. Government should not make standard limit on it.
- ) For successful industrial development, research and development is more essential and most be expended on it. Expenses made on it must be approved and should be fully allowed for deduction within any income year. Standard limit on it should not be made.
- ) There should be specific provision of depreciation of assets, which are taken on lease and installment basis. Act should not silent on it. Provision made on depreciation allowances must be generally understandable by all people.

) Carry forward of losses for four years is not sufficient as compared to other countries. So it must be extended up to 5 or 6 years. The provision of carry backward of losses should be considered because the accounting system of Nepal is not so standard to apply this provision.

Besides these suggestions, the following suggestions are made to compensate the loss of revenue due to the provision of additional exemptions and deductions suggested by the researcher.

1. The income tax policy should be formulated so as to match with the economic policy of the country.
2. The members involved in formulating income tax policies must have deep knowledge about income tax.
3. Timely revision and adjustments should be made in the matter of income tax policy.
4. Income tax policies should be formulated so as to satisfy the following criteria.

) It should be progressive ensure social justice.

) It must be consistent with tax administration capacity.

) It should not mitigate against national priorities and efficient resource use.

) The success or effective ness of any system entirely depends upon implementation of provisions, which is the major responsibility of administration. In Nepal, one of the most important reasons for unsound income tax system is inefficient and unscientific income tax administration. Following suggestions are made for the improvement of income tax administration in Nepal.

- ) All the tax personnel should be given compressive training on various aspects of taxation on regular basis. For this, a separate training section within tax department should be established.
- ) The performance, responsibilities, authorities and duties should be clearly defined.
- ) Financial benefits and extra incentives should be provided to the personnel to decrease corruption.
- ) Effective reward and punishment system should be established.
- ) Working environment of the tax office should be improved, Vehicle and necessary machinery should be provided.
- ) The administration should try to increase effective public participation to minimize the income tax evasion.
- ) Income tax experts/professional should be increased in tax administration.
- ) Coordination between staffs and departments must be established
- ) Delays and assessment should be reduced as soon as possible.
- ) Fair and scientific provision of promotion and career development should be introduced.
- ) The cost of collection is one of the determinants of administrative efficiency. So, the concerned authority should pay due attention on it.
- ) An integrated information system should be developed to prepare the list of potential tax payers and gathered information of various aspects relating to income tax.
- ) The system of recording by computer should be developed in income tax administration.
- ) Tax education should be provided to tax payers on regular basis.

6 Laws relating to income tax should be cleared, simple and comprehensive. It should not contain any loopholes and ambiguity; therefore it should be reviewed frequently and reformed. The following suggestions made for the reformation of existing tax laws in Nepal.

- ) The language should be simple and clear. In spite of using the vague meaningful words, clear provision should be made.
- ) The definition made in income tax act should be further clarified and well defined.
- ) The assessment and tax collection provision should be made clear and simple.
- ) The provision of fines, penalties and punishment should be made at higher rate for income tax evaders.
- ) The assessment of time limit after the submission of income statement should be reduced.
- ) Discretionary power of the tax officers must be curtailed and their rights and duties should be clarified in income tax act.

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**Appendix -II  
Table of Tax Revenue**

Heading	Fiscal Year							First Five Months		
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2005/06	2006/07	2007/08
Customs										
Imports	12552.1	12658.8	14236.4	15554.8	15701.6	15344.0	16707.6	8993.3	10204.8	14031.2
Exports	10391.9	9678.4	10567.7	10666.9	12299.1	11744.6	13626.1	8112.9	8107.2	11267.5
Indian Excise Refund	492.6	917.4	855.6	527.1	697.9	625.6	708.7	460.2	502.6	267.1
Others	1456.2	1700.9	2370.6	3882.7	2188.3	2314.4	1896.5	0.0	1312.7	2151.2
Tax on Consumption and product of Goods and Services	211.4	362.1	442.5	478.1	516.3	659.4	476.3	420.2	282.3	349.1
Excise on Industrial Products	16153.6	16074.3	18244.8	20705.6	25331.3	28118.3	35438.8	17869.6	20942.2	24181.2
Value Added Tax	3771.28	3807.0	4785.1	6226.7	6445.9	6507.6	9343.2	4156.5	5213.6	6462.1
Land Revenue and Registration	12382.4	12267.3	13459.7	14478.9	18885.4	21610.7	26095.6	13713.1	15728.6	17721.2
Land Revenue	612.9	1131.8	1414.3	1697.5	1799.2	2181.1	2253.5	1207.3	1111.3	1348.1
House and Land Registration Fees	5.1	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax on Property, Profit & Income	607.8	1131.0	1414.3	1697.5	1799.2	2181.1	2253.5	1207.3	1111.3	1348.1
Income Tax from Public Enterprises	9546.5	9465.7	8691.5	10215.1	11272.6	11787.0	16726.8	5870.0	8292.0	11331.2
Income Tax from Semi Public Enterprises	2928.5	1769.3	1251.0	2056.6	1332.4	195.7	1019.7	160.9	331.9	137.1
Income Tax from Private Corporate Bodies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income Tax from Individuals	1924.3	1412.0	1236.3	1531.3	2467.8	3404.3	5717.1	1536.7	2200.2	3645.1
Income Tax from Remunerations	3200.5	4419.1	3362.3	3533.4	3926.3	4234.7	5234.4	2946.3	2717.0	3393.1
Urban House and Land Tax	597.3	835.6	1252.6	1391.2	1775.9	1764.1	2007.9	0.0	1144.9	1428.1
Vehicle Tax	2.9	2.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax on Interest	429.6	559.7	559.5	700.6	806.5	847.6	995.0	0.0	762.3	877.1
Other Taxes	463.9	467.7	864.0	733.4	757.0	774.9	1054.9	491.7	693.9	751.1
	0.0	0.0	165.8	268.6	306.7	565.7	697.8	734.4	441.8	1101.1
<b>Total</b>	<b>38865.1</b>	<b>39330.6</b>	<b>42587.0</b>	<b>48173.0</b>	<b>54104.7</b>	<b>57430.4</b>	<b>71126.7</b>	<b>33940.2</b>	<b>40550.3</b>	<b>50891.2</b>

Provisional

Note: Value Added Tax Includes Sales Tax, Hotel Tax Air Flight Tax And Contract Tax

Sources: Financial Comptroller General Office

## Table of Non- Tax Revenue

Holding		Fiscal Year							First Bight Months		
		2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2005/06	2006/07	2007/08
1	Charges Fees,	386.7	518.8	579.6	1202.5	1359.9	1927.7	1945.4	1017.70	1128.40	1639.20
	Fines and	60.0	71.9	78.7	85.1	119.6	147.0	204.3	100.10	138.50	178.30
	Forfeiture	1.5	1.4	1.6	2.4	3.7	3.6	4.5	2.30	2.90	3.60
	Firm	95.0	111.1	119.5	635.4	635.9	677.4	850.3	452.90	515.90	889.10
	Registration	106.8	192.2	104.3	102.1	119.1	506.8	196	106.70	108.90	93.60
2	Arms	123.4	142.2	275.5	377.5	481.6	592.9	1690.3	355.70	362.20	474.60
	Registration							0	0.00	0.00	0.00
3	Vehicle	2728.0	2611.1	3063.0	3497.0	3849.9	3932.4	4776.8	2664.20	3057.30	2947.30
	License	9.1	6.5	5.6	5.3	5.0	3.7	3.8	2.50	2.10	2.00
	Judiciary	1.1	1.3	1.4	0.6	1.1	1.3	1.3	0.50	0.50	0.40
	Administration,	0.0	0.0	0.0	0.0	0.0	0.0	0	0.00	0.00	0.00
	Penalty,	229.6	230.3	219.9	247.0	245.7	246.3	226.8	177.00	161.10	136.60
	Forfeiture	50.6	45.9	42.3	42.0	43.6	57.2	48.2	35.80	25.00	23.80
	Receipts From	94.0	128.0	112.3	128.7	141.2	143.1	219.8	136.10	202.50	176.00
	sales of	602.6	546.2	683.6	674.1	553.7	410.2	510.3	247.40	297.90	168.60
	Commodities	86.3	99.9	93.5	131.6	133.7	116.8	102.6	81.50	69.50	61.70
	and Services	1654.7	1553.0	1904.4	2266.9	2720.9	2953.8	3664	1983.40	2298.70	2278.20
	Drinking Water	2336.5	2512.9	2497.6	2661.1	4589.9	3394.8	4937.7	1535.10	1233.30	2188.50
	Irrigation	2076.3	2281.8	1904.3	1103.1	1242.5	1313.9	3430.5	1002.60	1001.40	1501.60
	Electricity	13.4	8.8	11.0	9.1	3.1	4.7	0.6	2.90	0.00	0.00
	Postal Service	0.0	0.0	6.1	3.0	40.8	3.2	30	1.60	30.00	80.30
	Food and	226.6	1.6.8	576.2	1510.3	3303.5	2073.0	1476.6	528.00	201.90	606.60
Agriculture	20.2	60.5	0.0	35.6	0.0	0.0	0	0.00	0.00	0.00	
Education	949.6	723.9	1945.4	1465.0	90301.4	1196.8	1091.8	353.60	533.50	1451.10	
Forest	5.4	15.3	11.9	9.8	34.0	13.6	16.7	9.20	9.90	9.90	
4	Transport	483.1	637.2	1142.1	1002.2	33.1	933.6	1003	311.90	478.40	716.50
	Others	461.1	71.4	791.4	453.0	564.3	249.6	72.1	32.50	45.20	724.70
	Dividend	0.0	0.0	0.0	0.0	0.0	0.0	0	0.00	0.00	0.00
5	Financial	0.0	0.0	0.0	0.0	0.0	0.0	0	0.00	0.00	0.00
	Institutions	3497.2	3109.5	2464.3	3507.1	2714.3	3251.3	2085.7	665.80	747.70	1148.60
	Trading	2050.6	1880.7	1516.7	1826.7	1238.4	1510.5	1009.7	171.50	289.60	988.20
	Concerns	1437.1	1206.8	911.2	1654.0	1453.0	1732.9	1057.3	490.30	444.10	156.50
	Industrial	9.5	22.0	36.4	26.4	22.9	7.9	18.7	4.00	14.00	3.90
6	Undertakings	130.8	1638.8	3092.8	1825.3	1572.6	1148.7	1748.1	610.70	788.70	618.80
	Services Sector	130.8	1638.8	3092.8	1825.3	1572.6	1147.7	1748.1	610.70	788.70	618.80
	Others										
	Royalty and										
	Sale of Fixed										
	Assists										
	Royalty from										
	Mining										
	Royalties and										
	Sale of Fixed										
	Assists										
	Other Sales										
	Mint										
	Others										
	Principal and										
	Interest										
	Payment										
	Loan										
	Corporations										
	Interest from										
Loan to											
Companies &											
Corporations											
Others											
Miscellaneous											
Items											
Miscellaneous											
Total		10028.8	11115.0	13642.7	14158.2	16018.0	14851.7	16855.5	6847.10	7488.90	9993.50

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**Source: Financial Comptroller General Office**

**Table 1.7: GDP by Expenditure Category  
(At current price)**

Expenditure	Fiscal Year							
	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Gross Domestic	441519	441519	459488	481003	496026	514460	530890	555850
product at	390017	405389	421043	428452	446957	472949	485582	498617
producers price	35785	38586	42652	46397	46973	47328	50641	52911
Total	25376	27857	31375	33960	31008	30920	33084	36075
consumption	10409	10729	11277	12437	15965	16407	17556	16836
<b>Government</b>	348989	360947	371421	374057	392219	417244	425422	436109
<b>consumption</b>	205904	211341	218227	221113	233092	248307	252470	258632
Collective	100160	105392	108648	108153	110002	113589	114702	117596
Consumption	42926	44214	44546	44790	49125	55347	58249	59881
Individual	5243	5855	6970	7998	7765	8377	9519	9596
consumption	364641	377532	389669	394492	415950	442028	452497	462542
<b>Private</b>	98649	84808	90298	106047	114371	117179	127834	160104
<b>consumption</b>	84751	84863	88069	90949	91427	101569	103512	109758
Food	18063	16464	13218	12458	13389	13121	14536	16215
Non-food	66687	68398	74852	78491	78038	88448	88975	93543
Service	13899	55	2229	15098	22944	15609	24322	50345
<b>Nonprofit</b>	-47147	-48148	-51853	-53495	-65302	-75669	-82525	-102869
<b>institutions</b>	146757	124660	124734	135323	144647	153987	162256	179420
<b>Actual final</b>	126238	106025	107452	113725	121307	128962	133454	142807
<b>consumption</b>	20519	18635	17282	21598	23339	25026	28802	36614
<b>expenditure of</b>	99610	76512	72881	81828	79344	78318	79731	76550
<b>household</b>	69789	54440	47871	50469	55343	54748	52802	47814
<b>Gross capital</b>	29822	22072	25009	31359	24001	23570	26929	28736
<b>formation</b>								
<b>Gross fixed</b>								
<b>capital</b>								
<b>formation</b>								
Government								
private								
<b>Change in stock</b>								
<b>Net exports of</b>								
<b>goods and</b>								
<b>services</b>								
<b>Imports</b>								
Goods								

Services								
<b>Exports</b>								
Goods								
Services								

P= Preliminary, R=Revised  
Source: Central Bureau Of Statistics

