

# CHAPTER - 1

## 1.1 General Background:

**Nepal** is a sovereign, secular and landlocked country. Today's most important factor is to make it highly developed by bringing massive improvement on political, social and economic sector.

The country is facing economic crisis. The country has to manage massive economic resources for accomplishment of its national responsibility. It seems as a dangerous situation for Nepal to rely upon foreign aids and loans for budgetary purpose. It is necessary to expand its own revenue sector for the management of its uncontrollable expenses. Tax is an important tool of income source. The main objective of tax administration is to create stability in economy by raising more revenue with widened tax base and appropriate tax rate. Objectives of the 10<sup>th</sup> plan concerned to revenue broadening tax base, maximum mobilization of domestic resources and gradually reducing dependency on foreign assistance.

Income tax is a main part of revenue source. Authority related to levy tax; tax rebate and increasing tax are instituted by constitution, act and rules. The constitution of our country has given right to parliament (legislative) to introduce and amend tax act. It is given right to the government (council of ministers) to introduce regulation regarding tax for implementation of tax act.

Privy Council has defined income as "Amount derived from definite source. That source is not necessary to be productive but the purpose should be fruit full or profitable. Amount gained accidentally is not income." There are different concepts of deriving incomes. Anyone has said income obtained from any source While, anyone has assumed income getting without source. At present, income derived from any source or assets is defined as income to collect revenue. Irving Fisher has defined income as an instrument of getting pleasure psychologically.

Hicks defined income as a movement of capital. According to Seligman "Taxation is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit concerned" (DHAKAL 2049)

Nepal is an economic paradox in the sense that it is a rich country where poor people live. It has riches of natural and cultural beauties but the economic condition is far behind. Her economy is predominantly based on agriculture. Large portion of population who live under the line of poverty are village people.

One of the least developed countries Nepal cannot successfully tear a curtain built from massive poverty. Hunger, diseases, unemployment, heavy dependence on agriculture, lack of adequate industries, low income level and social, political and geographical constraints over 50 years of planned development. Yet, Nepalese economy is suffering from inactive and effortless plan, program and policy of development and is also fighting against whatever bottlenecks identified before the starting of planned period (DAHAL, 1996:2-3)

In each country, a lot of fund is spent 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 ammunition, maintenance of army or police and administration of justice and jail. The government for the public interest also incurs commercial expenditures. The third type of public expenditure is developed expenditures. This is the expenditure made on provide education, health utility facilities to the community (Vaish and Agrawal, 1992). The nation will be achieving maximum social welfare if it has sufficient funds.

Regular expenditures of our country take 57% of the total budget, for development projects 43% of budget is not sufficient. Among them 68% development projects depend upon foreign aid and assistance. To fulfill this amount and to stand on own foot, government should collect revenue from people (Budget Speech 2061\62). The government collects revenue for its self reliant economic system to upgrade its living standard of people. The source of government can be classified in external and internal. External source of government revenue are foreign loans, grants, external borrowing etc. External source are uncertain and inconvenient and not good for healthy development because they have to pay after a certain period of time. So, it is better to mobilize internal source rather than external source. Internal source of revenue is composed of tax and non tax revenue. The examples of non tax revenue are fees, fines, royalty, administrative and business income etc. Administrative income denotes the income charged by the government for providing administrative services. Business income means the return received by the government for providing various goods and services to the people. In the Nepal the contributions of non tax revenue on national revenue is 22.7 percent in fiscal year 2003/04 which was 14.80 percent in the fiscal year 1982/83 (Economic survey, various years). Tax revenue is the important source of government revenue. Custom excise, value added tax (VAT), corporate and personal income taxes are the source of tax revenue. The contributions of tax revenue to the total revenue is 77.28 percent in fiscal year 2003/04 and that was 80.20 percent in fiscal year 1982/83 (Economic survey various years).

Taxes are also classified into direct and indirect tax. According to Dalton "A direct tax is one which is really paid by person on whom it is legally imposed while an indirect tax is imposed on one person, but paid partly or wholly by another, owing to consequential change in terms of source contract or bargaining between them" (LEKHI 200:190). Tax payer cannot collect direct tax from other person. Income tax, Interest tax, contract tax, vehicle tax are some examples of direct tax. Direct tax is paid according to the income or property earn by a person. Tax Payer can collect indirect tax with other person. So, impact and the incidence of tax are different on different persons. In Nepalese tax structures, indirect tax includes custom exercise duties, VAT etc.

Income tax is the most important single source of revenue, though it is produced for less revenue in the most developing countries than other custom duties and taxes internal transaction. But these taxes are emphasized in all countries, because they have potential for increasing the yield of tax system and achieving a system of taxation that satisfies the demand for equity and social justice. (Singh, 2001:283). Income tax may be levied on the individual as well as business form. The former is known as the personal or individual income tax or simply income tax, while the later is more popular by the name of corporate income tax or corporation tax.

Income tax is the tax of equity. It is imposed on the basis of paying capacity of the payers. So, it will be possible to reduce the gap in income by imposing higher rate to those who are having higher income and from that collected amount, providing necessary assistance to the people with very poor economic condition.

### **1.2 Statement of Problem:**

Like other developing countries in the world, Nepal has been suffering from resources constraints, massive poverty, rapid growth of population, increasing frictional and seasonal unemployment, disease, aggressive dependent on the agriculture, subsistence living standard and poor infra structure over five decades(52 yrs) planned development effort.

A government needs development with higher economic growth to overcome from such serious problem for which government should have adequate financial resource. In Nepal, resource mobilization is still poor that does not cover the requirements. Nepal has been facing serious problem of resource gap and high dependency on foreign loan. Resource gap has incurred in Nepalese finance because the expenditure of government of Nepal has been increasing at a faster rate than the increasing in revenue. The resource gap is widening continuously with the increment of total expenditure in respect to total revenue collection. The resource gap was Rs. 4137.6 million in 1982/83 and in 1992/93 it was Rs 15749.3 million. It further widened to Rs 27111.60 million in 2003/04 (budget speech of government of Nepal, various years). To meet the growing national expenditure, government manages its funds from internal and external source. Such external sources are an uncertain, inconvenient and not good for healthy development in case of high dependency. It is better to mobilize internal source rather than expecting with beggars eye to donors.

Therefore, to raise government revenue it is necessary to raise its internal sources of revenue. Internal source of revenue constitute tax and non tax revenue. The contribution of tax revenue in the national revenue was 77.28 percent in fiscal year 2003/04 and that was 79.49 percent in fiscal year 2000/01. Government revenue is totally based in taxation revenue and it had declined in fiscal year 2003/04 which was not desirable indication (economic survey, 2004/05). Government has adopted various policies to strengthen the revenue structure of Nepal. Government implemented self-tax assessment system to enhance the government revenue although there is higher tendency of income tax evasion. The government has received 15 Billion income taxes by VDIS (Voluntarily Declaration Income Scheme) from Shrawan, 2065 up to Falgun, 2065. But the government has not made the policy of VDIS that the payer's source of income should not be inquired. From this system more and more revenue could be received. In the recent years, the contribution of income tax to total revenue is only about 16 percent in Nepal, which is very low contribution compare to developed countries (based on data of years 2001/02, 2002/3 & 2008). The contribution of income tax to GDP is only about 2 percent. There are many problems in Nepalese income tax system. Government can increase its income tax revenue through inefficient tax administrative system, wide spread income tax evasion, complicated & frequent change in tax rate and in policies are appearing a major factor for low contribution income tax revenue to national revenue.

Nepal depends upon the external sources more than on the internal source. The available resources do not meet the estimated budget fulfilling the aspiration of the people and constructing the social welfare state. Therefore, there is need of improvement of income tax collection system to mobilize internal sources that is also considered as the optimal solution of resource gap and high dependency on foreign loan. Nepalese tax system to mobilize the internal resource in optimal level is fundamental need of the country but appears very poor and inefficient picture.

### **1.3 Need of the Study:**

The importance of income tax cannot be minimized in the public finance of a nation. Developing countries, like Nepal can fulfill its financial needs by increasing its revenue through income tax. Revenue from income tax can be maximized either by imposing taxes at higher rate, or introducing new taxes or collecting income tax properly within existing portfolio. Increment in income tax rates may be more burdensome to the people. Moreover, the poor people collection of tax depends on good income tax system (Laws, policy and Management). Unfortunately, Nepal's income tax system is not free from problems. Though, this field is of high importance, sufficient and timely researches are not being made in this field so far.

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

The main objectives of present study are as following.

1. To analyze contribution of indirect tax and direct tax in total tax revenue
2. To find out the share of income tax in total tax revenue.
3. To examine the effectiveness of income tax revenue collection in Nepal.
4. To know views of the taxpayer, tax experts and tax officers about various aspect of present income tax.
5. To examine the administrative aspects of income tax in Nepal.
6. To recommend some measures to improve the effectiveness of income tax.

### **1.5 Scope of the study:**

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

1. Nepalese tax structure.
2. Role of income tax in Nepal.
3. Administrative aspects of income tax in Nepal.
4. Government revenue from direct tax and indirect tax.
5. Existing position of income tax in Nepal.

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

The present study is not free from the limitations. The limitations of this study are as follows;

1. The field survey was based on Kathmandu, Nepalgunj & Surkhet only. So this study may not represent the country as a whole.
2. The study has covered data of income tax only of fiscal year 1982/83 to 2003/04.
3. Absence of required data concerned with income tax of various countries limits to detail studies.



### **1.7 Organization of the study:**

This study has organized in six chapters. This study includes an introduction, conceptual framework, legal provision and review of related literatures; research methodology; income tax administration of Nepal: analysis and presentation of data and summary, conclusion & recommendations.

The **first chapter** is introduction chapter, which includes general background, statement of problem, objectives, scope and limitation of study.

The second chapter is about the conceptual framework, legal provision and review of literature regarding income tax. This chapter content concept of tax, concept and meaning of income tax, income tax in international context, legal provision of income tax in Nepal. This chapter also includes the review of literature through different relevant books, journals and unpublished dissertations.

The third chapter is research methodology that includes types of research, research design, population and samples, nature and source of data, data collection procedure and data processing and analysis procedure.

The fourth chapter contains evolution and development of income tax and administration in Nepal, Inland Revenue department and its organizational structure, Inland Revenue offices, declared objectives, target and policy of Inland Revenue department, power of director general and other officers, right of tax payers.

The fifth chapter is the main body of research that is data presentation, and analysis and empirical investigation. The content of this chapter are resource gap in Nepal, tax-GDP ratio, Nepalese government revenue structure, composition of tax revenue in Nepal, composition of indirect tax revenue, composition of direct tax revenue, composition of income tax, contribution of income tax of direct tax revenue, tax revenue, total revenue and GDP, income tax collection performance in Nepal, exemption limit and personal and corporate tax rate. This chapter also concerned about the empirical investigation and major findings. It deals on the analytical approach towards the responses of the questionnaire.

Summary, conclusion and recommendations are presented in the sixth or last chapter. On the basis of the study, certain measures would be found out and suggested for the further improvement of income taxation in Nepal.

## Chapter-2

### CONCEPTUAL FRAMEWORK, LEGAL PROVISIONS AND REVIEW OF LITERATURE

#### **2.1 Conceptual framework:**

##### **2.1.1 Concept of tax:**

The government of a country requires sufficient revenues to carry out development plans, to handle day-to-day administration, to maintain peace and security and to launch other public welfare activities. In order to carry out such activities, the government collects revenues from various sources such as tax, revenues from public enterprises, special assessment, fees, fines, grants and assistance etc. among them, tax is the main source of government revenue. Just like the circulation of blood in a body, money activates the different organs of the organization. When there is no money; no departments or lower level offices of the government work as the parts of the body stop working when there is no blood circulation. The government collects revenue from different sources like tax, price of goods or services provided by the government, receipt from public enterprises, fees, fines, grants etc. in short, all the sources of the government revenue can be divided into two parts- tax and non tax. Tax is the major source covering most part of the government revenue.

Tax is a kind of money of which it is the legal duty of every citizen of a country to pay honestly. Many economists are of the view that the tax is a compulsory payment to the government by taxpayer without any expectation of some specified return.

According to Findlay Shirras, "Tax is contributions to public authorities to meet the general expenses of the government which have been incurred for the public good and without reference to special benefits." (Lekhi, 200:146)

According to Plehn, "Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefit upon the residents of the states." (Dhakal, 1998:2)

According to Professor Saligman, "A compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred." (Lekhi, 2000:146)

From the definitions given above, it is clear that a tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the tax paid. The taxpayer cannot receive equivalent benefit from the government. Amount collected through taxation is spent for common interest of the people and it is collected from natural and artificial person.

Tax revenue constitutes direct and indirect tax revenue. An indirect tax is imposed on one person but paid partly or wholly by another. The examples of indirect taxes are customs, excise, contract tax value added tax etc. indirect tax is transferable. People pay tax when they receive or consumed goods or services. Therefore they don't feel burden to pay lump sum. There is mass participation because every person who receives goods and services, pay tax. Indirect tax is flexible. Indirect tax can charge at higher percent to discourage the harmful goods.

There is uncertainty about the collection of indirect tax. Every person either rich or poor pay equal amount of tax on receipt of goods or services. Therefore, it seems as regretful

for poor people. If tax imposed on higher rate, consumption reduces and also effect badly on production and employment.

A direct tax is really paid by the same person on whom it is legally imposed. Taxpayer can not collect direct tax from other persons. Income tax, interest tax, contract tax, vehicle tax are some examples of direct tax. Direct tax is paid according to the income or property earned by person. So it is found equal with and property. There is certainty about the time, design or process of payment of direct tax. Taxpayer can easily estimate his tax liability, government can easily increases or reduce according to needs. Taxpayers pay tax fro their own property, so they conscious about their contribution.

Taxpayers cannot collect direct tax from other persons and pay from their own property. Therefore, taxpayers feel pinch ad they don't ready to pay voluntarily. They try to pay lowest tax as possible as and also exercise for tax evasion. It is expensive for collection. There is lack f mass participation in case of direct tax. Direct tax discourages private saving and investment.

Income tax is a direct tax. In case of Nepal, income tax is the major source of direct tax revenue.

### **2.1.2 Objectives of Tax:**

Tax is a permanent instrument of collecting revenues. It is a major source of revenue in developed world and has been appearing as an important source of revenue in the developing world as well. It has been as instrument of social and economic policy of the government. The main objectives of tax are: (Bhattarai, Koirala, 2061)

#### **i To raise more revenue:**

The government requires carrying out various development and welfare activities in the country. For this, it needs a huge amount of funds. The government collects funds by imposing taxes. So, raising more and more revenues has been an important objective of tax.

#### **ii To prevent concentration of wealth in a few hands:**

Tax is imposed on persons according to their income level. High earners are imposed on high tax through progressive tax system. This prevents wealth being concentrated in a few hands of the rich. So, narrowing the gap between the rich and the poor is another objective of tax.

#### **iii To redistribute wealth for the common good:**

Tax collected by the government is expended for carrying out various welfare activities. In this way, the wealth of the rich is redistributed to the whole community. Tax helps in redistributing wealth in the country.

**iv To boost up the economy:**

Tax serves as an instrument for promoting economic growth, stability and efficiency. The government controls or expands the economic activities of the country by providing various concessions, rebates and other facilities. The effective tax system can boost up the economy.

**v To reduce unemployment:**

The government can reduce the unemployment problem in the country by promoting various employment-generating activities. Industries established in remote parts of various employment-generating activities. Industries established in remote parts of industries providing more employment are given more facilities. As a result, the unemployment problem can be reduced to a great extent through liberal tax policy.

**vi To remove regional disparities:**

Regional disparity has been a chronic problem to the developing countries like Nepal. Tax is one of the way through which regional disparities can be minimized. The government provides tax exemptions or concessions for industries established or activities carried out in backward areas. This will help increase economic activities in those areas and ultimately regional disparity reduces to minimum. (Bhattarai, Koirala, 2061)

**2.1.3 Canons of Taxation:**

There are different views regarding the requirements in a good tax system. Adam Smith's view in this respect is generally accepted as the characteristics of a good tax system. The canons that are given by Adam Smith are as follows: (Kandel, 2003)

**i Canon of equality:**

One of the Adam Smith's canon of taxation is the canon of equality emphasizing on paying the tax on the basis of the ability to pay. In the words of Adam Smith himself, "The subjects of every state ought to contribute towards the support of the government, a nearly as possible, in proportion to their respective abilities".

Canon of equality says that the people should contribute to the government as per the benefits that they get from the government.

**ii Canon of certainty:**

Another quality of tax system as laid by Smith is the canon of certainty. Certainty, in the words of Smith is related to the time, method, manner and quantity of paying the tax in his own words,

"The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person".

**iii Cannon of simplicity:**

Simplicity is another quality that should be in a tax system. Most of the taxpayers are ordinary people who neither have sufficient tax-related knowledge nor the capacity to hire tax experts. That is why the tax system should be of such type that can be followed by ordinary people in the society. In this respect, Adam Smith says, "Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay".

**iv Cannon of economy:**

Adam Smith says, "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible. Over and above what it brings into the treasury of the state".

That means, the cost of collecting the tax should be very small. There should be minimum difference between the amount that people take out of their pocket to pay tax and the amount that actually goes to the state treasury.

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

**v Cannon of Productivity:**

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

**Vi Cannon of flexibility:**

Flexibility indicates two things. First, a tax system should have the characteristics of revenue elasticity. There should be built-in tie-up between the economic activity of a country and revenue mobilization. Higher the economic activity, higher will be the revenue. Second, the tax system should be of that type which provides revenue as per the necessity of the situation. If there is need of higher revenue, the tax system should provide as per the needs.

**Vii Cannon of diversity:**

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

**Viii Cannon of simplicity:**

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

**ix Cannon of uniformity:**

Uniformity in this contest means uniformity in depreciation system, tax rate, stock valuation system, accounting method, dividend distribution system, accounting system,

appeal and penalty system, method of payment of tax and time of the payment of tax (Kandel, 2003).

#### **2.1.4 Concept and meaning of income tax:**

Taxes on income are the most important single source of revenue for government of developed and also developing countries either it contributes more or less.

The first problem encountered in establishing an income tax is the definition of income. Income, as the economic gain received by the person during the particular period, is most satisfactory defined by Henry Simons as the algebraic sum of two items:

- A. The person's consumption during the period, and
- B. The net increase in the individual's personal wealth during the period

Symbolically,  $Y=C + \Delta W$

Where, Y, C and W refer income, consumption and change in wealth respectively. It is very difficult to define income precisely and clearly. So, income is exemplified rather than defined income tax laws of various countries. For example, section 2 of the Indian tax act, 1961 keeps profit and gains, dividend, voluntary contributions received by charitable trust, value of any perquisite or profit on lieu of salary, any capital gain, winning from lotteries, crossword puzzles etc. under the head income. According to Income Tax Act, 2002, section 2(h), income means a person's income from any employment, business or investment and the total of that income as calculated in accordance with this act.

#### **2.1.5 Income Tax in the International Context:**

Income tax was first introduced in Great Britain in 1799 in order to finance wars with France. Only after 1880, it was accepted as a permanent tax. In the United States of America, first federal income tax was imposed in 1862 to finance civil war expenditure. However it became a permanent feature only in 1913 after 16<sup>th</sup> amendment to U.S constitution. In neighboring country India, at first income tax was introduced in 1860. After introducing Income Tax Act 1886 it was imposed permanently. Italy adopted income tax in 1864, New Zealand in 1891, Australia in 1915 and Canada in 1917. After First World War, the income tax became an important source of tax revenue in many developed countries. By 1939, it has become the most important source of revenue in most developed countries and had made appearance in a number of developing countries. (Agrawal, 1978:113)

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

### **2.2 LEGAL PROVISION:**

#### **2.2.1 Legal provision of income taxation in Nepal**

The function of revenue collection has remained one of the key activities of the government from ancient time in Nepal. During that time, very few economic activities were operated in the country. Hence, comment of government could not collect huge amount of money in the form of taxation. At that time, taxes were levied to the merchant,

travelers and farmers in the form of cash, kind or labor. In some occasion, gold and agricultural products were also paid as taxes but the nature of these taxes were temporary and taxes were raised for especial purposes (Regmi, 1971: 55).

In the lichhavis regime, income taxes from agriculture income and business were introduced as a direct tax for the first time in Nepal. Tax on agricultural income was called "Bhaga" and tax on business was called "Kar". Irrigation tax and religious monuments preservation taxes also existed at the time of King Anshu Verma of Nepal. During the period of 1768-1846 A.D, different types of taxes were levied to generate maximum revenue. The major sources of revenue were: Birta and Kipat, taxes on land monopolies customs, transit and market duties, mines and mints and the export of forest products, birds, animals and various levies and fines. Taxes were collected at three levels: Royal Place levies Government levies and local levies. The various taxes levied during that period were narrow in base and were imposed primarily on occupation and economic activities, not in income or property. There was no taxation of income in the modern sense of income tax.

During the period of Rana regime, there was not formal provision for imposition and collection of taxes. Taxes were imposed according to objectives, needs and whims of the ruling Prime Minister. There was not provision of separating the personal income of Prime Minister and state treasury. There was not system of preparing government budget. The surplus of revenue over expenditure was considered the personal income of the Rana Prime Minister.

The major sources of revenue in Nepal till 1951, were land tax, custom and excise duties in the form of lump sum contracts, reality on forest, reality on supply of potters and soldiers, entertainment tax and a few other minor taxes. Incomes were not taxed for raising regular revenues of the state treasury but for meting specific expenditure if the household of the extra ordinary expenditure necessitated by war or other emergencies.

There was no direct ax in the country except land tax collected on a contractual basis and "salami" which the government employees used to pay out of there salaries at a very small percentage. The Salami was abolished in 1951. The Rana rulers did not think of development of effective revenue administrative system. After the advent of democracy in the country in 1951, no taxes are levied and collected in Nepal except in accordance with law.

#### **Income Taxes in Modern Nepal:**

After the impendence of the country in 1951 the role of has changed. Since, the government was enforced to operate development activities, besides governing the regular function of maintaining law and order and the collection of revenue (Bhatta and Shrestha, 1981:3). A sound and efficient tax system is necessary to maximize the revenue collection from income tax. Whole income tax system is made of three sub systems i.e. income tax policy, income tax laws and income tax administration. The government itself through Ministry of Finance determines income tax policy should be such that the main objective of the income tax can be attained.

Parliament makes the laws to implement the various policies the government levy and collect the income tax in accordance with law. The constitution of the kingdom of Nepal, 1990 has made the clear provision about it. "No taxes shall be levied and collected except in accordance with law" (constitution of Kingdom of Nepal, 1990). Present legal provision of income tax is associated with constitution of the Kingdom of Nepal 1990, Income Tax Act 2002, Income Tax Rules 2002, finance act of concerned financial year etc.

#### **Business Profit and Remuneration Act 1960:**

The government of Nepal introduced a formal tax for the first time in Nepal in 1960 (2017 B.S) in the form of "Business Profit and Remuneration Tax". "The Business Profit and Remuneration, 1960 "governed it. According to this act only business profit and remuneration on income were subjected to tax but the revenue for these taxes should not be collected properly according to original estimates (Dhungana, 1976; 66). It had 22 sections.

#### Main features of Income Tax Act 1960 were as follows:

- i. Only business profit and remuneration income were subject to tax. Thus the coverage of income tax was too narrow.
- ii. Tax on remuneration was to be deducted at source.
- iii. The basis for calculating the tax liability for remuneration was the income of the current year whereas for business profits, it was the profit of the preceding fiscal year.
- iv. There was a provision of tax exemption on salary of foreign citizen, dividend of share holders, profit to be spend in religious or public welfare activities, crop from own land, allowances granted by government to ministers, assistant minister, chairman, speaker and deputy speaker, amount drawn from provident or saving fund.
- v. The tax officer was empowered to assess tax on best judgment estimation only in case of false statement of in absence of income tax return.
- vi. There was a provision of fines ranged from Rs.500 to Rs.5000 in case of default.
- vii. The first court of appeal against the tax officer's assessment was local "Bada Hakim" or Magistrate. There after tax payer could appeal to the "revenue and tax court" but he needs to deposit fixed amount of tax (Dhungana, ibid).

#### **Income Tax Act 1962:**

Business profit and remuneration tax act 1960 was replaced by "Income Tax Act 1962". It had become in implementation from July, 1962. It was an extension of the previous act. It has 29 sections. It was amended one time in 1972. The additional features of this act were as follows:

- i. Income was defined as all kinds of income including income from business, salaries and profession, rent from house or land, investment in cash or bond, agriculture, insurance agencies and any other sources.
- ii. Act has defined basic terminology such as tax payer, tax officer, company, firm, profit, remuneration, tax assessment, non resident etc.
- iii. Status of tax payer was defined impersonal as well as residential for the tax purpose.

- iv. Procedure for income tax assessment and methods for calculating net income was stated.
- v. Provision was made to carry forward of losses for a period of 2 yrs.
- vi. The provision was made to constitute the net income assessment committee with five members
- vii. The basis was specified for assessing tax on the best judgment estimate of the officers.
- viii. To broaden the tax coverage, agricultural income was brought under the income tax net for the first time. But the financial act 1966 exempted this income fully from tax net. Again it was brought into tax net by financial act 1973. However it was again exempted from 1977.
- ix. Provision was made for reassessment of tax as well as rectification of arithmetic errors.

#### **Income Tax Act 1974:**

Considering this act incapable of fulfilling the needs of the time, existing act was replaced by another act, "Income Tax Act 1974". This new act was brought in practice from October 1974. It had 66 sections. This act was amended in 1977, 1979, 1988, 1984, 1985, 1986, 1989 and lastly in 1993.

Main features of this act as amended are as follows:

- i. It had clarified the certain terminology used in the act example income tax, tax payer, non resident, tax assessment, income year, gross income, net income, agriculture income, remuneration income, loss etc.
- ii. Income head was clarified into 5 categories: (a) Agriculture income, (b) Industry, trade, profession or occupation, (c) remuneration, (d) house rent and compound rent and (e) others.
- iii. The methods of computing net income from various sources had been specified.
- iv. Appointment rights of tax officer are had provided to GOVERNMENT OF NEPAL and rights of tax officers had mentioned clearly.
- v. This act had made the provision of self assessment of tax for the first time in Nepal.
- vi. The provision of carry forward of loss for three subsequent years was made.
- vii. The act had made it obligatory for tax payers to register their industries, business, profession or vocation in the tax office before starting the work.
- viii. The expenses allowed for deduction while computing net income had clearly specified for sources of all income.
- ix. Procedure for assessment, reassessment, jeopardy assessment, tax deduct at source, payment and refund of tax had specified.
- x. There was additional provision of exemption from income tax than the former act as follows: income of Guthi; income of VDC, municipality; amount received against life insurance.
- xi. A right, duties, forms, appeals were specified.
- xii. Provisions of penalty up to Rs5000 in case of failure of maintain or preserve account.



### **Income Tax Act 2002:**

Since, 19<sup>th</sup> Chaitra, 2058 B.S, "Income Tax Act 2058" has been introduced in Nepal. This act was brought in Nepal to avoid the following defects of income tax act 1974 (Kandel, 2002:11).

- i. Tax was not levied on world wide income, on capital gain etc. Tax base was too narrow.
- ii. Income tax related provisions were given in different act such as employee provident fund act 1962, citizen investment trust act 1992, industrial enterprise act 1992, electricity act 1992 etc.
- iii. There was not the provision for controlling transfers pricing, controlling expenses, controlling of thing capitalization etc.
- iv. Income tax is the tax of equity. That means persons having same income should imposed equal amount of tax and person having lower income should imposed low tax. But under Income Tax Act 1974, tax was levied on the basis of nature of organization, nature on income, nature of person. Natural person's taxable income had declared on the basis of organizations memorandum and objectives rather than transaction.
- v. Penalty rate under Income Tax Act 1974 was very low. It was not appropriate to the present time to control the tax evasion.
- vi. After 8<sup>th</sup> amendment, provision of self tax assessment was made. But necessary definition, explanation and legal provision related to tax administration was not made. There was not clarity about the accounting system and design and also lack of high penalty who didn't maintain account accordingly.
- vii. Act became incapable to fulfill the need of time. So, it became compulsory to replace it by new act.

### **Objectives of Income Tax Act 2002:**

Following are the main objectives of Income Tax Act 2002 (Malik, 2003:26)

- i. To increase the tax coverage.
- ii. To make income tax related provisions clear and transparent.
- iii. To interlink Nepalese tax system with tax system of other countries.
- iv. To make tax system based on account.
- v. To minimize tax avoidance and tax evasion.
- vi. To make tax system compatible to modern economy.
- vii. Separating administrative and judicial responsibility.
- viii. Reducing the scope of discretionary interpretation of the tax administration thereby ensuring simplicity, uniformity and the transparency.
- ix. Defining the power as well as authority of the tax administration.
- x. Distinguishing taxpayers' violation of civil duties and criminal offences.
- xi. Making more effective and responsibility to tax administration.
- xii. Making more responsible to taxpayer by emphasizing on self tax assessment system.

## **Main features of income tax act 2002:**

Following are the main features of Income tax Act 2002 (Mallik, ibid).

- i. Income tax related provisions are included with in one act.
- ii. This act has classified all income into three headings under section 3: (a) Business, (b) Employment and (c) investment
- iii. Act has clearly specified the amount should be included while calculating a person's gains or profits from conducting business or investment for an income year.
- iv. All the expenses are allowed to deduct provided that the expenses are made by the same taxpayer in the same year in the production of income.
- v. There is the provision of carry forward of loss for subsequent for years. The act has also provided the facilities to carry backward of loss for five subsequent years in case of bank, insurance and long term contract.
- vi. Incentives are provided to infrastructure constructor, hydropower projects and special industries.
- vii. Now the economy of the most of the countries in the world is open one. The provision has introduced in the tax law related to international taxation. Transfer pricing, foreign tax credit, double taxation avoidance agreement etc are the provision of international taxation.
- viii. Theca has given the option for husband and wife as a separate natural individual until they do not accept as a couple.
- ix. Capital gain, dividend etc. as brought in tax net.
- x. Authorities of taxpayer have specified.
- xi. To control the tax evasion, provision of transfer pricing, thin capitalization, divided stripping is made.
- xii. Provision of fines and penalties has made more stringent in the new Income Tax Act 2002.
- xiii. This act has made provision of relaxing the submission of income statement by person who doesn't have taxable income or who has the income from remuneration only.
- xiv. There has the special provision for deduction pollution control and research development expenses.
- xv. The income of an approved retirement fund is free from tax. But retirement payments in hands of employees are taxable.
- xvi. Resident persons are taxed on their worldwide income while non resident persons are taxed only in their income sourced in Nepal.
- xvii. The pool system of depreciation of fixed assets has introduced at the first time. All types of assets are classified into five categories. Depreciation rate for class A, B, C and D is based on diminishing balance method but straight line method for class 'E' (intellectuals assets)
- xviii. The act has provided the facility of medical tax credit under which resident individuals may claims a medical tax credit of 15 percent of the amount of approved medical costs. Unabsorbed medical tax credit amount can carry forward forever. (Mallik, ibid)

### **2.2.2 Source of Income:**

Income Tax Act 2002 has classified the sources of income for the purpose of assessment under the following heads:

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

#### **2.2.2.1 Business Income:**

Income Tax Act 2002 has defined the business income for income tax purpose. For the purpose of computing income of business for any year of income, the income of such person shall include as profits or gains made by him from business and should include:

(See Income Tax Act 2002 for details)

- a. Service Charge (Sec. 7.2)
- b. Sales or disposal of business/trading stock. (sec. 7.2)
- c. Net gain from the disposal of person's business assets/liabilities of the business calculated as under chapter 8. (sec 7.2)
- d. Amount received against the disposal of depreciable assets (sec 7.2)
- e. Prize or gift in connection with business. (sec 7.2)
- f. Amount received instead of acceptance of any restriction regarding business. (sec 7.2)
- g. Amount included under change of accounting method. (sec 24)
- h. Excess amount received due to exchange rate currency. (sec 28)
- i. Bad debt recovered (sec 25)
- j. Proportionate amount under long term contract (sec 26)
- k. Under paid interest amount according to market price (sec )
- l. Amount received for compensation (sec 31)
- m. Other amount received under business income (sec 7.2)

While computing income tax from business, the following amounts are excluded on profit and income from business for tax purpose.

- a. Exempt amounts under section 10
- b. Taxation of dividends under section 54
- c. Final withholding payment under section 92.

#### **2.2.2.2 Income from Investment:**

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 investment for the year and there shall included: (See Income Tax Act 2002 for details)

- a. Any dividend, interest, natural resource payment, rent, royalty, gain, from investment insurance, gain from an unapproved retirement payment or retirement fund from approved retirement fund. (Sec 9.2)
- b. Net gains from the disposal of the person's non-business chargeable assets of investment. (Sec 9.2)
- c. Excess amount of incomings over the depreciation basis including outings on the disposal of the depreciable assets of the investment of the person. (Sec 9.2)
- d. Gifts or prizes received in connection with investment. (sec 9.2)

- e. Retirement contribution including those paid to a retirement funds in respects of the person and retirement payments on respect of investment. (sec 9.2)
- f. Amount received instead of acceptance of any restriction regarding investment. (sec 9.2)
- g. Amount include under change of accounting method (sec 24)
- h. Excess amount received due to exchange rate currency. (sec 28)
- i. Bad debt recovered allowed previously (sec 25)
- j. Proportionate amount under long term contract (sec 26 )
- k. Under paid interest amount according to market price (sec )
- l. Amount received as compensation (sec 31)
- m. Other amounts required being included on tax accounting or quantification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business. (sec 9.2)

The following amounts are excluded income from investment for tax purpose.

- a. Exempt amounts under section 10.
- b. Taxation of dividends under section 54
- c. Final withholding payment under section 92.
- d. Amounts that is included in calculating the person's income from any employment or business.

Includable income for the purpose of deriving the taxable income of a business has clearly stated in the act but in case of expenses, the act has not clearly stated. The expenses, which are allowable as per the Income Tax Act 2002, are as follows:

- a. All the expenses are allowed to deduct provided that the expenses are made by the same tax payer in the same year in the production of income. (sec 13)
- b. Interest on loan taken for the business purpose is deductible. However, the amount of such interest will not exceed 50 percent of the taxpayer's taxable income for the year calculated without including the interest received or without deducting any interest incurred by the tax payer in case of the person controlled by tax exempt entity. (sec 14)
- c. The cost of trading stock is deductible. The allowable for trading stock is calculated by adding opening value of stock plus purchase value minus closing value of trading stock. (sec 15)
- d. The cost of repair and improvement of the depreciable assets used in business or investment are deductible. Such costs do not exceed 7 percent of the depreciable basis of the pool at the end of the income year. (sec 16)
- e. The act has allowed deducting pollution control device costs to the extent of 50 percent of the taxpayer's adjusted taxable income of the concerned year. Non-deductible cost can be capitalized as depreciable asset under group 'D' in subsequent year. (sec 17)
- f. Act has allowed deducting research and development costs. If the expenditure is more than 50 percent of the taxpayer's adjusted taxable income of the concerned year.  
Remaining amount can be capitalized as depreciable asset under group 'D' in subsequent years. (Sec. 18)

- g. Depreciation of the depreciable assets used in business for the income year computed under the schedule 2 is allowed for deduction. (sec. 19)
- h. The loss can be set off from the profit of any business or investment in the same year in one hand and of the same business in subsequent 4 years while calculating the income in the other. (sec. 20)

Following amounts are not allowed for deduction for deriving taxable income from business/investment.

- a. Cost to the intent to which they are domestic or personal nature. (sec. 21)
- b. Income tax, bribe, fine and penalty paid to government of political subdivision of any country by breach of any law. (sec. 21)
- c. Cost incurred by a person in driving exempt amount as per sec 10 or final withholding payment. (sec. 21)
- d. Distribution of profit by entity. (sec. 21)
- e. Capital nature expenditure and foreign income tax. (sec. 21)
- f. Payment of cash exceeding Rs. 50,000 is not allowed for deductions in case where banking service is available and if annual turnover is more than Rs. 2 million(sec. 21)
- g. Any other amount that is denied by other provision of law. (sec. 21)

### **2.2.2.3 Income from Employment:**

Income tax act 2002 has defined the remuneration income for income tax purpose according to sec 8 of the act; an individual income from employment for an income year is the individual's remuneration from employment of individual for the year. According to this sec., the remuneration received by a person from the employment is as following payments made by the employer (sec. 8).

- a. Payments of wages, salary, leave pay, overtime pay, fees, commission prizes gifts, bonuses and other facilities.
- b. Payments of allowances including any cost of living, rent, entertainment and transportation cost.
- c. Payment of reimbursement of cost incurred by the individual or an associate of the individual.
- d. Payments for the agreements to any conditions of the employment.
- e. Payments for the termination or loss or compulsory retirement.
- f. Retirement contributions including those paid by the employer to the retirement fund in respect of the employee and retirement payments.
- g. Other payments in respects of the employment.
- h. Other amount as given in chapter 6 of the act perquisites and gains due to change in tax accounting required to be included.

In addition too above stated items or remuneration, the following types of perquisites are included in remuneration of a person.

- a. Prizes and gifts
- b. Other payments made in respects of employment
- c. The amount of difference of the interest of interest on loan paid by employer lower rate than the market rate.
- d. Market value of assets in case of the transfer of the assets.

- e. For the payment other than stated above, the value of benefit of the payment to a third person.

### **Excludable amount in the employment income**

While computing the net income from employment of natural person, the following amounts are excluded on employment income:

- a. Amounts exempt under section 10 and final withholding payments
- b. Meals or refreshment provided in premises operated by or behalf of an employer to the employer's employees that are available to all the employees in similar terms.
- c. Payments of prescribed small amounts, which are so small and thus unreasonable or administratively impractical to make accounting for them.
- d. Any discharge or reimbursement of cost incurred by the individual cost
  - ) That serves the proper business purpose of the employer.
  - ) That ate or would otherwise be deductible in calculating the individual income from any business or investment.

### **2.2.3. Methods of Income Tax Assessment:**

Income Tax Act 2002 provides for the following major methods of assessing income tax.

#### **a. Self Assessment of Tax:**

Act has fully applied the self-assessment of tax system. It has made more responsible to tax payer. It reduces the compliance cost. Under this system, taxpayer himself determines his tax liability with fine and penalty if any. If tax authority doubts the income of taxpayer, ax authority can investigate on revenue risk the basis. Otherwise, that becomes the final.

#### **b. Jeopardy Assessment:**

Under the Sec. 100 of the act, the provision of jeopardy assessment is made. The department will make jeopardy assessment when the person becomes bankrupt, is wound up, or goes into liquidation, the person is about to leave Nepal indefinitely, the person is otherwise about cease activity in Nepal, or the department otherwise consider it appropriate. Whereas assessment is made under the jeopardy assessment with respect to full income year, the assessed person will not file return of income for the year. However with respect to part of an income year, the assessed person is still required to file a return for the income year. Where the department makes a jeopardy assessment, it should serve of the assessment on the person.

#### **c. Amended Assessment:**

Tax department may amend an assessment made by the taxpayer under sec. 99 and sec.100 department may re amend the amended assessment. The department may not amend as assessment if the assessment has been amended or reduced pursuant to an order the revenue tribunal or court of competent jurisdiction except where the order is reopened.

### **2.2.4 Appeal:**

A person who is not satisfied with the decision of tax officer concerning income tax has the right of appeal.

#### **Appeal to Director General:**

A person who is aggrieved by a reviewable decision has the right of appeal against such order to the Department within 30 days after the decision is made. While filing the appeal the taxpayer is required to deposit half of the amount of the tax payable.

**Appeal to Revenue Tribunal:**

If any taxpayer who is aggrieved by the decision made in the appeal to the Director General may appeal to the Revenue Tribunal in accordance with the Revenue Tribunal Act, 1974. If the person has appealed, he should file a copy of the notice of appeal with the department within 15 days. However, the operation and enforcement of an objection decision is not stayed or otherwise affected by an appeal. If the Director General of the department has made the decision relating to administrative review, the appeal to the Revenue Tribunal would be effective.

If any taxpayer who is aggrieved by the decision made in the appeal to the Revenue Tribunal may appeal to the Appeal court. A taxpayer or the tax officer who is not satisfied with the decision made by the appeal court has the right to appeal in the Supreme Court.

**2.2.5. Fines and Penalties:**

**a. Penalty for Failure to Maintain Documentation or File Statements or Return of Income:**

A person who fails to maintain proper documentation for an income year or file return for an income year is liable to pay fees for each month and part of a month during which the failure continues. The rate of fees would be as the higher of 0.1 percent per annum of the person's assessable income with a gross of any deductions or Rs. 1000 per month whichever is higher. Accordingly, a withholding agent who fails to file a statement as required is liable to pay a penalty at 1.5 percent per annum applied to the amount of withheld for each month and part of a month during which the failure continues.

**b. Interest for understating estimated tax payable by installment:**

A person who understates estimated tax payable by installment basis is liable to pay interest for each month and part of a month from the date the first installment is payable until the date the tax is payable on assessment. The amount of interest is calculated at the standard interest rate.

**c. Interest for failure to pay tax:**

A person who fails to pay tax on or before the date on which the tax is payable is liable to pay interest for each month and part of a month for which any of the tax is outstanding calculated at the standard interest rate applied to the amount outstanding.

**d. Penalty for making false or misleading statements:**

A person who makes a statement to the department that is false or misleading in a material particular; or omits from a statement made to the department any matter or thing without which the statement is misleading in a material particular, is liable for a penalty as follows :-

- a. Where the statement is shown to be false or misleading without knowingly or recklessly, 50 percent of the underpayment of tax; or
- b. Where the statement is made false or misleading knowingly or recklessly, 100 percent of the 106

**e. Penalty for aiding and abetting**

A person who knowingly or recklessly aids or abets another person to commit an offence related to failure to comply with this act, failure to pay tax, makes false or misleading statements or impedes tax administration to counsels or induces another person to commit such an offences, is liable for penalty equal to 100 percent of the underpayment of tax that.

### **2.3 Review f Literature**

Various books are written, articles are published and different individuals and institution in concerning to income tax conduct researches. Income tax was firstly imposed in fiscal year 1959/60 in Nepal under the 'Business profit Remuneration Tax Act 1960'. Then after, various studies were made concerning with various aspect of this act such as the structure, role, productivity, legal and administrative framework etc.

#### **Summary of the relevant studies are given in the following paragraphs.**

Amatya prepared a book "Nepal Ma Aayakar Ko Byabastha." He has tried to describe about income tax and. Provision regarding income tax. His contribution was first in this field. Basically, he analyzed legal aspect of income tax in Nepal at that period (*Amatya, 1965*)

Shrestha has prepared a master degree thesis entitled "Income Tax in Nepal". He has described about historical background, income tax act, rules and administrative aspect of income tax. All things mentioned in it are not fully relevant at present (*Shrestha, 1967*).

Lent has presented a report entitled, "Survey of Nepalese tax Structure" under the request of IMF, Fiscal Affairs Department. He has critically analyzed the scope of income tax in Nepal, tax structure, taxable income exemption and allowance given at that time. He has suggested reforming both the income law and administration to increase government revenue through income tax (*Lent, 1968*)

Kayastha has tried to analyze the contribution of income and property taxes to overall revenue generation in Nepal. He has studied on legal and administrative aspect income tax system of Nepal and pointed out some drawback. According to him before 1951, Nepal did not have scientific economic policy, which could facilitate the economic development of the country. According to him, the major problems of income tax system of Nepal are income tax evasion at high level and greater role of indirect tax in tax revenue. These problems have not solved yet effectively (*Kayastha, 1974*).

Bhattarai and Shrestha have described about tax ct rules and regulations. They have tried to give details theoretical knowledge about legal aspect of tax rather than critical analysis (*Bhattarai and Shrestha, 1976*)

Dhungana, Kayastha and Rai have published a report entitled "An analysis of tax structure of Nepal" dealing the tax structure of Nepal. Writers have analyzed the income tax in Nepal and recommended to reform income tax to reduce resource gap and mobilize additional resource. Report wasn't analytical (*Dhungana, et al: 1976*).

Shrestha has explained about legal and historical aspect of income tax in Nepal. He has analyzed the role of income tax in the process of economic development, importance of income tax on overall tax structure income tax trends and analysis. He has mentioned that

tax evasion is the main problem of income tax. This problem is still considered as the one of the major problems in Nepalese income tax system (Shrestha, *ibid*)

Agrawal has provided details information in various aspects of income taxation in his report prepared in 1978. His study is the first comprehensive scientific study on this ground. He has organized his study on nine chapters. Resource mobilization through to income tax, legal aspect of income tax, administrative aspects etc. have been discussed. The study is very useful to find out the reality about income tax in Nepal. Various mathematical calculations have been shown. Per capita burden of income tax, buoyancy coefficient of income tax, elasticity coefficient of income tax etc have been calculated. This study has covered periods of nine years (1961-1976). He has identified the major problems in income tax system as inefficiency of tax administration and income tax evasion though other many have been also shown. He observes that tax authorities are insufficient in enforcement of law. There are not integrated programs for taxpayer's education; assistance, guidance and consoling. Tax officers are looked upon as heaven for corruption. Insufficient, delays, unfair dealings, harassment and incompetent personnel are the major problems of tax administration.

This research study was made 26 years before. It is however a comprehensive study and has included various aspect of income tax system of that period, all things mention in it are not fully relevant today. This means that it is no useful today. Some of the problems identified by it are still in existence in income tax system of Nepal (Agrawal, 1978)

Pandey, in his study had discussed various aspect of income tax such as legal aspects, structure of income tax role of income tax, problems of income taxation, economic effect of income tax in Nepal. He had highlighted on tax structure of Nepal. According to him income tax played a significant role in the economic development of Nepal. He found the capita burden of income tax was Rs. 0.2 in 1962/63 and it had increased to Rs. 7 in 1975/76. He had stated that indirect tax had a dominated role in the total tax revenue. Lack of scientific record keeping, lack of maintaining accounts by tax payers, lack of coordination, lack of scientific method of income tax assessment and collection procedure, lack of honest tax officers are major problems identified by him. His suggestions about income tax were capital gain should bring in tax net; income tax accounting assessment and collection method must be scientific etc.

His study was done with main objectives of examining the economic effects of income tax but he had not described it with numerical examples and empirical investigation (Pandey, 1978)

Subedi has analyzed about the role of income tax on national revenue of Nepal. He has examined the growth of income tax collection, its ratio to GDP, cost of income tax collection and elasticity. He has also included historical perspective and legal aspect of income tax in his study. He has pointed out that tax evasion, inefficient tax administration and dominated role of indirect tax are the major problems in Nepalese tax system. He has suggested that tax administrative reform is the major necessity in development of income tax system (Subedi, 1982).

Nepal has critically examined the income tax system of Nepal in that time. Her study has been conducted with purpose of examining the role of income tax in overall tax structure, analyzing the problems and prospects of income tax in Nepal and highlights the future prospective of the Nepalese income tax (Nepal, 1983).

Regmi has prepared a dissertation with the main objective of examining the trend of income tax in Nepal, ascertaining the share of income tax to total tax revenue and its ratio to gross domestic product. He has also stated as a great problem in income tax law should be clear and precise, scientific method for accounting assessment and collection of income tax, widening tax coverage, easy and simple procedure of tax payment, public awareness (Regmi, 1986).

Siwakoty has explained the various aspect of income tax. his study emphasized on drawing a clear sketch of role of income tax, structure of income tax, projection of income tax, legal aspect of income tax act and problems of income tax. Major problems exiting in Nepalese income tax system, stated by him are narrow coverage, unscientific and time consuming assessment and collection procedure, complicated act and defective income tax act (Siwakoty, 1987).

Baral has tried to shown the contribution of income tax on the structure of government revenue in Nepal. She stated that the composition of tax and not-tax revenue is still less satisfactory in Nepal. She found that total revenue; total tax revenue and direct tax revenue have an increasing trend in Nepal but in low rate. In her study, inefficient tax administration, unconsciousness of taxpayer, lack of scientific method of tax assessment and collection have identified as the major reasons for tax evasion at high level (Baral, 1989).

Poudyal and Timsina had described the provisions and laws related to income taxation of Nepal in a book named "income tax in Nepal". This book is extremely based on the syllabus of B. com. They were described the theoretical as well as practical aspect of income tax. He has not analyzed the role of income tax, income tax structure and defects of income tax in Nepal. The book was descriptive rather that analytical (Poudyal and Timsina, 1990).

Bhandari has tried to examine historical background, tax structure in Nepal and contribution of income tax to economic development of Nepal. He has stated that actual collection of revenue through income tax was lower than its estimated targets because of the poor tax paying habit of Nepalese tax payer, poor tax administration system, wide spread evasion of income tax. he has suggested to make effective personnel management, increasing habit of tax paying of Nepalese tax payer through proper tax education and better public communication system, minimize tax evasion, reduce tax collection cost (Bhandari, 1994).

Khadka had discussed the economic policy of Nepal, VAT as a long term tax for Nepal, income tax, improving tax administration, tax reform strategy. He had analytically described about development, existing structure, main problems and possible direction of reform of income tax. He had identified the major problems of income tax as narrow

coverage, unscientific tax assessment and collection, defective system from the perspective of international taxation. Weak tax administration, imbalance and inadequate organizational pattern, inadequate physical and other facilities, inadequate tax training, predominance of low level non-technical posts, debatable scope of revenue investigation department, lack of information system were the major problems of tax administration identified by him.

He had suggested some suggestions to overcome from the problems of income tax which were extension of tax coverage, scientific method of tax assessment, extension of withholding tax, inflation adjustment etc. he had also identified some possible direction for administrative reform. They were reorganization and expansion, applying integrated information system, research unit on taxation, strengthening the revenue service. His book was analytical and very useful to obtain the various aspects of income tax (Khadka, 1994).

Aacharya has mentioned the main the objectives of the income tax as to achieve social justice, to check inflation and to collect more government revenue. He has identified the contribution of the individual in total income tax revenue seems to be greatest period followed by public enterprises, remuneration, house rent, an interest taxes, semi public enterprise and private corporate bodies respectively. He has also analyzed the administrative and legal aspects of income tax. He has recommended simplifying the tax structure and legal and administrative aspects and understanding with the consent of tax payers to raise the income tax revenue (Aacharya, 1994).

Khadka has conducted a research on 'Nepalese taxation: A Path for Reform' Mar burg Germany, tax system. The major issues are; narrow tax base, less productive, inelastic, distortion, inequality, complicated procedures, lack of coherent and stable tax policy, weak tax administration, low level of voluntary tax confines etc. in his research indicated possible direction for reform as recommendation.

- ) Necessary to launch a comprehensive long term tax reform program with the aim of establishing an ideal tax system over the years.
- ) Improving tax administration.
- ) Raising the voluntary tax compliance (Khadka, ibid).

Shahu has found that 0.35 % of total population came under the categories of tax payers during his study period. Main objective of his study was to study Nepalese tax structure, role and contribution of income tax on national revenue. He has identified that income tax has been gradually increasing and was in the fourth place in the tax structure of Nepal. He has not discussed the major aspects of income tax clearly and analytically. So, it is incomplete study and all things mentioned in it are not also fully relevant today because it was made 9 yrs ago (Sahu, 1995).

Sakya presented a dissertation named "Income tax system in tax structure of Nepal". His study was done with basic objectives of analyzing the causes of heavy reliance of indirect taxes, analyzing the volume of indirect tax revenue and direct tax revenue in total tax

structure, highlighting the revenue assessment procedure from different sources and suggesting improve on them. In his study, he has identified that income tax has occupied 4<sup>th</sup> position along tax revenue of Nepal. Custom duty, sales tax and excise duty has occupied 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> position respectively in Nepalese taxes revenue. He has mentioned Nepalese taxable capacities is limited by various factors such as low per capita income, extensive subsistence economy, relatively “closed” (India) economy, weak export position etc.

He found that the ratio of income tax to GDP, total revenue, total tax revenue and direct tax revenue have been on increasing trend in Nepal. But increasing rate is very low In comparison to other countries, Tax evasion is the main reason behind it. Lack of clear and comprehensive definition of income, lack of punishment to the evaders, low tax paying capacity and non conscious of tax payers, lack inefficient tax administration, lack of scientific method of tax collection and lack of trained tax collectors were the main reasons of income tax evasion identified by him (Shakya, 1995).

Panth presented his masters level dissertation entitled “A study on income tax management in Nepal”. He has identified various problem of income tax management in Nepal and among them lack of managerial efficiency is the main problem. Lack of effective personnel management, poor reward and punishment system, weak income tax assessment procedure, poor tax information system, lack of tax payers education, very narrow coverage of income tax are the other problems of income tax management in Nepal identified by him.(Pant, 1996)

Dhakal had published a revised edition of book named “Income Tax and House and Compound Tax Law and Practice with VAT”. He had described his historical aspects of income tax and legal provisions relating to income tax with numerical examples. This book was fully based on the syllabus of B.B.S 3<sup>rd</sup> year and M.B.S 2<sup>nd</sup> year. Thi9s book was published before coming new Income Tax Act 2002 and it is very useful to know the general information and legal provision of Income Tax Act 1974. His book was informative rather than analytical. He had not analyzed the role of income tax, structure of income tax and problems of income tax system in Nepal (Dhakal, 1998).

Timilsina has consented his study on mainly on the analysis of exemption and deduction of income tax acts of Nepal. In his study, he showed that contribution of corporate tax is higher compared to individual income tax. He recommended increasing the exemption limit for an individual; to a minimum of Rs.90, 000 and for family exemption based on the mo of dependent children and parents. He further recommended living income tax on agriculture, capital gains and other sources to raise tax base (Timilsina, 2001).

Poudel presented a dissertation entitled “income taxation in Nepal; A study of its structure and productivity”. The objectives of her study were “To analyze the income tax administration in Nepal, to estimate the elasticity and buoyancy of income tax in Nepal, to access the role of income tax administration in Nepal, to evaluate the success of voluntary disclosure of income scheme (VDIS) program in brief and to provide the suitable

recommendation for improving the scenario of income tax. she has found that overall revenue of Nepal showed an annual growth 16%, indirect taxation has more significant contribution in total tax revenue, income tax occupied the 1<sup>st</sup> rank among the direct taxes, personal income tax slabs has been changed radically from 7 slabs in 1975/76 to two slabs in 1999/2000, VDIS could not attract more potential tax payers into tax mate due to lack of good planning and adequate homework of the government, working procedures of the tax administrations are still traditional and post of administration ahs not been brought to the satisfactory level.(Poudel, 2002)

Kandel had criticized the income tax act 2002 on several grounds. Exemption of agriculture income from income tax ,export duties levied on export , inequality between different capital earned income (i.e. tax on interest , dividend and capital gain ) with drawl of the provision of exemption suddenly and no adjustment for inflation are the major issue he raised in his article. The further criticized the act for the provision of income tax from export as 0.5% of total export because it is not good choice of income tax base (kandel, 2003).

Shrestha's study had covered the historical background, legal provisions, structure of income tax, income tax administration in Nepal and empirical investigation. For findings about tax structure were: there was dominant share of tax revenue in Nepalese government revenue. But the contribution of tax revenue showed the decreasing trend. The tax/GDP ratio was not found satisfactory with compared to other SAARC countries. It was 6.81% for the period of 1984/85 and 9.36% in 1998/99. There was serious and growing financial resource gap problem in Nepal seems to be never ending problem for Nepalese economy. There was dominant role of the indirect tax revenue in Nepalese tax revenue. The contribution of direct and indirect on tax revenue was 17.76% and 82.24% respectively in 1984/85 which become 26.14 and 73.86 percent in 1998/99. The contribution from individuals to income tax revenue was greatest in every fiscal year and it was in increasing trend. Income tax revenue was playing a significant role in direct tax revenue because the share of income tax in direct tax was increasing rapidly.

She had found various problems of income tax system in Nepal. They were narrow tax coverage , mass poverty of Nepalese people , lack of conscious of tax payer , widespread evasion and avoidance of income tax , unscientific assessment procedures , inefficient tax administration , complicated tax laws and procedures , instability in government policy. She had also identified the major week points of income tax administration in Nepal. They were failure to locate new taxpayers, failure to maintain proper accounts and records, defective selection of personnel, undue delay in making assessment, lack of motivation in tax personnel, existence of corruption.

She had suggested broadening in Nepalese income tax base by bringing agricultural income and capital gain under income tax net. She had suggested making consciousness to people, reform of income tax assessment, reform the income tax administration and minimizing the tax evasion. For the improvement of income tax administration, she had suggested computerizing and effective exchange of information, tax education to tax payers, tax inspectors and officials, effective personnel management. Her suggestion for

minimizing tax evasion were control illegal business activities, enforce auditing and investigation, enforce heavy fines and penalties and maintain proper records and accounts (Shrestha, 2001).

Pradhan's study is basically concerned with historical background, contribution of income tax to the public revenue, contribution of Nepal Telecommunication Corporation (NTC) to income tax, effectiveness of income tax collection. She had found the contribution of income tax from public enterprises in Nepal was not significant due to poor achievement, weakness in government's economic policy and deficiency in legislation. NTC had been contributing effectively to total income tax revenue. Contribution of tax revenue on GDP of Nepal was lower than SAARC countries except Bangladesh. Average contribution of income tax from NTC to total tax revenue, total income tax revenue and total government revenue was 2.37 percent, 15.60 percent and 1.93 percent in her study period.

Her suggestion about income tax system were clear cut provision, discretionary power of tax officers should curtailed, assessment and collection provision made clear simple, provision of reward, prize, incentive should introduced to encourage the tax payers to pay voluntarily, compulsory provision of auditing, etc. for the improvement income tax administration in Nepal, she had suggested promotion & rewards to active, efficient and honest tax personnel; tax education to taxpayers; strict actions against corruption; reduction of delays in tax assessment. Specially, her study had focused on the study on Nepal Telecommunication Corporation (Pradhan, 2001).

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

Adhikari has discussed the legal provision of new income tax act, 2002. His book is analytical rather than informative. Writer has not included administrative aspect, role and structure of income tax in his book. The book has only focused on the legal aspect of income tax. Agreement and protocol relating to avoidance of double taxation and the prevention of fiscal evasions with respect to taxes on income between different countries had also included in his book (Adhikari 2003).

Mallik had published book named "Nepalese Modern Income Tax system". He had described historical aspects of income tax g legal provisions relating to income tax with numerical examples. This book is very useful to know the general information and legal provision of income tax act 2002. His book was informative rather than analytical. He had not analyzed the role of income tax, structure of income tax in Nepal (Mallik, 2003).

Sherchan's study had covered tax structure, role of income tax and legal provision of income tax. But, specially, his study had focused on provision of fines and penalties. He had found that there was dominated share of tax revenue in Nepalese government structure. Income tax had occupied third position in his study period and it was increasing trend. The tax/GDP ratio was not found satisfactory. With the income tax, there was the dominated role of corporate income tax but it was in decreasing trend and contribution of individual income tax was second position and it was in increasing trend.

He had suggested revising the provision of fees and penalties, introducing reward, prize, incentives provision, clear income tax, rules and regulation, clear right and duties of tax officers. Further, his suggestions were: timely revision in income tax policy, computerized system for payment of income tax. This study was done with main objectives of analyzing tax structure of Nepal, analyzing the provision of fines and penalties under income tax law, know the taxpayers knowledge and tax officers view about fines and penalties. His study had focused only on study on provision of fines and penalties. So, this study is incomplete study (Sherchan, 2003).

Magar wrote a thesis entitled 'Income Tax in Nepal: a study an exemptions & deductions'. He had covered tax structure, role of income tax and exemptions & deductions provide in the law. He had found that there was dominated share of tax structure in Nepalese government revenue. Income tax had occupied third position in his study period and it was increasing trend. The tax/GDP ratio was not found satisfactory. With the income tax, there was the dominated role of corporate income tax but it was in decreasing trend and contribution of individual income tax but it was in increasing trend. Lack of trained employees, shortage of income tax experts/ professional in tax administration, lack of public participation, faulty organizational structure of tax administration, weakness in government policy, defective income tax act where the major cause for inefficient tax administration, observed by him. His suggestions about exemption were: revision the exemption limit, elimination double taxation on dividend, tax rebate for submitting true income statement in time, increase income tax rate slab up to 10, increases the exemption limit to individual as well as family etc. besides above suggestions, his suggestions about deduction were: clear provisions for deduction; fully allowed interest expense, pollution control expanses, repair and improvement expensed, research and development expanses. He is totally concentrated on the exemption and deduction in his study. He has not study about various aspect of income tax (Magar, 2003)

Bhattarai and Koirala published two books named 'Taxation in Nepal' and 'Tax laws and Tax planning'. First book has been designed in conformity with the syllabus of BBS 3<sup>rd</sup> year and the second one has designed based on the syllabus of MBS 2<sup>nd</sup> year. Relevant theoretical and practical aspects have been discussed in the books. Both books have shown how taxable incomes are computed under employment, business and investment sources (Bhattarai & Koirala, 2003)

Adhikari wrote a book entitled 'Modern Taxation in Nepal: Theory and practice'. This book also has been written according to the syllabus requirement of different faculties. Especially, the BBS 3<sup>rd</sup> year syllabus of Tribhuvan University has been taken into

consideration. Income Tax Act, 2058 as amended by finance ordinance, 2060 has also been included. Theoretical as well as practical aspects have been put in the book (Adhikari, 2003).

Rai and Baskota published a book entitled 'Taxation in Nepal'. This book has also been designed according to the syllabus of BBS 3<sup>rd</sup> year. Computations regarding different sources of income have been included in this book (Rai & Baskota, 2003).

Aryal and Poudel wrote a book entitled 'Taxation in Nepal'. This book is also designed as per the syllabus of BBS 3<sup>rd</sup> year. They have also included theoretical and practical aspects of taxation in their book (Aryal & Poudel, 2003).

Amatya, Pokhrel and Dahal wrote a book entitled 'Taxation in Nepal'. This book is also designed to meet the requirement of BBS 3<sup>rd</sup> year syllabus. Theoretical as well as practical aspects of taxation have been included in the book. This book is a descriptive one, not analytical (Amatya, et al).

Khadka wrote a book entitled "Modernizing Tax Administration in Nepal". This book is very much useful to anyone who is interested in Nepalese income Taxation. This book gives almost complete information about the system of Nepal from its ancient time to current situation of income tax system. He has shared his expertise in his book. Basically author focuses on the Administrative aspects of the tax system in Nepal (Khadka, 2005).

Besides these reports, books and master level dissertations, some articles about income tax published in Rajasw, Rising Nepal, Gorkhaptra the Kantipur, the Katmandu Post etc and publication of Ministry of Finance such as Budget speech, Economic Survey were reviewed in the study period.

## Chapter – 3

### RESEARCH METHODOLOGY

#### 3.1 Types of Research:

This study included three types of research as descriptive, analytical as well as empirical.

#### 3.2 Research Design:

The research study is focused on role of income tax, indirect tax and direct tax in total tax revenue; effectiveness of income tax revenue collection in Nepal. To achieve the stated objective of the study, the opinion of the various 60 respondents associated with distinct denomination i.e. tax experts; tax administrations and taxpayers were collected through structured questionnaire. The questionnaire included the role of income tax to national revenue, provisions of fines and penalty, soundness and effectiveness of income tax system, the most important factors for the effectiveness of income tax system including necessary suggestions for achieving effectiveness of income tax in Nepal etc. In this way, the research design of this research is descriptive, analytical and empirical.

#### 3.3 Population and sample:

In order to fulfill the objectives of the study, 60-sample size from Kathmandu, Birgunj and Biratnagar is selected. Persons included in the sample are carefully selected by consultation with lectures and best judgment of the researcher. The respondents have been divided into three groups. The following table shows the groups of respondents and the size of samples.

**Table 3.1**

Group of Respondents and size of Samples

S. No.	Groups of Respondents	Sample size
1	Income Tax Administrators	20
2	Income Tax Experts	20
3	Income Tax Payers	20
	Total	60

#### 3.4 Nature and source of data:

Necessary data and information to describe this study has been collected from primary as well as secondary sources. The major sources of data are as follows:

##### A. Primary Data:

Primary data and information have been collected through administering structured questionnaire to sample of population. The sample questionnaire was distributed to all respondents. Tax administrator is selected from tax department and various sectors of tax offices. Tax experts are the lectures, auditors, chartered accountants etc. tax payers are selected representing various sectors i.e. manufacturing company, trading company, private banks, insurance company, finance company, departmental store etc. total 75

questionnaires were distributed to the respondents among which 60 of them can be received in time. That is only 80% of the distributed questionnaire was collected.

## **B. Secondary Data:**

Secondary data and information are obtained from various sources specified as below:

1. Budget speech and Economic survey of various years, ministry of finance, Government of Nepal.
2. Reports and records of department of Taxation, ministry of finance Government of Nepal.
3. Dissertation related to income tax.
4. Books related to income tax and public finance.
5. National and international newspaper, journals, souvenir, and news magazines.
6. Various internet websites.
7. Other relevant records and data.

Secondary data from fiscal year 1982/83 to fiscal year 2003/04 is used in this study.

### **3.5 Data Collection Procedure:**

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

### **3.6 Data Processing and Analysis Procedure:**

For the analysis, all collected data and information of various aspects of income tax was arranged in order and processed. Then, the descriptive tool and statistical tools such as simple percentage, simple average, graphs, charts and diagrams etc have been applied in the way of analysis so that the findings could be presented and interpreted properly in order and clear.

## CHAPTER-4

# INCOME TAX ADMINISTRATION IN NEPAL

### 4.1 General Background:

Administration is the design of implementation government policies. An efficient and effective administration is essential to achieve the objectives of any system. So, it is also taken as the heart of any system. Tax administration is regarded as tool for including some responsibility for determining the policies and the programs of government related to tax. Specifically, it is the planning, organizing, directing, coordinating and controlling of government organizations related to taxation. The shape of tax system in practice is determined to a great extent by the way it is administered. Administrative reform must go hand in hand with structural tax reform. While stressing the central role of administration in successful tax reform in developing countries, attention was drawn to three aspects of tax technology.

- I) The role of administrative incentives;
- II) Costs of taxation and other quantitative questions and
- III) The link between expenditure.

The Inland Revenue Department administers income tax of Nepal. The Ministry of Finance, Customs administration, Revenue investigation administration and the Revenue Administration Training Center are also involved in the administration of income tax directly or indirectly. The Ministry of Finance is at the apex of the tax administration. It is responsible for overall administration of the government's fiscal and the monetary policy. The Revenue Division of this ministry is responsible for formulation tax policy and setting up appropriate tax administration to implement tax policy. It coordinates the activities of all revenue departments, including the inland Revenue Department and monitors the positions of revenue collection. It is responsible for the research, planning and analysis of the tax system. The customs administration collects advance income tax on imports. The Revenue Investigation administration investigates cases where revenue leakage was involved, with or without collusion between taxpayers and tax collectors. The Revenue Administration Training Center impacts Training, workshops, and seminars for tax officials.

### 4.2 Historical Development of Income tax in Nepal:

Taxes have been levied in Nepal in some form or another since time immemorial, and therefore some method of tax administration has always been in place. Land revenue, customs and excise duties have been the traditional instruments of taxation. As may be expected, taxes were initially enforced in Nepal in a rudimentary fashion. There have been periods when 'middlemen' were employed to collect tax, and also periods when the task of tax collection was undertaken jointly by middlemen and tax officials. While it is a relatively tough task to ferret out information about tax administration which existed prior to the 1950s, an attempt shall, however, be made to review the same on the basis of the sketchy information which is available concerning tax administration that existed during *Rana* regime.

Land revenue, of course is one of the oldest taxes in force. In ancient times, landowners had to pay set percentage of the agricultural yield of their lands to the government as tax. The initial trend was to pay the tax in kind, but the equivalent amount has also been paid in cash over the centuries.

The establishment of *Bakauta Tahasil Adda* in was a notable event in the annals of land revenue administration in Nepal. This was renamed as the Land Revenue Office in 1996. These offices were, however, not directly involved in assessing and collecting land revenue, by reason of the organizational difficulties involve in achieving this feat with the limited number of tax officials on the payroll. Instead, there existed an arrangement whereby these offices collected the land revenue with the help of middlemen known as "*Mukhiya*" and "*Zimwal*" in the hilly regions, and "*Zamindar*" and "*Patwari*" in the *Terai*. These middlemen were tasked with maintaining records of land holdings in their respective areas, collecting land revenue from landholder's very year, and depositing the same at concerned land revenue offices within a stipulated timeframe.

This system gained hereditary characteristics and offered several advantages to the government of the day. While the government was fully assured of a fixed amount of revenue year-in-year out, there was no need to hire a large number of staff to either maintain records or collect revenue, thus resulting in the regime incurring only a minimum Administrative cost in the collection of tax. Since middlemen were granted positions of power prestige in addition to monetary rewards, they carried out their functions in an earnest manner, spurred on by the double incentives of retaining their positions and passing these positions on to their descendants. Such middlemen also assumed a leadership role by involving themselves in the social and development activities in their respective areas. The arrangement was that the middlemen in question were entitled to commission at the rate of 5 percent from the tax amount they collected, the middlemen also used to extract unpaid labor. Although the practice was proscribed by legislation in 1951, instances of people demanding unpaid labor were reported long afterward.

The system of collecting land revenue with middlemen as agents also entailed a number of drawbacks. For example, since the authority to collect tax was granted to many middlemen, methods of actually collecting the dues varied from one area to another. Additionally, the system encouraged ruthlessness in the middlemen, to the point where farmers were forced not only to pay up land revenue but also to offer gifts in the form of "*Walak*", "*Salami*", or "*Bethbegar*" to "*Mukhiya*", "*Zamindar*" or "*Patwari*". It goes without saying that erstwhile rulers of Nepal did not overly concern themselves with the activation of the middlemen, since they were satisfied with the system in place since ensured a fixed income with minimal cost. In fact, the system in question continued unit early 1996 in those districts where the cadastral survey had not yet been conducted, while land revenue offices collected land revenue directly from landowners in other district where the cadastral survey had been completed. In January 1996, the task of collecting land revenue was devolved to local governments.

Yet another landmark in the annals of land revenue collection was the abolition of the "*Birta*" system in the year 1959/60. Under this system some privileged families had a right to collect and retain land revenue, and there were still others who stood entitled to own large swathes of land yet not pay any revenue whatsoever. While some had come to own the land by paying a nominal amount, others had not paid anything at all. The abolition of the system meant all landowners, without exception, had to pay land revenue. Moreover all those who were entitled to collect revenue and keep it were obliged to deposit the same at stipulated offices even as the period also saw nationalization of "*Birta Mal Tahashil*".

Customs duties have a long history in Nepal, going back as far as the *Lichhavi* period (464-1094 AD) when customs check-post were set up in various places. It is

assumed that customs duties were an important source of revenue during the *Malla* period (1200-1769 AD) when the trade between India and Tibet was routed via Nepal.

Customs duties were also a ready source of income during the *Rana* regime, and were imposed on both imports and exports. Customs offices known as *Bazar Adda* were set up in different parts of the Terai. In addition, an internal duty known as "*jagat*" was collected when merchandise crossed some sort of administrative boundary. However, the procedure adopted in collecting tax was quite rudimentary in some places, since the system was yet well organized.

Since the trend was to levy both external and internal duties, it so happened that duties were imposed on the same merchandise many times over. However, what is known as *Chimpu* system soon evolved to avoid the eventuality of the same goods attracting duties more than once. Under this system, merchandise destined to the hills via *Bazar Adda* was fully described and sealed. *Bazar Adda* did not collect any duties on it when the goods reached the specified custom office, the office had to verify them against the lists sent by *Bazar Adda* and charge the applicable duties, and then had to be communicated to the *Bazar Adda*.

Yet another system known as the ring system of *Mahajana* (businessman) was in force for some time during the *Rana* regime. Under this system, a person was allowed to engage in business activities only if the *Mahajana*. Since the volume of tax evasion was believed to be quite considerable under this system, it was soon abandoned. This paved the way for the system of checking goods and collecting revenue at the customs points.

The *Rana* period was also marked by the practice of collecting customs duties on a contract basis. There were customs contractor accomplished the job of mobilizing revenue. In fact, custom contractors were picked up at the end of the bidding process with the job going to the highest bidder for a specified of time. Contractors calculated the amount they quoted based on the size market and the expected volume of imports and exports at the concerned points. Since contractors were awarded the titles of *Dittha*, *Lapton*, *Subba*, *Subedar* and so forth in addition to the exclusive right to collect customs revenue, aspiring local businessmen involved themselves in such contracts even if the job not entail much profit.

Probably, the main reason of the *Rana* rules preferred the contract system was that they did not like to involve themselves in revenue administration and wanted to collect the maximum amount of revenue with minimum effort. They knew that effective tax administration could not be evolved with the limited number of revenue personnel available. It is also true that contract system had some merit as well. For Example, government officials could tell in advance the approximate amount of revenue that would be collected over a given period of time. Also, since the government officials not involved in the actual mobilization of the revenue, the government was required to have very few people to look after the job, resulting in lower administrative costs.

The system had drawbacks, too. *Inner alia*, there was always every possibility of the contractors collecting much more that they actually handed over to the authority. Furthermore, since contracts were awarded to many contractors to work in different regions without any guidelines on modus Operani, different contractors worked in different ways thus ruling out uniformity. The Ranas could not be professionalism and innovation. The system was outmoded, unequal and inefficient and was open to many abuses.

Much like customs duties, excise duties, were also employed to beef up revenue mobilization. The main sources of revenue from excise duties were liquor, leather, pig-hair, mining, herbs, hashish and opium, Excise duties levied on opium, ganja and hashish were known as *Krishi* (agriculture) *Rakam* while the excise duties levied on liquor, leather, bones and horns were known as *hadabhatti* (alcohol) *Rakam*, *Charsa* (leather) *Rakam* and *Had-sing* (bone and horn) *Rakam*, respectively.

The year 1885 is noteworthy in the history of this form of taxation in Nepal. The importance of the year lies in the fact that it saw enforcement of some legal provisions subsequent to the enactment of civil law. Excise duties were administered by *Rakam Bandobasta Adda*, which was set up during the reign of King *Surendra*. The office in question was concerned with awarding contracts for the collection of tax. There was no uniform excise rate for different parts of the country: contractors levied duties at differing rates a process largely based on past experience and the value of the contract.

The underlying reasons why the erstwhile rules went for the contract system have already been explained earlier. However, since the contract system, too, had inherent limitations, the year 1952 saw authorities switching over to the license system when it came to imposing and collecting revenue on hemp and opium in the Terai, a region where people cultivated hemp on a large scale.

Under what is known as the license system, excise duties were levied on the basis of the area of land under hemp cultivation, which was set at roughly Rs. 4500 *per Bigaha*. Land revenue offices issued licenses, surveyed the land under cultivation and collected the applicable excise duty. The land had to be surveyed when hemp and opium plantation was ready for harvesting. Staff belonging to *Gadi*, *Gauda* or *Goshwara* offices acted as witness to *Gadi*, *Gauda* or *Goshwara* offices acted as witnesses on these occasions. If the area under cultivation was found to have exceeded the permit by more than 5 percent, the farming was deemed to be an illegal activity, and often resulted in the farmer landing in the court. Under this system, the farmers had to pay up a fourth of the applicable revenue while applying for the license and the remainder after the land had been surveyed.

However, the system of collecting excise duty on hemp and opium in hilly regions was different from the system employed in the *Terai*. Unlike the *Terai* hemp grows on its own in hills and is not cultivated. Local people used to harvest the same on a small scale and sell it off to local businessmen. Since excise duties were collected under the contract system, the contractors used to collect the same from these businessmen at different points while the latter returned excise duty on hemp and opium was abolished in 1973/74, while pig-hair, hide and skin were exempted from excise duty in 1970/71.

However, in the case of liquor, the contract system was still in vogue until 1995/96, although it must be said that until 1960 there was a limited number of businessmen involved in liquor contracts. Since it was difficult control and regulates a large number of small businesses, the practice was to award contracts to big business that offered the quoted; the distillery had to pay up the balance irrespective of production. On the other hand, if the amount of tax thus paid was higher than the minimum amount, it was not refunded to distillery. The underlying objective was to exercise control over the production and quality of liquor.

However, the enforcement of the contract system, the minimums guarantee system and the normal excise collection system. This culminated in the abolition of the contract and

the minimum guarantee system during the fiscal year 1996/97, a year that saw the government issuing licenses to low quality liquor distillers. (Khadka, 2005)

### 4.3 Evolution of Modern Tax Administration:

Efforts aimed at modernizing tax administration go back to the year 1951, the year that the Ministry of Finance first came into being. The ministry had a revenue section to deal with tax administration at a central level. This section formulated tax policies and regulations, which were gazette forthwith. Efforts were undertaken to abolish the contact system of revenue collection. Similarly, Steps were also undertaken to abolish internal customs offices. Customs offices at the border replaced offices known as Bazar Adda. Customs tariffs were rationalized even as the authorities annulled Sanad Sawat (tax laws), which went back to the Rana regime. The years, which followed, saw enforcement of several steps with the holistic view of modernizing the tax administration. What follows is a brief outline of the steps taken.

#### 4.3.1 Customs and Excise Administration:

Under the Indo-Nepal Treaty of 1950, Nepal was obligated to open customs offices in different parts of the Terai region. Bhairahawa, Biratnagar, Birgunj, Janakpur, and Nepalgunj were Border towns which possessed such offices. Subsequent phases saw such customs offices opening up elsewhere too. These were classified into different categories on the basis of the volume of exports and imports and eventual collection of revenue.

The Office of the customs Commissioner was set up in 1957. It was a central level body. However, this office was converted into the Customs and Excise Department in 1959, a year that saw customs offices assigned the duty of collecting excise duty on agricultural contracts and industrial production along with customs duties. In 196, as the scope of both customs duties and excises expanded, the customs and Excise department was split into two separate departments: the customs Department and the Excise Department. Various excise offices were created under the Excise Department. These officers were classified into different categories. For examples, excise offices were classified into 5 categories as follows:

Table 4.1

Excise Office Classification

Class of Office	Annual Revenue Collection (Rs. In 000)
Class A	Over Rs. 4,000
Class B	Rs. 1,000 to Rs. 4,000
Class C	Rs. 500 to Rs. 1,000
Class D	Rs. 100 to Rs. 500
Class E	Up to Rs. 100

Customs Offices have been divided into main and sub-customs offices. Now the number of main customs offices and sub-customs offices is 29 and 143, respectively.

#### **4.3.2 Land Revenue Administration:**

The Land Revenue Department is the oldest revenue department and was under the jurisdiction of the Ministry of finance until late 1987, at which point it was put under the jurisdiction of the Ministry of land reform and Management. The number of land revenue offices has increased over the years, and now there is at least one land revenue office in each district. There are 3 land revenue offices in the Kathmandu district, 2 offices in the Kailali, Jhapa, Moran, Siraha, Nawalparasi, Baglung and Sankhuwasabha district and one office each in another 67 districts, making for a total of 84 land revenue offices.

The land revenue administration maintains records of land ownership, involved with the registration of land transaction, issues certificates of land ownership and collects house and land registration duties. Until January 1996, the land revenue administration used to collect land revenue directly in those districts where the land survey had been completed under the Land (Survey and Management) act 1964, while land revenue used to be collected through middlemen in other districts. The function of collecting the land revenue was transferred to local bodies like village Development Committees (VDCs) and municipalities in early 1996. (Khadka, 2005)

#### **4.3.3 Tax Administration:**

Tax administration was created as the Tax Directorate in 1959, the Internal Revenue Department in 1961/62 and the Tax Department in 1964, there were tax offices in 6 places like Kathmandu, Birgunj, Biratnagar, Nepalgunj, Bhairahawa and Janakpur. In Kathmandu, there were two offices: known as the eastern and western offices. The number of tax offices increased gradually. Tax offices were classified as zonal offices and branch offices over the years. For Example, there were 12 zonal offices and 12 branch office under these zonal offices until 1977/79, zonal and branch office were converted into tax offices.

The number of tax offices increased over the years. Similarly, area offices and unit offices were set up in smaller areas over the years. The number of tax offices, area offices and unit offices was 31, 7 and respectively in 2001- the year when tax administration and Value Added Tax (VAT) administration were merged together and the Inland Revenue Administration was created.

Originally, the Tax Department and field offices under this department were responsible for administering income tax, foreign investment tax, and urban house and land tax. Several new taxes including air travel tax, contract tax, house rent tax, sales tax, road toll, vehicle tax, interest tax and loan tax were introduced over the years which were kept under the hand of this administration. However, there was more or less the same organizational structure with unchanged strength. This ruled out any chance of the department keeping pace with development of the tax system. Moreover, the only tax, which interested the officials, was income tax and other varieties received little attention.

#### **4.3.4 Sales Tax Administration:**

Sales tax, which was one of the major sources of tax-based revenue, had remained very much neglected from the administrative of view for a long time. It was administered by the Tax Department, but there was not much organizational support with unchanged staff. As the Tax Department was already saddled with the task of administering about a dozen other taxes, it could not pay any attention to the implantation aspect of the sales tax.

However, sales tax started attracting some attention in the mid-1980s. This made evident by the creation of a sales tax unit within the Tax Department in 1984/85, tasked with looking into sales tax matters. Similarly, tax officials were deputed to handle this in tax offices. The arrangement did not prove as effective as expected largely because officials enough for the authorities to consider a separate unit for administration. Consequently, sales tax branch offices were set up in six big industrial cities (Bhairahawa, Biratnagar, Birgunj, Janakpur, Katmandu and Nepalgunj) in 1985/86, with Dharan and Hetauda having the same in the course of 1988/89

The year 1992 saw creation of a separate Sales Tax Department, and the sales tax branch offices were brought under the purview of this department. 1993 saw the Excise Department and the Sales Tax Department merging together to form the Sales Tax and Excise Department.

The Sales Tax and Excise Department had 18 field offices and 471 officials out of 471 staff. Evidently, the number of non-gazette staff was too many, with most of them experienced only in excise administration.

The mechanism surrounding sales tax and excise duty administration was functioning in a traditional way, Under this system, the same officer used to be responsible for the discharge of every task like registration, assessment and collection of a specific tax in a particular area. Evidently, such an organizational structure suffered from many limitations. For example, since it used to take a long time and considerable investment to train tax offices on all aspects of taxes, it was not possible to create any specialists. Absence of internal monitoring created scope for nefarious collusion between taxpayer and tax officer, leaving the system prone to corruption and abuse of authority. Additionally, the system suffered from a lack of an inspection, audit and enforcement section. This has to be viewed against the backdrop of a scenario where by sales tax and excise administration were deemed as the least important assignments of overall revenue administration, so much so that revenue officials preferred to work either in the tax or the customs offices. Conversely, officials who could not be tolerated on the tax or the customs administration used to be transferred to the sales tax and excise administration, which mobilized than 40.

Percent of total tax revenues was very much a neglected segment of the revenue administration.

This explains why the structure of the mechanism involved in sales tax and excise duty was not deemed fit for possible switchover to VAT . The need was felt for a revamp and necessary reorientation of the concerned section of the bureaucracy before the enforcement of VAT. Soon a new organizational structure and personnel administration system was drawn up, and subsequently approved. VAT administration went into enforcement on July 16, 1996, with Sales Tax and Excise duty Administration being converted into VAT Administration.

#### **4.3.5 VAT Administration:**

The VAT organization was structured along functional lines. Sections and sub- sections were created for each function. Large taxpayers, tax refund, taxpayer service, tax audit and investigation, internal monitoring, collection and registrations were important sections. The duties of each unit and the job description of each position in the organization were spelt out clearly. Under the functional structure, a tax officer was made responsible to carryout a specific job like registration, collection, refund or audit. The inherent idea is to allow any tax officer to meet his /her career aspirations and interests and to nurture

specialists in the area of tax administration. Evolution of a corruption-free system was considered as a precondition for an efficient and transparent tax administration.

Since the bulk of the tax come from a few taxpayers that pay high taxes, a large taxpayer unit was created within the department of VAT in order to treat the in the way that best suited them needs.

Similarly, an internal monitoring unit was also created in order to examine whether or not all tasks assigned to the VAT administration were carried out in the desired fashion. to this end, personnel from the internal monitoring section analyzed the performance of various sections in the department and field offices. They fixed targets fro frequency of visits, and the issues which mush be looked into in each major area of work. They prepared a checklist that covered all major functions of the tax administration based on advice from the management of the VAT Department. The unit visited VAT offices periodically and extended advice to AVT forces in case of errors, and also submitted reports to the higher functionaries outlining their findings. They also conducted follow-up their reports and dealt with any special issues that cropped up form time to time.

Since about 60 percent of total revenue was generated from imports by the customs offices, it was necessary to conduct internal monitoring of imports. However, this proved ineffective since it was restricted in scope. The idea concerning internal monitoring was agreed to in principle, but was not implemented owing to a lack of interest on the part of the customs administration.

Meanwhile, a new personal administration system was introduced for the administration of VAT. Under this system the number of gazette officers was raised while the numbers of non-gazette clerical personnel were cut down.

The Department of VAT and its field offices were responsible for administering VAT and excise duty. The Department of VAT was responsible forms and instructional material, compiling statistics and performing analysis, and drawing up budgets and allocating resources. Offices under it were responsible fro-collecting VAT and excise duty.

How ever, VAT administration was not attractive. In fact, even the staffs were keen to be transferred to customs. Similarly, those posted at the ministry of Finance or at the customs or other tax offices did not want to be transferred to the VAT administration. (Khadka, 2005)

#### **4.4 Existing Organizational Structure: An Overview:**

The Ministry of Finance is the apex body concerning tax administration. The Finance Minister presides over the affairs of the ministry. A Finance Secretary and other senior level bureaucrats assist any incumbent minister with day to day work.

The Ministry of Finance is divided into nine divisions: the Revenue Administration Division, the Foreign Aid Co-ordination Division, the Budget and Program Division, the Economic Affair and Policy Analysis Division, the Corporation Co-ordination and Privatization Division, the Revenue consultation Committee, the Administration Division,

The Legal Division and the Monitoring and Evaluation Division. The existing organization structure of this ministry is given in Figure 4.1

The Revenue Division of the Ministry of Finance is responsible for overall formulating of tax policy and for evolving appropriate tax administration to implement the taxation policy. It co-ordinates and supervises the functioning of the revenue developments and Revenue Administration Training Center. It also monitors the status of both tax and non-tax revenue collection. The Revenue Consultation Committee reviews the implementation of taxation policy and recommends measure concerning reform in the taxation system and tax administration

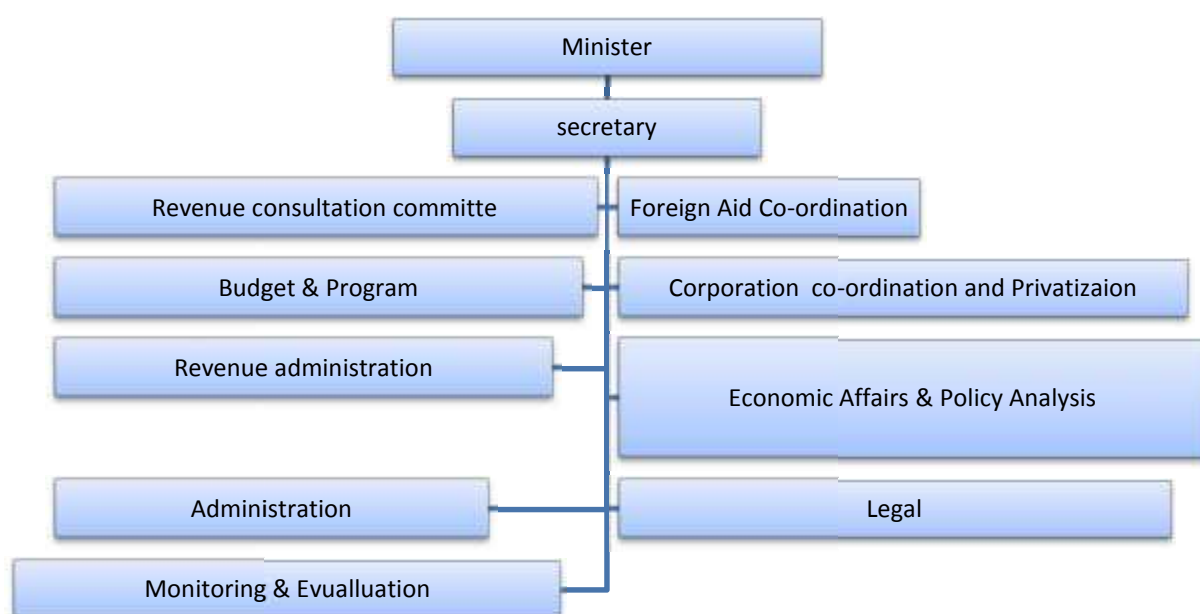
The Administration Division is concerned with personnel administrative for the whole tax administration. It is involved in creating new position, filling vacant positions, inter-departmental transfers and so on. Similarly, the Law Division is tasked with dealing with legal matters associated with various taxes.

While the civil servants under the general administrative service fall into different administrative groups there are some in the Ministry of Finance who belong to the revenue group. The total number of civil servants who belong to the revenue administration group during 2003/04 can be broken down as follows

<u>Position</u>	<u>Number of employees</u>
Under Secretary	19
Section Office	32
Nayab Subba `	38
Kharidar	14
Total position under the revenue	103
Grand total of employees of the Ministry of Finance	212

Figure 4.1

Ministry of Finance organizational Structure (2003/04)



There are three branch of tax administration under the ministry of Finance: Inland Revenue administration, Customs Administration and Revenue Investigation Administration. There is also a Revenue Administration Training Center. An outline of these administrative is given below.

#### 4.4.1 Inland Revenue Administration:

The Inland Revenue Administration is responsible under the Ministry of Finance: Inland Revenue administration, Customs Administration also administers the tourism development fee and motion picture development fee on behalf of the Nepal Tourism Development Board and Motion Picture Development Board, respectively. It also collects health tax, which is levied on tobacco products and laconic beverages. Revenue mobilized form this tax, however, is allocated to funding programs aimed controlling cancer.

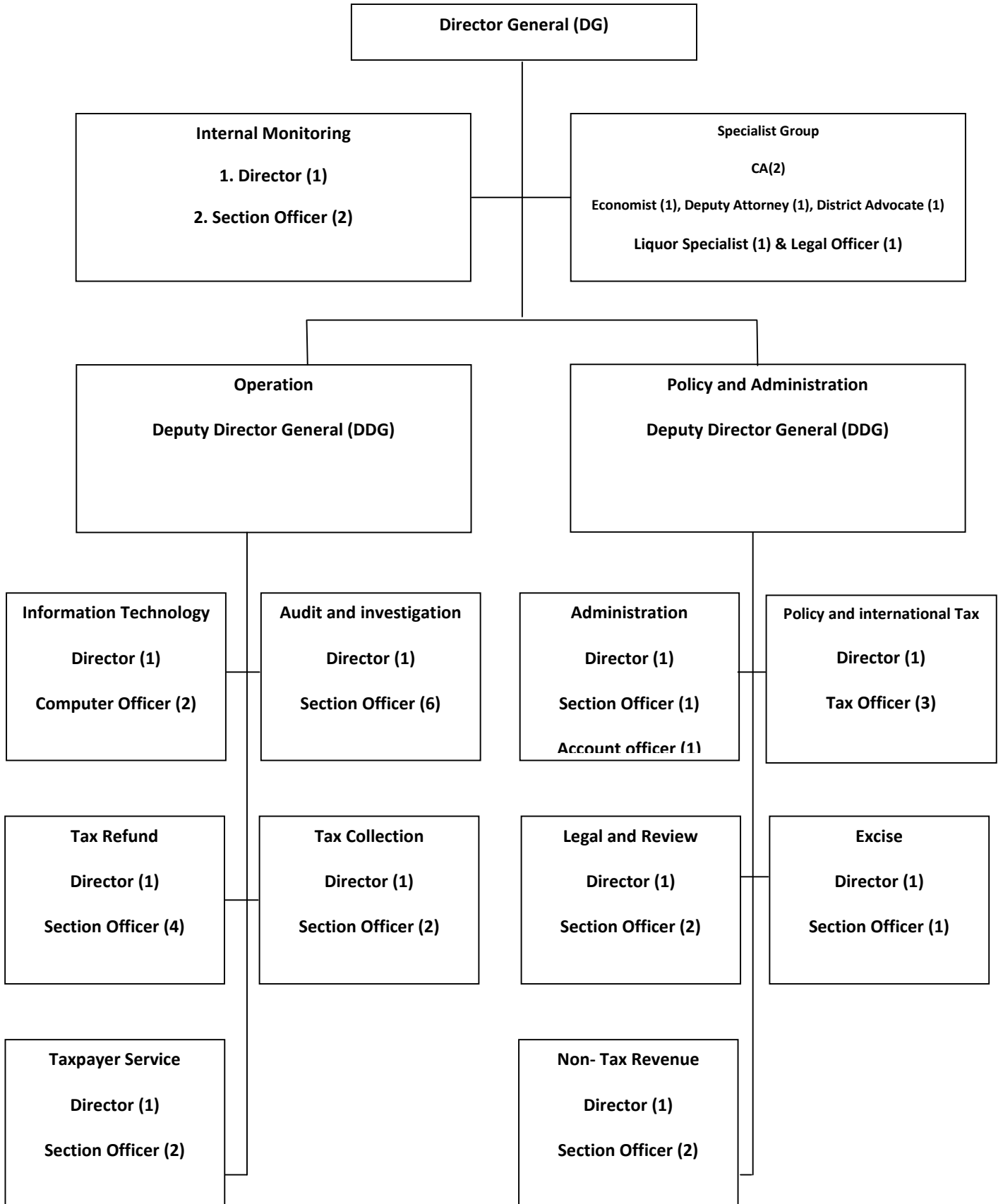
The Inland Revenue Administration consists of the Inland Revenue Department, 1 Large Taxpayer Office (LTO), 21 Inland Revenue Offices (IROS) and 16 window offices. Inland Revenue Development issues directives and guidance to the Large Taxpayer's Office / Inland Revenue office and monitors the functioning. While the Large Taxpayer's office / Inland Revenue offices are responsibility for the day-to-day operations of collecting taxes, window .

Offices extend some basic services such as supplying tax-related information to the taxpayers and receiving returns from them.

The Inland Revenue Department is structured along functional lines, which means there are different sections and sub-sections according to the major functions of the department. The organizational structure of the Inland Revenue Department is given figure 6.3 below.

Figure4.2:

Inland Revenue Department Organizational Structure (2003/04)



#### 4.4.2 Customs Administration:

The Customs administration is mainly responsible for enforcing customs duties, agricultural reform levies, VAT and excise duty on imports. It also collects the local development fee and special duties.

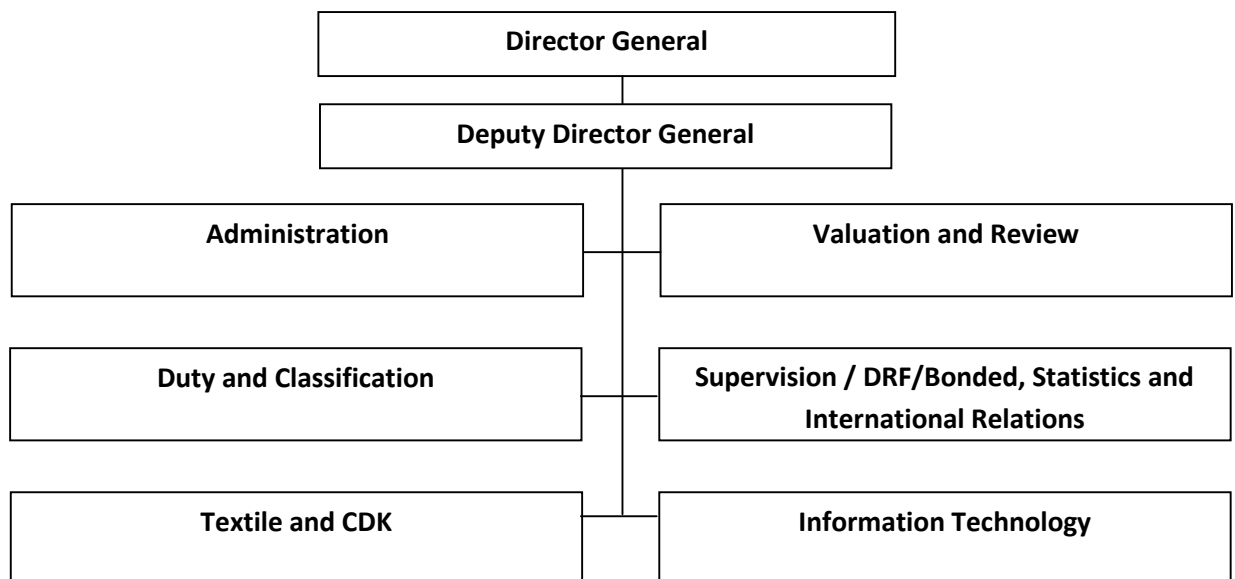
The Customs Department is involved in outlining operational guidelines, program development and evaluation, designing forms and instruction manuals, collecting and publishing international trade statistics, compiling statistical analyses, developing budgets, Allocating resources and dealing with matters relating to the world Trade Organization, etc.

Customs offices are responsible for assessing and collecting customs duties, preventing fraud and smuggling and controlling carriers, persons and articles entering into and leaving the country. These offices are also involved in collecting VAT, excise duties and advance income tax, if any, on imports. They also collect special duty on imports and the local development fee, a tax levied on the imports of goods on behalf of the municipalities.

The organizational structure of the Customs Administration does not strictly follow a particular line. While the organization structure of customs offices does not follow the functional line. The organization structure of the Customs Department is given figure 6.4 below.

Figure 4.3

Customs Department Organizational Structure (2003/04)



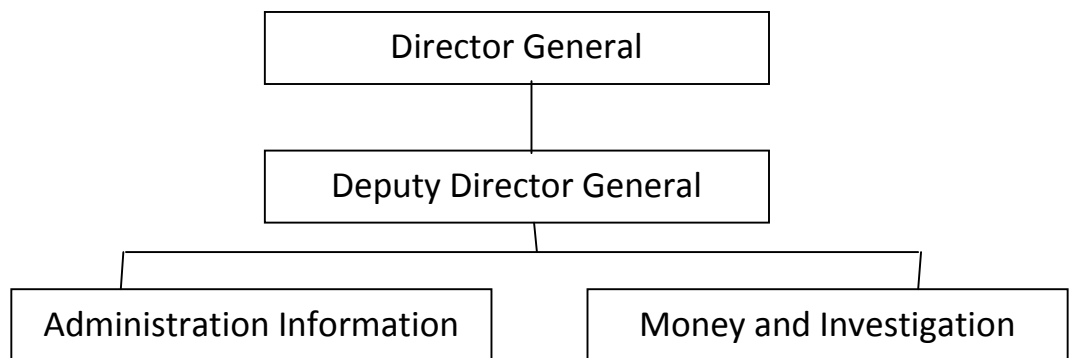
#### 4.4.3 Revenue Investigation Department:

The revenue investigation Department investigates cases of fraud and issues surveillance orders on suspected business enterprises, taxpayers and even tax official. It reviews suspect tax assessments and investigates possible case of collusion between taxpayers and tax officials. There are 4 unit offices under the Revenue investigation Department. The unit offices located in Itahari, Pathalैया and Butwal cover the eastern, middle and western development regions respectively whole the unit office located in Kohalpur covers the mid

And far-western development regions a sub-unit has also been created at Thankot under the Revenue Investigation. The Organization structure of the Revenue Investment Department given figure 6.5 below

Figure 4.4

Revenue Investigation Department Organizational Structure (2003/04)

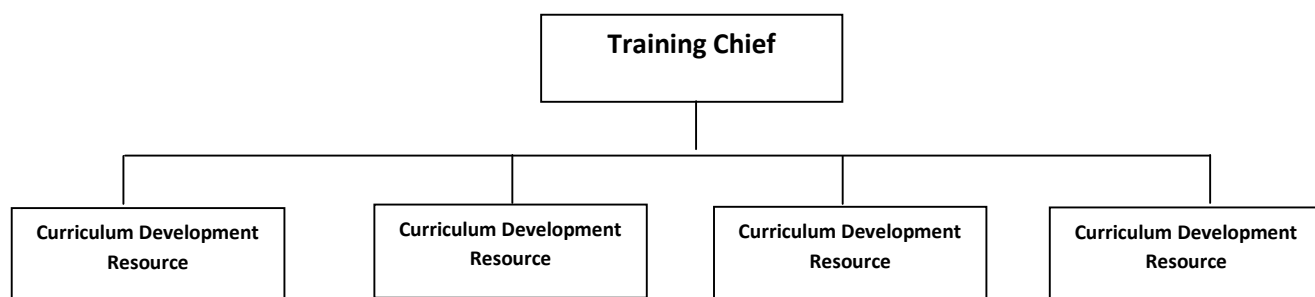


#### 4.4.4 Revenue Administration Training Center:

The Revenue Administrative Training Center is involved in conduction training programs for revenue and accounts officials. It organizes various short-term and medium-term raining programs. Short-term programs such as introductory, refresher and crash courses last up to 2 week, while medium-term programs generally last 5 week. This center also organizes seminars and also work shops on current and topical issued. It is also supposed to prepare manuals and also compile existing tax laws. The organizational structure of the Revenue Administration Training Center is given Figure 6.6 below

Figure 4.5

Revenue Administration Training Center Organization Structure (2003/04)



**4.5 Existing organization Issued :**

Currently, there are three revenue departments and one training center under the Ministry of Finance. There is a lack of necessary co-ordination amongst them all, with each department cleaving to its own interests. For example while taxes are levied on transaction value as a matter of principle, there is, however, no unanimity or uniformity of various on this issue between the customs Department and the Inland Revenue Department. As things stand, customs duties are levied on an *ad hoc* basis. *Inter alia*, they argue that such a value is fixed only for the customs purpose, not for the purpose of other taxes. What they do not pay attention to is that it creates a problem all the way to the retail level when it comes to issuing proper invoices. The customs Department blames the Inland Revenue Department and the Inland Revenue Department blames the customs Department for the job, which is not handled in the desired manner.

Meanwhile, much has been invested in the computerization of both the Inland Revenue Department and the Customs Department, mainly through the technical assistance extended by donors. However, there is far too little use of this information technology infrastructure, thus rendering the exercise of retrofitting the existing infrastructure a futile task.

Since there is an utter lack of co-ordination and co-ordination between the Inland Revenue Department and the customs Department, this indicates the need for the merger of this administration too. Integration is a highly desirable alternative when it comes to maintaining proper co-ordination in the administration of customs duties and other taxes and to bring uniformity in the processes and procedures of customs duties, VAT, income tax and excise duties. Integration would also bring economies of scale and minimize both administrative and compliance costs. It would also be useful to harmonize administrative procedures and practices. In that case, it would be also necessary to merge the Revenue Investment Department and Revenue Administration Training Center to create a single authority concerning all forms of taxes and duties.

However, the integration of these organizations is something which cannot be done overnight. It would require detailed planning and a lot of persuasion. Given the political atmosphere, the working style of the bureaucracy, the attitude of the administrators and the availability of financial resources; it would be realistic to draw a medium-term plan of five years for the complete merger of the revenue departments. It will be necessary to address many organizational, personnel and physical issues for a smooth transition to unified revenue administration.

Taxpayers are supposed to make tax payments at certain specified bank branches only. Currently only the following banks have been specified to accept cash from Taxpayers: (Khadka, 2005).

<b>Bank</b>	<b>No. of branches allowed accepting tax revenue</b>
Rastriya Banijya Bank	71
Nepal Bank Limited	50
Nepal Rastriya Bank	9
Nepal Bangladesh Bank (Tatopani)	1
Total	131

## Chapter-5

# DATA PRESENTATION AND ANALYSIS

### 5.1 ANALYSIS OF SECONDARY DATA:

#### 5.1.1 Resource Gap in Nepal:

Like other developing countries in the world, Nepal has been suffering from resource constraint, mass poverty, rapid growth of population, aggressive dependence on agriculture, subsistence living standard etc despite over four decades planned development efforts.

In Nepal, the source mobilization is still poor that does not cover the growing expenditure. Fiscal deficit is due to the continuously growing of the government instead of the low revenue performance in Nepal. That is why country is facing the increasing burden of foreign loan. Widening trend of the different resource gap is show in table 5.1.

As shown in the table, resource gap<sup>a</sup> of Rs.4137.6 million in fiscal year 1982/83 reach to Rs30941.5 million in the fiscal year 2000/01. It is continuously increasing trend. Resource gap<sup>a</sup> was decreased in the fiscal year 2001/02, 2002/03 and 2003/04 compare to previous year. Resource gap<sup>d</sup> (after considering foreign grants) was Rs. 3047.5 in the starting year and further widen up to Rs204188.1 million in fiscal year 2000/01. It was decreased in the fiscal year 1989/90 by the 141.10 million than the previous year and also decreased in the fiscal year 1993/94, 1994/95, 2002/03 and 2003/04. The government takes internal and external loan to meet deficit finance .Foreign loan had taken RS.985.80 million in the fiscal year 1982/83 and Rs.7629 million in 2003/04. After Foreign loan financing, resource gap<sup>c</sup> was Rs.2061.7 million in the fiscal year 1982/83 and increased to Rs.8199.20 million in the fiscal year 2003/04. The internal loan in the fiscal year 1982/83 had taken Rs.1000.0 million and Rs.5607.80 million in 2003/04. Even after loan (external and internal) financing, cash deficit has existed in Nepalese public finance. After internal loan financing, there was Rs.1061.70 million-deficit finance in the fiscal year 1982/83, Rs.3415.10 million in 1992/93 and Rs.2591.40 million in 2003/04. Thus, this increasing resource gap indicates that it necessary to additional domestic. Ultimate and the best measure to fill the resource gap is to increase public through effective tax system.

Table 5.1.1

## Resource Gap in Nepal

(Rs. In Million)

Fiscal Year	Total Expenditure (A)	Total Revenue (B)	Resource Gap <sup>a</sup> (A-B)	Foreign Grants (C)	Resource Gap <sup>b</sup> {A-(B+C)}	Foreign Loan (D)	Resource Gap <sup>c</sup> {A-(B+C+D)}
1982/83	6979.2	2841.6	4137.6	1090.1	3047.5	985.5	2061.7
1983/84	7437.3	3409.3	4028.0	876.6	3151.4	1670.9	1480.5
1984/85	8394.8	3916.7	4478.1	923.4	3554.7	1754.9	1799.8
1985/86	9797.1	4644.5	5152.1	1172.9	3979.7	2501.1	1478.6
1986/87	11513.2	5957.1	5556.1	1285.1	4271.8	2705.8	1565.2
1987/88	1410.5	7350.4	6754.6	2076.8	4677.8	3815.8	862.0
1988/89	18005.0	7776.9	10228.1	1680.6	8547.5	5666.4	2881.1
1989/90	19669.3	9287.5	10381.8	1975.4	8406.4	5959.6	2446.8
1990/91	23549.8	10729.9	12819.9	2164.8	10655.1	6256.7	4398.4
1991/92	26418.2	13512.7	12905.5	1643.8	11261.7	6816.9	4444.8
1992/93	30897.7	15148.4	15749.3	3793.3	11956.3	6920.9	5035.1
1993/94	33597.4	19580.8	14016.6	2393.6	11623.0	9163.6	2459.4
1994/95	39060.0	24575.2	14484.8	3937.1	10547.7	7312.3	3235.4
1995/96	46542.4	27893.1	18649.3	4825.1	13824.2	9463.9	4360.3
1996/97	50723.7	30373.5	20350.2	5988.3	14361.9	9043.6	5318.3
1997/98	56118.3	32937.9	23180.4	5402.6	17777.8	11054.5	6723.3
1998/99	59579.0	37251.0	22328.0	4336.6	17991.4	11852.4	6139.0
1999/00	66272.5	42893.8	23378.7	5711.7	17667.0	11812.2	5854.8
2000/01	79835.1	48893.6	30941.5	6753.4	24188.1	12044.0	12144.1
2001/02	80072.3	50445.5	29626.8	6686.1	22940.7	7698.7	15242.0
2002/03	84006.1	56229.8	27776.3	11339.1	16437.4	4546.4	11890.8
2003/04	89442.6	62331.0	27111.6	11283.4	15828.2	7629.0	8199.2

Source: Economic Survey, 2004/05, Ministry of Finance, 2005, Kathmandu.

**5.1.2 Tax-GDP Ratio:**

Tax-GDP and Tax effort ratio in Nepal from fiscal year 1982/83 to 2001/02 is presented in the table 5.3. Average tax –GDP ratio is 8.42 percent. Tax –GDP ratio in 1982/83 was 7.17

percent and revenue –GDP ratio was 8.42 percent for the same year. Tax GDP ratio has fluctuated from 6.81 to 9.88 percent. Minimum revenue-GDP ratio was 8.42 percent in the fiscal year 1982/83 and maximum 12.47 percent in 2001/02. Average revenue and has reached to 12.57 percent in the fiscal year 2003/04.

Table 5.1.2

**Tax –GDP and Tax-effort Ration in Nepal**

<b>Fiscal year</b>	<b>Tax –GDP ratio</b>	<b>Revenue-GDP ratio</b>
1982/83	7.17	8.42
1983/84	6.95	8.66
1984/85	7.09	8.82
1985/86	7.26	9.21
191986/87	7.56	10.30
1987/88	7.86	10.05
1988/89	7.33	9.06
1989/90	7.31	9.32
1990/91	7.04	9.24
1991/92	6.81	9.32
1992/93	7.05	9.16
1993/94	8.02	10.22
1994/95	9.36	11.70
1995/96	9.05	11.65
1996/97	9.06	11.27
1997/98	8.95	11.37
1998/99	8.71	11.29
1999/00	9.05	11.71
20001/01	9.88	12.42
2001/02*	9.72	12.47
2002/03	9.36	12.36
2003/04	9.72	12.57

\*The Figures of GDP are revised estimate.

GDP is taken in current Price.

Source: Economic Survey, 2004/05, Ministry of Finance, 2005, Kathmandu.

### 5.1.3 Nepalese Government Revenue Structure:

Government collects revenue from different sources. Basic sources of the government revenue are classified into tax and non-tax revenue. Nepalese economy is characterized by a low revenue performance in contrast to the growing public expenditure. The composition of government revenue from fiscal year 1982/83 to 2003/04 is presented in the table 5.4. The tax revenue of fiscal year 2003/04 was 77.28 percent as compared to 85.20 percent in and that was 14.80 percent in the initial of the study (i.e. fiscal year 1982/83). This indicates the role of tax revenue is very important in revenue mobilization of Nepal to meet the government expenditure. The total tax revenue in fiscal year 1982/83 was 2421.10 million, which is increasing every year and reached Rs.48173 million in fiscal year 2003/04 but in percentage on the total revenue has been fluctuating from 85.20 percent to 73.18 percent. The highest contribution of tax revenue to total revenue was 85.20 percent with amounting Rs.2421.1 million in fiscal year 1982/83 and lowest contribution was 73.1 percent with amounting Rs.9875.6 million in fiscal year 1991/92

From the fiscal year 1982/83 to 2003/04, the amount of non-tax revenue found increasing every year except fiscal year 1987/88, 1988/89 and 1996/97 with amount of Rs. 420.5 million to Rs. 11115.0 million. Non tax revenue for the fiscal year 1987/88 was 1597.6million and it had decreased by Rs. 5.10 million in compare to previous year. It further decreased to 1489.6 million in the fiscal year 1988/89. Then after, it is increasing continuously in absolute terms but percentage contribution has been fluctuating. Highest contribution was 26.82 percent in fiscal year 1986/87 with amounting Rs. 1602.7 million and lowest contribution was 14.80 percent in fiscal year 1982/83 with amounting of Rs. 420.5 million. The share of tax revenue has always been greater than the share of non tax revenue. Mean contribution of tax and non tax revenue to total revenue is 78.28 percent and 21.72 percent with in the study period respectively.

Table: 5.1.3

**Composition of Total Revenue**

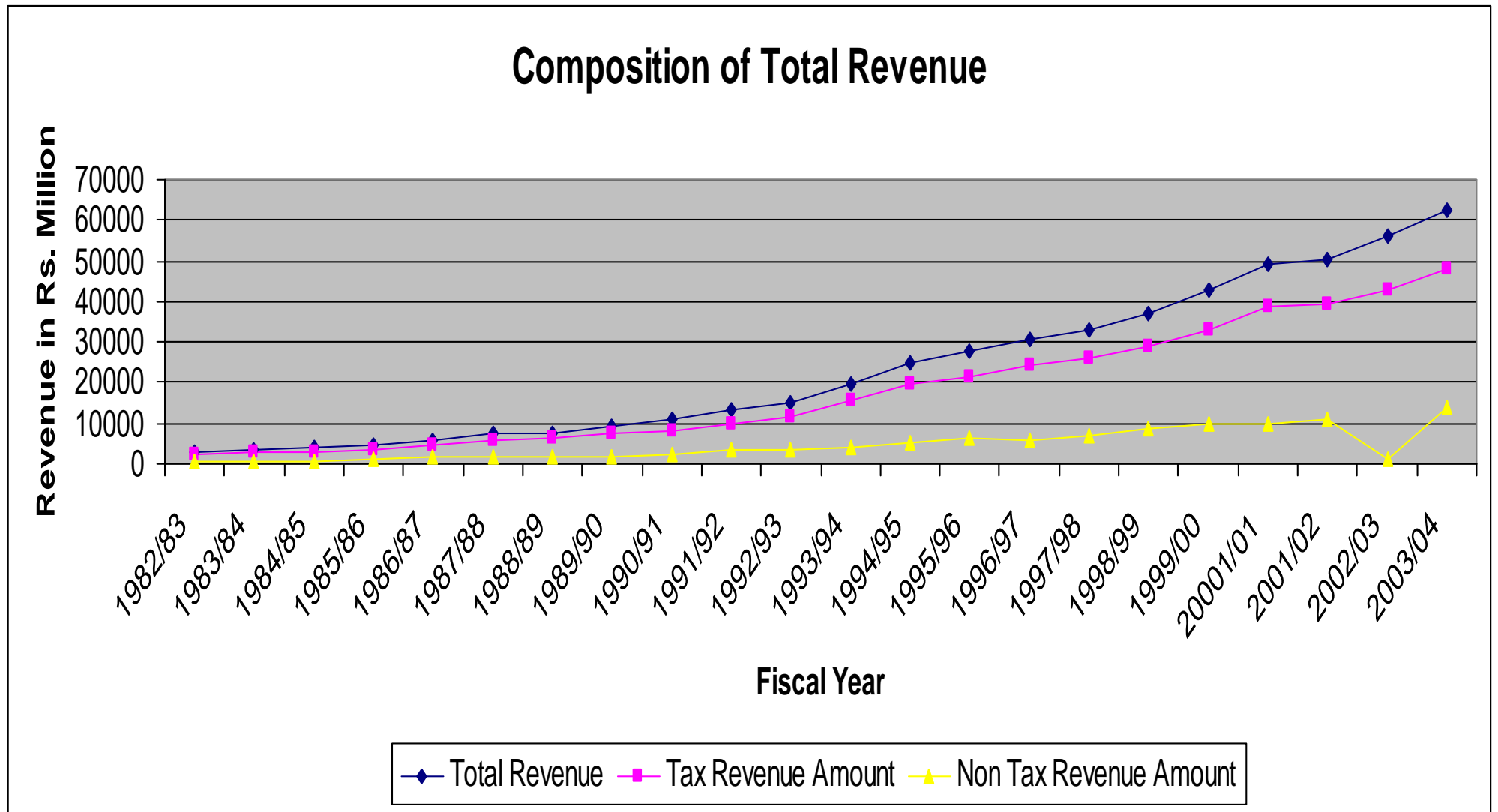
Rs. In Million.

Fiscal year	Total Revenue	Tax Revenue		Non Tax Revenue	
		Amount	Percentage as Total revenue	Amount	Percentage as Total Revenue
1982/83	2841.6	2421.1	85.2	420.5	14.8
1983/84	3409.3	2737.0	80.3	672.3	19.7
1984/85	3916.8	3151.2	80.5	765.6	19.5
1985/86	4644.5	3659.3	78.8	985.2	21.2
1986/87	5975.1	4372.4	73.2	1602.7	26.8
1987/88	7350.5	5752.9	78.3	1597.6	21.7
1988/89	7776.8	6287.2	80.8	1489.6	19.2
1989/90	9287.5	7283.9	78.4	2003.6	21.6
1990/91	10730.9	8177.4	76.2	2553.5	23.8
1991/92	13512.7	9875.6	73.1	3637.1	26.9
1992/93	15148.4	11662.5	77.0	3485.9	23.0
1993/94	19580.9	15371.5	78.5	4209.4	21.5
1994/95	24605.1	19660.0	79.9	4945.1	20.1
1995/96	27893.1	21668.0	77.7	6225.1	22.3
1996/97	30373.5	24424.3	80.4	5949.2	19.6
1997/98	32937.9	25939.8	78.8	6998.1	21.2
1998/99	37251.3	28752.9	77.2	8498.4	22.8
1999/00	42893.7	33152.1	77.3	9741.6	22.7
2000/01	48893.9	38865.1	79.5	10028.8	20.5
2001/02	50445.6	39330.6	78.0	11115.0	22.0
2002/03	56229.7	42587.0	75.74	1364.7	24.26
2003/04	62331.0	48173	77.28	14158.0	22.71

Source: Economic Survey 2004/05, Ministry of Finance, 2005, Kathmandu

Composition of total revenue of Nepal from the fiscal year 14982/83 to 2003/04 is shown in the figure no.5.1 following pages:

Figure 5.1.1



#### 5.1.4 Composition of Tax Revenue in Nepal:

Tax revenue is the principles source of the government revenue; however its contribution differs significantly in different countries. In the context of Nepalese economy, economy, tax revenue is the major measure to mobilize internal resources effectively and properly as it has been dominating the government revenue by contributing around 80 percent of the tax revenue. Tax revenue in Nepal constitutes direct tax revenue.

The figure of direct and indirect tax revenue from fiscal year 1982/83 to 2003/04 is presented in the table as below.

Table 5.1.4

#### Composition of Total Tax Revenue

(Rs. In Million)

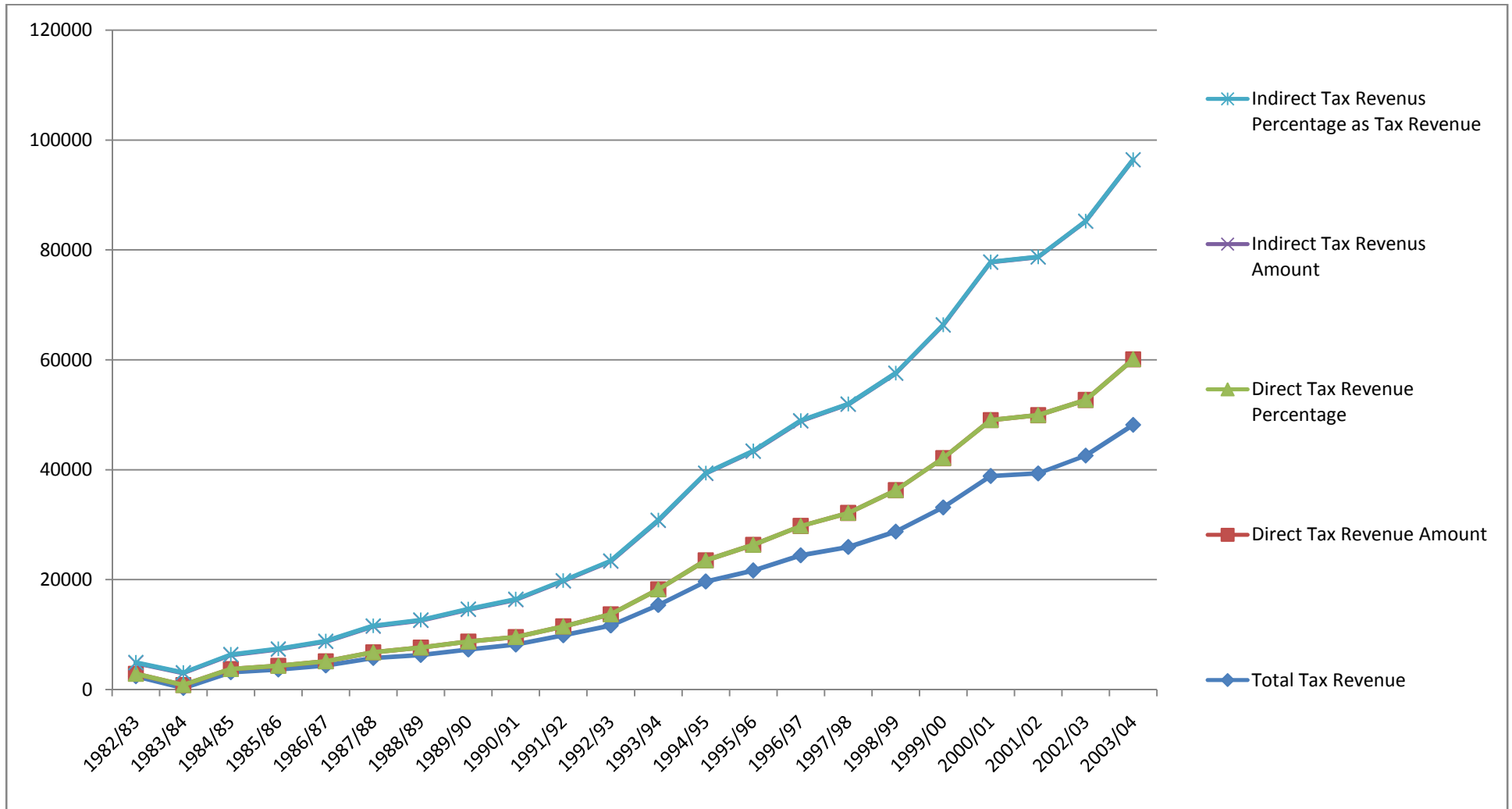
Fiscal year	Total Tax Revenue	Direct Tax Revenue		Indirect Tax Revenues	
		Amount	Percentage	Amount	Percentage as Tax Revenue
1982/83	2421.1	445.1	18.4	1976.0	81.6
1983/84	273.0	541.8	19.8	2195.2	80.2
1984/85	3151.2	559.7	17.8	2591.5	82.2
1985/86	3659.3	661.8	18.1	2997.5	81.9
1986/87	4372.4	768.7	17.6	3603.7	82.4
1987/88	5752.9	1010.2	17.6	4742.6	82.4
1988/89	6287.2	1331.4	21.2	4955.8	78.8
1989/90	7283.9	1435.1	19.7	5848.8	80.3
1990/91	8177.4	1369.7	16.7	6807.7	83.3
1991/92	9875.6	1595.2	16.2	8280.4	83.8
1992/93	11662.5	2036.2	17.5	9626.3	82.5
1993/94	15371.5	2855.3	18.6	12516.0	81.4
1994/95	19660.0	3849.3	19.6	15810.7	80.4
1995/96	21668.0	4655.9	21.5	17012.1	78.5

1996/97	24424.3	5340.0	21.9	19084.3	78.1
1997/98	25939.8	6187.9	23.9	19751.7	76.1
1998/99	28752.9	7516.1	26.1	21236.8	73.9
1999/00	33152.1	8951.5	27.0	24200.6	73.0
2000/01	38865.1	10159.4	26.1	28705.7	73.9
2001/02	39330.6	10597.5	26.9	28733.1	73.1
2002/03	42587	10105.8	23.7	32481.2	76.3
2003/04	48173	11912.6	24.7	36260.4	75.3

Source: Economic Survey 2004/05, Ministry of Finance, 2005, Kathmandu.

Figure No. 5.1.2

Composition of Tax Revenue



The trend and also in absolute Value, total tax revenue, direct tax and indirect tax is increasing. Direct tax includes income tax, land revenue and registration, urban house and land tax, Property tax, vehicles tax whereas indirect tax includes customs, sales tax (VAT), entertainment tax, air flight tax, contract tax, contract tax, road and bridges maintenance tax.

The mean share of direct tax revenue was Rs. 3833.92 million and that of indirect tax revenue was Rs. 14064.45 million. The amount of direct tax was Rs. 445.10 million in the fiscal year 1982/83. It is increasing each year and has reached to Rs. 11912.6 million in 2003/04 except in the year 1990/91 and 2003/04. in the fiscal year 1990/091 , direct tax was Rs. 1369.7 million which was came down by declining Rs. 65 million compare to Previous year and in fiscal year 2002/03, direct tax was Rs. 10105.8 which was came down by declining Rs. 491.7 Million compare to previous year. Percentage contribution of direct tax to total tax revenues is fluctuating over the study period from 16.20 percent with amounting Rs. 1595.2 million to 27.0 percent with amounting Ra. 8951.5 million. Trend of total tax revenue, direct tax and indirect tax is shown in figure 5.2

### **5.1.5 Composition of Indirect Tax Revenue:**

Indirect tax is levied on the spending on goods and services and tax is not directly paid to the government by the real taxpayer. Real incidence of such tax will not fall in the business enterprises immediately responsibly for paying it; rather it will be successively passed to the final consumer, who thus bears the tax burden indirectly. Indirect taxes on foreign trade (custom duties) are more important in the poorest country and domestic taxes on goods and services (sales and exercise) more important in the other.

Customs duties, excise duties and sales tax (VAT) are the classification of the indirect tax. Customs duties are composed of import duties, export duties and export service charge, custom duties and India excise refund. Sales tax /VAT has a wider coverage since it covers most of the goods either imported or domestically produce.

Table 5.6 shows that share of the custom duties to total indirect tax is more than 37.62 percent for each year under study. Its share in the fiscal year 2003/04 is 42.90 percent.

Which was 38.51 percent in the fiscal year 1982/83 During the study period, the lowest share was 37.62 percent in fiscal year 1983/84 and highest share was 46.70 percent in fiscal year 1987/88. Share of custom duties to total indirect tax is the highest than others each year. Average share of sales tax to indirect tax is 35.51 percent. Amount of sales tax revenue in the fiscal year 1982/83 was Rs.709.2 million and had reached to Rs.14478.0 million in fiscal year 2003/04. Sales tax has occupied second position on indirect tax revenue. Sales tax revenue is increasing each year except fiscal year 1997/98 and 2001/02. Average share tax of excise duties to indirect tax is 15.65 present. The highest share was 19.96 percent with amounting Rs. 432.2 in the fiscal year 1993/84 and 10.48 percent with amounting Rs 1657.3 in the fiscal year 1994/95. Amount of excise duties is increasing each year but in percentage it is fluctuate. Contribution of other taxes to indirect taxes is 6.46 percent in average. Most items of other taxes has replaced by VAT.

Table 1.5  
Composition of indirect Tax revenue

Rs. in Million

Fiscal Year	Total indirect Tax	Custom Duties		Sales tax (VAT)		Excise duties*		Other taxes**	
		Amount	%	Amount	%	Amount	%	Amount	%
198/83	1976.0	760.9	38.51	709.3	35.90	3658.8	18.51	140	7.09
1983/84	2195.2	825.9	37.62	770.7	35.11	432.2	19.69	166.4	7.58
1984/85	1591.5	1064.5	41.08	845.8	32.64	483.9	18.67	197.3	7.61
1985/86	1997.5	1231.0	41.07	985.9	32.89	558.8	18.64	222	7.41
1986/87	1603.6	1505.7	47.78	1143.8	31.74	678.6	18.83	275.5	7.64
1987/88	4742.6	2214.6	46.70	1300.5	27.42	825.3	17.40	402.4	8.48
1988/89	1955.8	2289.9	46.21	1379.7	27.84	177.7	17.71	408.5	8.24
1989/90	5848.8	2684.9	45.91	1650.1	28.21	1097	18.76	416.8	7.13
1990/91	6807.7	3044.3	44.72	2026.1	29.76	1200.2	17.63	536.7	7.88
1991/92	8280.4	8280.4	40.56	2840.7	34.31	1414.3	17.08	666.5	8.05
1992/93	9626.3	9626.3	40.98	3438.2	35.72	1452.8	15.09	790.3	8.21
1993/94	12516.2	12516.2	41.99	4693.1	37.50	1592.5	12.72	975.6	7.79
1994/95	15810.7	7018.1	44.39	6031.7	38.15	1657.3	10.48	1103.6	6.98
1995/96	17012.1	7327.4	43.07	6431.3	37.80	1944.3	11.43	1309.1	7.70
1996/97	19084.3	8309.1	43.54	7126.5	37.34	2298.1	12.04	1350.6	7.08
1997/98	19751.9	8502.2	43.05	7122.6	36.06	2885.8	14.61	1241.3	6.28
1998/99	21236.8	9517.7	44.82	7882.2	37.12	2953.2	13.91	883.7	4.16
1999/00	24200.6	10813.3	44.68	9854.9	40.72	3127.6	12.92	404.8	1.67
2000/01	28705.7	12552.1	43.73	12047.8	41.97	3771.2	13.14	334.6	1.17
2001/02	28733.1	12658.8	44.06	11964	41.64	3807	13.25	303.3	1.06
2002/03	32481.2	14236.4	43.83	13459.7	41.43	4785.1	14.73	0.0***	0.00
2003/04	36260.4	15554.8	42.90	14478.9	39.93	6226.7	17.17	0.0	0.00

\* It is the sum of taxation on industrial product and liquor contact

\*\* It includes entertainment tax, hotel tax, air flight tax, contract tax, road and bridges, maintenance tax and some others .However VAT replaced majors of these from 1997.

\*\*\* Provisional:- Due to reclassification of the headings of revenue, amount of revenue of some tax headings may not match with previous data. Value added tax includes sales tax, entertainment tax, hotel tax, air flight tax and contract tax etc.

Source: Economic Survey 2004/05, Ministry of finance, 2005, Kathmandu.

### 5.1.6 Composition of Direct Tax Revenue:

Direct tax is a levy by the government on the income and wealth received by households and business enterprises in order to raise revenue as an instrument of fiscal policy. It is progressive so far as the amount paid varies significantly according to the income and wealth of the tax payer. Direct tax in Nepalese economy is composed of different taxes namely: income tax, land tax, property and wealth tax, tax on registration. In Nepalese tax revenue structure, the contribution of direct tax and share of other components are shown in the table 5.7.

In the table, direct tax is classified into land and revenue & registration and tax on property, profit & income. Land revenue and registration is further classified into land revenue and house & land registration. House and land revenue registration is higher than land revenue each year. The share of Land revenue and registration was Rs.171.5 million in fiscal year 1982/83 and it is increasing each year up to fiscal year 1995/96. Then, it has started to decline each year. It was Rs.1066.6 million in 1995/96 and declined to Rs. 1003.2 in the fiscal year 1998/99. It increased by 12.7 million in fiscal year 1999/00 compare to previous year but it again declined by about 40 percent than fiscal year 1999/00. In case of percentage, it has fluctuated from 6.03 to 39.88 percent. Mean Contribution of land Revenue and Registration is 26.64 percent. The highest percentage Contribution was 39.88 percent in the fiscal year 1991/92 with amounting Rs. 636.1 million and lowest was 6.03 percent in the fiscal year 2000/01 with amounting Rs.612.9 million.

Another source of direct tax revenue is tax on property, profit and income. The share of property, profit and income tax to direct tax revenue is not less than 60.12 percent and not more than 93.97 percent over the study period. Total amount of it was Rs.273.6 in the initial period and increasing each year except fiscal year 1990/91 and 2001/02. Its highest share was Rs.10215.10 million in the fiscal year 2003/04 and lowest of Rs.273.6 in the fiscal year 1982/83. Average share is 73.035 percent

Table 5.1.6

## Composition of Direct Tax Revenue

Fiscal Year	Total Direct Tax	Land revenue and registration				Tax on profit and income				
		Land Tax	House, Land Registration	Total	% of Total Income Tax	Income Tax	Tax on Property	Other tax	Total	% of Total Income Tax
1982/83	450.1	6607	104.8	171.5	38.10	251.2	22.4	5.0	273.6	62.90
1983/84	541.8	77.2	135.2	212.4	39.20	298.8	30.5	0.1	329.4	60.80
1984/85	559.7	76.9	141.7	218.6	39.06	313.7	27.4	0.0	341.1	60.80
1985/86	661.8	74.2	170.1	244.3	36.91	374.6	28.4	14.5	147.5	63.09
1986/87	769.7	72.4	211.6	284.0	36.90	448.5	36.2	1.3	468.5	63.21
1987/88	1010.2	80.7	286.2	366.9	36.32	596.1	45.7	1.5	643.3	63.68
1988/89	1331.3	80.4	320.6	401.0	30.12	879.6	50.0	0.7	930.3	69.88
1989/90	1435.1	74.6	377.1	451.7	31.48	932.1	51.0	0.3	983.4	68.52
1990/91	1369.7	82.1	456.6	540.0	39.42	783.8	24.1	21.9	829.8	60.58
1991/92	1595.2	64.8	571.3	636.1	39.88	875.0	67.7	16.4	959.1	60.12
1992/93	2036.2	69.4	685.5	754.9	37.07	1198.2	80.0	3.1	1281	62.93
1993/94	2855.3	61.0	772.2	833.2	29.18	1921.2	49.8	51.1	2022	70.82
1994/95	3849.3	34.9	902.8	937.7	24.36	2823.4	88.2	0.0	2912	75.64
1995/96	4655.9	18.2	1048.4	1066.6	22.91	3431.4	157.9	0.0	3589	77.09
1996/97	5340.0	5.9	1009.5	1015.4	19.01	4123.4	201.2	0.0	4325	80.99
1997/98	6187.9	3.6	1000.6	1004.2	16.23	4898.1	285.6	0.0	5184	83.77
1998/99	7516.1	1.4	1001.8	1003.2	13.35	6170.2	342.7	0.0	6513	86.65
1999/00	8951.5	4.6	1011.3	1015.9	11.35	7420.6	515.0	0.0	7936	93.97
2000/01	10159.4	5.1	607.8	612.9	6.03	9114.0	432.5	0.0	9547	93.97
2001/02	1097.5	0.8	1131.0	1131.8	10.68	8903.7	562.0	0.0	9466	89.32
2002/03	10105.8	0.0	1414.3	1414.3	14.00	7966.2	559.5	165.8	8691.5	86.00
2003/04	11912.6	0.0	1697.5	1697.5	14.25	9245.9	700.6	268.6	10215.1	85.75

Source: Economic Survey 2004/15, Ministry of Finance, 2005, Kathmandu

### 5.1.7 Composition of Income Tax Revenue:

Income tax is an important source of the direct tax. In the present situation, Nepal is levying three different types of income tax. They are individual having income of taxable capacity. Corporate income tax is levied on the profit of corporation. A corporation is a separate entity forms its shareholders in both legal and economic grounds. The interest tax levied on the interest received.

When income tax was introduced in Nepal in first as business profit and remuneration tax in 1959/60, it had contributed Rs.203 thousand as revenue. The composition of income tax revenue for the recent 22 years is presented in the table 5.8. Income tax is increasing each year except 1990/91, 2001/02 and 2002/03. Total income tax was Rs.251.2 million in the fiscal year 1982/83 and has reached to Rs.9245.9 million in the fiscal year 2003/04. This amount is the total of income tax from public enterprises, semi public enterprises. Private corporate bodies, individuals, remuneration are tax interest. Total income tax had collected largest amount of Rs.9245.9 in the fiscal year 2003/04.

Contribution of income tax to total income tax from public enterprises is 25.72 percent in average. Total amount contribution from public enterprises has fluctuated from Rs.53.4 million to Rs.2928.0 million .Total amount of contribution is increasing each year from Rs.53.40 million in the initial year of study and reached Rs.2056.6 million in the fiscal year 2003/04 except 1990/91, 2001/02 and 2002/03. In the fiscal year 2002/03, it was declined by 29 percent than the previous year. The contribution of income tax to public revenue from public enterprises is not satisfactory. The main reasons for unsatisfactory contribution of income tax were poor performance of public enterprises, weakness in government's economic policy, defective income tax etc. (Pradhan,2001)

Contribution from semi public enterprises is lowest than other .It has not contributed one percent to income tax in any year. After restructuring the sources of income in fiscal year, share of semi public enterprises are not calculated separately. Average contribution of private corporate bodies is Rs.1138.59 million from 1994/95 to 2003/04 but earlier, it was only Rs.3.63 million for the ten year. Contribution of individuals to total income tax is the highest in each year. Share of individuals was Rs.173.9 million in the fiscal year 1982/83 and increased to Rs.3533.4 million in last year of study. In amount, it is increasing each year except fiscal year 1984/85, 1990/91 and 2002/03 but in percentage it is decreasing trend. The percentage contribution was highest in the fiscal year 1983/84 when it was 212.5 million. (Composition and trend of income tax revenue is shown in the figure 5.4 and 5.5 respectively).

Average contribution from remuneration and tax n interest is 6.37 and 4.27 percent respectively. Tax revenue from remuneration is increasing each year except fiscal year 1990/91. It was Rs. 11 million in the fiscal year 1982/83 and reached to Rs. 1391.2 million in fiscal year 2003/04. Tax on interest is also increasing and has Rs.733.4 million in last year of study. The annual growth rate of income tax collection was 18.79, 25.97, 20.26 and 22.82 percent in the 1997/98, 1998/99, 1999/00, 2000/01 respectively. The growth rate was positive but it was negative 2.6 and 10.53 percent in the fiscal year 2001/02 and 2002/03. Again it is positive 13.84 percent in final year 2003/04.

Table 5.1.7

## Composition of Income Tax Revenue

Rs. In Million

Fiscal Year	Total Income Tax Revenue	Public Enterprises	Semi-Public Enterprises	Private Corporate bodies	Individuals	Remunerations	Tax on Interest
1982/83	251.2	53.4	1.5	0.3	173.9	11	11.1
1983/84	298.8	63.7	2.2	0.8	212.5	11.7	7.9
1984/85	313.7	93.1	1.4	0.5	196.0	16.3	6.4
1985/86	374.6	110.8	1.8	2.0	234.5	15.3	10.2
1986/87	448.5	120.9	1.2	2.0	284.3	30.9	9.7
1987/88	596.1	193.2	1.9	1.9	348.6	33.4	17.1
1988/89	879.6	216.9	2.6	0.4	597.4	43.8	18.5
1989/90	932.1	240.9	2.4	0	625.0	50.7	13.1
1990/91	783.8	162.2	2.7	0	531.2	49.9	37.8
1991/92	875.0	171.1	5.3	6.5	617.9	54.7	19.5
1992/93	1198.2	255.3	2.6	9.5	800.7	56.7	73.4
1993/94	1921.2	534.1	2.1	19.7	1184.8	83.8	96.7
1994/95	2823.4	860.2	-	440.1	1293.1	118.4	111.6
1995/96	3431.4	1144.5	-	563.9	1470.1	133.1	119.8
1996/97	4123.4	1231.1	-	858.4	1711.4	168.1	154.4
1997/98	4898.1	1317.8	-	925.1	2120.8	322.2	212.2
1998/99	6170.2	1526.5	-	1155.0	2772.7	396.5	319.5
1999/00	7420.6	2198.8	-	1339.5	3016.4	451.5	414.4
2000/01	9114.0	2928.0	-	1924.3	3200.5	597.3	463.9
2001/02	8903.7	1769.3	-	1412.0	4419.1	835.6	467.7
2002/03	7966.2	1251.5	-	1236.3	3362.3	1252.6	864.0
2003/04	9245.9	2056.6	-	1531.3	3533.4	1391.2	733.4

Source: Economic Survey 2004/05, Page 6 (Statistical Tables), Ministry of Finance, government of Nepal.

Table 5.1.8

## Composition of Income Tax Revenue

In Percentage

Fiscal Year	Total Income Tax Revenue	Public Enterprises	Semi-Public Enterprises	Private Corporate bodies	Individuals	Remunerations	Tax on Interest
1982/83	100.00	21.26	0.60	0.12	69.23	4.38	4.42
1983/84	100.00	21.32	0.74	0.27	71.12	3.92	2.64
1984/85	100.00	29.68	0.45	0.16	62.48	5.20	2.04
1985/86	100.00	29.58	0.48	0.53	62.60	4.08	2.72
1986/87	100.00	26.93	0.27	0.45	63.32	6.88	2.16
1987/88	100.00	32.41	0.32	0.32	58.48	5.60	2.87
1988/89	100.00	24.66	0.30	0.05	67.92	4.98	2.10
1989/90	100.00	25.84	0.26	0.00	67.05	5.44	1.41
1990/91	100.00	20.69	0.34	0.00	67.77	6.37	4.82
1991/92	100.00	19.55	0.61	0.74	70.62	6.25	2.23
1992/93	100.00	21.31	0.22	0.79	66.83	4.73	6.13
1993/94	100.00	27.80	0.11	1.03	61.67	4.36	5.03
1994/95	100.00	30.47	0.00	15.59	45.80	4.19	3.95
1995/96	100.00	33.35	0.00	16.43	42.84	3.88	3.49
1996/97	100.00	29.86	0.00	20.82	41.50	4.08	3.74
1997/98	100.00	26.90	0.00	18.89	43.30	6.58	4.33
1998/99	100.00	24.74	0.00	18.72	44.94	6.43	5.18
1999/00	100.00	29.63	0.00	18.05	40.65	6.08	5.58
2000/01	100.00	32.13	0.00	21.11	35.12	6.55	5.09
2001/02	100.00	19.87	0.00	15.86	49.63	9.38	5.25
2002/03	100.00	15.71	0.00	15.52	42.21	15.72	10.85
2003/04	100.00	22.24	0.00	16.56	38.22	15.05	7.93

Source: Table 5.7

Figure 5.1.3

Composition of Income Tax Revenue

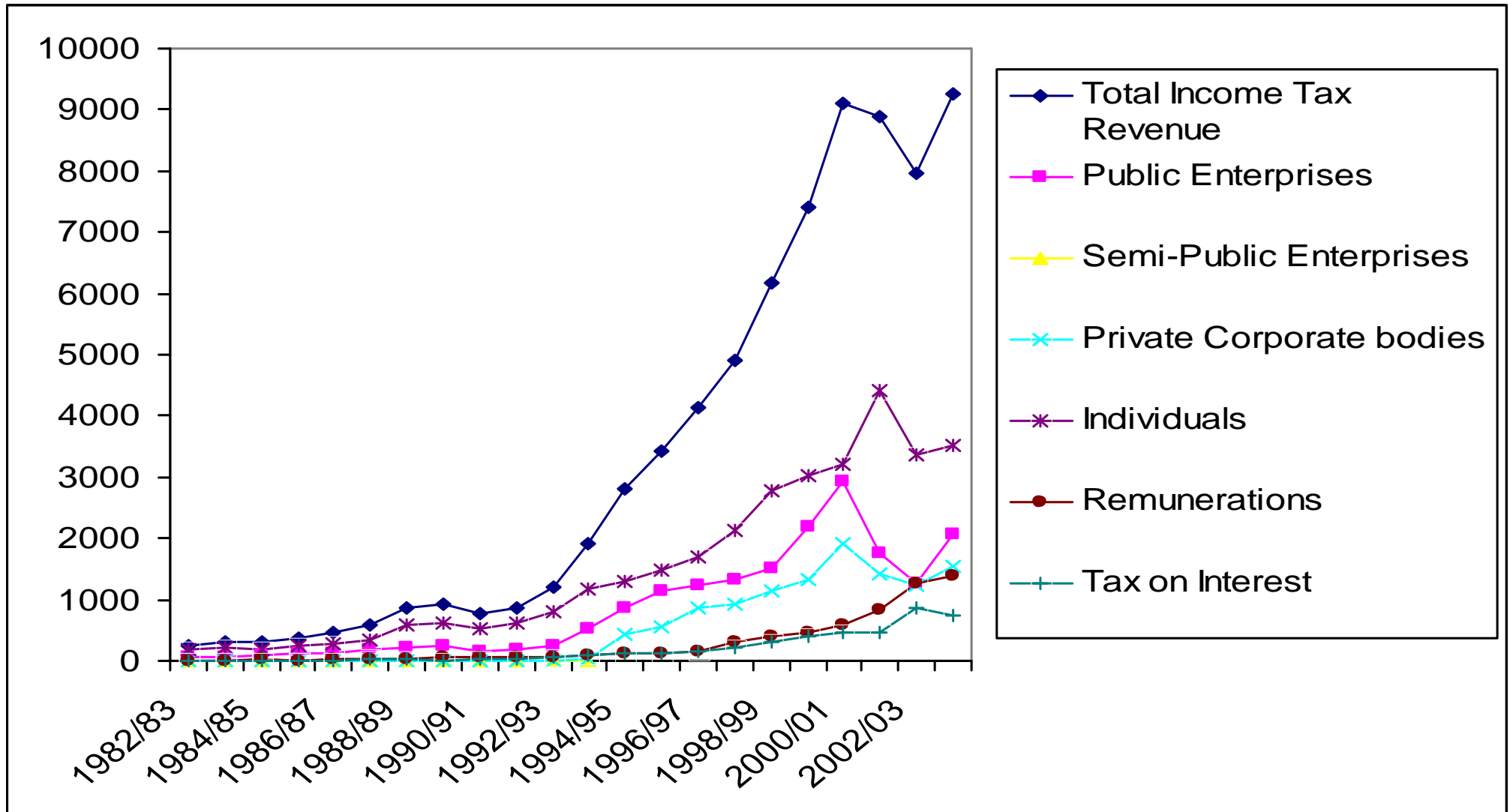
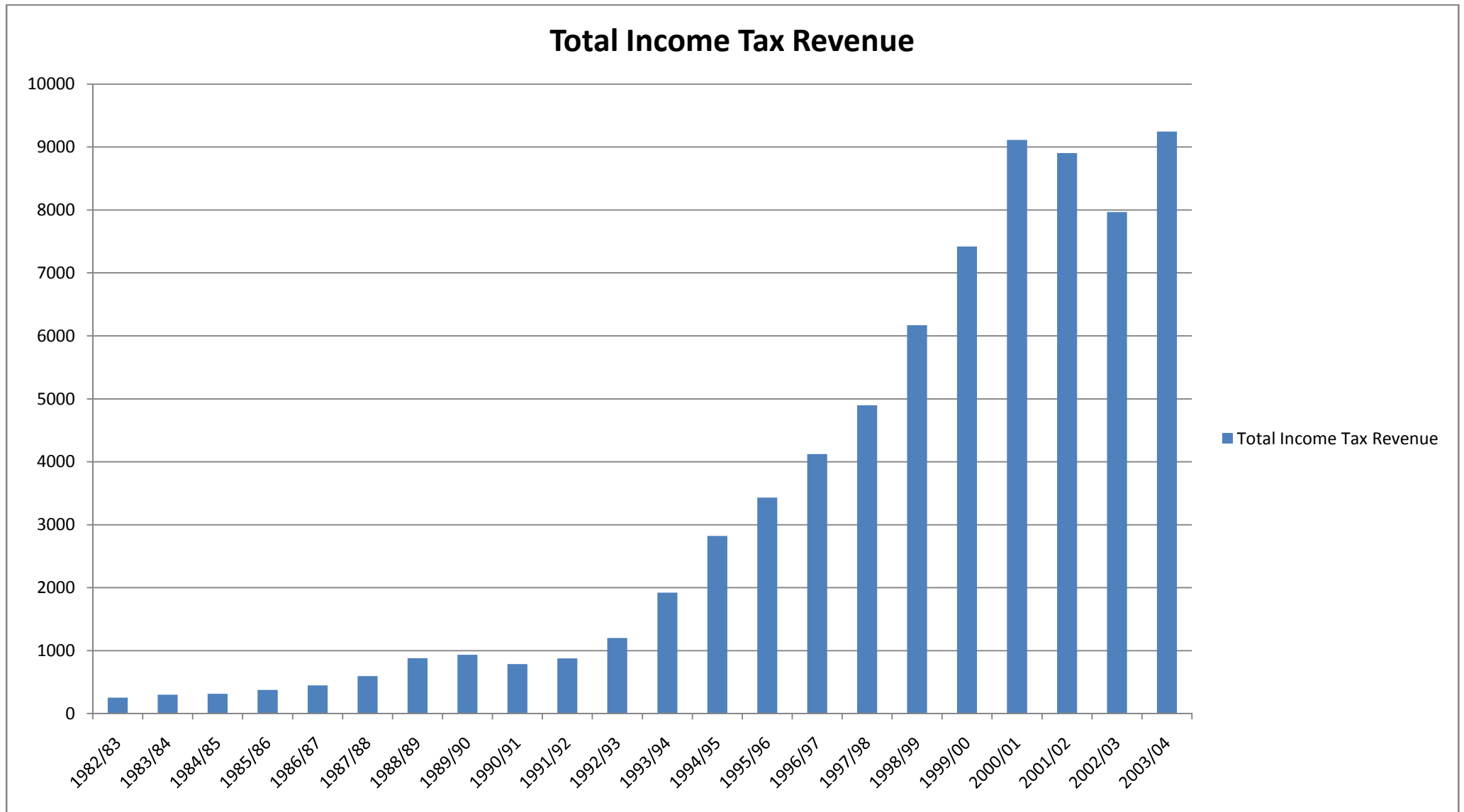


Figure 5.1.4

Trend of Income Tax Revenue



### **5.1.8 Contribution of Income Tax:**

Contribution of income tax to the GDP, Total Revenue, Total Tax Revenue and Direct Tax Revenue is computed as below.

#### **Contribution of Income Tax to the Direct Tax Revenue:**

The table 5.10 shows the contribution of income tax to the direct tax revenue in Nepal. There is the dominated role of income tax in the direct tax revenue. Average share of income tax to direct tax is 68.61 percent. In the beginning of the study, it was 56.44 percent and had reached maximum up to 89.71 percent. The contribution of income tax is not less than 54 percent in any year. The trend of income tax as the percentage of direct tax is presented in the figure 5.6 as below.

#### **Contribution of Income Tax to the Total Tax Revenue:**

Total tax revenue constitutes direct and indirect tax revenue. There is dominant role of indirect tax in the Nepalese tax revenue structure. The contribution of income tax to the direct tax revenue is presented in the table 5.10. Contribution was 10.38 percent in the initial period of study. The highest contribution of income tax was 23.45 percent in the fiscal year 2000/01 but average contribution 14.72 percent. The share of income tax as a percent of total tax revenue was 8.86 in the fiscal year 1991/92 which was the lowest contribution over the study period. The trend of income tax as a percentage of total tax revenue is shown in the figure 5.7.

#### **Contribution of Income Tax to Total Revenue:**

Total revenue constitutes tax and non tax revenue. In the Nepalese government revenue structure, tax revenue has occupied the most part of public revenue i.e. about two third part in total revenue. Share of income tax as a percentage of total revenue is presented in the table 5.10. The share of income tax as a percentage of total revenue has fluctuated from 6.48 percent to 18.64 percent. Average contribution is 11.53 percent over the study period. Contribution for in the fiscal year 2001/02 to 17.65 percent but it has declined in the fiscal year 2001/02 percent. It further declined in the fiscal year 2002/03 to 14.17 percent and again increases to 14.83 percent in fiscal year 2003/04. The figure 5.8 shows income tax as a percent of total revenue.

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

Table 5.10 shows the percentage contribution of income tax in gross domestic product (GDP). Contribution of income tax in GDP was 0.74 percent in the fiscal year 1982/83. Maximum contribution of income tax revenue as a percentage of GDP is 2.32 in the fiscal year 2000/01. From the fiscal year 1991/92, it is continuously increasing from 0.60 percent up to 2.32 but it has not continued in fiscal year 2001/02 and 2002/03 and declined to 2.20 percent and 1.74 percent respectively.

Table 5.1.9

**Contribution of Income Tax on Direct Tax Revenue, Tax Revenue,  
Total Revenue and GDP in Nepal**

<b>Fiscal Year</b>	<b>Total Income Tax</b>	<b>Percentage of Income Tax on GDP</b>	<b>Percentage of Income Tax on Total Revenue</b>	<b>Percentage of Income Tax on Total Tax Revenue</b>	<b>Percentage of Income Tax on Direct Tax Revenue</b>
1982/83	251.2	0.74	8.84	10.38	56.44
1983/84	298.8	0.76	8.76	10.92	55.15
1984/85	313.7	0.71	8.01	9.95	56.05
1985/86	374.6	0.70	8.07	10.24	56.60
1986/87	449.0	0.73	7.54	10.27	58.41
1987/88	596.1	0.81	8.11	10.36	59.01
1988/89	879.6	1.02	11.31	13.99	66.07
1989/90	932.1	0.93	10.04	12.80	64.95
1990/91	783.8	0.67	7.30	9.58	57.22
1991/92	875.0	0.60	6.48	8.86	54.85
1992/93	1198.2	0.73	7.91	10.27	58.84
1993/94	1921.2	1.00	9.81	12.50	67.29
1994/95	2823.4	1.34	11.49	14.36	73.35
1995/96	3431.4	1.43	12.30	15.84	73.70
1996/97	4123.4	1.53	13.58	16.88	77.22
1997/98	4898.1	1.69	14.87	18.88	79.16
1998/99	6170.2	1.87	16.56	21.46	82.09
1999/00	7420.6	2.03	17.30	22.38	82.90
2000/01	9114.0	2.32	18.64	23.45	89.71
2001/02	8903.7	2.20	17.65	22.64	84.02
2002/03	7966.2	1.74	14.17	18.70	78.83
2003/04	9245.9	1.87	14.83	19.19	77.61

Figure 5.1.5

Percentage of Income Tax on GDP

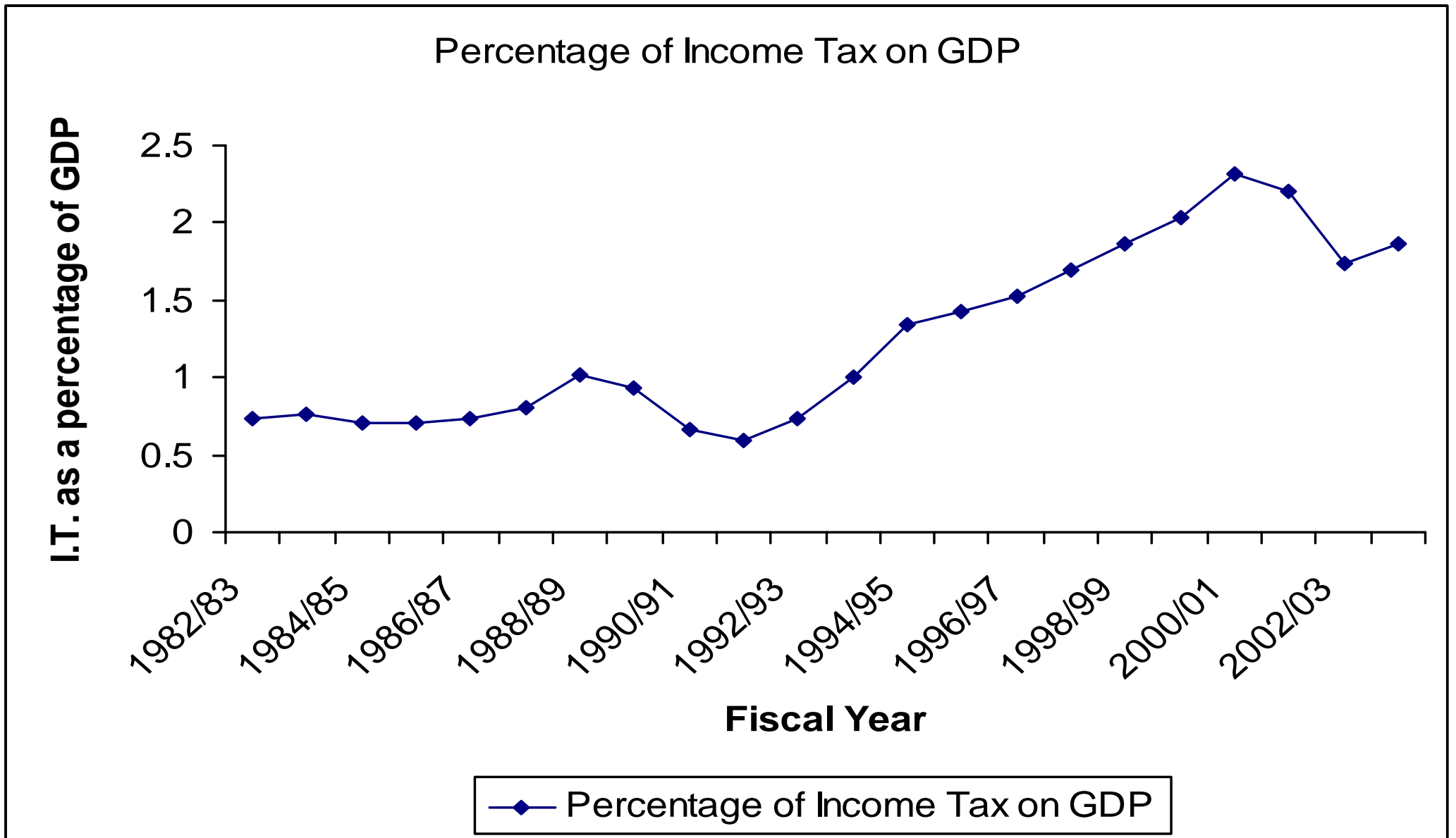


Figure 5.1.6

Percentage of Income Tax on Total revenue

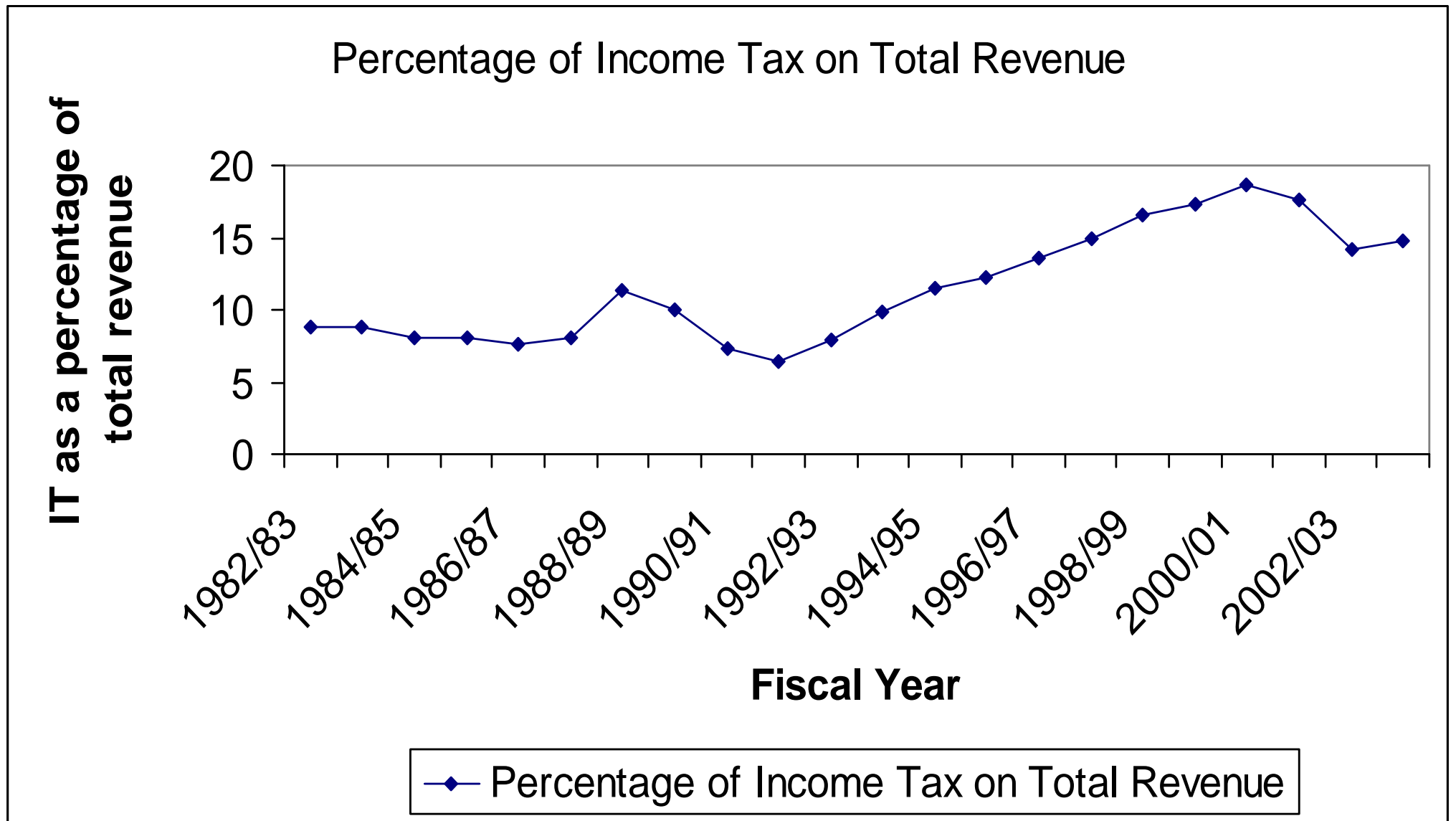


Figure 5.1.7

Percentage of Income Tax on Total Tax revenue

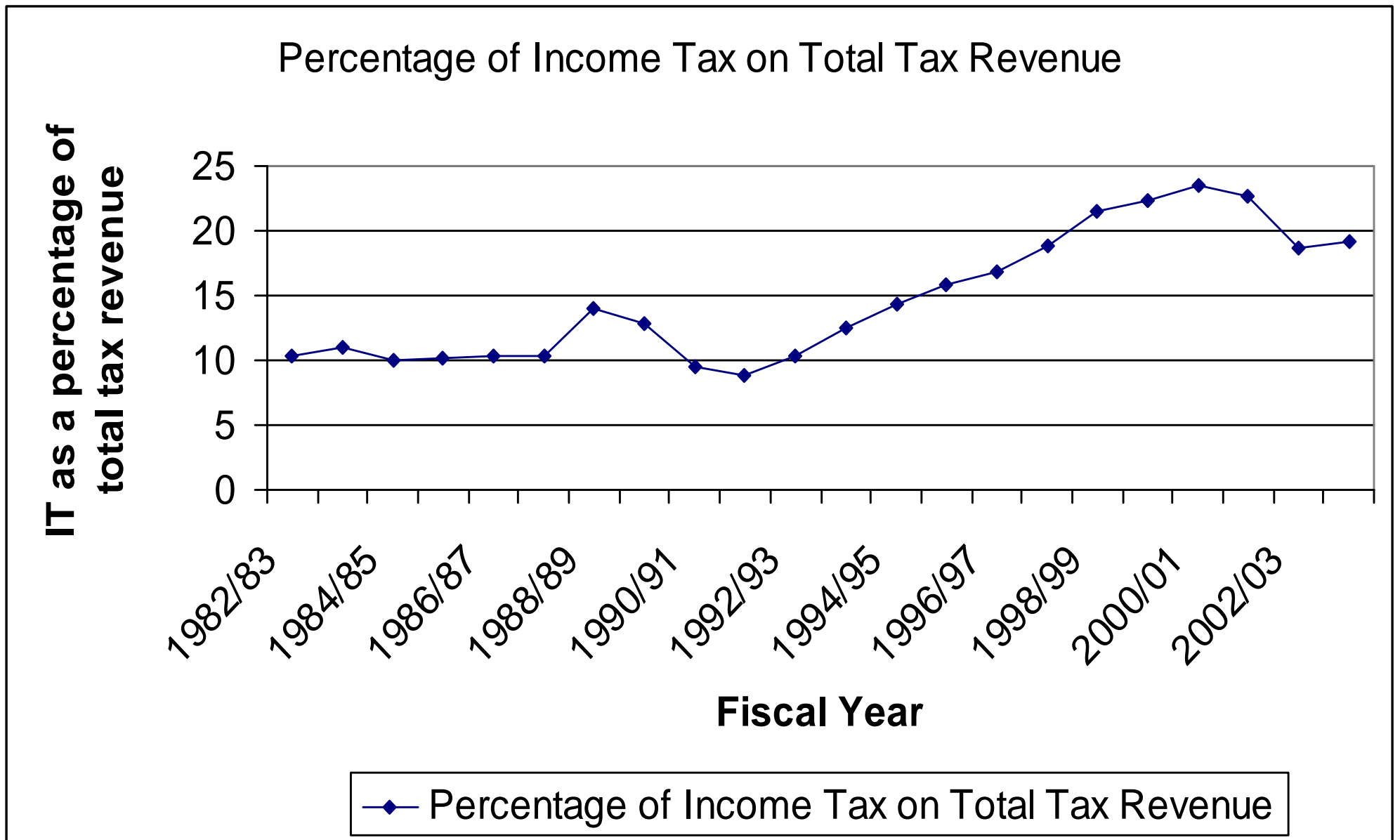
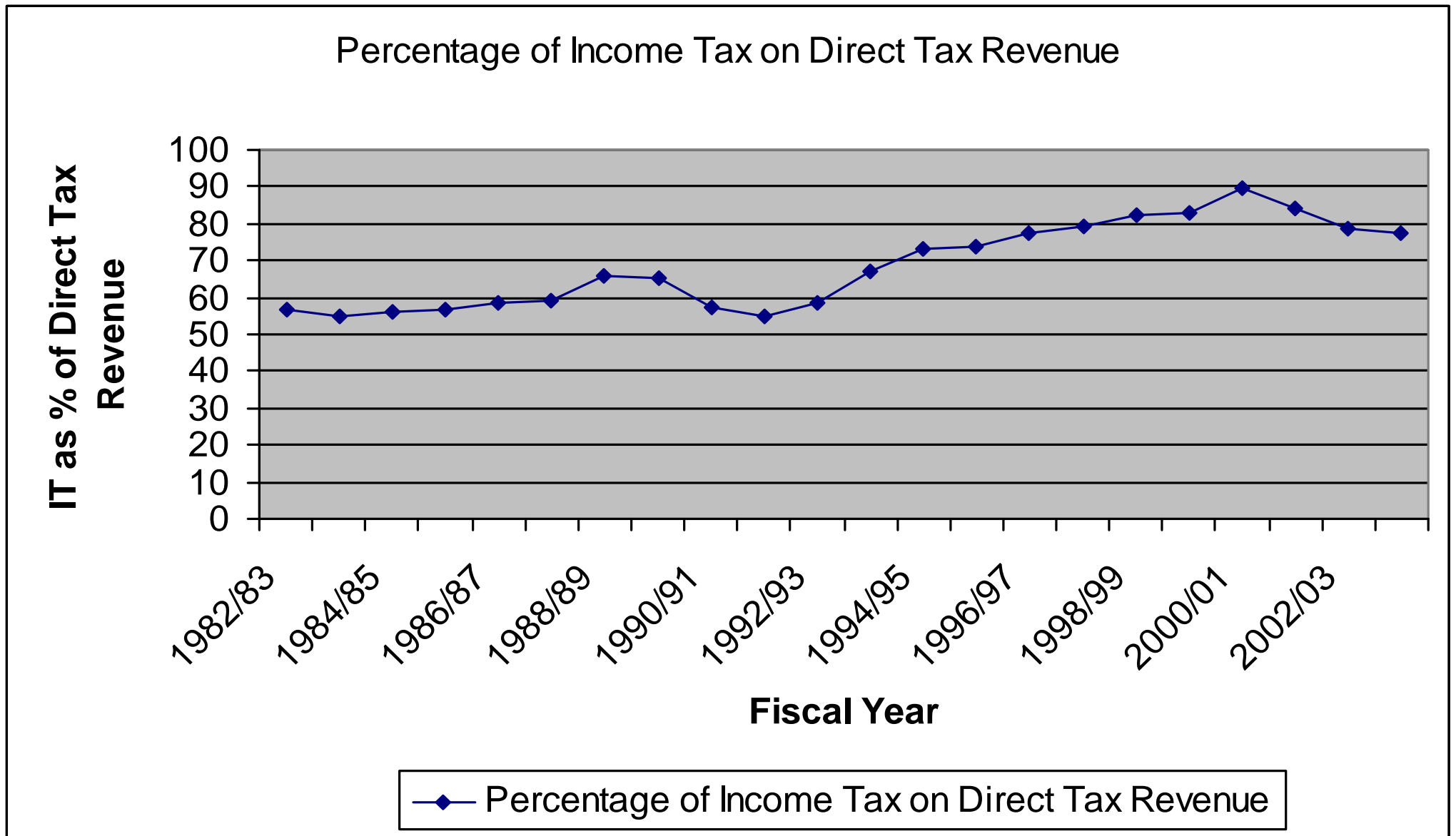


Figure 5.1.8

Percentage of Income Tax on Direct Tax revenue



### 5.1.9 Income Tax Collection Performance in Nepal:

Revenue from income tax is increasing trend but the performance of income tax collection is not satisfactory. Income tax collection performance in Nepal is presented in the table 5.11. The collection was only 79.31 percent of estimate in the fiscal year 1984/85. Tax was collected excess than the target only in the fiscal year 1987/88, 1992/93, 1993/94, 1997/98, 1998/99, 1999/00 and 2003/04 and highest was in the fiscal year 1992/93 with total collection of Rs. 1198.2. The lowest percentage of collection was 79.31 percent in the initial of the study. Performance of income tax collection is only 109.39 percent in the 2003/04.

Table 5.1.10

#### Collection Performance of Income Tax Revenue

From 1984/85 to 2001/02

Fiscal Year	Estimates	Collections	Difference	Collection as the % of Estimates
1984/85	395.5	313.7	(81.8)	79.31
1985/86	470.3	374.6	(95.7)	79.65
1986/87	507.5	447.2	(60.3)	88.12
1987/88	561	596.1	35.1	106.26
1988/89	1051	879.6	(171.4)	83.69
1989/90	940	932.1	(7.9)	99.16
1990/91	954	783.8	(170.2)	82.16
1991/92	905	875	(30)	96.68
1992/93	810	1198.2	388.2	147.92
1993/94	1558.7	1921.2	362.5	123.25
1994/95	3260	2823.5	(436.5)	86.61
1995/96	4000	3431.4	(568.6)	85.78
1996/97	4595	4123.4	(471.6)	89.74
1997/98	4750	4898.1	148.1	103.12
1998/99	5780	6170.2	390.2	106.75
1999/00	7380	7420	40	100.54
2000/01	9980	9110	(870)	91.28
2001/02	11140	8919.6	(2220.4)	80.07
2002/03	9862.5	8131.9	(1730.6)	82.45
2003/04	8697.5	9514.5	817	109.39

Source: Various years Budget speech and Economic survey, MOF, HMG/N

Note: Figure in bracket indicates negative value.

### 5.1.10 Exemption Limit in Nepal:

Exemption limit directly influence income tax revenue collection. Taxpayer having low tax paying capacity should exclude from the tax net for the social justice and economic balance between rich and poor. The exemption limit provided in the various years is presented in the table 5.12. In the earlier time, there was equal amount of exemption limit to all the taxpayers i.e. individual, couple, family and corporate bodies. Exemption limit to all tax payers was Rs.

7000 in the fiscal year 1959/60 to 1962/63. The exemption limit to the corporate tax payer was curtailed from the fiscal year 1965/66. The exemption limit to the couple and family was equal each year except 1967/68 to 1975/76 to 1978/79. The exemption limit to the family was Rs.6000 in the fiscal year 1975/67 to 1973/74 whereas it was Rs.4500 to the couple. The exemption limit to couple and family was Rs.6500 and 7500 respectively in the fiscal year 1974/75 and it was further extended by Rs.1000 for both for the fiscal year 1976/77 to 1978/79. from the table. 5.12, it is clear that exemption limit is extended according to need of time and income condition. At present time, individual having the taxable income u to Rs.80000 are exempted from tax and that for couple is Rs.100000.

Table5.1.11

**Exemption Limit in Nepal from fiscal year 1959/60 to 2007/08**

<b>Fiscal Year</b>	<b>Individual</b>	<b>Couple</b>	<b>All taxpayers</b>
1959/60-1962/63			7000
1963/64-1964/65			6000
1965/66-1966/67			5000
1967/68-1973/74	3000	4500	-
1974/75	4500	6000	-
1975/76	5500	6500	-
1976/77-1978/79	6500	7500	-
1979/80-1980/81	7500	10000	-
1981/82-1982/83	10000	15000	-
1983/84-1989/90	15000	20000	-
1990/91-1991/92	20000	30000	-
1992/93-1996/97	25000	35000	-
-1997/98	30000	40000	-
1998/99	40000	50000	-
1999/00	55000	75000	-
2000/01	55000	75000	-
2001/02	65000	85000	-
2002/03	75000	90000	-
2003/04	80000	100000	-
2004/05	80000	100000	-
2005/06-2006/07	100000	125000	-
2007/08	115000	140000	

Source: Finance Acts of Various Year, Ministry of finance, Government of Nepal

**5.1.11 Income Tax rate in Nepal:**

Income tax rate in Nepal for the various years is presented in the table 5.13 and 5.14. At the introduction time of income tax, there was narrow coverage and high tax rate but at present it is taken the principle of 'low rate, wide coverage'. In the history of Nepal, the highest tax rate for personal income was 60 percent in the fiscal year 1975/76. In 1980/81, the tax rate for personal income was 5 percent to 55 percent and eight slabs in 1985/86. But after that, rate and slabs is decreased. At present, there is only 15 and 25 percent tax rate for personal income with two slabs. But, tax is levied at flat rate to the corporation at the present.

Table 5.1.12

**Income Tax Rate in Nepal for personal Income**

<b>Slabs Fiscal year</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>
1980/81	5000 5%	5000 5%	10000 15%	20000 20%	20000 30%	30000 40%	Balance 50%	
1985/86	5000 10%	5000 10%	10000 20%	15000 25%	15000 30%	30000 40%	200000 50%	Balance 55%
1990/91	10000 15%	15000 20%	20000 35%	25000 40%	30000 15%	Balance 50%	-	-
1995/96	40000 10%	25000 20%	Balance a) 25% b) 33%	-	-	-	-	-
2000/01- 2006/07	75000 15%	Balance 25%	-	-	-	-	-	-
2007/08	75000 15%	Balance 26.5%	-	-	-	-	-	-

Table 5.1.13

**Income Tax Rate for Partnership Firms, Corporation and Non-Residence  
From 1983/84 to 2003/04**

<b>Slabs Fiscal year</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>
1983/84 to 1988/89	5000 10%	5000 5%	10000 20%	15000 25%	15000 30%	30000 40%	200000 50%	Balance 55%
1989/90 to 1990/91	5000 10%	5000 15%	10000 20%	15000 25%	15000 30%	30000 40%	Balance 50%	
1991/92	10000 15%	15000 25%	20000 35%	25000 40%	30000 45%	Balance 50%	-	-
1992/93	10000 15%	20000 20%	20000 30%	20000 40%	Balance 50%	-	-	-
1993/94	25000 15%	40000 25%	Balance 40%	-	-	-	-	-
1994/95- 1995/96	35% in total		-	-	-	-	-	-

1996/97-1997/98	33% in total	-	-	-	-	-	-	-
1998/99-2003/08	30% (a)25% (b)	-	-	-	-	-	-	-

(a) For Bank, finance com. etc. Other

Source: Finance Acts of various year, MOF, Government of Nepal

## 5.2 EMPIRICAL INVESTIGATION

### 5.2.1 Introduction:

The survey result has been conducted to find out the various aspects of income tax in Nepal. The structured questionnaire was prepared and distributed for this purpose. The opinion of the various 60 respondents associated with distinct denomination i.e. tax administration; tax expert and taxpayers were collected. The questionnaire has covered role of income tax, major problem of income tax system in Nepal. (See the format of questionnaire in a appendix B). The respondents were asked either to response yes/no or for ranking of choice were least important. No of respondents in each denomination is equal i.e. 20. Information received from the respondents are tabulated and analyzed in the proper way. Following table shows the groups and no. of respondents.

Table 5.2.1

#### Group of Respondents and No. from each Group

S. No.	Groups of Respondents	No.
1	Income Tax Administrators	20
2	Income Tax Experts	20
3	Income Tax payers	20
Total		60

Total 75 questionnaires were distributed to the respondents among which 60 of them can be received in time. That is only 80% of the distributed questionnaire was collected.

### Result of Empirical Investigation:

#### 5.2.2 View towards Income Tax System in Nepal:

To Know the respondents view regarding soundness and efficient of income tax system in Nepal, "In your opinion is income tax system of Nepal sound and efficient?" (Q.No.1, Appendix B). was asked. The responses are tabulated as follows.

Table5.2.2

### Soundness and effectiveness of income tax system in Nepal

Response Respondent	Yes		No		total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	2	10	18	90	20	100
Tax Expert	1	5	19	95	20	100
Tax payer	-	-	20	100	20	100
Total	3	5	57	95	60	100

Source: Opinion Survey, 2009

98.2 percent respondent approve income tax system of Nepal is not sound and efficient.

Only 1.8 percent respondents approve soundness and efficient tax system of Nepal.

#### 5.2.3. Income Tax as Suitable Means of Raising Government revenue:

To know whether income tax as a suitable means of raising government revenue in Nepal, a question was asked "Do you consider that income tax is the suitable means of raising government revenue in Nepal?"(Q.No.2, Appendix B). The respondent's responses are tabulated as follows.

Table 5.2.3

#### Income Tax as a suitable means of raising revenue

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	percentage	No.	percentage
Tax Administrator	19	95	1	5	20	100
Tax Expert	20	1001	-	-	20	100
Tax payer	18	90	2	10	20	100
Total	57	95	3	5	60	100

Source: Opinion Survey, 2009

From the opinion survey, it is found that 95 percent tax administrators, cant percent tax experts and 90 percent payers recognize income tax as a suitable means of raising government revenue. Only 5 percent tax administrator and 10 percent tax payer does not recognized income tax as a suitable means of raising government revenue in Nepal. Thus, it is concluded that income tax is a suitable means of raising government revenue in Nepal.

#### 5.2.4 Need of public Awareness Program:

To know the respondents' view towards public awareness programs the question was put "Do you think that public awareness program is necessary in Nepal for raising the government revenue?" (Q. No., Appendix B). Opinion result is summarized in the table 6.3 below.

Table 5.2.4

#### Need of Public Awareness Program

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	20	100	-	-	20	100
Tax Payer	20	100	-	-	20	100
Tax Payer	19	95	1	5	20	100
Total	59	98.33	1	1.67	60	100

Source: Opinion Survey, 2009

All of the samples of tax administrator and tax experts approved public awareness program is necessary in Nepal for raising government revenue. Only 5 percent of the tax payer does not approved public awareness program is necessary in Nepal. Thus, it can be concluded that public awareness program is necessary for raising Nepalese government revenue.

#### 5.2.5 Contribution of Income Tax Revenue:

Income tax has contributed about 20 percent in Nepal. It is blamed that contribution of income tax to national revenue is not satisfactory. To know the fact, the question was asked to respondent "In your opinion, is contribution of income tax to national revenue of Nepal satisfactory?" (Q.No.4, Appendix B). Opinion result is presented in the table 6.4 as below.

Table 5.2.5

#### Satisfactory Contribution of Income Tax Revenue

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	19	95	1	5	20	100
Tax Payer	20	100	-	-	20	100
Tax Payer	19	95	1	5	20	100
Total	58	96.67	2	5.33	60	100

Source: Opinion Survey, 2009

Present tax expert argue that contribution of income tax to national revenue in Nepal is satisfactory. But 5 percent of tax administrator and tax payer approve that income tax

contribution to public revenue is satisfactory. In aggregate, 96.67 percent respondents argue that Nepalese income tax contribution is satisfactory.

In order to know the major reasons for lower contribution of income tax, next question was asked, "If no, What are the major reasons." The respondents were requested to rank their choice from 1 to 5 according to preference.

Table 5.2.6

**Reasons for Low Contribution of Income Tax to National Revenue**

S. No.	Method	Total points Received				Percent	Rank
		Tax Administrator	Tax Expert	Tax Payer	Total		
1	Defective of income tax act	39	52	44	135	16.28	4
2	Mass poverty and low income level	96	85	89	272	32.81	1
3	Increasing habit of tax evasion	68	63	48	179	21.59	2
4	Increasing habit of tax administrator	44	60	52	156	18.81	3
5	Inappropriate rate and exemption limit	41	36	50	87	10.49	5
Total					829		

Source: Opinion survey, 2009

From the above table, the major reasons for low contribution of income tax to national revenue ranked in order of preference of the respondents are as follows.

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

### 5.2.6 Contribution of Direct Tax:

Direct tax includes tax on property, tax on income, tax in interest and other taxes. The contribution of direct tax to nation revenue is about 21 percent in average.

To know whether the contribution of direct tax to national revenue is effective or not a question was asked, "Do you think that contribution of tax to total revenue is effective?" (Q.N.6, Appendix B). The responses are tabulated as follows:

Table5.2.7

#### Effective Contribution of Direct Tax

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	1	5	19	95	20	100
Tax Expert	-	-	20	100	20	100
Tax Payer	1	5	19	95	20	100
Total	2	5.33	58	96.67	60	100

Source: Opinion survey, 2009

Only 5 percent of each tax administrator and tax payer recognized the contribution of direct tax to total revenue is effective. Cent percent tax expert direct tax to total revenue is effective. 96.67 percent respondent did not approve that contribution of direct tax to total revenue is effective. From this opinion, it can be concluded that the contribution of direct tax to total revenue is not effective.

### 5.2.7. Attitude towards Exemption and Deduction:

Adequate exemption and deduction is necessary to promote the business enterprises. Many exemption and deduction and dedication provided by 'Industrial Enterprises Act 2049' and 'Income Tax Act 2031' has curtailed by new 'Income Tax Act 2058'. The question "Are exemption and deduction provided by act appropriate "(Q. No .7, Appendix B) was asked to find out the opinion of the respondent regarding the exemption and deduction. Opinion result is summarized in the table as below.

Table 5.2.8

#### Attitude towards appropriateness of Exemption and Deduction

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	13	65	7	35	20	100
Tax Expert	16	80	4	20	20	100
Tax Payer	9	45	11	55	20	100
Total	38	63	22	37	60	100

Source: Opinion Survey, 2009

Most of respondent i.e.63 percent agree with present exemption and deduction. Only 37 percent respondents disagree with the present exemption and deduction. Majority of the respondent, who disagree with present provision of exemption and deduction, was view of increase the deduction and exemption limit to promote special industry

### 5.2.8 Income Tax Assessment Method:

Revenue collection from income tax also depends on the income tax assessment procedures. There fore, assessment procedure should be appropriate and effective a question, "Which income tax assessment method is appropriate in Nepal" (Q.No.8, Appendix B.) was asked to know the respondents' opinion about appropriate method of income tax assessment. The response is presented in the table 6.8 as below.

Table 5.2.9

#### Appropriate Method of Income Tax Assessment

S. No.	Method	Tax Administrator	Tax Expert	Tax payer	Total	percent
1	Self Assessment	12	10	11	33	55
2	Best Judgment	2	4	6	12	20
3	Tax Settlement commission	-	1	1	2	3
4	Lump sum (15%rate	6	5	2	13	22
Total		20	20	20	60	

Source: Opinion Survey, 2009

55 Percent respondents approved self-tax assessment method is more appropriate to assess income tax. 20 percent respond are in favor of best judgment, 22 percent in favor of lump sum and 3 percent in the favor of assessment by tax settlement commission, from the above opinion, it can be concluded that self –tax assessment method is more appropriate while assessing income tax to collect large amount of revenue through income tax.

### 5.2.9. Attitude toward Problems in Paying Income Tax:

To know the problems facing by the taxpayers while paying income tax, the respondents were requested to rant their choice from 1 to 5 according to their preference. The question was, "In your thinking, what types of problems are facing by the tax payer while paying income tax" (Q. No. 9, Appendix B). Responses received from respondents are tabulated as below.

Table5.2.10

## Problems in Tax Paying

S. No.	Problems	Points Received				Percent	Rank
		Tax administrator	Tax Expert	Taxpayer	Total		
1	Consuming unnecessary time	57	58	41	156	19.23	3
2	Expectation illegal incentives by tax personnel	39	46	64	149	18.37	4
3	Vague provision in income tax laws	75	69	59	202	24.91	1
4	Lengthy process	68	61	69	199	24.53	2
5	Lack of cooperation by tax administrator	35	38	32	105	12.94	5
Total				811	100		

Source: Opining Survey, 2009

From the above table ,the major problems facing by the taxpayer while paying income tax ranked in order of preference of the respondents are as follows.

- Vague provision in income tax laws
- Lengthy process
- Consuming unnecessary time
- Expectations illegal by tax administrator
- Lack of co-operation by tax administrator

To know whether the opinion of tax administrator and taxpayer are related or not, we can test rank correlation coefficient. But the views of tax expert are kept in constant.

Hypothesis:

There is not significant relationship between the views of tax administrator and taxpayers with respects to problems facing by the taxpayers while paying tax.

Calculating Correlation by formula,

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

$$Pr = 0.6745 \times \frac{1 \sum r^2}{\sqrt{n}}$$

Let, variable x and y denote views of tax administrator and taxpayers respectively.

Table 5.2.11

## Correlation coefficient calculation

S. No.	Problems	Total Points	Rank (R1)	Total Points (y)	Rank (R2)	Difference of Rank (R1-R2)	Square of Difference (R1-R2)
1	consuming unnecessary time	57	3	41	4	1	1
2	Expectation of illegal incentives	39	4	64	2	2	4
3	Vague Provision in income tax laws	74	1	59	3	-2	4
4	Lengthy process	68	2	73	1	1	1
5	lack of cooperation by tax administrator	35	5	32	5	0	0
Total							$d^2 \times 10$

Source : Table 7.10

$$R = \frac{\sum d^2}{\sum y^2} \times 0.5$$

$$Pr = 0.6745 \times \frac{1 \times 0.40}{\sqrt{5}} \times 0.22$$

Here,  $r$  is greater than  $Pr$ . The relation is not significant because to be significant  $r$  should be 6 times greater than  $Pr$ . However, the value of  $r$  is moderate, therefore there is some relationship between views of tax administrator and tax payer. So, null hypothesis is rejected. Then, we can conclude that the opinion of tax payer and tax administrator regarding the problems facing by taxpayer while paying tax is not significantly different.

### 5.2.10 Attitude towards fines and penalty:

Fines and penalty also play a significant role to reduce tax evasion and illegal activities and make morality to the tax payer. To know the views of respondents about the fine and penalty, the respondents were asked "How reasonable are the fines and penalty under the Nepalese tax system?" (Q.No.10, Appendix B). The opinion of respondents is as follows.

Table 5.2.12

**Attitude towards reasonableness of existing Fines and penalty**

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	14	70	6	30	20	100
Tax Expert	12	60	8	40	20	100
Tax Payer	11	55	9	45	20	100
Total	37	61.67	23	38.33	60	100

Source: Opinion Survey, 2009

61.67 percent respondents are in the favor of present provision of fines and penalty but 38.33 percent respondent are against the present provision of fines and penalty. Out of total taxpayer respondent, the highest 45 percent are against the present fine and penalty.

In order to know reasons of unreasonable fine and penalty provision, the next question was asked, "If no, how it be made reasonable?" (Q.No.10, Appendix B). Views of respondents are tabulated as below.

Table5.2.13

**Reasonable Rate of fine and penalty**

	Increasing		Decreasing		Total	
Tax Administrator	4	66.67	2	33.33	6	100
Tax Expert	7	87.50	1	12.5	8	100
Tax Payer	3	33.33	6	66.67	9	100
Total	14	60.87	9	39.13	23	100

Source: Opinion Survey, 2009

60.87 of the respondents, who were against percent fines and penalty, gave their view for increasing fine and penalty and 39.13 percent gave view in the favor of decreasing rate.

**5.2.11 Attitude towards Income Tax Administration:**

To know the respondents view regarding effectiveness of tax administration in Nepal, a question, "Do you agree that Nepalese income tax administration is effective?" (Q.No.11, Appendix B) was asked. The responses are tabulated as follows.

Table 5.2.14

### Attitude towards effectiveness of Income Tax Administration in Nepal

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	3	15	17	85	20	100
Tax Expert	2	10	18	90	20	100
Tax Payer	-	-	20	100	20	100
Total	5	8	55	92	60	100

Source: Opinion survey, 2009

Form the above table it has been clear that Nepalese income tax administration is not effective. Most of the respondents i.e. 92 percent of respondents recognize it ineffective.

#### 5.2.12 Most important factors for effectiveness of Income Tax:

The respondents were requested to rank their choice from 1 to 5 according to their preference to know the opinion of the respondents ' view regarding to important factors for effectiveness of income tax in Nepal .A question was , "In your opinion , what us the most important factor for effectiveness of income tax in Nepal to raise government revenue ?" (Q. No. 12, Appendix B) was asked. Responses are summarized in the table 6.15 as below.

Table 5.2.15

### Most important factors for effectiveness of Income Tax

S. No.	Method	Points Received				Percent	Rank
		Tax Administrator	Tax Expert	Tax payer	Total		
1	Clear Act, rules and regulation	70	78	75	223	25.25	1
2	Conscious and honest tax payers	81	59	50	190	21.25	3
3	Honest tax officers	57	53	65	175	19.82	4
4	Effective tax administration	60	81	74	215	24.35	2
5	Political non interruption	32	20	28	80	9.06	5
Total					883	100	

Source: Opinion Survey, 2009

The important factors for effectiveness of income tax in Nepal according to the preference of the respondents were as follows:

- a. Clear act, rules and regulation
- b. Effective tax administration

- c. Conscious and honest tax payers
- d. Honest tax officers
- e. Political non interruption

To know how much the opinion of tax administrator and tax payers are related, we can test rank correlation coefficient.

Hypothesis:

There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax. Symbolically;

Ho = There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax.

H1= There is significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax.

Correlation:

There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax.

Calculating Correlation by formula,

$$R = \frac{6 \sum d^2}{n^3 - n}$$

$$pr = 0.6745 \times \frac{\sum Zr^2}{\sqrt{n}}$$

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

Table 5.2.16

## Calculation of Correlation coefficient

S. No	Factors	Total points (x)	Rank (R1)	Total points (y)	Rank (R2)	Difference of Rank (R1-R2)	Square of Difference
1	Clear Act, rules and regulation	70	2	75	1	1	1
2	Conscious and honest tax payers	81	1	50	4	-3	9
3	Honest tax officers	57	4	65	3	1	1
4	Effective tax administration	60	3	74	2	1	1
5	Political non interruption	32	5	28	5	0	0
Total						$d \times 10$	$d^2 \times 12$

Source: Table 7.15

$$R = \frac{6 \times 12}{5 \times \sqrt{5^2 + 12^2}}$$

=0.40

$$Pr < 0.6745 \mid \frac{1 \times 0.40}{\sqrt{5}} < 0.25$$

Here,  $r$  is greater than  $pr$ . The relation is not significant because to be significant  $r$  should be 6 times greater than  $pr$ . So, null hypothesis is rejected. It means that the opinion of tax payer and tax administrator regarding most important factors for effectiveness of income tax in Nepal is significantly different. However, the value of  $r$  is moderate; therefore, there is some relationship between views of tax administrator and taxpayer.

### 5.2.13 other suggestions from respondent for achieving effectiveness of income tax in Nepal:

To know the respondents' other suggestions for achieving effectiveness of income tax in Nepal, a question, "Do you have any other suggestions for achieving effectiveness of income tax in Nepal? If yes, please specify." (Q. No 13, appendix B) was asked. Various mixed responses are found from the correspondents.

### 5.3 Major findings:

Major findings of this study are summarized as below.

- ❖ Income tax is a suitable source for collection of government revenue to develop economic condition of Nepal. It may enhance the revenue of the government, promote distribute justice and encourage private investment.
- ❖ Government revenue is the composition of external revenue and internal revenue. Tax and non-tax revenue are the sources of the internal revenue. There is dominant share of tax revenue in Nepalese government revenue. But contribution of tax revenue show the decreasing trend as it had contributed by 85.2 percent in fiscal year 1982/83 on the total but it was decreased to 77.28 percent in 2003/04.
- ❖ Nepalese tax revenue is the composition of direct and indirect tax. There is dominant role of indirect tax revenue in Nepalese tax revenue. Average contribution of direct and indirect tax revenue to total tax revenue is 20.94 percent and 79.06 percent over the study period.
- ❖ Nepalese government expenditure is increasing at the faster rate than the increase in revenue. Therefore, resource gap has existed in Nepalese economy and it is increasing trend. Resource gap in the fiscal year 2003/04 was Rs. 8119.20 million, had extended from Rs.2061.7 million in fiscal year 1982/83.
- ❖ The tax-GDP ration of Nepal is not found satisfactory compare to other developing countries. Tax-GDP ratio in 1982/83 was only 7.17 percent and has gradually increased and reached to 9.72 percent in 2003/04.
- ❖ Indirect tax revenue is the composition of custom duty, VAT, excise duty and other taxes. The composition of custom duty, VAT, excise duty and other and taxes to indirect tax were 38.51, 35.90, 18.15 and 7.09 percent respectively in 1982/83 and were 42.90, 39.93, 17.17 and 0.00 percent in 2003/04 respectively. Out of the various indirect taxes, the custom duty has occupied the first position and VAT has occupied second position and its contribution is increasing trend.
- ❖ Direct tax revenue is the composition of tax on property, profit and income. And land revenue & registration. Contribution of tax on property, profit and income to direct tax was 62.90 percent in 1982/83 and that for 2003/04 was 85.75 percent.
- ❖ Nepalese income tax revenue is the composition of income tax from public enterprises, semi public enterprises, private corporate bodies, individuals, remuneration and tax on individuals to tax revenue is the highest.
- ❖ Income tax is the important source of internal revenue of government. Contribution of income tax on GDP, total revenue, tax revenue and direct tax revenue were 0.74, 8.84, 10.38 and 56.44 percent respectively in 1982/83 and became to 1.87, 17.83, 19.19 and 77.61 percent in 2003/04 respectively.
- ❖ Within income tax, there is dominant role of individual and it is in decreasing trend, which was 69.23 percent of income tax revenue in 1982/83 but decreased to 38.22 percent of income tax revenue in 2003/04. The contribution of individual income tax is in first position.
- ❖ Income tax exemption limit in Nepal was Rs. 7000 for all taxpayer in 1959/60 but at present income tax exemption limit is Rs 80000 for individuals and Rs, 100000 for couple and family in 2004/05. The exemption limit is not provided for partnership firms, corporation and non-residents. It is found that exemption limit has been changed on the need of time and income.
- ❖ Personal income tax rate was 5 to 50 percent with 7 slabs in 1980/81 but present (i.e. for 2003/05) it is reduced to 2 slabs in the same way, corporate tax rate was 10 to 55 percent with 8 slabs in 1980/81 but at present corporate taxpayers are taxed at flat

rate. Income tax rate is 15 percent and 25 percent for personal income tax over exemption limit, 30 percent for bank, finance companies and 25 percent for other corporate taxpayers.

- ❖ Collection performance of income tax in Nepal is not so satisfactory. In 1984/85, total collection of income tax was Rs. 313.7 million which was 79.31 percent of estimates. Income tax was collected 109.39 percent of estimates in the fiscal year 2003/04.
- ❖ Relation between income tax and Direct Tax Revenue, Tax Revenue, Total Revenue, GDP have been found a perfect positive correlated.
- ❖ An opinion survey has been conducted in order to find out the role of income tax in Nepal and some other aspects of income tax. From the opinion survey with tax administrator, tax experts and tax payers, the following findings have been drawn.
- ❖ Income tax is the suitable means of raising government revenue.
- ❖ Public awareness program is necessary to increase tax consciousness and raising the government revenue.
- ❖ Tax Administration etc. are the major reason for the low contribution of income tax to national revenue.
- ❖ Exemption and deduction should be increased to promote the special industry and export.
- ❖ To increase the voluntary compliance by taxpayer, self-assessment method is the appropriate method while assessing the income tax.
- ❖ Lengthy process, vague provision in income tax laws, consuming unnecessary time etc are the major problems facing by the taxpayer while paying the tax.
- ❖ The fines and penalty under the Nepalese tax system are not reasonable and it should be increase to discourage tax evader and illegal activities.
- ❖ Clear act, rules and regulation, effective tax administration are the most important instruments for effectiveness of income taxation in Nepal.

## Chapter – 6

### SUMMARY, CONCLUSION AND RECOMENDATION

#### 6.1 Summary:

Taxes are the lifeblood of every government's revenue but it can't be over emphasized that the blood is taken from the arteries of the tax payer and therefore the transfusion has to be accomplished in accordance with the principle of justify and fair play. Nowadays taxation has become a reality of life without which government can not sustain itself. When it is levied on the basis of ability to pay it will be accepted by everyone but public dissatisfaction became inevitable when the burden of tax becomes too excessive.

Taxation is a general device for the government to extract money or valuable contributions from people. It is not expected that all people voluntarily compliance their tax responsibilities. As a patriotic, conscientious and responsible citizen it is duty of every tax payer to voluntarily comply with tax laws. It may be possible educated tax payers. The commitment of government or state to the creation of welfare and progressive state cannot be understated in this respect. The proper and effective implementation of tax laws is necessary to create a welfare state and equalitarian society conclusive to peaceful enjoyment of life, progress and prosperity and also to avoid evil consequences of tax evasion and tax avoidance.

Tax structure consists of various types of taxes. There is not doubt that income tax has a significant role on revenue. Most of the developmental activities after the great revolution of 2007 B.S have been conducted with the foreign grants and loans. Due to poor performance on internal revenue collection and mobilization, Nepal has still depended on foreign grants and loans. The dependency has not been reduced yet. The past history and experiences of various nations reveals that the dependency on eternal sources for long period may be very dangerous. This situation may arise when a country becomes faire to increase the internal revenue. It does not mean that a country can be lonely exist in the world. It does only mean that is better for a country to mobilize her own resources that to depend on external sources. Therefore the reliance on external sources should be reduced as far possible fro the continuity of existence, sovereignty and freedom of a country. Thus the importance of tax revenue, which is the major element of internal revenue, is enough.

Besides revenue purpose, income tax may be used as a device for minimizing the gap between haves and have not so as to create the social justice and equalitarian society. This aspect may vanish into vacuum in the absence of sound and effective income tax administration. On one side and effort is made to increase the revenue with levying high taxation, on the other side, the tendency of taxpayer to evade tax increase. It has been a major challenge to income tax administration.

To encourage people towards income tax, income tax system should be made legally justified and collected amount should be utilized appropriately for their benefit. The taxpayer should be made conscious through proper tax education. The law must be clarified, and simple. Te effort should be make to bring all potential new taxpayers into tax net on regular basis. The benefit of taxpayers should be equally considered while formulating or improving tax law. The convenience of both the administration and taxpayers should be equally considered.

The laws should be well defined and firm. The loopholes in laws should be immediately eliminated. The environment must be created for officials and taxpayers to fulfill their

corresponding responsibilities. There should be better coordination and mutual cooperation and understandings between taxpayers and administration.

Income tax evasion may be minimized through sound administration. For this, tax officials as well as general public may act simultaneously. Hearing opportunity, right to cross examine, opportunity to produce evidences and other relevant principles of natural justice should be strictly applied in practice. The hearing opportunity should be real, fair and reasonable. The taxpayers should be informed about the actual amount of tax assessed on different sources of income. The system of best judgment should be eliminated gradually.

In the contest of Globalization the developing countries are seen to suffer because of the less efficient tax administration. With the increase on personal morality and development of information technology and with the freedom to invest saving abroad the total income of many individuals will be consisting a large component of foreign earned income. These individuals are likely to underreport incomes earned abroad and the tax administration of their country of residence will be unable to ascertain or discover these foreign earned incomes. These individuals are likely to underreport incomes earned abroad and the tax administration of their country of residence will be unable to ascertain or discover this foreign earned, income. Due to this the high earners can escape from tax and the low earners. The first elected government in 1959 A.D finally introduced business profits and salaries Tax Act, 1060 in Nepal. At the time, income tax was levied only on business profits and salaries. About after three years experience of income tax, the government replaced the prevailing tax act by income tax act, 1962. The coverage was extended in the act. In 1974, Income Tax Act 1947 A.D. (2031 B.C) was enacted. The act remunerated income sources into five groups (a) Agriculture (b) industry, Trade, Profession or Occupation (c) Remuneration (d) House ad compounds rents (e) other sources. However, Agricultural income was kept outside the tax net except few years through the finance Acts.

To enhance revenue mobilization through effective revenue collection procedure fro the economic development of the nation, and to amend and integrate the laws relating to income tax, the parliament of Nepal enacted Income Tax Act, 2002 A.D (2058 B.C). This ac has replaced income Tax Act, 1974 A.D (2031 B.C) which was amended for eight times and existed for a period of 28 years. Government of Nepal formed Income Tax rules, 2059 B.S. in 2059 B.S to help clarifying the Act.

Lastly, A good tax system is one which is a little burdensome to people as possible, simple and clear tax laws, sound and effective income tax administration, tax consciousness on general public, adoption of principle of equity and ability to pay principle, appropriate income tax policies, minimum cost of collection etc. are the major characteristics of effective income tax administration. Though, efforts have been made to hold these characteristics of effective income tax administration. Though, efforts have been made to hold these characteristics in Nepalese income tax system, the complete success has not been achieved. There are many things remained to be reformed in Nepalese income tax system. Therefore it is the responsibility of all Nepalese citizens to participate in the efforts made by the state for introducing Nepal as a developed, advanced and powerful nation through better mobilization of internal revenue especially the taxation.

## 6.2 Conclusion:

Nepal being one of the least developed nations in the world has always suffering from the social and economic problems. Nepal cannot successfully and properly tear a curtain built from massive poverty, hunger, diseases, unemployment, heavy dependence on agriculture, lack of adequate industries, low income level and social-political and geographical constraints over 50 years of planned development. Yet, Nepalese economy is suffering from ineffective and effortless plan, program ad policy of development and is also fighting against whatever bottlenecks identified before the starting of planned period.

The government need huge amount to achieve the maximum objectives of nation. In developing countries like Nepal, lack of sufficient financial resource is the main constraint for the national economic development. Nepal is facing serious problem of resource gap and high dependency on foreign loan. Resource gap has been increasing at a faster rate than the increase in revenue. The resource gap is widening continuously with the increment of total expenditure in respect to total revenue collection. To solve such serious problem of deficit fiscal, income tax should play important role. But resource mobilization in Nepal is still poor.

The government of Nepal introduced a formal tax for the firs time in Nepal in 1960 (2017 B.S) in the form of “Business Profits and Remuneration Tax.” The “Business Profits and Remuneration Act 1960” governed it. According to this act only business profits and remuneration on income were subjected to tax but the revenue for these taxes should not be collected properly according to originals estimates. At present, income Tax Act 2002 is effective which was introduced in 2002. In the new ‘Income Tax Act 2002’, sources of Nepalese income are classified into business income, investment income and employment income for the tax purpose. The percentage share of income tax to government is not satisfactory in comparison to other developing country like India, Pakistan, Bangladesh; Sri Lanka etc. there are three major income tax assessment methods in the Nepal.

Currently, income tax revenue in Nepal is collected through four sector i.e. corporate income tax, individual income tax, house and land rent tax and interest tax. Among them, share of the individuals’ income tax is the highest. Exemption limit and tax rate of the income tax is determined according to the income level and sector wise but is not adjusted according to the inflationary situation of the country and number of dependents. Exemption limit is not provided to the corporate bodies.

The success or effectiveness of income tax system entirely depends upon implementation of provisions, which is the major responsibility of income tax administration. Income tax system of Nepal has blamed as not efficient enough. Various problems existed in the income tax such as increasing habit of tax evasion, inefficient income tax administration, defective income tax law are the reason of lower contribution of income tax. But if we analyze the data relating to it then we can find out that revenue collection from income tax is increasing continuously. Provisions in act and language have to be made clear. Some reform in income tax administration is needed to raising the income tax revenue.

### 6.3 Recommendations:

Following recommendations are presented for raising tax collection and widening tax base.

- ) Income tax policy should be formulated according to the economic policy of the country and should be revised timely.
- ) The members involved in formulating income tax policies must have deep knowledge about income tax.
- ) The government should go on discussion for including professionals (doctors, engineers, specialists, lawyer, consultants, tutors and auditors) on net of tax.
- ) Business through internet should be included in tax base.
- ) Additional exemptions should be provided for natural person to discourage cash transactions who transacts his/her business through credit card.
- ) The director general of IRD should pre-order and circulars through the committee of business professionals to make it impartial and judicial.
- ) IRD should announce public circular if any pre order is the type of public matter.
- ) A certain amount of expenditure should be excluded for taxation that reinvests his savings towards industrial development.
- ) Advanced tax should be charged at resource on profit earned from share market and tax amount should be treated as final payment for natural person.
- ) Rent with holding tax for natural person charged at 15% as entity, natural persons have not been paying income tax for special purpose. So, five percent of final withholding tax should be charged to natural person for paying of rent. It should be strictly applied. Huge amount revenue should be received.
- ) One should discourage the provisions of 75% tax evasion on foreign allowance provided by the government of Nepal for foreign employment. This facility should be provided to the other tax payers who send employees in different countries.
- ) The provision of tax revenue against IRD is performed by director general of IRD. Decision regarding his own sub ordinate the D.G must be based with the departmental decision towards tax payers claims. So, it should be should be only judicial review from independent entity.
- ) Expenditure related to reserve f or unexpired risk and provision for unsettled claim of general insurance companies should be included in tax claim.
- ) The provision of rewards, prize incentives should be introduced in the act to encourage the tax payers to pay tax voluntarily rather through coercive measures. In this context, the government has forwarded a plan named "VDIS" (voluntary declaration income system). This plan is most valuable at present. But the government should not inquire the source of income who one has invested his earning to productive sector.
- ) A research and intelligence center should be established in IRO for proper planning and to collect the information in regard to income tax evaders, potential new tax payers and non resident who have conducted business without registration.
- ) Tax personnel should be encouraged, punished and transferred on the basis of there work experience. Regular and effective training system, record, prize and punishment system should be established for the effective personnel management.
- ) Separate income tax department should be established so that the specialization could be achieved in matter of income tax.

) Income tax administration implements the tax laws. There effectiveness of income tax system depends upon the income tax administration. In Nepal one of the most important reasons for unsound income tax system is insufficient and unscientific income tax administration. Following recommendations are made for improvement of income tax administration.

(A). Delays in assessment should be reduced as possible.

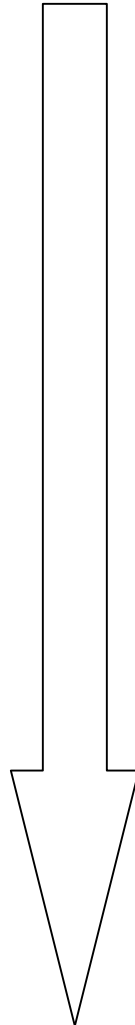
(B). Computerized information system to keep up to date records of income Tax

(c). Proper tax education should be provided to tax officials as well as tax payers regularly.

(D). Income tax experts/ professions should be increases in tax administration.

(E). Post of income tax collection should be reduced.

) Following recommendations are presented for amendment in income tax act, 2002 (2058 B.S)



<b>S.N</b>	<b>Section</b>	<b>Amendment detail</b>	<b>Cause for amendment</b>
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1.	2(Ha)	Definition of payment is unclear. So, a statement giving exact meaning of payment is needed.	Main purpose of act assumed to be accrual basis of accounting. There is a possibility of differentiating and acknowledgement between tax payer and tax officer towards incurred and accrual basis.
2.	2(Ka, Anga)	Definition of president person is unclear. So, definition should not be more difficult to understand than the word predefined.	The word normal resident person is stated on the act. But what type of condition (home or family or economic activities) should be assumed as normal resident person that is not described.
3.	2(Gya)	The definition of employment is not clarified. So, clear definition the word "employment" is needed.	Income from investment is stated in section 2(Gya). But definition of employment is not described. There arises a problem of differentiation between consultant and employee.
4.	2(ka, Ma)	Service charged is defined in the act but the "service" is not defined.	There is a provision of advanced tax credit in payment of service charged.
5.	20(4)	Loss carries back from business or investment only after the written notice of IRD. The provision should be amendment.	Right of loss carry back should be written in the act for adjustment of tax.
6.	21.1(Ch)	Not deductible expense section 21.1(Ch) to be eliminated.	There is a possibility of selfishness of tax

			officer that he should deny any expense as not deductible expenditure.
7.	24.	Accrual basis accounting: value of liability should not be estimated realistically. So, such liability should be treated as expenditure which should be estimated realistically.	It is not clear to tax officer that what value of liability is estimated.
8.	25.2(Kha)	Written of that debt as reverse amount which is at confidential base. Confidential base should be clarified.	Interpretation of confidential base is solely dependent upon tax officers.
9.	100(2)	Jeopardy assessment IRD should make tax assessment judiciously. Judicial tax assessment should be interpreted.	Jurisdiction assessment is the power of selfishness. The tax officer may asses the tax basely.
10.	101	Amended assessment of tax. IRD should make amended assessment of tax. There should be a provision of amending income statement for tax payer.	To verify his fault in income statement the tax payer should also submit his amended income statement.

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**D. WEBSITES**

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**APPENDIX - A**

**COVERLETTER**

Dear Sir,

First of all, I would like to introduce myself as a student of R.R.M Multiple Campus, Janakpur, and Master in Business studies (M.B.S) final year. I am going to prepare a dissertation entitled "income tax administration in Nepal" to fulfill partial requirement of master's degree in business studies of Tribhuvan university of Nepal.

I have sent this questionnaire to spare some of your valuable time to provide your valuable suggestions and opinions concerning with income tax system in Nepal, which will be very useful and guide me for completing my research work. I would be very much appreciated if you could provide your important time for filling this questionnaire.

I assure to keep every detail you provide me confidential.

I am looking forward to your co-operation and support with many thanks as soon as possible.

Yours sincerely,  
Shila Kant Labh

APPENDIX - B

QUESTIONNAIRE

Name .....  
Designation: .....  
Office/organization : .....  
Address : .....

Please you are requested to tick ( ) the answer of your choice or wherever appropriate put in order of preference from 1 to last number. Number 1 stands for the most important and the last number for least.

1. In your opinion, is income tax system of Nepal sound and efficient?  
Yes ( ) No ( )
2. Do you consider that the income tax as a suitable means of raising government revenue? Yes ( ) No ( )
3. Do you think that public awareness program is necessary in Nepal for raising government revenue? Yes ( ) No ( )
4. In your opinion, is contribution of income tax to national revenue of Nepal satisfactory? Yes ( ) No ( )
5. If no, what are the major reasons?
  - i. defective of income tax act ( )
  - ii. Mass poverty and low income level ( )
  - iii. Increasing habit of tax evasion ( )
  - iv. Inefficient income tax administration. ( )
  - v. inappropriate rate and exemption limit ( )
6. Do you think that contribution of direct tax to total revenue is effective?  
Yes ( ) No ( )
7. Are exemption and deduction provided by act appropriate?  
Yes ( ) No ( )  
If no, please specify .....
8. Which income tax assessment method is more appropriate in Nepal?
  - i. Self-assessment ( )
  - ii. Assessment on the best judgment ( )
  - iii. Tax settlement commission ( )

- iv. Lump sum (15% rate) ( )
  - v. Others, please specify .....
9. In your thinking, what types of problems are facing by the tax payers while paying income tax?
- i. consuming unnecessary time ( )
  - ii. Expectation illegal incentives by tax personnel ( )
  - iii. Vague provisions in income tax laws ( )
  - iv. Lengthy process ( )
  - v. Lack of co-operation by tax administrator ( )
10. Are the provisions of fines and penalty under Nepalese tax system reasonable?  
 Yes ( ) No ( )  
 If no, how should it be made reasonable?  
 a. by increasing b. by lowering c. effective implementation of act is necessary
11. Do you agree that Nepalese income tax administration is effective?  
 Yes ( ) No ( )
12. In your opinion, what is the most important factor for effectiveness of income tax in Nepal to raise government revenue?
- i. Clear Act, rules and regulation ( )
  - ii. Conscious and honest tax payers ( )
  - iii. Honest tax officers ( )
  - iv. Effective tax administration ( )
  - v. Political non interruption ( )
  - vi Others, please specify . .....
13. Do you have any other suggestions for achieving effectiveness of income tax in Nepal? If yes, please specify .....
- .....

THANKS FOR CO-OPERATION

## APPENDIX – C

### LIST OF RESPONDENTS

#### A. Income tax administrator

- |  |                                    |
|--|------------------------------------|
| 1. Lavraj Shrestha, chief tax administrator, | Inland Revenue office Kathmandu.   |
| 2. Arjun Prasad Bhattarai, Tax officer,      | Inland Revenue office Kathmandu.   |
| 3. Baburam Gautam, Tax officer,              | Inland Revenue office Kathmandu.   |
| 4. Mrs. Nita Devi Gautam, Tax officer,       | Inland Revenue office Kathmandu.   |
| 5. Gobind Prasad Poudel, Tax officer,        | Inland Revenue office Kathmandu.   |
| 6. Visnu Prasad Upadhaya, Tax officer,       | Inland Revenue office Kathmandu.   |
| 7. Satya Narayan Mandal, Chief tax officer,  | Inland Revenue office, Birgunj.    |
| 8. Khadanand Gautam, tax officer,            | Inland Revenue office, Birgunj.    |
| 9. Dhundi Raj Pokhrel, Chief tax officer,    | Inland Revenue office, Biratnagar. |
| 10. Krisna Bahadur Basnet, tax officer,      | Inland Revenue office, Biratnagar. |
| 11. Durga Datt Bhandari, tax officer,        | Inland Revenue office, Biratnagar. |
| 12. Dharmendra Kumar Mishra, tax officer,    | Inland Revenue office, Biratnagar. |
| 13. Punya Bikram Khadka, tax officer,        | Inland Revenue office, Biratnagar. |
| 14. Dayanand Keshari, tax officer,           | Inland Revenue office, Biratnagar. |
| 15. Krishna Prasad Mainali, tax officer,     | Inland Revenue office, Biratnagar. |
| 16. Ramanath Dahal, tax officer,             | Inland Revenue office, Biratnagar. |
| 17. Krishna Bista, tax officer,              | Inland Revenue office, Biratnagar. |
| 18. Khagendra Khadka, tax officer,           | Inland Revenue office, Biratnagar. |
| 19. Keshav Prasad, tax officer,              | Inland Revenue office, Biratnagar. |
| 20. Bishnu Prasad Aryal, tax officer,        | Inland Revenue office, Biratnagar. |

## **B. Tax Experts**

1. Binod Bahadur Raj Bandari, FCA president, ICAN
2. Dewakar Prasad Rimal, Council Member, ICAN
3. Narayan Bajaj, FCA
4. Bijya Kumar Agrawal, FCA
5. Pushpa Lal Shrestha, FCA
6. Bal Krishna Sharma, FCA
7. Maheshwor Prakash Shrestha, FCA
8. Sudershan Raj Pandey, FCA
9. Shivnath Pandey, FCA
10. N. Krishna Swami, FCA
11. Gandhi Pandit, Attorney at law
12. Anil Kumar Sinha, Advocate
13. Chirinjibi Bagale, Economist
14. Jeevali, CA, Nepal, Rastya Bank
15. Dr. Dipak Sakya, Thakurram Multiple Campus, Birgunj
16. Ganesh Lath, President, Birgunj Chamber of commerce and industry
17. Ashok Remani, Vice, President Chamber of commerce and industry
18. Mahesh Jaju, President, Biratnagar Chamber of commerce and industry
19. Jeevan Nepal, Vice President, Biratnagar Chamber of commerce and industry
20. Bholal Dulal, secretary, Biratnagar Chamber of commerce and industry

### **C. Tax Payers**

1. Dewaker Prasad Rimal, Under secretary, Financial Compiler General Office, Kathmandu
2. Tirthman Shakya, President, Public Service commission Nepal
3. Indra Nepal ,president , NGO's (Non Governmental Organization)
4. Tek Bahadur Thapa, Secretary Minister Of agriculture and co-operative
5. Bachu Ram Nepal. Auditor General Nepal.
6. Birendra Karki, Joint Secretary, Secretariat of Parliament, Singhdurbar, KTM
7. Sanjay Manandhar, Computer Engineer, Financial Comptroller general office KTM
8. Sher Bahadur K.C Joint Secretary, Financial Comptroller general office KTM
9. Prakash Tiwadewal, member, Birgunj Chamber of Commerce and Industry
10. Susil Ghurka, member, Birgunj Chamber of Commerce and Industry
11. Purusotam Lal Sanghai, M.D, Triveni Textile Pvt. Ltd Birgunj
12. Prakash Kumar Khandelwal, M.D, Unique Trade Link Pvt. Ltd, Birgunj
13. Jagadish Rungta, M.D, National Health Care Pvt. Ltd, Birgunj
14. Rajesh Kumar Khandelwal, M.D, Triveni Dal and Oil Industry, Birgunj
15. Parsuram Sarawagi , Professor, Dinanath, Parsuram, Birgunj
16. Pursotam Agrawal, M.D, Peakok Colour Lab Pvt. Ltd, Birgunj
17. Yugal Kishore Rathi, M.D, Rathi Vermi Fertilizer Industries Biratnagar
18. Ashok Mural, M.D, Pasupati Iron and Industries Pvt. Ltd, Biratnagar
19. Kiran Kumari Yadav, M.D, Vipul Training Center
20. Rishi Bachan Yadav, M.D, Manakamna, Grochem, Biratnagar

## Appendix – D

### Macro Revenue Scenario(%)

(For the FY 2000/01 to 2004/05)

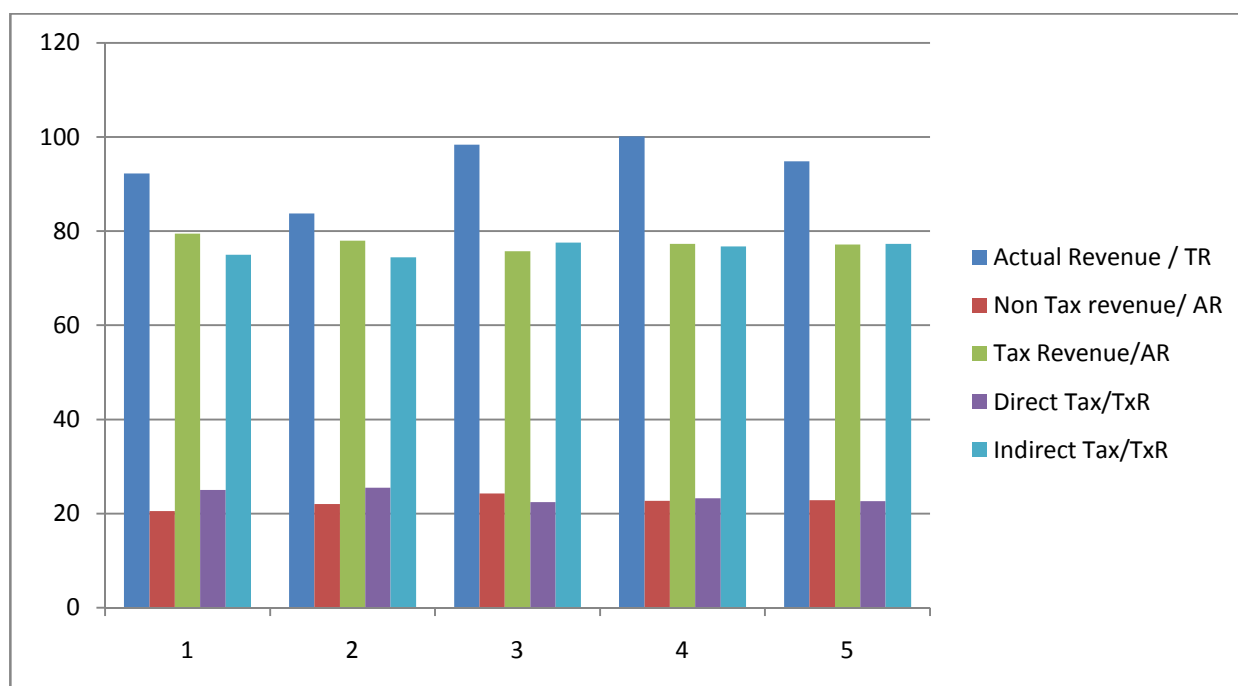
Revenue showed fluctuating trend, in the year 20001/02, reduction of 8.54% was recorded compared to 2000/01 and increased significantly during the following two years i.e. 2002/03, and 2003/04 and went down to 94.86% in the year 2004/05. Non tax revenue increased by 1.52 and 2.23 percent respectively during 2001/02 and 2002/03, decreased by 1.55 percent in 2003/04 and remained almost constant in 2004/05. Share of Tax Revenue that holds more than 75% of total revenue, decreased till 2002/03 and slightly rose during the later years.

Contribution of indirect income tax is more than ¾ of total Tax Revenue with an increasing trend throughout the period and reached to 77.33% in 2004/05 whereas tax revenue decreased by 2.36% in the year 2004/05 as compared to the year 2001/01

**Table 1**

Actual Revenue / TR	92.27	83.73	98.39	100.17	94.86
Non Tax revenue/ AR	20.51	22.03	24.26	22.71	22.84
Tax Revenue/AR	79.49	77.97	75.74	77.29	77.16
Direct Tax/TxR	25.03	25.52	22.42	23.27	22.67
Indirect Tax/TxR	74.97	74.48	77.58	76.73	77.33

### Revenue Scenario (%)



Source : Consolidated financial statements, Fiscal Year 2004/2005. Government of Nepal, Financial controller general office.

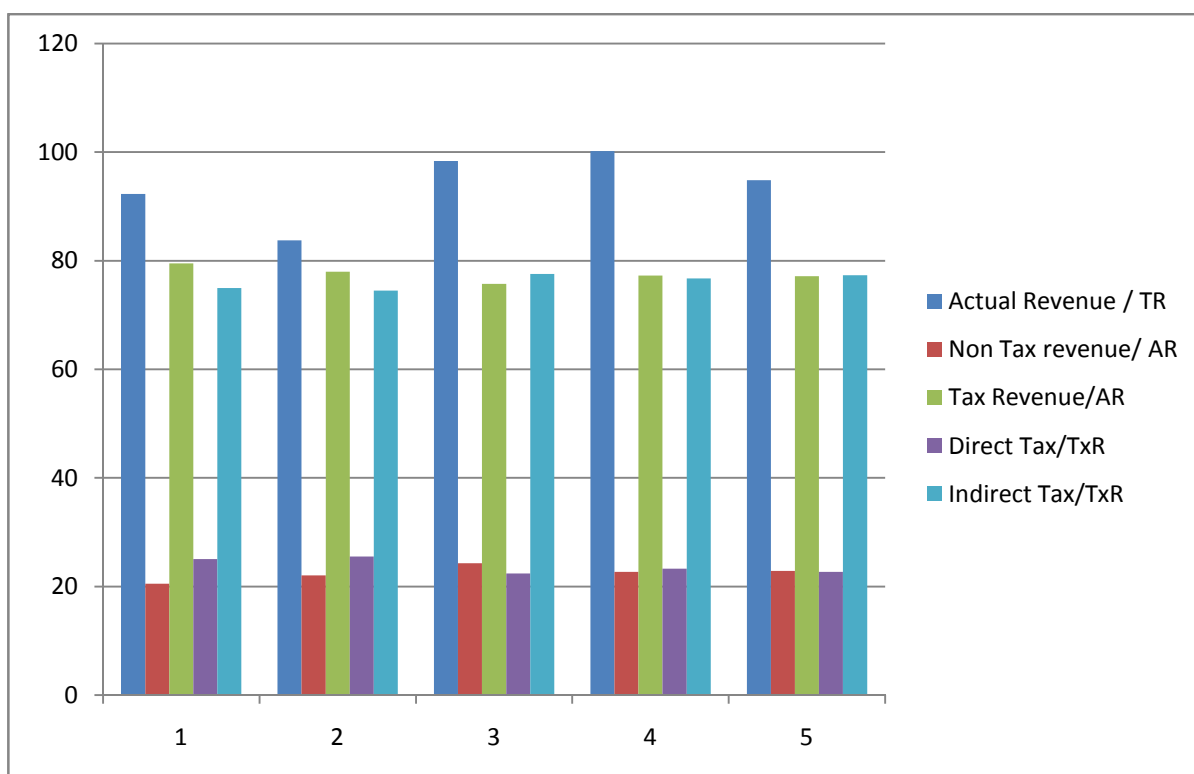
## Appendix - E

### DEVELOPMENT REGIONWISE REV.COLLECTION (%)

(For the FY 2000/01 to 2004/05)

Revenue collection of all development region shows almost constant trend despite some fluctuations throughout the observing period. Comparison of development region-wise revenue collection reveals central development region collected more than ¾ of total revenue followed by eastern and western development region. Mid western and far western region has very nominal contribution in total revenue collection.

Development region wise revenue collection	Eastern development region	10.39	11.13	10.62	9.87	11.22
	Central development region	78.84	76.55	76.25	78.63	77.03
	Western development region	7.93	8.96	9.71	8.31	8.88
	Mid western development region	1.8	2.13	2.08	2.09	1.84
	Far western development region	1.04	1.23	1.33	1.11	1.02



Source : Consolidated financial statements, Fiscal Year 2004/2005. Government of Nepal, Financial controller general office.

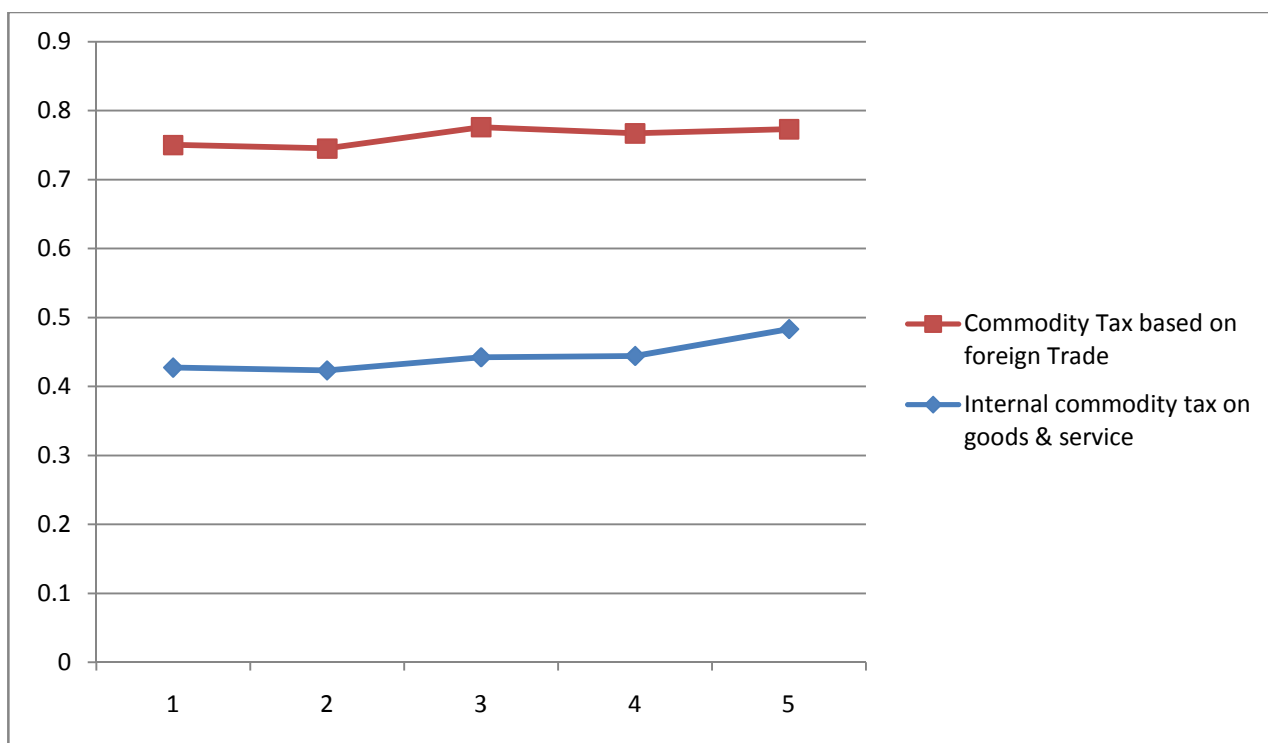
## Appendix - F

### DEVELOPMENT REGIONWISE REV.COLLECTION (%)

(For the FY 2000/01 to 2004/05)

Internal commodity tax on goods and service shows slight increasing trend. Trend of commodity tax based on foreign trade was constant despite of slight fluctuations. Comparing the final year of the analysis period to the first year, commodity tax on foreign trade decreased slightly.

<b>Ratio with tax revenue</b>	Internal commodity tax on goods & service	0.427	0.423	0.442	0.444	0.483
	Commodity Tax based on foreign Trade	0.323	0.322	0.334	0.323	0.29

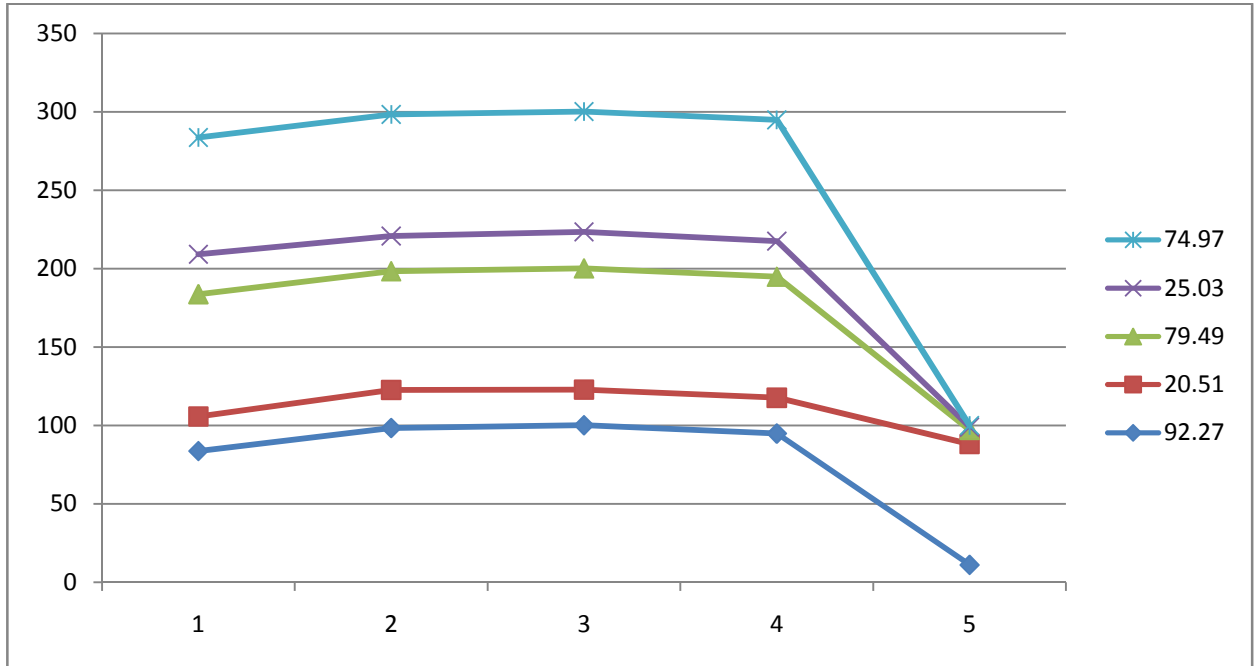


Source : Consolidated financial statements, Fiscal Year 2004/2005. Government of Nepal, financial Controller General Office.

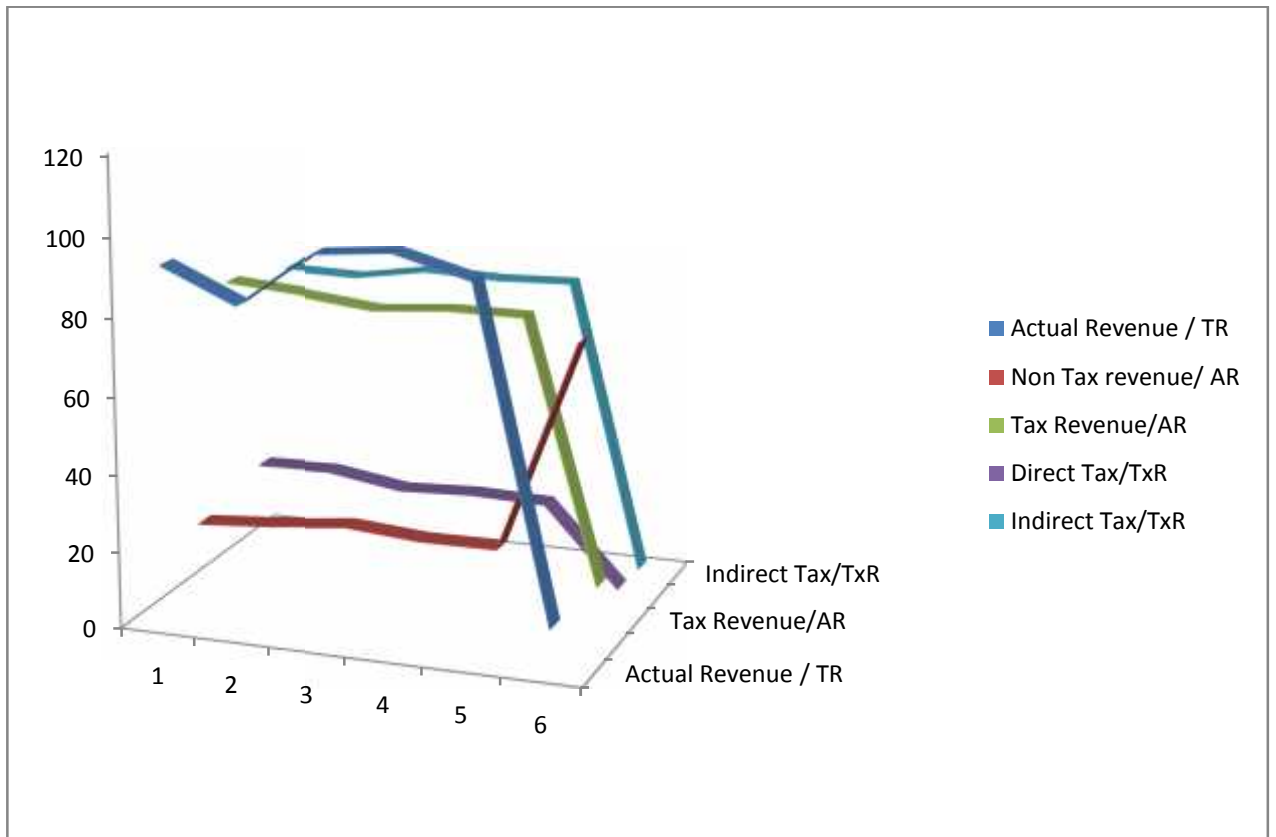


# Appendix - G

## REVENUE COLLECTION TREND



## Trend Of Revenue Collection





## APPENDIX-H

### COMPRATIVE DISTRICT WISE GOVERNMENT REVENUE

Distri ct Code	District Name	FY 2057/58(2000/20 01)	FY 2058/59(2001/20 02)	FY 2059/60(2002/2 003	FY 2060/61(2003/20 04)
1	Taplejung	7848973	10702128	14775192	18530394
2	Panchthar	13539695	18208331	20844615	28073161
3	Illam	40541995	53499043	38399774	52782730
4	Jhapa	773787217	1038509905	1386951436	1472837047
5	Sankhuwasava	9597423	13663473	17594365	23691770
6	Terathum	7476942	9773206	11397995	16425355
7	Bhojpur	11387076	14653327	15871917	20841869
8	Dhankuta	18613404	27274350	27278137	34965953
9	Sunsari	276878088	316881756	335033134	388140603
10	Morang	3613080920	3658748140	3688288932	3678301661
11	Solukhumbu	37629236	8121227	14528747	26524362
12	Khotang	11006721	14097366	15444305	23051977
13	Udayapur	33142573	153263662	112955944	110166235
14	Okhaldunga	8565387	10352142	12472868	18174494
15	Saptari	66827044	75855737	67929868	83160344
16	Siraha	150291445	191274331	193929936	202131203
<b>Eastern Region Total</b>		<b>5080314139</b>	<b>5614878123</b>	<b>5973697165</b>	<b>6197763157</b>
17	Dhanusha	806719288	816114440	859874991	923925324
18	Mahottari	85289669	87232868	82475852	85332410
19	Sarlahi	73546505	73922501	105048671	95116249
20	Sindhuli	12111457	21379482	25831518	26597099
21	Ramechhap	7647051	9325932	11819870	14782438
22	Dolakha	10882409	13022113	12744823	17784624
23	Sindhupalcho wk	640567325	1419089551	1410069866	1236517698
24	Rasuwa	6774609	6242383	6466077	8273461
25	Dhading	12724163	17691938	21235493	31171536
26	Nuwakot	14309825	19086664	21320898	30298077
27	Kathmandu	23646626165	21569168618	22964701323	27273682298
28	Lalitpur	819545914	846508057	1015123975	1105314395
29	Bhaktapur	81400061	169513510	229727094	272557428
30	Kavrepalancho wk	50127418	46764155	53992217	66534033
31	Makwanpur	459919420	503694156	505858965	652816679
32	Rauthat	166584610	174842950	117443129	126887411
33	Bara	247068974	361104784	455476854	420056160
34	Parsa	669657137922	10949489043	13240351050	15370830754
35	Chitwan	1747731550	1511700640	1733866931	1641424474
<b>Central region total</b>		<b>38546714335</b>	<b>38615893786</b>	<b>42873429597</b>	<b>49399902548</b>
36	Nawalparasi	73225386	69446447	105532155	118243538

37	Rupandehi	2528429238	2997516190	3838370726	3601487347
38	Argakhanchi	16128408	15867148	16862231	30865307
39	Palpa	27309136	35832176	37173160	49555013
40	Gulmi	17743285	21977612	29521620	33323301
41	Syanga	23331966	25343846	40111008	49749312
42	Tanahu	35901536	25921307	44977524	51316890
43	Gorkha	17857804	23367736	28645403	38931435
44	Manang	1026843	1392915	1827366	3186956
45	Lamjung	12066325	17355344	20328165	29586045
46	Kapilbastu	542965009	677859493	701753210	515647329
47	Kaski	531535435	550300401	514115495	595800545
48	Parbat	12905658	12666885	22934574	27056123
49	Baglung	22829109	27882043	38379940	45953644
50	Myagdi	10833075	13697404	16743382	22125934
51	Mustang	4803521	4375766	5315076	6299161
<b>Western region total</b>		<b>3878891734</b>	<b>4520822714</b>	<b>5462591036</b>	<b>5219127881</b>
52	Mugu	1446962	2201330	5139582	3344553
53	Dolpa	1836625	2119217	2013704	6671020
54	Humla	1892761	2956462	2196259	3962942
55	Jumla	3766655	5107554	4397497	6139504
56	Kalikot	2028248	1764980	2598358	4009524
57	Rukum	5432371	7702273	8774738	14776718
58	Rolpa	11110232	10998904	12251213	15694889
59	Pyuthan	9565101	10879002	12232463	13481020
60	Dang	109740540	99841992	103859953	113061685
61	Salyan	7700574	7263887	12027410	13240329
62	Banke	664743671	855272824	928763694	1022400251
63	Bardiya	27718955	25897102	35394372	46194207
64	Surkhet	24719986	32210806	31787926	34845035
65	Jajorkot	2425284	3265164	3637238	4613765
66	Dailekh	4692058	5119665	5292590	8023866
<b>Mid-Western Region</b>		<b>878822023</b>	<b>1072601163</b>	<b>1170366996</b>	<b>1310459308</b>
67	Kailali	327318477	421296798	521198067	464788193
68	Doti	4989592	8928939	8523135	22291066
69	Accham	6081571	4966713	3293845	5886594
70	Bajura	2245931	2276731	2755655	4591794
71	Bajhang	3304913	3201596	4088431	4346136
72	Darchula	3489839	3738628	4409188	6246436
73	Baitadi	5434582	5448859	7156997	8051526
74	Dadeldura	22297267	18991906	27004285	20942594
75	Kanchanpur	133656822	152445262	171276415	160519959
<b>Far-Western Region Total</b>		<b>508818994</b>	<b>6240295430</b>	<b>749706017</b>	<b>697664297</b>
<b>Grand Total</b>		<b>48893561225</b>	<b>50445491216</b>	<b>56229790810</b>	<b>62824917191</b>

Source: Consolidated Financial Statements, Fiscal Year 2004/2005.



# APPENDIX-I

## Nepal: Summary of Government Operations 2000/2001-2004/2005

Descriptions	Fiscal Year					
	2000/2001	2001/2002	2002/2003	2003/2004		2004/2005
Total Revenue and Grants	53590	54400	66029	71766		83266
Total Revenue	46836	48556	54690	60480		68875
Tax Revenue	38865	39331	42587	48173		54105
Non Tax Revenue	7971	9226	12103	12308		14770
Grants	6753	5844	11339	11286		14391
Total Expenditure	72807	71522	72907	76797		87779
Regular Expenditure	37079	42174	45414	47657	Recurrent	61686
Development Expenditure	35009	29348	27493	29140	Capital	26093
Overall Balance Before Grants	-25251	-22965	-18217	-16317		-18904
Overall Balance After Grants	-18498	-17122	-6878	-5031		-4513
Financing	18498	16216	7905	3195		2051
Net Foreign Loss	7543	2658	-950	1863		3313
Gross Disbursements	12044	7410	4546	7629		9266
Amortization	4501	4751	5496	5766		5953
Net Domestic Financing	10954	13558	8855	1332		-1262

Source : consolidated Financial Statements, Fiscal Year 2004/2005.

Government of Nepal, Financial Comptroller General Office.

**APPENDIX-J**

**Comparative Summary Of Income and Expenditure**

Rs. In Thousand

Head	Actual of 2002/03	Actual 2003/04		Actual of 2004/05
<b>Total Expenditure</b>	<b>84006081.18</b>	<b>89445155.47</b>		<b>102560471.86</b>
Regular	54973061.71	58451621.31	Recurrent	61686433.40
Development	29033019.46	30993534.16	Capital	27340719.44
			Principal Payment	13533319.02
<b>Source of Finance</b>	<b>67568936.91</b>	<b>73616986.01</b>		<b>84513913.49</b>
<b>Revenue</b>	<b>56229790.81</b>	<b>62331027.66</b>		<b>70122742.00</b>
Tax	42586933.39	48172981.61		54104779.05
Non-tax	13642857.43	14158046.05		16017962.95
<b>Foreign Grant</b>	<b>11339146.10</b>	<b>11285958.35</b>		<b>14391171.49</b>
Bilateral Grant	9387207.90	8949781.39		9104318.99
Multilateral Grant	1951938.20	2336176.96		5286852.50
<b>Surplus (+) Deficit (-)</b>	<b>-16437144.27</b>	<b>-15828169.45</b>		<b>-18046558.37</b>
Sources of Deficit Finance	13426423.37	13236798.84		18204229.62
<b>Foreign Loan</b>	<b>4545423.37</b>	<b>7628998.84</b>		<b>9266129.62</b>
Bilateral Loan	657221.33	66013.30		126461.98
Multilateral Loan	3889202.05	7562985.54		9139667.64
<b>Domestic Borrowing</b>	<b>8880000.00</b>	<b>5607800.00</b>		<b>8938100.00</b>
<b>Cash Balance Surplus (+) Deficit (-)</b>	<b>3010720.89</b>	<b>2591370.61</b>		<b>-157671.26</b>

Source : consolidated Financial Statements, Fiscal Year 2004/2005.

Government of Nepal, Financial Comptroller General Office

# CURRICULLUM VITÆ

1. Full Name : Shila Kant Labh
2. Date of Birth : 2017 / 09 /0 9 B.S.
3. Nationality : Nepali
4. Religion : Hindu
5. Martial Status : Married
6. Permanent Address : Janakpurdham-4, Anandnagar, Dhanusha, Nepal  
Phone No:- 041-524246
7. Academic Qualification : Master's Degree in Business Studies  
(M.B.S) from Tribhuvan University, Nepal  
: Bachelor's Degree in Business  
Administration From Tribhuvan University.  
: Proficiency Certificate in Management  
from Tribhuvan University, Nepal.  
: Matriculation from SLC Board on Nepal.
8. Language Skills : Nepali - Excellent  
English - Good  
Hindi - Excellent  
Maithili - Excellent

