

CHAPTER-I

INTRODUCTION

1.1 Background of the study

Every nation requires sufficient funds to carry out development plans, handle day-to-day administration, maintain peace and security and launch other public welfare activities. The funds required by government are normally collected from two sources: debt and revenues. The debt can be collected either from internal sources or external sources. The debt collected within the country is known as internal debt while the debt collected from outside the country is called external debt. The debt financing of the government is also known as deficit financing (Bhattarai and Koirala, 2007).

Developing countries like Nepal is in need of huge capital investments for development process. The government has to make heavy spending on the social overheads in which the private sector are not willing to invest. Despite infrastructure development the government also has the need to run several development projects. The expenditures incurred by the state can be fulfilled by two sources. They are internal and external sources.

Internal sources fund are own sources within the nation. It is the best alternative for the nation to mobilize internal sources that is certain, convenient and reduces the dependability to other countries use of external sources of fund to raise necessary public fund is not good because it reduces the liquidity position of the government, increases over-dependency upon other countries and increases the inflation. So, internal sources are more important not only financing necessary funds but also for the proper mobilization of external sources. But past experience shows that Nepal is unable to mobilize its internal sources properly or effectively.

On the other hand, internal sources of fund can be classified into two types. They are: (a) Tax sources and (b) Non-tax sources. Tax sources include the amounts, which are compulsory contributed by taxpayers to the government. They are customs, excise duty, VAT, corporate and personal income taxes. Non-tax sources include fees, special assessment, gift and grants, fine and penalties etc. Non-tax sources are

uncertain and inconvenient because they are imposed according to the necessary of the government. So, taxes are the better sources of public revenue. The use of tax is safer for financing public revenue in developing countries. So, taxation has been taken as the best effective tool for raising the public fund.

External sources fund are foreign grants and loans. This kind of fund is received from foreign countries and international organization. External sources of fund are more important for undeveloped and underdeveloped countries. It is used for economic development, reconstruction, foreign exchange and to recover from crisis condition for productive use etc (Sharma and Luitel, 2002). But external sources are uncertain, inconvenient and not good for healthy development of the nation because they have to be paid after a certain time. So, it is better to mobilize internal sources rather than looking with beggars eyes the donors (Pant, 1996).

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

Prof. Seligman defined tax as "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."

So, a tax is a compulsory levy imposed by the government. It is levied on persons as per the prevailing laws. The person, who pays tax, does not get any equivalent benefit from the government. It is a compulsory liability if the person who has to pay tax. The collected tax is spent for common interest of the people or it is collected from haves and spent for the interest of have-nots in the society.

Generally, taxes can be classified into two types. They are: (a) Direct tax and (b) Indirect tax. These taxes are collected according to income level or people or Organization. Income tax, property tax, interest tax, etc. are direct tax. Indirect tax is that tax which is imposed on one person but paid partly or wholly by another. Custom duty, excise duty, VAT, sales tax, import and export tax etc. are indirect tax.

Income tax is most popular direct tax. It is considered as one of the major element of tax revenue. Income tax is charge on person's income according to the law

of nation. It covers all the fees, additional fees, fines etc. Income includes all income, which are received from business, investment and employment. Income tax is superior to other because it is imposed on the basis of paying capacity of tax payers. People, whose income is under the taxable income is free from the incidence of income tax.

Within the income tax system, exemptions and deductions are more important to know about income tax because they are used continuously and treated differently year to year. To make up-to-date knowledge about income tax system, it should be known. By knowing it, we can compute net income and tax liability. Income tax law of every nation has clearly mentioned about the exemption of income and deduction of expenses.

Income tax reduces concentration of wealth in a few hands by imposing high rate to those persons and organizations have high level of income and low rate to those whose income level is less. It also helps to increase the government revenue, which can use for public welfare to develop infrastructure, provide general service etc. People who are paying tax to the government expend the revenue in good manner. Income tax is not only essential for collecting government revenue but also to control over consumption to promote saving and generate more employment.

First of all, income tax system was introduced in England to manage the war. Similarly, to manage the civil war, USA introduced corporate income tax in 1862. In 1909 Federal Corporation income tax was originated. Now a day it is expanded all over the world. Every nation is introducing income tax according to their needs.

In Nepal, the first elected government in 1959 introduced “Business Profit and Salaries Tax Act 1960.” At that time, income tax was levied only on business profit and salaries. In earlier days both individual and corporate tax was taxed on progressive rate. The government replaced the prevailing tax act by “Income Tax Act 1962.” In 1974, “Income Tax Act 2031(1974)” was enacted. Now, “Income Tax Act 2058 ” is in implementation.

Income tax plays a very important role in the economic development of Nepal. It is a tool of achieving maximum social and economic objective as laid down by the constitution of Nepal. Taxation in the modern world has been taken as the best

effective tool for raising the ratio of saving of the national income” (Pant 1996). It is also recognized as a good financial tool to make narrow the inequality in income. It reduces the regional economic unbalance by providing tax concession and holidays to the business or industry, which is established in remote and backwards area. “ Income tax is essential not only for collecting government revenue but also to control over consumption, to reduces inequality of income and wealth to promote saving and investment and to accelerate economic development”(Joshi, 1998).

It is no doubt that income tax is the main source of government revenue. It is also usable in the balance economic development. Nobody can doubt that, the distribution of income of income is also possible through progressive income tax rate. The percentage of income tax in government revenue is increasing trend, but government is unable to maximize the share of income tax to the public fund as per expectations. Income tax is assessed on yearly basis.

Although the legal provision has been made and updated timely, there are many problems about income tax and exemptions and deductions. There are many problems in income tax practice in Nepal such as; leakage in tax, feeling of people about tax as a penalty, lack of consciousness of people, inability of tax administration to cover new tax payer, delays in computation and collection, lack of accuracy and unity in accounting system etc (Khadka, 1994). The main objectives of taxation are more revenue collection. Exemptions and deductions play important roe to collect the tax. Because of all these reasons exemptions and deductions of income tax system must be reviewed and immediate correction can be made.

1.2 Statement of the Problems

As other developing countries, Nepal is in need of huge capital investments for development purposes. The government has to make heavy spending on the several overheads. The funds required to make expenditure for development activities can be obtained by two sources: External sources and internal sources. The external financing depends upon the interest and the conditions of the funding countries and agencies and internal source has no obligation towards the third party and less risky compared to the external funds.

Under developed countries are facing various problems in the process of economic development. Nepal is not an exception to this condition. Nepal has facing very serious problem of resource gap high dependency of foreign loan and grants. Taxes are important sources of public revenue. It is the major instruments to increase the rate of capital formulation to achieve high rate of economic development. Higher resources mobilization is the best option of healthy economic development for the nation.

Nepal's low revenue collection is due to poorly design and defective tax system where the taxes are less productive, less responsible and distortion. In Nepal, the coverage of income tax is very low. There is poor tax paying habit of Nepalese people. Tax authorities are inefficient and ineffective in enforcement. Tax offices are looked upon as heaven for corruption. Incompetent personnel are other major problems. The assessment producer of income tax is ineffective. There are no integrated programs for taxpayer's education, assistance, guidance and counseling (Agrawal,1978).

Rich people are avoiding taxes by using legal loopholes and taking advantages of an inefficient tax administration. The coverage of income is very narrow in Nepal, agricultural income is exempt from income tax widespread income tax evasion, complicated and frequent change in the tax rate and policies etc. are major factor for low contribution income tax revenue at present.

Income tax act has provided some exemptions granted to the special industries and the industries established in the backward areas of Nepal are not effective and scientific. Although tax incentives or concessions encourage or support to establish industries in certain area but they vanish or change name, ownership or place of the business when the tax exemptions and concession period.

Income tax act has also provided exemption limit to an individual into two distinct categories in Nepal. They are individual and the family according to the personal status. This classification does not recognize the various sizes of the dependent family members. There is no discrimination between a taxpayer having only a spouse and a taxpayer with a spouse, parents and children. Therefore this limit

is the Nepalese context neither shows any specific or definite relationship with per capita GDP nor with the rate of inflation nor with poverty norm.

In Nepal the present deductions allowed are the provident fund contribution of the taxpayers, the life insurance premium, the contribution and the investment on the Citizen Investment Fund, Medical expenses, Research and Development, Pollution control cost. Besides these provisions, the tax deductible expenses are the donations made for non-profit earning institutions and other expenses as mentioned above. At present, there is no any provision for deduction on the necessary expenses like the higher education expenses, pregnancy delivery expenses, incurred by the taxpayers or his/her dependents.

However, various problems of income tax and exemptions and deductions can be stated in terms of the following questions:

- Is the contribution of income tax to national revenue of Nepal satisfactory?
- Are the exempted items of income and exemption limit being provided by enacted Income Tax Act are sufficient?
- Are the current deductions of expenses sufficient?
- Are the provisions made under the Nepalese Income Tax Act sufficient in all respect?

1.3 Objectives of the Study

Generally, the main objective of this study is to gain and insight into the exemptions and deductions of present income tax system. Giving the suggestions as much as possible to improve the tax system, help the government to collect more revenue and use it in the process of national development. This research does not help the government only to collect more revenue but also aware the people about exemption of incomes and deduction of expenses. However, the other objectives of the study are:

-) To analyze the contribution of income tax to national revenue of Nepal.
-) To examine the deductions facilities provided by the Income Tax Act 2058.

-) To evaluate the exemption limit under the Income Tax Act 2058.
-) To analyze the views of the tax experts, tax officers and tax payers about the exemptions and deduction facilities provided in the present Income Tax Act 2058.
-) To provide suggestions and recommendations about Income Tax Administration and Income Tax Law.

1.4 Scope of the Study

The study tries to cover the major constituents of income tax system in Nepal. It aims to find out the exemption and deduction of income tax provided by Income Tax Act, problems and weakness in income tax system, contributions of income tax to the government revenue and tries to suggest some possible areas for reform. Especially the income tax exemption and deduction is discussed in detail.

In brief the study covers the following aspects of income tax system of Nepal:

-) Nepalese tax structure.
-) Role of income tax in Nepal.
-) Exemption limit and deduction facilities under Income Tax Act 2058.
-) Existing position of Income Tax in Nepal.

1.5 Significance of the Study

Development country like Nepal requires higher magnitude of financial resources for the development program. Internal resources have more significant role than the external resources for developmental program. The income tax is one of the most important internal sources of government revenue. Income tax plays significant role in the economic. But it is a matter of great embarrassment to quote that the contribution of income tax to the national revenue is very low in Nepal. To increase the contribution of income tax to the national revenue, problem faced by the income tax system should be researched and analyzed objectively and then the corrective actions should be started. Few studies and research works have been conducting in the

area of income tax in Nepal. Within income tax, the intensive study on tax exemption and deduction hasn't been done in Nepal. Most of the researchers are based on contribution on income tax or national revenue. They are not giving main emphasis to research on exemption and deduction topic which is maintained in Income Tax Act. Due to this context need and significance of this study can be known easily.

1.6 Limitation of the Study

There are various constraints in this study. Focus is only given to analyze only certain aspects of income tax and study of exemptions of incomes and deductions of expenses in Nepalese income tax. The research should be conducted according to the objectives, statement problems and methodology. It is not complete study of income tax system of Nepal. So, it has the following limitation:

-) It is based on exemptions of income and deductions of expenses but not as the complete study of income tax.
-) In the context of Nepal related sectors still are unable to provide relevant data properly. There is no systematic database that makes it difficult to carry out on any research in Nepal. Sometimes authority person do not want to provide relevant information, this problem is also incorporate with this study.
-) Due to the small sample size it may not fully represent Nepal as a whole.
-) The views of respondents are collected only from Kathmandu valley.
-) Absence of required related data of various countries concerned with the study limits to details study.

1.7 Organization of the Study

The whole study has organized in five chapters. They are:

-) Introduction
-) Review of literature
-) Research methodology

) Data presentation and analysis

) Summary, conclusion and recommendation

The first chapter is introduction chapter. It includes background, statement of the problem, objectives of the study, scope of the study, limitation of the study and scheme of the study.

The second chapter is about the review of the literature and conceptual frame works. Books unpublished dissertation reports and articles etc have been reviewed for the study. Conceptual frame work includes legal provisions regarding Income Tax Act 2058, concept of tax, concept and meaning of income tax, income tax in international context, and some legal provisions of income tax in Nepal etc.

The third chapter is concerned with research methodology which includes research design, population and sample, nature and sources of data collection procedure, data processing and analysis procedure etc.

The forth chapter is the major part of this study. This chapter is termed as presentation and analysis of data. This chapter includes tax GDP ratio; Nepalese government revenue structure, composition of tax revenue in Nepal, exemption of incomes and deduction of expenses in income tax system etc and opinion survey have been analyzed. It describes the problems and weakness of tax administration in Nepal. It contains major finding of the study also.

Fifth is mainly concerned with summary, conclusion and recommendations, Appendix and bibliography are presented in the last part of the study.

CHAPTER - II

CONCEPTUAL FRAME WORK AND REVIEW OF LITERATURE

2.1 Theoretical Concept

Great Britain is the first country in the world to introduce the modern income tax system. She introduced income tax in 1799 in order to generate revenue to finance the war fought with France.

While the history of income tax was not bright, the situation is different now, Income tax has been an important element of the modern tax system. All sorts of countries have been adopted this tax as an important instrument to generate revenue required to finance state activities. This tax is also considered as fairest tax since it can be tied with the taxable capacity of the taxpayers.

The finance act annually prescribes tax rates classifies some of the procedures mentioned in the income tax act, whereas income tax act governs procedure, penalty and administration of taxes. Hence the provisions and procedures of income tax can be analyzed only by the study of both the income tax exemption and deduction was started since the enactment of the first finance act in 1959 A.D. Since then the tax exemption limit and deduction have been revised several times.

Review of Books

Brief review of different studies has been performed in this research study. The researcher has consulted many books, dissertations, articles, annual reports of different institutes, news, magazines, published and unpublished materials concerning with income taxation during the thesis writing.

While reviewing the books, it was found that most of the books were syllabus wise oriented but some of them have described the problems and prospects of income tax system and a path for reform of income tax. Similarly, most of the dissertations have described the income tax laws, provisions, structure, problems and prospects, contribution of income tax etc. there were no any detailed studies made on the topic of

income tax exemptions and deductions. although, some books of taxation are useful and helpful for this research work which are briefly described below:

Poudyal and Timilsina (1990) 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 aspects 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 than analytical.

Tiwari (1993) published a book named "Income Tax System in Nepal." He described the legal provisions relating to income. He described the process, provisions and methods to assess the income with numerical examples. The books was based on T.U. syllabus. Tiwari did not describe the role of income tax in economic development of Nepal and problems of income tax system. His book was descriptive of legal provisions rather than analytical.

Dhakal (1999) published a book named "Income tax and House and Compound Tax and Practice with VAT." Dhakal described the legal provisions relating to income tax with numerical examples. This book is very useful to know about legal provisions of income tax act 2031 B.S. Dhakal was fully based on T.U. syllabus. His book was informative/ descriptive rather than analytical. He did not mention the role of income tax and the structure of income tax.

Adhikari (2002) published a book named "Income Tax Law: Then and Now." Adhikari described the legal provisions of new income tax act 2058. Adhikari also described the decisions made by supreme court about the income tax. Adhikari described the legal provisions with critical analysis. His book was very useful to know the new income tax act 2058 but not analyzed the role of income tax and income tax structure.

Bhattarai and Koirala (2003) published a book named "Income Taxation in Nepal with Tax Planning and VAT." This book was published second, third and fourth time in 2004, 2007 and 2008 respectively. This book has described the legal provisions with critical analysis. This book has theory and enough practical problems. Critical and comprehensive problems are given. This book also has added income tax

act, 2058 (as amended by Finance ordinance, 2061) and value added tax act 2052 (as amended by Finance Ordinance, 2061). This book has also described the tax planning. This book is very useful to know the new income tax act 2058 with tax planning and VAT but not described the role of income tax and income tax structure.

Review of Some Articles, Reports

Some articles, reports, were reviewed for this study, which are described briefly below:

Agrawal (1978) in his study of "Resource Mobilization for Development: The Reform of Income Tax in Nepal," presented to CEDA, T.U., described the different concepts of income tax. Agrawal described the resource mobilization through income tax, fiscal policy, role of income tax, legal provisions relating to income tax, legal aspects of income tax, administrative aspects of income tax etc. Agrawal identified the major problems in income tax system as inefficiency of tax administration and tax evasion. Agrawal observed that the tax authorities were insufficient in enforcement of law. There were no integrated programs for taxpayers' education, assistance, guidance and counseling. Tax offices were taken as heaven for corruption. Delays, unfair dealings, insufficiency, harassment and incompetent personnel were the major problems of tax administration.

About the exemption and deductions, Agrawal suggested to increase the exemption limit from the range of Rs. 8000 to Rs. 12000. On his study, the income tax exemption limit was Rs. 6500- for an individual, Rs. 7500 for a couple. Agrawal also suggested to provide additional deductions to the salaried taxpayers for educational expense, medical expenses and house rent and he was favoured for more progressive rates of income tax:

This study is very useful to find out the reality about the income tax in Nepal. This study was a comprehensive and included. Various aspects of tax system of that period, all things mentioned in it are not fully relevant today. But some of the problems identified in it are still inexistence. Agrawal described various aspects of income tax but he did not describe business expense. Agrawal did not conducted any research on business expenses as exempted income too.

Ghimire (1993) analyzed the principle of direct tax and provision of direct tax. Ghimire described the classification of tax, relation of capital and income, base of income or expenditure tax, procedure of computing income, weakness of traditional accounting system classification of tax rates index, index of income tax in Nepal, contribution of income tax to national revenue, errors of past provisions, briefification of tax improvements, etc. Ghimire found that the income tax was only 7% of total revenue that was very low as compared to neighbouring countries. For this, he has identified the following causes: No taxation on agricultural income, narrow base of income of retail business, high exemption limit on remuneration income etc. Ghimire accounted the improvement made on income tax like provision of tax collection of source, provision of self assessment of tax, increase in additional fee to remove tax evasion etc. It also described some steps of administrative improvement. They were provision of income assessment committee, flat rate of tax to small taxpayers, establishment of tax offices etc.

Bhattarai (1993.) critically analyzed the income tax facilities provided by Industrial Enterprise Act 2049 in his draft, "Income Tax Facilities provided by Industrial Enterprise Act 2049, an analysis of Rajaswa." Bhattarai described the facilities given to the industries. Bhattarai also critically analyzed these facilities as continuous 7-8 years exemption of income tax would develop the tradition of taking exemption by incorporating legal ways. The deduction allowed on modernization industries, pollution control device, product and technology development, sales promotion expenses etc. would protect only the big industries but not effect to the small industries. Provisions made on advertisement and entertainment or hospitality expenses would create rude on income tax because if it was given to the all industries in the same manner. There was a provision of exemption of income tax of an industry which did not get exemption but reinvested on non-exempted industry. This provision exempts the tax to the industry of alcohol, tobacco etc., if an industry reinvest on non-exempted industry. Periodic exemption of tax would create bad effects such as change in signboard, change in name and change in ownership to own family members.

Kandel (2001) published a draft of Income Tax Act 2058 as a critical analysis. Kandel criticized the ITA 2058 on several grounds such as exemption of agricultural income from income tax, export duties levied on export, inequality between different

capital earned income, withdrawal of exemption and adjustment for inflation. Kandel further criticized the act for the provision of income tax from export as 0.5 percent of total export because it is not good choice of income tax base.

Pant (2004) presented an article entitled, "Problems in Tax Administration and their Remedies" published in Journal of Finance and Development. Pant comprehensively explained about the problems and their remedies related with tax revenue. The major types of practical problems and challenges, in tax administration he has mentioned in his article are; showing limited amount of transaction, showing low selling price, lack of issuing and taking bills, lack of showing the real factory cost, commercial fraud, lack of cooperation in tax auditing legal ambiguity and complexity is implementation and lack of coordination between Inland Revenue Department and revenue investment unit. Meanwhile Pant has recommended some valuable suggestions to solve the problems and to overcome the challenges. They are, statistical and information system should be properly managed fixed norms and standards should be used to assess selling price and factory cost, the billing system should be made compulsory, coordination between Inland Revenue Office with various entities, revenue investigation department and its related units should play the important role and auditing of tax should be widened etc.

2.2 Review of Related Studies

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

Tuladhar (1979) presented a dissertation named "Role of Income Tax in the Mobilization of Domestic Resource in Nepal." Tuladhar described the trends of revenue from income tax, structure of income tax, taxes as percent of GDP, per capita burden of income tax, agricultural income tax, elasticity and buoyancy of income tax. Tuladhar described the role of income tax in the mobilization of domestic resources for the economic development had been increasing significantly. The growing share of income tax to the total tax revenue indicated that the tax would be the major source of revenue in future. According to him, tax efforts in Nepal seemed quite insufficient. Tuladhar further added that consistent efforts should be made to mobilize resources for development through taxes.

Tuladhar suggested to widen the income tax base, income tax holiday to new industries, simple and easy tax law, reformation of income tax administration, research in income tax, but Tuladhar did not mention the legal provision relating to income tax. Tuladhar accounted the exemptions and deductions too.

Suwal (1981) presented a dissertation named "Income Tax System in Nepal." In her study, Suwal studied the problem of financial resource gap in Nepal. Suwal also analyzed the resource mobilization and income taxation in Nepal, direct and indirect tax along with their relative importance, origin, definition and concept of income tax, importance of income tax on overall tax structure and the role of income tax system in the process of economic development.

Her finding about the main reasons of tax evasion were absence of a clear and comprehensive definition of income, lack of tax consciousness of Nepalese people, loopholes, widespread illegal business activities open borders, high tax rates, corruption etc. Similarly her finding about the problems of income tax in Nepal were lack of accounts and records of taxpayers, delays in tax administration, lack of responsibility and honesty among the tax officers, tax evasion etc. Which are more relevant now a days also.

Suwal concluded that the tax structure of Nepal is failed to make account of the prevailing economic structure and pattern of income distribution. More effective use of income tax is needed for structural changes and has to be implemented and designed deliberately.

Nepal (1983) presented a dissertation named "A Study on the Problems and Prospects of Income Tax in Nepal." Nepal described the fiscal system of Nepal, tax structure of Nepal and an opinion survey of the problems and prospects of income tax in Nepal. Her findings about the problems of income tax were lack of account keeping by the taxpayers, narrow tax coverage, lack of cooperation between the taxpayers and departments, lack of tax education, assessment deficiency etc. which are considerable at now. Nepal mentioned that the future income tax is good because it is growing year to year. Nepal has taken an opinion survey of 10 tax officers and 25 taxpayers about the different aspects of income tax. About the exemptions and deductions, she has taken opinion survey of exemption limit. Nepal conducted an opinion survey of the

appropriateness of exemption limit. Out of 10- tax officers, 9 were in positive response and 1 was in negative response about the appropriateness of exemption limit. Similarly, out of 25 taxpayers, 9 were in positive response and 16 were in negative response. Nepal has also taken an opinion survey of adjustment of exemption limit according to the inflation, out of 10 tax offices, 8 were agreed to adjust and 2 were disagreed. About taxpayers, 23 taxpayers were agreed to adjust and 2 were disagreed. On the widening the percent income tax coverage, all total (10) tax officers were agreed and all total 25 taxpayers were agreed.

Her suggestions about the tax rate and exemption limit was that it should be elastic, scientific and progressive. The exemption limit should be separated to the couple and family. But only the increase in exemption limit would not create benefit. If exempted income is spent in luxurious consumption, it would hamper saving and investment. Nepal did not mention the legal provisions relating to income tax, exemption incomes and deductions of expenses.

Regmi (1986) presented a dissertation entitled "The Role of Income Tax in Nepal." Regmi described the conceptual framework of income tax, structure of income tax, income tax and resource mobilization, problems and income tax. Regmi has also described the objectives of income tax. Regmi has given more concentration on the study of tax structure of Nepal. In his study, Regmi found the share of indirect tax was more than 70 percent of total tax revenue in 1981/82. The share of direct tax was about 30 percent of total tax revenue. Within direct tax, the share of income tax was 17.29 percent in 1972/73 which was increased 35.68 percent in 1981/82.

Regmi found the problems of income tax, they were lack of maintaining the record of taxpayers assessment delays, lack of responsibility and honesty among the tax officers, tax evasion, corruption, lack of coordination between the various revenue and other non-revenue departments, leakage in personal income tax collection.

Regmi has given suggestions about the income tax were, income tax law should be clear and precise widening the tax coverage, application of scientific assessment method, simple and easy procedure of tax payment, honest and efficient staffs, coordination between staff and departments, establishment of research unit, tax holidays to new industries. Although, Regmi did not mention the legal provisions

relating to income tax. His topic was about the role of income tax but he did not describe any role of income tax, any numerical examples and mention the exemption and deduction.

Shivakoti (1987) accomplished a research entitled "Analytical Study of Income Tax in Nepal." Shivakoti presented the concept of income tax along with its historical perspective, role of income tax in Nepal, income tax structure of Nepal, problems of income tax administration in Nepal. Shivakoti also explained that the taxation plays an effective way of mobilizing internal and external sources adequately.

Shivakoti further added that taxation policy in a developing country should include three objectives: First, it should promote saving in the private sector. Secondly, it should reduce wide gap between income of few rich and poorer. Thirdly, it should not have undesirable inhibiting effects in terms of inflationary pressures and it should be or counter inflationary in its action. According to him, income tax plays a vital role for the development of the country. It reduces the unequal distribution of wealth among people and is a suitable method to collect funds. In case bridge the increasing gap of disparity of income. For this purpose, higher income group has to pay more tax and lower income group has to pay less tax.

Shivakoti concluded that income tax has been a pivotal element in direct tax and equally significant for the government revenue in Nepal. But its significance does not seem to have achieved equal attention on the part of the government.

Shivakoti also recommended for a deliberate programme of tax information to awareness to the public so that they can feel that to pay tax is to contribute to the economic development of the country. Likewise, tax administration should be honest, efficient, trained and effective-research unit should be established. Shivakoti further stressed to keep up to date information in tax offices to reduce the delay in the assessment. The personnel working should be encouraged through awarded on the basis of performance and also computer and other scientific equipment should be used.

Acharya (1994) did a research on "income Tax in Nepal" A study of its structure, productivity and problem" T.U. Acharya described the structure of

income tax, productivity of income tax and problems of income tax system. He presented some numerical and diagrams of structure and productivity of income tax. His study about income tax was not so detailed because he did not explain the provisions relating to income tax and his study was more concentrated on the problems of income tax system. Although, his findings about the problems of exemption limit and allowances were considerable and accountable. Acharya showed the problems of exemption limit as follows:

- Exemption limit being equal to remuneration taxpayers and business individual does not seem reasonable. The exemption limit for remuneration taxpayers should be comparatively higher than the business individual.
- The exemption limit in the Nepalese context neither shown any definite relationship with per capita GDP nor with the rate of inflation nor with poverty line so it seems to be unscientific. His findings about the problems with allowances were as follows:
 - Fifteen percent depreciation allowances for corporate taxpayers seem to be inadequate.
 - Private boarding schools running now a days are basically inclined with profit. They are excluded from income tax, which is not reasonable.
 - One and two percent deduction of the total income from trade, industry, profession and vocational for advertisement and guest hospitality, respectively seem to be low.
 - Allowances for remuneration taxpayers are not scientific in specifying the figure in obsolete term also. Only the proportional figure is recommended, otherwise these should be frequent adjustment in income tax act, which is not so practical.
 - Additional allowances are lacking for specific industries provided that they are feasible in the Nepalese economy. Tourism industries, cooperative organizations in rural sectors etc. are in this category and

should be encouraged. On the other hand, the special allowances for export income of industry does not seem essential such as for carpet or garment industry. It is because that small business investors are unable to export their products.

Tripathee (1995) presented a dissertation entitled "Income Tax System in Nepal and some potential Areas for reforms," T.U. In this study, Tripathee tried to show the tax structure in Nepal, role of income tax in Nepalese economy, income tax administration and tax evasion in Nepal along with reforms.

Tripathee has more emphasized on the income tax administration and tax evasion. Tripathee conducted an opinion survey about the sufficiency of tax incentives and tax holidays to the industries. Tripathee took a sample of 26 respondents, out of them 16 respondents were in positive response and 10 respondents were in negative response about the sufficiency of tax incentives and holidays. According to the respondents following reformatory activities should be performed.

- The industries, who invest Rs. 500,000 or more should be defined as employment oriented industries.
- There should be prize system, which may be as the form of tax incentives or tax holidays to the taxpayers.
- The period of tax holiday should be extended for industry, which utilized Nepalese raw materials and produces handicrafts. The period of tax holidays should be extended 10, 8 and 5 years instead of existing period of 7, 5 and 2 years respectively.
- For the expansion of industry, additional incentives should be provided.
- The items of deduction should be added.

Tripathee suggested should to increase the exemption limit of Res. 25,000 to Rs. 30,000 for an individual, Rs. 35,000 to Rs. 40,000 fore a couple and Rs. 35,000 to Rs. 50,000 for a family

Tripathee's suggestions about deduction of expenses of remigration taxpayers were as follows:

- Expenses for better education of their children not exceeding the amount of Rs. 10,000 pa
- House rent allowances not exceeding Rs. 12,000 p.a.
- Educational expenses for taxpayers himself. If he is studying in an educational institution. His dissertation is very useful to further study about income tax purpose. But he did not include the exempted items of income and business expenses and also not mention about the legal provision relating to income tax system.

Kandel (2000) presented the Ph.D. thesis entitled, "Corporate Tax System and Investment Behaviour in Nepal." He undertook the research work to find out the problems relating to corporate tax, which blocks the development of the private investments. The main objectives of his study were to evaluate the corporate tax system in general to examine the sensitivity of certain policy like inflation, capital gain tax, dividend tax and interest tax etc. based on their impact on tax burden. Kandel showed the relationship of private investments with average effective tax rate (AETR), Marginal effective tax rate (METR) and tax incentives in Nepal. Kandel found that the METR for debt-financed project are almost negative i.e. (-17%) and positive for equity financed project and debt equity ratio project by 27% and 19% respectively. Kandel has also found the impact of inflation to the METR. According to him, the statutory tax rate deduction had impact on private investments by 60% to 20%. In his regard, he showed the adjusted R^2 value 0.87 at 5% level of significance. Kandel concluded that the statutory tax rate was in moderate level under the financing options: debt mix and equity i.e. it was not much distortive. The relationship between inflation rate and effective tax burden in Nepal was negative.

Shakya (2003) submitted a thesis entitled, "A Study on Income Tax Collection form Commercial Banks." The thesis report was aimed to evaluate the contribution of income taxed paid by commercial banks in the government revenue, point out main income tax related problems faced by commercial banks, analyze relevant options and views of bankers regarding income tax, put forward necessary

suggestions and recommendation for income taxation with reference to commercial banks.

Shakya found that during the five years direct tax revenue has contributed 20.01 percent in an average on total tax revenue and it was 79.99 percent of indirect tax revenue. Shakya also pointed out some problems pertaining corporate tax has been found in the course of investigation. Thesis problems are: assessment delay, undue delay in settlement of fixed appeals with revenue tribunal, negative attitudes and have been affecting in the profitability of banks. Increasing compliance cost and decreasing corporate tax collection. Shakya has recommended that the private investment from domestic as well as from foreign countries should be encouraged so that economic transaction in the national economy would be increased and boosted up when private institutions invest in different sectors, the banking transactions would also be increased and they make higher profits. As a result, corporate tax collections from those sections as well as from other new corporate sectors would be increased. From this, the government has to show the flexibility in making various laws relating to trade, industries and banking to make incentives in order to form new corporate.

Kafle (2004) presented a dissertation named, "Income Tax Contribution from Nepalese Public Enterprises with Reference to Nepal Electricity Authority." Kafle tried to determine to effectiveness of income tax revenue collection from public enterprises and major problems of income tax system and Kafle also tried to find out the contribution of income tax from Nepalese electricity authority to total revenue and total income tax revenue as national revenue of Nepal. Kafle found that income tax on total tax revenue was 8.36 percent in the fiscal year 1993/94 and it increased up to 22.64% in fiscal year 2003/04. Income tax revenue/GDP ratio, income tax revenue/total tax revenue and income tax revenue/direct tax revenue ratios are 2.2%, 22.64% and 84.02% respectively in the fiscal year 2003/04. The contribution of income tax from Nepal Electricity Authority to total income tax revenue has also been flotation the average contribution is 2.57%. In the composition of income tax from Nepal Electricity Authority on the income tax from public enterprise has shared 8.5% in an average. Lack of clear transparent and progressive economic policy the main reason for unsatisfactory tax collection was due to the lack of effective income tax system of Nepal.

Khatiwada (2004) conducted a research entitled, 'Structure of Income Tax System in Nepal, A Managerial Study'. T.U. Khatiwada aimed to evaluate the structure of income tax system and managerial study. Khatiwada accepted that ITA, 2058 and Provisions are difficult to understand, language is vague and unclear, narrow base i.e. agricultural income has not been included in tax net, provision of double taxation in dividend, insufficient provisions related to capital gains.

Khatiwada also analyzed that income tax management system in Nepal is not effective and efficient due to ineffective management system, inadequate government policy and defective income tax laws. Khatiwada also mentioned the major constraints of effective and efficient income tax management system are:

- Misuse of power by tax administrators.
- Less consciousness of tax payers.
- Lack of motivated and trained human resources.
- Inadequate experts in tax management, non-maintenance of books and accounts, time consuming process of income assessment i.e. scientific assessment.

Khatiwada also added income tax assessment procedure is not sound and efficient, high level of evasion found in income tax, income tax administration as a high degree of corruption has been found. But he did not mention any provision about exemption of incomes and deduction of expenses in Nepal.

Niroula (2005) did a research study named, "Study of Incentives and Facilities to Industries Under Income Tax Act. 2058" T.U. This study was aimed to examine and analyze the effectiveness of tax incentives and facilities to industries. Niroula concluded that;

- Income tax incentives and facilities do not play the major role in the establishment of industries but other factors such as political stability, industrial environment, administrative efficiency and availability of market, raw material, Labour, infrastructure etc play key role in the establishment of

industries. If these facilities are available the incentives and facilities provided by the ITA might play major role in the establishment of industries.

- Investment tax credit and investment allowance play vital role in the establishment of new industries.
- A flat rate of 20% income tax to all industries seems to be little bit higher to the small industries.
- The deduction facility of PCC and R & D has been tremendous effect to achieve its objectives and industries are exploiting these facilities.
- Tax rebate of 25% and 30% to the undeveloped and underdeveloped areas are not sufficient.

Niroula has recommended that investment tax credit and investment allowance should be provided to new industries. The rate of 20% to the export industry is higher and it should be minimized. Niroula further recommended that the contradiction between the Income Tax Act and Industrial Enterprises Act should be eliminated. Niroula further conducted from time to time to make aware about the tax incentives and facilities to current taxpayers and potential investors.

Dhungel (2006) had presented a dissertation entitled “Special Provision to Individual under Income Tax Act 2058”. She had examined and analyzed the effectiveness of special provision provided by ITA 2058 to individual and identified the other provisions to be included in the special category. She also wanted to make aware about special provisions to individual (Taxpayers) and tax experts. She has found special provision to in individual provided by Income Taxes Act 2058 is not sufficient and more provisions should be provided and the retirement contribution should be wholly exempted, the tax concession to individuals working at different area is contradictory. Tax experts are satisfied and tax payers are not satisfied.

Dotel (2007) presented a dissertation named “Income Tax Act 2058; Expectations and Realities” in 2007. The objectives of the study was to measure the effectiveness of Income Tax Act 2058 both in theory and practice, to review the views of taxpayers, tax experts and tax administrators to ITA 2058. He found that Income

Tax Act 2058 seems effective because it has the features of provisions of international taxation, taxing capital gains and dividends income, abolition of various tax related concessions, rebate and exemption etc. He also found that the most of taxpayers, tax administrators and tax experts are acquainted to present Income Tax Act. However they suggest that some of the words in the act needed to be further simplified.

Baral (2008) Presented a dissertation named “Income tax in tax structure in Nepal”. She has mentioned the contribution of income tax in tax revenue of Nepal. She has also shown that contribution of direct tax has been decreasing and indirect tax has been increasing. She has stated the problems of raising government revenue. She has mentioned the main cause of tax evasion were, lack of clear and comprehensive definitions of income, lack of punishment to tax evaders, lack of tax consciousness, lack of efficient tax administration, lack of public information, lack of scientific method of tax collection and trained tax collectors.

Khatri (2009) in his dissertation “Effectiveness of self assessment tax system in Nepal” explains that the audit and investigation function towards limited issue focused examination of the transaction towards limited issue focused examination (LIFE) of the taxpayer’s business. It will help to develop professionalism in tax administration.

Bhandari (2010) presented a dissertation named, “Tax Administration and its Effectiveness in Nepal”. In his work he had made a review of tax laws about self assessment, analyzed the problem faced by the assesses while doing the self assessment of their own income and made relevant recommendation to reform income tax laws as well as administration in future. He had concluded that self assessment of tax is suitable means of raising domestic resources and it would be effective if taken seriously. He had further expressed that the effectiveness of self assessment of tax depends on appropriate reformation.

Magar (2011) wrote a thesis entitled “Income Tax in Nepal: A Study and Exemptions and Deductions”. He had covered tax structure, role of income tax and exemptions & deductions provided 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 shortage of income tax experts/ professional in tax administration, lack of public participation, faculty organizational structure of tax administration, weakness in 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 theme, 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 expenses, repair and improvement expenses, research and development expenses. He is totally concentrated on the exemption and deduction in his study. He has not stud about various aspect of income tax.

2.3 Research Gap

During the research study, the researcher viewed various books, reports, articles and dissertations and thesis. Most of the researchers are concerned on the legal and assessment procedure of income tax, administrative and historical aspect of income tax. The thesis and dissertations presented by the researcher have focused about the trend of income tax collection and buoyancy of income tax with GDP, inefficiency of tax administration, widespread of tax evasion, value added tax, role of income tax income tax system in Nepal, problems and prospects of income tax in Nepal, corporate tax planning of Nepal, income tax collection from commercial banks etc. There is a limited number of research studies carried out specifying tax payer groups and concentrated on exemption and deductions of income tax. No attention is paid on a particular problem like exemption of incomes and deduction of expenses. Most of them have been taken various problems as their research objectives and no thoroughly study on a particular subject problem. The researcher has found that no more study done in exemption of incomes and deduction of expenses. This study will help to know the provisions of exemptions and deductions provided by ITA, 2058 and getting optimum benefits within the frame of ITA by exempting of incomes and deducting of expenses to the taxpayers.

CHAPTER-III

RESEARCH METHODOLOGY

3.1 Introduction

"Research methodology is the way to solve systematically about the research problem" (Kothari, 1996). This is a procedure of planned framework for the research study dealing with the research design, nature of the data, data gathering procedure, population and sample and data processing procedures.

3.2 Research Design

"Research design is the plan structure and strategy of investigation conceived so as to obtain answers to research questions and variances" (Kerlinger, 1986). This research study attempts to analyze the present exemptions and deductions of income tax. Opinion of 60 respondents associated with the income tax. Income tax experts, income tax administrators and income tax payers are collected through the questionnaire. Different types of questions regarding income tax are used in questionnaire. Similarly various publications regarding income tax are used for this study. In this way, the research design of this research is descriptive, analytical and empirical.

3.3 Population and Sample

To fulfill the objectives of the study, 60 sample sizes from the Kathmandu valley is selected. Samples are carefully selected by consultation with the supervisors and best judgments of the researcher. The respondents have been divided into three groups. The following table presents the groups of respondents and size of sample.

Table 3.1

Group of Respondents and Size of samples

| S.N | Group of respondents | Sample Size |
|-------|---------------------------|-------------|
| 1 | Income Tax Experts | 5 |
| 2 | Income Tax Administrators | 15 |
| 3 | Income Tax Payers | 20 |
| Total | | 40 |

3.4 Nature and Sources of Data

The significance of research basically depends upon the nature availability and accuracy of information. On the side method of data collection constitute important activity of research work and on the other it is very tough task. So far as this research is concerned, I have used two method of data collection procedure;

- I. Primary data collection.
- II. Secondary data collection

Primary Data

Primary data and information are collected through the questionnaire from the sample population. The questionnaires were distributed to different respondents. Tax administrators are selected from department and various sector of tax offices. Tax experts are the faculties have experience of tax management, auditors, chartered accountants etc. tax payers are selected from various sector i.e. finance company, bank, insurance company, private company, departmental store etc.

Secondary Data

The secondary data were collected from secondary sources. The major sources of secondary data are as follows:

-) Budget speech and economic survey of various years, ministry of finance.

-) Report and record of department of taxation, ministry of finance of Nepal.
-) Book and bulletins related to income and public finance.
-) National and international newspapers, journals and news magazines.
-) Different dissertation related to income tax.
-) Other relevant records and data.

3.5 Data Collection Procedure

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

3.6 Data Analysis

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

CHAPTER-IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Tax Structure of Nepal

Modern economic development of Nepal was started with the initiation of first economic planning in 2013 B.S. Since then, taxes have been sued for the achievement of national economic goals. So, taxes play vital role for the economic development of Nepal. Tax structure should be known to study about the taxes. Tax structure refers to the level as well as relative importance of various taxes in the composition of total tax revenue of a country. Tax structure of any country is composed of both direct and indirect taxes. Total tax structure of Nepal from the fiscal year 2001/02 to 2010/11 are presented below.

4.1.1 Composition of Total Revenue

Total revenue in Nepal is composed of tax revenue and non-tax revenue. When the government of Nepal presented first national budget in the 1951/52, the revenue structure was typically that of traditional economic with 73% of government receipts coming from non-tax sources and land tax, out of 73% the share of non-tax revenue was 43% (Budget speech of 1951/52, MOF, GON. In 1960, the share of non-tax revenue was declined drastically because of the increasing contribution of indirect tax on foreign trade. In 2010/11, the share of non-tax revenue was 19.14% of total revenue as compared to 22.71% in 2001/02. In the other hand, the share of tax revenue of the fiscal year 2001/02 was 77.29% of the total revenue and was increased to 80.85% in fiscal year 2010/11, which are given in the following table 4.1.

Table 4.1
Composition of Total Revenue

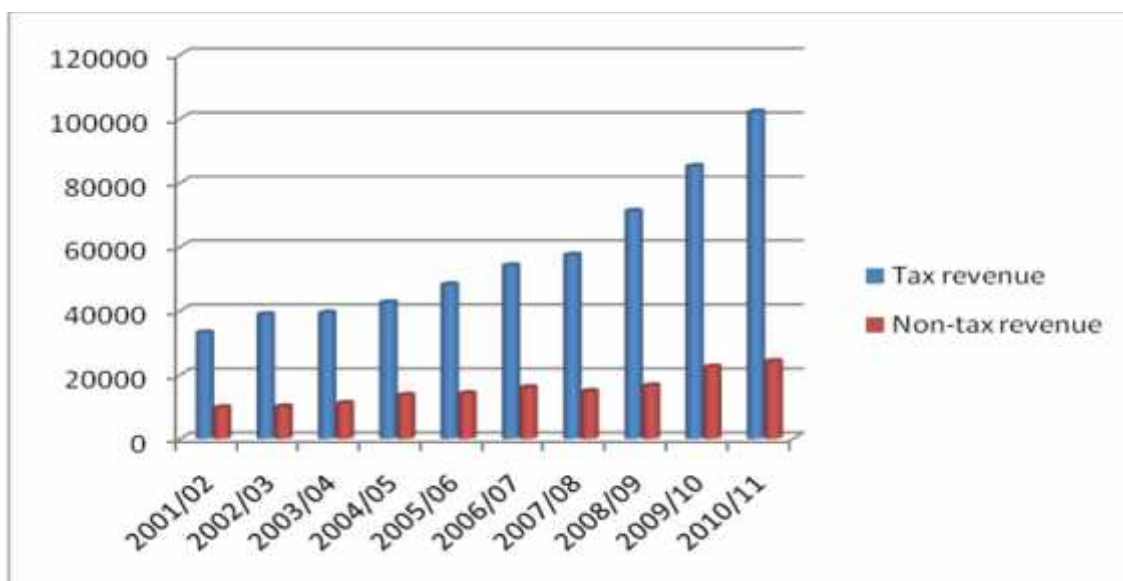
Figure in Rs. Million

| Fiscal year | Total revenue | Tax revenue | Tax revenue as % of total revenue | Non-tax revenue | Non tax revenue % of total revenue |
|-------------|---------------|-------------|-----------------------------------|-----------------|------------------------------------|
| 2001/02 | 42894 | 33152.2 | 77.29 | 9741.6 | 22.71 |
| 2002/03 | 48893.9 | 38865.1 | 79.49 | 10028.8 | 20.51 |
| 2003/04 | 50445.5 | 39330.5 | 77.97 | 11114.9 | 22.03 |
| 2004/05 | 56229.7 | 42586 | 75.74 | 13642.86 | 24.26 |
| 2005/06 | 62331 | 48173 | 77.28 | 14158 | 22.71 |
| 2006/07 | 70123.1 | 54104.7 | 77.16 | 16018 | 22.84 |
| 2007/08 | 72282.1 | 57430.4 | 79.45 | 14851.6 | 20.54 |
| 2008/09 | 87712.2 | 71126.7 | 81.09 | 16585.5 | 18.9 |
| 2009/10 | 107622.5 | 85155.54 | 79.12 | 22467.04 | 20.87 |
| 2010/11 | 126304.8 | 102120.3 | 80.85 | 24184.5 | 19.14 |
| Total | 724838.8 | 572044.44 | 78.920229 | 152792.8 | 21.079556 |
| Average | 72483.88 | 57204.444 | 66.24 | 15279.28 | 33.76 |

Source: Economy Survey 2010/11.

From the table 4.1, it can be concluded that the source of tax revenue on total revenue is fluctuating from 77.29 percent to 80.85 percent. The total tax revenue, non-tax revenue and total revenue were Rs. 572044.44million, Rs. 152792.8 million and Rs. 724838.8 million respectively whereas average percentage collected tax revenue and non-tax revenue were 66.24 % and 33.76 % respectively during the study periods. So the tax revenue contributes about three fourth of the total revenue. This also indicates that the tax revenue plays the significance role in total revenue. The composition of tax revenue is shown graphically as follows:

Figure 4.1: Composition of Total Revenue



4.1.2 Composition of Tax Revenue

Tax revenue is the sum of direct tax and indirect tax. There has been simultaneous increase in direct tax, indirect tax and the total tax revenue in absolute term. In 2001/02, the amount were Rs. 8555 million, Rs. 24607 million and Rs. 33152 million respectively and during the period of 10 years, these amount became Rs. 29571.3 million, Rs. 72549 million and Rs. 102120.3 million in 2010/11 respectively. The basic reasons for the increment were due to the expansion of the tax base and tax rates both wide and deep.

Despite the absolute increment of direct tax during the study period, its total share in total tax revenue is shrinking continuously from 25.80 percent amounting to Rs. 8555 million in 2001/02 to 28.95 percent amounting to Rs. 29571.3 million in 2010/11. The contribution of indirect tax in 2001/02 was 74.20 percent amounting to Rs. 24607 million and decreased to 71.09 percent amounting to Rs. 72549 million in 2010/11. The average collection of tax revenue, direct tax and indirect tax were Rs. 57205.1 Rs. 15000.95 and Rs. 42204.15 million and the average direct tax and indirect tax on total revenue were 26.22 percent and 73.78 percent respectively during the study periods. This implies the significant role in the tax revenue. As indirect tax is considered regressive in nature, the structure of Nepal is not justifiable on equity ground and progressiveness. From the following table 4.2, it can be concluded can see

that there is greatest reliance on indirect tax making our tax system regressive in nature and it needs to shift towards direct tax. The composition of total revenue has been also shown graphically.

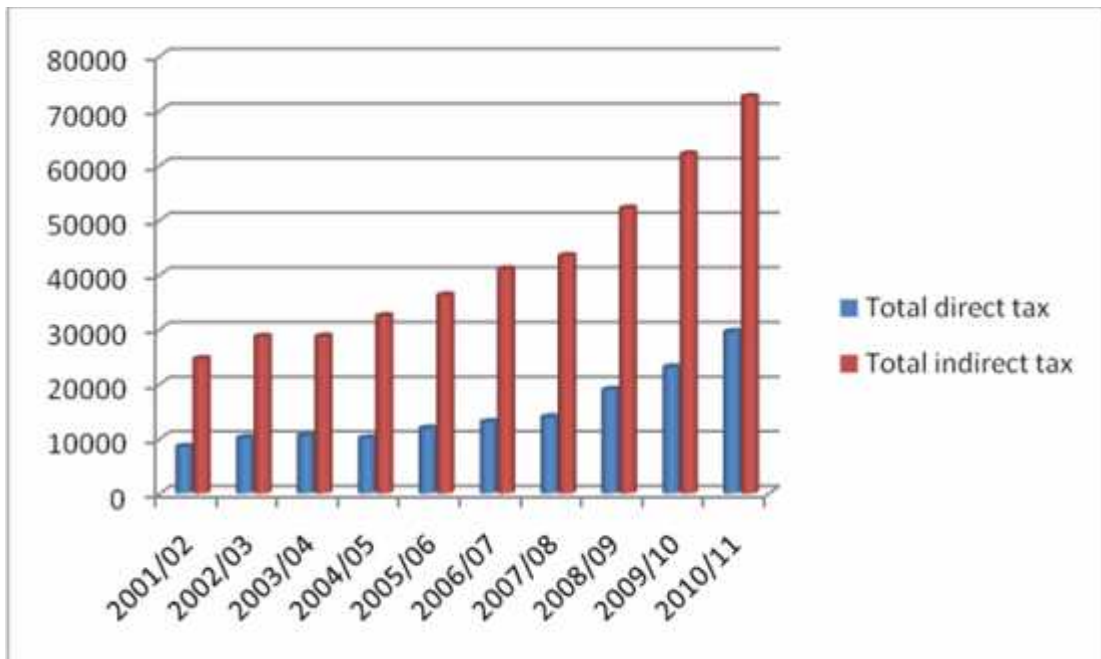
Table 4.2
Contribution of Direct and Indirect Tax to Total Tax Revenue

Figure in Rs. Million

| Fiscal year | Total tax revenue | Total direct tax | % share of direct tax to total revenue | Total indirect tax | % share of indirect tax to total revenue |
|-------------|-------------------|------------------|--|--------------------|--|
| 2001/02 | 33152 | 8555 | 25.8 | 24607 | 74.2 |
| 2002/03 | 38865.8 | 10159.4 | 26.14 | 28701.4 | 73.86 |
| 2003/04 | 39330.64 | 10597.55 | 26.94 | 28733.1 | 73.06 |
| 2004/05 | 42586.92 | 10105.66 | 23.73 | 32481.2 | 76.27 |
| 2005/06 | 48173 | 11912.6 | 24.74 | 36260.7 | 75.27 |
| 2006/07 | 54104.7 | 13071.8 | 24.16 | 41032.9 | 75.84 |
| 2007/08 | 57430.4 | 13968.1 | 24.32 | 43462.3 | 75.68 |
| 2008/09 | 71126.7 | 18980.3 | 26.68 | 52146.4 | 73.31 |
| 2009/10 | 85155.54 | 23087.76 | 27.12 | 62067.82 | 72.88 |
| 2010/11 | 102120.3 | 29571.3 | 28.95 | 72549 | 71.04 |
| Total | 572046 | 150009.47 | 26.223323 | 422041.52 | 73.777549 |
| Average | 57205.1 | 15000.95 | 26.22 | 42204.15 | 75.22 |

Source: Economy Survey 2010/11

Figure 4.2: Composition of Tax Revenue



4.1.3 Contribution of Various Taxes as Percent to GDP

The contribution of total revenue on GDP has increased from 11.71 percent to 14.8 percent as compared 2001/02 and 2010/11. The contribution of tax revenue on GDP is increasing satisfactorily. In 2001/02, the share of tax revenue was only 9.05 percent, which was increased to 12.2 percent in 2010/11 within the tax revenue, there is significant role of indirect tax, which contributes about three folds more than the direct tax. In 2001/02, the contribution of indirect tax and direct tax was 6.61 percent and 2.44 percent respectively which were increased to 8.67 percent and 3.53 percent in 2010/11.

The contribution of income tax on GDP is increasing gradually. It contributed 2.02 percent in 2001/02, which was increased to 2.55 percent in 2010/11. Within direct ax, income tax is in the leading role at now. The contribution of land tax and house and building registration was 0.28 percent and 0.48 percent in year 2001/02 and 2010/11 respectively, which is in fluctuating trend. Which is decreased to 0.15in year 2002/03and started to increased and reached to 0.31 percent in year 2005/06. again decreased to 0.30 percent in year 2006/07, which is 0.48 percent in year 2010/11.

Within the indirect tax, the contribution of custom duty on GDP is higher than other individual tax. The custom duty is composed of import and export duties which had contributed 2.95 percent 2001/02 and 2.76 percent in 2010/11. The contribution of VAT is also in increasing trend. It contributed 2.80 percent in 2001/02, which is increased to 34.25 percent in 2010/11. VAT as a substitute of sales tax, contract tax, entertainment tax, hotel tax is increasing in recent years. The contribution of excise duty was. 0.85 percent in 2001/02. But in 2003/04, it was decreased to 0.83 percent and then it is fluctuating trends till 2007/08 and then started to increased and reached to 1.65 percent in 2010/11. The contribution of various taxes as percent to GDP is given in the following table 4.3.

Table 4.3
Contribution of Various Taxes as GDP (In Percentage)

| Year | Total revenue as % GDP | Tax Revenue | Direct tax | Indirect tax | Income Tax | Custom duties | Excise duties | VAT | Land revenue and regd. Tax | House & building registration |
|---------|------------------------|-------------|------------|--------------|------------|---------------|---------------|------|----------------------------|-------------------------------|
| 2001/02 | 11.71 | 9.05 | 2.44 | 6.61 | 2.02 | 2.95 | 0.85 | 2.80 | 0.28 | 0.28 |
| 2002/03 | 12.41 | 9.86 | 2.58 | 7.28 | 2.31 | 3.18 | 0.95 | 3.14 | 0.25 | 0.25 |
| 2003/04 | 11 | 8.6 | 2.61 | 6.28 | 1.94 | 2.76 | 0.83 | 2.68 | 0.24 | 0.24 |
| 2004/05 | 11.4 | 8.7 | 2.31 | 6.63 | 1.62 | 2.90 | 0.97 | 2.74 | 0.28 | 0.28 |
| 2005/06 | 11.6 | 9 | 2.51 | 6.77 | 1.72 | 2.90 | 0.89 | 3.70 | 0.32 | 0.32 |
| 2006/07 | 11.9 | 9.2 | 2.38 | 6.97 | 1.73 | 2.66 | 1.09 | 3.21 | 0.30 | 0.30 |
| 2007/08 | 11.1 | 8.8 | 2.31 | 6.65 | 1.58 | 2.35 | 0.98 | 3.31 | 0.33 | 0.33 |
| 2008/09 | 12.1 | 9.8 | 2.61 | 7.18 | 2.07 | 2.21 | 1.28 | 3.59 | 0.32 | 0.32 |
| 2009/10 | 13.2 | 10.4 | 2.82 | 7.58 | 2.11 | 2.57 | 1.36 | 3.64 | 0.35 | 0.35 |
| 2010/11 | 14.8 | 12.2 | 3.53 | 8.67 | 2.55 | 2.76 | 1.65 | 4.25 | 0.48 | 0.48 |

Source: Economy Survey, 2010/11

4.1.4 Composition of Indirect Tax

Nepalese tax revenue is dependent mainly on taxes on international trade and sales tax/VAT on goods and services supplemented by taxes on income tax and

property to some extent. Nepalese tax structure is heavily dependent on indirect taxes. Which contributed 71.04 percent of total tax revenue in 2010/11.

The major components of indirect tax in Nepalese tax structure contributes custom duty, excise duty, VAT etc. custom duty has been classified mainly into import duty and export duty. Other components of indirect tax like entertainment tax, hotel tax, contract tax, sales tax etc. contribute nominal share even zero because they were included in VAT in 1997. The compositions of indirect taxes are given in the following table 4.4 and figure 4.3.

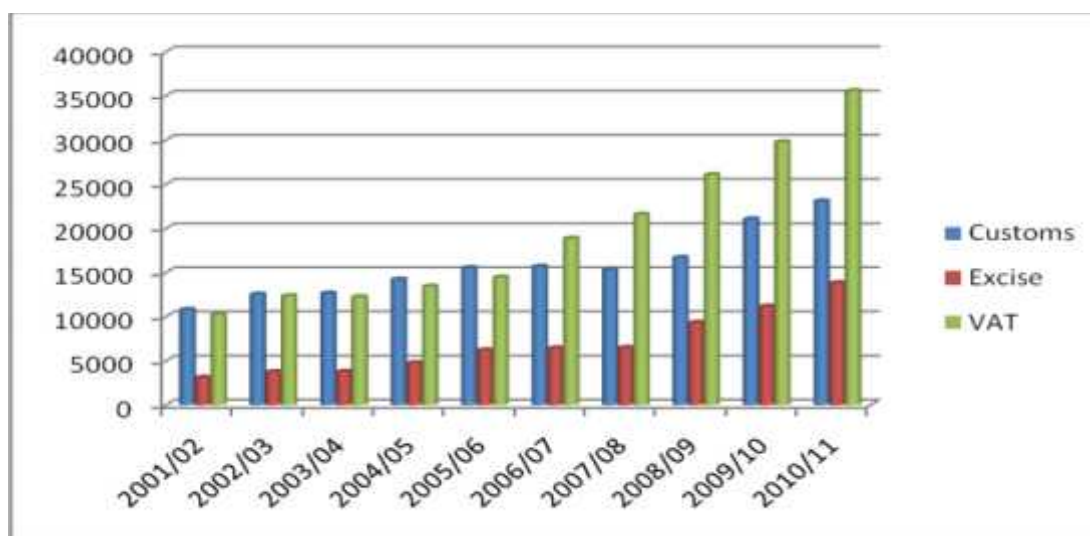
Table 4.4
Major Sources of Indirect Tax and Their Relative Percentage of Indirect Taxes

Figures In Rs. Million

| Fiscal year | Indirect tax | Customs | Percentage | Excise | Percentage | VAT | Percentage |
|-------------|--------------|-----------|------------|----------|------------|----------|------------|
| 2001/02 | 24607 | 10813.3 | 43.94 | 3127.6 | 13 | 10259.7 | 42.41 |
| 2002/03 | 28701.4 | 12552.1 | 43.73 | 3771.2 | 13.14 | 12382.4 | 43.13 |
| 2003/04 | 28733.1 | 12658.75 | 44.06 | 3807.05 | 13.25 | 12267.3 | 42.70 |
| 2004/05 | 32481.2 | 14236.43 | 43.83 | 4785.12 | 14.73 | 13459.7 | 41.44 |
| 2005/06 | 36260.4 | 15554.8 | 42.9 | 6226.7 | 17.17 | 14478.9 | 39.93 |
| 2006/07 | 41032.9 | 15701.6 | 38.27 | 6446.9 | 15.71 | 18885.4 | 46.02 |
| 2007/08 | 43462.3 | 15344 | 35.30 | 6507.6 | 14.97 | 21610.7 | 49.72 |
| 2008/09 | 52146.4 | 16707.6 | 32.03 | 9343.2 | 14.91 | 26095.6 | 50.04 |
| 2009/10 | 62067.82 | 21062.5 | 33.93 | 11189.58 | 18.02 | 29815.7 | 48.03 |
| 2010/11 | 72549 | 23105.85 | 31.84 | 13831.95 | 19.06 | 35611.2 | 49.08 |
| Total | 422041.52 | 157736.93 | 37.37 | 69035.9 | 16.36 | 194866.6 | 46.17 |
| Average | 42204.15 | 15773.7 | 37.37 | 6903.6 | 16.36 | 19486.6 | 46.17 |

Source: Economy Survey, 2010/11.

Figure 4.3: Composition of Indirect Tax



The custom duty and VAT occupies major portion in indirect tax. The total indirect tax revenue collected in fiscal year 2001/02 is Rs. 24607 million of which Rs. 10813.3 million i.e. 44.68% is contributed by custom duty, Rs. 10259.7 i.e. 42.41% is covered by VAT and Rs. 3127.6 i.e. 13% is covered by excise duty. The share of custom duty is continuously decreasing from year 2003/04 to 2008/09 which is 44.06% in 2003/04 and 32.03% in 2008/09 and increased to 31.84% in year 2010/11. The collection of VAT seems to be fluctuating in different years. The amount of VAT in year 2001/02 was Rs. 10259.7 i.e. 42.41% which is increased to 49.08% in year 2010/11 i.e. amounting to Rs. 35611.2 million. Which was maximum in year 2008/09 i.e. 50.04% this is the highest percent of collection from VAT during the study period. Such significant increase in VAT shows the improving consumption pattern of Nepalese market. The share of excise duty was increasing trend till year 2006/07. Which was 13% in year 2001/02 and increased to 17.17% in year 2005/06. However its collection was increasing trend in year 2001/02 to 2010/11 i.e. Rs. 3127.6 million in year 2001/02 and Rs. 13831.95 million in year 2010/11. But its percentage share was in fluctuating trend. In year 2001/02, its percentage contribution was 13% and increased to 17.17% in year 2005/06. The highest contribution of excise duty was 19.06% in year 2010/11 representing Rs. 13831.95 million. From the table 4.4 it can be concluded that the percentage contribution of excise duty to indirect tax revenue is not significantly changed. Although total collection from excise duty is increased.

4.1.5 Composition of Direct Tax

In Nepalese tax structure, the major component of direct taxes are income tax, land and house tax and land registration tax. Until the fiscal year 1993/94 vehicle tax was considered as a direct tax and since 1994/95 budget speech, it has been classified under the indirect tax. On the other hand, interest tax and urban house and land rent tax were included under the income tax since 1994/95. Thus the contribution of income tax has become larger than the other direct taxes. The share of the major components of the direct tax is given the following table (Annual report, 1994/95, MOF, Inland Revenue Department, Kathmandu).

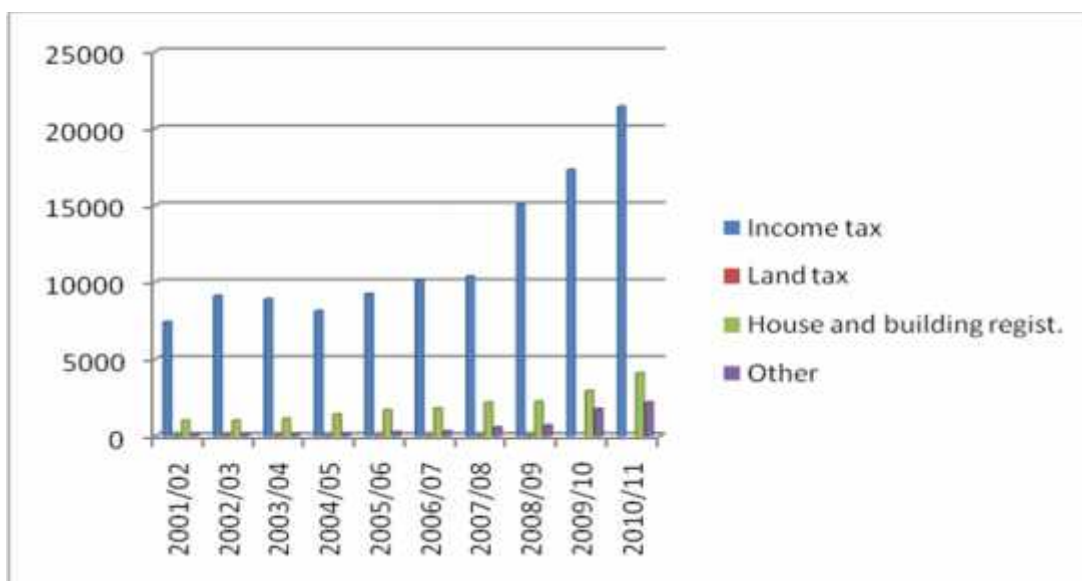
Table 4.5
Components of Direct Tax and Percentage Share

Figures in Rs. Million

| Fiscal year | Direct tax | Income tax | % share of IT | Land tax | % share of LT | House and building regist. | % share of HBR | Other | % share of other |
|-------------|------------|------------|---------------|----------|---------------|----------------------------|----------------|---------|------------------|
| 2001/02 | 8555.0 | 7420.6 | 86.74 | 4.6 | 0.05 | 1001.8 | 13.73 | 123.8 | 1.69 |
| 2002/03 | 10159.4 | 9110.0 | 89.67 | 5.1 | 0.05 | 1011.3 | 11.82 | 118.5 | 1.39 |
| 2003/04 | 10597.55 | 8903.6 | 84.01 | 0.82 | 0.01 | 1131.82 | 10.68 | 118.5 | 4.30 |
| 2004/05 | 10105.66 | 8132.2 | 80.47 | - | - | 1414.30 | 14 | 165.77 | 1.64 |
| 2005/06 | 11912.6 | 9245.9 | 77.61 | - | - | 1697.50 | 14.25 | 268.6 | 2.25 |
| 2006/07 | 13071.8 | 10159.4 | 77.72 | - | - | 1799.20 | 13.76 | 306.7 | 2.35 |
| 2007/08 | 13968.1 | 10373.7 | 74.27 | - | - | 2181.10 | 15.61 | 565.7 | 4.05 |
| 2008/09 | 18980.3 | 15034 | 79.20 | - | - | 2253.50 | 11.87 | 697.8 | 3.67 |
| 2009/10 | 23087.76 | 17311.22 | 74.98 | | | 2940.74 | 12.73 | 1766.59 | 7.65 |
| 2010/11 | 29571.3 | 21418.05 | 72.92 | | | 4084.05 | 13.81 | 2184.6 | 7.38 |
| Total | 150009.47 | 117108.67 | 78.07 | 10.52 | 0.11 | 19515.31 | 13 | 6316.56 | 4.2 |
| Average | 15000.95 | 11710.87 | 78.07 | 3.51 | 0.037 | 1951.53 | 13 | 631.66 | 4.2 |

Source: Economy Survey 2010/11.

Figure 4.4: Composition of Direct Tax



Income tax occupies largest share in the direct tax and that the percentage share of this component in the fiscal year 2001/02 was 86.74 percent amounting to Rs. 7420.6 million. Land tax, which comprised 0.05 percent of direct tax in 2001/02, contributed only 0.05 percent in 2002/03 and zero in 2010/11. The share of land tax was decreased sharply in the mid 1970's due to the rise in the relative importance of indirect taxes and income tax and large exemptions granted under the land revenue system. Since 1996/97, land revenue collection authority has been transferred to total government revenue and has ceased to become revenue sources of control government. Thus land tax has been a negligible contribution to the revenue structure of Nepal. The total collection of income tax, land tax, house and land registration during the study period were Rs. 117108.67 million, Rs. 10.52 million, Rs. 19515.31 million and Rs. 6316.56 million respectively, in which average collection on direct tax were 78.07,0.01,13,4.2 percent respectively.

4.1.6 Contribution of Direct Tax

The contribution of direct tax in tax revenue and total revenue were 28.35 percent and 23.41 percent respectively in 2010/11 as against 25.38 percent and 19.59 percent in 2001/02, which is given in the following table 4.6.

Table 4.6**Contribution of Direct Tax****Figures in Rs million**

| Year | Direct tax (DT) | DT as % of tax revenue | DT as % of GDP | DT as % of total revenue |
|---------|-----------------|------------------------|----------------|--------------------------|
| 2001/02 | 8555.0 | 25.80 | 2.44 | 19.94 |
| 2002/03 | 10159.4 | 26.14 | 2.58 | 20.78 |
| 2003/04 | 10597.55 | 26.94 | 2.61 | 21 |
| 2004/05 | 10105.66 | 23.73 | 2.31 | 17.97 |
| 2005/06 | 11912.6 | 24.73 | 2.51 | 19.11 |
| 2006/07 | 13071.8 | 24.16 | 2.38 | 18.64 |
| 2007/08 | 13968.1 | 24.32 | 2.31 | 19.32 |
| 2008/09 | 18980.3 | 26.68 | 2.61 | 21.63 |
| 2009/10 | 23087.76 | 27.12 | 2.82 | 21.45 |
| 2010/11 | 29571.3 | 28.95 | 3.53 | 23.41 |
| Total | 150009.47 | 26.22 | 2.61 | 20.33 |
| Average | 15000.95 | 26.22 | 2.61 | 20.33 |

Source: Economy Survey 2010/11

From the table 4.6, the share of direct tax on total tax revenue was 25.80 percent in 2001/02, after that it is increasing slowly up to 28.95 percent in 2010/11. The main reason of this loss contribution of direct tax in Nepal is the exemption of income from agriculture sector.

The share of direct tax on GDP is very low. Its share in 2001/02 was only 2.44 percent and it increased to 2.61 percent in year 2003/04. After that it decreased to 2.31 percent in year 2004/05 and started to increase and reached to 3.53 percent in year 2010/11. On the other hand, the share of direct tax on total revenue remained from 19.94 percent in 2001/02 to 23.41 percent in 2010/11. The average percentage of direct tax on tax revenue, GDP and total revenue were 26.22, 2.61, 20.33 percent respectively during the study period.

4.1.7 Contribution of Income Tax in Nepal

Nepal has started delay in practicing of income tax. First of all income tax was imposed in Nepal in 1959/60 as business profit and remuneration tax. Since then it has contributed revenue to the nation. In the beginning of this tax, it contributed Rs. 203 thousand as revenue in 1959/60. Income tax was initially levied on business income and salary. In 1962, the first income tax act was enacted which replaced the business profit and remuneration tax 1959. After the introduction of new act, the share of income tax was 10 folds increased within 4 years. The contribution of salary tax and business tax to total income tax during the first four years after the introduction of income tax is given in the following table 4.7.

Table 4.7
Income Tax Revenue Collection from 1959/60 to 1962/63

Figures in Rs. Million

| Heading | 1959/60 | 1960/61 | 1961/62 | 1962/63 |
|------------------------|---------|---------|---------|---------|
| Business | 162 | 339 | 1031 | 1767 |
| Salary tax | 41 | 67 | 135 | 169 |
| Total | 203 | 406 | 1166 | 1936 |
| Foreign investment tax | - | - | 1 | 140 |
| Grand total | 203 | 406 | 1167 | 2076 |

Source: Budget speeches and economic survey of various fiscal years, Ministry of Finance.

Table 4.8**Contribution of Income Tax on Different Revenue Heads****Figures In Rs million**

| Year | Income tax (IT) | IT as % of direct tax | IT as % of tax revenue | IT as % of total revenue | IT as % of total GDP |
|---------|--------------------|--------------------------|---------------------------|-----------------------------|-------------------------|
| 2001/02 | 7420.6 | 86.74 | 22.38 | 17.30 | 2.03 |
| 2002/03 | 9110.0 | 89.67 | 23.44 | 18.63 | 2.31 |
| 2003/04 | 8903.7 | 84.01 | 22.63 | 17.65 | 1.94 |
| 2004/05 | 8132.2 | 80.47 | 18.70 | 14.16 | 1.62 |
| 2005/06 | 9245.9 | 77.61 | 19.19 | 14.83 | 1.72 |
| 2006/07 | 10159.4 | 77.72 | 18.77 | 14.48 | 1.73 |
| 2007/08 | 10373.7 | 74.27 | 18 | 15.35 | 1.58 |
| 2008/09 | 15034 | 79.20 | 21.13 | 17.14 | 2.07 |
| 2009/10 | 17311.22 | 74.98 | 20.32 | 16.08 | 2.11 |
| 2010/11 | 21418.05 | 72.92 | 20.97 | 16.95 | 2.55 |
| Total | 117108.77 | 79.76 | 20.55 | 16.16 | 1.97 |
| Average | 11710.88 | 79.76 | 20.55 | 16.16 | 1.97 |

Source: Economy Survey 2010/11.

Income tax was increased about 3 folds in 2010/11 as against in 2001/02. Total income tax in 2001/02 was Rs. 7420.6 million and it increased to Rs. 21418.05 million in 2010/11. The share of income tax to total direct tax was 86.74 percent in 2001/02. The share of income tax to total direct tax was decreased to 72.92 percent in 2010/11. The share of income tax to total tax revenue was 22.38 percent in 2001/02, which decreased to 20.97 percent in 2010/11. Similarly, its share on total revenue and total GDP were 17.30 percent and 2.03 percent respectively in 2001/02 and 16.95 percent and 2.55 percent respectively in 2010/11. The average percentage collection of income tax on direct tax, tax revenue, total revenue and GDP were 79.60 percent, 20.55 percent, 16.16 percent and 1.97 percent respectively during the study period of 10 years.

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

4.1.8 Composition and Trend of Income Tax

Till 1993/94 income tax revenue was divided into corporate income tax, individual income tax and remuneration. From 1993/94, the income tax revenue was divided into four groups, they were: corporate income tax, individual income tax, house and land rent tax and interest tax. Corporate tax is collected from government corporations, public and private limited companies and partnership firms. Individual tax is collected from remuneration, and industry, business, profession or vocation. Interest tax is collected from banks and financial companies that pay interest on all type of deposits and the house rent tax is levied on income obtained from renting house and land in urban areas. The composition and trend of income tax revenue is given in the following table 4.9.

Table 4.9
Components of Income Tax (2001/02 to 2010/11)

Figures in Rs Million

| Years Sources of income tax | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|----------|----------|
| A. Corporate income tax | 4440 | 5990 | 3668.4 | 3358.3 | 4575.8 | 4979.8 | 4855 | 8145.3 | 9121 | 10032.4 |
| i. Government corporation | 2200 | 2930 | 1769.3 | 1251 | 2056.6 | 1332.4 | 195.7 | 1019.7 | 204.6 | 722.20 |
| ii. Public ltd. company | 1340 | 1930 | 987 | 871 | 987.9 | 1179.6 | 1255 | 1408.5 | 1729.9 | 1715.9 |
| iii. Private ltd. company | 900 | 1130 | 1412 | 1236.3 | 1531.3 | 2467.8 | 3404.3 | 5717.1 | 7186.5 | 7594.4 |
| B. Individual income tax | 2320 | 2400 | 4419.1 | 3528.2 | 3533.4 | 3926.3 | 4234.7 | 5234.4 | 6381.2 | 8608.7 |
| i. Remuneration | 450 | 600 | 835.6 | 1252.6 | 1391.2 | 1675.9 | 1764.1 | 2007.9 | 2451 | 2709.6 |
| ii. Industry, business, profession, and others | 1870 | 1800 | 3583.5 | 2109.6 | 2142.2 | 2250.4 | 2470.6 | 3226.5 | 3930.2 | 5899.1 |
| C. House and land tax rent | 250 | 260 | 348.5 | 381.7 | 403.3 | 496.3 | 509.1 | 599.4 | 721.1 | 993.7 |
| D. Interest tax | 410 | 460 | 467.7 | 864 | 733.4 | 757 | 774.9 | 1054.9 | 1087.9 | 1783.35 |
| Total | 7420 | 9110 | 8903.7 | 8132.2 | 9245.9 | 10159.6 | 10373.7 | 15034 | 17311.22 | 21418.05 |
| % increase of income tax collection | 20.26 | 22.78 | 2.26 | 8.66 | 13.69 | 9.88 | 2.10 | 44.92 | 15.15 | 23.72 |

Source: Annual report of Inland Revenue Department, 2010/11.

From the table 4.9, the amount of corporate income tax was gradually increased up to 2002/03 but it decreased in 2003/04 to 2004/05. Again it started to increase from year 2005/06 which was Rs. 4575.8 million and reached to Rs. 10032.40 million in year 2010/11. In overall, it plays the vital role in income tax.

The contribution of individual income tax was in increasing trend till the year 2003/04 and it was decreased in 2004/05. But it started to increase from year 2005/06 and reached to Rs. 7608.65 million in year 2010/11. Industry business profession, and others contributed in income tax is relatively higher than the remuneration.

The contribution of house and land rent tax and interest taxes were in increasing trend. Their contribution were Rs. 250 million and Rs. 410 million respectively in 2001/02 and Rs. 993.7 million and Rs. 1783.4 million respectively in 2010/11.

The percentage increased in income tax collection were 20.26, 22.78, 2.26, 8.66, 13.69, 9.88, 2.10, 44.92, 15.15 and 23.72 in year 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively.

Table 4.10
Composition of Income Tax (2001/02 – 2010/11)

Figures in Rs. Million

| Year | Total income tax | Corporate tax | % of income tax | Individual tax | % of income tax | House and land, rent tax | % of income tax | Interest tax | % of interest tax |
|---------|------------------|---------------|-----------------|----------------|-----------------|--------------------------|-----------------|--------------|-------------------|
| 2001/02 | 7420.6 | 4440.6 | 59.84 | 2320.0 | 31.26 | 250 | 4.72 | 410 | 5.53 |
| 2002/03 | 9110.0 | 5990 | 65.75 | 2400.0 | 26.34 | 260 | 2.85 | 460 | 5.05 |
| 2003/04 | 8903.7 | 3668.4 | 41.2 | 4419.1 | 49.63 | 348.5 | 3.91 | 467.7 | 5.25 |
| 2004/05 | 8132.2 | 3358.3 | 42.16 | 3528.2 | 42.21 | 381.7 | 4.79 | 864 | 10.85 |
| 2005/06 | 9245.9 | 4575.8 | 49.49 | 3533.4 | 38.22 | 403.3 | 4.36 | 733.4 | 7.93 |
| 2006/07 | 10159.4 | 4979.8 | 49.02 | 3926.3 | 38.86 | 496.3 | 4.89 | 757 | 7.45 |
| 2007/08 | 10373.7 | 4855 | 46.80 | 4234.7 | 40.82 | 509.1 | 4.91 | 774.9 | 7.47 |
| 2008/09 | 15034 | 8145.3 | 54.18 | 5234.4 | 34.82 | 599.4 | 3.10 | 1054.9 | 7.02 |
| 2009/10 | 17311.22 | 9121 | 52.68 | 6381.2 | 36.86 | 721.1 | 4.17 | 1087.9 | 6.28 |
| 2010/11 | 21418.05 | 10032.4 | 46.84 | 8608.7 | 40.19 | 993.67 | 4.64 | 1783.4 | 8.32 |
| Total | 117108.77 | 59166.59 | 50.52 | 4458.95 | 38.07 | 4963.07 | 4.24 | 8393.18 | 7.17 |
| Average | 11710.88 | 5916.66 | 50.52 | 4458.6 | 38.07 | 496.31 | 4.24 | 839.32 | 7.17 |

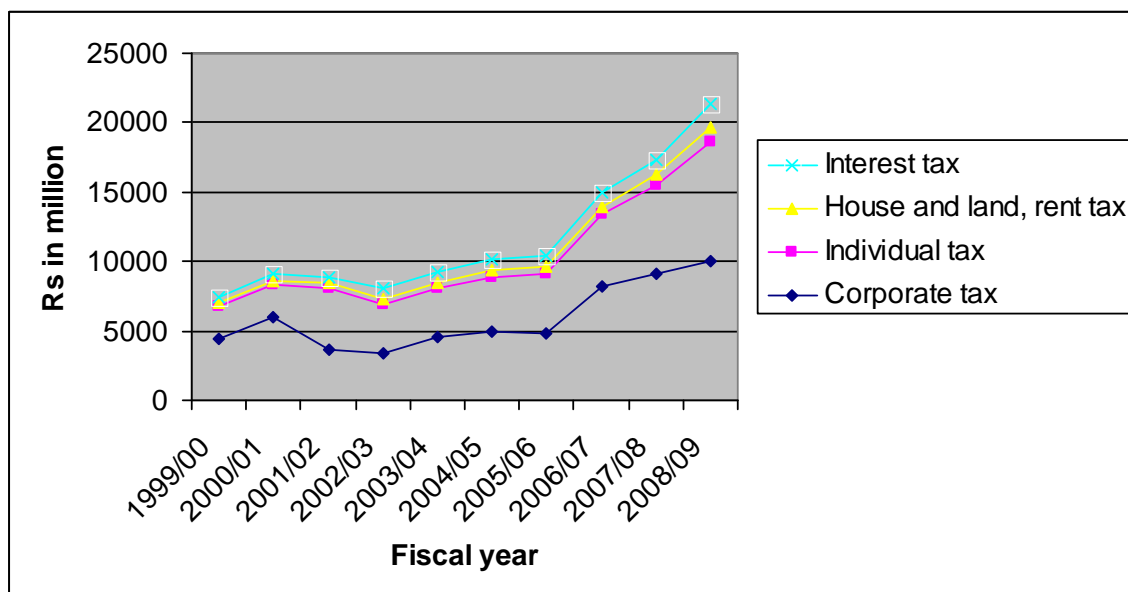
Source: Annual report of Inland Revenue Department, 2010/11.

The share of corporate income tax on total income tax was 59.84 percent in 2001/02, which was increase to 65.75 percent in 2002/03. It was in fluctuating trend during the study period. In year 2010/11, the share of corporate income tax on total income tax was 46.84 percent.

Individual income tax contributed 31.26 percent of total revenue tax in 2001/02 which was decrease to 26.34 percent In year 2002/03. it was fluctuating trend and its share on total income tax in year 2010/11 was 40.19 percent. It contributed 49.63 percent in 2003/04 on total income tax which was maximum contribution during the study period. The contribution of house and land rent tax was in between 2 to 5 percent. Its share in 2001/02 was 4.72, which was decrease to 2.85 percent in 2002/03. The maximum share of house and land rent tax on total income tax was 4.91 percent in year 2007/08. Its share on total income tax was 4.64 percent in 2010/11.

Interest tax contributed 5.53 percent in 2001/02 which was increased up to 10.85 percent in 2004/05 and till 2009/10 it started to decrease. Interest tax was decreasing trend since 2004/05 to 2009/10. In 2010/11, the share of interest tax was 8.32 percent on total income tax. The composition of total income tax has been shown graphically as follows:

Figure 4.5: Component of Income Tax



4.1.9 Income Tax Rate

Tax rate and its structure has been changing frequently since its introduction in 1959/60. Since 1959/60 to date, there are various records of highest and lowest income tax rate. In 1963/64, the lowest income tax rate was 4 percent and in 1975/76, the highest income tax rate was 60 percent. After introducing of income tax, tax rate is charged on different slabs. In 1975/76, the income tax rate for personal income was 10 percent to 60 percent for 7 different slabs. Form 1998/99 to till date, the income tax rate for personal income is 15 percent and 25 percent for two different slabs.

Under new Income Tax Act 2001; individual income tax is levied with two rates of 15 percent and 25 percent. For individuals; who have Rs. 120,000 income or Rs. 1200,000 turnover form any kind of business in metropolitan or sub-metropolitan cities, municipalities and other areas in Nepal are subject to pay tax as follows:

| | |
|---|----------|
| Metropolitan or sub-metropolitan cities | Rs. 2000 |
| Municipalities | Rs. 1500 |
| Anywhere else in Nepal | Rs. 1000 |

The income tax rate for partnership firms, corporations and non-resident was 15 to 60 percent for different slabs in 1975/76 which decreased to 30 and 25 percent for total taxable income. Income tax act has provided rebates or facilities so only 20 percent is taxed on their income for a special industry.

For every year, finance acts prescribe the exemption limit for individual, family and couple. Above the exemption limit, different income tax rate have been levied. The exemption limits in different years are shown in the following table:

Table 4.11
Exemption Limit in Nepal (1959/60 – 2010/11)

Figures in Rs Million

| Fiscal year | Individual | Couple | Family | All taxpayers |
|-------------------|------------|--------|--------|---------------|
| 1959/60 – 1962/63 | - | - | - | 7000 |
| 1963/64 – 1964/65 | - | - | - | 6000 |
| 1965/66 – 1966/67 | - | - | - | 5000 |
| 1967/68 – 1973/74 | 3000 | 4500 | 6000 | - |
| 1974/75 | 4500 | 6000 | 6000 | - |
| 1975/76 | 5500 | 6500 | 7500 | - |
| 1976/77 – 1978/79 | 6500 | 7500 | 8500 | - |
| 1979/80 – 1980/81 | 7500 | 10000 | 10000 | - |
| 1981/82 – 1982/83 | 10000 | 15000 | 15000 | - |
| 1983/84 – 1989/90 | 15000 | 20000 | 20000 | - |
| 1990/91 – 1991/92 | 20000 | 30000 | 30000 | - |
| 1992/93 – 1996/97 | 25000 | 35000 | 3500 | - |
| 1997/98 | 30000 | 40000 | 40000 | - |
| 1998/99 | 40000 | 50000 | 50000 | - |
| 1999/2000 | 50000 | 60000 | 60000 | - |
| 2002/03 – 2003/04 | 55000 | 75000 | 750000 | - |
| 2004/05 | 65000 | 85000 | 85000 | - |
| 2005/06 | 80000 | 100000 | 100000 | - |
| 2006/07 | 85000 | 115000 | 115000 | - |
| 2007/08 | 100000 | 125000 | 125000 | - |
| 2008/09 | 115000 | 140000 | 140000 | - |
| 2009/10 | 115000 | 140000 | 140000 | - |
| 2010/11 | 160000 | 200000 | 200000 | - |

Source: Finance Acts of Various Year, MOF, GON.

The above table 4.11 shows that there was only one exemption limit for all individual, taxpayers from 1959/60 to 1966/67. After 1967/68, individual taxpayers were categorized into 3 heads i.e. individual, couple and family. From the FY 1967/68

to 1978/79, exemption limit was distinct for each 3 categories. But after 1981/82 to till date, the exemption limit of couple and family is treated equal. This indicates that the exemption limit is given only for 2 categories i.e. individual and family or couple. Above the exemption limit of individual income, different sets of tax rates are levied for different slabs. The following table shows the rates for personal income tax in Nepal.

Table 4.12
Rates of Personal Incomes Tax in Nepal (1975/76 to 2010/11)

Figure in Rs Million

| Fiscal year | Slabs over exemption limit | | | | | | | |
|---------------------|----------------------------|----------------|-------------------------------|--------------|--------------|----------------|----------------|----------------|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| 1975/76 | 5000 7% | 5000 10% | 10000 20% | 10000 30% | 10000 45% | 500000 55% | Balance 60% | |
| 1980/81 | 5000 5% | 5000 10% | 10000 15% | 20000 20% | 20000 30% | 30000 40% | Balance 50% | |
| 1985/86 | 5000 10% | 5000 15% | 10000 20% | 15000 25% | 15000 40% | 30000 40% | 200000 50% | Balance 55% |
| 1990/91 | 1000 15% | 15000 20% | 20000 35% | 25000 40% | 30000 45% | Balance 50% | | |
| 1995/96 | 40000 10% | 25000 20% | Balance 30% (a) 33% (b) | | | | | |
| 2002/03 | 75000 15% | Balance 25% | | | | | | |
| 2003/04- 2008/09 | 75000 15% | Balance 25% | Additional 1.5% | | | | | |
| 2009/10 | 85000 15% | Balance 25% | - | | | | | |
| 2010/11 | 85000 15% | Balance 25% | - | | | | | |

. Source: Finance Acts of Various Years, MOF, G/N.

Where, (a) Remuneration (b) Others.

From the above table 4.12, the rates for personal income tax in Nepal are different for different slabs. In 1975/76, the tax rate for personal income was 7 to 60 percent for 7 different slabs. After 1975/76, the slabs were increased to 8 in 1985/86. But after 1985/86, the numbers of slabs and rates of personal income tax decreasing till date. From 2003/04 to 2008/09 there was 15% rate for first Rs. 75,000 and 25% for balance and additional 1.5% for balance too. From fiscal year 2009/10, the additional tax for balance has been eliminated. There was 15% tax rate for first 85000 and 25% for balance.

Similarly, income tax is charged for partnership firms, corporation and non-residents. The exemption limit for them is not provided by the income tax act. Tax is charged on the income after deducting all expenses. The rates and slabs approved for different years are given below:

Table 4.1
Income Tax Rates for Partnerships Firms, Corporation and Non-Residents (1975/76 – 2010/11)

| Fiscal year | Slabs over exemption limit | | | | | | | |
|-----------------|-------------------------------|--------------|--------------|---------------|----------------|----------------|----------------|----------------|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
| 1975/76 | 10000 15% | 10000 25% | 10000 40% | 500000 55% | Balance 60% | - | - | |
| 1980/81 | 5000 5% | 5000 10% | 10000 15% | 20000 20% | 20000 30% | 30000 40% | Balance 50% | |
| 1985/86 | 5000 10% | 5000 15% | 10000 20% | 15000 25% | 15000 30% | 30000 40% | 200000 50% | Balance 55% |
| 1990/91 | 10000 15% | 15000 20% | 20000 35% | 25000 40% | 30000 45% | Balance 50% | | |
| 1995/96 | 33% in total | | | | | | | |
| 2002/03-2007/08 | 30% (a) 25% (b) | | | | | | | |
| 2008/09-2010/11 | 30% (a) 25% (b) 20% (c) | | | | | | | |

Source: Finance Act of various years, MOF, G/N.

(a) For banks and financial companies and alcohol/tobacco industry.

(b) Others (including partnership firms)

(c) For special industry.

The above table 4.13, shows that the income tax rates for partnership firms, corporation and non-resident were different for different slabs in the earlier years. But after 1995/96, the rate and slabs is only one. This shows the progressive tax in earlier year and flat tax rate in the recent years. The income tax rates for 1975/76 was 15 to 60 percent for 5 slabs. But in 1995/96, tax rate was in total 33 percent. And from 2004/05, to till date, the tax rates are 30 percent for banking and financial institutions and tobacco and alcohol industries, 25 percent for other (including partnership firms) and 20 percent for the special industry at a flat rate on taxable income.

4.2 An Analysis of Exemption and Deduction

Income Tax Act 2031 was replaced by Income Tax Act 2058 has classified the income heads into the following 3 heads:

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

The act has defined the income heads as follows:

- a. Business: Business means any industry, a trade, a profession, or the like isolated transaction with a business character and includes a past, present or prospective business. By contrast to employment, business is an earning activity typically consisting of not only the provision of labor but of the combined provision of Labour and capital.
- b. Employment: The income earned with the help of Labour is defined as an employment income. In other words, the payment or benefit received either in cash or kind from the employment or his/her associate in exchange of Labour is defined as employment income.
- c. Investment: The income earned with the help of using capital is defined as an investment income. Income Tax Act, 2058 has defined investment as an act of holding or investing one or more assets.

For the calculation of net income of these three income heads, the act has defined the incomes or amounts, which are taxable and non-taxable and expenses, which are allowed for deduction and not allowed for deduction. For the computation of income, act has made the following provisions:

4.2.1 Income from a Business

Income Tax Act 2058, section 7, has clearly mentioned the incomes or amounts which are includable in computing the income from business. They are:

- a. Service charge (sec. 7.2)
- b. Disposal of business/trading stock (Sec. 7.2)
- c. Net gain from the disposal of the person's business assets or liabilities of the business (Sec. 7.2).
- d. Gain form disposal of pool of depreciable assets (Sec. 7.2)
- e. Prizes of gifts received by the person in respect of business (Sec. 7.2).
- f. Amount received in lieu of accepting any restrictions regarding business (sec. 7.2).
- g. Amount received form any investment directly related to business (sec. 7.2)
- h. Income to be included due to change in accounting methods (sec. 22.6).
- i. Excess amounts received due to exchange rate variation (sec. 24.4)
- j. Bad debts received (sec. 25.1)
- k. Proportionate amounts received under long-term contract (sec. 26.1).
- l. Under payment of interest according to market rate (sec. 27.1).
- m. Receivable amounts paid to others (sec. 29).
- n. Amount received from compensation (sec. 31).
- o. Other amounts received under the head of 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 payments (sec. 92) and
- d. Dividends distributed by a controlled foreign entity at the end of the year under section 69.

4.2.2 Income from an Employment

Income Tax Act 2058, section 8, has clearly defined the incomes, which are includable in computing income from employment. An individual's income from an employment for an income year is the individual's remuneration from the employment

of the individual for the year. For the purpose of computing income from an employment, the following amounts or incomes received by him in respect of any employment of services rendered by him in any of income shall be included.

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

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

Non-includable amounts on employment income:

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

- a. Amount exempt under section 10 and final withholding payments.
- b. Meals or refreshments provided in premises operated by or on behalf of an employer's employee that the available to all the employees or similar terms.
- c. Any discharges or reimbursement costs incurred by the individual:
 - i. that serve the proper business purpose of employer or

- j. that would otherwise be deductible in calculating the individual's income from any business or investment.
- d. Payments of prescribed small amounts, which are so small and thus unreasonable or administratively impractical to make accounting for them. (Only up to Rs. 500 at once-expenses may be stationery, boxis gift, tea/coffee expenses, emergency medical expenses and pointed by department).

4.2.3 Income from an Investment

Section 9 of Income Tax Act 2058, has defined the income received form an investment for income tax purpose. For the purpose of computing income of any person from an investment for an income year is the person's profits and gains from conducting the investment for the year and there shall be included:

- a. Any dividend, interest, natural resource payment, rent, royalty, gain form investment insurance, gain from an unapproved retirement fund interest or retirement payment, made by an approved retirement fund, gain received from non-approved retirement fund or retirement payment from approved retirement fund.
- b. Net gains from the disposal of the person's non-business chargeable assets of investment.
- c. Excess amount of incomings over the depreciation basis including outgoing on the disposal of depreciation assets of the investment of the person.
- d. Gifts received by the person in respect of investment.
- e. Bad debt recovered related to investment.
- f. Under payment of interest related to investment.
- g. Compensation received.
- h. Exchange gain.
- i. Amount required to be included due to change in accounting system.
- j. Income from natural resources.
- k. Royalty received.
- l. Rent received except from house and land.
- m. Interest except received by a natural person/bank.
- n. Retirement contributions, including those paid to a retirement payments in respect of investments.

- o. Amounts derived as consideration for accepting restriction on the capacity to conduct the investment.

Others amounts required to be included on tax accounting or qualification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business.

In the above provision, act has included the amounts derived as consideration for accepting or restriction or the capacity to conduct the investment, it is fruitful to the investors who receive the compensation against the restriction. But it will not be possible to implement, if the act does not clarify the nature of restriction, cause of imposing restriction, process of compensation-computing and entity which give compensation non-includable amounts on investment income.

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

- a. Exempt amount under section 10,
- b. Taxation of dividend under section 54,
- c. Dividend distributed by a controlled foreign entity at the end of the year under section 69 and final withholding payments, and
- d. Amounts that are included in calculating the person's income from any employment or business.

4.2.4 Exemption from Income Tax

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

1. Exempt Amounts

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

- a. Amount derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between government of Nepal and foreign country or an international organizations.
- b. Amounts derived by an individual from employment in the public service of the government of foreign country provided that.
 - i. The individual is a resident person solely by reason of performing the employment or is a non resident person and

- ii. The amounts are payable from the public funds of the country.
- c. Amounts derived from public fund of the foreign country by an individual who is not a citizen of Nepal as referred to paragraph (b) or by member of the immediate family of the individual.
- d. Amounts derived by an individual who is not a citizen of Nepal from employment by government of Nepal on terms of tax exemption.
- e. Allowances paid by government of Nepal to widows, elder citizens, or disabled individuals.
- f. Amounts derived by way of gift, bequest, inheritance or scholarship (which are including exception of business employment or investment income)
- g. Amounts derived by an exempt organization by way of
 - h. Gift, donation.
 - ii. Other contributions that directly relate to the organization's function of the definition of exempt organization in section 2.
 - ii. Amounts earned by Nepal Rastra Bank as its objectives.
- i. Pension received by a Nepali citizen retired from the army or police service of a foreign country provided the amounts are payable from the public fund of that country.

In the above section, pensions amount received by Nepalese people being retired from the service by army or police of foreign country is exempted from income tax. It restricts the objective of raising more revenue of government because some of the receive more amount than the exemption limit approved by the government.

2. Exempt Organization

Exempt organization means:

- i. A social, religious educational or charitable organization of public character register without having profit motive.
- ii. An amateur sporting association formed for the purpose of promoting social or sporting amenities not involving the acquisition of gain.
- iii. a political party registered with the Election Commission.
- iv. A Village Development Committee (VDC), Municipality or District Development Committee.
- v. Nepal Rastra Bank.
- vi. Government of Nepal.

vii. The prescribed entity that has been issued with a personal ruling under section 76 stating that to is an exempt organization.

Income Tax Act has mentioned the organizations, which are tax-free (Exempt Organization) as social, religious, educational or charitable organization of a public character registered without having profit motive, in the case of non-transparent private business like boarding schools, NGO's or other like entities, where profits are earned but they are tax free. Budget speech 2065/66 has announced that the private boarding schools have to pay 5 percent tax through the every students fees to the government.

3. Business Exemptions and Concessions

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

- a. An agricultural income derived from sources in Nepal during an income year by a person, other than the income from an agriculture business derived by a registered firm, or partnership, or a corporate body, or through the land about the holding ceiling as prescribed in the Land Act 2021, is exempted from income tax.
- b. Incomes derived by co-operative societies, registered under Cooperative Act 2048, from business mainly based on agriculture and forest products such as agriculture and silk production, horticulture and fruit processing, animal husbandry, dairy industries poultry farming, fishery, tea gardening and processing, coffee farming and the other processing, herb culture and herb processing, vegetable seeds processing, bee- keeping, honey production, rubber farming, floriculture and production and forestry related business such as lease- hold forestry, agro-forestry, cold storage of established for the stores of vegetables and business of agricultural seeds, insecticide fertilizer and agricultural tools (other than machine operated) and rural community based saving and credit co-operatives are exempt from tax. Dividends distributed by such societies are also exempted from tax.
- c. Income derived from sources in Nepal during an income year by a person from a special industry is taxed as follows:
 - a. The industry provides direct employment to 600 or more Nepalese citizens throughout the year, 10 percent rebate is provided to the

special industries or 90 percent of rate is applicable to that income for the period of forever.

- b. The special industry operated in a underdeveloped, undeveloped, highly undeveloped and remote zone, at 90, 80, 75% and 70 percent respectively, of the rate is applicable for the period of ten years from commencing and including the year in which the operation commences.
- c. The special industries based on information technology established in a information technology (IT) park like Banepa, 25% rebate is provided on existing rate for forever.
- d. A person who is entitled to concession under subsection a, b or c shall calculate the income referred to in those subsections as though the income was the only driven by a separable.
- e. When a person qualifies for more than one concession under subsection (b) I or II with respect to the some income, the person shall only be entitled to one concession with respect to that income but shall be entitled to select which concession applies.

4. Donation gifts to exempt organizations:

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

- a. a person may claim to have his taxable income for an income year reduced by donation gifts made by the person during the year to an exempt organization, that are approved for the purposes of this section by the department.
- b. Donation made to an exempt organization, approved by Inland Revenue Department (IRD) is allowed for reductions from taxable income. Reductions allowed to an individual or an entity will not exceed Rs. 100,000 or 5% of adjusted taxable income. However, the government of Nepal may prescribe by a notification in the Nepal Gazette, as to allow full or partial deduction at the time of assessing income of the expense incurred for special purpose or donation given by the person.
- c. Donation given to national political parties up to Rs. 10,00,000 before three months of election is deductible expenses from taxable income. Likewise donation given to Lumbini Development fund and Pashupati Development Fund up to Rs. 10,00,000 is tax exempt amount.

From the above provision, it is clear that the donation given to political parties is allowed for deduction but it has not been able to solve the voice of people of transparency of donation amount given by businessmen to political parties.

4.2.5 Deduction Allowed

Income Tax Act 2058 has provided the provisions relating to expenses, which are allowed for deduction and not allowed for deduction. They are discussed or analyzed in the following section:

1. General Deductions (Sec. 13)

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

2. Interest Expenses (Sec. 14)

For the purpose of calculating the income of a person from an income year from a business or investment, there shall be deducted all interest incurred during the year by the person under a debt obligation of the person that the debt obligation was incurred in borrowing money, used during the year or was used to purchase an asset that is used during the year or in any other case the debt obligation was incurred.

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

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

It is an unlawful step to businessmen not to get the deduction of full amount of interest. It does not fulfill the objectives of industrial or economic development. There is a controversial condition between the law of banking and law of income tax because according to the law of banking interest must be paid to bank but according

to the law of income tax there is a provision of not to get the deduction of full amount of interest for an income year.

3. Cost of Trading Stock (sect. 15)

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

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

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

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

Where trading stock of a person's business is not readily identifiable, the person may elect that the cost of trading stock be determined according to the first in first out (FIFO) method and average cost method. Once chosen the method may only be changed with the written permission of the department. In the case where average cost method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which the cost of particular type of trading stock is determined as the weighted average cost of all trading stock of that type and held by the business.

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

4. Repair and Improvement Costs (Sect. 16)

For the purpose of calculating a person's income for an income year from any business or investment, there shall be deducted all costs to the extent incurred during the year in respect of the repair or improvement of depreciable assets owned and used by the person during the year in the production of the person's income from the investment or business.

But the deduction allowed under the above case with respect to all repair and improvement costs should not be excess amount of 7% of depreciable base or actual repair and improvement expenses whichever is less is deductible and the excess repair expenses (Inadmissible portion) is capitalized in respective groups at the beginning of the next income year.

5. Pollution Control Costs (Sect: 17)

For the purpose of calculating a person's income for an income year from any business, there shall be deducted pollution control costs to the extent incurred by the person during the year in conducting the business. But the deduction allowed to a person for an income year with respect to all business conducted by the person shall not exceed 50% of the taxable income. Any excess costs or part thereof, for which deduction is not allowed shall be capitalized and may be depreciated in accordance.

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

Government has a will of controlling pollution and then protection of environment but has not spent a little bit money on it. In the other hand all the expenses made by the businessmen to control pollution are not allowed for deduction

and has made a standard limit for it. So, it is not a good symptom of controlling pollution.

6. Research and Development Costs (Sec. 18)

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

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

7. Depreciation Expenses (Sect. 19)

For the purpose of calculating a person's income for an income year from any business or investment, there shall be deducted in respect of depreciation of depreciable assets owned and used by the person during the year in the production of the person's income from the business or investment. But the following provisions shall be applied in respect of depreciation of machines, equipment and other machinery installed in the electricity projects that are involving in building power station, generating and transmitting electricity and in the projects conducted by any entity so as to build public infrastructure, own operate and transfer to the government of Nepal.

In case where the old machines, equipment and other machinery that are already installed require replacement in any income year as they are out of order due to being too old, the balancing value of the old machines, equipment and other machinery remained after cost shall be allowed as expenses for the year.

At the time of transfer of other assets to the Nepalese government except of old assets replace in accordance with above paragraph, the balancing value of

remained, after subtracting the depreciation up the year of the transfer from their cost shall be allowed as expenses.

For the purpose of depreciation calculating, depreciable assets are categorized into five groups on their size, nature, cost, durability, similarly, utility and so on as A, B, C, D and E block, pool or group. Depreciation are charged at the rate of 5, 25, 20 and 15 percent for A, B, C and D respectively and for pool E depreciation is charged on the basis of cost divided by useful life.

Rates of depreciation are far from reality because there is no specific estimation provision of real age of assets and depreciation rate in Nepal. In the other hand, there is no any specific provision of depreciation of assets, which are taken in lease and installment payment basis. It shows a weak point of new income tax act.

8. Loss Recovery (Sec. 20)

For the purpose of calculating a person's income from an income year from any business or investment there can take place different losses in business or investment. When losses incurred in business of domestic source, those losses can be set off and carry forward up to 7 years from any business income situated within the country or outside the country. In the case of electricity projects involving in business power station, generating and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own operate and transfer (BOOT) to the government, entity conducting petroleum business under Nepal Petroleum Act 2040, losses can be deducted up to next 12 years.

When losses incurred in investment of domestic source, those losses can be set off and carry forwarded up to 7 years from any incomes of investment within the country or outside the country only.

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

Carry forward the losses for 7 years is not sufficient as compared to other countries. It is not enough to encourage the business for taking risk. The provision of carry backward is also thoughtful because of accounting system of Nepal is not so standard to apply this provision.

4.2.6 Expense not Allowed for Deduction

To calculate the income of a persons' for an income year from any business, employment, or investment, the following expenses are not allowed for deduction under section 21 of Income Tax Act 2058.

- a. Personal nature or domestic expenses.
- b. Income tax paid, fines and penalties.
- c. Expenses incurred for acquiring tax free income and final withholding payments.
- d. Cash payment in excess of Rs. 50,000 at a time by a person having annual transaction more than Rs. 20,00,000 (2 million) except in certain circumstances.
- e. Distribution of profits by an entity for example dividend distribution to the shareholders.
- f. Expenses not related to earning of income.
- g. Any reserve, provision or fund.
- h. Expenses of capital nature.
- i. Foreign income tax.
- j. Other expenditures not exempted as admissible.

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

- a. Payment made to government of Nepal, a constitution body, a corporation owned by the government of Nepal, or a bank or financial institution,
- b. Payment is made to a farmer or producer producing primary agriculture products even in the case where the product is primary processed by the farmer himself,
- c. Payment is a retirement contribution or retirement, payment,
- d. Payment is made in an area where banking services are not available. An area having banking services means the area where there are no banking facilities within the surrounding of ten kilometers.
- e. Payment is made and must necessarily be made in cash or on a day when banking services are closed.
- f. Payment is made into a bank account of the payee.

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

4.3 An Empirical Analysis

4.3.1 Introduction

An empirical investigation has been conducted in order to find out various aspects of income tax from the experience of the real world. The major tools used for this purpose is an opinion questionnaire, which was dispatched to 80 persons representing tax administration, tax experts and taxpayers, but only 60 responses were received. The questionnaire included the various aspects of income tax concerning with provisions of exemptions and deductions and contribution of income tax to the government revenue. The questionnaire either asked for a yes/no response or asked for ranking of choice according to number of alternatives where a first choice was most important and last choice was least important. Information received from respondents were tabulated into the separate format and they were expressed in percent of total numbers or points then analyzed into descriptive way.

The following table shows the groups of respondents and code used to represent them,

Table 4.14
Groups of Respondents and Code Used

| S.N. | Groups of respondents | Sample size | Code used |
|-------|-----------------------|-------------|-----------|
| 1 | Tax experts | 10 | A |
| 2 | Tax administrators | 25 | B |
| 3 | Taxpayers | 25 | C |
| Total | | 60 | |

4.3.2 Contribution of Income Tax to National Revenue of Nepal

In order to know the respondent's opinion about the contribution of income tax to national revenue of Nepal, a question was asked, "Do you think that contribution of

income tax to national revenue of Nepal is satisfactory? The responses were received from the respondents which are tabulated as follows:

Table 4.15
Satisfaction towards contribution of Income Tax to National Revenue of Nepal

| Response Respondents | Yes | | No | | Total | |
|-------------------------|-----|----|-----|----|-------|-----|
| | No. | % | No. | % | No. | % |
| A | 4 | 40 | 6 | 60 | 10 | 100 |
| B | 10 | 40 | 15 | 60 | 25 | 100 |
| C | 12 | 48 | 13 | 52 | 25 | 100 |
| Total | 26 | 43 | 34 | 57 | 60 | 100 |

Source: Opinion Survey, 2010.

The questionnaire received as 26 respondents i.e. 43 percent of the total respondents were agreed that the contribution of income tax to national revenue of Nepal is satisfactory and 34 respondents i.e. 57 percent of the total respondents were not agreed about the contribution of income tax to national revenue. Most of the respondents of the all codes (A, B, C) were disagreed about the contribution of income tax to national revenue. Thus it can be concluded that the contribution of income tax to national revenue of Nepal is not satisfactory.

4.3.3 Opinion on Current Income Tax Rates

In order to know the opinion on current income tax rates, respondents were requested to tick only among the 3 alternatives (high, medium and low). The question was asked, "What is your opinion about the current income tax rates?" The respondent received are tabulated as follows:

Table 4.16
Opinion on Current Income Tax Rates

| S.N. | Tax rates | Group | | | Total number | % | Ranking |
|-------|-----------|-------|----|----|--------------|-----|---------|
| | | A | B | C | | | |
| 1 | High | 3 | 6 | 12 | 21 | 35 | 2 |
| 2 | Medium | 6 | 16 | 13 | 35 | 58 | 1 |
| 3 | Low | 1 | 3 | - | 4 | 7 | 3 |
| Total | | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

Out of the cent percent response, 58 percent of the respondents were agreed that the current income tax rate is medium where as 35 percent of the respondents agreed on high tax rate and 7 percent of the total respondents were agreed on low tax rate. From the above table, it can be concluded that the current income tax rate is medium. Some respondents feel that the rate is not higher in absolute terms but it is higher as compared to taxpaying capacity of Nepalese people.

4.3.4 Sufficiency of Exempted Items of Income Tax

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

Table 4.17
Sufficiency of Exempted Items of Income

| Respondents Responses | Group | | | Total number | % | Ranking |
|-----------------------|-------|----|----|--------------|-----|---------|
| | A | B | C | | | |
| Yes | 4 | 18 | 10 | 32 | 53 | 1 |
| No | 6 | 7 | 15 | 28 | 47 | 2 |
| Total | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

There was 100 percent responses received from respondents out of 60 respondents, 32 respondents i.e. 53 percentage were agreed that the exempted items of income are sufficient whereas 28 respondents i.e. 47 percentage were disagreed about the sufficiency of exempted items.

Those respondents who gave [No] response about the sufficiency of exempted items of income were asked another question, "If no, what kind of incomes should be exempted?" It was requested to response in the blank orders. Most of the respondents did not response about it. Only few responses were received which are classified according to the code used in number-wise.

A. Tax experts

1. Provident fund
2. Life insurance premium
3. Export earning
4. Remote area allowance
5. Interest received from the government banks.
6. Awards and rewards.
7. Scholarship or
8. Rationale exemptions should be given to all kind of incomes.

B. Tax Administrators

1. Life insurance premium.
2. Citizenship investment fund.

C. Taxpayers

1. Over time allowance.
2. Retirement benefits.
3. Income of foreign employee.
4. Life insurance premium.
5. House rent.
6. Educational allowances for the children.
7. Electricity and water.
8. Medical expenses on the basis of bills.
9. Tiffin allowance.

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

4.3.5 Adequateness of Current Income Tax Exemption Limit

Finance act of Nepal yearly prescribes the tax rate and exemption limit of income. When the income tax introduced, tax rates and exemption limit are changing yearly. To know the respondent's view about the current exemption limit, a question was asked in yes or no answer as, "Do you think that the current income tax exemption limit is adequate?" The responses are as follows:

Table 4.18
Adequateness of Current Income Tax Exemption Limit

| Respondents Responses | Group | | | Total number | % | Ranking |
|--------------------------|-------|----|----|-----------------|-----|---------|
| | A | B | C | | | |
| Yes | 4 | 10 | 3 | 17 | 28 | 2 |
| No | 6 | 15 | 22 | 43 | 72 | 1 |
| Total | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

From the above table 4.18, it can be seen that the current income tax exemption limit is inadequate 43 respondents out of 60 i.e. 72 percent were against the adequateness of current exemption limit whereas only 28 percent of the respondents i.e. only 17 out of 60 were for the adequateness of current exemption limit. The respondents who were against the adequateness of current exemption limit was asked a question, 'If no, what exemption limit do you suggest for an individual and a couple or a family?' The responses were as follows:

Table 4.19
Suggestion of Exemption Limit for an Individual

| Respondents Responses | Group | | | Total number | % | Ranking |
|--------------------------|-------|----|----|-----------------|-----|---------|
| | A | B | C | | | |
| Rs. 140,000 | - | 2 | 3 | 5 | 12 | 3 |
| Rs. 150,000 | 2 | 4 | 4 | 10 | 23 | 2 |
| Rs. 200,000 | 4 | 9 | 15 | 28 | 65 | 1 |
| Total | 6 | 15 | 22 | 43 | 100 | - |

Source: Opinion Survey, 2010.

From the above responses about the exemption limit of an individual, it was found that 65 percent of the respondents in favour of Rs. 200,000 whereas 23 percent of the respondents suggested that the exemption limit should be Rs. 150,000 and 12 percent of the respondents suggested Rs. 140,000.

Table 4.20
Suggestion of Exemption Limit for a Couple or a Family

| Respondents Responses | Group | | | Total number | % | Ranking |
|-----------------------|-------|----|----|--------------|-----|---------|
| | A | B | C | | | |
| Rs. 175,000 | 1 | 3 | 2 | 6 | 14 | 4 |
| Rs. 190,000 | - | 2 | 5 | 7 | 16 | 3 |
| Rs. 200,000 | 2 | 5 | 5 | 12 | 28 | 2 |
| Rs. 250,000 | 3 | 5 | 10 | 18 | 42 | 1 |
| Total | 6 | 15 | 22 | 43 | 100 | - |

Source: Opinion Survey, 2010.

From the above table 4.20, it is clear that most of the respondents (i.e. 42%) suggested for Rs. 250,000 as exemption limit for a family. 28 percent of the respondents suggested for Rs. 200,000 also Rs. 190,000 and Rs. 175,000 suggested by respondents of 16% and 14% respectively. It can be concluded that most of the respondents are in favour of Rs. 250,000 as an exemption limit for a family. On the personal discussion with the respondents, the researcher found that more people were in support to provide income tax exemption limit equivalent to annual remuneration income of a government employed section offices.

4.3.6 Family Exemption Limit According to the Number of Dependents

Income tax act has provided exemption limit to a family. But it has not defined the number of dependents within a family. So, to know the opinion about the exemption limit of a family according to the number of respondents, a question was asked, "Do you agree that family exemption limit must be provided according to the number of dependent?" The responses were as follows:

Table 4.21

Family Exemption Limit on the Basis of the Number of Dependents

| Respondents Responses | Group | | | Total number | % | Ranking |
|--------------------------|-------|----|----|-----------------|-----|---------|
| | A | B | C | | | |
| Yes | 2 | 8 | 15 | 25 | 42 | 2 |
| No | 8 | 17 | 10 | 35 | 58 | 1 |
| Total | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

The above table 4.21 shows the response of respondents about the family exemption limit that must be provided according to the number of dependents. Out of the 100 percent response, 58 percent of the respondents disagreed whereas 42 percent of the respondents agreed that the family exemption limit must be provided according to the number of dependents. The majority of respondents of group A and B were disagreed but Group C were agreed on providing the family exemption limit according to the number of dependents. On the personal discussion, either of any group of the respondents having micro family were against on providing the family exemption limit according to the number of dependents due to their lowest exemption limit. But as a whole, it can be concluded that most of the respondents disagreed on providing the family exemption limit according to the number of dependents., Researcher also found that respondents were in favor to provide exemption limit to a family according to the number of dependents but it is difficult to execute because it is impossible to apply in real field.

Similarly, one question was asked to know the opinion of respondents or exemption limit that should be adjusted according to the inflationary situation of the country. The question was, "Do you agree that exemption limit should be adjusted according to the inflationary situation of the country?" The responses were:

Table 4.22
Exemption Limit According to the Inflationary Situation of the Country

| Respondents Responses | Group | | | Total number | % | Ranking |
|--------------------------|-------|----|----|-----------------|-----|---------|
| | A | B | C | | | |
| Yes | 4 | 17 | 20 | 41 | 68 | 1 |
| No | 6 | 8 | 5 | 19 | 32 | 2 |
| Total | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

The above table 4.22 shows that 68 percent of the respondents were agreed to adjust the exemption limit according to the inflationary situation of the country whereas only 32 percent of the respondents were disagreed about it. So it can be concluded that the exemption limit of a family or an individual should be adjusted according to the inflationary situation of the country. But this situation makes the tax administration more complicated and vague, rather every year's fiscal policy may give tax relief to accommodate inflation.

4.3.7 Opinion on Providing Exemption Limit on Agriculture Income

After commencing of Income Tax Act, agricultural income has been treated as taxable income in sometimes in a specific case and sometime as exempted income too. The new Income Tax Act has exempted agricultural income tax other than the income from company, or partnership, or corporate body, or through the land above the holding ceiling an prescribed in land act 2001. To know the opinion on it one question was asked as, "What is your opinion on exemption providing on agricultural income?" The following table gives the breakdown of responses;

Table 4.23
Exemption on Agricultural Income

| Responses | Respondents | | | Total number | % | Ranking |
|--------------------------------------|-------------|----|----|--------------|-----|---------|
| | A | B | C | | | |
| Yes, it should be exempted | 6 | 15 | 20 | 41 | 68 | 1 |
| No, it shouldn't be exempted | 2 | 6 | - | 8 | 13 | 2 |
| It should be treated as other income | 2 | 2 | 3 | 7 | 12 | 3 |
| Other, (if any, specify) | - | 2 | 2 | 4 | 7 | 4 |
| Total | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

From the above table 4.23, it shows 68 percent of the total respondents were in support to exempt the agricultural income whereas 13 percent of the respondents were against the exemption of agricultural income. Only 12 percent of the respondents were in favour to treat it as other income. The respondents who specified their responses as other were given the following suggestions;

- Certain area and the income of marginal farmers should be exempted.
- Based on subsistence farmer and commercial farming, for the first, it should be exempted.
- A practical arrangement for taxing agriculture should be formulated, for example, base on the size of landholding.
- Commercial agricultural income because there is a condition of not collecting land tax or revenue. On this condition, how can it collect the agricultural tax?

4.3.8 Sufficiency about the Itemized Deductions

Income Tax Act 2058 has provided different kinds of expenses as deductions. Some expenses are allowed for deduction as itemized deduction and some are standard deduction.

In order to know the attitude towards the item-wise deduction of expenses, a question was asked as, "Do you think that the itemized deductions are sufficient?" The responses were follows:

Table 4.24
Sufficiency about Itemized Deductions

| Responses | Group | | | Total number | % | Ranking |
|-----------|-------|----|----|--------------|-----|---------|
| | A | B | C | | | |
| Yes | 4 | 15 | 10 | 29 | 48 | 2 |
| No | 6 | 10 | 15 | 31 | 52 | 1 |
| Total | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

There was cent percent response received from the respondents. Majority of the respondents were against sufficient of itemized deduction of expenses. Except tax administrators, majority of tax experts and taxpayers were in against of itemize deduction of expenses from the above table, it can be concluded that there are insufficiencies about itemized deductions.

The respondents who were against the sufficiency about itemized deductions was asked another question as, "If no, what kind of other expenses should be deducted while computing taxable income?" The respondents were requested to write in the blank orders. Few respondents replied responses which are classified according to the code used in number wise.

A. Tax experts

- Repair and maintenance should be fully allowed there is no meaning of allowing only 7% of the depreciation base according to the existing provision.
- Special Economic Zones (SEZ) should be created and alternative tax administration, exemption allowed for industries, processing units; infrastructure development projects in such regions.

B. Tax Administrators

- Daily T.A. expenses from residence to business.
- Educational expenses.
- Traveling expenses.
- Delivery expenses.

C. Taxpayers

- House rent
- Educational allowance
- Medical expenses on the basis of bills.
- Tiffin allowance.
- Traveling allowance.

4.3.9 Sufficiency of Provisions Relating to Exemptions and Deductions

In order to know the sufficiency of provisions related to exemptions and deductions under the Nepalese Income Tax Act, respondents were requested to give their response in yes/no alternatives. The question was asked as, "In your opinion, are the provisions relating to exemptions and deductions under the Nepalese Income Tax Act sufficient in all aspects?" The responses received on it are tabulated as below:

Table 4.25
Sufficiency of Provisions Relating to Exemptions and Deduction
under the Nepalese Income Tax Act

| Responses | Respondents | | | Total number | % | Ranking |
|-----------|-------------|----|----|--------------|-----|---------|
| | A | B | C | | | |
| Yes | 4 | 18 | 5 | 27 | 45 | 2 |
| No | 6 | 7 | 20 | 33 | 55 | 1 |
| Total | 10 | 25 | 25 | 60 | 100 | - |

Source: Opinion Survey, 2010.

From the above table 4.25, it is seen that 45 percent of respondents were agreed whereas 55 percent of respondents were disagreed about sufficiency of provisions relating to exemptions and deductions under the Nepalese Income Tax Act. Form the above table, it can be concluded that majority of the respondents were against the sufficiency.

The respondents who gave negative responses about the sufficiency of provisions relating to exemptions and deductions under the Nepalese Income Tax Act the question was requested to give their responses on the blank order. The question was, "If no, in which aspects the improvements are needed?" The responses received

by the respondents for the improvement of different aspect of Nepalese Income Tax Act are as follows:

Group 'A' : Tax Experts

- a. Tax rates.
- b. Payment system.
- c. Income statement.
- d. Tax administration.
- e. Monitoring unit.
- f. Attitude of tax administration.
- g. Tax base should be enlarged.
- h. Tax laws.
- i. Exemption limit.
- j. First of all, business income should be brought into tax net, then tax should be imposed on the basis of level of income using multiple tax rates.
- k. All rental incomes of the landlords or in urban areas should be brought into tax net by determining the minimum rent that could be collected from the tenant by the house owner, excess of the rent should be taxed using appropriate rate.
- l. Depreciation allowance should be simplified.

Group 'B': Tax Administrators

- a. Tax laws.
- b. Accounting system.
- c. Specification of job of the department.
- d. Tax administration.
- e. Computerized system in all tax offices.
- f. Functional system.
- g. Simplify the language.
- h. Remove complicated provisions.

Group 'C': Taxpayers

- a. Language.
- b. Depreciation.
- c. Remuneration income.
- d. Tax administration.
- e. District wise tax offices.
- f. Exemption limit on the basis of market price.

g. Property tax.

From the above aspects for improvement, most of the respondents were suggested to improve tax law and language to be simplified they also focused to improve the tax administration too.

4.3.10 Suggestions about Income Tax in Nepal

Income Tax Act 2058, is better than earlier Income Tax Act 2031, but this new act is not free from weaknesses and vague and complicated language used. Thus a question was asked to give suggestions about income tax in Nepal. The question was asked as, "Do you have any suggestions about income tax in Nepal?" Only few respondents of all kinds of group have given the suggestions which are given below;

- The tax laws needs to be simplified, easily interpreted and understood by even a layman.
- Tax administration and assessment procedures are also required to be simplified and should be made taxpayers as friendly..
- Accessibility of the tax administration should be improved.
- Utilization of revenue takes vital role to revenue generation and voluntarily self registration and assessment.
- Public awareness is needed and political commitment and credibility should be necessary.
- Income tax act should facilitate people to pay tax by making honestly and friendly organization and employees.
- It should give focus on the area of taxation rather than high tax rate.
- Lowering tax rate and increasing tax base
- Increasing exemption limit.
- Motivating for self-compliance.
- Developing competence within tax personnel.
- Starting court cases to evading people/entity.
- Compulsory declaration of assets of each individual.
- Different privilege and nation-wise recognition must be given to the regular and high taxpayers and also should give for abroad visiting.
- Punishment should be given for not paying tax to the government.

4.3.11 Major Findings

According to the preceding chapters, some important findings can be drawn. These summary of this research study are summarized below:

1. The composition of the government revenue is internal revenue and external revenue. Internal revenue includes both tax revenue and non-tax revenue. Tax revenue is dominating to non-tax revenue of Nepalese government. The contribution of tax revenue shows the increasing trend which contributed 77.29 percent in 2001/02 on the total revenue and it was increased to 80.85 percent in 2010/11.
2. The total tax revenue, non-tax revenue and total revenue collected were Rs. 4,80136.44 million, Rs. 152792.8 million, and Rs. 724838.8 million respectively whereas average percentage collected tax revenue and non-tax revenue were 66.24 percent and 33.76 percent respectively during the study periods of 10 years.
3. The average collection of direct tax and indirect tax were Rs. 15000.95 million and Rs. 42204.15 million respectively, and the average percentage of direct tax and indirect tax on total revenue were 26.22 percent and 73.78 percent respectively during the study periods of 10 years.
4. The average tax collection in indirect tax viz. custom duties, excise duties and VAT during the study periods were Rs. 15773.7 million, Rs. 6903.6 million, and Rs. 19486.66 million respectively and average percentage on total indirect were 37.37, 16.36 and 46.17 percent respectively.
5. The average tax collection in direct tax viz. income tax, land tax and house and building registration during the study periods of 10 years were Rs. 11710.87 million, Rs. 3.51 million and Rs. 1951.53 million respectively whereas average percentage on the same were 78.07, 0.01, 13 percent respectively.
6. The average percentage of direct tax on tax revenue, GDP and total revenue were 26.22, 2.61 and 20.37 percent respectively during the study periods of 10 years.
7. The average percentage collection of income tax on direct tax, tax revenue, total revenue and GDP were 79.76 percent, 20.55 percent, 16.16 percent and 1.97 percent respectively during the study periods.

8. Nepalese tax revenue is the composition of direct and indirect tax revenue. But there is dominant role of indirect tax revenue in Nepalese tax revenue. The contribution of direct and indirect tax revenue were 25.80 percent and 74.20 percent respectively in 2001/02 whereas 28.95 percent and 71.04 percent in 2010/11. It shows that contribution of direct tax is increasing trend (i.e. 25.80% to 28.95%) whereas contribution of indirect tax is decreasing trend (i.e. 74.20% to 71.04%).
9. The tax revenue on GDP (i.e. tax/GDP ratio) of Nepal is not satisfactory. It has never exceeded 13 percent from 2001/02 to 2010/11. In 2001/02, the tax/GDP ratio was only 9.05 percent, which exceeded to 12.2 percent in 2010/11. This shows the increasing trend to tax/GDP ratio in slower pace.
10. Income tax is the composition of corporate income tax, individual income tax, and investment income tax. Corporate income tax is collected from government corporations, public and limited companies, partnership firms. Individual tax is collected from remuneration and industry, business and profession. Investment income tax is collected from dividend tax, interest tax, royalty tax, rent tax etc.
11. All incomes generated by an individual are not taxable income. because the minimum cost expenses required for living can not be taxed. So, from the commencement of income tax in Nepal, some extends of amounts are exempted from income tax. This extent is known as exemption limit. Income tax exemption limit in Nepal has been changing on the basis of time and condition. From the empirical studies, respondents have suggested to change exemption limit according to the inflationary situation of the country. In 2009/10, the exemption limit provided for an individual and for a family or couple were Rs. 115,000 an Rs. 140,000 and in 2010/11, that limit providing Rs. 160,000 and Rs. 200,000 respectively. The exemption limit is not provided or partnership firms, corporations and non-residents. From the view of respondents, most respondents suggested to increase exemption limit for individual and for a family or couple were Rs. 200,000 and Rs. 250,000 respectively.
12. The income tax rates and slabs have been changed radically in recent years. Personal income tax rates, which ranged from 7 percent to 60 percent in seven slabs in 1975/76, was reduced to only two rates i.e. 15 percent up to Rs. 75000

and 25 percent of the rest amounts in 2002/03. Similarly, the corporate income tax rate has been reduced from 60 percent in 1975/76 to 30 percent (For banking and financial companies and firms), 25 percent (for other including partnership firms) in 2002/03 and 20 percent (for special industries) in 2010/11.

13. In Nepal, the coverage of income tax base is low. Agricultural income is exempted from income tax. Exclusion of agricultural income from the tax net alone cuts out about half of the GDP. In the other hand, employment income is taxed more heavily than the capital income. Retirement amount received by Nepalese people being retired from the service by army or police of foreign country is also exempted from income tax. Such provision provides loopholes for tax evasion.
14. Income tax act has clearly mentioned the organizations, which are tax free which is called exempt Organization. Act has exempted a social, religious, educational or charitable organization of a public character registered without having profit motive.
15. Donation made to an exempt organization, approved by Inland Revenue Department (IRD) is allowed for deduction from taxable income. Deduction allowed for an individual or an entity will not exceed Rs. 100,000 or 5% of adjusted taxable income. However, the government of Nepal may prescribe, by a notification in the Nepal Gazette, as to allow full or partial deduction at the time of assessing income of the expense incurred for special purpose or donation given by the person. Here, the act has not defined "What is special purpose?"
16. Donation given to national political parties up to Rs. 10,00,000 before three months of election and donation given to Lumbini Development Fund and Pashupati Development Fund up to Rs. 10,00,000 is deductible expenses from taxable income. From the above provision it is clear that the donation given to political parties is allowed for deduction but it has not been able to solve the voice of people of 'transparency of donation amount given by business to political parties.'
17. For the purpose of calculating the income of person for an income-year from a business or investment, all the interest expenses are allowed for deduction. But in the case of an exempt-controlled resident entity, it can deduct the

amount of interest but not exceeding the sum of all the interest derived by the entity during the year that is to be included in calculating the entity's taxable income for the years and 50 percent of entity's taxable income for the year calculated without including any interest derived by the entity or deducting any interest by the entity. It is an unlawful step to business which is not getting the deduction of full amount of interest. Here a controversial condition exists between the law of banking and law of income tax because law of banking says that the interest must be paid to bank but the law of income tax does not give the deduction of full amount of interest for an income year.

18. For the purpose of calculating a person's income for an income-year from any business, no deduction is otherwise allowed for the cost of trading stock except the allowance determined by subtracting the amount of closing value of trading stock of the business from the opening value of trading stock plus the cost of trading stock of the business acquired by the person during the year.
19. For the purpose of calculating a person's income for an income year from any business or investment, there shall be deducted all costs to the extent incurred during the year in the respect of the repair or improvement of depreciation assets owned and used by the person during the year in the production of the person's income from the business or investment. But the deduction allowed should not exceed 7% of the depreciation basis of the pool at the end of income year and the deduction shall be allowed with respect to cost in the order to which they are incurred. Any excess cost, or part thereof, for which deduction is not allowed shall be added to the depreciation basis of the pool to which it relates in accordance. The provision of adding any cost or part thereof to the depreciation basis amount is not contextual and lawful provision because it shows that the repair or improvement cost of a depreciable assets has not got full approval. In the other hand, the tendency of carrying forward of this cost will increase the income tax revenue of the government in some content but it will not bring the cordial relationship between the taxpayers and the government.
20. All the costs made on pollution control by a person during the year in conducting the business are allowed for deduction. But the expenses shall not exceed 50% of the person's taxable income calculated without deduction for

pollution control costs. Any excess costs, or part thereof, for which a deduction is not allowed shall be capitalized and may be depreciated in accordance. Here, the government has a will of controlling pollution and then protection of environment but has not spent a little bit money on it. In the other hand, all the expenses made by the business to control pollution is not allowed for deduction and has made a standard limit for it. So, it is not a good symptom of pollution control.

21. All the expenses made on research and development by a person during the year in conducting the business are allowed for deduction. But the deduction allowed shall not exceed 50% of the persons' tax income calculated without a deduction for research and development costs. Any excess, or part thereof for which deduction is not allowed shall be capitalized and may be depreciated in accordance. Researcher is an instructor of development. For successful industrial development research and development is more important and must be expended on it. Expenses made on it must be approved and should be allowed for deduction for tax purpose. But the provision of income tax has not given full deduction on it. It is a myopic vision of government.
22. Depreciation of depreciable assets owned and used by the person during the year in the production of person's income from the business or investment allowed for the deduction. But the following provision shall be applied in respect of the depreciation of the machines, equipment and other machinery installed in the electricity projects that are involving in building power station, generating and transmitting electricity and in the projects conducted any entity so as to build public infrastructure own, operate transfer to the government. In case where the old machines, equipment and other machinery that are already installed require replacement in any income year as they are out of order due to being too old, the balancing value of the old machines, equipment and other machinery remained after subtracting the depreciation up to the year from their cost shall be allowed as expenses for the year.

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

Rates of depreciation are far from reality because there is no specific estimation provision of real age of assets and depreciation rate in Nepal. In the other hand, there is no any specific provision of depreciation of assets, which are taken in lease and installment payment basis. It shows a weak point of new Income Tax Act.

23. Any unrelieved loss of the year incurred by the person from any other business and unrelieved loss of the previous 7 years incurred by the person from any business are allowed for deduction. In the case of electricity projects involving in building power station, generating and transmitting electricity and the projects conducted by an entity so as to build public infrastructure, own, operate and transfer (BOOT) to government, entity conducting petroleum business under Nepal Petroleum Act 2040, and losses can be deducted up to next 12 years. Carry forward of losses for 7 years is not sufficient to encourage the business for taking risk. The provision of carry backward is also thoughtful because the accounting system of Nepal is not so standard to apply this provision.
24. A person whose annual turnover for an income year exceeds Rs. 20,00,000 is not allowed for deduction for a cash payment exceeds of Rs. 50,000 incurred at once other than in the following conditions by the person during the year the payment made to the government, a constitutional body, a corporate owned by government of Nepal, a bank or financial institution. A farmer or producer producing primary agricultural products even in the case where the products is primarily process by the farmer himself, a retirement contribution or retirement payment, is an area where banking services are not available in cash or on a day when banking services are closed or into a bank account of the payer. It means that the payment made with an ignorance will not get full approval as an expense, for the purpose of tax calculation, these amount should be added back.
25. An opinion survey was conducted in order to find out the various aspects of income tax. From the opinion survey of various respondents (i.e. tax experts, tax administrators and tax payers), the following findings have been drawn as;
 - I. The contribution of income tax to national revenue of Nepal is not satisfactory. Most of the respondents of all codes (A, B, C) were disagreed that contribution of income tax to national revenue.

- II. Income tax rates of Nepal are considered as medium. Most of the tax experts and tax administrators were agreed that the income tax rates are medium whereas most of the taxpayers were agreed on high income tax rate.
- III. The exempted items of income are sufficient.
- IV. The current income tax exemption limit is not adequate, most of the respondents were suggested to provide Rs. 200,000 and Rs. 250,000 as exemption limit for an individual and a family respectively.
- V. The family exemption limit must not be provided according to the number of dependents.
- VI. The exemption limit should be adjusted according to the inflationary situation of the country.
- VII. Agricultural income should be exempted from income tax.
- VIII. The itemized deductions are not sufficient.
- IX. The provisions relating to exemptions and deductions under the Nepalese Income Tax Act is not sufficient in all aspects. Improvements are needed in languages, tax rates, laws, tax administration, exemption limit, tax base, payment system etc.

CHAPTER-V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 SUMMARY

Developing countries like Nepal needs huge capital investments for development process, which can be fulfilled by tax sources, nontax sources and foreign grants and loans.

Taxes can be classified into direct and indirect tax. Income tax is the most popular direct tax. Within the income tax exemptions and deductions are more important. There are many problems in income tax practice in Nepal such as leakage in tax, feeling of people about tax as a penalty, lack of consciousness of people etc.

Modern economic development of Nepal was started with the initiation of first economic planning in 2013 B.S. Nepal has introduced its first tax act in 2031 B.S. and in 2058 B.S named Income Tax Act (as amended by finance ordinance 2061).

Total revenue in Nepal is composed of tax and nontax revenue. First budget of Nepal (2051/52) shows that 73% revenue was from nontax sources and land tax. After that it declines every year. In 2010/11, the share of non-tax revenue was 19.14 % of total revenue as compared to 22.71 % in 2001/02.

Tax revenue is the sum of direct and indirect tax. Record shows that there has been simultaneous increase in direct tax, indirect tax and the total tax revenue in absolute term. There was 25.80% and 74.20 % share of direct tax and indirect tax simultaneously in 2001/02. It increases in 2010/11 to 28.95% and 75.22%. It is same in contribution of total revenue on GDP also. It has increased from 11.71% to 14.8% as compared o 2001/02/ and 2010/11.

Nepalese tax revenue is dependent mainly on taxes on international trade and sales tax/vat on goods and services. He major components of indirect tax in Nepalese tax structure contributes are custom duty, excise duty, Vat etc. there was 31.84%, 19.06% and 49.08% contribution on indirect tax of customs excise and vat simultaneously.

Under the income tax act 2058; tax was levied 15% to those who have Rs 120000 and 25 % to those who have Rs1200000 turnover from any kind of business in a year. It is Rs 160000 for individual and Rs 200000 for couples in 2010/11. It has

also classified income to Business, Employment and Investment and its exemptions and deductions.

Income from Business such as; service charges, disposal of business etc. Incomes from employment like any wages, salary leave pay any personal allowances etc. And investment income such as any dividend, interest, natural resources payment etc.

5.2 Conclusions

Developing countries like Nepal is facing serious problems in the process of economic development. Lack of sufficient financial resource and its efficiency is the main constraint for economic development of Nepal. Sufficient funds are required to meet the objectives of economic development. But, Nepal has not been able to collect necessary funds or revenue. Due to poor performance on internal revenue collection and its mobilization, Nepal has been heavily relying on foreign loans and grants. Thus the dependence is increasing day by day, which is not desirable for any economy. Thus, it is the most necessary to mobilize the internal fund or revenue to the optimum level.

To increase the government internal revenue, Nepalese government is trying to extract money from people through taxation. Within tax, income tax is the most important source of government revenue, which is considered as a good remedy to cure growing resource gap in Nepal.

In Nepal, the history of income tax is not so long. It was started only on late fifties. The income tax was introduced as a trial on business profit and the remuneration income. The first elected government levied the first income tax and no specific act was made to define and treat income tax. The first income tax act was introduced only in 1959/60, since then four income tax acts has been implemented. From the very beginning the concept of exemptions, deductions and other forms of tax relief in income tax have emerged in Nepal. All incomes of an individual can not be taxable income because the minimum cost required for subsistence can not be taxed. The exemptions, deductions and other forms of tax relief are essential to encourage an individual to work more. The tax relief works as an incentive to an

individual. So, the concept of exemption, deductions, and tax reliefs were emerged in Nepal from the very beginning of income tax.

Exemption limit and the rate of the income tax is determined according to the income level and sector wise but has not been adjusted according to the inflationary situation of the country and number of dependents.

Income tax system of Nepal has been blamed as being inefficient system. Being various problem relating to income tax, revenue collection from income tax is low as compared to other developing countries like India, Sri Lanka, Pakistan etc. Nevertheless, if the data are analyzed relating to it, it is found that it is neither bad nor worse but it is has been continuously improving. However, income tax laws and administration in Nepal are to be deeply scrutinized and properly implemented. The provisions made on the act have to be mentioned clearly and language has to be made clear some reforms in tax administration are needed. If the problems relating to income tax system in Nepal can be solved and resources are effectively utilized then only the prospects of revenue collection through income tax will be effective and bright and the economic development of Nepal will be achieved.

5.3 Recommendations

As earlier described, there are various problems regarding to income tax of Nepal. The existing tax assessment procedure is also unsound and inefficient. The major causes of being unsound and inefficient tax assessment procedure are weakness in governments economic policy, lack of public participation, complicated tax laws and provisions, lack of trained and competent employees etc. In the opinion survey, it was noticed that most of the respondents were dissatisfied with the government economic policy and lack of public participation. The study mostly focused into the problems that are related to exemption and deduction. So, the recommendations made for other than the exemptions and deductions may have been considered as the general recommendations. Hence, the research of the study has made the following recommendations on tax exemption and deduction.

Exemption:

1. To increase the income tax revenue, the present tax base must be widened by including the incomes from agricultural sector, retirement amount received by Nepalese people being retired from the services by army or police of foreign country and currently exempted other sources income.
2. In the agricultural income, there should be some exemption limit and the income above this limit should be taxed.
3. The present provision of an individual and a family exemption limit are not appropriate. It should be raised to a minimum of Rs. 200,000 for individual and Rs. 250,000 for a family.
4. The exemption limit should be adjusted according or the inflationary situation of the country of yearly basis.
5. There are many provisions relating tax exemptions and concessions. Some concessions granted to achieve certain objectives are not effective,. Tax concessions encourage the establishment of industries in certain areas but they vanish or change names, ownership or place the business when the concession facility expires. The incentives provided to special industries are not effective. Such kinds of concession do not encourage to open the industry in remote areas,. For the purpose of industrial development of remote area, a separate special package should be introduced.

6. Few percentage of tax rebate should be provided to the taxpayers who submit true income statement within the specified period of time.
7. Income tax on total export amount is not appropriate because income tax should be based on income not on the total amount. So, the provision of taxing on export income should be introduced. Similarly, export fee on export transaction should be eliminated or exempted.
8. Double taxation on dividend should be eliminated.
9. Income Tax Act has mentioned the organizations, which are tax free (exempt organizations). Act has exempted a social, religious, educational or charitable organization of a public character registered without having profit motive. In the case of non-transparent private business like boarding school, NGO's or other entitles, where profits are earned, but for the sake of tax planning, is called retained earning or something else. So, they should new taken into tax net.
10. Retirement Contributions are nothing else than the product of sacrifice of present earnings. There are the bases for living standard of oldness of employees. So, they should be excluded from income tax.
11. Dearness allowance is given to meet the living standard of employees, it is not lawful to include in taxable income. So it should be fully exempted from income tax.
12. The provision of special fee must be eliminated.

Deduction:

1. Donation given to a political parties registered with the election commission is allowed for deduction. But it has not been able to solve the voice of people of 'transparency of donation amount given by business men to political parties'. So, donation amount given to political parties should be transparent.
2. Deductions allowed from an employment income are not sufficient. So, the following deductions should be provided to the tax payers whose sources of income is only the remuneration.
 - a. Expenses for better education of their children.
 - b. Medical expenses made by taxpayers.
 - c. Expenses made for house rent.

- d. Educational expenses for taxpayers himself if he is still studying in an educational institution.
 - e. Life insurance premium.
 - f. Pregnant delivery expenses for certain limit.
3. Clear provisions should be made in the case of deduction. All the items of deductions should be clearly defined in the act.
4. Deductions allowed from business or investment incomes are not sufficient. So the following deductions should be provided to the taxpayers. Whose source of income is business or investment.
- a. In the case of exempt controlled resident entity, full deduction of interest expense is not allowed. It is not lawful step to the businessmen who operate the business with loan or debt amount. So, it should be full allowed for deduction within an income year.
 - b. The provision of adding any excess lose or part thereof repair and improvement costs to the depreciation basis amount is not contextual and lawful provision because it shows that the repair or improvement cost of a depreciable asset has not got full approval or deduction. So it should be fully allowed for deduction within an income year.
 - c. To control pollution and protection of environment, environmental protection is more essential and should be expended on it, expenses made on it should be approved and should be fully allowed for deduction within an income year. Act should not make standard limit on it.
 - d. For successful industrial development, research and development is more essential and should be expended on it. Expenses made on it should be approved and should be fully allowed for deduction within an income year. Standard limit on it should not be made.
 - e. There should be specific provision of depreciation of assets, which are taken on lease and installment basis. Act should not be silent on it. Provisions made on depreciation allowances should be generally understandable by all people.
 - f. Carry forward of losses for 7 years is not sufficient as compared to other countries. So, it should be extended up to 8 or 9 years. The provisions of carry backward of losses should be considered because

the accounting system of Nepal is not so standard to apply this provision.

Besides this recommendation, the following recommendations are made to compensate the loss of revenue due to the provision of additional exemption and deductions recommended by the researcher;

1. The income tax policy should be formulated so as to match with the economic policy of the country.
2. The members involved in formulating income tax policies must have deep knowledge about income tax.
3. Timely revision and adjustment should be made in the matter of income tax policy.
4. Income tax policy should be formulated so as to satisfy the following criteria:
 - a. It should be progressive ensure social justice.
 - b. It should be consistent with tax administration capacity.
 - c. It should not mitigate against national priorities and efficient resource use.
5. The success or effectiveness of any system entirely depends upon implementation of provisions, which is the major responsibility of administration. In Nepal, one of the most important reason to be unsound income tax system is inefficient and unscientific income tax administration. The following recommendations are made for the improvement of income tax administration in Nepal:
 - a. All the tax personnel should be given comprehensive training on various aspects of taxation on regular basis. For this, a separate training section within tax department should be established.
 - b. The performance, responsibilities, authorities and duties should be clearly defined.
 - c. Financial benefits and extra incentives should be provided to the personnel to decrease corruption.
 - d. Effective reward and punishment system should be established.
 - e. Working environment of the tax offices should be improved, other facilities should be provided.

- f. The administration should try to increase effective public participation to minimize the income tax evasion.
 - g. Income tax experts/profession should be increased in tax administration.
 - h. Coordination between staffs and departments should be established.
 - i. Delays in assessment should be reduced as soon as possible.
 - j. Fair and scientific provision of promotion and carrier development should be introduced.
 - k. The cost of revenue collection is one of the determinant of administrative efficiency. So, the concerned authority should pay due attention on it.
 - l. An integrated information system should be developed to prepare the list of potential taxpayers and gather information of various aspects relating to income tax.
 - m. The system of recording by computer should be developed in income tax administration.
 - n. Tax education should be provided to taxpayers on regular basis.
6. Laws relating to income tax should be clear, simple and comprehensive, it should not contain any loopholes and ambiguity; therefore it should be reviewed frequently and reformed. The following recommendations made for the reformation of existing tax laws in Nepal as;
- a. The language should be simple and clear. In spite of using the vague meaningful words, clear cut provision should be undertaken.
 - b. The definition made in Income Tax Act should be further clarified and well defined.
 - c. The assessment and tax collection provisions should be made clear and simple.
 - d. The provision of fines, penalties and punishments should be made at higher rate for income tax evaders.
 - e. The assessment of time limit after the submission of income statement should be reduced.
 - f. Discretionary power of the tax officers should be curtailed and their rights and duties should be clarified in Income Tax Act.

7. The reward, prize, incentives provisions should be introduced in the act to encourage the taxpayers to pay tax voluntarily rather than coercive measures.
8. Clear provisions should be made in the case of deductions. All the item of deductions should be clearly defined in the act.
9. There should be compulsory provisions of auditing.
10. The administrative should pay great attention to bring the income from house and land rent, doctors clinic, consultancy services, tuition center etc into income tax net. In these sectors income tax has been highly evaded.
11. Unnecessary political and outsiders pressure should be avoided.
12. The provision of tax deduction at source and advance payment to tax should be extended to different source of income as far as possible.

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