

CHAPTER-1

INTRODUCTION

1.1 General Background:

Nepal is a small country situated between two large countries India and China. It has its own problems and prospects. Although being rich in natural heritage and bio-diversity, they are in under utilization. Primitive and orthodox society with conservative norms, values and institution exists there in. The per-capital GDP after adjusting the population growth is estimated to Rs. 30750 (equivalent to US dollar 410).

Nepal's economy is predominantly based on agriculture. Out of total population, 81 percent is based upon agriculture which contributes about 39 percent to the total GDP. Agriculture is the major supplier of raw materials to industries. Main obstacle to economic development of Nepal is vicious circle. It explains the economic backwardness. The basic vicious circle stems from the fact that Nepal's total productivity is low due to deficiency of capital, market imperfections, and economic backwardness and under development.

In order to reap advantage from the improved trends in the global economy and to sustain economic growth at a higher level, Nepal needs to undertake a flexible and appropriate structural reform measures.

"There has been negative impact on overall production, supply, price, deposit mobilization, credit disbursement and implementation of development projects due to several problems emanating from conflict and unfavorable security situation. Those problems are like massive destruction of physical infrastructure, slackness in private sector investment and

development expenditure, bank and cooperatives heading towards closure or merger and obstruction in the operation of NGOs and INGOs which are greater number, and unpredicted closures and blockades and so on. Also, there has been growing pressure on urban migration in a bid to move to suffer places clearly reflected in declining rural self-employment. Therefore, the foremost challenge today is to address conflict through dialogue based on national consensus and regain momentum in the overall economic development of the country.” [Economic Survey [Pant, 2003/2004:16].

The interim constitution of Nepal has clearly directed Nepalese government for a self reliant economic system, encouragement to national enterprises, prevention of economic exploitation as well as upgrading the standard of the people.

For self sustain, government must be able to generate sufficient government revenue which is most important source of financing. Through the proper administrative strategy, the national objective can be achieved.

For the self reliant economic system and sound infrastructure, government should generate sufficient public revenue. Since, public revenue is the income of the government. To meet the public expenditure, government collects fund through external and internal sources.

“Government revenue has grown by an average of 18 percent during the nineties. As a percent of GDP, government revenue increased from 8.8 percent in 1985 to 11.3 in 1996. Due to low level of revenue surplus, development financing of the government continues to be highly dependent on foreign aid. The share of foreign aid in development expenditure stood high, at approximately 55 percent in the nineties. The share of loan in total foreign aid has been growing and external debt of the country has increased from 2 percent of GDP in 1975 to 56 percent in 1996. Apart from the government sector, there are a number of non government organizations injecting financial resources into the economy. The financial investment of the

NGOs and INGOs stood as high as Rs. 11 billion in 1995, which is more than one-tenth of the total government expenditure in the social sector. Tax revenue accounts for around four-fifths of the total revenue. The most outstanding characteristics of Nepal's tax systems is its heavy dependence on indirect taxes and rigidity in its structure. Indirect taxes contribute more than 80 percent of the total tax revenue" [Pant, 2004:39].

Since, being a major source of fund collection of tax should be more flexible to achieve maximum social and economic objectives. Collection of tax helps in redistribution of economic means by the transformation of wealth from person with higher economic level to lower economic level.

Regional economical imbalances may also be reduced by providing incentive and concessions in income tax for promoting industries in backward areas. It has become an effective instrument to ensure balanced socio-economic growth [Siwakoti, 1987].

Beside these, following points should be considered while collecting tax:

- How much purchasing power of tax payer has been received?
- Whether tax payers are not feeling burdensome?
- Is there any reduction in consumption of goods?

Although the legal provision is made and updated timely, there are many problems exist in income tax practice in Nepal. The leakage in tax, feeling of people about tax as a penalty, payment of additional fees, lack of consciousness of people, inability of tax administration to cover the new tax payer within the tax portfolio, delay in tax assessment and collection, lack of accuracy and uniformity in accounting system, high cost of tax collection are some examples of those problems.

Having all these existing reasons, tax administration in Nepal must be reviewed. Tax administration is the wheel of whole tax system. It gives right direction to the government and country.

1.2 Focus of the Study:

The study is focused to analyze the structure of income tax and its administration aspect. The main focuses of the study are on the following aspects of income tax in Nepal.

- Effectiveness of tax revenue collection.
- Structure of income tax.
- Contribution of income tax to the total revenue.
- Role of tax administration in tax collection process.

1.3 Statement of Problem:

After 1980, Nepal has followed a liberal and open market economy. Social and economic development is not sufficiently reached at target point as it has a small economy with limited resources and political instability. All of those unfavorable features help to draw back the country. There is a gap between planning and its execution. Thus, policies and strategies have been largely ineffective. Dependency over foreign aid is dramatically increasing so the deficit of budget is at a pick level. In recent year, the budget provision of debt servicing has reached around Rs. 24 billion which are paid by the taxes money and it is around 25% of annual revenue, it is alarming signal. Pattern of foreign assistance is now changing their slogan from “**no business**

but assistance” to “no assistance but business”. Due to this reason, the increasing foreign aid is harmful from the prospective of national interest. To face with this problem government needs to increase internal source of finance.

It is known that increasing funds from internal source is not an easy task, particularly when business economy in itself going backward. There is another problem i.e. inadequacy internal sources in itself. To increase internal sources of finance, a sufficient resource is needed in the hand of government. There are various ways of rising internal resources like taxation, internal borrowing etc.

If we look at a glance to the budgetary system of Nepal, we can found a significant resource gap. Resource gap is the difference between total expenditure and total revenue. The financial expenditure of the GON has been increasing at a faster rate that increases in revenue. Every year, the resource gap is increasing at a faster rate due to the slow increase in the rate of revenue to fulfill the expenditure requirement, owing to the inefficiency of tax administration and incomprehensive tax act.

The resource gap is fulfilled by internal and external borrowing. There is dominant role of external resources to fulfill the gap. However, it may push in trap the economy of the country as it creates extra burden to the economy because debt servicing charge increases every year. Thus, the internal resource mobilization should be cared into mind to decrease vast level of external loans and grants.

Out of total internal resources, revenue collection from income tax plays important role. Past trend has proved that the income from taxation has not been effective. As, the income tax administration of Nepal has been blamed that it is not efficient. There are many advantages of income tax collection as revenue. Some examples are:

- Only capable tax payers are needed to pay the tax.
- Income tax is levied on progressive way.

Further in connection to Nepal, income tax is not able to make vital role for economic development of the country. The main reasons behind it are as follows:

- a. Nepalese people do not support the tax officials by giving their true information regarding tax evaders.
- b. Richer Nepalese people have lack of tax paying habit and tax consciousness.
- c. The tax evasion and avoidance habit is increasing day by day due to low standard of education for tax responsibility to tax payers.
- d. Tax structure of Nepal is biased towards indirect taxes.
- e. The tax act and other related acts, rules, regulations and policies create complexity for calculation of tax.
- f. The successful implementation of income taxation in Nepal is limited by its narrow coverage and base, inefficient administration, corrupt bureaucracy.

In connection to these points, various problems regarding tax administration are:

- A. Failure to locate new tax payers.
- B. Failure to record proper accounts and records.
- C. Assessment delays.
- D. Collection delinquency.
- E. Poor tax payer compliance.
- F. Problem of evasion and avoidance.
- G. Defective personnel management:-
 - Defective selection of personnel.
 - Lack of efficiency in tax personnel.

- Poor taxing opportunities.
- Lack of motivation in tax personnel.
- Lack of integrity in tax personnel.
- Defective organizational arrangements.

1.4 Objectives of the Study:

The major objectives of this study are as follows:

- i. To evaluate performance of income tax and its share in total tax revenue.
- ii. To analyze the tax administration system in Nepal.
- iii. To study the effectiveness of tax administration in Nepal.
- iv. To provide suitable recommendations for improving current scenario of income tax administration.

1.5 Significance of the Study:

Income tax plays significant role in the overall economic development in developed as well developing countries. It occupies a very important role in overall tax structure. The role of income tax is gradually increasing in the world because of economic betterment of countries.

Nepal is one of the lowest taxed economics in the world as its tax/GDP and tax/GNP ratios are the lowest among SAARC countries and among the rest of the world as well. This shows poor performance of tax management in Nepal. The portion of indirect tax is greater than direct tax. However it should be just reverse for economic welfare. The role of income tax should not be minimized in Nepal. It may also be useful instrument to measure the life standard of people. But the income tax administration of Nepal is suffering from various problems. The main problems of tax administration of Nepal are inappropriate tax policies, administrative bottlenecks of direct tax structure and existence of mass poverty. So, to identify the problem

and to overcome them for improvement of existing level of tax administration, studying it is must.

Again, as being very much important role of income tax in economic development, to study it thoroughly is needed. Because it gives a plus point for policy maker as the research has supposed to become milestone for them. Though, a bit attention has been seemed towards the subject matter, those are not being sufficient to through the light upon our subject matter. All of these reasons have pushed to select the topic as tax administration in Nepal with making special reference to income tax.

1.6 Hypothesis of the Study:

For the achievement of the objectives of the study, following hypotheses have been posed:

Hypothesis: 1

$H_0: \mu=0$, There is no significant relationship between the views of tax administrators and tax payers with respect to the poor performance of Nepalese income tax system.

$H_1: \mu \neq 0$, There is significant relationship between the views of tax administrators and tax payers with respect to the poor performance of Nepalese income tax system.

Hypothesis: 2

$H_0: \mu=0$, There is no significant relationship between the views of tax administrators and tax payers with respect to the causes of inefficient tax administration of Nepal.

$H_1: \mu \neq 0$, There is significant relationship between the views of tax administrators and tax payers with respect to the causes of inefficient tax administration of Nepal.

Hypothesis: 3

$H_0: \mu=0$, there is no significant relationship between the views of tax administrators and tax payers with respect to the difficulties and complexities in tax administration after implementing ITA, 2058.

$H_1: \mu \neq 0$, There is significant relationship between the views of tax administrators and tax payers with respect to the difficulties and complexities in tax administration after implementing ITA, 2058.

1.7 Limitations of the Study:

There are some limitations regarding this study, which are as follows:

- The extent of this study is based on the availability of reliable data and sufficient literature.

- The primary data is collected as a field survey (opinion survey) within Kathmandu valley due to time, budget and other constraints.
- This study has tried to cover the data relating to income tax structure of past 5 years i.e. from fiscal year 2004/05 to 2008/2009
- This study is limited to Nepalese laws, rules and regulations to the income tax.

1.8 Organization of the Study:

This study has been divided into five chapters via:

Chapter 1: Introduction:

It contains introductory aspect of the study e.g. general background, focus of the study, statement of the problem, objectives of the study, significance of the study, hypothesis of the study, limitation of the study etc.

Chapter 2: Conceptual Framework & Review of Literature:

This chapter contains two parts i.e. conceptual framework of the selected topic and review of literature. The conceptual framework contains theoretical aspects of tax and administration individually, tax from different perspective, concept, significance and essential functions of tax administration. It again contains review of literature of previous researchers on the relevant subject matter.

Chapter 3: Research Methodology:

It includes research design, population of sample, sampling procedure, source of data, procedure of data collection, data processing procedure and analysis tools, rank correlation coefficient, testing of hypothesis.

Chapter 4: Presentation and Analysis of Data:

This chapter has two parts. The first one is concerned with analysis of secondary data and second one is concerned with primary data. Analysis of secondary data contains tax and non tax revenue in Nepal, structure of government revenue in Nepal, tax/GDP ratio in Nepal and revenue collection of IRD – A comparative study, structural condition of income tax. The second part is about analysis of empirical study.

Chapter 5: Summary, Conclusions and Recommendations:

It is designed for summary, conclusions and recommendations based as the study.

CHAPTER-2

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1 CONCEPTUAL FRAMEWORK

2.1.1 Tax:

In simple terminology, tax is a liability to pay an amount to the government. It is compulsory contribution to the national revenue. To get specific definition of tax, it can be cleared from an example. If a person is levied on its business income by government, then it becomes tax which is to be paid by the person to the government. But if the person is charged certain amount for keeping a gun for a specified time period, then it does not becomes tax. It is just a special fee to extent his personal benefit not for national interest. When a state levies tax, it is to be collected compulsory and tax payers are compelled to pay. Taxpayer is not benefited directly. Tax is a monetary contribution paid to the government.

2.1.2 Tax and Efficiency:

A tax except in the form of a lump sum levy reduces the consumer's welfare in two ways: directly through a transfer of resources from him to the government and indirectly through a rise in the consumer prices of taxed commodities relative to those of non-taxed ones. The former produces a (direct) income effect while the latter gives rise to both an (indirect) income effect and a substitution effect in the standard manner following a relative price change.

The efficiency loss of a tax refers to the excess of the reduction in the consumer's welfare above and beyond that which can be accounted for by income loss due to payment of the tax. For this reason, the efficiency loss is usually referred to as the excess burden of the tax.

2.1.3 Tax and Equity:

Equity is one of the main issues in taxation. Equity means distribution of income, wealth and /or other variables of interest equally. A possible way to give concreteness to the meaning of equity is to interpret it only in the context of redistribution. Equity issues in taxation are generally examined under the two complementary rubrics of horizontal equity and vertical equity. The former calls for the equal tax treatment of equal individuals while the latter calls for the unequal tax treatment of unequal individuals.

2.1.4 Types of Tax:

Tax may be of various types. The rate and nature of tax may be different as economists have classified the tax from different angles. They have given a very long list of the types of tax. But on the basis of impact and incidence the tax may be classified into two types:

- Direct Tax
- Indirect Tax

A direct tax is really paid by the person on whom it is legally imposed. Direct taxes are levied on the income and property. The direct taxes have been used to bridge the gap of income and wealth inequality in the society. An indirect tax is imposed on one person but paid partly or wholly by another. Indirect taxes are generally imposed on consumption of goods and service. The taxes on such goods and services are integrated with their price. Selling those goods and services on higher price, the tax payers easily transfer the burden on general consumers. [Kandel, 2003:6]

2.1.5 Income Tax:

Income tax is a direct tax that is imposed on the earning of individual and corporation. Actually, tax levied on the taxable income is known as the income tax. It is charged by the government on the income of the previous year at the rate prescribed each year by the finance act. From very earlier, income tax has always been regarded as a tax based on the canon of ability. The tax could be adjusted as to exempt the lowest income groups from the operation of the tax and make the richer groups bear the burden of tax according to their income. Tax economists have a view that an income tax is a levy imposed upon the income of an individual after the exemption limit. All incomes above the tax exemption level are subjected to income tax that is based on the income tax act of the concerned country.

2.1.6 Administration:

Certain established practices and techniques in society are recognized as constituting the field of administration. Those administrative practices and managerial techniques enable the various organizations of a society – its governments and business enterprises, its social clubs and labor unions to fulfill their responsibilities and to execute their programs. The majority of authors agree that administration plays an important role in society. But while they agree on the importance of administration, they assign to the subject different degrees of significance.

Henry Fayol believes that the administrative process is universal, that its existence is percentage wise the most element in particularly all vocations and professions. So, there is widespread need for the scientific study of administration. While Paul Pigars feels that the main purpose of administration is to preserve the status quo in society. Brooks Adam regards administration as a more important, indeed as the most important human facility because its function is to facilitate social change and to cushion the stock of social

revolution. James Burnham contends that the administrators or managers of society have appropriated so much power that the decisive revolution has already arrived, neither fascistic nor communistic revolution, but managerial. Charles E. Merriam regards administration as the evolution of another human technology leading to man's adaptation to his complex environment. Charles A. Beard believes that administration is the key science of contemporary civilization.

2.1.7 Tax Administration:

Tax administration is regarded as a tool for including some responsibilities for determining the policies and the programs of government related to tax. Especially it is the planning, organizing, directing, coordinating and controlling of government organization related to taxation. The shape of tax system in practice is determined to a great extent by the way it is administered.

The main objectives of tax administration should be the efficient assessment, collection and enforcement of taxes legally due, without undue cost and harassment to the government or taxpayer in terms of money, time, inconvenience and mental worry. More specifically, the objectives of tax administration may be stated as follows:

1. To assess and collect taxes in order to meet the revenue requirements of the country.
2. To facilitate and encourage voluntary compliance by taxpayers.
3. To deter tax evasion and avoidance.
4. To maintain public confidence in the fairness and integrity of the tax system.
5. To administer tax legislation fairly, uniformly, impartially with firmness.
6. To keep high the morale and motivation of tax officials.
7. To work efficiently in order to make the tax system effective.

2.1.8 Significance of Tax Administration:

Tax evasion and tax avoidance, whether at the national or international level, violate the principle of fiscal equity and undermine the concept of voluntary tax compliance, that is, the timely filing and reporting of required tax information, correct self-assessment of taxes due and their timely payment without resource enforcement action.

Tax evasion is normally considered to occur when non compliance is the result of a willful and conscious failure to notify the taxing authorities of taxable assets or income activities giving rise to taxable income, a deliberate failure to pay taxes legally owed or use of fraud to conceal the existence of taxable income and/ or obtain allowances or the repayment of taxes. Tax avoidance on the other hand, a less precise concept, is generally in such a way as to take advantage of weaknesses or ambiguities in the tax law to reduce the tax payable below what it could otherwise be, without actually breaking the law.

Tax avoidance techniques, although legal-that is, in conformity with the letter of the law – nevertheless achieve the reduction or elimination of tax liability in circumstances where it is the underlying intention of the law that tax should be charged. Although tax avoidance may be regarded as immoral, the techniques employed are legal and tax conduct involved is not fraudulent.

It has shown that there are multiple motives for both compliance and non-compliance with the tax laws. With regard to compliance, it gives the meaning of self motivated to pay tax. Tax payers who obey may be motivated by a sense of civic responsibility or social justice or by a fear of sanctions that some cases by fear of the less of social acceptance if their delinquency should ever become public knowledge.

With regard to non-compliance, a number of reasons for failure to abide by the tax laws:

1. High tax rates.
2. Lack of trained staff to examine or audit accounts.
3. Weakness in the tax laws and administration.
4. Lack of coordination between tax departments and other government departments.
5. Weakness in the tax laws and administration.
6. Lack of coordination between tax departments and other government departments such as custom.
7. Absence of international conventions on income tax for exchange of information.

Tax evasion and avoidance—two forms of non-compliance—significantly reduce the amount of collected taxes, that is, the amount of compulsory unrequited payments to government that enable to perform the tasks constitutionally and legally entrusted to them, and increase their dependence on non tax resources.

Tax evasion and avoidance also increase the desire for tax payer to ignore the tax laws or seek artificial ways around them. In order to offset the revenue losses this occurs, government may have to levy new taxes; increases tax rates and eliminate exemptions, thereby imposing an unfair burden on honest taxpayers. The impact of this is perceived to be high taxes which are not returned with services or other identifiable benefits. They are accompanied by criticism of the size and inefficiency of government.

In the circumstances described above, the ability of tax administrations to enforce compliance and thus minimize the disparity between taxable capacity and tax effort levels becomes a matter of honest priority.

The challenge facing by many developing countries is thus to overhaul their tax administrators so as to enhance their overall performance. A tax administration of high quality can help not only to meet of achieving revenue requirements but can also constitute a means of achieving greater financial self-reliance, since external financial assistance – even when forthcoming – can be no more than an adjunct to domestic financial resources. Moreover, any existing or new foreign borrowing will have to be serviced within the limits of two degree, the ability of developing countries to attain sustainable administration with great integrity, capable of collecting revenue as specified in the tax legislation and, at the same time, of providing tax payers with better service.

A tax administration that operates with maximum efficiency and effectiveness helps to mobilize more revenue, thereby enabling governments to achieve greater financial reliance and facilitating the pursuit of growth – oriented structural adjustment programs, the provisions of requisite infrastructure for economic and social development, and the creation of a more hospitable environment for private foreign investment.

In addition to fostering a more attractive environment for foreign investment, a smoothly functioning tax administration yields other benefits including the following:

1. It enhances the ability of government to efficiently enforce tax with potentially high revenue yields (such as income tax and excess profit tax) which requires precise and sophisticated applications.
2. It obviates the need to broaden the tax base, i.e. to levy new taxes and/ or raise tax rates and may make it possible to eliminate or reduce burdensome taxes, grant more tax exemptions and enlarge income tax brackets without reducing tax revenue; and
3. It may make it possible to successfully tax the agricultural sector, which in many, countries remains largely untaxed despite its inherent potential as a significant source of revenue.

In a broader context, an efficient and effective tax administration will help developing countries to take advantage of economic recovery elsewhere in the world by including their determination to undertake necessary reforms. Thus bolstering their ability to attract a greater share of foreign direct investment, bring back home resources lost to capital flight and come to grips with their external debt servicing burden through negotiations with their creditors. It might even help these countries to qualify for more official development assistance for the financing of needed infrastructure [www.imf.org].

2.1.9 Tax Administration and Fiscal Policy:

Tax administration interacts with fiscal policy, in various ways:

For example:

1. Higher taxes on certain activities or sectors, although an administratively convenient way of increasing revenue or reducing a deficit, may in fact act as a disincentive to production and efficient revenue utilization; these taxes also have a contractive effect on consumption, since they reduce the tax payer's purchasing power.
2. If it is considered politically unacceptable to increase taxes as a means of reducing budget deficits, the tax administration may be called upon to help achieve this goal by operating more efficiently and effectively. If successful, this approach reduces the budget's contribution to growth in the money supply and this help to curb inflation and decrease dependence on non-bank financing.
3. A budget- balancing determination would make the government more conscious of its spending behavior and give the tax administration an additional incentive to combat tax evasion and avoidance and
4. A larger budget deficit resulting from weaknesses in tax administration may lead to a larger public debt and higher interest and tax rates as well as to lower capital accumulation and employment growth rate. Financing large deficits through money creation fuels inflation and discourages private investment. Higher tax rates and/ or

new taxes may then become the only viable means of generating the domestic savings needed for capital-formulation projects.

2.1.10 Tax Administration and Tax Policy:

With regard to tax policy, experience has shown that even in countries where tax policy reforms have been implemented their economic impacts have often been compromised by poor tax administration and revenue yields have not been up to the mark. Efficient and effective tax administration gives the maker of tax policy a wider range of options and is, in fact, the key to effective tax policy, for no policy can be constructive or even feasible unless properly implemented by the tax administration.

2.1.11 Tax administration and Tax Structure:

The effectiveness and efficiency of the tax administration also affects the tax structure. The tax structure can be modified, but unless the tax administration is capable of enforcing both new and existing taxes, the modifications may have no significant impact on tax collection. The importance of tax administration performance in relation to the tax structure has been described by the Director of the Fiscal Affairs Department of the IMF [2002] in the following terms:

“In arriving at the desirable tax structure that they will recommend, fund missions take into account:

1. The government’s priorities.
2. The country’s macro-economic situation.
3. The strength and honesty of the country’s tax administration.
4. The existing statutory tax structure.
5. The structure of the economy, and

6. A variety of other factors such as constitutional or legal limitations, prevailing customs and attitudes, the incidence of the existing tax system and so forth.

The factors mentioned above constrain the number of feasible options and, to some extent, influence the final tax structure. The weakness of tax administration may rule out all but the simplest options the maxim that 'old taxes are good taxes' would argue against a major overhaul of the tax system. There is only so much change that a tax administration can absorb at any one time." [IMF, 2002]

2.1.12 Essential Functions of the Tax Administration:

The tax laws impose on tax payers certain obligations with which they are required to comply. Generally speaking, they must be registered on the tax rolls, file returns, provide full and accurate information and pay the taxes due on time. A tax administration 'carries out the ordered of tax policy' its basic mission is to ensure compliance with the tax laws and regulations as they stand or are interpreted by the courts. It must help tax payers to fulfill their tax obligations and when necessary, induce or compel them to do so.

In order to execute its basic mission, a tax administration performs certain fundamental functions tax payer registration and identification, assessment (including valuation), collection and audit. These functions have been classified as 'essential' whereas personnel management planning and control, and tax payer information and assistance have been described as 'auxiliary' or 'support' functions. The 'essential' functions have also been labeled 'operational', since they involve the actual collection of

taxes and entail close relations with tax payers while the 'auxiliary' or 'support' functions have been designated as 'normative' meaning that they involve in interpretation and application the preparation and issuance of guides and standards and the establishment of working methods and procedures.

In the performance of its essential functions, a tax administration usually faces serious constraints and difficulties in developing countries, where many tax payers, unlike tax payers in industrialized countries, are not enmeshed in a set of interlocking recorded transactions. In industrialized countries, a major part of the tax base is linked to the activities and assets of large organizations, whereas, in developing countries, the potential base would normally be linked to the activities and assets of self-employed business persons, farmer and professionals, who constitute the 'hand-to-tax'. Consequently, for reasons of administrative convenience and feasibility, developing countries tend to rely on a handful of easy-to-administer indirect taxes such as export duties, import duties and excise duties, other taxes on imported goods.

In fact, in many developing countries the tax laws can, to a large extent, be enforced fully only in the formal sector, for frequently only corporations have the capacity to maintain proper accounts. First, developing countries often have a large informal sector, consisting of black markets, capital flight and so on, which are virtually beyond the reach of level of illiteracy not only creates ignorance of the tax laws and regulating but provides an excuse for it. The alleged inability of tax payers to furnish the documentation needed for a realistic assessment prevents the income, net worth; gift and land-whose incidence is generally assumed to rest with those who pay them- offer greater incentives and more opportunities for tax dodging. In addition, incomes, imports, sales, real estate and the like may have objective or true values completely different from those on the basis of which the relevant taxes are calculated. This is not necessarily due to a deliberate intent to evade or avoid taxes, but any be the result of poor record-keeping and accounting standards, other things being equal, the lower the compliance cost, the better the tax

administrations performance. Optimum compliance is the result of improved tax payer registration and identification assessment, collection and audit.

2.1.12. a. Taxpayer Registration and Identification:

A tax administration needs to take all feasible steps to ensure that all natural and legal persons liable to taxation are registered. However, given the limited resources of many tax administrations ,efforts to register new tax payers has to concentrate on areas which seem likely to yield significant revenue.

Upon registration, each tax payer is immediately be issued an identification number to ensure that documents and records in master files can easily be traced to a specific tax payer. Once, issued the identification number has not be duplicated, reissued or cancelled in the event of the tax payers' death or cessation of operation.

2.1.12. b. Assessment:

For assessment, it has been followed where feasible and appropriate, what is called the conventional approach to assessment, which emphasis voluntary compliance through self assessment- backed by random but rigorous auditing and stringent penalties and the provision to taxpayers of outreach services, including technical advice on tax assessment obligations. In that connection, tax payers have been authorized to file and play in ways that minimize compliance cost.

On the other hand, when prevailing conditions make it necessary to rely primarily on administrative or official-assessment of all tax returns, the tax administration has to carry out economic or statistical studies where finding helps tax official to make 'best judgment assessment, when the information supplied by tax payers is deemed to be

incomplete or inaccurate. To determine estimated income or value-added in the case of tax payers who can not be counted on to maintain comprehensive accounts. “Best judgment’ assessment would result from the application of the rule of thumb used by experienced tax officials and the judgmental guidelines formulated by many plausibility of the information supplied by tax payers.

2.1.12. c. Collection:

In developing countries – as well as in industrialized countries – the tax collection function is guided by the need to maximize revenue. Collection at source and other current payment arrangements for direct taxes (personnel income tax, taxes based on accounts and records) has been strengthened and even extended. To that end, the tax administration is to be designed and implemented a monitoring system comparable to the credit control system used in private business.

In developing countries, where must tax payers either do not keep reliable records on manage not to reveal them – the scarcity of administrative resources makes it highly desirable to use withholding as extensively as possible: third parties engaged in transaction with potential and actual tax payers is required to withhold appropriate amounts from payments. The amounts thus withheld by third parties on behalf of the tax administration is transmitted to official accounts as promptly as possible and credited against the tax liabilities of the appropriate tax payers.

A person is to be imposed if the tax payer underestimates by more than a given percentage (e.g. 25 or 30 percent) his or her liability, as opposed to the actual assessment made by the tax administration or if the tax payer fails to pay a tax installment within specified time period.

2.1.12. d. Audit:

Auditing is accurately focused and carried out with a high degree of supervision in order to ensure its effectiveness and integrity. Auditing is to be based on appropriate selection criteria: over-extensive auditing is impractical since any additional revenue raised is offset by increased administrative costs. A good information system, using computers where feasible and appropriate is to be facilitated rapid detection of non-filers, stop-filers. Tax payers must be categorized according to type of tax, type of business, geographical location and potential contribution to revenue [IMF Annual Report: 2002].

2.2 REVIEW OF LITERATURE

2.2.1 Review of Books, Journals & Articles

Agrawal GR Dr. (1978) conducted a study on “Resource Mobilization for Development; The Reform of Income Tax in Nepal,” It was identified that a substantial resource gap was found in revenue structure in Nepal. Tax administration was suffered from a number of interacting and interrelating problems which has badly affected its productivity. Dr Agrawal conducted a primary research in various aspects of income tax and also explained mathematically the untapped side of elasticity of income tax and its future projection. The picture of resource gap in Nepalese finance has been identified in the first chapter of the report. The main reason for this resource gap has been identified as the low-sided growth of government revenue generation from domestic resources as compared to government expenditure. He has calculated the elasticity of major Nepalese taxes using the double log linear model. Projection of income tax and resource gap has been made using similar linear model. Though the study has been identified as the first comprehensive scientific study in the income tax in Nepal and useful for the research purpose from various aspects, they are partially irrelevant at least at present context.

Suwal R.S. (1981) described and examined various problems in Nepalese tax system, importance of income tax in solving the financial problems in Nepal and economic effects of income tax on production and trend of income tax in her dissertation 'Income tax system of Nepal'. The problems as noted by her are the absence of clear and comprehensive definition of income, low paying capacity and tax consciousness, high tax rate corruption etc. Her suggestion was to establish some measures regarding tax administration for collection of income tax in Nepal.

Baral S. (1989) studied the contribution of income tax in tax structure of Nepal'. She gave some notable points of income tax evasion in Nepal. She also blamed the inefficient tax administration as one of the main reason of evasion of tax in Nepal.

Poudyal S.R. and Timilsina P.P. (1990) published a book 'Income tax in Nepal'. It gives a thorough ideal of theoretical and practical ideas of income tax but it does not able to deal with major problems and defects of income tax system.

Khadka R.B. (1994) wrote a book entitled "Nepalese taxation: A path for reform". It deals with national and local taxes and tax administration in Nepal. It traces the path of evolution of Nepalese tax system and present the tax system of that period. It appraises the Nepalese tax system on the basis of conventional, theoretical concepts and suggests measures of its improvement. It examines the structure and operation of the Nepalese tax system of that period in more detail.

Pant P. (1996) tried to show the income tax system and its role in National economy in his dissertation 'A study on identified various problems of income tax management in Nepal'. He has shown the problem as lack of effective personnel management, lack of reward and punishment system, lack of managerial efficiency, poor income tax procedure, poor tax information system, lack of tax payer's education etc.

Bhattarai R.K. (1997) examined the effectiveness of corporate income tax in his dissertation "Effectiveness of Corporate Income Tax in Nepal". He had thoroughly studied government mechanism with special reference to tax administration in Nepal. He concluded that there is a deep rooted corruption in income tax administration of Nepal where the tax officer is leader and both the tax payer officer is leader and both the tax payer and auditor are follows in the function of corruption. He pointed out the major cause and regulations in theory and practice. He has shown the lack of balance between rights and duties of tax payers, balanced delegation of authority, responsibility and accountability, poor reward and punishment system and lack of systematic evaluation and control mechanism as the drawback of tax system.

Dhakal K.D. (2002) has presented his extended, modified and enlarged edition of his book as prescribed by the syllabus of BBS third year. It includes the provisions made under income tax laws and the methods of income tax assessment. The book is informative rather than analytical.

Malik V. (2003) has published a book on Nepalese modern income tax system including changes brought by the income tax act 2058 and the recent development of income tax management in Nepal. The need and importance of modern income tax system is also discussed. He has also discussed on tax administration, assessment procedure, collection of tax review etc.

Shakya D.R. (2004) studied about Income Tax Act, 2002 in his dissertation "A study on ITA, 2002". He concluded that a commitment is must within tax payers and tax administration to make a fair and safe tax administration. He gave emphasis to provide sufficient incentives and remuneration with is program like promotion and motivation. His suggesting were for the improvement of tax administration after implementing ITA, 2002, were: The tax act must be simple and understandable to tax payers and tax administrators; The emphasis is given to

establish information center where tax payers can get information regarding tax law; The focus point must be provide sufficient incentive and remuneration to tax administrators to expect the full effort of tax administrators towards their duties and to conduct training programs.

Ghimire D.P (2005) had examined contribution of income tax particularly focusing in public enterprises in his dissertation “Income Tax in Nepal; Its Structure and Contribution from public enterprises to Government”. He evaluated the performance of tax administration of Nepal, particularly after implementation of tax ITA, 2002. He found that the tax administration of Nepal is inefficient due to mainly lack of trained and competent employee and complicated tax laws.

Bhattarai I. & Koirala G.P. (2006) jointly have presented a book named ‘Taxation in Nepal’ specially designed for BBS third year as a reference. They have presented some theoretical aspects with numerical problems of taxation in Nepal based on income tax act 2058. But the book does not able to give a direction to deal with problem of tax administration.

Adhikari C. (2007) wrote a book named “Public Finance in Nepal: Revenue and Tax Policy, Administration and Organization” in Nepali. In his book, he mainly focused on the administrative part of taxation in Nepal. He described the structure of tax administration from about the administrative aspect regarding tax. Moreover, this book gave overall idea about tax administration in Nepal. However, the book is presented in only descriptive manner, the new idea has generated after studying the book.

Khadka R. (2008) presented a book named “Modernizing Tax Administration in Nepal”. It has really most useful book to conduct whole research. It gave through idea about tax administration in analytical way. The book has a nine chapters starting from development of tax administration to conclusions and recommendations. The writer focused on the human resource

development of tax administrators. He also gives new ideas on tax administration to reform it such as computerization and autonomous revenue improvement of tax administration in Nepal.

2.2.3 Review of Thesis

Subedi P. (1984) discussed the role, legal aspect, historical background and cost of collection of income tax in his dissertation 'An analytical study of income taxation in Nepal'. He analyzed the contribution of income tax to total revenue, growth of income tax collection and its ratio from one prospective of tax administration.

Nepal N. (1987) analyzed existing position, problems and prospects of income tax in her dissertation 'A study on problems and prospects of income tax in Nepal'. She has indicated the major problems in Nepalese tax system are inefficient income tax administration, mass poverty, lack of tax cooperation between tax payers and tax administration, assessment deficiency etc. Her suggestion was towards the improvement on those specified problems.

Shrestha R. (1992) studied the origin, definition, concept, historical aspect, role, objective and structure of income tax in her dissertation 'Income tax in Nepal'. She has noted that tax administration is not efficient because of lack of trained and skilled personnel, lack of new source for income tax revenue, lack of proper incentive and low salary of tax officers. Her suggestion was to make tax department as efficient.

Siwakoti C. (1995) examined various factors related in the field of income tax in his dissertation 'An analytical study of income tax in Nepal'. The major problems identified by him are tax evasion, delay in assessment, and lack of public information, complicated acts and other defects in the income tax act. He suggested for progressive, separate research units efficient administration, separate research units in tax offices and penalties to tax payers who do not maintain accounts.

Shrestha B. (2002) presented a dissertation under heading 'Revenue collection form income tax in Nepal: Problems and prospects'. She cleared various aspect of income tax in its contribution for national economic development. Her finding showed that there are many problems related to income tax for example one of the main problem as indicated by her is revenue collection form income tax is low. Again, she concluded that Nepalese income tax law is inappropriate and the administration is worse. She suggested that income tax laws and administration in Nepal are to be deeply scrutinized and properly implemented. Strong commitment, fair and uniform imposition is to be stored. Manpower development planning within the administration is desired for the efficiency of tax personnel side by side. Tax education packages are to be made and initiated.

Dahal T. (2007) submitted a dissertation with heading 'Income tax management in Nepal'. He focused on many administrative aspects of income tax. He concluded that the effectiveness of tax system depends on the existing management and leadership. A vigilant and transparent tax administration and capability of timely reviews in policy back sliding the gains in the revenue front. He suggested that, for the improvement of tax management strong political commitment is most.

In this way, various books, dissertations reports and articles published in journals and newspapers are reviewed while preparing this dissertation. Most of literatures are concentrated on administrative, legal and assessment procedure of income tax. Since, all of them have identified the main problem in this sector as poor performance of tax administration. Although very few studies was concerned on focusing tax administration covering all sources of taxes in separate way. Setting the lack of study mainly concentrated on covering all aspects of tax and focusing particularly income tax in more specific way.

CHAPTER-3

RESEARCH METHODOLOGY

3.1 Research Design:

For *descriptive research* to achieve result of objectives of the study, the study of income tax act, finance ordinance, income tax rules and other acts, rules and regulations has been previewed.

For *analytical research*, provision of tax administration in income tax act and role of income tax in generating tax revenue in Nepal has been carried out.

For *empirical research*, an opinion survey has been conducted. The opinions of various 60 respondents associated with distinct category i.e. tax administrators, tax experts and tax payers have collected through structured *questionnaire* with reference to tax administration in Nepal. The characteristics of Nepalese tax system, role of income tax in equal distribution of income, efficiency of tax administration, power of tax officers in Nepal, instruments to improve tax administration in Nepal has included in questionnaire. Again, views of distinct group of people relating to income tax act, 2058 with its difficulties and complexities have also been added there in.

3.2 Population of Sample:

Tax administrators, tax experts and tax payers are considered as the total, population. Out of them, 20 tax experts, 35 tax administrators and 20 tax payers are considered as the target population for the study. In order to facilitate this study, 75 sample sizes from Kathmandu

valley is selected. The respondents have been divided into three groups. The following table shows the groups of respondents and the size of sample.

Table - 3.1

Groups of Respondents and size of Sample from each group

S.N.	Group of Respondents	Sample size
1	Income tax administrators	35
2	Income tax experts	20
3	Tax Payers	20
Total		75

Responsiveness of respondents has been received from IRO, area no-1 and area no-2, Babar Mahal, ICAN, Babar Mahal and other personal sources.

3.3 Sampling Procedure:

Random sampling technique has been used to select the target and sample selection. The views of tax administrators, tax experts and tax payers have been collected on the basis of stratified selection by distributing questionnaire individually.

3.4 Sources of Data:

The primary as well as secondary sources of data have been collected in order to achieve the real world factual result. The major sources of data are as follows:

3.4.1 Primary Sources of Data:

Primary source of data has been collected with in Kathmandu valley from those respondents who are representing form various sectors i.e. tax administrators, tax experts and tax payers. Tax administrators have been selected from IRO, area no. 1 and 2, Babar Mahal, tax exports have been selected from ICAN, Babar Mahal and tax payers have been selected from various business houses in Putalisadak.

3.4.2 Secondary Source of Data:

The secondary sources of data are the information received form books, journals, newspaper reports, dissertations etc. The major sources of secondary data are as follows:

1. Economic Survey and Budget Speeches, MOF, GON.
2. Annual Reports of IRD, MOF, GON.
3. Published Documents of National Planning Commission and NRB.
4. Dissertations related to tax administration.
5. CEDA publications, TU.
6. Books related to income tax and tax administration.
7. Other relevant records and data including useful websites.

3.5 Procedure of Data Collection:

For *primary data*, information has been collected by developing a schedule of questionnaires and distributing to three distinct types of respondents. Distribution has been done through personally field visit to get accurate and actual information in time. For *secondary data*, information has been collected from published reports of different organizations.

3.6 Data Processing Procedure and Analysis Tools:

Information collected from questionnaire has been classified and tabulated as required. Data analysis has been made by applying different tools like simple percentage, simple average and spearman's rank correlation coefficient. Graphs and charts have been presented to interpret the data visually.

Rank Correlation Coefficient:

Rank correlation coefficient is the measurement of relationship between the two variables with their respective ranks. It is also called spearman's rank correlation coefficient and is given by:

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

Where,

r_s = Spearman's rank correlation coefficient between variable X and Y.

d = Difference between the rank for each pair of observations.

i.e. $d = R_1 - R_2$

$R_1 - R_2$ = Rank of X and Y respectively.

n = Number of paired observations

Σ = Notation meaning "The sum of".

3.6.2 Testing of Hypothesis about Rank Correlation:

Setting the hypothesis:

Null hypothesis and alternate hypothesis are set as follows:

$H_0: \mu_s = 0$ (Null Hypothesis): there is no significant relationship between the views of tax payers and tax administrators with respect to the various aspects of tax administration (keeping the view of the tax experts constant).

$H_1: \mu_s \neq 0$ (Alternative Hypothesis): there is significant relationship between the views of tax payers and tax administrators with respect to the various aspects of tax administration (keeping the view of the tax experts constant).

Where μ_s is the spearman's rank correlation coefficient in the population.

$\alpha = 0.05$ (level of significance for testing these hypothesis.)

A two tailed test has been applied. So, by looking at table values in the row for the number of pair observation and the column for a significance level of 0.05, it has found that the upper limit of acceptance region is +ve and the lower limit of acceptance region is -ve.

3.6.3 Decision:

If rank correlation coefficient (r_s) lies outside the acceptance region, null hypothesis of no correlation is rejected.

If rank correlation coefficient (r_s) lies in the acceptance region, null hypothesis of no correlation is accepted.

CHAPTER- 4

DATA PRESENTATION AND ANALYSIS

4.1 ANALYSIS OF SECONDARY DATA

This chapter deals with the presentation and analysis of data and information in connection with the taxation in Nepal. Full attention was given to find out the effectiveness of tax administration with the help of trend and contribution of income tax in government structure of Nepal. At the end, empirical investigation based on Opinion Survey 2009 has been presented with relevant sub topics.

4.1.1 Tax and Non -Tax Revenue in Nepal:

The sum of tax and non-tax revenue is the total revenue. The structure of total revenue for the fiscal year 2004/05 to 2008/09 is shown in the table 4.3. The share of tax revenue has always been more than 75 percent i.e. greater than the share of non tax revenue. The average share of tax revenue for the 5 years time period was 79.54 percent. Tax revenue is placed as a major source of government revenue in Nepal. The trend of tax and non tax revenue is shown in chart 4.1.1.

Table - 4.1.1

Composition of Tax and Non-Tax Revenue in Nepal

(Fiscal year 2004/05 to 2008/09)

Rs. in million

Fiscal year	Total Revenue (Rs.)	Tax Revenue		Non-Tax Revenue	
		In Rs.	In %	In Rs.	In %
2004/05	70,122.70	54,104.70	77.16	16,018.00	22.84
2005/06			79.45		20.55

	72,282.00	57,430.40		14,851.60	
2006/07	87,711.90	71,126.70	81.09	16,585.20	18.91
2007/08	107,622.94	85,155.54	79.12	22,467.40	20.88
2008/09	84,203.20	68,080.20	80.85	16,123.00	19.15

Source: Economic Survey 2009

From the year 2004/05 to 2005/06 the amount of tax revenue found to be increasing every year with the amount of Rs. 70,122.70 million to Rs. 107,622.94 million. The maximum contribution of tax revenue to total revenue was 81.09 percent in the fiscal year 2006/07 and least contribution of tax revenue to total revenue was 77.16 percent in the fiscal year 2004/05.

The trend of non tax revenue collection was also fluctuating during the period from 2004/05 to 2008/09. The lowest contribution of non tax revenue in the fiscal year 2006/07 is 18.91 percent and the highest contribution of non tax revenue in the fiscal year 2004/05 is 22.84 percent. However, there is fluctuation in the revenue from time to time; both of the revenues, that is, tax revenue and non tax revenue are in increasing trend. It has clearly shown in the chart 4.1.1.

Chart – 4.1.1

Trend of Tax and Non Tax Revenue

4.1.2 Structure of Tax Revenue in Nepal:

The structure of government revenue in Nepal has been represented in table 4.1.2 and table 4.1.3 in Rs. and percentage respectively from the fiscal year 2004/05 to 2008/09. The structure of government revenue of Nepal is formulated by customs, excise, sales tax (VAT), income tax, land revenue and registration, miscellaneous tax revenue and non tax revenue.

Out of those, sales tax/VAT has a position at the top level. The revenue from sales tax/VAT varies from Rs. 18885 million to Rs. 29815 million from 2004/05 to 2008/09. The trend shows that the gradual increase in sales tax/VAT makes it to hold the top position. The average percentage of sales tax/VAT to total revenue for last 8 fiscal years is 28.49 percent.

The second top position is occupied by customs. Revenue from customs is increased from Rs. 15701 million to Rs. 21062 million from the fiscal year 2004/05 to 2008/09. The average contribution of customs to the total revenue for last 5 years is 20.10 percent. Similarly, income tax has occupied the third rank. On the basis of average contribution, income tax is in the third position. From the year 2004/05 to 2008/09 income tax found to be increasing with the amount of Rs. 9402 million to Rs. 16223 million. The percentage contribution of income tax

to total revenue is fluctuate in various year. The average contribution of income tax to total revenue for the past 8 years is 14.64 percent.

Revenue from excise is increasing in each year except in the last year of the study period. It is increased from Rs.6445 million in year 2004/05 to Rs. 9221 million in the year 2008/09. The average percentage contribution of excise to total revenue has 10.39 percent throughout the study period.

Land revenue and registration is also increased from Rs. 1799 million in year 2004/05 to Rs. 2722 million in year 2008/09. But the percentage of contribution of land revenue and registration has increased from 2.5 percent in 2004/05 to 3.2 percent in year 2008/09.

Revenue from miscellaneous tax has also been increased from fiscal year 2004/05 to 2008/09. After that revenue from miscellaneous has increased from Rs 1870 million to 3901 million from year 2004/05 to 2008/09.

On the other hand, non tax revenue is another portion in contributing revenue structure of the government. Non-tax revenue has been increased from fiscal year 2004/05 to year 2008/09 but it got slightly decreased in the last year of the study period than in 2007/08. I e it increased from Rs.16018 million to Rs. 22467 million in 2007/08 then it decreased to 16123 million in 2008/09. The average contribution of non-tax revenue to the total revenue for past 5 years is 20.46 percent.

Table - 4.1.2

Structure of Government Revenue in Nepal

(Fiscal Year 2004/05 to 2008/09)

Rs. in million

Fiscal Year	Customs	Excise	Sales Tax/VAT	Income Tax	Land Revenue &Registration	Miscellaneous Tax	Non Tax Revenue	Total

2004/05	15701.60	6445.90	18885.40	9402.4	1799.2	1870.20	16,018.00	70122.7
2005/06	15344.00	6507.60	21610.70	9598.8	2181.1	2188.20	14,851.60	72282
2006/07	16707.60	9343.20	26095.60	13979.1	2253.5	2747.70	16,585.20	87711.9
2007/08	21062.50	11189.58	29815.70	16223.29	2940.74	3923.73	22,467.40	107622.94
2008/09	15403.90	9221.30	23740.80	13089.8	2722.7	3901.7	16,123.00	84203.2

Source: Economic Survey 2008/09, MOF: GON

Note:

- Custom includes; Imports + Exports + Indian Excise Refund + Others
- Excise includes; Industrial Products + Liquor contracts
- Income Tax includes; Tax from –PEs + Semi PEs + Private corporate bodies + Individuals + Remunerations + Tax on Interest
- Miscellaneous includes; Entertainment Tax + Hotel Tax + Air Flight Tax + Contracts Tax + Road & Bridge Maintenance Tax + Urban House & Land Tax + Vehicle Tax + Other Taxes
- PEs=Public Enterprises

Table - 4.1.3

Structure of Government Revenue in Nepal (In percentage)

(Fiscal Year 2004/05 to 2008/09)

Rs. in million

Fiscal Year	Customs	Excise	Sales Tax/VAT	Income Tax	Land Revenue &Registration	Miscellaneous Tax	Non Tax Revenue	Total
2004/05	22.39	9.19	26.93	13.40	2.56	2.66	22.84	100
2005/06	21.22	9.00	29.89	13.27	3.01	3.02	20.54	100
2006/07	19.04	10.65	29.75	15.93	2.56	3.13	18.90	100
2007/08	19.57	10.39	27.70	15.07	2.73	3.64	20.87	100
2008/09	18.29	10.95	28.19	15.54	3.23	4.63	19.14	100

Source: Table 4.1.2

4.1.3 Tax/GDP Ratio in Nepal

Nepal is one of the lowest taxed economies in the world. In Nepal, Tax/GDP ratio never exceeds 15 percent. The average percentage of Tax/GDP ratio of 5 fiscal years is 12.26 percent. From the chart 4.1.1, it is cleared that the growth rate of contribution of tax revenue on GDP is in positive direction but in slow rate and somehow in fluctuation. If the share of tax revenue on GDP is considered, it is not found satisfactory .except year 2007/08. The Tax/GDP ratio was decreased from 12.78 percent to 11.82 percent; again it was started to increase from 2006/07 up to 2007/08. The fluctuation was continued up to 2007/08 and thereafter, the trend is in negative path.

Table - 4.1.4

Contribution of Tax Revenue in GDP

(Fiscal year 2000/01 to 2005/06)

Rs. in million

Fiscal Year	GDP	Tax Revenue	Tax revenue as Percentage of GDP
-------------	-----	-------------	----------------------------------

2004/05	548485.00	70,122.70	12.78%
2005/06	611118.00	72,282.00	11.82%
2006/07	676210.00	87,711.90	12.97%
2007/08	756756.00	107,622.94	14.22%
2008/09	882955.00	84,203.20	9.53%

Source: Economic Survey.

Chart No. 4.1.2

4.1.4 Income Tax/GDP Ratio:

Table - 4.1.5

Contribution of Income Tax in GDP

(Fiscal year 2004/05 to 2008/09)

Rs. in million

Fiscal Year	GDP	Income tax	Income tax as percentage of GDP
2004/05	548485.00	9402.4	1.71425
2005/06	611118.00	9598.8	1.5707
2006/07	676210.00	13979.1	2.06727
2007/08	756756.00	16223.3	2.14379
2008/09	882955.00	13089.8	1.4825

Source: Economic Survey, 2009

While evaluating income tax with connection to Gross Domestic Product of five years, it was found that the income tax/GDP ratio was fluctuating in various fiscal years i.e. in 2004/05, it was 1.71 percent but in fiscal year 2005/06, it was 1.57 percent. There after it was increased in later two years and lastly decreased in the fiscal year 2008/09 with the ratio 1.48 percent.

Chart – 4.1.3

Income tax as percentage of GDP

4.1.5 Revenue collection of IRD- A comparative Study:

In almost year, the collection of Tax revenue was in top position where the VAT has been in second position. If the net contribution of the fiscal year 2008/09 is evaluated, it was found that the Tax revenue was in top position with 54 percent. The VAT came to second position with 18 percent, then after income tax excise duty and vehicle tax are in the 3rd, 4th and 5th position (see chart 4.1.4).

Table - 4.1.6

Inland Revenue Collection Rs in '000'

Fiscal Year	2004/05	2005/06	2006/07	2007/08	2008/09
Tax Revenue	35200000	44300000	48817000	58126800	85660000
VAT	15503500	16950000	23650000	26463000	29651900
Income Tax	10500000	11800000	12710500	16869200	27087000
Excise Duty	7000000	7950000	8637500	10523200	14073000
Vehicle Tax	750000	900000	1006000	1082500	3500000

Source: IRD Annual Report 2008/09

Chart – 4.1.4

Contribution of Inland Revenue Collection

5.1.6 Structural Condition of Income Tax

With comparison of five fiscal years, collection of income tax in the fiscal years 2007/08 and 2008/09 exceeded the targeted point. Out of sub categories of income tax, corporate tax was in top position in all years. Individual income tax was placed in second position. The contribution of other sub categories such as house rent and interest were playing nominal role

but not least. Recently capital gain tax is also showing good presence in the structure. Growing tax on dividend is another good sign for the economy. Corporate income tax was at the top level in among the income tax component and its increasing smoothly throughout the study period.

Table - 4.1.7

Structural condition of Income Tax Collection

Rs. in '000'

Year/Particulars	2004/05	2005/06	2006/07	2007/08	2008/09
Corporate Income Tax	7345003	7576530	11605600	13268756	19624768
Public Corporations	1332430	195774	1019677	204585	959047
Public Limited Companies	2467789	3405582	5717056	7186458	9425132
Private Limited Companies	1531305	1703027	2306976	3140371	4197536
Sole Trading firm	1885657	1958791	2306645	2452345	4472091
Others	127822	313356	255246	284997	570962
Remuneration	1675861	1771129	2007930	2451039	3195623
Tax on Investment	1424770	1546555	2080024	3271475	4161963
Rent	495549	528457	594181	721102	960198
Interest	757035	774820	1054942	1087927	1685094
Capital Gain Tax	7030	657	1127	803492	761617
Dividend	165147	242585	429502	657694	736546
Other income from Investment	9	36	272	1260	18508
Windfall Gain	6775	8810	11697	19151	17380
Others	13817	30496	26553	67392	246698
Total	10466226	10933520	15731804	19077813	27246432

Source: www.ird.gov.np (Annual report of IRD 2065/066)

Note: The figure above may be different than the figure previously kept in this chapter because of differing with Economic Survey due to taking round figure in Economic Survey.

Table – 4.1.8

Target and Achievement of Income Tax-A Comparative Study

Rs. in '000'

Fiscal year	Target	Achievement	Ratio
2004/05	10500000	10466226	99.6783
2005/06	11800000	10933520	92.6569
2006/07	12710500	15738040	123.819
2007/08	16869200	19077813	113.093
2008/09	27087000	27247386	100.592

After evaluating the income tax of five fiscal year that is from 2004/05 to 2008/09, it was found that the performance of income tax was moreover good in recent year i.e. in the year 2006/07, 2007/08 and 2008/09, it had 123.81, 113.09 and 100.59 percent ratio of achievement over target and it slightly decreased on the final year. It shows that the ratio of achievement was highest in 2006/07 and then it started to decrease in the final two years of the study period. Within the heading the income tax, contribution of corporate income tax is more than the individual income tax and interest.

Chart-4.1.5

Target vs. Achievement of Income Tax Collection

4.2 EMPIRICAL STUDY

An empirical investigation has been conducted to examine effectiveness of tax administration in Nepal. The major tool used for this purpose is an opinion questionnaire. While conducting this investigation, 75 sets of questionnaire were distributed to the tax administrators, tax payers and tax experts but only 60 sets of questionnaire were received. The responses received from various respondents have been arranged, tabulated and analyzed.

The questionnaire is arranged in response of yes/no and ranking of choices according to number of alternatives where first choice was most important and the last choice as least important. If the number of alternative were ten, then the first preferred choice got ten points and if the number of alternative were one, then the last choice got point one. The total points available to each choice were converted into percentage in reference to the total points available for all choice. The choice with the highest score of percentage was ranked as the most

important choice and one with the lowest percentage being ranked as last choice. Table 5.2.1 shows the groups of respondents and code used to represent them:

Table - 4.2.1

Groups of respondents and code used

S.N.	Groups of respondents	Sample Distributed	Sample Received	Code Used
1	Tax administrators	35	30	A
2	Tax experts	20	15	B
3	Tax payers	20	15	C

1. Attitude towards performance of Nepalese tax system:

Since, it has been accused that the Nepalese tax system has many problems. To know whether the tax system of Nepal has problems or not, a question was asked “Do you think that Nepalese tax system has poor performance?” The responses received from the respondents are tabulated as follows:

Table 4.2.2

Attitude towards performance of Nepalese Tax system

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	18	60	12	40	30	100

B	11	73.33	4	26.67	15	100
C	15	100	0	0	15	100
Total	44	73.33	16	26.67	60	100

Source: Opinion Survey 2009.

From the above table, it has been cleared that Nepalese tax system has some how problems. Majority of the respondents (i.e. 73.33 percent) thought that there were problems in Nepalese tax system with regard to its performance.

To know causes of being poor performance, another question was attached with this. "If yes, what are the major causes of being poor performance in Nepalese tax system?". The respondents are requested to rank their answer of the responses their priority. The breakdown of the responses is shown below:

Table 4.2.3

Major reasons towards poor performance of Nepalese Tax system

S.N.	Major reasons	Groups			Total point	Percent	Rank
		A	B	C			
1	Lack of incentives for maintenance of Accounts	40.98	50.53	48.14	139.65	14.6	7
2	Lack of meaningful tax payer information	72.34	66.21	72.22	210.77	12.6	1
3	Defective assessment procedures	52.04	51.70	74.08	177.96	12.33	4
4	Complicated collection procedures	48.06	51.61	53.70	153.37	10.63	8
5	Failure of public sector enterprises to pay the tax	54.68	35.61	68.51	158.8	11.00	6
6	Tax concession granted to industries located at remote area.	29.56	11.11	19.98	60.65	4.20	9
7	Lack of tax payer education	57.30	65.08	62.96	185.34	12.84	2
8	Lack of research in tax matters	58.77	63.04	50.00	171.81	11.90	5
9	Problem of evasion and avoidance	62.38	70.75	51.85	187.98	12.82	3
Total		-	-	-	1443.3	100	-

Source: Opinion Survey 2009.

The major reasons of the tax system of being poor performance in Nepal were ranked in order of the preference of the respondents as follows:

1. Lack of meaningful tax payer information.
2. Lack of tax payer education.
3. Problem of evasion and avoidance.
4. Defective reassessment procedure.
5. Lack of research in tax matters.
6. Failure of public sector enterprises to pay the tax.
7. Lack of incentives for maintenance of Accounts.
8. Complicated collection procedures.
9. Tax concession granted to industries located at remote area.

It can be concluded from above results that in the opinion of respondents there are problems in tax system of Nepal, basically due to lack of meaningful tax payer information, lack of tax payer education and problem of evasion and avoidance.

To know whether there is significant relationship or not between the above views of tax administrators and tax payers (keeping the views of tax experts constant), it is tested by spearman rank correlation coefficient.

Test of Hypothesis:

Hypothesis 1

H₀: $\mu=0$, there is no significant relationship between the views of tax administrations and tax payers with respect to the poor performance of Nepalese income tax system.

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

Table 4.2.4

Calculation of Spearman's Rank Correlation Coefficient

S.N.	Major Problems	Total points X	Re rank R1	Total points Y	Re rank R2	Difference of rank d=R1-R2	Square of R1-R2=d ²
1	Lack of incentives for maintenance of Accounts	41	8	48	8	0	0
2	Lack of meaningful tax payer information	72	1	72	2	-1	1
3	Defective assessment procedures	52	6	74	1	5	25
4	Complicated collection procedures	48	7	54	5	2	4
5	Failure of public sector	55	5	69	3	2	4

	enterprises to pay the tax						
6	Tax concession granted to industries located at remote area.	30	9	20	9	0	0
7	Lack of tax payer education	57	4	63	4	0	0
8	Lack of research in tax matters	59	3	50	7	-4	16
9	Problem of evasion and avoidance	62	2	52	6	-4	16
Total		-	-	-	-	-	66

Source: Table 5.2.3

Note: X refers to tax administrators and Y refers to tax payers.

Substituting the value, we get

$$r_s = 1 - \frac{6 \times 66}{9(81-1)} = 0.55$$

The critical value of r_s at 0.05 level of significance for $n=9$ are ± 0.6833 , that is, the upper limit of the acceptance region is 0.6833 region is -0.6933.

Decision:

Since, r_s calculated lies in the acceptance region (± 6833). Therefore, the null hypothesis (H_0) is accepted. That is, there is no significant relationship between the views of tax administrators and tax payers with respect to the problems of Nepalese tax system.

2. Attitude towards the income tax as acting discouragement for earning higher income:

To know the attitude towards effectiveness of income tax on higher income level, a question was asked. "Do you think that income tax acts as a discouragement for earning higher income?" The responses received from the various respondents are tabulated as below:

Table 4.2.5

Attitude towards the income tax as acting discouragement for earning higher income

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	8	26.67	22	73.33	30	100
B	2	13.33	13	86.67	15	100
C	8	53.33	7	46.67	15	100
Total	18	30	42	70	60	100

Source: Opinion Survey 2009.

It is clear from the above that 70 percent respondents are disagreed with the statement that the income tax as acting discouragement for earning higher income. A minority of respondents, 30 percent are agreed with the statement.

3. Attitude towards the role of income tax to reduce the gap between rich and poor:

Table 4.2.6

Attitude towards the role of income tax to reduce the gap between rich and poor

Respondents	Highly Effective		Fairly Effective		Not Effective		Total	
	No.	%	No.	%	No.	%	No.	%
A	5	16.67	15	50	10	33.33	30	100
B	3	20	9	60	3	20	15	100
C	0	0	0	0	15	100	15	100
Total	8	13.33	24	40	28	46.67	60	100

Source: Opinion Survey 2009.

From above, it is cleared that there is low level of attitude towards the role of income tax as highly effective in reducing gap between rich and poor, i.e. 13.33 percent. Whereas, 40 percent of respondents believes that the role of income tax is fairly effective in reducing gap between rich and poor. The majority portion of respondents i.e. 46.67 percent believes that the role of income tax in reducing gap between rich and poor is not effective at all.

To know causes of being not effective as income tax to reduce gap between rich and poor, a question was attached with this, i.e. "If it is not effective, what may be the probable reasons not supporting to reduce gap between rich and poor?" The respondents are asked to rank their answer according to their priority. The break down of the responses is shown below:

Table 4.2.7

**Major causes which are responsible not to reduce the gap between rich and poor by
income tax**

S.N.	Major reasons	Groups			Total point	Percent	Rank
		A	B	C			
1	Wide spread evasion of taxes.	56	83	61	200	13.31	1
2	Small number of tax payers.	52	39	53	144	9.58	8
3	Inefficient instrument for reducing the gap by income tax.	30	83	55	168	11.18	4
4	Poor tax paying capacity.	60	38	61	159	10.58	7
5	Lack of tax consciousness.	50	60	86	196	13	2
6	Defective government expenditure programs.	39	67	59	165	10.98	5
7	Defective tax rates.	72	44	47	163	10.84	6
8	Poor administration.	74	78	39	191	12.70	3
9	Decreasing purchasing power of people.	67	11	39	117	7.78	9

Total	-	-	-	-	1503	-	-
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Source: Opinion Survey 2009

The causes of being not effective as income tax to reduce the gap between rich and poor were ranked in order of the preference of the respondents as follows:

1. Wide spread evasion and avoidance of tax.
2. Lack of consciousness.
3. Poor tax administration.
4. Inefficient instrument for reducing the gap by income tax.
5. Defective government expenditure.
6. Defective paying capacity.
7. Poor tax paying capacity.
8. Small number of tax payers.
9. Decreasing purchasing power of people.

It can be concluded from the above table that in the opinion of respondents, wide spread of evasion and avoidance of tax, lack of consciousness towards tax and poor tax administration are the main reasons as being causes that responsible for not to reduce the gap between rich and poor.

4. Attitude towards efficiency of tax administration:

To know the attitude of respondents towards efficiency of tax administration, a question was asked “Do you think that tax administration is Nepal is efficient?” The responses received from the various respondents are tabulated as below:

Table 4.2.8

Attitude towards efficiency of tax administration

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	15	50	15	50	30	100
B	4	26.67	11	73.33	15	100
C	2	13.33	13	86.67	15	100
Total	21	35	39	65	60	100

Source: Opinion Survey 2009

It is cleared from above table that majority of the respondents i.e. are dissatisfied with the present efficiency of tax administration. On the other hand, only 35% are in favor of the efficiency of tax administration of Nepal.

To know causes of inefficient tax administration of Nepal, respondent were asked to rank the given causes according to their priority. The break down of the responses is show below:

Table 4.2.9

Major causes responsible for inefficient tax administration in Nepal

S.N.	Major reasons	Groups			Total point	Percent	Rank
		A	B	C			
1	Lack of trained and competent staff.	81	92	74	247	16.38	1
2	Complicated tax laws.	71	59	51	181	12	4

3	Lack of information.	82	49	76	207	13.73	2
4	Unnecessary outside pressures.	33	56	53	142	9.42	7
5	Undue delay is making assessments.	51	38	36	125	8.29	8
6	Lack of coordination within the tax department.	48	51	67	166	11.01	5
7	Lack of motivation in tax personnel.	59	65	68	192	12.73	3
8	Defective procedures.	35	39	69	143	9.48	6
9	Defective organizational arrangements.	45	43	18	106	7.03	9
Total	-	-	-	-	1508	-	-

Source: Opinion Survey 2009

The major causes for inefficient tax administration of Nepalese were ranked in order of preference of the respondents as follows:

1. Lack of trained and competent staff.
2. Lack of information.
3. Lack of motivation in tax personnel.
4. Complicated tax laws.
5. Lack of coordination within tax department.
6. Defective procedures.
7. Unnecessary outside pressures.
8. Undue delay in making assessments.
9. Defective organizational arrangements.

It can be concluded from the above table that in the opinion of respondents, lack of trained and competent personnel, lack of information about tax payers and lack of motivation in tax personnel are the main causes for the responsible of inefficient tax administration in Nepal.

To know there is significant relationship or not between the above views of tax administration and tax payers (keeping the views of tax experts constant), it tested by spearman rank correlation coefficient).

Test of Hypothesis

Hypothesis 2

H0: $\mu=0$, there is no significant relationship between the views of tax administrators and tax payers with respect to the causes of inefficient tax administration in Nepal.

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

Table 4.2.10

Calculation of Spearman's rank correlation coefficient

S.N.	Major Problems	Total points X	Re rank R1	Total points Y	Re rank R2	Difference of rank d=R1-R2	Square of R1- R2=d ²
1	Lack of trained and competent staff.	81	2	74	2	0	0
2	Complicated tax laws.	71	3	51	7	-4	16
3	Lack of information.	82	1	76	1	0	0
4	Unnecessary outside pressures.	33	9	53	6	3	9
5	Undue delay is making assessments.	51	5	36	8	-3	9
6	Lack of coordination within the tax department.	48	6	67	5	1	1
7	Lack of motivation in tax personnel.	59	4	68	4	0	0
8	Defective procedures.	35	8	69	3	5	25
9	Defective organizational arrangements.	45	7	18	9	-2	4
Total	-	-	-	-	-	-	64

Source: Table 5.2.9

Note: X refers to tax administrators and Y refers to tax payers.

Substituting the value, we get

$$r_s = 1 - \frac{6 \times 64}{9(81-1)} = 0.4667$$

The critical value of r_s at 5 percent level of significance for $n=9$ are ± 0.6833 , that the upper limit of acceptance region is 0.6833 and the lower limit of the acceptance region is - 0.6833.

Decision:

Since, r_s calculated lies in the acceptance region (± 0.6833). Therefore the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers with respect to the causes of inefficient tax administration of Nepal.

5. Attitude towards the widespread boundless power of tax officer in Nepal:

To know the attitude of respondents towards the power of tax officer, a question was asked 'Do you think that tax officer has widespread boundless powers in Nepal'. The cause of keeping this question is to compare power of tax authority as given by the acts 2031 and 2058. The responses received from the various respondents are tabulated as below:

Table 4.2.11

Attitude towards the widespread boundless power of tax officer in Nepal

Respondents	Yes	No	Total

	No.	%	No.	%	No.	%
A	0	0	30	100	30	100
B	0	0	15	100	15	100
C	8	53.33	7	46.7	15	100
Total	8	13.33	52	86.67	60	100

Source: Opinion Survey 2009

From above table, it is noted that majority of respondents i.e. 86.67 are against with the statement that tax officers have widespread boundless power in Nepal. Thus, the conclusion should be drawn in such a way that there is no discretionary power with tax officers.

6. Attitude towards legal opportunities for redressing tax payer's grievances:

To know the attitude of respondents towards the redressing tax payer's grievances, a question was asked "Do you think that tax payers have adequate administrative and legal opportunities for redressing their grievances?" The responses received from the various respondents are tabulated as below:

Table 4.2.12

Attitude towards legal opportunities for redressing tax payers'

Grievances

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	22	73.33	8	26.67	30	100

B	13	86.67	2	13.33	15	100
C	5	33.33	10	66.67	15	100
Total	40	66.67	20	33.33	60	100

Source: Opinion Survey 2009

It is cleared from above table that majority of respondents i.e. 66.67% accepts that there is adequate administration and legal opportunities to handle tax payer's grievances. On the other hand, minority of respondents i.e. 33.33 percent are disagreed with the former.

It shows that, even there in some how legal provisions to handle tax payer's grievance, it does not cover whole tax payer as a whole.

7. Attitude towards the improvement of tax administration in Nepal:

To know the view of respondent towards improvement of tax administration in Nepal, they are asked to rank given guidelines to improve tax administration in Nepal according to their priority. The break down of the responses is shown below:

Table 4.2.13

Guidelines for the improvement of tax administration in Nepal

S.N.	Guidelines	Groups			Total point	Percent	Rank
		A	B	C			
1	Proper training to tax officers.	76	66	59	201	13.89081	1
2	Better coordination with custom office, banks, registration office and others.	56	41	56	153	10.5736	6
3	Better tax information system.	53	62	59	174	12.02488	3
4	Better public relation by tax office.	31	42	63	136	9.398756	8
5	Simple tax policies.	65	47	59	171	11.81755	4
6	Realistic tax policies.	63	56	43	162	11.19558	5
7	Simple tax procedures.	62	48	67	177	12.2322	2
8	Educating tax payers.	57	47	33	137	9.467865	7
9	Motivating tax personnel.	56	47	33	136	9.398756	8
Total	-	-	-	-	1447	-	-

Source: Opinion Survey 2009

The guidelines noted for the improvement of tax administration of Nepal were ranked in order of preference of the respondents as follows:

- 1 Proper training to tax officers.

- 2 Simple tax procedures.
- 3 Better tax information system.
- 4 Simple tax policies.
- 5 Realistic tax policies.
- 6 Better coordination with custom office, banks registration office and others.
- 7 Educating tax payers.
- 8 Motivating tax personnel.
- 8 Better public relation by tax office.

From above, the conclusion is drawn in such a way that proper training to tax officers, simple tax procedures and better tax information system are the main notable points for the improvement existing level of tax administration in Nepal.

8. Attitude towards changes of collection pattern by efficient tax administration after restoration of democracy:

Table 4.2.14

Attitude towards changes of collection pattern by efficient tax administration after restoration of democracy

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	18	60	12	40	30	100
B	12	80	3	20	15	100
C	13	86.67	2	13.33	15	100
Total	43	71.66	17	28.33	60	100

Source: Opinion Survey 2009

Since, it has been said that the tax administration in Nepal after restoration of democracy has been improved.

It is cleared from above table that there is significantly change in tax administration with special reference to its collection procedure. Because majority of respondents i.e. 71.66% were in favor of change and only 28.33% are in against. If it is individually analyzed, then it is seem that most of respondent from group A i.e. tax administration are either not responding or denying the change due to recent political development in the country. Thus, who did not respond, were also included in rejecting the change in tax administrator.

9. Attitude towards difficulties and complexities after implementing ITA, 2058:

To know the attitude of respondents towards the difficulties and complexities faced by respondents after its implementation, a question was asked 'Do you think that implementing ITA, 2058 has created difficulties and complexities in tax administration?' The responses received from the various respondents are tabulated as below:

Table 4.2.15

Attitude towards difficulties and complexities after implementing ITA, 2058

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	15	50	15	50	30	100

B	11	73.33	4	26.67	15	100
C	13	86.67	2	13.33	15	100
Total	39	65	21	35	60	100

Source: Opinion Survey 2009

From above table it is cleared that the majority of respondent i.e. 65% felt that implementation of ITA, 2058 has really created difficulties and complexities whereas 35% of the respondent were in against of the statement. The conclusion drawn from it is that is reality, stakeholders of tax are facing difficulties after implementation of ITA, 2058.

To know the view of respondent towards causes of being difficulties faced by tax administration after implementation of ITA, 2058, they are asked to rank given causes according to their priority. The break down of the responses is shown as follows:

Table 4.2.16

Major causes towards difficulties and complexities after implementing ITA, 2058

S.N.	Major Causes	Groups			Total Points	Percent	Rank
		A	B	C			
1	Tax payers and tax administrators have not got orientation before	75	72	83	230	29.75	1

	application of Act.						
2	Many confusion regarding new provisions and procedures.	62	66	58	186	24.06	3
3	Difficult to understand the Act.	82	75	32	189	24.45	2
4	Inclusion of more theoretical aspect than practical aspect	55	61	52	168	21.74	4
	Total	-	-	-	773	-	-

Source: Opinion Survey 2009

The major causes for being the difficulties faced after implementation of ITA, 2058 are ranked in order of preference of respondents as follows:

1. Tax payers and tax administrators have not got orientation before application of Act.
2. Difficult to understand the Act.
3. Many confusion regarding new provisions and procedures.
4. Inclusion of more theoretical aspect than practical aspect.

To know there is significant relationship or not between the above views of tax administration and tax payers (keeping the views of tax experts constant), it is tested by spearman rank correlation coefficient.

Test of Hypothesis:

Hypothesis 3

H0: $\mu=0$, there is no significant relationship between the views of tax administrators and tax payers with respect to the causes of being difficulties arising after implementation of ITA, 2058.

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

Table 5.2.17

Calculation of Spearman's Rank Correlation Coefficient

S.N.	Major Causes	Total points X	Re rank R1	Total points Y	Re rank R2	Difference of rank d=R1-R2	Square of R1-R2=d ²
1	Tax payers and tax administrators have not got orientation before application of Act.	75	2	83	1	1	1
2	Many confusion regarding new provisions and procedures.	62	3	58	2	1	1
3	Difficult to understand the Act.	82	1	32	3	-2	4
4	Inclusion of more	55	4	52	4	0	0

	theoretical aspect than practical aspect						
Total		-	-	-	-	-	6

Source: Table 5.2.16

Note: X refers to tax administrators and Y refers to tax payers.

Substituting the value, we get

$$r_s = 1 - \frac{6 \times 6}{4(16-1)} = 0.6$$

The critical value of r_s at 10 percent level of significance for $n=4$ are ± 0.80 , that the upper limit of the acceptance region is 0.80 and the lower limit of the acceptance region is -0.80.

Decision:

Since, r_s calculated lies in the acceptance region (± 0.80). Therefore, the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers with respect to the causes of being difficulties arising after implementation of ITA, 2008.

5.1 Major Findings of the Study

On the basis of previous chapter data presentation and analysis, some important and major findings can be drawn. The major findings of this dissertation are summarized as follows:

- In the structure of government revenue of Nepal, VAT/Sales tax, customs, income tax, excise duty and land revenue & registration are the major sources. The average contribution of VAT/Sales tax, custom, income tax, excise duty and land & revenue were 28.49, 20.10, 14.64, 10.03 and 2.82 percent respectively for the fiscal year 2004/05 to 2008/09. If we evaluate individually, contribution of custom is in decreasing rate for several years. Overall tax revenue has more than 75 percent contribution in total revenue within the country.
- However, there is a fluctuation in non tax revenue for several years; the contribution of it is less than 25 percent of total revenue.
- The income tax /GDP ratio of Nepal is not found in satisfactory level. The trend is found to be in a fluctuating trend. The income tax as a percentage of GDP was 1.71% in 2004/05 and now the same percentage is 1.48 in 2008/09 after a decrease from 2.14 in 2007/08.
- While evaluating tax with connection to Gross Domestic Product of five years, it was found that the tax/GDP ratio was fluctuating in various fiscal years. It was 12.78% in 2004/05 increased to a highest point of 14.22% in 2007/08 and then decreased to 9.53% in 2008/09.
- In the fiscal year 2006/07, the net contribution of income tax was 15.93 percent out of total tax revenue of Inland Revenue Department which was not satisfactory and the connection was also improved in the fiscal year 2008/09.

From the Opinion Survey 2009, the following findings have been drawn:

- Nepalese tax system has poor performance due to mainly following reasons:
 - Lack of meaningful tax payer information.
 - Lack of tax payers' education.
 - Problems of evasion and avoidance.

- Income tax is not a barrier for people of higher level income.

- Income tax is not playing effective role to reduce the gap between rich and poor. The main reasons as stated:
 - Widespread evasion and avoidance.
 - Lack of tax consciousness.
 - Poor tax administration.

- Tax administration was not found at efficient level. The main reasons as stated:
 - Lack of trained and competent staff.
 - Lack of information.
 - Lack of motivation in tax personnel.

- After implementing ITA, 2058, the widespread power of tax official was found to be decreased.

- From the perspective of tax administrators, there was found enough legal opportunities to handle tax payers' grievances.

- Tax administration and its collection were found to be changed in positive way after restoration of democracy.

- After implementing ITA, 2058, certain difficulties were found to be faced by tax officials.

They are:

- Tax payers and tax administrators have not got orientation before application of Act.
- Difficult to understand the Act.
- Many confusion regarding new provisions and procedures.

CHAPTER-5

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Nepal is rich in natural heritage and bio-diversity. There is underutilization. The per capita income is estimated to be Rs 33840 which is equivalent to USD 470. To reap the advantage from the improved trends in a global economy and to sustain economy growth at higher level, Nepal needs undertake of flexible and appropriate structure reform measures primarily in the tax administration.

For self sustain, government must be able to generate sufficient revenue, which is the most important sources of financing. Through the proper administrative strategy, the national objective can be achieved. For the self-reliant economy system and sound infrastructure, government should generate public revenue since public revenue is the income of the government. To meet the public expenditure, government collects fund through external and internal sources. Tax is the most important sources of the revenue. So the collection should be more flexible to achieve social and economic welfare. Collection of tax helps in redistribution of economic means by the transformation of wealth from person with higher economic level to lower economic level.

Although the legal provision are made and update from time to time, many problem exit in tax administration in Nepal, The leakage in tax feeling of people about tax is a penalty, payment of additional tax, lack of consciousness of people, in inability of tax administration to cover the new tax payer within the tax portfolio, delay in tax assessment and collection, lack of accuracy

and uniformly in accounting system, high cost of tax collection etc. are some example of such problem.

The proportion of tax revenue in the total revenue has always been more than 75% since the fiscal year 2004/05 to 2008/09. This shows the greater importance of tax revenue and the need of improved roll of tax administration system in Nepal.

The structure of government revenue of Nepal's formulated by Customs, excise, sales tax (VAT), income tax, land and revenue registration, miscellaneous tax revenue and non tax revenue. The revenue from sales tax/VAT varies from Rs 18885 million to Rs. 29817 million from fiscal year 2004/05 to 2008/09. The average percentage of sales tax/VAT to total revenue during the period was 28.49 Percent, the highest among other.

Second to it the customs which increased from Rs. 15701 million to Rs. 21062 million from fiscal year 2004/05 to fiscal year 2007/08. The average percentage of it to total revenue being 20.10 percentage during the period. Income tax has occupied third position due to its average percentage to total revenue being 14.64 percent. It is increased from Rs. 9402 million to Rs. 16223 million from fiscal year 2004/05 to fiscal year 2007/08.

Land revenue and registration increased from Rs. 1799 million in 2004/05 to Rs. 2940 million in fiscal year 2007//08 but it decreased to 2722 million in the final year of the study period. The average contribution of land revenue and registration to the total revenue was 2.82 % during the period revenue from miscellaneous tax increased from Rs. 1870 million in 2004/05 to 3901 million in 2008/09.

Non tax revenue during the study period was found to be in a fluctuating average contribution to total revenue was 20.46 percentage during the period.

Tax GDP ratio in Nepal never exceeds 15% the average percentage of tax GDP ratio was 12.78 percent during the period of fiscal year 2004/05. This ratio decreased to 11.82% in 2005/06 and then again increased to 12.97 in fiscal year 2006/07. This ratio was highest in 2007/08 as 14.22% and then again decreased to 9.53 in the final year of the study period.

The analysis of revenue collection by IRD shows that tax revenue has the greater contribution i.e. 54 percent of the total revenue followed by VAT 18 percent income tax 17 percent, excise duty 9 percent and vehicle tax 2 percent.

Analysis of primary data shows that Nepalese tax system has poor performance. 73.33 percent of the respondents agree with this fact. The major cause for being the poor performance is lack of incentive for maintenance of account followed by lack of tax payer education, problems of evasion and avoidance lack of meaning full tax payer information, defective assessment procedures and other.

70 percent of the respondents do not agree that income tax acts as a discouragement factor for earning higher income. 13.33 percent of the respondents say that income tax is highly effective to reduce the gap between rich and poor. 40 percent of them say that it is fairly effective where as majority of the respondent is 46.67 percent says that income tax is not effective to reduce such gap. The major reason for the income tax not reducing such gap as ranked by the respondents are widespread evasion of taxed, lack of tax consciousness poor administration, inefficient instrument for reducing the gap by income tax and so on.

65 percent of the respondents say that tax administration in Nepal is not efficient. The major reason behind such inefficient are lack of trained and competent staffs, lack of information, and lack of motivation in tax personnel, complicated tax laws lack of co-ordination with in tax department and so on.

Majority of the respondent is 86.67 percent says that tax officer in Nepal do not have wide speed boundless power.

66.67 percent of the respondent agrees that tax payer have adequate administrative and legal opportunities for redressing their grievances.

For the improvement of tax administration Nepal respondents ranked proper training to tax officer of the no 1 guide line followed by simple tax procedures better tax information system, simple tax policies realistic tax policies as 2nd, 3rd, 4th and 5th guide lines and so on.

More than 70 percent respondents agree that significant change has been made by efficient tax administration in tax collection after the restoration of democracy.

Major of the respondent (65%) say that implementation of ITA 2058 has brought many difficulties and complexities in tax administration. The major causes for such difficulties and complicities are tax payer and tax administration no it getting orientation before application of the act, difficult to understand act, confusion regarding new provision and procedure and finally inclusion of more theoretical aspect than practical aspect.

4.2 Conclusion

After restoration of democracy, particularly from point of conflict there has been a dramatic change in the composition of public expenditure. The public expenditure pattern has show in early 1990s regular expenditure accounts for about one third of expenditure and the development expenditure was about two thirds of the total public expenditure. But the regular

expenditure increased rapidly and exceeded the development expenditure during 1998/99. In recent years, the volume of development expenditure has also decreased in real terms.

On the other hand, the development expenditure is increasing at a slow rate which is not desirable condition for country like Nepal. Because only development expenditure is responsible to create the infrastructure required for economic development and the execution of many projects to improve social conditions such as health and education.

Public revenue, main source to fulfill the need of public expenditure has not been able to pace with public expenditure. The public revenue are of two types i.e. tax revenue and non tax revenue. Tax revenue contributes about 75 percent of the total revenue while the non tax revenue represents about 25 percent of the total revenue. To increase the revenue through non tax revenue is very tough job due to its rigidity characteristics. So, it is necessary to make every effort to generate more revenue through taxes, which are levied on commodities, incomes and properties.

Income tax is one of the most important resources of the government revenue and it is considered as a good remedy to cure growing and serious resources gap problems of Nepal. Contribution of income tax for the economic development of Nepal has been increasing significantly in recent years as compared to past seventeen years but does not meant that it has the share in satisfactory level.

Nepal attracts foreign assistance in the form of grants and loans from different bilateral and multi-lateral donors. Till the 1980s, grants were used to be major component of foreign assistance, but after 1980s, loans have been increased at significant level. Since, public revenue and foreign grants lay behind in relation to public expenditure; there is a large deficit in the fiscal system. Furthermore, heavy reliance on external loans indicates a danger of debt trap

since Nepal will have to pay a higher amount of principal and interest. Just like external loans, internal loans also cause inflationary pressure.

Since, a large part of revenue is spent on regular expenditure, there has been very little revenue surplus, i.e. revenue minus regular expenditure. Revenue surplus provides a small part of total development expenditure. The situation has become even more critical in recent years.

Since, non tax revenue cannot be used as an effective instrument of revenue mobilization; attempts must be made to mobilize more tax revenue through the reform of the tax system.

The major steps attempted to reform the tax systems are found as:

Introduction of VAT:

As a part of tax reform, it has been implemented. It replaced the sales tax, hotel tax, contract tax and entertainment tax.

Implementation of new Income Tax Act:

The Income Tax Act of 2058 was introduced in place of Income Tax Act, 2031. It is comprehensive and follows modern concepts. It adopted full-flagged self assessment system and reduced the discretionary power of tax official. Although, it has many difficulties and confusions at execution level.

Administrative Reform:

A functional organization was established in mid July 1996 for the administration of VAT. It was computerized in order to establish a strong database and an information based tax system.

Income tax and VAT has been merged in order to avoid duplication and overlapping of functions. It is now being beneficial for parties, government and tax payers.

The new unified administration is structured along functional lines, which is expected to reduce the scope for collusion and corruption. A large tax payer office is also opened mid-January 2004.

Implementation of VDRS:

The 1st elected republican government and the then finance minister Dr. Baburam Bhattarai took an initiative to implement the Voluntary Disclosure of Revenue Scheme (VDRS) in the fiscal year 2008/09. This scheme has a positive impact on the income tax collection and the achieved result was pretty much greater than the targeted amount.

Introduction of a Toll Free Number/SMS:

The IRD office has just introduced a toll free number and launched SMS service to answer the different kind of queries of the tax payers. This will be a great implication and it will be beneficial in terms of more revenue collection in the coming days by fulfilling the queries of general people.

Introduction of E-TDS, E-PAN and E-filing:

IRD has started E-TDS, E-PAN and E-FILING system recently for the convenience of tax payers. This system will ease on electronic registration of personal accounting number (PAN), and to know the status of vat return on sales files. This is another milestone in tax administration of Nepal and will have a positive effect.

5.3 Recommendations:

Without efficient tax administration, tax policy does not work. So, time to time measurement of tax administration and its reform is must. To increase the efficiency of tax administration reform of tax administration is needed on all fronts such as the organizational structure, the personnel system, the incentive package, tax procedures, automation and the appeal system.

They are described as follows:

1. Organizational Structure:

- a. Inland Revenue Administration is based on functional basis, but it has not been implemented strictly. So, focus should be given for implementation.
- b. The recently created LTO must structure functionally and it should have adequate physical facilities. The best resources should be arranged for this office.

2. Specialized Group:

- a. Since, taxation is taken as semi technical discipline. Thus, its administration needs to be developed as a professional group. Tax audit is very important for the success of self assessment system. Thus, good knowledge of accounting and auditing is must for tax personnel.
- b. There is a need to create some technical positions to carry cut some technical functions in the tax administration.

- c. Appropriate selection process should be adopted for tax officials. The recruitment process must be made faster, so that the tax administration can have the required number of tax officers on time.

3. Human Resource Management:

- a. It is necessary to create an appropriate working environment that should include higher salaries among other things so that competent professionals can be attracted and retained in tax administration.
- b. Incentives should be given in various forms. For example, they could be paid a certain percentage of the difference between the actual tax collection and tax targets.
- c. Training must be institutionalized. Tax personnel should be given comprehensive training on various aspects of taxation in a phase wise manner.
- d. Personnel management system should be developed with which the evaluation of tax officials is done on the basis of their overall work performance.

4. Procedural Simplification:

- a. Registration under any tax should be made simple. De-registration should also be easy.
- b. Blank tax return forms should be made easily available tax offices, post offices, banks, local chambers of commerce and industry or other public places.
- c. Tax payers should be allowed to pay tax to any bank, not on any specified government owned bank only.
- d. Appropriate collection strategy should be adopted. Immediate action must be taken to collect large dues.
- e. The due amount should be collected on the basis of time period, i.e. the oldest due should be collected first.
- f. Tax payers should be selected for audits on the basis of risk assessment where there is a possibility of an error and high revenue significance.

5. Computerization:

- a. The automation should be developed in tax administration in order to facilitate the day to day work of the tax administration and to ensure transparency in tax administration.

- b. The data should be exchanged between the tax departments.

6. Priority:

- a. To increase the level of voluntary compliance, establishment and expansion of information systems and encouragement of tax payer's education is must. The national of taxation needs to be targeted at the school and college level.
- b. Tax administration should control, design, analyze and schedule in a systematic way.

7. Internal monitoring:

- a. Considering the small size of the Nepalese tax administration and the limited number of tax payers that pay various taxes, internal monitoring could be organized jointly for VAT, income tax, excises and customs administrations.

8. Grievance Handling:

- a. At least at this movement, IRD has a process to heard grievances of tax payers once a week. But it only serves as a platform for tax payers to express their grievances, but it has no legal basis. Therefore, it is necessary to create legal basis for this.
- b. Some professionals such as lawyers and chartered accountants could also be involved in the grievance handling process.

9. Independent Appeal:

An appeal system should be established as independent and important. It should cover administrative and tribunal levels.

10. Revenue Advisory Board:

- a. The existing structure of the revenue consultation committee should be a small team of full-time members in order to carry out serious research and advise the finance minister on tax policy.
- b. There should have a few permanent staff to facilitate the work of the committee.

11. Autonomous Revenue Authority:

- a. The concept of ARA is not new. To reform the tax administration, it has a very crucial experience in the overall tax reform process, particularly since the mid 1980s. Since, tax administration is a part of civil service. But some countries have tried to reform tax administration within the civil service. This is done by changing civil service rules regarding recruitment, transfer, promotion, salary and other incentive packages in order to create a proper working environment and also to make it more effective and efficient. To retain qualified staffs, it is necessary to create a suitable environment for them. Some countries have found it very difficult to reform tax administration under civil service system. Due to this reason, it becomes difficult to attract and retain good and competent people in tax administration through public service. Thus, some countries have tried to create the desired environment by taking the tax administration out of the civil service and creating an Autonomous Revenue Authority (ARA) as a shortcut to reform.
- b. The concept of autonomous authorities is not new to Nepal; the government has already created three authorities, the Nepal Electricity Authority, the civil Aviation Authority of Nepal and Nepal Tele communications Authority. If it is decided to set up an ARA in Nepal, the ARA could be made responsible for handling VAT, income tax, excises and other minor taxes first, and at a later stage, customs duties could be added. House and land registration fees could be administered, as new, by the land revenue and management department, which should be kept outside the purview of ARA.
- c. The ARA should be managed by a professional organization, by a strong management as it administers the tax laws. A governing body should be created to oversee the ARA, but there should be no intervention from the governing body in the day to day activities of the ARA. The ARA should be accountable to the ministry of finance. It should serve as the provider of information and input needed for the formulation of tax policy by the ministry of finance and implement tax policy. The overall authority to administer the laws as they relate to specific tax cases must rest with the head of the ARA.

- a. The concept of ARA should be adopted after reviewing the prevailing socio cultural and political environment of Nepal.
- b. There is a need of adoption of strong recruitment and selection process.
- c. Strong system of reward and punishment is must.
- d. There should not be interface by the outsides such as political leaders, business houses etc.
- e. Since, revenue is the key for development and independency of a country, the process of implementing concept should be adopted in incremental way, not in big bang.

12. Reward system:

Inland Revenue department should disclose the name of highest corporate and individual tax payer and either provide them certain subsidy or a prize/reward to motivate them and to attract more tax payers in the coming days.

13. Mandatory tax system:

Recently the government removed the income tax ceiling on individuals and implied 1% mandatory tax paying system as a social security tax but this system does not seems to be effectively working as promised. The government and IRD should revise this system as it seems to be a burden to the low earning people and providing security is a primary responsibility of the government itself.

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Appendix 1

Dear Sir\madam

I would like to request you to fill the attached questionnaire prepared for the collection of your opinion as precious data input for my research work.

This research is conducted for the partial fulfillment of the requirement of Master of Business Studies (MBS) degree. The research is related to the title "**TAX ADMINISTRATION AND IT'S EFFECTIVNESS IN NEPAL**". The responses provided by you will be taken as input for this research only and will be kept confidential and will not be published anywhere else.

Please answer the following questions by ticking, rating, ranking whichever as demanded by question. Your kind cooperation will be of high value to complete this study successfully and will be highly appreciated.

Thank you

Marizman Limbu

Researcher

(MBS)

Shanker Dev Campus

Appendix- 1

Tax administration and its effectiveness In Nepal

Questionnaire

Name :

Designation :

Office :

Please tick (✓) the suitable answer of your choice from the following question and wherever appropriate please rank them on the basis of number of alternatives and importance.

1. Do you think that income tax administration system has poor performance in Nepal?
 - a. yes
 - b. No

If yes, what are the major causes of being poor performance in income tax systems? (Please rank 1-9, according to the priority)

- a. lack of incentives for maintenance of account .
- b. lack of meaningful tax payer information .
- c. defective assessment procedures.
- d. complicated collection procedure.
- e. Failure of public sector enterprises to pay the tax.
- f. Tax concession granted to industries located at remote area.
- g. Lack of tax payer education.
- h. problem of evasion and avoidance.

2. Do you think that tax administration acts as a discouragement for earning higher income?
 - a. Yes

b. No

3. How effective is the role of income tax to reduce the gap between rich and poor.(please tick ☒ to choose one of them)

a. Highly effective

b. Fairly effective

c. Not effective

If not effective, what causes are responsible for not reducing the gap between rich and poor. (please rank according to priority)

a. Wide spread evasion of taxes.

b. Small number of tax payers.

c. Insufficient instruments for reducing the gap by income tax.

d. Poor tax paying capacity.

e. Lack of tax consciousness.

f. Defective government expenditure programs.

g. Defective tax rates.

h. Poor administration.

i. Decreasing purchasing power of people.

4. Do you think that tax administration in Nepal is efficient?

a. yes

b. No

If not, what are the major reasons for inefficient tax administration in Nepal? (Please rank according to priority)

- a. Lack of trained and competent staff.
- b. Complicated tax laws.
- c. Lack of information.
- d. Unnecessary outside pressure.
- e. Undue delay in making assessments.
- f. Lack of coordination within the tax department.
- g. Lack of motivation in tax personnel.
- h. Defective procedures.
- i. Defective organizational managements.

5. Do you think that tax officer has widespread boundless powers in Nepal?

- a. yes
- b. No

6. Do you think that tax payers have adequate administrative and legal opportunities for redressing their grievances?

- a. yes
- b. No

7. What are the guidelines for the improvement of tax administration in Nepal? (Please rank according to priority)

- a. Proper training to tax officers.
- b. Better coordination with customs office, banks, registration office and others.
- c. Better tax information system.
- d. Better public relation by tax office.
- e. Simple tax policies.
- f. Realistic tax policies.
- g. Simple tax procedures.
- h. Educating tax payers.
- i. Motivating tax personnel.

8. Has the collection pattern by efficient tax administration after the restoration of democracy improved?

- a. yes
- b. No

9. Do you think that implementing ITA 2058 has created difficulties and complexities in tax administration?

- a. yes
- b. No

If yes, what are the major difficulties and complexities? (Please rank according to priority)

- a. Tax payers and tax orientation before application of act.
- b. Many confusion regarding new provisions and procedures.
- c. Difficult to understand the act.
- d. Inclusion of more theoretical aspects than practical aspects.

85660000	Tax Revenue
29651900	VAT
27087000	Income Tax
14073000	Excise Duty
35000000	Vehicle Tax