

A STUDY ON INCOME TAX SYSTEM IN NEPAL

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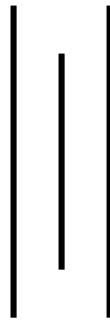
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RECOMMENDATION

This is to certify that the Thesis

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A STUDY ON INCOME TAX SYSTEM IN NEPAL

has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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DECLARATION

I, hereby, declare that the work reported in this thesis entitled “**A STUDY ON INCOME TAX SYSTEM IN NEPAL**” submitted to office of the Dean, Faculty of Management, Tribhuvan University, is my original work done for the partial fulfillment of the requirement for the Masters of Business Studies (MBS) under the supervision of Prof. Dr. Kamal Deep Dhakal of Shanker Dev Campus.

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Finally, due to limitations of resources constraint and others the study may be shortcoming. So I do not heart to declare that the study is comprehensive. I hereby, take responsibility of any defects of analysis or error in this thesis.

Bhagirath Nyaupane

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ABBREVIATIONS

CA	Chartered Accountant
DCs	Developed Countries
DT	Direct Tax
DY	Deputy
Eg.	For Example
FY	Fiscal Year
GDP	Gross Domestic Product
GON	Government of Nepal
i.e.	That is
KTM	Kathmandu
MOF	Ministry of Finance
SN	Serial Number
TA	Tax Administrator
TE	Tax Export
TP	Tax Payer
TU	Tribhuvan University
UDCs	Underdeveloped Countries
VAT	Value Added Tax
WDR	World Development Reports

CHAPTER- ONE

INTRODUCTION

1.1 General Background

In modern days, government invests its revenue for the social welfare towards its people. From ancient time to modern age, government fulfills its responsibility by spending a certain amount towards its people. In the ancient time government manage its fund by internal resources and spend in the war. Now the time has changed, from government to people all know their responsibility. Government is very careful towards its social responsibility and people themselves are too much concerned towards nation. They want to contribute a little amount of their income to the government and the government invests for peace and security, education, development etc.

Today, to achieve the more demanding social welfare of its nation the government must have sufficient fund. For this the government has two alternatives, one is internal and the other is external resources.. Internal resources are convenient, certain and long different sources .In the word, most of the developing countries are well experienced regarding external sources and its negative impact to the economy. It is because nobody wants to invest a huge amount without benefit. So the best alternative for the nation as to mobilize internal sources that is certain, convenient and one should not beg its hand to other.

The main and reliable internal source is tax. Tax is compulsory contributed by a person without hoping and personal benefit. According to Frindley Shirrag "Taxes are compulsory contribution to the public authorities to meet the generate expenses of government which have been incurred for the public good and without reference to special benefits." The tax can be divided

in to two parts, one internal sources and another external sources. Internal sources of funds are tax and non-tax revenue. Among them tax is the most important source of government revenue because it occupies largest and part of total revenue. Tax is not a fine. Government collects tax with the permission of legislature to fulfill financial needs of the state. It is a compulsory payment to government for the composition of public expenditures. Tax fulfills the needs of central or local government to spend for philanthropic work. The main objective of tax is to distribute wealth and income equally.

Tax is classified in two groups. They are direct and indirect tax. A direct tax is really paid by the same person on whom it is legally imposed. Tax payer cannot collect direct tax from other persons .Income tax, interest tax, contract tax, vehicle taxes are same examples of direct tax. Direct tax is paid according to the income or property earned by a person. An indirect tax is imposed on one person but paid partly or wholly by another example of indirect taxes are customs, excise, contract tax ,value added tax etc. There is uncertainty about the collection of indirect tax. Every person either rich or poor pays equal amount of tax on receipt of goods or services. So, it seems as regretful for poor person.

Taxes can be classified into two types according to the firm. They are direct and indirect tax. Direct tax is a tax on income and property. The characteristics of a direct tax are equitable as per the property or income, certainty as per the process of payment to be paid, time of payment, elastic in nature etc. The examples of direct tax are income tax, property tax, vehicle tax and inheritance tax. (Kandel, 2003:8)Indirect taxes are those taxes, which are collected from the goods or services, used. These taxes can be shifted by the tax-payer to some other persons or organizations. The examples of indirect taxes are VAT, sales tax, Excise duty, Entertainment tax etc.

Income tax is a personal tax imposed on the income of individuals and corporation. According to tax economists." An income tax is a levy imposed up on the income of individuals after the exemption limit. Income tax is direct tax based on the total income of the payer from all sources and is graduated on a special system of exemption. "The concept of income tax differs in different countries. In United Kingdom the original concept of tax was applied to five schedules. In United State of America, income tax is viewed, as a matter of practice, recurrent is not relevant to the tax status. In India, the personal income tax is levied on the net of all individual, joint Hindu families, unregistered firm and other associations of person (Due & Fried Lander. 1977:111). Income tax can easily be modified to give elasticity in raising revenue and is highly productive, in a developing country like Nepal. Income tax is the major contributor towards government treasury among direct taxes.

Income tax helps to prevent the concentration of wealth in a few hands by imposing higher rate to those persons where income is high and lower rate to those persons whose income is less it also helps to increase the government revenue, which can use for good governance, to develop infrastructure, provide general services etc. Income tax is not only essential for collecting government re/venue but also to control over consumption, to promote saving and to generate more employment. (Nyaupane, 2005:2)Income tax system was introduced in England in 1799 to manage the War. Similarly, corporate income tax originated in USA in 1862 in order to manage the civil war. In 1909 federal corporation income tax was originated in Nepal. Income tax was imposed in 1959 by enacting Business, Profit and Remuneration Tax.

Income tax Act 2058 replaced income tax act 2031, and other acts related to income tax.

- a) Income from a Business.
- b) Income from an Employment.
- c) Income from an Investment.

In earlier days both individual and corporate tax was taxed on progressive rate. Now the income tax Act 2058 B.S has been implementing since 2056 Chaitra. Income tax plays a vital role in Revenue collection in National economy. It is a tool for achieving maximum social economic objectives as laid down by the constitution of Nepal. Today tax is the major instrument for the government to achieve the rate in economic growth and to increase in capital formulation. Ancient tax system was based on Vedas, Smritis, and Purans directives propounded by Manu, Yagyabalaka, and Chanakya etc guided the taxation system. At that time the principle of collecting tax from the people was imposing of tax without harming the activities of the people.

Income tax management is the process of planning, organizing, directing, and coordination, communicating and controlling income tax in systematic and scientific manner. It plays the vital role in income tax system. Income tax, in modern age, is recognized as a most important in instrument for resources mobilization. Internal resources must be mobilized properly to achieve the goal of National Development. It is believed that minimum required of people can be fulfilled through economic and social development. Every development activity requires capital. Income tax is one of the sources of government revenue and it can play vital role in internal source mobilization if it is managed properly. (Lamsal, Bharat Kumar: 21)

The objective of income tax management is to achieve the goal of income tax system. The objectives of income tax management. Thus, is to impose income tax on people for maximum revenue collection without making it burden some to

the tax payer, so that the economic imbalances can be reduced and balance regional economic development can be achieved.

This study is related to following income tax act:

-) Business profit and Remuneration Act 1960.
-) Income tax Act 1962.
-) Income tax Act 1974.
-) Income tax in Nepal before income tax Act, 2058.
-) Income tax Act 2058 (including objectives and features).
-) Inland Revenue Management in Nepal and its Administrative Aspects.
-) The purpose of imposing tax on person's income.
-) h) Main objectives of Inland Revenue Department for the Revenue Management.

1.2 Statement of the Problem

Government has to spend a lot of money to fulfill responsibility towards its people. I lie responsibility may be for either security or special services or economic development or other development activities. Therefore, government expenditure is increasing day by day. To meet the growing public expenditure, the government has to manage its funds from internal as well as external sources. Such external sources are an uncertain, inconvenient and not good for healthy development if there is heavy dependent on them. It is better to mobilize internal sources rather than expanding with beggar's eyes to the donors. Taxes are important sources of public revenue and major fiscal policy instrument have an important role in increasing the role of capital formulation and there by achieving a high rate of economic growth. Nepal is facing the serious problem of recourse gap, which is and high dependency of foreign loan. Cutting expenditure on development work infrastructure and social services will not like just for a

country crawling toward development. Therefore, higher resource Mobilization through taxes remains to be the best option.

In Nepal, resource mobilization is still poor that does not cover the growing expenditure. Because of deficit financing and external loan, the economy has to face the resource gap, which is widening continuously with the increment of total expenditure respect to total revenue collection. The resource gap was 13824.20 million in 1995/96 and 34319.2 million in 2006/07 which is presented in the table.

Table No: 1.1
Resource gap in Nepal

(Rs. in million)

Fiscal year	Total Expenditure	Total Revenue	Defect Resource gap
1995/96	46542.4	32718.2	13824.20
1996/97	50723.7	36361.8	14361.90
1997/98	56118.0	38340.10	17777.90
1998/99	5979.0	41587.60	17991.40
1999/00	66272.50	48605.00	17667.50
2000/01	79835.10	55647.00	24188.10
2001/02	80070.20	57131.60	22940.60
2002/03	84006.10	67568.90	16437.20
2003/04	89442.60	73614.40	15828.20
2004/05	102560.4	84513.9	18046.5
2005/06	110889.2	86109.6	24779.6
2006/07	122532.4	88213.2	34319.2

Source: Economic Survey, 1998, 2006 and 2008

The study of "the Nepalese budget indicates that there is a significant resource gap. The sources of filling up the resource gap are internal and external borrowing. The external borrowing has playing dominant role while fulfilling the resource gap. The uses of borrowing to fulfill the growing government expenditure bring various problems, which are mentioned above. This is

because income tax has not been playing any significant contribution to the government revenue because of growing resource gap that exists in Nepalese economy, there is no better alternative to finance the additional expenditure in the budget except deficit financing although its nature is inflationary. Each budget contributes enlarging its size in the budget. Therefore, its increasing trend is still continuous. Government expenditure is increasing day by day while there is no equivalent increase in government revenue. Such unbalance growth in revenue and expenditure has resulted in massive revenue expenditure gaps or budgetary deficit in the country. The major causes of persisting fiscal deficit in Nepal is inadequate mobilization of resource, which, in turn, is due to poorly designed defective tax structure. The design of tax in Nepal is so poor and defective that as revenue rising instruments they always have very disappointing for performance. The weak performance of taxes is rising revenue is clearly reflected in Nepal's low tax GDP ratio.

Nepal's low revenue mobilization is due to the poorly designed and defective tax system when the taxes are less productive, less responsible and distortion.

Therefore, to raise government revenue it is necessary to raise its internal source of revenue. Internal source of revenue constitutes tax and non-tax revenue. Government has adopted various policies to strengthen the revenue structure of Nepal. Government self-tax assessment system to enhance the government revenue. Although, there was higher tendency problems in Nepalese income tax system. Government effects to increase income tax revenue is hammered by inefficient tax administrative system, widespread income tax evasion, and complicated and frequent change in tax rate and in policies are appearing a major factor for low contribution income tax revenue to national revenue.

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

1.3 Objectives of the study

The main objectives of present study are as follows:

- 1) To analyze the contribution of income tax to national revenue of Nepal.
- 2) To examine the effectiveness of income tax revenue collection in Nepal.
- 3) To examine the views of the taxpayers, tax experts and tax officers about various aspects of present income tax.

1.4 Need of the study

Government needs money to run its responsibility. To fulfill the need, government collects money from different sources, among them, the income tax is one of the most important sources of government revenue. The portion of income tax can be increase by imposing higher rates of interdicting new taxes or collecting income tax properly within existing portfolio. But most of the Nepalese people are under the poverty line. Introducing of new taxes and proper collection of tax depends up on good income tax system mainly in income tax management. Presently the study aims examine the effectiveness of income tax collection in Nepal. The major areas covered by this study are as follows.

- 1) Nepalese tax structure.

- 2) Government revenue from direct and indirect tax.
- 3) Existing position of income tax in Nepal.
- 4) Role of income tax in Nepal.

1.5 Limitations of the study

Due to various constraints, this study is focused to analyze the only certain aspects income tax management for Revenue collection in Nepal. Having outlined the objectives, statement of problems and methodology of the study, now brief note of its principal, limitation which are stated below. The study is based on purely income tax management for Revenue collection in Nepal.

The Major limitations of this study are as follows:

1. Basically, secondary data has used in this study.
2. Due to small sample size, it may not fully represent Nepal as a whole.
3. The study has covered data only from fiscal year 1995/96 to 2007/08.
4. Absence of required data concerned with income tax of various countries limits to details study.

1.6 Scheme of the study

The study has organized in five chapters. The first chapter is introduction chapter, which includes general background, statement of the problem, objectives of the study, need of the study, and limitation of Study.

Second chapter is about the literature Review through different relevant books, journals, and unpublished dissertations.

The third chapter is Research Methodology, which includes types of Research, Research Design, Population and Samples, Nature and Source of Data, Data Collection Procedure and Data Processing and Analysis Procedure.

The fourth chapter is the main body of research which is Data Presentation and Analysis. The contents of this chapter are Nepalese Government Revenue Collection Structure, Composition of Tax Revenue in Nepal, Composition of Indirect and Direct Tax Revenue, Income Tax Collection Performance in Nepal, Tax- GDP Ratio, Result of the Opinion Survey and major findings.

Summary, Conclusion and Recommendation are presented in this fifth or last chapter.

CHAPTER-TWO

CONCEPTUAL FRAME WORK AND REVIEW OF LITERATURE

2.1 Conceptual Frame Work

2.1.1 Concept of Tax

The government of any country needs sufficient money to lunch the development programs, to handle the daily administration, to keep peace and security and to lunch other welfare programs. When there is no money; no departments or lower level offices of the government work as the parts of the body stop working when there is no blood circulation. The government collects revenue from different sources like tax, price of goods or services provided by the government, receipt from public enterprises, fees, fines, grants etc. In short, all the sources of the government revenue can be divided into two parts- tax and non-tax. Tax is the major source covering most part of the government revenue.

Tax is a compulsory payment to the government. Taxpayers do not get any direct benefit from the state by paying tax. Tax is not a fine. Government collects tax with the permission of legislature to fulfill financial needs of the state. Tax is a compulsory payment to government for the compensation of public expenditures. Tax fulfills the needs of central work. The main objective of tax is to distribute wealth and income equally. Mainly, tax is classified in two groups. They are direct and indirect (Adhikari, 2003).

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

According to Plehan," Tax is general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefit upon the residents of the states" (Dhakal, 2002:2).

According to classical economist Dalton "A tax is a compulsory contribution imposed by a public authority irrespective of the exact amount of service rendered to the taxpayer in return and not imposed a penalty for any legal offence."

According to P.E. Tylar, "A tax is compulsory payment to the government without expectation of direct benefit in return to the tax payers" (Pokharel, Amatya and Dahal, 2004:3)

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

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

Many economists have classified taxes into several categories but the major categories of taxes may be direct and indirect taxes. If a person has to pay directly the tax liability to the government, such tax is known as direct tax. A direct tax is really paid by the person on whom it is legally imposed. The taxpayer cannot collect tax from other persons. Income tax, Gift tax, interest tax, property tax, vehicle tax, house and land tax, and contract tax are some example

of direct tax. Direct tax is paid according to the income or property earned by a person. So it is found equal with and property. Direct tax has a quality of certainly, the taxpayers are informed about the amount, time and procedure of payment. Taxpayer can easily estimate his tax liability. The government can easily increase or decrease according to proper economic situation of the country. Taxpayers pay tax from their own property, so they conscious about their contribution.

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

There is uncertainty above the collection of indirect tax. Every person either rich or poor pays equal amount of tax on receipt of goods or services. Therefore, it seems as regretful for poor person. If tax imposed on higher rate, consumption reduces and also effects badly on production and employment.

In classical economics, tax was taken as an extra burden to the people and the economists were in the fervor of small government, which only had to maintain law and order in the state. But now time has changed and the government has to provide maximum social welfare to the people. Thus the government has to burden its revenue. Income tax is a direct tax. In case of Nepal, income tax is the major source of direct tax revenue.

2.1.2 Concept and Meaning of Income Tax

Income tax may be understood very easily if we first define the term "income". Income is generally regarded as the best measure of ability in the sense of economic well-being, for income is the primary determinant of the living, which a family enjoys. Income tax is a personal tax imposed on the net income of individuals and corporation. In most of the countries especially the United States of America, Canada and other countries, the income tax is defined in terms of the 'flow of wealth' of reception money or goods from the taxpayer during the period. In flow of wealth method, taxation is imposed on a realization rather than as an accrual basis' and the applies only when a transaction occurs between other person and tax payers (Due, 1959).

In a broad sense, income refers to the economic gain to a particular period of time. It includes the person's consumption during a particular period of time as well as the net increase in the individual's personal wealth during the same period. This definition can be expresses as follows:

$$Y = C + W$$

Where,

Y = income

C = Value of consumption

W = increase in wealth

Logically this is the most satisfactory definition of income in light of the objectives but it is not the approach used in tax Laws. The usual is in terms of flow of money to a limited extent of commodity to person. This is a concept somewhat easier for the non-economists to understand; it is in agreement with the every day nations of income, and it is a workable approach.

In developed countries, the most important feature of the tax policy has been the rise of the personal income tax to a significant proportion in the revenue

structure. The income tax was introduced to finance the war in most of these countries. But it remained in place after the war, primary as a relatively modest tax on higher incomes and latter became a mass- tax during or soon after the Second World War. Since then, the personal income tax revenue has a trend of unparalleled increase in real and especially in nominal terms.

In Nepal the history of income tax is not so long. It started only on late fifties. The personal income tax was introduced as a trial on the business profit and the remuneration income of the government employees. The first elected government levied the first income tax and no specific act was made to define and to treat the income tax. The first income tax act was made only on 1962 since then three income tax acts has been implemented and the new income tax act is going to be passed in the next year. The present income tax act defines "Income means the income earned or derived in cash or kind from sources mentioned in section 5" (Income Tax Act, 2031, Section 2,; p 1). The different heads of income according to section 5 are as follows:

- a) Agriculture
- b) Industry, Business, Profession or Vocation
- c) Remuneration
- d) House and land rent
- e) Other sources

Now let's define the term "income tax". Income tax, as the world itself, refers to a tax on income. In a broad sense, income tax is a levy based upon the production or receipts or period of time (Encyclopedia American, 1966: 7490). From the very beginning, income tax has been always 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 the tax according to their income. A part from such consideration as

revenue productivity, income tax has been regarded as the ideal tax from the point of view of equity (Andley, 1964: 213).

Different countries have different concepts on income tax. In Great Britain, the original concept of tax was that of a levy on recurrent income and the tax was applied to five schedules. In U.S.A, as a matter of practice, recurrence is not relevant to the net income of all individuals, Hindu in divided family unregistered firms and other association of persons (Chhellich, 1959:111)

In Nepal income tax is defined as the tax levied on the net income derived as the tax levied on the net income derived after deducting all allowable deductions. Income tax is levied on the incomes derived from business, agriculture, remunerations, professions, insurance, investment, agencies, and other sources derived in cash or kind (Singh, 1977: 160). Tax on house rent was a part of income tax before 1966 in Nepal but after that it was separated from this heading.

Income may be regular or irregular. By irregular income it is meant that income which is of the nature of non-recurring or occasional profit and is not the source of one livelihood. Chance gains are generally considered as the irregular incomes. These tend to increase the ability to pay each individual. Therefore they should be subjected to tax but in Nepal they are treated at par with regular incomes. The same rate of income tax is applied for the regular as well as irregular income.

According to income tax Act 2058, sec 2(h), income means a person income from any employment business or investment and the total of that income as calculated in accordance with this act.

2.1.3 Taxation in ancient Nepal

Reliable records about taxation in ancient and medieval Nepal are not available. However, taxation takes its earliest form in the actions of petty rulers, scattered in various parts of the country, which extracted levies and tolls from the travelers and merchants. Although land tax was the major source of revenue in ancient Nepal there did exist irrigation tax and religious monuments' preservation tax in the time of king Amsuvarma of Nepal. There was tax for purification of castes as well as cremation of the dead.

In ancient Nepal, taxes were levied in the form of kind, cash and labour. Specific portions of agricultural produce were payable to the king as tax. There also existed tax payable in gold. Fixed taxes were levied in the villages. Compulsory manual work from all artisans and laborers was also a common way of paying taxes. The nature of taxation was temporary and taxes were raised for special purposes (Agrawal, 1980: 42)

2.1.4. Taxation during the unified Nepal (1768-1816)

During the period 1768-1816, major sources of revenue in Nepal were land and homestead taxes, monopolies customs, transit and market duties, mines and mints, the export of forest produce, birds, and animals and various levies and fines. Maximization of revenue was the main objective of the tax policies during that period. Local administrators were directed "to take what ever is paid willingly by the people". The taxes were usually collected at two levels:

- a) Government: To finance administrative, military and other purposes assessed on official functionaries, occupational groups and other people.
- b) Local: Perquisites of local officials, functionaries and medicants.

Collection of customs, transit, market, and excise duties was given on contracts. In some parts of Terai, taxes were collected at specific rates on jewellery, textiles, falcons, horses, elephants, homespun cloth, yarn, blankets, borax, wax copper, iron, paper, tobacco, herbs, drugs, cotton, salt, yaks' tail, musk, sheep and goats. Levying duties on timber exports derived revenue from forests.

The various taxes levied during that period were narrow in base and were imposed primarily on occupations and economic activities, not on income or property. The system of direct taxation was confined to land and special levies like "Darshanbhet", "Salami", "Walak", etc. there was no taxation of income in the modern sense of income tax.

2.1.5 Income Tax in the International Context

Great Britain introduces the income tax in 1799 in order to finance wars with France. Only after 1880, it was accepted as a permanent tax. In United States of America, first federal income tax was imposed in 1862 to finance civil war expenditure. However it became permanent features only in 1913 after 16th amendment to U.S. constitution, his neighbor country India, at first income tax was introduced in 1860. After introducing 'income tax Act 1886, New Zealand in 1891, Australia in 1915 and Canada in 1917, after First world war, the income tax became an important source of tax revenue in many developed countries. By 1939, it has become the most important source of revenue in most developed countries and had made appearance in a number of developing nations, (Agrawal, 1978:113). From the First World War decade, income tax has shown as an important source of revenue in developed country. In the beginning of introducing time, it was generally levied at flat rate only after 1909, the principle of progression was introduced from the UK and New Zealand.

2.1.6 Income Tax in Modern Nepal

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

Parliament makes the laws to implement the various policies. The government levies and collects the income tax in accordance with law. The constitution of the kingdom of Nepal, 1990 has made the clear provision about it no taxes shall be levied and collected except in accordance with law (Constitution of kingdom of Nepal, 1990). Present legal provision of income tax is associated with constitution of the kingdom of Nepal, 1990; income tax act 2058; income tax Rules 2058; finance act of concerned financial year etc.

2.1.7 Legal Provision of Income Taxation in Nepal

The collection of income tax was the key element of the government. During that time, very few economic activities were operated on the country. The government could not collect the targeted money. At that time, taxes were levied to the merchant, travelers and farmers in the form of cash, Kind of labor. In some occasion, gold and agricultural products were also paid as taxes but the nature of these taxes were temporary and taxes were raised for special purposes (Regmi, 1971: 55)

In the lichavis regime, income taxes from agriculture income and business were introduced as direct tax for the first time in Nepal. Tax on agriculture income was called "Kara". Irrigation tax and religious monuments preservation taxes also existed at the time of king Ansubarma of Nepal. During the period of 1768-1846 AD, different types of taxes were levied to generate maximum revenue. The major sources of revenue were: birta and kipat, taxes on land, monopolies customs, transit and market duties, minies and the export of forest products, birds, animals and various levies and fines. Taxes were collected at three levels Royal palace levies, government levies and local levies. The various taxes levied during that period were narrow in base and were imposed primarily on occupations and economic activities, not in income or property. There was no taxation of income in the modern sense of income tax.

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

The major source of revenue in Nepal till 1951, were land tax, custom and excise duties in the form of lump sum contracts, royalties on forest, royalty on supply or porters and soldiers, entertainment tax and a few other minor taxes. Incomes were not taxed for raising regular revenues of the state treasury but for meting specific expenditure of the household of extra ordinary expenditure necessitated by war or other emergencies. There was no direct tax in the country except land tax collected on a contractual basis and 'Salmi' Which the government employees used to pay out of their salaries at a very small percentage. The salami was abolished in 1951. The Rana rulers did not think of development of effective

revenue administrative system. After the advent of democracy in the country in 1951, no taxes are levied and collected in Nepal except in accordance with law.

2.1.8 Importance of Income Tax

Taxes on income are the most important single source of revenue for governments of developed countries though they at present produce for less revenue in most developing countries than custom duties and taxes on internal transaction (Singh, 1985: 208)

Thus from the above lines it is clear that taxes on income are the most important sources of government revenue in developed countries. But in the context of developing countries income tax can not produce more revenue because the people of developing countries are poor as a result income tax cannot produce more revenue as in developed countries.

In very poor countries income taxes contributes between one sixth and one fifth of total tax revenue, which they are the source of about one half of total tax revenue in the United States (Singh, 1985: 208)

Like other developing countries Nepal is not an exception from the serious problem of domestic resource mobilization. There is also lack of saving and investments for economic development. To mobilize resources taxation can be used as positive instrument, in most of developing countries indirect taxes play important role than direct taxes on the overall tax structure, for a rapid growth it is essential to increase investment.

Therefore, to fulfill the required capital for investment taxation can play an important role. Income tax is a modern tax for Nepal. This is built on a scale system, and on the size of the family. Among the different components of income tax individuals' contribution is the highest with increasing ratio. In our tax structure custom duty, value added taxes, excise duties are major sources of

revenue, in come tax also contributes some portion for capital formation. The history of income tax revenue has been increasing in every year; more over it can certainly develop into a useful form of taxation in the future.

The income tax also helps to direct the flow of resource of the economy into useful and productive channel and also increases the productive capacity of the economy of income tax is properly used it can make significant contribution to other tax revenue income tax has an increasing trends. It can influence on the distribution of income and is regarded as an important instrument of growth and social justice in Nepal.

2.2.1 Main Features of Income Tax Act 1960 were as follows

- a. Only business profit and remuneration income were subject to tax. Thus the coverage of income tax was too narrow.
- b. Tax on remuneration was to be deducted at source
- c. The basis for calculating the tax liability for remuneration was the income of the current year whereas for business profits it was the profit of the preceding fiscal year.
- d. There was a provision of tax exemption on salary of foreign citizen dividend of shareholders, profits to be spent in religious or public welfare activity, crop from own land allow allowances granted by GON to ministers, assistant minister, chairman, speaker and deputy speaker, amount drawn from provided or saving fund.
- d. The tax officer was empowered to assess tax on best judgment estimation only in case of false statement of in absence of income tax return.
- e. There was a provision of fines ranged from Rs. 500/- to Rs. 5,000 in case of defaults.

- f. The first court of appeal against the tax officer's assessment was local 'Bada Hakim" or magistrate.

Therefore, taxpayer could appeal to the "Revenue and tax court' but he need to deposit fixed amount of tax.

2.2.2 Income Tax Act 1962

'Business Profit and remuneration tax act 1960¹ was replaced by 'Income tax Act 1962', it had come in implementation from July, 1962. It was an extension of the previous act. It has 29 sections. It was amended only one time in 1972. The additional features of this act were as follows.

- a. Income was defined as all kinds of income including income from business, salaries, only profession, rent from house or land, investment in cash or bond, agriculture insurance agencies and any other sources.
- b. Act has defined basic terminology such as taxpayer, tax officer, company, firm, profit, remuneration, tax assessment, nonresident etc.
- c. Status of taxpayer was defined on personal as well as residential for the tax purpose.
- d. Procedure for income tax assessment and methods for cascading net income were stated.
- e. Provision was made to carry forward of losses for a period of two years.
- f. The provision was made to constitute the net income assessment committee with five members.
- g. The basis was specified for assessing tax on the best judgment estimate of the officers.

- h. To burden the tax coverage, agriculture income was brought under the income tax net for the first time. But the financial act 1966 exempted this income fully from tax net. Again it was brought into tax net by financial act 1973. However, It was again exempted from 1977.
- i. Provision was made for reassessment of tax as well as rectification of arithmetic errors.

2.2.3 Income Tax Act 1974

Considering this act incapable of fulfilling the needs of the time, existing act was replaced by another act 'Income tax Act 1974.' This new act was brought in practice from October 1974. It had 66 sections. This act was amended in 1977, 1979, 1984, 1985, 1986, 1988, 1989 and lastly in 1993. It had clarified the certain terminology used in act e.g. income tax, tax payer, non resident, tax assessment, in come year, gross income, net income agriculture income, remuneration income, loss etc.

Income head was classified into five categories: (a) Agriculture income, (b) industry, trade, profession or occupation, (c) the methods of computing net income from various sources had been specified, (d) appointment rights of tax officers had provided to Gorer and rights of tax officers had mentioned clearly, (e) This act had made the provision of self assessment of tax for the first time in Nepal, (f) The provision of carry forward of loss for three subsequent years was made, (g) The act had made it obligatory for taxpayers to register their industry, business, profession or vocation in the tax office before starting the work, (h) The expenses allowed for deduction while computing net income had clearly specified for all sources of income, (i) Rights, duties, forms, appeal were specified.

2.2.4 Weakness of Income Tax Act, 2031

Tax administration is not effective enough due to lack of professional skill of tax personnel, loopholes in tax laws, lack of taxpayer's information (A Study on self-tax assessment under the income Tax Act in Nepal "-Shree Krishna Kharel - 2052)

- a. **Limited taxable objects or base:** As per this law, income heads were limited. This law did not recognize income of worldwide of resident. It was lacking a clear-cut vision of taxation on capital gain. Fiscal Acts exempted tax on the; income of agricultural income industrial enterprise Act and other law had provisions of tax exempts on industrial income, etc previous law had provisions of different expenditure deductions that narrowed down the tax base
- b. **Discretionary Power:** After the 8th amendment of income tax Act there was the introduction of self-assessment system. To support this assessment system provision was lacking regarding accounting system. In other words, the act could not specify for particular income group. Because of this resin, self-assessment system could not develop tax authority practiced assessment using its discretionary power.
- c. **Imposition of various laws with regards to tax:** different acts regarding tax were effective to tax exemption, deduction times, tax rates, tax deductions at sources, income computation criterion, etc.
- d. **Poor control mechanism for tax evasion and avoidance:** there was no country mechanism on transfer pricing, division of incomes, unheated provision on interest and repair and maintenance eductions. It was lacking control on tax planning.

- e. **Ambiguous and insufficient:** the law could not define clearly the resident's approach. This law could not explain about accounting standards. It had no provisions of values of international taxation for foreign investors. VI. Tax law had not mentioned the right of taxpayers: taxpayers could not enjoy the right of tax system.

2.3 Income Tax Act 2058

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

- a. Tax was not levied on worldwide income, on capital gain etc. tax base too narrow. Income tax is the tax of equality. That means persons having same income should imposed equal amount of tax and person having lower income should imposed low tax. But under income tax Act 1974, tax was levied on the basis of nature of organization, nature of income, nature of person. Natural person's taxable income had declared on the basis of organization's memorandum and objectives rather than transaction.
- b. Income tax related provisions were given in different act such as employee provident, fund act 1962, citizen investment trust Act 1962, industrial enterprise act 1992, Electricity Act 1992 etc.
- c. Act became incapable to fulfill the need of time so, it became compulsory to replace to it by new act.

2.3.1 Objectives of Income Tax Act 2058

- a. To make tax system compatible to modern economy
- b. To increase the tax coverage
- c. To interlink Nepalese tax system with tax system of other countries

- d. To make tax system based on account
- e. To minimize tax avoidance and tax evasion
- f. To make income tax related provisions clear and transparent
- g. Defining the power as well as authority of the tax administration.
- h. Separating administrative and judicial responsibilities.
- i. Reducing the scope of discretion any interpretation of the tax administration thereby ensuring simplicity, uniformity and transparency.
- j. Making more responsible to taxpayer by emphasizing and self-tax assessment system.
- k. Distinguishing taxpayer's violation of civil duties and criminal offences
- l. Making more effective and responsibility to tax administration.

2.3.2 Main Features of Income Tax Act, 2058

Following are the main feature of income tax Act 2058 (Mallik, 2003:26)

- a. Income tax related provisions are included with in one act. II. This act has classified all income into three headings under sections: (a) Business, (b) Employment and (c) Investment
- b. Act has clearly specified the amount should be included while calculating a person's gains or profit from conducting business or investment for an income year.
- c. All the expenses are allowed to deduct provided that the expenses are made by the same taxpayer in the same year in the production of income.
- d. There is the provision of carry forward of loss for subsequent four years. The act has also provided the facilities to carry backward of loss for five subsequent years in case of bank, insurance and long-term contract.
- e. Incentives are provided to infrastructure constructor, hydropower projects and special industries

- f. Now the economy of the countries in the world is open one. The provision has introduced in the tax law related to introduced in the tax law related to international fixation. Transfer pricing. Foreign tax credit, double taxation avoidance agreement etc are the provision of international taxation. VIII. The act has given the option for husband and wife as a separate natural individual until they do not accept as a couple.
- g. Capital gain dividend etc. has brought in tax net.
- h. Authorities of taxpayer have specified.
- i. To control the tax evasion, provision to transfer pricing, thin capitalization dividend stripping is made.
- j. Provision of fines and penalties has made stringent in the new income tax Act 2058.
- k. This act has made a provision of relaxing the submission of income statement by a person who doesn't have taxable income or who has the income from remuneration only.
- l. There has the special provision for deduction pollution control and research and development expenses.
- m. The income of an approved retirement fund is free from tax. But retirement payments in hands of employees are taxable. XVI. Resident persons are taxed on their worldwide income while non-resident persons are taxed only in their income source in Nepal.
- n. The pool system of depreciation of fixed assets had introduced and the first time. All types of assets are classified into five categories. Depreciation rate for class A,B,C and D is based on diminishing balance method but straight line method for class 'E'¹ (intellectuals assets)

- o. The act has provided the facility of medical tax credit under which resident individuals may claim a medical tax credit of 15% of the amount of approved medical costs. Unabsorbed medical tax credit amount can carry forward forever.

2.3.3 Function of Income Tax Management

Every management has to perform some tasks to achieve desired goal. The functions of income tax management are no different from the functions of other management i.e. organizing, directing planning etc. the functions of income tax administration can be classified as follows:

- a) To find out taxpayers
- b) To find out the net income of tax payer
- c) To make timely assessment of income of a tax payer
- d) To Whom It May Concern: collect taxes in an efficient and secured way
- e) To launch vigorous enforcement programs

Identification of objective is first job of any management. The objective provides the guideline to the management. Income tax management must determine the objective of income tax. Why the income tax is going to be imposed? To whom income tax is going to be imposed? Answers of such question must be pre-fixed. The second important function of management is to determine policy, policy provides the guideline for achieving the desired goal. Policy regarding income tax gives the answer of following questions; at what rate? To whom? How? When? And Where? After the identification of objective and determination of policy the program is required. Programming regarding income tax may be about resource plan. The program incorporates the objectives and policy into practice. With the preparation of various programs, the implementation phase starts. The objectives are achieved through the

implementation, which is the most important function of management. Identification of objective and policy formulation is the job of top management and can be done in room. But sitting cannot do the implementation work in a room. The role of a leader is very important while implementing the program. The income tax officers may be taken as the leaders. The management must monitor the implementation to know whether to not the program is performing well, if the program is not performing well, the intermediate corrective action should be taken. Finally the feed back through implementation should be made to evolution the past work and correct the objectives, policies and program for easy achievement of goal in future. But un-fortunately Income tax system in Nepal has not been managed with scientific management system till now.

2.3.4 Inland Revenue Management in Nepal

Income tax, in modern age, is recognized, as a most important instrument for resources must be mobilized properly to achieve the goal of national development. It is believed that minimum requirement of people can be fulfilled through economic and social development. Every development activity requires capital, income tax is one of the sources of government revenue, and it can play vital role in internal resource mobilization if it is managed properly. It is a process of picking money from it person's pocket. There fore imposing taxes on person's income is very difficult task. The purpose of imposing tax on person's income can be listed as follows:

-) To collect maximum revenue for development Reduce in equality of income and wealth among people.
-) For a balance regional economic development
-) To promote private sector investment etc.

2.3.5 Administrative Aspects of Income Tax in Nepal

Tax administration is an important subsystem in the total tax system that can either carefully tend or mercilessly kill the goose that lays golden eggs. It is the essence of implementing tax policies and laws. Too much preoccupation with what to do in terms of tax policies and laws alone is not good unless attention is given to how to do it in terms of tax administration. It is the tax administration that provides feedback about the effective ones of tax policies and laws. In the hands of incompetent tax administration, good tax policy and bad tax policy may end up looking remarkably alike (Bird/ oldman, 1973 : 82). Effective tax administration paves. The way for effective tax policies and laws. Improved tax administration widens the choices available to policy makes and law formulators. It is easy to devise a policy but difficult to administer it effectively.

The main objectives of tax administration should be 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:

- To assess and collect taxes in order to meet the revenue requirement of country.
- To facilitate and encourage voluntary compliance by taxpayers.
- To determine tax evasion the avoidance.
- To maintain public confidence in the fairness and integrity of the tax system.
- To maintain public confidence in the fairness and integrity of the tax system.
- To administer tax legislation fairly, uniformly, impartially and with firmness.

- To achieve cooperation and coordination with governmental and non-governmental institutions and within in the organization structure of tax administration.
- To keep high the morale and motivation of tax officials.
- To work efficiently in order to make the tax system effective.
- To gather information and conduct investigation into the financial affairs of taxpayer's.
- To educate taxpayers and extend courtesy to them.

Over ambitious tax system invariably fail at the implementation front. Tax system, therefore, should be simple in design and fit inconveniently with the administrative competence available. The administration should not only be fair, efficient and responsive but should be recognized and accepted as being such (Agrawal, 1980: 100)

2.4. Source of Income

Income tax act 2058 has classified the sources of income for the purpose of assessment under the following heads:

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

2.4.1 Business Income

Income tax act 2058 has defined the business income for income tax purpose for the purpose of computing income of business for any year of income, the income of such person shall include as profit or gains made him form business and should include:

- a. Service charge (Sec 7.2)

- b. Sales or disposal of business / trading stock (Sec 7.2)
- c. Net gain from the disposal of person's business assets / liabilities of the business calculated as under chapter 8 (sec 7.2)
- d. Amount received against the disposal of depreciable assets (sec 7.2)
- e. Prize or gift in connection with business (sec 7.2)
- f. Amount received instead of acceptance of any restriction regarding investment (sec. 9.2)
- g. Amount included under change of accounting method (sec 24)
- h. Excess amount received due to exchange rate currency (sec 28)
- i. Bad debt recovered (sec 25)
- j. Proportionate amount under long-term contract (sec 26)
- k. Amount received for compensation (sec 31).
- l. Other amount received under business income (sec 7.2)

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

- m. Exempt amount under section 10
- n. Taxation of dividends under sections 54
- o. Final withholding payment under section 92

2.4.2 Income from Investment

For the purpose of computing income of any person from an on investment for an income year is the person's profits and gains from conducting investment for the year and there should include:

- a. Any dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from an unapproved retirement payment or retirement fund from approved retirement fund, (sec 9.2)
- b. Net gains from the disposal of the person's non-business chargeable assets of investment. (sec 9.2)
- c. Excess amount of incoming over the depreciation basis including outings on the disposal of the depreciable assets of the investment of the person (sec 9.2)
- d. Gifts or prizes received in connection with investment (sec 9.2)
- e. Retirement contribution including those paid to a retirement funds in respects of the personal retirement payments on respect of investment (sec 9.2)
- f. Amount received instead of acceptance of any restriction regarding investment (sec 9.2)
- g. Amount included under change of accounting method (sec 24)
- h. Excess amount received due to exchange rate currency (sec 28)
- i. Bad debt recovered (sec 25)
- j. Proportionate amount under long term contract (sec 26)
- k. Under paid interest amount according to market price
- l. Amount received as compensation (sec 31)
- m. Other amounts required to be included on tax accounting or quantification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business (sec 9.2)

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

- a. Exempt amount under section 10
- b. Taxation of dividends under sections 54
- c. Final withholding payment under section 9.2

- d. Amount that are included in calculating the person's income from any employment or Business.

The expense which are allowable as per the income Tax Act 2058 are as follows:

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

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

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

- a. Cost to the extent to which they are domestic or personal nature (sec.22)
- b. Income tax, bridge, fine and penalty paid to government of political subdivision of any country by breach of any law (sec.21)
- c. Cost incurred by a person in driving exempt amount as per sec 10 or final with holding payment (sec.21)
- d. Distribution of profit by entity, (sec.21)
- e. Capital nature expenditure and foreign income tax (sec.21)
- f. Any cost incurred in cash exceeding Rs. 50,000 is not allowed if the taxpayer lives in a place where banking service is available and if annual turnover is more than Rs 2 million, (sec. 21)
- g. Any other amount which is defined by other provision of the law. (sec 21)

2.4.3 Income from Employment

Income tax act 2058 has defined the remuneration income for income tax purpose. According to sec 8 of the act; an individual income from employment for an income year is the individual's remuneration from employment of individual for the year. According to this sec, the remuneration from employment for an income year is the individual's remuneration from employment of individual for the year according to this sec., the remuneration received by a person from the employment is as following payments made by the employer (Sec. 8)

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

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

- a. Prizes and gifts.
- b. Other payments made in respects of employment.
- c. The amount of difference of the interest on loan paid by employer lower rate than the market rate.
- d. Market value to assets in case of the transfer of the assets.
- e. For the payment other than stated above, the value of benefit of the payment to third person.

Excludable amount in the employment income where as follows:

While computation the net income from employment of natural person the following amounts are excluded on employments income.

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

2.5 Methods of Income Tax Assessment Income Tax Act 2058 Provides for the Following Major Methods of Assessing Income Tax.

- a. Self-assessment of tax act has fully applied the self-assessment of tax system. It has made more responsible to tax payer. It reduce the compliance cost. Under this system, taxpayer himself determines his tax liabilities with fine and penalty is any. If tax authority doubts the income of taxpayer, tax authority can investigate on revenue risk the basis. Otherwise, that becomes the final.
- b. Under the sec. 100 of the act, the provision of jeopardy assessment is made. The department will make jeopardy assessment when the person becomes bankrupt, is wound up, or goes into liquidation, the person is about to leave Nepal indefinitely, the person is otherwise about cease activity in Nepal, or the department otherwise consider it appropriate. Where as assessment is made under the jeopardy assessment with respect to full

income year, the assessed person will not file return of income for the year. However with respect to part of an income year, the assessed person is still required to file a return for the income year. Where the department makes a jeopardy assessment, it should serve of the" assessment on the person.

- c. Amended Assessment: Tax department many amend an assessment made by the taxpayer under sec.99 and sec. 100. Department many are amend the amended assessment. The department many not amend as assessment if the assessment has been amended or reduced pursuant to an order the revenue Tribunal or court of competent jurisdiction expect where the order is are opened.

2.6 Appeal

A person who is aggrieved by a review able decision has the right of appeal against such order to with the department within 30 days after the decision is made. While filling the appeal the taxpayer is required to deposit half of the amount of the tax payable.

2.6.1 Appeal to Revenue Tribunal:

If any taxpayer who is aggrieve by the decision made in the appeal to the Revenue Tribunal Act, 1974. If the person has appealed, he should file a copy of the notice of appeal with the department within 15 days. However, the operation and enforcement of an objection decision is not stayed or otherwise affected by an appeal. If director general of the department has made the decision relating to administrative review, the appeal to revenue Tribunal world effective. If any tax payer who is aggrieved by the decision made in the appeal to the Appeal court. A taxpayer or the tax officer who is not satisfied with the decision made by appeal court has the right to appeal in the supreme-court.

2.6.2 Fines and Penalties

a. Penalty for Failure to Maintain Documentation or file Statements or Return of Income

A person who fails to maintain proper documentation for an income year or file return for an income year is liable to pay fees for each month and part of month during which the failure continue. The rate of fees would be as the higher of 0.1 percent per annum of the person's assessable income with a gross of any deductions or Rs. 1000 per month which ever is higher. Accordingly, a withholding agent who fails to file a statement as required is liable to pay a penalty at 105 percent per annual applied to the amount of withhold for each month and past of a month during which the failure continues.

b. Interest for Understating Estimated Tax Payable by Installment

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

c. Interest for Failure to Pay Tax

A person who failure to pay tax or before the date on which the tax is payable is liable to pay interest for each month and part of a month for which any of the tax is outstanding calculates the standard interest outstanding.

d. Penalty for Making false or Misleading Statements

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

- a. Where the statement is happened to be false or misleading without knowingly, 50% of the underpayment of tax; or
- b. Where the statement is made false or misleading knowingly or recklessly, 100% of the tax.
- c. Penalty for adding and abetting a person who knowingly recklessly aids or abets another person to commit an offence related to failure to comply with this act, failure to pay tax, makes false or misleading statements or impedes tax administration to counsels or induces another person to commit such an offences, is liable for penalty equal to 100 %of the underpayment of tax.

2.7 Review of Related Studies

Many books, dissertations, articles and reports had been reviewed for performing this research study. While reviewing the books, it was found that most of the books were syllabus oriented and some of them had described the problems and prospects of income tax system and a path for reform of income tax system and a path for reform of income tax. Similarly, many dissertations, articles and reports had described the income tax law, provisions, and structure of income tax, problems and prospects of income tax and path for reforms of income tax. There were no detail studies made on the topic of income tax exemptions and deductions. All the researchers who made research were concise study on the exemptions and deduction. Nevertheless, some books are more important and relevant for this study which are as follows:

2.7.1 Review from Books

Poudyal and Timilsina (1990) has described the provisions and laws related to income taxation of Nepal in book named "Income tax in Nepal." This book is extremely based on the syllabus of B.Com. They were described

the theoretical as well as practical aspects of income tax. He had not analyzed the role of income tax, income tax structure and defects of income tax in Nepal. The book was descriptive rather than analytical (Poudyal and Timilsina 1990).

Tiwari (1990) has presented a book about income tax system in Nepal. Basically this book is written for the students of Tribhuvan University. It is also equally useful to the taxpayers, tax administrations, and the person who want to get theoretical as well as practical knowledge about income tax. He has described the provision under income tax Act 2031, income tax rules, provision under finance act 2055, other provisions, information and acts related to income etc. He has not analyzed the major problems of income tax system. (Tiwari, 1999).

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

Khadka (1994) has discussed the economic policy of Nepal, VAT as long term tax for Nepal, income tax, improving tax administration, tax reform strategy. He had analytically described about developments existing structure, made problems and possible direction for reform of income tax he had identified the major problems of income tax as narrow coverage Unscientific tax assessment and collection, defective system from the perspective of international taxation, leak tax administration, imbalance and inadequate organizational pattern, in adequate physical and other facilities, inadequate tax training, predominance of low level non-technical posts, debatable scope of

revenue investigation department, lack of information system were the major problems of tax administration identified by him. (Khadka, 1994)

Acharya (1994) has mentioned the main objectives of income taxes to achieve social justice, to check inflection and to collect more government revenue. He has identified the contribution of individual is in total income tax revenue seems to be greatest during his study period followed by public enterprises, remuneration, house rent, and interest taxes, semipublic enterprises and private corporate bodies respectively. He has also analyzed the administrative and legal aspect of income tax. He has recommended simplifying the tax structure, legal and administrative aspect, and understanding with the content of taxpayers to raise income tax revenue (Achrya, 1994)

Karna Bir Paudel (1994) has been conducted a research on the topics of corporate tax planning in Nepal with the showing proportion of corporate tax revenue separate direct tax revenue in total tax revenue where mentioning the objectives are; to examine the corporate tax structure in Nepal to examine the implication of tax factors in selecting the best alternative strategy in different aspects of strategy planning and soon. It is research shows that corporate tax is collected from book profit a book profit means corporate profit which is committed for tax purpose. This study also expended that income tax is raised under different acts provision in different times. He had been found about corporate tax structure into two points, tax base and tax rate under previous income tax rule only. (Poudel, 1994)

Dhakal (1998) had published a revised edition of book named "Income tax and house and compound tax law and practice with VAT." He had described historical aspects of income tax and legal provisions relating to income tax with numerical examples. This book was folly based on the syllabus of BBS third year and BBS second year. This book was published before coming new income

tax Act 2058 and it is very useful to know the general information and legal provision of income tax act 1974. His book was informative rather than analytical (Dhakal, 1998)

Adhikari (2003) has discussed the legal provision of new income tax Act, 2058. his book is analytical rather than informative writer has not included administrative aspect, role and structure of income tax in his book the book has only focused on the legal aspect of income tax. Agreement and protocol relating to avoidance of double taxation and the prevention of fiscal evasions with respect to taxes on income between different countries had also included in his book (Adhikari, 2003)

Mallik (2003) had published a book named "Nepalese Modern Income Tax System." He had described historical aspects of income tax and legal provisions relating to income tax with numerical examples. This book is very useful to know the general information and legal provision of income tax Act 2058. His book was informative rather than analytical. He had not analyzed the role of income tax structure of income tax in Nepal. Structure role of income tax and exemptions and dedications provided in the law. He had found that there was dominated share of tax structure in Nepalese government revenue. Income tax had occupied third position in his study period and it was increasing trend. The tax/GDP ratio was not found satisfactory, with the income tax, there was the dominated role of corporate income tax but it was in decreasing trend and contribution of individual income tax was second position and it was in tax administration, lack of public participation, weakness in government policy, defective income tax. Act were the major cause for inefficient tax administration, observed by him (Mallik 2003)

Wagle (2003) has published a book which is the compilation of value added tax Act, value added tax Rules, income tax Act, and Income tax Rules

2059. It is simply the English translation of the act and Rules. The book is mainly prepared for non-Nepalese who are interested to study about the tax, law and rules of Nepal. His book is only informative rather than analytical. (Wagle, 2003)

2.7.2 Review of Dissertations

Shrestha (1967) has prepared a master degree thesis entitled "Income Tax in Nepal." He has given some general idea about income tax relating to historical background and some problems existing in income tax system in Nepal. He has described the various aspects and provisions of income tax but has not shown the major problems and it is not helpful to get knowledge about income tax at present (Shrestha, 1967)

Pandey (1978) has described the brief review of Nepalese economy resource mobilization, structure of income tax and legal aspect, role and problem of income tax in Nepal. He has given more emphasized on tax structure of Nepal. He has identified two main things: one is the role of indirect taxes are more significant than direct taxes because of various problems to impose direct taxes and the other is role of income tax to control the inflationary trend within the country. He has identified that the problems of income tax are lack of record keeping, lack of maintaining account by taxpayer, lack of responsibility and honesty of tax officers, lack of co-ordination between various tax department and revenue department, and leakage in personal income tax collection. He has suggested that capital gain should be included on income tax, income from bank interest should be subjected to income tax, the system of granting income tax holiday to industries should be scrapped, and income tax account assessment and collection method be scientific.

Although he had explained various aspect of income tax in Nepal, he had not described it with numerical examples and empirical investigation. (Pandey, 1978)

Tuladhar (1979) has studied income tax and presented a dissertation "Role of income tax in the mobilization of Domestic Resources in Nepal." In his study, he mentioned growing resource gap problem in Nepalese fiscal system. He emphasized to mobilize additional resource through income tax system to release this resource gap. The legal aspect and problems of income tax are also shown in his study but other aspect like evasion; exemption, income tax assessment etc have not been discussed. (Tuladhar, 1979)

Suwal (1981) has described the concept of income tax, objective of income tax importance and role of income tax for the economic development. The major problems identified by the were the absence of clear and comprehensive definition of income, low tax paying capacity and tax consciousness, high tax rate, corruption etc. She has found out that the reasons of tax evasion were loopholes, widespread illegal business activities, open boarder, lack of account and records of taxpayer delays in tax administration, lack of responsibility and honesty among tax officers. She has suggested the application of scientific methods for the purpose of accounting assessment and collection of income tax and widening tax coverage.

Although she has explained various aspect of income tax system of Nepal has not mentioned the research methodology and legal provisions in her study, she has not conducted any empirical investigation. (Suwal, 1981)

Shrestha (1984) has basically concern with origin, definition, concept historical background, role, objective and structure of income tax. She has also described per capital burden of income tax in Nepal and the major problem existing in Nepalese income tax system. She has found that the evasion of tax is a

serious problem of tax. The reasons of tax evasions were low tax paying capacity of Nepalese people, high tax rate, corruption, lack of heavy punishment system, lack of scientific assessment procedure etc. she has also found that the tax administration is not efficient.

Although she has given various useful suggestion about the income tax like scientific method should be applied for the collection of tax, administration should made efficient, income tax law should be simple and easy, and tax base should broaden etc. has not presented the legal provision of income tax law and not conducted the empirical investigation (Shrestha, 1984)

Rai (1987) has explained various aspect of income tax. This study emphasized the role, importance and problems of income tax. He also mentions domestic sources for resource mobilization and factor. For the increment of tax paying habit of Nepalese people (Rai, 1987)

Baral (1989) has described the contribution of income tax in the structure of government revenue in Nepal. She found that the composition of tax and non tax revenue is still less satisfactory in Nepal, she also found that total revenue, total tax revenue and direct tax revenue have an increasing trend in Nepal but in low data she has mentioned that tax evasion as the major problem of income tax system in Nepal. In her study, inefficient tax administration, unconsciousness of taxpayer, lack of scientific method of tax assessment and collection are identified as the major reasons for tax evasion at high level. She has not mentioned the legal provision relating to income tax and numerical examples. (Baral, 1989).

Nepal (1993) has critically examined the income tax system of Nepal of that time. Her study has been conducted with purpose of examining the role of income tax in overall tax structure, analyzing the problems and prospects of income tax in Nepal and highlights the future prospective of the Nepalese income tax. (Nepal, 1983)

Tripathee (1995) has tried to give various aspect of income tax in Nepal. He has discussed government revenue in Nepal, income tax administration, income tax evasion, income tax assessment, role of best judgment assessment, efficiency of income tax system etc. He has identified the major defects in income tax system and also suggested the possible areas for reform in income tax system (Tripathee, 1995)

Kharel (1996) prepared a dissertation entitled "Self Tax Assessment Under income tax act in Nepal." His study was done with the basic objectives review of tax laws about self tax assessment, analyzed the problems faced by the assessee while doing the self tax assessment of there own income. In his study, he has identified that tax administration is not effective due to lack of meaning full taxpayer's information, lack of knowledge about the assessment procedure to the taxpayers. He has suggested for self tax assessment procedure should be simplified incentives and rewards to regular tax payer, timely assortment of tax, adoption of scientific accounting system and self tax assessment system should be imposed compulsory to all types of assessee. There have been considerable changes in income tax since his study, and his study is based on income tax since his study, and his study is based on income tax act 1974 (Kharel, 1996)

Siwakaty (1997) has examined various factors presenting in the income tax. He has described the role of income tax in Nepal, income tax structure, income tax rate, exemption limit etc. he has identified delay in assessment and high level of tax evasion are the major problem of Nepalese income tax system. There is high use of best judgment assessment method, no compulsion to maintain books of accounts and auditing of accounts of all type of business, ineffective use of times and penalties. He has suggested for honest and efficient administration, research unit in tax office penalties for taxpayers who do not

maintain accounts, the time limit for assessment should be reduced. (Siwakoty, 1987)

Thapa (1998) has examined the income tax assessment procedures, the problem of growing fiscal defect, administrative aspect of income tax, reasons of poor tax morality and tax payer's compliance, legal provision concerning income tax assessment procedure and also reviewed the legal provision relating to income tax assessment procedure prevailing in SAARC countries. His major findings are adocism in tax assessment, undue delay in tax assessment, lack of adequate accounting skill in the tax personnel, lack of adequate information about tax payers, negligence by tax officers, administrative harassment and complicated proceed due to complex tax laws. He has conducted opinion, Survey of income assessment procedure. He has suggested for taxpayer's assistance, guidance and counseling service should be provided, incentives to regular taxpayer's, capital gain should be taxed, granting tax holiday to new industries as investment allowances and agriculture income should be taxed. He has not described the other aspect of income tax clearly and analytically and all things mentioned in it are not also fully relevant today because it was made under income tax act 1974. (Thapa, 1993)

Sharma (2000) presented a dissertation named "Income Tax System in Tax Structure of Nepal". His study was done with basic objectives of analyzing the causes of heavy reliance of indirect taxes. Analyzing the volume of indirect tax revenue and direct tax revenue in total tax structure, highlighting the revenue assessment procedure form different sources and suggesting to improve to them. In his study, he has identified that income tax has occupied forth position among tax revenue in Nepal. Custom duty, sales tax and excise duty has occupied first, second and third position respectively in Nepalese day revenue. He has mentioned Nepalese taxable capacity is limited by various factors such as low

per capita income, relatively "Closed (India" economy weak export position etc. (Sharma 2001).

Koirala (2003) has found that 0.37 percent of total population come under the categories of tax payer during his study period. Main objective of his study was to study Nepalese tax structure, role and contribution of income tax on national revenue. He has identified that income tax has been gradually increasing and was in the fourth place in tax structure Nepal. He has not discussed the major aspects of income tax clearly and analytically. So it is incomplete study and all things mentioned in it are not also fully relevant toady because it was made 6 years ago. (Koirala 2003).

Shrestha (2006) had covered the historical background, legal provision, structure of income tax, income tax administration in Nepal and empirical investigation. His findings about tax structure were: these was dominant share of tax revenue in Nepalese government revenue. But the contribution of tax revenue should the decreasing trend. The tax/GDP Ratio was not found satisfactory with compare to other SAARC countries. It was 9.81 percentage in the study period. There was serious and growing financial resource gap problem in Nepal seem to the never ending problem. (Shrestha, 2006)

Thapa Magar (2008) had covered tax structure, role of income tax and exemptions and deductions provided in the law. He had found that there was dominated share of tax structure in Nepalese government revenue. Income tax had occupied third position in his study period and it was increasing trend. The tax/GDP ratio was not found satisfactory with the income tax, these was the dominated role of corporate income tax but it was in decreasing trend and contribution of individual income tax was second position and it was in increasing trend. Lack of trained employees, shortage of income tax exports, professional in tax administration, lack of public participation faculty

organizational structure of tax administration were the major cause for inefficient tax administration, observed by him. (Thapa Magar 2008).

Beside these reports books and master level dissertation some articles about income tax published in Rajaswa, Rising Nepal, Ghorkhapatra, The Kathmandu Post etc and publication and ministry of finance such as budget speech, economic survey were reviewed in the study period.

CHAPTER-THREE

RESEARCH METHODOLOGY

This study is undertaken to analysis the income tax management for revenue collection in Nepal. The main concentration of the study is on the source of income, income tax collection in Nepal, the structural analysis of government revenue are incorporated in this study. To achieve these objectives a research methodology was designed methodology covers research design, nature and source of data and procedure of data analysis

3.1 Types of Research

This study was mainly based on three types of research, which are descriptive, analytical as well as empirical.

3.2 Research Design

The research study was focused on role of income tax, indirect tax and direct tax in total tax revenue, effectiveness of income tax revenue collection in Nepal. To achieve the stated objective of the study, the opinion of the various 60 respondents associated with distinct personalities i.e. tax experts, tax administrators and tax payers have collected through structured questionnaire. The questionnaire included the role of income tax management for revenue collection in Nepal, efficiency of income tax management in Nepal, provision of fines and penalty, soundness and effectiveness of income tax system, the important factors for the effectiveness of tax system including necessary suggestions for achieving effectiveness of income tax in Nepal etc. In this way, the research design of this research is descriptive, analytical and empirical.

3.3 Population and Sample

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

Table No. 3.1

Group of Respondents and Size of Samples

S.N.	Groups of respondents	Sample size
1	Income Tax Administrators	20
2	Income Tax Experts	20
3	Income Tax Payers	20
	Total	60

3.4 Nature and Source of Data

In order to achieve the real result out of this research, primary as well as secondary data was collected. The major sources of data are as follows:

A: Sources of Primary Data:

Through administrating structured questionnaire of the sample population. The same questionnaire was distributed to all respondents. Tax administrators are selected from tax department and various sectors of tax offices. Tax experts are the faculties have experience of tax management, auditors, chartered accountants etc. Tax payers are selected representing various sectors i.e. manufacturing company, trading company, private banks, insurance company, finance company, departmental store etc.

B: Sources of Secondary Data:

The secondary data for this research has been collected from the following different sources.

- a. Published documents of National planning commission and Nepal Rastra Bank
- b. Published and unpublished reports, articles and dissertation on the concerned subject.
- c. Reports and records of department of Taxation, ministry of finance, GON Nepal.
- d. Dissertation related to income tax.
- e. Books related to income tax and public finance.
- f. National and international newspaper, journals and newsmagazines.
- g. Published reports and seminar paper of CEDA.

3.5 Data Collection Procedure

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

3.6 Data Processing and Analysis Procedure

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

CHAPTER FOUR

PRESENTATION AND ANALYSIS OF DATA

4.1 Revenue Structure of Nepal

Every government is responsible to perform numerous activities for the betterment of the people in the country. Government needs huge volume of income to fulfill various types of expenditure for this purpose. The government collects revenue from different source like grants, administrative income, business incomes and taxation. Generally, the revenue is classified into two categories tax revenue and non-tax revenue and their sum constituted the government revenue. Beside these sources, government has other sources which are subject to repayment such as loans and however grants are not compulsory repaid. These sources are desirable only to meet these fiscal defects.

The trends and composition of tax revenue and non-tax revenue in different fiscal year represented below:

In fiscal year 1995/96 the total revenue was Rs. 27893.1 (Million) in which the part of tax revenue was 77.68% and non-tax revenue 22.32% respectively in the fiscal year 2000/2001 that total revenue was 48893.9 Million. Which share of tax and non-tax revenue was 79.49% and 20.51% respectively. So that the contribution of both tax revenue to total revenue total revenue seem to be growing simultaneously, the dominated role is tax revenue during the study period contribution of tax revenue has increased but non tax revenue has decreased in the fiscal year 2005/06 and 2006/07 by 2% the fiscal year 2007/2008 tax revenue has decreased by only percentage.

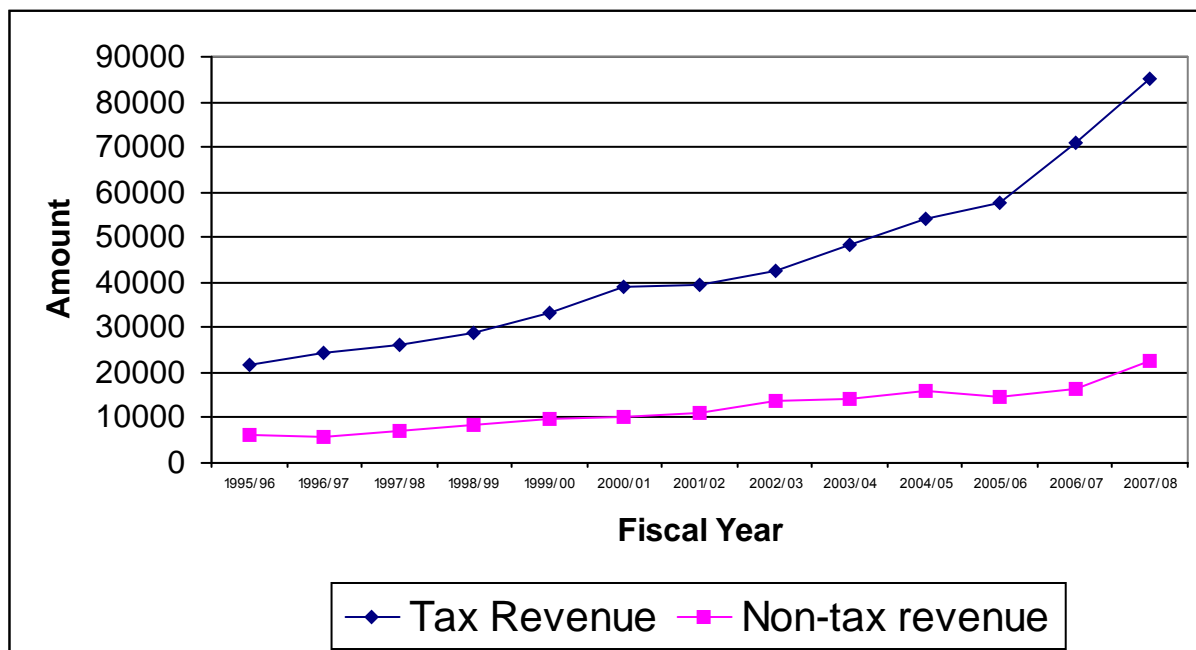
Table No. 4.1.
Magnitude of Revenue Collection in Nepal

(Rs. Million)

Fiscal	Total Revenue	Tax revenue		Non tax revenue	
		Amount	% as total revenue	Amount	% as total revenue
1995/96	27893.1	21668.0	77.68	6225.1	22.32
1996/97	30373.5	24424.3	80.41	5949.2	19.89
1997/98	32.937.9	25939.8	78.75	6998.1	21.25
1998/99	37251	28752.9	77.18	8498.1	22.82
99/00	42893.9	33152.2	77.29	9741.6	22.71
00/01	48893.9	38865.1	79.49	10028.0	20.51
01/02	50445.6	39330.6	77.97	11115.0	22.03
02/03	56229.7	42586.9	75.74	13642.7	24.26
03/04	62331	48173.0	77.29	14158.0	22.71
04/05	70122.7	54104.7	77.16	16018.0	22.84
05/06	72282.1	57430.4	79.45	14851.7	20.55
06/07	87712.2	71126.7	81.09	16585.5	18.91
07/08	107622.4	85155.5	79.12	22466.9	20.88

Source: Economic Survey July 2006/2007 and 2009, Ministry of Finance
(MOF) Nepal.

Figure No. 4.1
Figure of Revenue Collection in Nepal.



4.2. Tax Revenue Structure of Nepal

Taxes are not a voluntary contribution by the taxpayer but it is compulsory in Nature; Taxation is the main sources of income of the government excluding foreign aid. Total tax revenue is composed of direct tax and indirect tax. The tax on consumption is known as indirect tax where tax on income and capital is known as direct tax. Further VAT, custom, sales tax, hotel, entertainment, other services tax, excise duty, contract tax etc are source of indirect tax and the sources of direct taxes are income tax, house rent vehicle, land registration fees etc. So that, the contribution of tax total revenue as the sum of direct and indirect tax i.e. tabulated below.

Table No. 4.2.
Tax Revenue Structure of Nepal

(Rs. in Million)

Fiscal	Total Tax Revenue	Direct Tax		Indirect Tax	
		Amount	% as total revenue	Amount	% as total revenue
1995/96	21668.8	4655.9	21.48	17012.1	78.52
1996/97	24424.3	5340.0	21.86	19084.03	78.14
1997/98	25939.8	6187.9	23.85	19751.9	76.15
1998/99	28752.9	7516.0	26.14	21236.9	73.85
99/00	13152.2	8951.5	27.00	24200.6	72.99
00/01	38865.1	10159.4	26.14	28705.7	73.85
01/02	39330.6	10597.5	26.94	28733.1	73.05
02/03	42586.9	10105.8	23.72	32481.1	76.28
03/04	48173.0	11912.6	24.72	36260.4	75.28
04/05	54104.7	13071.8	24.16	41032.9	75.83
05/06	57430.4	13968.1	24.32	43462.3	75.67
06/07	71126.7	18980.3	24.68	52146.4	73.31
07/08	85155.5	23087.7	27.11	62067.8	72.88

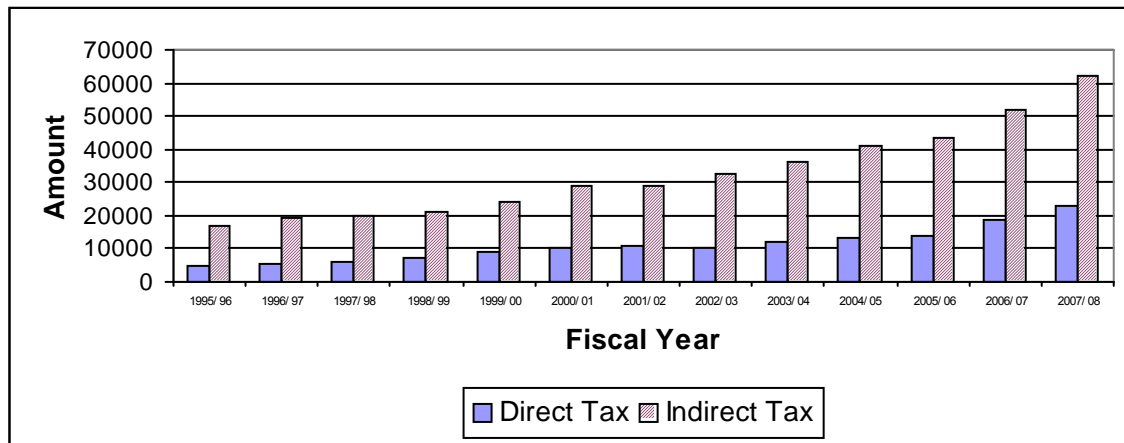
Source: Economic Survey July 2009, MOF, Nepal.

From the above table, it is clear that the completely Nepalese tax structure is dominated by indirect tax revenue during this study period, the share of last tax in total tax in is increasing simultaneously from 1995/96 to 2001/02 but it has decreased by 3% in fly 2002/03 because of instability of govt. and political conflict in the country. It has increase after fiscal year 2005/06 by 2% because of stable political situation.

In developed mobilization like UK and USA, direct tax ptaxs leading role for the internal resource mobilization where as developing country Nepal, indirect tax ptaxs important role by dominating direct laid. Indirect tax is the principle

source to general revue. So to divert the economy is the channel of development, it is necessary to increase the share of direct tax.

Figure No. 4.2
Trend of Composition of Tax Revenue



4.2.1 Direct Tax Revenue

Direct tax is actually paid by the person on whom it is imposed legally. By definition, direct tax is a charge imposed by government authority up to property, individual or transaction to raise money for public purpose direct tax is levy by the government on the income and wealth received by hour host and business enterprise in order to Raise revenue and as an instrument of fiscal policy direct tax is progressive as far as the amount paid varies significantly according the income and wealth of tax payers.

With very limited tax base and narrow coverage direct tax in Nepal seems to less effective to mobilize the domestic resource. Altogether it is and inevitable instrument of the fiscal policy and hence it must he deigned and properly practice. In general revenue productivity of the direct tax goes in increasing as the economy of the country grows over time. If the economic growth increase per capita income per annum of that country will automatically raise. In depth it means that he possesses the ability to pay direct tax. Thus, the magnitude of direct tax goes up and substitutes in the place of indirect tax's magnitude in compost lower the share of direct tax indicates to the les developed or developing country and hence

country needs to accelerate the growth path to substitute the share of direct tax is less than developing economies like Bangladesh and Pakistan etc. Thus, it lies as a minor source of tax revenue source of Nepal. Direct tax in Nepalese economic it composed of direct taxes namely income tax, land tax and wealth tax, interest tax on other side, tax it includes land revenue, Bhumikar and hours and land registration and hour and land tax.

4.2.1.1 Magnitude of Direct Tax Revenue

The composition of direct tax are Land revenue and registration and tax on property and income is shown below.

Table No. 4.3
Magnitude of Direct Tax Revenue (Rs. on million)

Fiscal	Direct Tax	Land Revenue and Registration		Tax on property income	
		Amount	percent	Amount	Percent
1995/96	4655.9	1066.6	22.9	3589.3	77.09
1996/97	5340.0	1015.4	19.0	4324.6	80.09
1997/98	6187.9	1004.2	16.22	5183.7	83.77
1998/99	7516.0	1003.2	13.34	6512.9	83.65
99/00	8950.5	1015.9	11.34	7935.6	88.65
00/01	10159.4	612.9	6.03	9546.5	93.96
01/02	10597.5	1131.8	10.67	9465.7	89.32
02/03	10105.8	1414.3	13.99	8691.5	86.00
03/04	11912.6	1697.5	14.24	10215.1	85.85
04/05	13071.8	1899.2	13.76	11272.6	86.23
05/06	13968.1	2181.1	15.61	11787.0	84.40
06/07	18980.3	2253.5	11.87	16726.8	88.12
07/08	23087.7	2940.7	12.74	20147.00	87.26

Source: Economic survey July 2009, Ministry of finance (MOF), Nepal.

In fiscal year 1995/96 the both components to direct tax was 22.90% (Rs. 1066.6 Million) and 77.09% (Rs. 3589.3 Million) respectively similarly in 2003/04 were 13.99% and 86.00% and 2007/08 were Rs. 2940.7 (12.74%) Million and 20147.00 (87.265%) Million respective land revenue registration went declining and reached to the lowest percent is 6.03% in 2000/01 best after 2 year. Collection

of land Revenue were factually increases and decreases whole year and tax on property income is almost steady.

4.2.1.2 Composition of Direct Tax Revenue.

The major components of direct taxes in Nepalese tax structure are income tax, land tax and house and land registration tax. Until the fiscal year 1993/94. Vehicles tax was considered as a direct tax and since 1994/95's budget speech it has been classified under the indirect tax on the other hand, interest tax and urban house and land rent tax were included under the income tax since 1994/95. Thus the continuation of direct tax has become larger than other direct tax. The share of the major composition of the direct taxes from 1995/96 to 2007/08 is given below.

Table No. 4.4
Composition of Direct Tax Revenue

(Rs. in Million)

Fiscal Year	Income Tax	Land Tax	House and Land Registration	Tax on Property	Total Direct Tax
1995/96	3431.4	18.2	1048.4	157.9	4655.9
1996/97	4123.3	5.9	1009.5	201.20	5340.0
1997/98	4898.1	3.6	1000.6	285.6	6187.9
1998/99	6170.60	1.30	1001.8	342.7	7516.0
1999/00	7420.3	4.6	1011.3	515.00	8951.5
2000/01	9114.00	5.1	607.8	432.5	10159.4
2001/02	8903.7	0.80	1131.00	562.00	10597.5
2002/03	7966.20	0.00	1414.30	725.30	10105.8
2003/04	9245.9	0.00	1697.5	969.2	11912.6
2004/05	10466.1	0.00	1799.2	806.5	13071.8
2005/06	10374.7	0.00	2181.1	1412.7	13968.1
2006/07	15034	0.00	2253.5	1692.8	18980.3
2007/08	17311.22	0.00	2940.74	2835.74	23087.7

Source: Economic Survey July 2009, Ministry of finance (MoF) Nepal.

The largest share in the direct tax is occupied by income tax. The continuously except tax to direct tax is increases in the fiscal year 2001/02 and 2002/03, highly increasing in the fiscal year 2006/07 and then house and land legislation tax and property tax also contribute total direct tax properly. The revenue collection from land tax is declining continuously and gone Zero up to 2007/08 . In the fiscal year 2007/08 tax on property was increase 1200 Million because of VDIS policy adopted by government,

4.2.1.3 Indirect Tax Revenue

Indirect tax, a popular approach concerning taxation implies in the world, is very powerful missile of fiscal policy level of resource especially for the optimum level of resources mobilizing with the principle; more gain form the tax which falls firstly and directly on the taxpayers, but the persons must bear it due to the shirting of tax affected. In short, indirect tax is imposed on one person but is paid either partly or wholly by another person. So, the impact and the incidence of tax are on different person.

Nepal depends heavily on the indirect tax rather than the direct tax because there is not any good alternative especially for the optimum level of revenue mobilization one hand and on the other hand, wide spread poverty, heavy depending on agriculture, snail's pace industrialization, low level income and weather and very weak administration. Since, 1951, indirect tax had grown rapidly and speedily. As indirect tax was effective and proper, its tax mobilize was quickly boosting. So most of the developing countries mobilize it effectively and properly of the domestic resources.

The major components of indirect tax in Nepalese tax structure constitute custom duty, excise duty, sales tax (VAT and contract tax. Custom duties are composed of mainly import duties, export duties. Other components of indirect tax

like entertainment tax, hotel tax and contribute very nominal share because they are included in since 1997, other from of indirect taxes includes emission of Indian excise duties road bridge tax and other taxes.

4.2.1.4 Composition of Indirect Tax Revenue.

Indirect tax refers to three categories of taxes in Nepalese tax structure namely custom duty sales tax/VAT and excise duty. The share of Major components of the direct taxes is given below.

Table No. 4.5
Composition of Indirect Tax Revenue

(Rs. in Million)

Fiscal Year	Custom Duties B	Sales Tax/VAT	Excise DutyBB	Other TaxesBBB	Total Indirect Tax
1995/96	7327.7	6431.3	1944.3	1309.1	17012.1
1996/97	8309.1	7126.5	2298.1	1350.6	19084.03
1997/98	8502.2	7122.6	2885.8	1241.3	19751.9
1998/99	9517.7	7882.2	2953.2	883.7	21236.9
1999/00	10813.3	9854.9	3127.6	404.8	24200.6
2000/01	12552.1	12382.4	3770.0	00	28705.7
2001/02	12658.8	12267.3	3807.7	00	28733.1
2002/03	14236.4	13459.7	4785.12	165.77	32481.1
2003/04	15554.8	14478.9	6226.7	268.6	36260.4
2004/05	15701.6	18885.4	6445.9	306.7	41032.9
2005/06	15344	21610.7	6507.6	565.7	43462.3
2006/07	16707.6	26095.6	9343.2	697.8	52146.4
2007/08	21062.5	29815.7	1189.58	1766.5	62067.8

Source: Economic Survey 2007/08 July 2009 Ministry of Finance of Nepal.

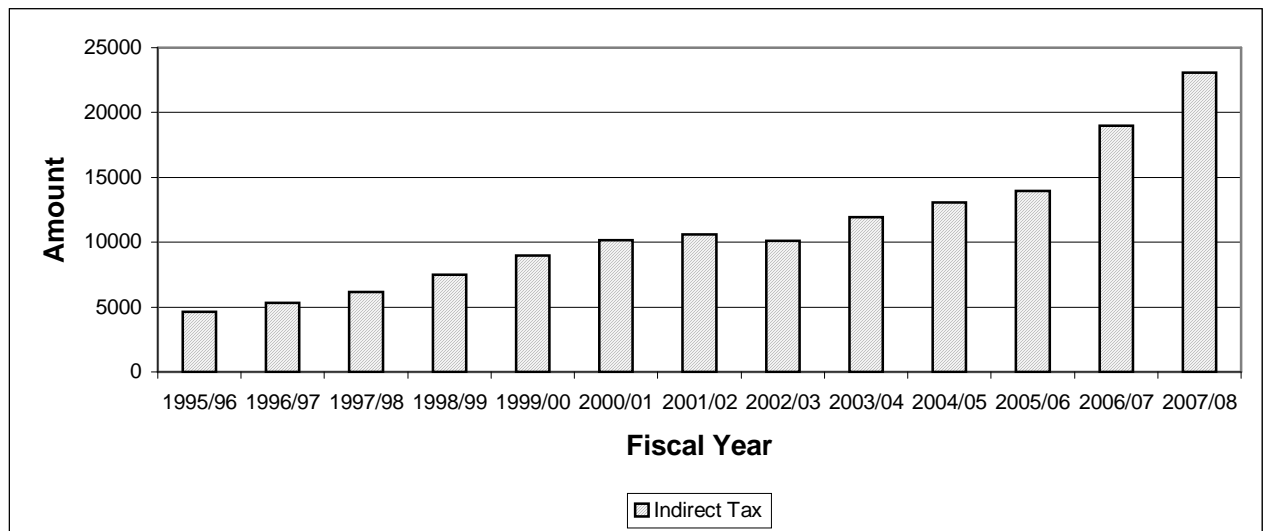
*Custom duties include import; export Indian excise return and others.

**Excise duties are the sum of the taxation, Industrial product and higher contact.

***Other taxes include entertainment tax, aiz flit tax contract tax, road and bridges maintain tax and others.

Above table shows that the contribution of custom duties to indirect is in incuriosity trend. Its share is the fiscal year 1995/96 is Rs. 7372.4 million and it reached up to VAT to indirect tax is also Increasing contributed Rs. 6431.3 million in FY 1995/96 and it reached up to Rs. 29815.7 million in the FY 2007/08. Similarly, revenue collection from exercise duties is increasing up to FX 1996/97. These after, it was decreasing trend up to 2001/02 and then it was again increasing trend up to FX 2007/08.

Figure No. 4.3
Composition of Indirect Tax Revenue to Total Tax Revenue



4.3 Non-Tax Revenue Structure of Nepal

Non-tax revenue is another sources of the government revenue in the revenue structure of Nepal. It is not imposed by public authority to the tax payers. Fees, Fines, penalties, dividends royalty, sales of fixed assets, principle and interest payment etc are the base of non tax revenue. The composition of non-tax revenue in Nepalese fine forfeiture, receipts form sales of commodities and services, dividends, royalty, sales of fixed assets, principle and interest payment etc. While there is a some scope of generating more revenue through the rationalization of in piracy politics and operational performances. There sources cannot be used effectively as a revenue raise since most of these sources are levied not for revenue purposes.

Table No. 4.6
Composition of Non-Tax Revenue

(Rs in million)

FY	Heading	Charges, fees fine and forfeiture	Receipts from sales and service of commodities	Dividend	Royally and sales of fixed assets	Principle interest payment	Miscellaneous items	Total
1995/96		286.1	1673.31	1363.0	67.8	2818.8	16.1	6225.1
1996/97		270.8	1799.6	1164.4	447.9	2220.7	75.8	5949.2
1997/98		329.6	2255.5	1311.0	565.2	2161.1	75.7	6998.1
1998/99		336.1	2146.6	1782.8	202.3	3927.5	102.8	8498.1
99/2000		386.7	2428.9	2507.5	563.3	3751.0	104.6	9741.7
00/01		386.7	2728.0	2336.5	949.6	3497.2	130.8	10028.8
01/02		518.8	2611.1	2512.9	723.9	3109.5	1638.8	11115.0
02/03		579.6	3063.0	2497.6	1945.5	2464.3	3092.8	13642.7
03/04		1202.5	3497.0	2661.1	1465.0	3507.11	1825.3	1415.8
04/05		1359.9	3849.0	4589.9	1931.4	2714.3	1572.6	16018.0
05/06		1927.7	3932.3	3394.8	1196.8	3251.3	1148.7	14851.7
06/07		1945.4	4776.8	4937.7	1091.8	2085.7	1748.1	16585.5
07/08		2554.7	4897.7	5025.9	5773.65	3440.0	774.80	22466.9

Source: Economic Survey 2007/08 July 2009 Ministry of Finance of Nepal.

In the Context of Nepal non-tax revenue is minor source of the government revenue because of its volunteer nature. It contributes to total revenue only 18% to 24%. Thus its role of inseparable but is not a leading role. The main contribution form non-tax revenue are receipts from sales of commodities of other sources like charges fees, fines, and forfeiture, royally and sales of fixed assets etc are minor to them.

Non-tax revenue increased by 35.5% to Rs. 22466.9 million in FY 2007/08 compares to that of FY 2006/07 of the total non-tax revenue, the share of fees, fines, forfeitures was 11.4%, the share of income from government service and sales of goods was 21.8% dividend was 22.4% sales of royally and government property was 25.7% principle or interest was 15.3% and miscellaneous non tax revenue was 3.4% on the non tax revenue front the growth of firm registration fee

was 41.6% and administrative fee, fines and forfeitures was in FY 2007/08 compares to previous fiscal year dividend of service oriented organization is funs to have increase by 2% and income of other government sectors by 2.9%. In total the non tax revenue was increasing trend from FY 1995/96 to FY 2007/08 which was reached Rs. 22466.9 million.

4.4 Tax and Non-Tax Revenue in GDP

In order to understand the growth pattern of taxation on properly, it would be desirable to examine the share of tax revenue and non tax revenue in GDP, following table represents an account of the tax and non tax revenue as percentage of GDP.

Table No. 4.7
Tax and Non-Tax Revenue as Percentage of GDP.

(Rs. in Million)

FY	Gross D.P.	Tax revenue	Non tax revenue	Percentage of G.D.P.	
				Tax/GDP	Non tax/GDP
1995/96	239388	21668.0	6225.1	9.05	2.60
1996/97	269570	24424.2	5949.2	9.06	2.21
1997/98	289798	25939.8	6598.1	8.95	2.41
1998/99	330018	28752.9	8498.1	8.70	2.58
99/2000	366218	33152.1	9741.6	9.05	2.66
00/01	394052	38865.1	10028.6	9.8	2.55
01/02	406138	39330.6	11114.9	9.68	2.74
02/03	437546	42587.0	13642.9	9.73	3.11
03/04	474919	48173.0	14158.0	10.14	2.99
04/05	508651	54104.8	16018.0	10.64	3.14
05/06	586241	57430.4	14851.6	9.80	2.23
06/07	646121	71126.7	16885.5	11.00	2.66
07/08	704254	85155.5	22466.9	12.09	3.19

Source: Economic Survey 2007/08 July 2009 Ministry of Finance of Nepal.

The above table represents an account of tax and non tax revenue percentage of GDP, the tax revenue has been increasing much higher than the non tax revenue over the study period 1995/96 to 2007/08. The share of tax revenue decrease FY 2005/06 to 2007/08. The share of tax revenue increased from 9.05% of the GDP in fiscal year 1995/96 to 10.64% in year 2004/05. The share of tax revenue decrease 2007/08. The share of won tax revenue barely increase from 2.41% of GDP in fiscal year 1997/98 to 3.11% in fiscal year 2002/03 and fluctuate up to 2007/08. The relationship between tax and GDP is known a tax/GDP ration. This is an indicator of the utilization of taxable capable capacity. The above table shows rather disappointing scenario of tax/GDP ratio is still much lower than that of many other developing countries. By comparison to the world standard, this is very low level of taxation.

4.5 Direct Tax and Indirect Tax Revenue in GDP

Tax revenue is composed of direct and indirect tax. However, the indirect tax revenue dominates the completely Nepalese tax structure the contribution of direct tax revenue is very low in Nepal in comparison to developed concise lived USA, Japan etc because being and underdeveloped country, the people of Nepal live in substance level and all their income is spent on consumption as a result 'direct tax cannot produce more revenue than indirect tax'.

To known the contribution of direct tax and indirect tax revenue it will be describable to examine the share of direct tax and indirect tax revenue in GDP. The following table indicated the share of direct and indirect tax revenue in GDP.

Table No. 4.8
Tax and Non-Tax Revenue as Percentage of GDP

(Rs. in Million)

FY	GDP	Direct tax	% of GDP	Indirect tax	% of GDP
1995/96	239388	4655.9	1.34	17012	7.11
1996/97	269570	5340.0	1.38	19084.3	7.08
1997/98	289758	6187.0	2.14	19751.9	6.82
1998/99	330018	7516.0	2.28	21236.9	6.44
1999/00	366251	8951.5	2.44	24200.6	6.61
00/01	394052	10159.4	2.58	28705.7	7.28
01/02	406138	10597.5	2.61	28733.1	7.07
02/03	437546	10105.8	2.31	32481.1	7.42
03/04	474919	11912.6	2.51	36260.4	7.64
04/05	508651	13071.8	2.57	41032.9	8.07
05/06	586241	13968.1	2.38	43462.3	7.41
06/07	646121	18980.3	2.93	52146.4	8.07
07/08	704254	23087.7	3.27	62067.8	8.81

Source: Central Bureau of Statistics or Economic Survey July, 2009.

From the above table, the percentage of share of direct tax in GDP is in increasing trend but the share of indirect tax is in fluctuating trend the share of direct tax revenue in terms of GDP, increased from 1.34% in FY 1995/96 to 3.27% in the FY 2007/08 where as the share of indirect tax revenue increased and decreased this percentage is not continuous it raised FY 2007/08 to 8.81%.

4.6 Contribution of Income Tax

Contribution of tax revenue to direct tax revenue, contribution of indirect tax revenue to the total tax revenue contribution of income tax revenue to total revenue was computed as below:

A. Contribution of Tax Revenue to the Direct Tax Revenue.

The table No. 4.2 shows the contribution of income tax to the direct tax revenue in Nepal. There is dominated role of income tax in the direct tax revenue average share of direct tax to total tax revenue is 22.48% and had raised maximum up to 27%. The contribution of income tax is not less than 54% in any year.

B. Contribution of Indirect Tax Revenue to the Total Tax Revenue

Total tax revenue constitutes direct and indirect tax revenue. There is dominated role of indirect tax in the Nepalese tax revenue structure. The contribution income tax to the indirect tax revenue is presented in initial period of study. The highest contribution of income tax was 27% in fiscal year 2007/08. The share of indirect tax revenue to total tax revenue was 78.51% in the fiscal year 1998/96.

C. Contribution of Income Tax to Total Revenue

Total revenue contributes tax and non-tax revenue in the Nepalese government revenue structure, tax revenue has occupied the most part of public revenue i.e. about two third parts in total revenue. Share of income tax as a percentage of total revenue is presented in table 4.2.

Table No.: 4.9
Collection Performance of Income Tax Revenue

(Rs. in Million)

FY	Estimates (in 000)	Collections (in 000)	Differences	Collection as % of estimates % of GDP
1995/96	4000	3431.4	(568.6)	85.78
1996/97	4595	4123.4	(471.6)	89.74
1997/98	4750	4898.1	148.1	103.12
1998/99	5780	6170.2	390.2	106.75
1999/00	7380	7420	40	100.54
00/01	9980	9110	(870)	91.28
01/02	11140	8919.6	(2220.4)	0.07
02/03	9862	8059.6	1820	81.72
03/04	8697	9514.7	817.7	109.40
04/05	10500	10452.2	47.4	99.55
05/06	11800	11900.3	100.3	100.85
06/07	12710.5	12905.6	195.1	101.53
07/08	16869.2	199077.813	2208.613	113.09

Source: Annual Report of IRD Various Year

Note: Figure in bracket indicates negative value.

The income tax collection was 85.78% in FY 1995/96 that was less than the estimation. The estimation income tax collection was increased in the next fiscal year 1997/98 which was 103.1% that trend was still in FY 1999/00. FY 2000/01 and 2001/02 the estimation was failed. The estimation of income tax not good performance to collect the revenue in FY 2004/05 also. But there after FY 2005/06 to 2007/08 collection performance was very good position in FY 2007/08 income tax collection percent of estimates was 113.09% that was the

highest percentage of whole study period because of higher tax collection policy adopted by government.

4.7 Empirical Study

An empirical investigation was carried on to conduct this study from the experience of the real world. In this context, education related to this system has been provided for tax years are at the same time the export officers are appointed. In this empirical study, the analysis has been done about income tax on the basis of information collection collected form the tax exports, tax officers and businessman. The tool that is basically used is the questionnaire. In the study, the questions are asked to sixty different individuals related to this field. The opinion of the vapors 60 respondents associated with distinct denominations i.e. tax administrators, fax exports and taxpayers were collected. The questionnaire has covered role of income tax, major problem of income tax system problem facing by taxpayer, the most impotent factors for the effectiveness of income tax system in Nepal. The respondents were asked either to response yes/no or for ranking of choice according to no. of alternative where first choice was the most important and last choice was least important. No of respondents in each denomination is equal i.e. 20. Information received from the respondents are tabulated and analyzed in the proper way following table shows the group and no of respondents. The conclusion of the conducted empirical study has been given below.

Table no: 4.10

Group of Respondents and No. from Each Group

S.N.	Groups of respondents	No
1.	Income tax Administrators	20
2.	Income Tax Exports	20
3.	Income Tax Payers	20
	Total	60

Result of empirical investigation

A. Effectiveness of Income Tax System in Nepal

Table No. 4.11

Effectiveness of Income Tax System

Respondent	Yes		No		No Idea		Total	
	No.	Percentage	No.	Percentage	No.	Percentage	No.	Percentage
T.A.	15	75	5	25	-	-	20	100
T.E.	3	15	11	55	6	30	20	100
T.P.	1	5	12	60	7	35	20	100
Total	19	31.67	28	46.67	13	21.66	60	100

Source: Opinion Survey, 2009.

In this question total 19 people showed their view in favor of the question. In their opinion the present system of taxation for the small taxpayers is good. Because they don't have to maintain the proper account. Only they have to do is pay Rs. 2000 per year. Major portion of the responded were not in favor of the question. 28 persons out of 60 think that the present system of tax in Nepal is not efficient. Because the tax office don't impose same rule for all kinds of taxpayers. In their opinion the department of taxation collects more tax from the small taxpayers and less from others. Other 13 person have no ideas about the tax system of Nepal. They only know that they have to pay the but they do not want to do so.

B. Contribution of Income Tax Revenue

Income tax has contributed about 25 percent to public revenue in Nepal. It is accused that contribution of income tax to national revenue is not satisfactory. To know the fact, the question was asked to respondent "In your opinion, is contribution of Income tax to national revenue of Nepal satisfactory?" opinion result is presented in the table as below.

Table No.4.12**Satisfactory Contribution of Income Tax Revenue**

Response Respondent	Yes		No		Total	
	No	Percent	No	Percent	No	Percent
Tax	19	95	1	5	20	100
Tax Export	20	100	-	-	20	100
Tax Payer	19	95	1	5	20	100
Total	58		2	3.33	60	100

Source : Opinion Survey, 2009

All tax experts argue that contribution of income tax to national revenue in Nepal is satisfactory. But five percent of tax administrators and taxpayers approved that income tax contribution to public revenue is in satisfactory. In aggregate, 19.67 percent respondents argue that Nepalese income tax contribution is satisfactory. In order to know the major reasons for Lower contribution of income tax, another question was asked, "if no, what are the major reasons?" The respondents were requested to rank their choice from 1 to 5 according to preference.

Table No: 4.13**Reasons for Low Contribution of Income Tax to National Revenue**

S.N.	Methods	Total point received					
		Tax Administrator	Tax Expert	Tax Payer	Total	Percent	Rank
1.	Defective of Income Tax Act	39	52	44	135	16.28	4
2.	Mass Poverty and low income level	98	85	89	272	32.81	1
3.	Increasing habit of tax evasion	68	63	48	179	21.59	2
4.	Inefficient income tax administrator	44	60	52	156	18.81	3
5.	Inappropriate rate land exemption limit	41	36	50	87	10.49	5
	Total			829			

Source: Opinion Survey, 2009.

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

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

C. Income Tax as a Suitable Means of Raising Government Revenue

To know whether income tax as a suitable means of raising government revenue in Nepal, a question was asked "do you consider that income tax is the suitable means of raising government revenue in Nepal?" The respondent's responses are is tabulated as follows.

Table No. 4.14

Income Tax as a Suitable Means of Raising Revenue

Respondent	Yes		No		Total	
	No	Percent	No	Percent	No	Percent
Tax administrator	20	100	-	-	20	100
Tax Export	20	100	-	-	20	100
Tax Payer	19	95	1	5	20	100
Total	59	98.33	1	1.67	60	100

Source: Opinion Survey, 2009

All the tax administrator and export argue those public awareness programs are necessary in Nepal for raising government revenue. Only five percent of the taxpayer did not approve public awareness program necessary in Nepal. Thus,

it can be concluded that public awareness program is necessary for raising Nepalese government revenue.

D. The major problems of Income Tax Management in Nepal

Table No. 4.15

Problems of Income Tax Management in Nepal

S.N.	Problems	Point received				Percent	Rank	
		T.A.	T.E.	T.P.	Total			
1	Legal	65	39	49	153	11.22	3	
2	Less consciousness of taxpayers	58	52	75	185	13.57	1	
3	Lack of sufficient power to the tax Administrators	30	49	36	115	8.44	6	
4	Lack of training facility to the employee	29	50	31	110	8.07	7	
5	Lack of sufficient incentives to the employee	40	38	57	135	9.92	4	
6	Lengthy process of income tax assessment	31	52	35	118	8.65	5	
7	Lack of identical accounting system	27	32	41	100	0.734	8	
8	Lack of appropriate organization structure	45	59	71	175	12.84	2	
9	Inadequate exports in tax management	39	49	65	153	11.22	3	
10	Misuse of power by tax administrator	29	54	35	118	8.65	3	
Total						1362	100	

Source: Opinion Survey 2009

The sixty respondents were given the question:

What are the major problems of income tax management in Nepal? For this all together 10 choices were given. They ranked the choice according their response.

- The major problem of tax management is less conscious of taxpayer, because when the taxpayer becomes more conscious about taxation then the taxpayer itself tries to pay the actual amount. And that helps to manage tax structure properly.
- The second problem is legal consideration. In their opinion the law and act should be very clear and understandable to all the people. Most of the small taxpayers are not so much educated that's why they cannot understand the rule and regulation properly so they have to pay more than actual. Due to the legal aspect the income tax management is facing the great problem.
- The third major problem of income tax management is increasing habit of tax deceit. In their opinion most of the taxpayers do not want to the actual amount of tax to the government. They always try to deceit the tax amount, which should be stopped.
- Another major problem of income tax management is its lengthy process of assessment. Taxpayers never want the lengthy and time - consuming process of assessment. They always try to pay the tax amount in very short span of time.
- Next problem of the tax management system is found to be the lack of identical according system. In their view in Nepal there is no any single accounting system of maintaining records, which create the problems while assessing the taxpayers.
- Most of the small taxpayers think that their is lack of exports in tax management in Nepal. Due to which the management process is

problematic to the taxpayers. Due to the lack of the exports the income tax management cannot be effective.

- In Nepal, now days, everywhere the misuse of power and authorities is found in Nepal. So the small taxpayers think that the tax administrator do the same. The tax administrators promote the illegal process of tax deceiving by getting personal benefit from the large taxpayers. This creates the problem of tax management.
- Lack of appropriate organization structure of the income tax department is not perfect, because the power is centralized. All the major decisions are taken in the Kathmandu, which creates the problems for the taxpayers of the other places. So the organization structure should be flexible which enable to facilitate the taxpayers.
- Lack of training facilities to the employees is another major problems of the income tax management of Nepal. Due to the lack of proper training the employee of the tax department have to face the different kinds of problems in the tax matters. Due to which they also make difficulties for the taxpayers as well.
- Lack of sufficient incentives to the employees also creates serious problems to the management. If the employees do not get the proper facilities they start getting extra income from the illegal work. So they must get the sufficient benefits they require

E. Need of Public Awareness Program:

To know the respondents view towards public awareness program the questions whom put "Do you think that public awareness program is necessary in Nepal for Raising the government revenue? Opinion result is summarized in the

Table No. 4.16.
Need of Public Awareness Program

Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	20	100	-	-	20	100
Tax Expert	20	100	-	-	20	100
Tax Payer	19	95	1	15	20	100
Total	59	98.33	1	1.67	60	110

Source: Opinion Survey, 2009.

All the tax administrator and tax experts argue that public awareness program are necessary in Nepal for raising the government revenue. Only five percent of the taxpayer did not approve public awareness program necessary in Nepal thus it can be concluded that public awareness program is necessary for raising Nepalese government revenue.

F. Attitude Toward Problem in Paying Income Tax

To know the problem facing by the taxpayer while paying income by the taxpayers while paying income tax, the respondents were requested to rank their choice from 1 to 5 according to their preference. The question was, "In your thinking, what types of problems are facing by the tax payer while paying income tax.?" Responses received from respondents are tabulated as below.

Table No. 4.17
Problems in Tax Paying

S.N.	Problems	Points received				Percent	Rank
		T.A	T.E	T.P	Total		
1	Consuming unnecessary time	57	58	41	156	19.23	3
2	Expectation illegal incentives by tax personnel	39	46	64	149	18.37	4
3	Vague Provision in income tax laws	74	69	59	202	24.91	1
4	Lengthy process	68	61	69	199	24.53	2
5	Lack of cooperation by tax administration	35	38	32	105	12.94	5
	Total				811	100	

Source: Opinion Survey, 2009

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

- a. Consuming unnecessary time
- b. Vague provision in income tax laws
- c. Lengthy process
- d. Expectations illegal incentives to the personnel.
- e. Lack of co-operation by tax administrator.

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

Hypothesis

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

Calculating correlation by formula,

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

$$Pr=0.6745 \mid \frac{1Zr^2}{\sqrt{n}}$$

Assume, variable X and Y denotes views of tax administrator and taxpayers respectively.

Table No: 4.18
Correlation Coefficient Calculation

S.N.	Problem	Total points	Rank (R ₁)	Total point	Rank (R ₂)	Difference of rank (R ₁ -R ₂)	Square of differences (R ₁ -R ₂)
1	Consuming unnecessary time	57	3	41	4	4	1
2	Expectation of illegal incentives	39	4	64	2	2	4
3	Vague Provision in income tax laws	74	1	59	3	-2	4
4	Lengthy process	68	2	69	1	1	1
5	Lack of cooperation by tax administrator	35	5	32	5	0	0
	Total						Id ² -10

Source: Table 4.17

$$R = \frac{6(10)}{5(5^2 - 1)}$$

$$= 0.5$$

$$Pr = 0.6745 \mid \frac{1Z(0.40)^2}{\sqrt{5}}$$

$$= 0.22$$

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

G. Tax Paying Habit of Nepalese People

Table No. 4.19

Tax Paying Habit of Nepalese People

S.N.	Method	Point received					Rank
		T.A.	T.E.	T.P.	Total	Percentage	
1	Educating taxpayers	82	65	45	192	21.29	2
2	Simplifying tax laws	51	46	55	152	16.85	5
3	Timely assessment of taxes	75	65	47	187	20.73	3
4	Incentive to regular taxpayers	48	55	68	171	18.96	4
5	Penalties and fines	80	71	49	200	22.17	1
	Total				902	100	2

Source: Opinion Survey, 2009.

When the respondents were asked the question about how can we increase the tax paying habit of Nepalese people then they ranked the answers in different ways. First of all they want high fine and penalties to those who do not want to pay the income tax. Again high penalty should be imposed on those who deceive tax amount. In their view the high fine and penalty motivates the taxpayers to pay the tax in time and they get a habit of it. The second alternative of increasing the habits of taxpayer is education of the taxpayers. When the taxpayers will be well education of the taxpayers. When the taxpayers will be well educated then they themselves start paying taxes.

Making assessment in regular time interval can increase taxpayers' tax paying habits. This is the third option of the increasing tax paying habits of the taxpayers. In fourth alternative, the regular taxpayers should be given the incentives and facilities. It helps to attract other taxpayers to pay the tax regularly.

The tax laws should be very clear and understandable for all the people. But the present tax law of the government is not so much understandable. When the tax laws are simple then automatically the potential taxpayers come to join in the net of tax.

All these suggestions given by the respondents are very appreciable. So the concerned authority should pay attention towards these suggestions.

H. Most Important Factors for Effectiveness of Income Tax

The respondents were requested to rank their choice from 1 to 5 according to their preference to know the opinion of the respondent's view regarding to important factors for effectiveness of income tax in Nepal. A question was, "in your opinion, what is the most important factor for effectiveness of income tax in Nepal to raise government revenue?" Was asked Responses are summarized in the table as below

Table No: 4.20

Most Important factors for Effectiveness of Income Tax

S.N.	Method	Points Received				Percent	Rank
		Tax administrator	Tax expert	Tax payer	Total		
1	Clear act, rules and regulation	70	78	75	223	25.25	1
2	Conscious and honest tax payers	81	59	50	190	21.25	3
3	Honest tax officers	57	53	65	175	19.82	4
4	Effective tax administration	60	81	74	215	24.35	2
5	Political non interruption				80	9.06	5

Source: Opinion Survey, 2009

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

- a) Clean Act, Rules and regulation
- b) Conscious and honest tax payers
- c) Honest tax officers
- d) Effective tax administration
- e) Political non interruption

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

Hypothesis

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

Calculating correlation by formula,

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

$$Pr=0.6745 \left| \frac{1}{\sqrt{n}} \sum Zr^2 \right|$$

Suppose, variable X and Y denotes views of tax administrators and taxpayers respectively.

Table No: 4.21
Calculating of Correlation Coefficient

S.N.	Factors	Total Points (X)	Rank (R1)	Total Points (Y)	Rank (R2)	Difference of rank (R1-R2)	Square of difference (R1-R2)
1	Clear Act, Rules and regulation	70	2	75	1	1	0
2	Conscious and honest tax payers	81	1	50	4	-3	9
3	Honest tax officers	57	4	65	3	1	1
4	Effective tax administration	60	3	74	2	1	1
5	Political non interruption	32	5	28	5	0	0
Total						d=0	d ² =12

Source: Table 4.20

$$R=1-\frac{6(12)}{5(5^2-1)}$$

$$=0.40$$

$$Pr=0.6745 \times \frac{1-Z(0.40)^2}{\sqrt{5}}$$

$$=0.25$$

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

4.8 Major Findings

Major findings of the study can be drawn on the basis of preceding chapters.

-) The major sources of the government revenue is income tax. It many enhance the revenue of the justice and encourage private sector investment.

-) External revenue and internal revenue are included in government revenue. Tax and non tax revenue are the sources off internal revenue. These is dominated role of the tax revenue in Nepalese government revenue but contribution of tax revenue shows the increasing trend as it has contributed by 79.12% in FY 2007/08 on the total but in the non tax revenue was fluctuating trend it was 20.88% in FY 2007/08.
-) Nepalese tax revenue is the composition of direct or indirect tax there is dominated role in indirect tax revenue. The direct tax was high in FY 2007/08 by 27.11% indirect tax was also fluctuating trend it was 78.50% in 1995/96 and 72% in 2007/08.
-) The tax GDP ratio of Nepal is not found satisfactory compare to other developing countries. The GDP ratio in FY 2007/08 12.09% and non tax revenue was 3.19%.
-) Indirect tax revenue is the composition of custom duty, vat, excise duty and other tax. The contribution of custom duty, VAT excise duty and other taxes, the custom duty has occupied the first position and VAT has second position.
-) Direct tax revenue is the composition of tax an property, profit and income and land revenue registration.
-) Nepalese income tax revenue is composition of income tax from public enterprises, some public enterprises, private corporate bodies, individuals, remunerations and tax on interest.
-) Income tax is the important source of internal revenue of government.
-) Income tax exemption limit in Nepal was Rs. 7000 for all taxpayer in 1959/60 but at present income tax exemption limit is Rs. 160000 for individuals and Rs. 200000 for couple and family, in 2066/67. The exemption limit is not provided for partnership firms, corporation and

non-residents. It is found that exemption limit has been changed on the need of time and income.

-) Relations between income tax and Direct Tax Revenue, Tax Revenue, Total Revenue, GDP have been found a perfect position correlated.

An opinion survey has been conducted in order to find out the role of income tax in Nepal and some other aspects of income tax. From the opinion survey with tax administrator, tax experts and taxpayers, the following findings have been drawn.

-) Public awareness program is necessary to increase tax consciousness and raising the government revenue.
-) Income tax is the suitable means of raising government revenue.
-) Exemption and deduction should be increases to promote the special industry and export.
-) To increase the voluntary compliance by taxpayer, self-assessment method is the appropriate method while assessing the income tax.
-) Lengthy process, vague provision in income tax laws, consuming unnecessary time etc are the major problems facing by the taxpayer while paying the tax.
-) The fines and penalty under the Nepalese tax system are not reasonable and it should be increase to discourage tax evader and illegal activities.
-) Clear act, rules and regulation effective tax administration are the most important instruments for effectiveness of income taxation in Nepal.
-) Mass poverty and low-income level, increasing habit of tax evasion, ineffective income tax administrations etc. are the major reason for the low contribution of income tax to national revenue.

CHAPTER- FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Nepal is a landlocked and least developed country in the world. It has per capita income of around US \$250. The economic condition of Nepal is very poor. The Nepalese economy has not become successful in creating an investment friendly environment. The private sector does not seem to be confident with the current economic and political environment. In such a situation, there remain fewer possibilities to materialize the slogan of public-private partnership.

The Nepalese income tax system was introduced in 1959(2016). The elected government levied the first income tax and so specified act was made to define and to treat income tax. Since then four Income Tax Acts have been implemented. The present study entitled Income tax system in Nepal. This study has covered the structure of income tax system in Nepal, structure of direct tax in Nepal, tax and non tax revenue in Nepal, composition of direct tax and indirect tax revenue in Nepalese tax structure. Moreover, role of income tax in Nepal is also presented and analyzed. This study incorporates to examine the effectiveness of income tax collection in Nepal.

In second chapter, the literature review has made through the study of various books, articles, dissertations and other reference materials. Various concepts of taxation have been discussed in this study. Various pertinent books, article, dissertations, publications and other materials are observed during the study. They have been found written on various aspects of income tax. Various national and international reviews have been made regarding income tax during the study. Although, some them have arisen issues on income tax system, no

one has made a detailed study on this subject matter. Even territorial sources have not been found to address this aspect of taxation in detail. Except certain books almost all books are found based on Universities syllabus and descriptive rather than analytical. The subject matter of income tax system is found to be little bit tough because of the study is unique and original. Conceptual framework was also discussed in this chapter. It deals with meaning, definition and concept of income tax.

In third chapter, it has been discussed about various aspects of research methodology. Such a research design used for this study, data collection procedure, population and sample, nature and sources of data, selection of the respondents, procedure of processing and analysis of data.

The fourth chapter consists of both primary as well as secondary data which has been analyzed to give the meaningful result. Economic surveys, budget, speeches, annual reports of Inland Revenue Department and websites of NRB, MOF, IRD, etc. were the major sources secondary data. Primary data has been collected by opinion survey technique. It has been collected via tax experts, administrators and tax payers. Tax experts are selected from lecturers of TU, auditors, chartered accountants, executive from NRB, and lawyers & intellectual having well knowledge of income tax. Tax administrators are selected from tax department, various IRD offices within the Kathmandu valley. Tax payers are selected from different manufacturing companies, trading companies, various industries, banks, finance companies, airlines, departmental stores, shopping complex, etc.

Secondary analysis was done by presenting the relevant data into tables and figures consisting thirteen-years period, i.e. from fiscal year 1995/1996 to 2007/2008. The comparative analysis for different years was done in the analysis part of the study. Major findings of the secondary data analysis have

been put at the end of the chapter. Data obtained from opinion survey with the respondents were tabulated and analyzed to achieve desired end result.

This study has tried to present crystal clear picture of income tax system with respective analysis & assessment. Effort has made to maintain balance between the theories and actual practices. The researcher hopes that the study has been completed with the successful achievement of the stated objectives.

5.2 Conclusion

Income tax is a suitable means of raising government revenue and mobilization of the domestic resources. To achieve the goal of national development and economic growth of this country specified objective of income taxation has to be set up. Not only the specified objectives has to set up at effective programs should implement to achieve these objectives.

Nepal is the one of the least developed countries. Nepal cannot successfully and properly tear a curtain built from massive poverty, hunger, diseases unemployment, heavy dependence on agriculture, heavy dependence on agriculture, and lack of adequate industries, low-income level and social-political and geographical constraints of planned development. Yet, Nepalese economy is suffering from ineffective and effortless plan, program and policy of development and is also fighting against whatever bottlenecks identified before the starting of planned period. Now a day, prime concern of every nation of world is rapid economic development and Nepal is no exception to this ever-continuing process. Nepal aims for self-reliant economic system to upgrade its living standard of people. Thus a lot of money has to be spent to achieve maximum national objectives.

Either to pay regular expenditure or to do developmental works, governments collect revenue. The source of government revenue is foreign loans, grants; external borrowing etc. external source is uncertain, inconvenient and not good for healthy development of nation because they have to pay after a certain time. So it is better to mobilize internal source rather than external source.

Another source of government revenue is internal which constitute tax and non-tax revenue. The examples of non-tax revenue are fees, fines, royalty, administrative and business income etc. administrative income denotes the amount charged by government for providing administrative service. Business income means the return received by government for providing various goods and services to the people.

Tax revenue is the important source of government revenue. Taxation of government revenue. Taxation is regarded as effective economic activities in a country. Customer excise, value added tax, corporate and personnel income tax are the example and personal income tax are the examples of the source of tax revenue. Governments collect revenue of economic development and economic stability (Laudari, 2001; 1). Taxation is the stability sources of government revenue since it occupies the most important place is in the government treasury. The contribution of

Tax revenue to total revenue is 81.09 Percent is fiscal year 2006/07 which was higher all over the studied year, which was shown in the table 4.1. It is clear that a tax is a compulsory levy and those who are taxed has to pay it without getting corresponding receive direct benefit from the government. The taxpayer does not have any right to receive direct benefit from the tax paid. The taxpayer cannot receive equivalent benefit from the government. Government need funds for its running, therefore tax is paid to the government. Amount collected

through taxation is spent of common interest of the people and it is collecting from natural and artificial person.

Taxes on income are the most important single source of revenue for governments of developed countries, though they at present produce for less revenue in the most developing countries than customs duties and taxes are emphasized in all countries, developed as well as developing because they have the potential for increasing the yield of the tax system and achieving a system of taxation that satisfies the demand for equity and social justice (Single, 2001; 283). Income tax may be levied on the individuals as well as business firms, the former is known as personal or individual income tax or simply income tax, while the latter is more popular by the name of corporation income tax or corporation tax.

Income tax is the tax of equity it is imposed on the basis of paying capacity of taxpayers. So, it will be possible to reduce the gap in income by imposing higher rate to those who are having income and form that assistance to the people with very poor economic condition. The government need huge amount to achieve the maximum objectives of nation. In developing countries like Nepal, the main constraint for the national economic development.

The government of Nepal introduced a formal tax for the first time in "Business profit and remuneration tax." It was governed by the "Business profits and Remuneration Act 1960." According to this act only business profits and remuneration and income were subjected to tax but be collected properly according to tax but the revenue for these taxes should not be collected properly according to originals estimates. At present, income tax act 2058 is effective which was introduced in 2058. Source of Nepalese income are classified into Business income, investment income and employment income for the tax purpose. The percentage share of income tax to government is not satisfactory in

comparison to other developing country like India, Pakistan, Bangladesh, Srilanka etc.

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

The success or effectiveness of income tax system entirely depends upon implementation of provisions, which is the major responsibility of income tax administration. Income tax system of Nepal has blamed as not efficient enough. Various problems existed in the income tax such as increasing habit of tax evasion, inefficient income tax administration, defective income tax law are the reasons of lower contribution of income tax. But if we analyze the data relating to it then we can find out that revenue collection from income tax is increasing continuously. Provision in act and language have to be made clear. Some reforms in income tax administration are needed to raising the income tax revenue. An opinion survey has been conducted in order to find tax. From the opinion survey of various respondents (i.e. tax experts, tax administrations, and tax payers), the following conclusions have been drawn.

5.3. Recommendation

) Following recommendation are made for the improvement of income tax collection. The members involved in formulating income tax policies must have deep knowledge about income tax.

-) The terms objectives of income taxation should be growth redistribution and stabilization the income tax policy should be properly formulated on the basis of critical analysis of existing situation.
-) Tax ratio should be increased gradually on long run basis to meet the deficit in budget. For this the tax base should be widened. The principle of ability to pay should be completely adopted.
-) Income tax policy should be formulated according to the economic of the country. Income tax policy should be revised timely.
-) Income tax rules and regulation should be clear and simple for all the taxpayers as well as for tax administrators.

Following recommendations are made in income tax law

-) The language of Act should be simple and clear.
-) The assessment and tax collection provisions should -be clear and simple so that tax payers would be encourage to pay income tax.
-) Discretionary power of the officials should be curtailed in the Act.
-) The assessment of time limit after the submission of income assessment should be reduced.
-) The definition made in income Tax Act should be further clarified and well defined.
-) The provision of rewards, prize, incentives should be introduced in the act to encourage the taxpayers to pay tax voluntarily rather through coercive measures.

-) The rate of fine and penalties should be increased. The provision of fines, penalties and punishment should be made higher rate for income tax evaders.
-) A research and intelligence center should be established in each tax office for proper planning and to collect the information in regard to income tax evaders, potential new taxpayers and non residents who have conducted business without registration.
-) Tax personnel should be encouraged punished and transferred on the basis of their work and experience. Regular and effective training system; reward, prize and punishment system should be established for the effective personal management.
-) Effective public participation is necessary to minimize the income tax evasion. Continuous effort should be done by tax authority in order to develop the taxpayers' positive attitude towards taxation.
-) Clear provision should be made in case of deduction fill the items of deductions should be clearly defined in the act.
-) To promote export, more deduction should be provided.
-) The provision of tax deduction of source and advance payment of tax should be extended to different source of income as far possible.
-) Separate income tax department should be established so that the specialization could be achieved in matter of income tax.
-) Income tax administration implements the tax laws. Therefore, effectiveness of income tax system depends upon the income tax administration. In Nepal, one of the most important reasons for unsound

income tax system is inefficient and unscientific income tax administration. Following recommendations are made for improvement of income tax administration.

-) Delay in assessment should be reduced as possible.
-) A computerized information system is necessary to keep up to date record of income tax.
-) Proper tax education should be provided to tax officials as well as tax payers regularly.
-) Cost of income tax collection is one of the determinants of efficiency of administration. Therefore, the concerned authority should pay due attention to it should be reduced.
-) Unnecessary outside pressure should be avoided.
-) Income tax experts/profession should be increased in tax administration
-) The administration should pay great attention to bring the income from house and land rent; doctor's clinic, consultancy service, tuition, research works into income tax net. In these sectors, income tax has been highly evaded.

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