CHAPTER - I
INTRODUCTION

1.1 Background of the Study

Every government has to spend a lot of money to fulfill its responsibilities towards the people. The responsibilities may be either for security, health, education, or other developmental activities. In each country, a lot of fund is spent by the public authority for the protection of common people and for the creation of various socio-economic in fractures. Protection expenditure includes the purchase of arm and ammunitions army and police expenses and administrations of jails. Commercial expenditure is also incurred by the government for operating transportation and public enterprises. Which are undertaken by the government for the public interest? The other type of public expenditure is development expenditure. This is the expenditure incurred for providing education, health and public utility facilities to the community.[1]

So, the government expenditure is increasing day by day because of time demand; increase in price and national income; increase in population, social progress and so on. The government needs more money to run it successfully. The money that is so much important to the government is called public revenue. It is received from different kinds of sources. These are external and internal sources.

External sources of fund are foreign grants and loans. This kind of fund is received from foreign countries and international organizations. External source of fund is more important for underdeveloped and undeveloped countries. It is used for

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[1] Vanish, M.C. and Agrawal, H.S. (1992) ***Public Finance***. New Delhi: Wiley eastern Limited.

economic development; reconstruction and foreign exchange to recover from crisis condition for productive uses community.[2] But external sources are uncertain; inconvenient and not good for healthy development of nation because they have to be paid after a certain period. So it is better to mobilize internal sources rather than looking with beggar's eyes to the donors[3]**.** Like developing countries try to mobilize their internal sources for regular and developmental activities. Nepal is not exception for it but Nepal's experience is that she has mobilized internal resources fewer than expected.

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

In other hand, sources of public revenue can be classified into two types as tax revenue and non-tax revenue.

Tax revenue includes the amount which is compulsory contributed by tax payers to the government. Non-tax revenue includes fees; special assessment, gifts, grants, fine and penalties. Non-tax sources are uncertain and inconvenient because they are imposed according to the necessary of the government. So taxes are the better sources of public revenue. The use of taxes is safer for financing public revenue in developing countries. So taxation has been taken as the best effective tool for the raising the public fund. Taxation as a must viable method of resource

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2 Sharma, Neelam Kumar & Luitel, Chakrapani:(2059***).*** ***Micro Economic***; ***Money, Banking: Public Finance & International trade.*** Kathmandu: Pairavi Prakashan, Kathmandu.

3 Panta, Parmeshwor,(1996). ***Study on Income Tax Management in Nepal***: A dissertations presented to T.U. Kathmandu.

mobilization may exist of imposition of new taxes, increase in rates of existing taxes, widening the tax coverage and improving the administrative effectiveness e. t c. In normal circumstances, taxation seems to be the most effective and perhaps the least harmful ways of mobilizing internal resources. Taxes are emphasized in all countries developed as well as developing. Because they have the potentiality for increasing the yield of tax system and achieving a system of taxation that satisfies the demand for equity and social justice. Income tax more or less affects on production and growth, development of various small cottage industries, distribution of income, employment, inflation and deflation e. t. c. Tax is the main source of financing government activities in every country. The largest part of the government revenue is raised through taxation.

Taxes on income may be levied on individual as well as business firm. The former is known as personal income tax and the later is known corporate tax. A proper tax system should be able to generate the required amount of revenue.

"A tax is a compulsory contribution from the person to the government to defray the expenses incurred in the common interest of all without references to special benefit conferred."[4] So, a tax is a compulsory levy paid or to be paid by a natural or artificial person to the government without getting corresponding benefit of goods or services provided by the government. The person who pays tax does not get any equivalent benefit from the government. It is compulsory liability of the person who has to pay tax.

"A tax is a compulsory contribution imposed by a public authority, irrespective of exact amount of services rendered to the tax payer in return and are imposed as penalty for any legal offences" (Dalton; as cited in Bhattarai and Koirala 2064)

Generally taxes are classified into two types as direct tax and indirect tax.

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[4] Poudel, Santosh Raj, (2060). ***Income tax and Practice***: Atharai Enterprises Kathmandu.

A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax; the person paying and bearing tax is the same. It is the tax on income and property. Examples of direct taxes are: income tax; property tax; vehicle tax; interest tax; expenditure tax; death tax and gift tax.

An indirect tax is a tax imposed on one person but partly or wholly paid by another. In indirect tax, the person paying and bearing the tax is different. It is the tax on consumption on expenditures. Examples of indirect taxes are: VAT, sales tax; entertainment tax; hotel tax; excise duty; import and export duty etc. income tax is the most popular tax. It is considered as one of the major elements of tax revenue. Income tax is a charge on person's income according to the law of nation. It covers all the fees; additional fees; fines etc. incomes includes all the incomes which received from employment; business and investment. Income tax is superior to other taxes because it is imposed on the basis of paying capacity of tax payers. People having taxable income have to bear the incidences of income tax.

It will be possible to reduce the gaps in income by imposing higher rate of tax to those who are having high income and from that collected amount, providing necessary assistance to the people with very poor economic condition. It helps to make equitable economic distribution in the society. Balanced regional economic development is also possible through the provision of income tax. The government should charge higher income tax on the income from urban area and less on the income from remote area. Income tax holiday and incentives would help to develop the priority sector of a national economy.

Income tax plays a very important role in the economic development of Nepal .it is a tool of achieving maximum social and economic objectives as laid down by the constitution of the kingdom of Nepal. It is also recognized as a good financial tool to make narrow the inequality in income. It reduces the regional economic imbalances by providing tax concessions and holidays to the business or industries; which are established in remote and backward areas. Income tax is essential not only for collecting government but also to control over consumption, to reduce inequality of income and wealth to promote saving and investment and to accelerate development process.[5]

It is no doubt that income tax is the main source of government revenue. It is also useable in the balanced economic development. Nobody can doubt the distribution of income is also possible through progressive income tax. It is being realized that contribution of income tax to the government revenue must be increased in Nepal. Nepal has been adopting the income tax system since the last four decades. It is assessed on yearly basis. Although the legal provision has been made and updated timely, there are many problems about income tax practices in Nepal such as; leakage in tax; feeling of people; about tax as a penalty; lack of consciousness of people; mobility of tax administration to cover new tax payer, delays in computation and collection, lack of accuracy and unity in accounting system.[6] In other hand raising more revenue is the main objective of taxation but it also affects the pattern of consumption, production and distribution in the economy.

Within the income tax system, Business exemptions and privileges are more important for knowing about income tax because they are used continuously and treated differently year to year. To make up to date knowledge about income tax system, it should be done. By knowing it, we can compute net income and tax liability. Income tax law of every nation must clearly mention about the inclusion of incomes and deductions of expenses.

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5 Joshi, Dr. Shyam, (2055). ***Economic for Humanities***: Talaju Prakashan, Kathmandu.
6 Khadka, Rup Bahadur, (1994). ***Neplease Taxation***, Path for Reform.

Because of all these things; business exemption and privileges of income tax system must be reviewed and immediate correction should be made.

1.2 Statement of the Problem

Economic development is the prime concern of every nation of the world. But it is impossible for Nepal due to the cause that Nepal is least developed country having poor economic growth rate. It has been facing serious gaps and fiscal gap problems. Total expenditure was exceeded than total revenue in each subsequent year. The government expenditure is continuously rising due to weakness and large investment in selecting development projects. To get rid of from this serious problems, every nation of the world i.e. Nepal also accomplishing various activities. Nevertheless; underdeveloped countries are facing serious problems in the process of economic development. Nepal is not an exemption to this

Condition The poverty line of the people and the GDP per capita show the economic conditions of Nepal. It needs huge amount of capital for the economic development of Nepal. Despite various measured adopted by the government to boost revenue collection there is still a substantial resources gap between expenditures and revenue collection. The rate of government expenditure is exceeding the rate of growth revenue almost every from the beginning of its development phase. The sources of filling up to the resources gaps are internal and external borrowings. The use of borrowings to fulfill the growing government expenditure brings various problems. The development of countries will be possible only when the government can collect its own internal revenue that constitutes tax and non-tax revenue. Tax revenue constitutes a significant proportion on government revenue of the total revenue collected in fiscal year 2005/06, tax and non-tax revenue are 40505.3 million and 7488.9 million respectively.[7] It is thus evident that the major portion of government revenue is covered by taxation. Although the tax composition of Nepal shows that the government of Nepal is highly dependent on direct tax.

As the mean of economic growth and social justice, income tax has not succeeded to play significant role in Nepalese tax structure. The revenue collections of direct tax and indirect tax to total revenue in 2006/07 are 18,393,787000 and 51,652,398 thousand respectively. It shows that the government is largely depending upon indirect tax. People in developing nations tend to have greater propensity to tax evade taxes. This is because they have lesser knowledge about income tax and they have to maintain their livelihood from their limited income. Rich people are avoiding taxes by using legal loopholes and taking advantages of an inefficient tax administration. Recent notice of authority misuse investigation commission has proved that there is a corrupt bureaucracy in revenue office or tax office.

In Nepal, the coverage of income tax is very low. Only 05 percent of the total population pays the income tax. There is a poor income tax paying habit of Nepalese people. The tax authorities are inefficient and ineffective in enforcement. There are no integrating programs for tax payer's education, assistance, guidance and counseling. Tax officers are looked upon as heaven for corruption, harassment and incompetent personnel. The assessment procedure of income tax is not effective, undue delay in tax assessment not only reduces the total revenue, but also brings harassment to the tax payers.

So, the coverage of income tax is very narrow in Nepal. Agriculture income is exempt from income tax. Labor tax is taxed more heavily than the capital income. Retirement amount received by Nepalese people being retire from the service by army or police of foreign government is also exempted from income tax.

[7] Annual Report of Financial Comptroller General Office.

Exemption of these sources provided loopholes for tax evasion and complicates to the tax administration. In other hand, exclusion of agricultural income from the tax net alone cuts out about half of the GDP.

Some exemptions granted to achieve certain objectives are not effective. Tax incentive is one of the examples of this. Tax incentives or concessions encourage the establishment of industries in certain area but they vanish or change names, ownership or place the business when the tax concessions period expires.

At present the exemption limit to an individual has been provided into two distinct categories in Nepalese tax system. The present tax act and rules classify persons into an individual and the family according to the personal status. Thus, classification does not recognize the various sizes of the dependent family members. There is no discrimination between a taxpayer having only spouse parents and children. Therefore this limit is the Nepalese context neither shows any specific or definite relationship with per capita GDP nor with the rate of inflation nor with poverty norm.

Income tax act has clearly mentioned about the expenses, which are allowed for deduction and not allowed for deduction. But they are not sufficient and systematic. In Nepal, 10 percent of the gross profit is allowed as a deduction against net income on account of expenses related with technology or product development and efficiency improvement. This is not enough, other hand there is no special provision of deduction that keeps proper records and books of an account and file accurate returns. There is no any provision for deduction of necessary expenses like newspaper expenses, higher education expenses made by the tax payer or his dependent etc.

There are various problems of income tax and Business exemptions and privileges specifically this study has been carried out to answers the following research questions:

a. Is tax administration of Nepal is sound?
b. Are the exemptions items of income sufficient?
c. What kind of income should be prioritized for exemption?
d. Is the current exemption limit is appropriate?
e. How much rupee should be exemption limit for an individual a couple and a family?
f. Should the agricultural income tax be exempted?
g. Should the exemption limit be adjusted according to the inflation?
h. Are the current deductions of expenses sufficient?
i. What kind of expenses should be prioritized for deductions?
j. Are the provisions made under the Nepalese income tax act sufficient in all respect?

1.3 Objectives of the Study

The main objectives of the study is to gain an insight into the Business exemptions and privileges of present income tax and give appropriate suggestions to improve the tax system, so that the government can collect more revenues and use then in the process of national development. The study does not only help the government to collect more revenue but also make the concerned people aware about the exemption of income and deductions of expenses. Being an opinion survey, it analyzes the exempted income, which are provided by the income tax act and it also analyzes the deductions of expenses, which are provided by income tax act.

So the specific objective if the study will be as follows:

a. To analyze the exemptions of income which are provided by the tax act
b. To study the provision of exemption limit provided to individual, couple and family
c. To analyze the deductions of exemptions which are provided allowed by the income tax act
d. To find out the contribution of income tax in public fund of Nepal
e. To provide suggestions and recommendations about income tax administration and income tax law.

1.4 Scope of the Study

The study tries to cover the major constituents of income tax system in Nepal. Its aims is to find out the business exemptions and privileges provided by income tax act, problems and weakness in income tax system, contribution of income tax to the government revenue . It also tries to suggest some possible areas for confirm. Especially income tax business exemptions and privileges are discussed in details. The study is covered the following aspects of income tax system of Nepal:

a. Business exemptions and privileges of income tax
b. Structure of the government revenue in tax
c. Contribution of income tax to the government revenue and GDP.
d. Administrative aspects of income tax in Nepal

1.5 Significance of the Study

Developing countries like Nepal require higher magnitude of financial resources, for the developmental program. Domestic resources have more significant role than the external resources for the development programs. Among the domestic resources income tax plays a significant role. But it is a matter of great unpleasures to quote that the contribution of income tax to the national revenue is very low in Nepal. To increase the contribution of income tax in the national revenue, problems faced by the income tax system should be researched and analyzed objectively. But it is pity to say that the study and research work in the areas of income tax have been lacking in Nepal. Within income tax the intensive study on tax exemptions and deductions has not been any in Nepal. Even though several scholar doing research on income tax has studied tax exemptions and deductions as a minor topic. In the context, need and signification of this study can be known easily.

1.6 Limitations of the Study

Any research study is limited by the time period, area of the study, information and data. This study is based on exemption of income and deductions of expenses in Nepalese income tax. It is not a complete study of income tax system in Nepal. So, the limitations of this study are as follows:

a. This study is based on primary data
b. Some secondary data also taken into considerations
c. It is based on exemption of income and deduction of expenses but not as the complete study of income tax system
d. The views of respondents are collected only in Kathmandu valley
e. Samples are selected only for opinion survey due to time constraint.

f. This study has been conducted to fulfill the requirement of the MBS program of T.U. for the prescribed time, not for generalization purpose.

g. The study confined to Nepalese law, acts, ordinance, regulations and circular to income tax.

1.7 Organization of the Study

The entire study designed into five main chapters. The first chapter introduction includes: background of the study, statement of the problem, objectives of the study, scope of the study, need of the study, limitations of the study and organization of the study.

The second chapter includes; review of the literature this is done to know what research had been done in the related topic in previous days and what is to be done in at present or in future. This chapter has been divided into two main aspects:1) conceptual / theoretical review 2) review of related studies i.e. review of books of the thesis, review of newspaper, magazines, journals and articles,

The third chapter is about research methodology. In this chapter, research design, population and sample, nature and sources of data, data collection procedures, analysis of data, weight of choice and weight of respondents have been described.

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

The last chapter five is mainly concerned with findings, summary, conclusion and recommendations. In the beginning of the chapter, the major findings have presented about the business exemptions and privileges of income tax system, tax structure and administration aspects of revenue administration. Some possible area for reforms the defects in income tax system have been recommended. Lastly essential appendices and bibliography have been presented at the end of the study.

CHAPTER - II
REVIEW OF LITERATURE

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. Similarly many dissertations, articles and reports had described the income tax law, provisions, and structure of income tax. There were no detail studies made on the topic of income tax business exemptions and privileges. The researcher who made research was not sufficient. Nevertheless, some books are more important and relevant for these studies which are:

A. Theoretical Review

This section deals about the historical background of income tax law in Nepal, meaning and classification of tax, canons of taxation, objectives of taxation, direct and indirect tax, final withholding payment, exempt organization, concept and sources of income, the history of income tax in Nepal, the features of income tax act 2058, sources of income, business income , employment income, income from investment, exemption in income tax act 2058, methods of income tax assessment, installment payment, non-taxable income.

2.1 Historical Background of Income Tax Law in Nepal

Great Britain is the first country in the world to introduce the modern income tax. It introduced income tax in 1799 to finance the war fought with France. USA introduced income tax in 1862 to generate revenue to finance civil war. In India, while income tax in its moderns form was adopted in 1860, several experiments were made from 1860 to 1866 and finally the systematic income tax legislations were enacted in 1886. Although the taxes were collected in various forms in ancient era, the history of modern income tax is not very old in Nepal. The idea of introducing income tax in Nepal originated in the early 1950s when a multi-party democratic political system was introduced in 1951, then the finance minister in his budget speech declared in intention of the government to levy on income tax. (Bhattarai and Koirala, (2064). ***Taxation in Nepal with Tax Planning and VAT***)

Attempts were made to introduce income tax in subsequent years. In 1954, an income tax with Rs. 10,000, basic allowance and progressive taxes ranging from 5 to 25 percent was proposed. Due to political instability it could not be introduced until 1958.

The first elected government in 1959 finally introduced business profits ad salaries tax act, 1960 in Nepal. At that time, income tax was levied only on business profits and salaries. After about three years of experience of income tax the government replaced the prevailing tax act by income tax act, 1962. The coverage was extended in the act. In 1974, income tax act, 1974 (2031) was enacted. The act remunerated income sources into five groups. (A) agriculture (B) industry, trade, profession or occupation (C) remuneration (D) house and compound rents (E) other sources. However, agricultural income was kept outside the tax net except few years through the finance acts.

To enhance revenue mobilization through effective revenue collection procedures for the economic development of the nation, and to amend and integrate the laws relating to income tax, the parliament of Nepal enacted income tax act, 2002 (2058). This act has replaced income tax act, 1974 (2031) which was amended for eight times and existed for a period of 28 years. The government of Nepal framed income tax rules, 2059 in 2059 to help clarifying the act.

2.2 Meaning of Tax

Tax is a compulsory levy from individuals, households and firms to centers or local government. It is simply a liability to pay an amount to the government. It is a compulsory contribution from the taxpayers. Tax is computed and paid as prescribed in the law.

Seligman defined Tax as "compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred." (Bhattarai and Koirala, (2064). ***Taxation in Nepal with Tax Planning and VAT***)

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

From the above definitions it is clear that tax is a compulsory contribution to the state from a person. The natural person and artificial person having tax liabilities pay the taxes to the government. The government does not provide any corresponding benefit to the taxpayer for the amount of tax he buys. Tax is paid to the state to perform the functions of the government and the amount of tax is spent for common benefits and interest of the people.

2.3 Objectives of Tax

Taxation has been a very essential element of the government from the very beginning of the state system. Tax is a permanent instrument for collecting revenues. It is a major source of revenue in the developed world and has been appearing as an important source of revenue in the developing world as well. It has been an instrument of social and economic policy of the government. However, the objectives of taxation have been different for different epochs. In ancient times, the objectives of taxation were strengthening the muscle of the state by providing the resources. Till the time of Adam smith, the objective of the revenue was to provide resources to the government for providing security to and society from violence, invasion, injustice and maintaining public institutions which can never be for the interest of an individual. In modern days, the objective of taxation has been shifted from security perception to the economic development. The modern objectives of taxation is raising revenue to have resources mobilization, prevent concentration of wealth for the common good, boost up the economy, reduce employment, remove regional disparities and enforcement of government policy.

2.4 Classifications of Taxes

There are two types of taxes named direct tax and indirect tax. If the persons paying and bearing the tax is same, it is called direct tax. A direct tax is really paid by same person on whom it is legally imposed. The characteristics of a direct tax are equitable as per the property or income, certainty as per the payment, time of payment, and elastic in nature etc. in contrast to direct tax an indirect tax is the tax system where the person paying the tax and person bearing the tax is different. An indirect tax is imposed on one person but paid partly or wholly by another. The main features of indirect tax are convenience to pay, mass participation limited not evasion etc.

2.5 Canon of Taxation

Canons of taxation emphasizes of a good tax system. The government of a country adopts various principles while formulating suitable tax policy. These principles are referred to as the canons of taxation. The canons of taxation were first developed by Adam smith as a set of criteria by which to judge taxes. They are still widely accepted as providing a good basis by which to judge taxes. Smith's four canons of taxations as outlined in his book entitled "wealth of nations" are as follows:

2.5.1 Canon of Equity

High earners should be imposed higher taxes as compared to low earners. Tax policy should not discriminate the persons with same income level.

2.5.2 Canon of Certainty

Taxpayers should feel certainty regarding time, place, tax amount and procedure for payments of taxes.

2.5.3 Canon of Convenience

Tax system should be simple so that ordinary people can easily understand and follow it. Time, procedure and place of payment of tax should be convenient to the taxpayers.

2.5.4 Canon of Economy

The collection expenses of tax should be less than the amount of tax collected so that a surplus to public revenue is generated and the country will be benefited.

Besides the above stated canons of taxation give by Adam smiths; there are others to develop by other economists. These canons are: canon of productivity, canon of flexibility, canon of diversity, canon of simplicity, canon of neutrality, canon of co-ordination and canon of uniformity.

2.6 Defects of Income Tax Act 2031

Income tax act, 2058 has been enacted to avoid the following defects of ITA 2031:

a. ITA, 2031 had a narrow tax base. Global incomes of residents were not brought into tax net. Only the income generated in Nepal was taxed.

b. Income tax related matters were governed by various acts. Dispersion of tax related acts had arisen confusion in the effective implementation of the act.

c. There were no clear provisions regarding taxation of capital gains. The act was also silent with regard to international taxation.

d. The terminology and provision in the act were inadequate. Many important provisions required to be in modern taxation system were lacking.

e. The fine and penalty imposed bye the act were very low. As a result the level of voluntary compliance had decreased substantially.

f. There was a weak mechanism to control the tax avoidance scheme of taxpayers.

g. Tax accounting method was not prescribed in the act. Despite the provision of self- assessment in the act, it had not been implemented properly.

h. The act had not distinguished civil liabilities of the tax payers from criminal liabilities.

i. There were double appeal systems in the act. The taxpayers were allowed to lodge an objection against assessment with the revenue tribunal or the director general. The director general was empowered to act as a court and there were complaints that he used to make decisions in favor of tax officers. There were no provisions for administrative review.

2.7 Features of Income Tax Act, 2058 (2002 A.D.)

Income tax act, 2058 has been enacted with wide a perspective. Various new concepts have been introduced in this act as compared to income tax act, 2031. Many of the concepts put forward in this act were not prevailing at Nepalese tax culture. This act contains 143 sections. The key features of income tax act 2058 are:

a. All income tax related matters are confined within the act by abolishing all tax related concessions, rebates and exemption provide by different acts. This act has been made super in regard to all income tax matters.

b. The act has broadened the tax base. Unlike previous tax act, tax rates have been spelled out in the act. The tax rates and concessions have been harmonized on equity grounds.

c. The act has introduced a pool system of charging depreciation. A provision has also been made foe depreciating intangible assets.

d. The act has first introduced the taxation of capital gains.

e. The act has provided liberal losses set off and carry forward/back ward provision inter-head adjustment of losses have been clearly specified. Such provision has been made from international perspective.

f. The act ahs first introduced a provision for administrative to correct mistake made by tax administrators internally.

g. The act has made provision for a stringent fine and penalty for the defaulters. There have been made provision for punishment in the fines up to Rs.300,000 and imprisonments on conviction up 00to 3 years.

h. Global income of a resident are made taxable non- residents are also tax on their income with source in Nepal.

i. List of expenses are inclusive. All expense relating to income has been made admissible.

j. The act has made provision for international taxation. Foreign tax credit had been introduced for the first time.

k. The act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.

2.8 Sources of Income

Income is the accretion of wealth or purchasing capacity of a person or entity. According to income tax act, 2058 it is the term used to define income derived from employment, business and investment. It is the gross income less deduction allowed under tax act. This means; income tax act, 2058 had specified sources of income into three heads named as Income from Business (section 7), Income from and Employment (section 8) and Income from an Investment (section 9).

Section 6 of the act specifies that assessable income includes income earned from any country of the world in case of resident and income earned in Nepal incase of non-resident

2.8.1 Business Income

These are the receipts which are included in computation of income from business.

1. Service fees
2. Amount received from d of trading stocks
3. Net profit from disposal of business assets or business liability calculated as per chapter 8.
4. Amount treated as net profit from disposal if depreciable assets calculated as per schedule 2.
5. Gift received from the course of business.
6. Amount received in lieu of restriction accepted in relation to business operation.
7. Amounts derived are directly connected with the business and that would otherwise be included in calculating the income from investment.
8. According to sect.25
    a. Bad debts written off but subsequently recover.
    b. Any liability which is not payable now and
    c. Any expenses claimed but not now payable.
9. According to sec. 26 any income derived proportionately from a long term contract.
10. according to chapter 7,
    a. interest charged on loan and advances at the rate lower than the prevailing market rate, the difference amount(sect.27 4 & 3)

b. Income deemed to the derived from transfer pricing and others arrangement between associates as per sect. 33

11. amounts distributed as dividend otherwise than from income(sect.56 (3)
12. income of general insurance as per sect. 60

2.8.2 Employment Income

These are the receipts which are to be included in computation of income from employment.

1. Wage, salary, leave pay, overtime pay, fees, commissions, prizes, gifts, bonus and other facilities.
2. Dearness allowance, cost of living expenses, rent, entertainment and transportation allowance and like personal allowances are expenses.
3. Amount received in reimbursement of personal expenses of the employee or related person
4. Amount received in lieu of acceptance of any condition with regard to the term of employment.
5. Payments received for redundancy or loss or termination of the employment.
6. Amount received from retirement fund.
7. Contribution of employer to a retirement fund.
8. Other payments made in respect of the employment.
9. Amount received or deemed to be received as per sub point no: (h), (i) & (j) of point no: 4.10.1
10. These receipts are excluded in the taxable income of the employee

- Meals or refreshment provided in the premised by the employer and that is available to all the employees of the employer in similar terms
- Reimbursement of expenses incurred for the employer
- Payment of an amount up to Rs. 500 for such a purpose which is unreasonable of administratively impracticable to make accounting for them.

2.8.3 Investment Income

These are the receipts which are to be included in computation of income from investment

1. Any dividend, interest , natural resources payment, rent, royalty, gin from investment insurance, gain from an unapproved retirement fund and amount received from an approved retirement fund.
2. Net gain from disposal of the person's non-business chargeable assets of the investment as calculated under chapter 8.
3. the excess amount of incoming over the depreciation basis including outgoings, on the disposal of depreciable assets of the investment of the person as per paragraph (492) 9 a of schedule
4. Gifts received by the person in respect of the investment.
5. Retirement contribution including those paid to a retirement fund in respect of the person and retirement payments in respect of the person.
6. Amount received in lieu of restriction accepted in relation to the investment.
7. Amounts received or deemed to be received as per sub point no: (h), (i), (j) & (k) of the point 4.10.1

Amounts those are included in calculating the person's income from any employment or business that should be excluded in calculating a persons profit from investment.

2.9 Final Withholding Payments

As per section 92, the following payments will be taxed as final withholding payments.

1. Dividend received from resident company
2. meeting fees
3. Gain from investment insurance received from resident entity.
4. gain from unrecognized retirement fund
5. interest received by a natural person from bank, financial institution(not related to business)
6. Amount received from recognized retirement fund.
7. Rent for the lease of land or a building and associated fittings and fixtures having a source in Nepal and an individual other than in conducting a business receives that.
8. Amount received from accumulated home or sick leave.
9. Part time teaching salary(remuneration)
10. Windfall gain
11. Examiner ship remuneration / writing articles

2.10 Exempt Organizations

The Inland Revenue Department (IRD) is responsible to decide whether an organization is liable to pay tax or not. For getting tax-exempt facility, the organization should pay to the IRD with necessary document that prove the organization. An exempt organization means any entity that should not pay the tax. Social and religious organization that are not operated for profit earning are provided with such facilities ITA 2058 sec (2) dha, has included the following entities with tax exempt organization.

1. Religious educational or charitable organizations of public character registered without having a profit motive.
2. A political party registered with the election commission
3. Village Development Committee, Municipality or District Development committee.
4. An entity that has been declared as exempt organization issuing notice by the government of Nepal.
5. The government of Nepal.
6. An amateur sporting association formed for the purpose of promoting social or sporting am unities not involving the acquisition of gain.
7. Nepal Rastra Bank.

2.11 Non -Taxable Income

According to the ITA 2058, section 10 & 11, the following incomes are tax free incomes or non-taxable income.

1. Income from agriculture (except received by registered agriculture firm)
2. Income of a co-operative society registered under co-operative act 2048 from business under agriculture / forest product as well as income of rural saving and credit cooperative.
3. Tax exempt remuneration under bilateral or multilateral government agreement with foreign government, international agency.

4. Remuneration received from the public fund of a foreign government.
5. Remuneration provided by Nepal government to a foreign citizen under the tax exempt condition.
6. Allowances provided by Nepal government to widows, senior citizen and disable persons
7. Gifts , bequest inheritance and scholarship except to be included under section 7 , 8, & 9
8. Pensions received by retired army or police from the public fund of a foreign government.

- **Methods of Income Tax Assessment.**

ITA 2058 has specified three types of assessments. They are as follows:

1. Self Assessment (sect.99)
2. Jeopardy Assessment (sect.100)
3. Amended Assessment (sect.101)

Self assessment is done by assesses himself whereas jeopardy and amended assessment are the assessment based on judgments of the department.

2.12 Payment of Installment

There is a provision of payment of income tax of the current year by three installments that is 40 %, 70% and 100 % by the end of Poush, Chaitra and Ashad respectively.

I) Review of Related Studies

Various studies are made and researches are conducted by different individuals and institutions, concerning with various aspects of the act such as the structure, role, productivity, legal and administrative framework of income taxation system off Nepal after the income tax was imposed in Nepal by the first parliamentary government in 1959. Therefore some of the books, reports and dissertations that are reviewed during this study which are as under:

II) Reviews of Dissertations

In 2002, Timalsina, Satyendra wrote a thesis entitled "Personal income taxation in Nepal: A study of Exemptions and deductions”. He has analyzed the existing system of tax exemption and the deductions and given of tax exemption to improve the tax system so that government can collect more revenues and use it in the process of national development. He has measured extend of exemption limit provided to the individual and the family and examined its appropriateness to its subsistence requirement and analyzed the existing nature of standard deductions.

In 2001, Shrestha, Binita wrote a thesis on “Revenue collection from income tax in Nepal: problems and prospects”. She has analyzed the effectiveness of income tax collection policy examined the problems of revenue collection from income tax and recommended measures for improvement of income tax law and management in Nepal. She has found that level of income tax collection has been rising. Income tax system of Nepal is suffering from various problems such as narrow tax coverage, mass poverty of Nepalese people, lack of conscious taxpayers, inefficient tax administration, instability in government tax policy etc.

In 2007, Ghimire, Robin presented dissertations entitled "Special provision and contribution of employment income to tax revenue in Nepal". He has specified the special provisions regarding the employment income from ITA 2002. He has concluded that the contribution of income tax from employment income to the tax revenue can be increases mainly by making tax deductions at source more effective and changing income tax policy, rules and regulations.

In 1996, Kharel, Shree Krishna presented a dissertation entitle "Self assessment under income tax act in Nepal". In his work he has made a review of tax laws, about self assessment, analyzed the problems faced by the assesses. While doing the self assessment of their own income and made relevant recommendations to reform income tax laws as well as administration in future. He has concluded that self assessment of tax is a suitable means of raising domestic resources and it would be effective of taken seriously. He has further expressed that effectiveness of self assessment of tax depends upon its appropriate reformation.

In 1984, Shrestha, Roshani wrote a dissertation entitled "Income tax in Nepal". She has described the historical background of income tax in Nepal and the role of income tax in Nepalese tax structure. She has studied the problems of income tax in Nepal. She has found that revenue from the income tax is small due to tax evasion, which shows that income tax policy is not well operated and the collective revenue is low. To increase the revenue from taxation per capita income should first be increased. Growing per capita real income provides a handed to collect larger tax revenue. To increase income tax revenue, there must be efficient administration. She has suggested that practice of tax evasion must be checked if the taxes are to contribute to be the economic growth of Nepal.

In 1978, a senior researcher in the field of Nepalese taxation, Agrawal, Govind Ram had conducted a research entitled "Are sources mobilization for development; the reform of income tax in Nepal". The main objective of this study were to examine the problems of growing resources gap in Nepalese finance in the context of the role of income tax in Nepal including projection if income tax , to examine the ways and means for increasing tax consciousness in Nepalese people etc.

In 2000 Kandel, Puspa Raj presented the Ph.D. thesis "corporate tax system and investment behaviors in Nepal". He undertook the research work to find out the problems relating to corporate tax, which blocks the developments of the private investment. The main objectives of this study were to evaluate the corporate tax system in general to examine the sensitivity of certain policy like inflation, capital gain tax, dividend tax and interest tax etc. best on their impact on tax burden. He has showed the relationship of private investment with average effective tax rate, marginal effective tax rate and tax incentives in Nepal.

In 2007, Bhandari, Bishwaraj has submitted his thesis entitled "contribution of income tax on national revenue of Nepal". According to him income tax is a suitable means for collecting government revenue. To increase tax consciousness and to raise the government, public awareness program is necessary. He has given emphasis on clear act, rules and regulation and effective tax administration for effectiveness of income tax in Nepal. He pointed that lengthy process, vague provision in income tax laws, consuming unnecessary times are the major problems faced by the taxpayer while paying tax. He recommended that the administration should pay more attention to bring the income from house and land rent, doctor's clinic, consultancy service, tuition, research works into tax net. According to him in these sectors income tax has been highly evaded.

In 1978, Pandey, Kedar Bilas presented his dissertation on "An analysis of income tax in Nepal". In his study he has shown the role of direct tax in total revenue and tax revenue, dominant role of indirect tax in Nepalese tax system and the role of income tax to control the inflationary trend of the country. Also, he has discussed the legal aspect, role and problems of income tax, structure and economic effect of income tax in Nepal, mode of mobilizing additional resources from income tax.

In 2002, Paudel, Jayanti presented a dissertation entitled "Income taxation in Nepal: study of its structure and productivity”. The objectives of her study were to analyze the structure of income tax in Nepal, to estimate the elasticity of buoyancy of income tax administration in Nepal, to evaluate the success of VDIS (voluntary Discussion Disclosure of income Scheme) in brief and to provide suitable recommendation for improving scenario of income tax. She has found that overall revenue of Nepal showed the annual revenue growth of 16 percentage, indirect taxation has more significant contribution in total tax revenue, income tax occupied the first rank among the direct taxes, personal income tax slabs has been changed radically from seven slabs in 1975/76 to two slabs in 1999/2000, VDIS couldn’t attract more potential taxpayers into tax net due to lack of good planning and adequate homework of the government, working procedures of the tax administrations are still traditional and cost of administration has not been brought to the satisfactory level.

In 2006, Basnet, Furtiman submitted a dissertation entitled "A study on effectiveness of self tax assessment in Nepal”. According to this study self tax assessment system is effective in Nepal but not as expected. According to this thesis, the trend of applying self tax assessment system is increasing. It contributes for increment of tax revenue. The numbers of taxpayers are increasing in some extent. They are motivated to collect the tax to self assessment system. He has recommended that further policies should be determined to bring the potential tax payer within the tax net and there should be organized consciousness campaign to provide the orientation for basic accounting system and self assessment system.

In 2006, Bhandari, Dansiram presented a dissertation named "Taxation knowledge of tax payers about Nepalese tax system”. He has also tried to make relevant suggestions and to generate practical ideas of modern taxation for the taxpayer. He has recommended that to increase good knowledge of income tax to tax payer clear tax laws, dynamic tax administrations and stability of economic and taxation policy plays the important role. He has also suggested that tax related information should be organized regularly to increase the taxation knowledge of taxpayer.

III) Review of Books and Articles

In 2007, K.C., Jit Bahadur, wrote a book entitled “Tax Laws and Tax Planning” for M.B.S. second year. He has presented practical as well as theoretical aspects on taxation in this book. This book is useful to any one who is interested in the subject of taxation. This book is also useful to research work.

In 2003, Mallik, Vidhayadhar published a book named "Nepal Ko Aadhunik Aayakar Pranali”. This book is very much useful to anyone who is interested in the subject of taxation. In this book, Mallik has explained Income Tax Act, 2002 with examples wherever necessary. He has presented the complete act in simple and lucid manner, so that it will be easy to understand the act. He has shared his expertise in his book. His book is descriptive as well as analytical. All the provisions in the act have been clarified in simple language. He has also compared the provision of the old act and the new act.

In 1980, Agrawal, Govinda Ram had written a book entitled “Resource mobilization in Nepal Published by CEDA”. The book had been divided into eight chapters, the first chapter deals with special reference to Nepal. The second chapter deals with fiscal policy in developing nations and Nepal. Third chapter looks at income tax in Nepal from the historical prospective. The fourth chapter deals with structure of Nepalese taxation. Fourth chapter is related to tax structure, the writer had concluded that taxation trend in Nepal have been shown that role of indirect taxes have been predominant in the tax structure. More than 60 % of tax revenue was derived from foreign trade alone. However, since 1974/756 the role of income tax had been increasing. Agrawal had made an empirical study taking tax policy makers, tax experts, tax administration, tax lawyers and accountants and tax payers of different parts of Nepal. From that study he had concluded that Nepalese taxpayers were favorably disposed to income tax. However, the major constraints in the effective functioning of tax system seem to be administrative deficiencies, poor tax paying habits, lack of tax payer education, complex procedures and defective tax information system.

In 2002, Dhakal, Kamal Deep wrote his revised edition of his book “Aayakar Tatha Ghar- jagga kar Samabandhi Kar ra Lekha”. This book was based on income tax act 2031.This book is very much useful in getting knowledge about the history of taxation and the practice under the previous act.

In 2003, Bhattrai, Ishwor and Koirala, Girija Prasad published two books named "Taxation in Nepal’ and “Tax Laws & Tax Planning”. First book has been designed in conformity with the syllabus of BBS 3rd year and the second one has been designed based on the syllabus of MBS 2nd year. Relevant theoretical and practical aspects have been discussed in the books. Both books have shown how taxable incomes are computed under employment, business and investment sources. It also includes tax planning and VAT.

In 2003, Kandel, Puspa Raj wrote two books on taxation- one book entitled "Tax Laws and Tax Planning" and another “Nepal Ko Bartaman Kar Byabastha” for

BBS 3rd. He has presented practical as well as theoretical aspects on taxation in these books.

In 2003, Amatya, Surendra Keshar, Pokharel, Bihari Binod and Dahal, Rewan wrote a book entitled "Taxation in Nepal." This book is also designed to meet the requirement of BBS third year syllabus. Theoretical as well as practical aspects of taxation have been included in the book. This book is a descriptive one not analytical.

Khadka, Rup Bahadur wrote a book entitled “Nepalese Taxation: A Path for Reform”. The book dealt with both national and international taxes. The writer had described the scenario of Nepalese tax system from origin of Income tax , adaptation of quasi-global or a limited schedule system, segregation of corporate income tax from individual income tax increasing dependence on the presumptive basis, basic allowance and progressive tax rate structure, move from joint taxation to individual taxation and shift from itemized to flat system of standard expenses, experiment with an advance tax on impacts and the existing structure, commodity taxes and poverty taxes. He had evaluated the Nepalese tax system base on conventional, theoretical concepts and suggested various measures for its improvements. The book had been directly focused on corporate tax only but explains the whole Nepalese taxation system and structure for its reform.

In 2001, Khadka, Rup Bahadur wrote another book named: “Income Taxation in Nepal: Retrospect and prospect”. It first traces out the evolution of income tax around the world. It then analyzed relative importance of income tax in the tax system of some selected countries. It also defines various concepts which are widely used in the modern income tax literature. The book also reviews major changes introduced in the field of the Nepalese income tax system. Since its inception in 1959 A.D. and examined its existing structure and operation. It also analyzes the current problems and makes recommendations for the rationalization of the structure and modernization of operation of the income tax system. The book also includes income tax acts of 1959, 1962 and 1974 A.D.

Aryal, K.P. and Poudel, Surya Prasad (2004) had written a book entitled, “Taxation in Nepal”. They had explained about the income tax system in Nepal along with house and land tax and Value Added Tax. The book has been designed based on the curriculum of B.B.S. It had been divided into 3 parts. In the first part of the book includes introduction and development of income tax, capital and revenue nature expense and income items, entity and retirement saving, dividend tax, computation of income from business, Employment and investment have been explained with numerical and theoretical examples. House and land tax and value added tax have been explained in the second and third part respectively, the book also included proper bibliography and adequate appendix. Where various income tax, house rent and VAT related forms, schedules and format had been described.

Pant, P.R. (2004) had written an article entitled "Problems in Tax Administration and Their Remedies Published in Journal of Finance and Development" ‘Rajaswa 2004 April Vol.1. In this article he had comprehensively explained about the problem and their remedies related with tax revenue and major types of practical problems and changes in tax administrators. He had mentioned in his article that the major problems of taxation system were showing limited amount of transaction, showing low selling price, less of issuing in taking bills, lack of showing the real factory cost, commercial fraud, lack of co-operation in tax auditing , legal ambiguity and complexity in implementation and lack of co-ordination between IRD and revenue investigation unit. Meanwhile, he had recommended some valuable suggestions to solve the problems and to overcome the challenges. They were, statistical and information system should be properly managed, fixed norms and standards should be used to assess selling price and factory cost, the billing system should be made compulsory, co-ordination between Inland Revenue office with various entities of Nepal Government, revenue investigation and its related unit should play the important role.

In 2004, Kandel, Pushpa Raj had written an article entitled “Are tax incentives useful? If so, which one? Published in journal of finance and development," ‘Rajaswa’ Vol. 1, 2004 April. In that, article he had tried to seek the answer from the survey of various empirical studies earlier done in Nepal, India, Pakistan and other western countries. He found that the incentives are still the controversial matter whether they promote the investment or not. But he argued that most of the developing countries need tax incentives.

As per the empirical studies done in various countries, he concluded that among different type of tax incentives, investment allowance or investment tax credit and accumulated depreciation are superior to other types of tax incentives. Tax holiday is the most inferior type of tax incentives which causes revenue loss without enhancing the investment environment. Meanwhile, most of the researchers have opposed the tax holiday system both within Nepal and outside Nepal.

He further added that the survey of the study indicates that accelerated depreciation system had positive impact on investment. The work of reducing tax rate, especially followed after 1990’s to such lowest rate was not a proper decision. That is why, if Nepal wants to go tax incentives again, she should adopt investment allowance, or investment tax credit not the full tax holiday in future.

In this way, various dissertations, reports and articles have been reviewed while preparing this thesis. Books are found mainly based on Tribhuvan University (T.U.) syllabus requirement of T.U. Almost dissertations were written has been founds that no one has studies on Business exemptions and privileges aspect of income tax in detail. Thus, this study remains a unique and original.

IV) Research Gap

To achieve the ultimate goal of taxation, only tax policies and acts are not enough. For the achievement of targeted goals, the plans and policies must be implemented in efficient and effective manner. Business exemptions and privileges is an important part of taxation system. It is necessary for successful implementation of tax laws and policies. Policy making is relatively easy but it is more difficult to administer.

All the researches mentioned in review of literature are concerned with the study of laws, provisions and structure of tax revenue. Most of them have indicates the inefficiency of tax administration, widespread tax evasion and weak government laws and policies. The role of business exemption and privileges is very important for high collection of tax revenue. Therefore, the research has been conducted on the topic Business Exemption and Privileges provided in Income Tax Act 2058".

CHAPTER - III
RESEARCH METHODOLOGY

This chapter is devoted to research methodology applied in the study for the achievement of desired objectives. Primary as well as secondary data were used for the study. Opinion survey techniques are adopted to collect the primary data about different aspects of income tax. While conducting opinion survey, questionnaires were distributed to different groups who were related to income tax. They were income tax payers, income tax maker, income tax administrators, income tax experts, accountants, auditors, lawyers and officers.

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

3.1 Research Design

This study attempted to analyze the present business exemptions and privileges of income tax, opinion of 50 respondents associated with the income tax via income tax policy makers, administrators, experts and payers, are collected through questionnaires. The questionnaires included the problem of income tax administration; soundless of income tax administration, exempted incomes, exempted level, deductions of expenses, sufficiency of provisions etc. similarly, various publications of income tax of different organizations were used for this study. Hence, the research methodology followed in this study can be termed as survey cum descriptive research design.

3.2 Population and Sample Size

The population for this study comprised all the persons belonging to income tax of Nepal.50 sample from Kathmandu valley have been taken to fulfill the objectives of the study. The respondents had been divided into3 groups. The following table shows the groups of respondents and size of sample.

Table 3.1 Group of respondents and size of samples from each group

S. No:	Group of Respondents	Sample size
1.	Income Tax experts	10
2.	Income tax administrator	20
3.	Income tax-payers	20
	Total	**50**

3.3 Nature and Sources of Data

According to the nature of study, the study requires primary as well as secondary data. Primary data has collected through a schedule of self structured questionnaires, informal dialogues, discussions and interviews with concerned persons separate sets of questionnaires were used to have options /information from three samples, population. To get the accurate and actual information total 50 questions are distributed to selected respondents of different groups such as tax administrator, tax experts and tax payers.

Secondary data are collected through annual report of IRD of different years, Economic survey of various years published by Ministry of Finance, Nepal Rastra Bank Economic Bulletins of various times and central bureau of Statistics etc.

3.4 Data Collection Techniques

Various numerical data and information are collected as per the objective the study and research question. Firstly, laws, rules, regulations and policies related to income tax and corporate tax are studied to get more information about income tax including book related to public finance. Secondly, different libraries such as chamber of commerce, FNCCI and NRB are also consulted. Thirdly, the numerical data are collected from the publication of Annual Reports of IRD of Nepal, Economic Bulletin of NRB, economic survey of Ministry of Finance (MoF), publication of security board, Central Bureau of Statistics, Publication of center for Economic development and Budget speeches. Lastly, various journals, National newspapers are also reviewed.

3.5 Data Processing and Analyzing

Data obtained from the various sources can't be directly used in their original firm. Further, they need to be verified and simplified for the purpose of analysis, Data information; figures and facts related to the study are checked, rechecked. Edited and to be tabulated for computation.

According to the nature of data, they are inserted in meaningful tables, which have shown in annexes. Homogeneous data are sorted in one table and various tables have prepared in understandable manner. Data is analyzed and interpreted using different types of analytical tools.

3.6 Weight of Choice

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

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

This chapter is devoted to the presentation and analysis of tax revenue which affects the business organization to encourage paying tax as far as they can. To achieve this objectives qualitative as well as quantitative data and information has been analyzed.

4.1 Tax Structure of Nepal

Modern economic development of Nepal had started with initiation of first economic planning in 2013. Since then, taxes have been raised for the achievement of national economic goals. So, taxes play vital role to the economic development of Nepal. To know about the taxes, the tax structure should be known. The tax structure refers to the level as well as relative importance of various taxes in the composition of total tax revenue of country. The tax structure of any country is composed of both direct and indirect taxes. The total tax structures of Nepal from the fiscal year 1996/97 to 2005/06 are given below.

4.1.1 Composition of Total Revenue

In Nepal, the total revenue is composed of tax revenue and non -tax revenue. When the Nepal government presented first national budget in 1951/52.

Table 4.1.1 shows the composition of total tax revenue of government, which includes tax and non-tax revenue from the FY 1996/97 to 2005/06.it seems that the share of tax revenue has always been greater than the share of non-tax revenue. In FY 2005/06, the share of tax revenue and non-tax revenue was 79.45 % and 20.55

% respectively as compared with 80.41% and 19.59%in the FY 1996/97.This indicated that the role of tax revenue is very much important expenditure. Tax revenue has been placed as a major source of government revenue in Nepal. The composition of total revenue is given below.

Table 4.1 : Composition of Total Revenue

(Amount in Million)

F.Y.	Total Revenue	Tax revenue		Non-tax revenue	
		Amount	Percentage	Amount	Percentage
1996/97	30373.5	24424.3	80.41	5949.2	19.59
1997/98	32937.9	25939.8	78.75	6998.1	21.25
1998/99	37251	28752.9	77.19	8498.1	22.81
1999/00	42893.2	33152.1	77.29	9741.6	22.71
2000/01	48893.9	38865.1	79.49	10028.8	20.51
2001/02	50445.6	39330.3	77.97	11115	22.03
2002/03	56229.7	42587	75.74	13642.7	24.26
2003/04	62331	48173	77.29	14158	22.71
2004/05	70122.7	54104.7	77.16	16018	22.84
2005/06	64277.5	51668.7	79.45	13209	20.55

Source: Economic Survey fiscal year 2005/06, 2006/07, GON / MoF

The above table revealed that the tax revenue was gradually increased in every year since in the FY 1996/97 amount Rs. 30373.5 million to Rs. 70122.7 million in the year 2004/05. But in the year 2005/06 was decreased to Rs. 64277.5 million as compared with Rs. 70122.7 million in the FY 2004/05. The percentage contribution of tax revenue was found fluctuating in different years. The contribution of tax revenue to total revenue was maximum 79.45 % in FY 2005/06 and minimum was 75.74% in FY 2002/03 during the study period. The non-tax revenue collection was also in the increasing trend in those 9 years i.e. Rs.5949.2 million in 1996/97 to Rs. 16018 million in 2004/05. But the non-tax revenue in the fiscal year 2005/06 was decreased to Rs. 6847.1 million as compared with Rs.

16018 million in the fiscal year 2003/04. The tax revenue collection was seen to be in the gradually increasing trend FY 1996/97 to 2004/05 but in the FY 2005/06 it was decreased by Rs.5845.2 million.

4.1.2 Composition of Tax Revenue

Tax Revenue is the combination of direct and indirect tax. A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax the person paying and bearing tax is the same. Direct tax includes land revenue and registration, tax on property, profit and income where as indirect tax includes customs, tax on consumption and product of goods and services. The composition of Nepalese tax revenue is presented in the table 4.1.2 in terms of direct and indirect tax revenue from FY 1996/97 to 2005/06. The composition of tax revenue has been shown below:

Table 4.2 : Composition of Tax Revenue

(Amount in Million)

Fiscal year	Total Tax Revenue	Total Direct Tax Revenue		Total Indirect Tax Revenue	
		Amount	Percentage	Amount	Percentage
1996/97	24424.3	5340	21.86	19084.3	78.14
1997/98	25939.8	6187.9	23.85	19751.9	76.15
1998/99	28752.9	7516.1	26.14	21236.8	73.86
1999/00	33152.1	8951.5	27.00	24200.6	73.00
2000/01	38865.1	10159.4	26.14	28705.7	73.86
2001/02	39330.3	10597.5	26.94	28733.1	73.06
2002/03	42587	10105.8	23.73	32481.2	76.27
2003/04	48173	11912.6	24.73	36260.4	75.27
2004/05	54104.7	13071.8	24.16	41032.9	75.84
2005/06	51668.7	13968.1	24.32	43462.3	75.68

Source: Economic Survey fiscal year 2005/06, 2006/07, GON / MoF

From the above table, it is found that there has been simultaneous increase in direct tax, indirect tax and total tax revenue in absolute terms. In the FY 1996/97, these amount were Rs. 5340 million, Rs.19084.3 million and Rs. 24424.3 million respectively and during the period of ten years there amounts become Rs. 13968.1 million, Rs. 43462.3 million and Rs.57430.4 million respectively.

Despite of absolute increment of direct tax, its contribution to total tax revenue in the FY 1996/97 was 21.86 % amount Rs.5340 million which increased up to 27% amount Rs.8951.1 million in the FY 1999/00. but the direct tax contribution percentage to total tax revenue was decreased down to 23.72% amount Rs. 10105.8 million in FY 2003./03 and it is slightly increase up to Rs. 24.72% amount Rs.11912.6 million in the FY 2003/04. But the FY 2005/06, direct tax was 24.32% and amount Rs. 13968.1 million. In FY 1996/97 the indirect tax was 78.14% amount Rs. 19084.3 million and it was gradually decreased down to 73 % amounting Rs.24200.6 million in the FY 1999/00. After then it was increased to 76.28% amount Rs.32481.2 million in the FY 2002/03 and it was 75.68% amount to Rs. 43462.3 million in the FY 2005/06.

Comparing direct and indirect tax, it reveals that the heavy reliance of economy on indirect tax to direct to economy in the channel of development it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax. Therefore, the attention should be paid on the sufficient resource mobilization through internal resources.

4.1.3. Composition of Indirect Tax

The tax structure of Nepal is mainly dependent on indirect taxes, which constituted 75.68% of total tax revenue in 2005/06. Nepalese tax revenue it dependent mainly on international trade and sales / VAT on goods and services supplemented by taxes on income and property to some extent.

The major components of indirect tax in Nepalese tax structure constitutes custom duties, Tax on consumption and production of goods and services. Custom duty has been classified mainly import duty ad export duty. Other components of indirect tax like entertainment tax, hotel tax, air flight tax and other tax contribute normal share zero. Table shows the composition of indirect tax given as follows:

Table 4.3 : Composition of Indirect Tax Revenue

(Amount in Million)

Fiscal Yea r	Total Indirect tax	Custom Duties		Tax on Consumption and product Of Goods and services			
				Value Added tax		Excise on Industrial products	
		Amount	%	Amount	%	Amount	%
1996/97	19084.3	8309.1	43.54	8477.1	44.42	2298.1	12.04
1997/98	19751.9	8502.2	43.04	8363.9	42.34	2885.8	14.61
1998/99	21236.8	9517.7	44.82	8765.9	41.28	2953.2	13.91
1999/00	24200.6	10813.3	44.68	10259.7	42.39	3127.6	12.92
2000/01	28705.7	12532.1	43.66	12382.4	43.14	3771.2	13.14
2001/02	28733.1	12658.8	44.06	12267.3	42.69	3807	13.25
2002/03	32481.2	14236.4	43.83	13459.7	41.44	4785.1	14.73
2003/04	36260.4	15554.8	42.90	14478.9	39.93	6226.7	17.17
2004/05	41032.9	15701.6	38.27	18885.4	46.03	6445.9	15.71
2005/06	43462.3	15344	35.30	21610.7	49.72	6507.6	14.97

Source: Economic Survey fiscal year 2005/06, 2006/07

The above table revealed that the custom duty and VAT occupies major portion in indirect tax. In FY 1996/97 the contribution of custom duty was 43.53% which fluctuated between 44.18 % to 35.30 % and it was 35.30% and it was 35.30 % in the FY 2005/06. The average percentage contribution of custom duty to indirect tax was 42.40 % during the study period.

The percentage of custom duty to indirect tax has been decreasing from the fiscal year 2001/02. The sales tax / VAT have become an important source of overall tax revenue with an increasing trend, which contributed 49.72% to indirect tax in FY 2005/06 as compared to 43.53 % in FY 1996/97.

The share of excise duty was 12.06% in FY 1996/97 and was gradually increased to 17.18% in the FY 2003/04 then after it has been decreasing to 14.98% in FY 2005/06.its average contribution was 14.03% during the study period. Which is not satisfactory and it needs to increase in the future. The total tax amount collected from excise on industrial product was increased continuously during the study period, which was Rs. 6507.6 million in the FY 2005/06.

4.1.4 Composition of Direct Tax

The major components of direct tax are land revenue and registration, tax on property, profit and income. The share of major components of direct tax is given in table 4.4

Table shows that the contribution of income tax to direct was lighter than other tax and it occupied the largest share in the direct tax. The percent share of income tax to direct tax in FY 1996/97 was 77.21% amounting Rs.4123.4 million which gradually increased up to 89.71% amounting Rs. 9114 million in FY 2000/01. The average share of income tax revenue was 80.34%. It was 74.26% amount Rs.

10373.7 million in FY 2005/06. So, this regular decrease in contribution percentage of income tax to direct tax is not satisfactory.

Table 4.4 : Composition of Direct Tax Revenue

(Amount in million)

Fiscal year	Total Direct Tax	Land Revenue And Registration				Tax On Property Profit and income				
		Land revenue	House and Land Registration	Total	% of Total D.T.	Income Tax	Tax on Property	Other Tax	Total	% of total D.T.
1996/97	5340	5.9	1009.5	1015.4	19.01	4123.4	201.2	0	4324.60	80.99
1997/98	6187.9	3.6	1000.6	1004.2	16.23	4898.1	285.6	0	5183.70	83.77
1998/99	7516.1	1.3	1001.8	1003.1	13.35	6170.2	342.7	0	6512.90	86.65
1999/00	8951.5	4.6	1011.3	1015.9	11.35	7420.6	515	0	7935.60	88.65
2000/01	10159.4	5.1	607.8	612.9	6.03	9114	432.5	0	9546.50	93.97
2001/02	10597.5	0.8	1131	1131.8	10.68	8903.7	562	0	9465.70	89.32
2002/03	10105.8	0	1414.3	1414.3	13.99	7966.2	559.5	165.5	8691.50	86.01
2003/04	11912.6	0	1697.5	1697.5	14.25	9245.9	700.6	268.6	10215.10	85.75
2004/05	13071.8	0	1799.2	1799.2	13.76	10159.4	806.5	306.7	11272.60	86.24
2005/06	13968.1	0	2181.1	2181.1	15.61	10373.7	847.6	565.7	11787.00	84.39
Average	**9781.07**	**2.13**	**1285.41**	**1287.54**	**13.43**	**7837.52**	**525.32**	**130.68**	**8493.52**	**86.57**

Source: Economic Survey F/Y 2005/06, 2006/07

Land revenue and house and land registration fees have contributed 19.04% amount Rs. 1015.4 million in the FY 1996/97, which was decreased gradually and reduced to 6.03% amount Rs.612.9 million in the FY 200/01. There after started to increase gradually and reached to 15.61% amount Rs.2181.1 million in the FY 2005/06. The average percentage of land revenue and house and land registration fees to total direct tax was 13.42%.

The share of property tax to total direct tax was 210.1 million in the FY 1996/97 and 847.6 million in the FY 2005/06. The percentage of property tax to direct tax is very lower in comparison to income tax, land revenue and registration.

The major portion of direct tax covered by income tax that's why to increase the volume of direct tax we must focus in the income tax.

4.1.5 Contribution of Total Revenue, Total Tax Revenue, Direct Tax Revenue and indirect Tax revenue on GDP

According to the table 4.5, we found that the contribution of total revenue on GDP was in increasing trend, which was 11.27% in the FY 1996/97 amount Rs. 30373.50 million, which was gradually increased and reached to 12.78% amount Rs. 70122.70 million in the FY 2004/05. But it decreased to 11.97% in the FY 2005/06. The contribution of total tax on GDP was fluctuating on the past ten years. It was 9.06% amount Rs. 24424.30 million in the FY 1996/97 and 9.51% amount, Rs. 57430.40 million in the FY 2005/06. There is significant role of indirect tax in the tax structure of Nepal, which has contributed about three times more than the direct tax. In the FY 1996/97, the contribution of indirect tax and direct tax on GDP were 7.08% and 1.98% amount Rs. 19084.30 million and 5340.00 million and 7.20% and 2.31% amount Rs. 43462 and Rs.13968.10 million respectively in the FY 2005/06.

Table 4.5 : Contribution of Total Revenue, Total Tax Revenue, Direct Tax Revenue and Indirect Tax Revenue on GDP

(Amount in Million)

Fiscal Year	GDP	Total Revenue		Total Tax Revenue		Direct Tax revenue		Indirect Tax Revenue	
		Amount	% on GDP	Amount	% on GDP	Amount	% on GDP	Amount	% on GDP
1996/97	269570	30373.50	11.27	24424.30	9.06	5340.00	1.98	19084.3	7.08
1997/98	289798	32937.90	11.37	25939.80	8.95	6187.90	2.14	19751.90	6.82
1998/99	330018	37251.00	11.29	28752.90	8.71	7516.10	2.28	21236.80	6.44
1999/00	366251	42893.70	11.71	33152.10	9.05	8951.50	2.44	24200.60	6.61
2000/01	413429	48893.90	11.83	38865.10	9.40	10159.40	2.46	28705.70	6.94
2001/02	430397	50445.60	11.72	39330.60	9.14	10597.50	2.46	28733.10	6.68
2002/03	460325	56229.70	12.22	42587.00	9.25	10105.80	2.20	32481.20	7.06
2003/04	500699	62331.00	12.45	48173.00	9.62	11912.60	2.38	36260.40	7.24
2004/05	548485	70122.70	12.78	54104.70	9.86	13071.80	2.38	41032.90	7.48
2005/06	603673	72282.10	12.97	57430.40	9.51	13968.10	2.31	43462.30	7.20

Source: Economic Survey F/Y 2005/06, 2006/07

4.1.6 Structure of Income Tax in Nepal

The income tax structure of Nepal is the composition of tax from public enterprises, private corporate bodies, individuals, remunerations and tax on interest. The structure of income tax in Nepal is presented in Table 4.1.6

The table presents the structure of income tax in Nepal which shows that the total income tax has increased in every fiscal year except in the FY 2001/02 and 2002/03. it has increased from Rs. 4123.4 million in 1996/97 to Rs. 10373.7 million in the FY 2005/06. It’s the year 2001/02 it was decreased to Rs.8903.7 million from Rs. 9114 million on in the FY 2000/01 and in 2002/03. It was Rs. 7966.2 million than again it started to increase in each year till FY 2005/06.

The contribution of public enterprises also increased from Rs.1231.1 million to Rs. 2929 million from FY 1996/97 to 2000/01. After than started to decrease that it decreased that it decreased to Rs.195.70 million in 2005/06.

The contribution from individual in income tax revenue is greatest in every fiscal year. The revenue from individual tax payers increased Rs.1711.4 million in FY 1996/97 to Rs. 4419.1 million in FY 2001/02.in the year 2002/03 it was increased to Rs.3362.3 million. After than it started to increase again reached to Rs.4237.7million in the year 2005/06.

The collection of income tax from remuneration has been increasing. It was Rs.168.10 million in the FY 1996/97 to Rs.1764.10 million in the FY 2005/06.

Income tax from interest was fluctuating between Rs.154.40million to 864.10 million from FY 1996/97 to 2002/03. It was Rs.774.9 million in the FY 2005/06.

Table 4.6 : Structure of Income Tax Revenue

(Amount in million)

Fiscal year	Total Income Tax Revenue	Public Enterprises		Private Corporate bodies		Individual		Remuneration		Tax on Interest	
		Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1996/97	4123.4	1231.1	29.86	858.4	20.82	1711.4	41.50	168.1	4.08	154.4	3.74
1997/98	4898.1	1317.8	26.90	925.1	18.89	2120.8	43.30	322.2	6.58	2121.2	43.31
1998/99	6170.2	1526.5	24.74	1155	18.72	2772.7	44.94	396.5	6.43	319.5	5.18
1999/00	7420.6	2198.8	29.63	1339.6	18.05	3016.3	40.65	451.5	6.08	414.4	5.58
2000/01	9114	2928	32.13	1924.3	21.11	3200.5	35.12	597.3	6.55	463.9	5.09
2001/02	8903.7	1769.3	19.87	1412	15.86	4419.1	49.63	835.6	9.38	467.3	5.25
2002/03	7966.2	1251	15.70	1236.3	15.52	3362.3	42.21	1252.65	15.72	864	10.85
2003/04	9245.9	2056.6	22.24	1531.3	16.56	3533.4	38.22	1391.2	15.05	733.4	7.93
2004/05	10159.4	1332.4	13.11	2467.3	24.29	3926.3	38.65	1675.9	16.50	757	7.45
2005/06	10373.7	195.7	1.89	3404.3	32.82	4232.7	40.82	1764.1	17.01	774.9	7.47

Source: Economic Survey F/Y 2005/06, 2006/07

4.1.7 Resource Gap in Nepal

The resource mobilization is the main challenge in the economic development of the country. The internal resource plays vital role in economic development of the country. Government collects the resource from different ways. The tax structure is major source of revenue for the government. Government has imposed two types of tax like direct and indirect tax. In the present tax structure, the government revenue comes more indirect tax rather than direct tax. Tax plays has to be made a part of the instrument of the development goals.

The resource mobilization has been a major problem in financing of growing government expenses. Since the beginning of planned of Nepal, there has been tremendous increment in size of government expenditure. The developmental works have to be carried out by the government in the initial stage. An increase in government expenditure creates additional demand in economy through multiplier affects and their by induces arises in aggregate output. The government resource have been concentrated more on expending economic overhead in the form of the transport, power and communication which will stimulate agriculture, industry and transport in the private sector.

Many studies have been attempted to examine the problem of resource gap and prospect of internal resource gap. Domestic resource gap is the amount of excluding net foreign grants and loans. But the overall resources gap includes the contribution made by foreign grants and loan in financing public expenditure. The problem of resource gap has increased from one year to another which has been recovered through massive inflow if external capital. Regular expenditure is fulfilled by internal resources whereas development expenditure is mostly depending in external resources. The dependence of foreign aid and deficit finance had not been shown any declining trend. If the regular gap in minimized through the over dependence of foreign loans, it can further create the resource problem in the near future.

The problem of resources mobilization and resource gap is related to the saving and investment. The level of income and the rate of interest influence the saving structure. The low rate of saving is prevailing in the country as a result of low level of income of the people. The low level of income creates the problem of resources mobilization for undertaking investment program in a large scale by both government and private sector.

Table 4.7 : Overall Resource Gap in Nepal

Fiscal year	Total Expenditure	Total revenue	Resource gap [1]	Foreign Grants	Resource gap [2]	Foreign loan	Resource gap [3]
1996/97	50723.7	30373.3	20350.2	5988.3	14361.9	9043.6	5318.3
1997/98	56118.3	32937.9	23180.4	5402.6	17777.8	11054.5	6723.3
1998/99	59579	37251	23328	4336.6	17991.2	11852.4	6139
1999/00	66272.5	42893.7	23378.8	5711.7	17667.6	11812.6	5854.9
2000/01	79835.1	48893.9	30941.2	6753.4	24187.5	12044	12143.8
2001/02	80072.2	50445.6	29626.6	6686.3	22940.5	7698.4	15241.8
2002/03	84006.1	56229.3	27776.4	11339.1	16437.2	4546.5	11890.9
2003/04	89442.6	62331	27111.6	11283.4	15282.8	7629	8199.2
2004/05	102560	70122.3	32437.7	14391.2	18046.5	9266.3	8780.4
2005/06	110889	7282.3	38607.1	13827.5	24779.6	8214.3	16565.3

Source: Economic Survey F/Y 2005/06, 2006/07

Resource Gap [1]

The resource gap was Rs.20350.3 million in the fiscal year 1996/97 and it was Rs.38607.1 million in the fiscal year 2005/06. The average resource gap was Rs.27573.8 million for the last ten years. The amount of resource gap was in increasing trend up to 2000/01, amounting Rs.30941.2 million, it was decreases to Rs. 27111.6 million in FY 2003/04.

Resource Gap [2]

This resource gap is taken as the difference between total expenditure and total revenue plus foreign grants. In the FY 1996/97 the gap was Rs.14361.9 million which was increased to Rs. 24187.8 million in the FY 2000/01. Then after it was decreased to Rs.15828.2 million in the FY 2003/04. This was due to the high proportionate increment in foreign grants from Rs.6686.1 million in the FY 2000/01 to Rs.11283.4 million in FY 2003/04.

Resource Gap [3]

This resource gap is taken as the difference between total expenditure and total resource plus foreign grants plus foreign loan. In the FY 1996/97 the gap was Rs.5318.3 million which was increased to Rs.16565.3 million in the FY 2005/06. This resource gap was fluctuating between Rs.5318.5 million to Rs.16565.3 million in the FY 1996/97 to 2005/06.

The above analysis shows a clear indication of the serious and growing financial resource problem in Nepal. The increasing magnitude of resource gap clearly indicates that there is an urgent need for mobilizing additional resources. Income tax has appeared as one of the most effective fiscal policy instrument to mobilize additional resources and for achieving the desired developmental objective of Nepal.

4.1.8 Share of Government Revenue, Foreign Aid and Corporate Income Tax Revenue in Public Expenditure

Government's expenditure is increasing at a higher rate than the growth of government revenue. The growth rate of domestic saving has not increased substantially even the external capital inflow has been increasing with higher rate. As a consequence of which the resource gap is highly increasing instead of minimizing. In this context, the small amount or percentage of average of 4.19% contribution by CITR will have dwindling importance to fulfill resource gap from the internal resources.

The following table shows the share of Government Revenue, Foreign Aid and CITR in Public Expenditure:

Table 4.8 : Share of Government Revenue, Foreign Aid and CITR in Public Expenditure.

Fiscal year	Total govt. Expenditure	Total govt. Revenue	Total Revenue as % of TE59.88	Foreign Aid	Foreign Aid as % of TE	CITR	CITR as % of TE
1996/97	50723.3	30373.6	58.69	15031.9	29.63	2089.5	4.12
1997/98	56118.3	32937.3	62.52	16457.3	29.33	2242.9	4.00
1998/99	59579	37251	64.72	16189	27.17	2681.5	4.50
1999/00	66272.3	42893.7	64.72	17523.9	26.44	3538.3	5.34
2000/01	79835.1	48893.5	61.24	18797.3	23.55	4852.3	6.08
2001/02	80072.2	50445.6	63.00	14384.5	17.96	3181.3	3.97
2002/03	84006.1	56229.3	66.94	15885.5	18.91	2487.3	2.96
2003/04	89442.6	62331.	69.69	18912.3	21.14	3587.4	4.01
2004/05	102560	70122.3	68.37	23657.3	23.07	3800.2	3.71
2005/06	110889	72282.1	65.18	22041.8	19.55	3600	3.25

Source: Economic Survey F/Y 2005/06, 2006/07

The above table indicated the contribution of the government revenue in financing public expenditure. It was 64.12% on an average government revenue share was maximum 69.69% in the FY 2003/04 and minimum 58.69% in the FY 1997/98 during the study period. Similarly, the contribution made by foreign and comprising both foreign grants and loans come to 23.62% on an average. The foreign aid was Rs 29.63% amount Rs.15031.9 million in FY 1996/97 and 19.88% amount Rs.22041.8 million in the FY 2005/06. The contribution of foreign aid on total government expenditure in the FY 2005/06 is comparatively lower than the initial period of study. The CITR amount and its contribution percentage to total expenditure was 4.12% amount Rs.2089.5 in the FY 1996/97 but in the FY 200/01. it was increases to 6.08% amount Rs.4852.3 . There was fluctuating in CITR from 2001/02 to 2005/06. The average percentage was 4.19% during the study period.

4.1.9 Contribution of Income Tax on Total Government Revenue, Total Tax Revenue and GDP

The contribution of income tax from total government revenue, total tax revenue and GDP is given in table 4.1.9. from the above table it is clear that the contribution of income tax on total government revenue was 13.58% amount Rs.412304 million in the FY 1996/97 which was increased to 18.64% amount Rs.9114 in the FY 2000/01. But after that it was decreased to 14.35% amount Rs.10373.7 in the FY 2005/06. The percentage of income tax on total government revenue had fluctuated between13.58% to 18.64% during the study period.

The contribution of income tax on total tax revenue was 16.88% amount Rs.4123.7 in the FY 1996/97 and 18.06% amount Rs.10373.3 in FY a 2005/06. The contribution of income tax on total tax revenue was maximum 23.45% in the

FY 1996/97. It had fluctuated between 16.88% to 23.45% during the past ten years.

The contribution of income tax on GDP was increased income tax was 1.52% amount its 4123.52 in FY 1996/97 and 2.20% amount Rs.9114 million in the FY 2000/01 than after it was gradually decreased to 1.71% amount Rs.10373.3 million in the FY 2005/06.

Table 4.9 : Contribution of Income tax on Total government revenue, Total tax revenue and GDP

(Amount in million)

Fiscal year	Total revenue	Total tax revenue	GDP	Total income tax	% of income tax on total revenue	% of income tax on total tax revenue	% of income tax on GDP
1996/97	30373.5	24424.30	269570	4123.4	13.58	16.88	1.53
1997/98	32937.9	25939.80	289798	4898.10	14.87	18.88	1.69
1998/99	37251	28752.90	330018	6170.2	16.56	21.46	1.87
1999/00	42893.7	33152.3	366251	7420.6	17.30	22.38	2.03
2000/01	48893.9	38865.10	413429	9114	18.64	23.45	2.20
2001/02	50445.6	39330.60	430397	8903.7	17.65	22.64	2.07
2002/03	56229.7	42587.00	460325	7966.2	14.17	18.71	1.73
2003/04	62331	48173.00	500699	9245.9	14.83	19.19	1.85
2004/05	70122.7	54104.70	548485	10159.4	14.49	18.78	1.85
2005/06	72282.1	57430.40	603673	10373.7	14.35	18.06	1.72

Source: Economic Survey F/Y 2005/06, 2006/07

4.1.10 Exemption Limit in Nepal

Exemption limit directly affect the income tax revenue. Taxpayer having low tax paying capacity should exclude from the tax bracket (net) for the social justice. The exemption limit provided in the various years is presented below in table. In the earlier time, there was equal amount of exemption to all the taxpayers i.e. individual, couple, family and corporate bodies. From the table it is clear the exemption limit is extended according to the need of time and income condition. At present time individual having the taxable income up to Rs. 115,000 is exempted from tax and that for couple is Rs. 140,000.

Table 4.10 : Exemption Limit in Nepal

Fiscal Year	Individual	Couple
1985/86 to 1989/90	15000	20000
1990/91to 1991/92	20000	30000
1992/93to 1996/97	25000	35000
1997/98	30000	40000
1998/99	40000	50000
1999/00 to 2000/01	55000	75000
2001/02	65000	85000
2002/03to 2005/06	80000	100000
2005/06	100000	125000
2006/07	115000	140000

4.1.11 Estimate and Collection of Income Tax in Nepal

Table 4.1.12 shows the performance of income tax in Nepal. Nowadays, the collection of income tax in Nepal seems to be satisfactory. The collection of income tax in Nepal is in increasing every year. It was collected Rs.4123.4 million in the FY 1996/97 which was 89.74% of estimation and in the FY 1998/99 the collection of income tax reached to Rs.6170.20 million which was 106.75% of estimation. For the period of 10 years i.e. from 1996/97 to 2005/06 the collection was maximum in the year 1998/99 and minimum in the FY 2001/02 when it was 79.39% of estimation.

Table 4.11 : Estimate and collection of Income tax in Nepal

Fiscal year	Estimate	Collection	Difference	% of collection on estimates
1996/97	4595	4123.4	471.6	89.74
1997/98	4750	4898.1	-148.1	103.12
1998/99	5780	6170.3	-390.2	106.75
1999/00	7380	7420.2	-40.6	100.55
2000/01	9980	9114	866	91.32
2001/02	11140	8903.2	2236.3	79.93
2002/03	9862.5	7966.2	1896.3	80.77
2003/04	8697.2	9245.9	-548.4	106.31
2004/05	10250	10159.4	90.6	99.12
2005/06	10999.6	10373.7	625.9	94.31

Source: Estimates from various budget speeches and actual collections from economic survey 2005/06

4.2 An Empirical Analysis

An empirical analysis is conducted in order to find out our various aspects of income tax imposition in Nepal. This chapter analyzes information collected from primary sources i.e. through questionnaire. The major tool used for this purpose is an opinion questionnaire, which was dispatched to 60 persons representing tax administrators, tax experts and tax payers, but only 50 responses were received. The questionnaire included the various aspect off income tax concerning with provision of Business Exemption and Privileges. The questionnaire either asked for a yes/no response or asked for ranking of choice according to number of alternatives where a first choice was most important and least choice was least important. Information received from respondents was tabulated in the separate format and they were expressed in percent of total number or points then analyzed into descriptive way.

4.2.1 Group of respondents and code used

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

Table 4.12 : Group of respondents and code used

Serial No:	Group of Respondents	Sample Size	Code used
1	Tax Experts	10	A
2	Tax Administrators	20	B
3	Tax payers	20	C
	Total	**50**	

4.2.2 Soundness of Income Tax Administration in Nepal

In order to know, the respondents' opinion about the soundness of income tax administration of Nepal a question was asked "Do you consider that the income tax administration of Nepal is sound?" The responses received from the respondents are tabulated as follows:

Table 4.13 : Soundness of income tax administration of Nepal

Respondents	**Yes**		**No**		**Total**	
	Number	**%**	**Number**	**%**	**Number**	**%**
A	3	30	7	70	10	100
B	10	50	10	50	20	100
C	3	15	17	85	20	100
Total	**16**	**32**	**34**	**68**	**50**	**100**

Source: Opinion Survey

The question received 100 % response as 32%of total respondents agree that the income tax administration of Nepal is sound and 68% of total respondents do not agree about the soundness of income tax administration of Nepal. Most of the respondents of code A and C were disagreed about the soundness of income tax administration of Nepal. Half of the administrators were against the soundness of tax administration. From this, it can be concluded that the income tax administrators of Nepal is not sound.

In order to know, the causes of unsound income tax administration, the next question was asked" if no, what are the causes which are responsible for the creation of unsound tax administration?" The respondents were requested to rank their answer from 1 to 6. But most of the responses were received as a tick mark. For ranking purpose, the alternative, which got many more tick mark, was arranged as the most important.

Table 4.14 : Causes for the creation of unsound income tax administration

S. No.	Causes	Group			Total Frequency	Percentage	Rank
		A	B	C			
1	Defective income tax act	1	2	5	8	8	6
2	Lack of public participation	5	7	10	22	21	3
3	Lack of trained employee	6	6	12	24	23	1
4	Faculty organizational structure of tax administration	3	6	8	17	16	4
5	Lack of income tax experts/ professionals in tax administration	5	6	12	23	22	2
6.	Weakness in government economic policy	2	3	6	11	10	5

Sources: Opinion Survey

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

From the above in overall, it can be concluded that main cause for the creation of unsound tax administration of Nepal is lack of trained employee in tax administration.

In separate view of each group of respondents, Group A (Tax Expert) and Group C (Tax Payers) were prioritized the lack of trained employees as the main cause of unsound income tax administration. Group C (Tax Payers) were prioritized the shortage of income tax experts professional in tax administration also. In the other hand, Group B (Tax Administration) were prioritized the lack of public participation as the main cause of unsound tax administration. In overall, most of the respondents of each class were agreed that the main causes of unsound income tax administration are lack of trained employees, lack of income tax expert/ professionals in tax administration and lack of public participation.

4.2.3 Opinion on Current Income Tax Rates

In order to know the opinion on current income tax rates, respondents were requested to tick one among the three alternatives (High, Medium and Low). The question was asked" what is your opinion about the current income tax rate?" The income tax rate is "The response receives are tabulated below:

Table 4.15 : Opinion on current income tax rates

S. No.	Tax Rate	Group			Total	Percentage
		A	B	C		
1	High	1	-	11	12	24
2.	Medium	5	12	7	24	48
3.	Low	4	8	2	14	28
					Total	**100**

Sources: Opinion survey

Out of the 100% responses, 48% of the respondents were agreed that the current income tax rate is medium, 24% of respondents agreed on high and remaining respondents agreed on low tax rate from the above table, it can be concluded that the current income tax rate is medium. Some respondents feel that the rate is not higher in absolute terms but it is higher as compare to tax paying capacity of Nepali people.

4.2.4 Sufficiency of Exempted Items of Income Tax

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

Table 4.16 : Sufficiency of exempted items of income

Responses	**Group**			**Total no.**	**Percentage**
	A	**B**	**C**		
Yes	4	18	7	29	58
No	6	2	13	21	42
			Total	**50**	**100**

Sources: opinion survey

There were hundred percent responses received from respondents. Out of 50 respondents 29 respondents (58 percent) were agreed that the exempted items of income are sufficient. But this was the cause of tax administration because majority of tax administrations feel that they do not to make bias against government.

As who gave negative response about the sufficiency of exempted items of income were asked a question," if no, what kind of income should be exempted?" The respondents were requested to write in the blank numbers. Most of the respondents did not response about it. Only four responses of tax experts, ten responses of taxpayers and one responses of tax administrator were received.

The responses were classified according to the code used in number wise.

A. Tax Experts

1. Provident fund
2. Life insurance premium
3. Expert earning
4. Remote Area Allowance
5. interest received from government bank
6. Awards and rewards
7. Scholarship

B. Tax Administration

1. Life insurance premium
2. Citizens investment Trust

C. Tax Payers

1. Overtime allowance
2. retirement benefits
3. income from foreign employees
4. medical allowances
5. provident fund
6. employees gratuity
7. Life insurance premium

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

4.2.5 Appropriateness of Current Income Tax Exemption Limit

Finance act of Nepal nearly prescribes the tax rate and exemption limit of income from the very beginning of income tax, tax rate and exemption limit are changing year to year. To know the respondents view about the current exemption limit; a question was asked," Do you think that the current income tax exemption limit is appropriate?" the responses as follows:

Table 4.17 : Appropriateness of current income tax exemption limit

Responses	Group			Total No.	Percentage
	A	**B**	**C**		
Yes	2	7	-	9	18
No	8	13	20	41	82
			Total	**50**	**100**

Sources: opinion survey

From the above table, it is clear that the current income tax exemption limit is appropriate.82 % of the respondents were against the appropriateness of current exemption limit where as only 18% of the respondents were for the appropriateness of current exemption limit. Respondents who were against the appropriateness of the current exemption limit was asked," if no, how much is the exemption limit should be for an individual unit?" the responses were as follows:

Table 4.18 : Exemption limit for an individual

Exemption Limit	Group			Total	Percentages
	A	B	C		
Rs.100,000	4	8	8	20	48
Rs.150,000	3	5	7	15	36
Rs. 200,000	-		1	1	2
Rs.250,000	1	-	4	5	12
Others	1			1	2
Total				**42**	**100**

Sources: opinion survey

On the response about the exemption limit of an individual, it was found that 48% of the respondents in favor of Rs.100,000.36% of the respondents suggested that the exemption limit should be Rs.150,000. 2% of the respondents suggested that the exemption limit should be Rs.250,000. One respondent (2%) who specified on other (if any) was Rs. 85000. From the above table, it is clear that the exemption limit for an individual should be Rs.100000.

Similarly, a question was raised on the topic of exemption limit for a family as, "how much exemption limit should be for a family?" the responses were given the following table:

Table 4.19 : Exemption limit for a family

Exemption Limit	Group			Total	Percentages
	A	B	C		
Rs.100,000	1	-	-	1	2
Rs.150,000	4	8	6	18	43
Rs. 200,000	3	4	4	11	26
Rs.250,000	1	1	6	8	19
Others	-		4	4	10
Total				**42**	**100**

Sources: opinion survey

From the above table; it is clear that the most of the respondents i.e. 43% suggested for Rs.150,000 as exempted limit for a family, 26% of the respondents were suggested for Rs.200,000. Similarly 2 % were for 100000 and 19% were for Rs.250,000. Four respondents who were specified as other (if any) was Rs.300,000 on the personal discussion with the respondents , the researcher found that more people were in support to provide income tax exemption limit equivalent to annual remuneration income of the government employees section officers.

4.2.6 Family Exemption Limit that must be provided According to the Number of Dependent

Income tax act has provided exemption limit to a family. But it is not mentioned the number of dependent about a family. So to know the opinion about the exemption limit of a family according to the numbers of dependents; a question was asked." Do you agree that family exemption must be provided according to the number of dependent?" The responses were:

Responses	**Group**			**Total No.**	**Percentage**
	A	**B**	**C**		
Yes	2	8	15	25	50
No	8	12	5	25	50
				Total	**100**

Sources: opinion survey

The above table shows; the response of respondents about the family exemption limit that must be provided according to the number of dependents. Out of the 100 % response, 50 % of the respondents agreed that the family exemption limit must be provided according to the number of dependent , majority of respondents of Group A and B were disagreed but Group C was agreed on providing the family exemption limit according to the number of dependent. On the personal discussion with the respondents, the researchers found that respondents were in support to provide exemption limit to a family according to the no of dependents but it is difficult to execute because it is impossible practically.

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

Table 4.20 : Exemption limit according to the inflationary situation of the country

Responses	Group			Total No.	Percentage
	A	B	C		
Yes	10	19	20	49	98
No	-	1	-	1	2
			Total	**50**	**100**

Sources: opinion survey

From the above table, it shows that 98% of the respondents limit according to the inflationary situation of the country. So it can be concluded that the exemption limit of a family or an individual should be adjusted according to the inflationary situation of the country.

4.2.7 Opinion on providing exemption on Agriculture income

From the commencement of Income tax act, agricultural income has been treated as taxable income in sometime and exempted income in sometime. The new income tax act has exempted agriculture income tax other than the income from or a corporate body, through the law above the holding ceiling a prescribed in land act 2058. To know the opinion on it one question was asked," what is your opinion and providing exemption on agriculture income?" the responses were:

Table 4.21 : Exemption on Agriculture income

Responses	Group			Total No.	Percentage
	A	B	C		
Yes, it should be exemption	5	5	15	25	50
No,	2	6	3	11	22
No, it should be treated as other income	1	5	-	6	12
Other, if any specify	2	4	2	50	100

Sources: opinion survey

On the question asked, 50 % of the respondents were in support to exempt the agriculture income where 22 percent of the respondents were against the exemption of agriculture income only 12 % of the respondents were in support to treat it as other income.

4.2.8 Attitude Towards the Itemized Deductions

Income tax act 2058 has provided different kinds of expense as deduction as standard deductions.

In order to know the attitude towards the item-wise deduction expenses, the following two questions were asked

1. Do you suggest for itemized deduction in income tax?
2. Do you think that itemized deductions are sufficient?

The responses to these above questions are tabulated in the following separate two tables:

Table 4.22 : Suggestions for itemized deductions

Responses	Group			Total No.	Percentage
	A	B	C		
Yes	8	8	12	28	56%
No	2	12	8	22	44%
Total	**10**	**20**	**20**	**50**	**100**

Sources: opinion survey

Table 4.23 : Sufficiency for itemized deductions

Responses	Group			Total No.	Percentage
	A	B	C		
Yes	2	14	5	21	47
No	6	4	14	24	53
Total	**8**	**8**	**19**	**45**	**100**

Sources: opinion survey

There was 100 % response received on first question from the respondents. Majority of the respondents were suggested for item wise deduction of expenses expect tax administrators, majority of tax experts and tax payer were in favor of item-wise deduction form the above table it can be concluded that the experts should be deducted in item-wise from the point view of the respondents.

There was 90 % responsive received of second question from the respondents. The above second table shows that 53 % of the total respondents were agreed on insufficiency of itemized deduction or there was not sufficient deduction of item-wise deduction. majority of the respondents of Group A (tax experts) and Group C (tax payer) were against the sufficiency of itemized deduction of expenses where as majority of the respondents of group B (tax administrator) were in favor of sufficiency of itemized deduction of expenses. From the above table it can be concluded that there was insufficiency of itemized deductions.

4.2.9 Knowledge about the Present Depreciation System

Income tax act 2058 has classified the assets into five classes and approved different rates to each class for depreciation purpose. The legal provisions relating to depreciation is given as the section of legal provision relating to deduction allowed in former chapters. To know the opinion or knowledge of respondents a question asked," Do you know about the present depreciation system on ITA?" The responses about it were given in the following table:

Table 4.24 : Knowledge about the Present Depreciation System

Responses	Group			Total No.	Percentage
	A	B	C		
Yes	8	20	13	41	82
No	2	-	7	9	18
Total	**10**	**20**	**20**	**50**	**100**

Sources: opinion survey

From the above table; out of the total respondents, 82% of the total respondents were familiar with present depreciation system on income tax whereas only 18% of the total respondents were not familiar with present depreciation system. So, it can be concluded that majority of the respondents were familiar with present depreciation system on personal discussion one respondent had criticized the classification of assets.

4.2.10 Problems and Weaknesses of Nepalese income tax system

Income tax system of Nepal is not efficient enough. To know the causes of problems and weakness of Nepalese income tax system a question was asked," the respondents were requested to rank their answer from 1 to 9. But most of the respondents were marked with tick. For ranking purpose the alternative, which got many more tick mark, was arranged most important are ranked as first.

Table 4.25 : Major problems and weakness of Nepalese income tax system

S. No.	Problems and weakness	Group			Total No.	Percentage	Rank
		A	B	C			
1.	Lack of trained employees	9	16	12	37	16	1
2.	Lack of timely adjustment of tax laws	5	5	3	13	6	9
3.	Lack of cooperation in tax administration	9	10	15	34	15	2
4.	Limited tax base	7	14	1	22	10	6
5.	Relatively high tax rate	4	5	7	16	7	8
6.	Increased corruption	8	9	13	30	13	3.5
7.	Ambiguous provision under the Nepalese income tax laws	7	9	7	23	10	5

Sources: opinion survey

The major problems and weakness of the Nepalese income tax system of Nepal were ranked in order of preference of the respondents as follows:

1. Lack of trained employees
2. Lack of co-operation in tax administration
3. Increased corruption
4. Ambiguous provision under the Nepalese
5. Limited tax base
6. Relatively high tax rate
7. Lack of timely adjustment of tax laws

From the above view of respondents of each group, Group A (Tax expert) and Group C (Tax payers) had ranked first rank to lack of co-operation in tax administration as the major problems and weakness of income tax system where Group B (Tax Administration) had ranked first rank to the lack of trained employees as the major problems and weakness of Nepalese tax system. In overall all the respondents were agreed on the tax administration as the cause of problems and weakness of Nepalese income tax system.

In the personal discussion with respondents most of the tax payer said that increased corruption is the major problems and weakness of Nepalese income tax system one respondents gave the example of increased corruption on his industry.

From the above ranking, it can be concluded that the major problems and weakness of Nepalese income tax system are lack of trained employees; lack of cooperation in tax administration, voluntary compliance, and increased corruption.

4.2.11 Sufficient Provisions Made Under the Nepalese Tax Act

In order to know the sufficiency of provision made under the Nepalese income tax act, respondents were requested to tick between two (yes/no) alternatives. The question was, “in your opinion are the provisions made under the Nepalese income tax act sufficient in all aspect? The responses were received are as follows:

Table 4.26 : Sufficiency of Provisions of Income Tax Act

Responses	Group			Total No.	Percentage
	A	B	C		
Yes	4	15	3	22	47
No	5	4	16	25	53
Total	**9**	**19**	**19**	**47**	**100**

Sources: opinion survey

Since; 47% of the respondents were agreed in the sufficiency of provisions made under the Nepalese income tax act, but 53% of the total respondents were against the sufficiency of provisions. From the above table, it can be concluded that majority of the respondents were against the sufficiency.

4.3 Major Findings of the Study

On the basis of preceding chapters; data presentation and analysis some major findings can be drawn. The major findings of this study are summarized below.

1. Revenue of the government of Nepal is composed of tax and non-tax revenue. There is dominant share of tax revenue in Nepalese government revenue. The tax revenue collection was seen to be in the gradually increasing trends from FY 1996/97 TO 2003/04 but in FY 2004/05 it was decreased by Rs.5845.2 million
2. Revenue of the government of Nepal is the composition of direct and indirect tax revenue. There is dominant role of indirect tax revenue in Nepal. The contribution of direct and indirect tax on total tax

revenue were 21.86 and 778.16 become 24.32 and 75.68 percent in 2005/06. however, the share of indirect tax in Nepalese tax revenue is decreasing but still it is dominating direct tax revenue and the widespread evasion of income tax may be major reason for the low contribution of direct tax

3. The major components of indirect tax in Nepalese tax structure constituent's customs duties and tax on consumption and product of goods and services. The contribution of custom duty, VAT and excise on industrial products on indirect tax were 43.54 % , 44.42 % and 12.04% respectively in FY 1996/97 and the contribution of each tax were reached to 35.30%, 49.72% and 14.97% in FY 2005/06. It shows that VAT and excise on industrial products were in increasing trends but customs duties were in decreasing trend.

4. The major components of direct tax are land revenue and registration, tax on property, profit and income. Average amount of land revenue, house and land registration fees, income tax, tax on property and other tax were 2.13 million,1285.41 million ,7837.52 million,525.32 and 130.68 million respectively. In the composition of direct tax income tax was the giant one which contributes more in FY 2002/03 than in the FY 2001/02. Land revenue and house and house and land registration fees have contributed 19.04% amounting Rs.1015.4 million in the FY 1996/97 which was decreased gradually and reached to 6.03% amounting Rs. 612.9million in the FY2000/01. Then after started to increase steadily and reached to 15.61% in the FY 2005/06. The major portion of direct tax covered by income tax that’s why to increase volume of direct tax we must focus in the income tax.

5. The contribution of total revenue on GDP was in increasing trend. This was 11.27% in the FY1996/97 and 12.78% in the FY 2005/06.

The contribution of total tax revenue on GDP nearly remained constant during the study period. It was 9.06% in the FY 1996/97 and 9.51% in the FY 2005/06. The contribution of direct and indirect tax on GDP were 1.98% and 7.08% in the FY 1996/97 and 7.20% and 2.31% in the FY 2005/06. The contribution of total revenue, total tax revenue, direct tax revenue, and indirect tax revenue on GDP are not satisfactory.

6. In income tax structure, the contribution from individual to income tax revenue is in increasing trend. The share of income tax from individual was Rs.1711.4 million which increased to Rs.4234.7 million in the FY 2005/06. The income tax from public enterprises, private corporate bodies, remuneration and tax on interest are also in increasing trend.

7. There was a clear indication of the serious and growing financial resource problem in Nepal. The increasing magnitude of resource gap clearly indicates that there is an urgent need for mobilizing additional resources. Income tax has appeared one of the most effective fiscal policy instruments to mobilize additional resources and for achieving the desired developmental objective of Nepal.

8. On an average contribution of the government revenue in public expenditure as 65.18%. In the FY 2005/06. Government revenue was 69.69% in the FY 2003/04 at maximum level and it was 58.69% at lowest level in the FY 1997/98. Similarly, the contribution made by foreign at comprising both grants and loans was 23.71% on an average. This indicates the internal indebtedness of the country.

9. The contribution made by CITR to total expenditure was 4.194% on an average. Its contribution was 6.08% of maximum in the FY 2000/01 and 2.96% of minimum in the FY 002/03. The drastic reduction in contribution percentage sector was mainly due to the

unfriendly business environment created by unstable political and economic situation of the country.

10. Contribution of income tax on total government revenue, total tax revenue and GDP were 13.58%, 16.88 % and 1.53% in the FY 1996/97. This had been increased to 18.45%, 23.45% and 2.20% in the FY 200/01 respectively and fell down to 14.35%, 18.06% and 1.72% in the FY 2005/06. The government target to increase in income tax can not be fulfilled in this increment ration as per the projected data.
11. Income tax exemptions limit in Nepal changed the basis of time and income condition. The present exemption limit provides Rs.115000 to an individual and Rs.140000 for family in the FY 2006/07. The exemption limit is not provided for partnership firms, corporation and no-residents.
12. There were eight slabs of income tax rate in the FY 1985/86 in Nepal but at present there are two slabs for personal income and for corporate taxpayer they are taxed at flat rate. At present income tax tar is 15 and 25% for personal income over exemption limit, 30% for bank and financial institutions and 25% for other corporate tax payer without exemption limit.
13. If we see the estimation and collection performance of income tax in Nepal, then it seems to be satisfactory at present in 1996/97. The collection was 89.74% of estimation and in the FY 2005/06/ it was 94.13% of estimation.

The opinion survey with tax administrators, tax payers and tax experts conducted for the income tax has drawn the following conclusions:

1. Income tax is a suitable means of raising government revenue.

2. Business exemption and privileges is help government to collect more revenue by providing more facilities to business organizations, individuals and tax payers
3. Tax education is the most necessary in Nepal to increase the tax consciousness of tax payers
4. The major objectives of the income tax in Nepal are to achieve the goal of national development and equal economic distribution, to enhance the revenue of the government to meet the government expenditure, to narrow the income gap between poor and rich.
5. Income tax system of Nepal is not sound and efficient, basically due to increasing habit of tax evasion, inefficient income tax administration, lack of consciousness of tax payers, complexity of income tax act, rules and regulations, lack of appropriate assessment procedure etc.
6. Self-assessment method is more appropriate for Nepal while assessing income tax.
7. There is corrupt practice existed in Nepalese income tax administration. The major causes according to the preference of the respondents were dishonest tax personnel; weaknesses of acts; rules and regulations dishonest tax payers, and lower remuneration to tax personnel. It can be minimized by taking of severe actions to corrupters; reduction of tax officers; discretionary power; development of check and balance system; regular super vision to tax personnel etc.
8. The current provisions of fines, fees and penalties under income tax system are not reasonable.
9. Income tax administration is not efficient to collect tax. Lack of trained and competence tax personnel, complicated tax laws, lack of proper communication , unnecessary outside pressures, undue delay

in making assessment, lack of proper direction, lack of voluntary compliance by tax payers lack of tax awareness to tax payers are the most important causes of ineffectiveness of Nepalese tax administration.

10. Honest tax payers, honest tax officers, clear tax act, rules and regulations are the most important factors for the effectiveness of income tax in Nepal.
11. Extension of coverage, minimizing the problems of tax evasion and avoidance tax consciousness of people, reform in income tax administration, reform in income tax assessment, voluntary compliance by the tax payer are the major prospectus to enhance the contribution of income tax on government revenue.

Findings of Empirical Investigation

1. Income tax administration of Nepal is considered as unsound. Main causes of unsound income tax administration are lack of trained employee, shortage of income tax expert/ professional in tax administration and lack of public participation.
2. Income tax rates of Nepal are considered as medium. Most of the tax expert and tax administration were agreed that the income tax rates are medium whereas most of the taxpayers were agreed on high income rate
3. Exempted items incomes in Nepal are sufficient.
4. Family exemption limit must be provided according to the number of dependents.
5. Exemption limit should be adjusted according to the inflationary situation of the country.

6. Average respondents were suggested for itemized deductions and average respondents were agreed on that there is sufficiency of itemized deduction.
7. All expenses which are related to earning income must be prioritized for deductions
8. Most of the respondents were familiar with the present depreciation system.
9. Improvement is needed in language, law, tax administration, exemption limit and depreciation.

4.4 An Analysis of Business Exemption and Privileges

Income Tax Act 2031 has been replaced by Income Tax Act 2058. Income Tax Act has classified the income into business, employment and investment.

The act has defined the income heads as bellows:

Business means any industries, a trade, a Profession or the like isolated transaction with a business character and includes a pat, present or prospective business.

Employment includes a past, present, or prospective employment.

Investment means an act of holding or investing one or more assets of a similar nature that re used in an integrated fashion but excludes. Act of holding of assets other than non-business chargeable assets, primarily for personal use by the person owning the assets or investing amount on such assets.

For calculation of net income of these 3 incomes or amounts, which are taxable and non- taxable and expenses which are allowed for deduction and not allowed for deduction. For the computations of incomes, act has made the following provisions.

4.5 Sources of Income

Income is the accretion of wealth or purchasing capacity of a person or entity. According to income tax act, 2058 it is the term used to define income derived from employment, business and investment. It is the gross income less deduction allowed under tax act. This means; income tax act, 2058 had specified sources of income as income from business (section 7), income from an employment (section 8) and income from an investment (section 9).

Section 6 of the act specifies that assessable income includes income earned from any country of the world in case of resident and income earned in Nepal incase of non-resident

4.5.1 Business Income

These are the receipts which are included in computation of income from business.

1. Service fees
2. Amount received from d of trading stocks
3. Net profit from disposal of business assets or business liability calculated as per chapter 8.
4. Amount treated as net profit from disposal if depreciable assets calculated as per schedule 2.
5. Gift received from the course of business.
6. Amount received in lieu of restriction accepted in relation to business operation.

7. Amounts derived are directly connected with the business and that would otherwise be included in calculating the income from investment.
8. According to sect.25
   a. Bad debts written off but subsequently recover.
   b. Any liability which is not payable now and
   c. Any expenses claimed but not now payable.
9. According to sec. 26 any income derived proportionately from a long term contract.
10. according to chapter 7,
    a. interest charged on loan and advances at the rate lower than the prevailing market rate, the difference amount (sect.27 4 & 3)
    b. Income deemed to the derived from transfer pricing and others arrangement between associates as per sect. 33
11. Amounts distributed as dividend otherwise than from income (sect.56 (3)
12. Income of general insurance as per sect. 60

4.5.2 Employment Income

These are the receipts which are to be included in computation of income from employment.

1. Wage, salary, leave pay, overtime pay, fees, commissions, prizes, gifts, bonus and other facilities.
2. Dearness allowance, cost of living expenses, rent, entertainment and transportation allowance and like personal allowances are expenses.

3. Amount received in reimbursement of personal expenses of the employee or related person
4. Amount received in lieu of acceptance of any condition with regard to the term of employment.
5. Payments received for redundancy or loss or termination of the employment.
6. Amount received from retirement fund.
7. Contribution of employer to a retirement fund.
8. Other payments made in respect of the employment.
9. Amount received or deemed to be received as per sub point no: (h), (i) & (j) of point no:4.10.1
10. These receipts are excluded in the taxable income of the employee

    - Meals or refreshment provided in the premised by the employer and that is available to all the employees of the employer in similar terms
    - Reimbursement of expenses incurred for the employer
    - Payment of an amount up to Rs. 500 for such a purpose which is unreasonable of administratively impracticable to make accounting for them.

4.5.3 Investment Income

These are the receipts which are to be included in computation of income from investment

1. Any dividend, interest , natural resources payment, rent, royalty, gin from investment insurance, gain from an unapproved retirement fund and amount received from an approved retirement fund.

2. Net gain from disposal of the person’s non-business chargeable assets of the investment as calculated under chapter 8.
3. the excess amount of incoming over the depreciation basis including outgoings, on the disposal of depreciable assets of the investment of the person as per paragraph (492) 9 a of schedule
4. Gifts received by the person in respect of the investment.
5. Retirement contribution including those paid to a retirement fund in respect of the person and retirement payments in respect of the person.
6. Amount received in lieu of restriction accepted in relation to the investment.
7. Amounts received or deemed to be received as per sub point no: (h), (i), (j) & (k) of the point 4.10.1

Amounts those are included in calculating the person’s income from any employment or business that should be excluded in calculating a persons profit from investment.

4.5.4 Business Exemption and Privileges

Tax exemption are usually meant either to reduce the tax burden from a particular segment of society in the interest of fairness or to promote some type of economic activity reducing the tax burden on those organizations or individuals who are involved in that activity. Generally tax privileges system is applied to promote domestic industry. It helps to export domestic production to the international market. To protect and encourage industrial development of the nation many countries apply quota system while importing goods. This reduces consumption of foreign goods.

Due to these reasons the act provides several tax exemptions and incentives to the person including industrial units of the country. These reduce tax incidence substantially.

The following business incomes are exempted from payment of tax as per section 11(i) & (ii) of income tax act 2058.

Agriculture Income: - An agriculture income derived from sources in Nepal during an income year by a person, other than income from an agriculture business derived by a registered firm, or company, partnership, or a corporate body, or through holding load more than person's bed ceiling in hands relating act 2021, is exempt from income tax.

Region and their ceiling of land prescribed by Land relating Act 2021.

Region	Agriculture	House and compound
Terai, including inner Terai	10 Bighas	1 Bighas
In kathmandu valley	25 Ropanies	5 Ropanies
All Hilly Areas	70 Ropanies	5 Ropanies

Agriculture Business: Agriculture business signifies the business of producing crops from public or private land, or deriving crops from a tenant using the land. For the income tax purpose, income derived by a landlord, holding the land within the ceiling prescribed Land Act 2021. From agriculture business is exempt from income tax. However, income from an agriculture business received by a registered firm, or partnership, or company or a corporate body, or through the land above holding ceiling as prescribed in the Land Act, 2021 is taxable income.

Agriculture Business Income of Land Owned by Trust: For the income tax purpose income derived by a trust from an agriculture business from Land Owned by trust is exempt from payment of tax.

Business Income of Co-operatives : Income derived by Co-operative, societies, registered under based on agriculture and forest products such as sericulture and silk production, horticulture and fruit processing, animal husbandry, diary industries, poultry farming, fishery, Tea gardening and processing, coffee farming and processing horticulture and herb processing vegetables seeds farming, bee-keeping, honey production and forestry related business such as lease hold-forestry, agro forestry, cold storage, established for the storage of vegetables and business of agricultural seeds insecticide, fertilizer and agricultural tools (other than machine operated) as well as income derived by rural community based saving and credit co-operatives are also exempt from tax.

Dividend income tax of prescribed Entities: Dividend income distributed by agro or forest based co-operatives and rural community based credit cooperatives are exempted from payment of divided tax.

Income from domestic industry

Income derived from domestic industries is exempted from payment of income tax to them which have already taken tax exempted certificate before the Shrawan 1st, 2063. After Shrawan 1, 2063, there is no provision of tax exempt certificate to the domestic industries. The domestic industry refers that production intensive industry of labor, traditional, skill relating to art and culture and raw materials mobilization of local level excluding, wool dying carpet, pashmina and woolen cloth production using more than five kilo watt motor power.

Business Privileges

A privilege signifies civil liberties or special rights given to someone in return for a monetary consideration. Thus income tax privileges are special right in return for a monetary consideration for payment of tax. According to Black's Law Dictionary privileges means

A particular and peculiar benefit or advantage enjoyed by a person, company or class beyond the common advantage of other citizens. An exceptional or extra-ordinary power or exemption; a peculiar right, advantage, exemption, power, franchise or immunity held by a person or class, not generally possessed by others. (P.1197)

ITA, 2002 has divided industries into two categories. Special industries and industries. The special industry excludes industries producing cigarettes, biddy, cigar, chewing tobacco, Khaini (Tobacco) or other goods using tobacco as the basic raw materials or alcohol, bear, or other goods of a similar nature.

Income of a Special Industry: Income derived from an entity having a source in Nepal that is wholly engaged in operating a special industry, an entity that operates any road, bridge; tunnel, ropeway, or overhead bridge construction, and an entity operating any trolley bus is taxed at the rate of 20 percent.

Special Industry if provides 600 or more Employment Throughout the Year : A special industry if provides direct employment to six hundred or more Nepali citizen throughout the year, the tax is levied at the rate of 90% of the rate otherwise applicable to the income of that year.

Special Industry if operated in Underdeveloped, Undeveloped Areas:- A special industry if it is operated in a underdeveloped and undeveloped areas, tax is levied at the rate of 80% and 75% respectively of the rate otherwise applicable for the period of 10 income years commencing from and including the year in which the operation commences. Thus, 54 districts out of 75 districts of Nepal fall under these prescribed three zones.

Industries Established in Remote Area: Income derived by industries established in remote area is exempted for the period of 10 income years commencing from and including the year in which the operation commenced.

Industries Established in Special Economic Zone: Income derived by industries established in special economic zone is exempted for the period of 5 income years commencing from and including the year in which the operation commenced. After, the completion of the exempted, 5 income years, they are taxed at the rate of 50 percent of the rate otherwise applicable to the income of that year.

Information Technology Intensive Industry Established in Information Technology Park (ITP):- An industry if based on information technology industry and has established within ITP prescribed by government of Nepal, the tax is levied at the rate of 75 % of the rate otherwise applicable to the income of that year.

A Special Industry Operated by Natural Person : A natural person if involved in operating special industry throughout the year or an entity involved in special industry or exports the goods or involved in infrastructure works is taxed at the rate of 20 percent of the rate otherwise applicable to the income of that year.

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

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

Donation, Gifts to exempt Organizations: Section of Income Tax Act 2058 has mentioned the provision of donation, gifts to exemption. The provisions are:-

1. A person may lean to have their taxable income for an income year reduced by donation, gifts made by the person during the year to an exempt organization, that are approved for the purpose of this section by the department.
2. Notwithstanding subsection (a), reduction allowed to a person under subsection (I) for an income year shall not exceed Rs.100000 or 5% of the person's taxable income for the calculated without a deduction for gifts referred to a subsection (a) and ignoring the limitations in 17(2) and 18(2) whichever is less.

3. Notwithstanding subsection (a) and (b) Nepal government may prescribe by a notification in the Nepal Gazette as to allow full or partial deduction at the time of assessing a person's income of the expenses incurred for special purpose, or the expenses of gifts given by the person.

From the above provision (I), it is clear that the donation given to political parties is allowed for deduction. But it is not able to solve the voice of people "Transparency of donation amount given by business to political parties."

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

Allowable Deduction

1. **General Deduction (Sec 13):** Subject to income tax act 2058, for the purpose of calculating a person's income from any business or investment, there will be deduction of all expenses to the extent incurred, during the income year by the person and in the generation of income from business or investment.

2. **Interest (Sec 14):** The interest incurred during the year for the borrowed fund of the person is allowed for deduction to the extent that; the borrowed money is used in that year, if the money is borrowed for purchase of an asset and that asset is used in that year or in other case, the debt obligation is created in the production of income from business or investment. If a resident entity pays interest to the controlling entity, the resident entity may deduct the interest without exceeding the sum of a and b.

a) All interests that are to be included in the entity's taxable income and

b) 50 % of the entity's adjusted taxable income for the year calculated without including any interest income and deducting any interest expenses.

- Portion of the interest not deducted during the year because of the limitations will be deducted in next income year.
- For this purpose, the controlling entities are the following entities which own or control the resident entities to the extent of 25% or more at any time during the income year.

3. Cost of Trading Stock (Sec 15): Trading stock includes these stocks with a person: raw materials; work in progress and finished goods. But it does not include stock in foreign currencies.

The cost of trading stock is derived as follows

	Cost of opening stock	xxx
Add:	Purchase or produced during the year	xxx
Less:	Cost of closing stock	xxx
	Cost of trading stock	xxx

- The closing stock of last year will be the opening stock for this year. Closing stock showed be taken/ valued at cost price or market price whichever is lower.
- The person keeping accounts on a cash basis can adopt either the prime cost or factory cost as basis for the valuation of trading stock.

- ❖ The person keeping accounts on an accrual basis must adopt factory cost basis for the valuation of trading stocks.
- ❖ In case of actual cost could not be derived for the particular trading stock either; FIFO or weighted average cost mentioned can be adopted.

- ❖ The prime cost is derived as follows:

Cost of raw material consumed	xxx
Direct Labour Cost	xxx
Factory variable overhead	xxx
Prime Cost	xxx

- ❖ The factory cost is derived as follows:

Cot of raw material consumed	xxx
Direct Labour cost	xxx
Factory Overhead (fixed+ variable)	xxx
Factory cost	xxx

4. **Repair & Improvement Cost (sec 16):** The repair and improvement cost incurred during the year for the depreciable assets owned and used by a person in generating income from business or investment is deductible. Eligible repair and improvement cost is 7 % of depreciation basis of asset pool at the end of the income year. The unabsorbed repairs are capitalized at the beginning of the next income year in respective blocks (i.e. Blocks A, B, C, & D). However, this repair and improvement limit is not applicable air line business for overhauling of aircraft according to the standards prescribed by Civil Aviation Authority of Nepal (CAAN).

5. **Pollution Control Cost (Sec. 17):** pollution control cost means cost incurred by a person with respect to a process or an asset that seeks to control pollution or otherwise protect or sustain the environment. Pollution control costs though these are of capital nature are allowed for deduction to an extent from taxable income of the person. The lower amount of the below is deducted. Actual pollution control costs or 50% of the adjusted taxable income from all business conducted by the person. The person of pollution control cost is not allowed as deduction will be capitalized at the beginning of the next income year under Block ‘D”.

6. **Research and Development Cost (Sec 18) :** R& D cost means cost incurred by a person for the purpose of developing the persons business and improving business products or process. However, it does not include cost in respect of natural resource prospecting, exploration and development incurred by a person in the production of the persons income from a business, which is treated as an outgoing for an asset used by the person in that production. Research and development cost though there are of capital nature are allowed for deduction to an extent from taxable income of the person. The lower amount of the below is deducted. Actual Research and Development cost or 50% of adjusted taxable income from all businesses. The portion of Research and development cost is not allowed as deduction is capitalized at the beginning of next income year under Block”D”.

7. **Depreciation Allowance (Sec. 19):** Depreciation is the depletion in the value of assets by wear and tear, obsolescence, or the passing of time. Depreciation at prescribed rate is allowed on used depreciable

assets owned by the person. The block wise details and rate of depreciation are given in the following table:

Block	Particular of Assets	Rate of Depreciation
A	Building, Structure and similar works of a permanent nature	5 %
B	Computers, Data processing equipments, Furniture, fixtures and office equipment	25 %
C	Automobile, Bus and Minibus	20%
D	Construction and Earth moving equipment portion of pollution control cost, Research & development cost and any tangible assets not included in above blocks(Plant and Machinery)	15%
E	Intangible assets other than not included in block D (patent, design, software etc.)	$\frac{\text{cost}}{\text{useful life}}$ (rate of Depreciation is calculated)

- ❖ Depreciation basis (pool-wise) is calculated as under

Opening depreciation basis	xxx
Add: Addition during the year	xxx
Total	**xxx**
Less: Disposal during the year	xxx
Depreciation Basis	**xxx**

- ❖ Depreciation = Depreciation rate applicable to that block x Depreciation basis
- ❖ These under noted entities are allowed an additional depreciation of 1/3rd of the rate prescribed on the assets falling under Blocks A, B, C & D.

    - ➢ Entity engaged in building public infrastructure to transfer to the government of Nepal and any other entity engaged in power generation, transmission, or distribution of electricity.

- Entity wholly engaged in operating special industry.
- Entity wholly engaged in operating road, bridge, tunnel, ropeway or flying bridge constructed by the entity.
- Entity wholly engaged in operating trolley bus or tramp.
- Entity that earned income from export in an income year
- Addition during the year in any block is divided into two parts: absorbed and unabsorbed portion. Such division is based on the later of the time, the asset is first/ owned / used or the cost is incurred. The table is given herewith to clarify the position.

Time	Absorbed Portion	Unabsorbed Portion
Shrawan first to Poush end	3/3	-
Magh first to Chaitra end	2/3	1/3
Baisakh first to Asadh end	1/3	2/3

During the income year, the absorbed portion of the addition is only considered for calculating depreciation.

- The assets falling under Block A, B, C, & D should be included in respective blocks. Whereas in case of Block ‘E’ the individual assets should be shown in Block ‘E’.
- If the block balance after depreciation during an income year comes less than Rs.2000, the whole amount is allowed as expenses during the income year.
- Gain (loss) on disposal of pool of depreciable assets are treated as normal revenue(expenses)

8. **Bad Debts (sect. 25.2) :** under the following conditions, bad debts can be written off:

a. If the outstanding loan of bank or financial institutions has become a bad debt in accordance with the standards prescribed by Nepal Rastra Bank.

b. In other case, the person receiving payment believe that the amount could not be recovered after taking reasonable steps(to recover the amount or loan)

9. **Losses from Business(sect.20):-** For the purpose of calculating income from Business for an income year, the following losses are allowed for deduction

➢ Any unrelieved loss of the year incurred by the person from any other business.

➢ Any unrelieved loss of previous four income years incurred by the person from any business.

Expenses not allowed for Deductions:

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

1. **Personal or Domestic Expenses:** Expenses of a domestic or personal nature are costs incurred by individuals in respect of themselves, which means that the individuals spend money for their personal consumption to satisfy their personal needs. These expenses

are not deductible from any of the income heads-employment; Investment or expenses include:

- Personal expenses of an individual:- costs for the provision of shelter as well as meals, refreshment, entertainment or other leisure activities.
- Expenses incurred with respect to an individual commuting between the individuals home and a place at which the business or investment is conducted. However, computing in the course of conducting a business or investment is allowed for deduction.
- Cloth expenses for the individuals other than clothing that is not suitable for wearing outside of work. This means cost of work dresses such as uniform, aprons etc. are allowed for deduction.
- Expenses for education and training of an individual. If the education is directly relevant to a business or investment by the individuals and the education and training does not lead to a general degree or diploma, but has a link to the business.

2. If the tax payer has borrowed money to bear expenses as mentioned above and needs to pay interest for that , these interests are related to a non-deductible expenses and therefore also not deductible.
3. The expenses of a domestic or personal nature also include costs incurred by another person in respect of an individual. However, in the following conditions, such expenses are not treated as personal or domestic nature.

- If the payment is included in calculating the income of the individual. For example, salaries and wages paid to employees are allowed for deduction because employees include such payments in their incomes.
- If the individual makes a return payment of an equal market value to the person as a consideration of a payment.
- Payment for petty expenses related to tea, stationeries, tips, prizes, and emergency medical treatment up to Rs.500 at a time whose accounting is not practical or administratively difficult.

4. Tax payable under this act
5. Fines and penalties paid to government or its local bodies fro breach of any law or regulation.
6. Expenses incurred to derive the tax exempted amounts or final withholding payments.
7. Cash payments over Rs.50000 (except in certain circumstances) by an individual or an entity with an annual turnover of more than Rs. 2 million. The whole amount of cash payment (not only the excess amount) is disallowed for deduction, if it is more than Rs.50000. However, the clauses of Rs.50000 are not applicable in the following conditions.

- If payment is made to the government of Nepal a constitutional body, a corporation owned by the government of Nepal, or a bank or financial institutions.
- If payment is made to a farmer or a producer producing primary agricultural products.

- If payment is made to retirement contribution or retirement payments.
- If payment is made in an area where banking services are not available. An area having banking services means the area where there are no banking facilities within the surroundings of ten kilometers.
- If payment is and most necessarily be made in cash or on a day when a banking services are closed.
- If payment is made into a bank account of the payee.
- Distribution of profits by an entity such as dividend, reserves etc.
- Capital nature expenditure.
- Foreign income tax. However, foreign tax credit not exceeding the average rate of Nepal income tax can be claimed if the person has paid foreign income tax with respect to the foreign assessable income.

CHAPTER - V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

Nepal is agriculture based least developed country. The economic status of Nepalese people is very poor. One of the main objectives of each and every country is to raise the living standard of the people through economic development activities. But developing countries like Nepal are facing serious problems in the process of economic development. Lack of sufficient financial resource is the main constraint for economic development of Nepal. A lot of funds are required to meet the objective of economic development. But Nepal is not being able to collect necessary fund due to poor performance on internal revenue (fund) collection and mobilization, Nepal has been heavily relying on foreign loans and grants. The dependence is increasing which is not desirable for any economy. Thus it is more essential to mobilize the internal fund to the optimum level.

To increase the government revenue, Nepalese is trying to extract money from people through taxation. With in tax, income tax is the most important sources of government revenue. It is considered as good remedy to cure growing resources gap problems in Nepal.

In Nepal, the history of income tax is not so long, it is started only on late fifties. The income tax was introduced as a trial on business profit and the remuneration income. The first elected government levied the first income tax act was made only in 2016/17. Since than four, income tax act has been implemented. From the very beginning the concept of Business Exemption and Privileges and other form of tax relief in income tax have changed in Nepal. All incomes of an individual can not be taxable because the minimum cost required for subsistence can not be taxed. The business exemptions and privileges and other forms of tax relief are essential to encourage an individual to work more. The tax relief works as an incentive to an individual. So, the concepts if business exemption and privileges and tax rely were emerged in Nepal from the very beginning of income tax. Currently, income tax system of Nepal encompasses four taxes, i.e. corporate income tax, individual income tax, house rent tax and interest tax. Among them, contribution of corporate sector is highest. Exemptions limit and the rate of the income tax is determined according to the income level and sector wise but it is not adjusted according the inflationary situation of the country and number of dependents. The present study entitled" A Study on Business exemption and privileges provided by Income Tax Act 2002" is related to the income tax collection in Nepal. This study has concerned the structure of income tax in Nepal, comparison of direct tax and indirect tax revenue in Nepalese tax structure, contribution of government revenue on GDP, income tax revenue on GDP, total tax revenue on GDP, resources gap in Nepal.

In second chapter, the literature review has made through the study of various books, articles, dissertations and other reference material. Various concept of taxation have been discussed in this study. Meaning of tax, classification of taxes, objectives of taxation, historical background of income tax, heads of income, and features of income tax act 2002 have been discussed in conceptual framework of this study.

In chapter three, the researcher has discussed about various aspect of research methodology. Such as research design, used for this study, data collection procedures, population and sample size, nature and source of data, selection of respondents, procedures of processing and analysis of data.

In chapter four, the researcher has presented the primary as well as secondary data has analyzed them to get the meaningful result. Economic survey, budget speech, Annual Report of IRD, and websites of NRB, MOF, IRD etc. were the major sources of secondary data. To collect primary data on Business Exemption and privileges, opinion survey techniques was conducted in this study. Primary data were collected from three respondents groups of tax administrators, tax experts and tax payers. A set of questionnaires was developed and distributed to the administrators, tax experts and tax payers. Secondary data analysis, was done by presenting the relevant data into tables and figures consisting ten years period i.e. FY 1996/97 to 2005/06. The comparative analysis for different years was done in the analysis part of the study. Data collection from opinion survey with the respondents were tabulated and analyzed. Major findings of secondary and primary data analysis, business exemption and privileges and its contribution in tax collection of government revenue have been presented at the end of this chapter.

Conclusions of the study are given in the last chapter and some recommendations are also given at end of the study to increase the income tax revenue in Nepal.

In this way the study was completed with the achievement of the study objectives.

5.2 Conclusion

In the context of Nepal, she has been adopting the mixed and dual economy in the last many decades. The economy has been liberalized after the restoration of democracy in 1990. Numbers of public enterprises have been privatized in this period and some of them have been either liquidated or merged. Likewise Nepal has entered in WTO mainstream of trade in 23rd April 2004, which has given the potentially to increase foreign direct investment and access of Nepal to international market. But in reality, it has strongly challenged the Nepalese entrepreneurs and the corporate house too in the side of quality and price and it has also increased the possibility of Nepal being as a dumping side of giant multinational companies. So, Nepalese corporate sector has been facing serious challenges. The main reasons are significant expansion of regular government activities increasing cost of maintenance increasing debt servicing charges etc.

Resources gap in Nepal has been increasing every year. The internal revenue is sometimes in sufficient even to meet regular expenditure and most of the development activities depend on foreign aid where Nepal has been compelled to harmonize the donor. The major problems of domestic resources base, small and stagnant industrial sector, poor performance of public sector enterprises, poor economic growth and inadequate tax effort etc. So, in this context, revenue generation from internal sources is very important in which income tax is one of the major sources and it is considered as a good remedy to cure growing resource gap problem in Nepal. Income tax was introduced in the FY 1959/60 and the percentage share of income tax to government revenues is in increasing trend at present but it is not regarded satisfactory in comparison to other developing countries. Revenue from income tax in Nepal is collected through five different sectors. Among them contribution of individual sector is highest. Exemption limit and rate structure of the income tax is determined according to the level and sector wise but it is not adjusted according to the inflationary situation of the country.

Due to various problems related to Business Exemption and Privileges revenue collection from income tax is law in Nepal. It is changed that Nepalese income tax law is inappropriate and the administration is worse.

However, income tax laws and administration in Nepal are to be deeply scrutinized and properly implemented. Act itself is not bad; some provisions would have to be mentioned clearly. Strong commitment, fair and uniformity imposition are be stored and revitalized. Manpower development planning within the administration is desired for the efficiency of tax personnel side by side, tax education packages are to be made and initiated. Hence; tax administration and tax compliance could be improved. Some reforms in tax administration are needed. If the problems relating to income tax system in Nepal can be solved and resources are effectively utilize then only the prospects of revenue collection from income tax will be bright and the economic development of Nepal will be achieved.

5.3 Recommendations

There are various problems regarding to income tax of Nepal. The major problems of Nepalese income tax system consists problems relating to income tax policies, income tax laws and income tax administration. The major problems observed in present days are the problems of efficient tax administration. In opinion survey it was noticed that all the respondents were dissatisfied with the tax administration. The study did not look heavily into the problems that are not related to Business exemption and privileges. So, the recommendations made for other than the business exemptions and privileges may be considered as the general recommendation. The research of this study has made the following recommendations on Business Exemptions and privileges.

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

3. The present level of income tax exemption is not appropriate. It must be raised to a minimum of Rs.150000 against Rs.115000 for an individual. The recommendation is based on the assumption that the remuneration income of the section officer in a government institution must not be taxed.
4. The present provision of family exemption is not appropriate and fair. It must be raised to minimum of Rs.200000 for a family against Rs.140000. The government has to provide the family tax exemption in such a way that would consider the number of family member. The researcher recommends for providing this exemption limit for a maximum of two dependents children and dependents parents.
5. The exemption limit must be adjusted according to the inflationary situation of the country on yearly basis.
6. There are many provisions relating to Business exemption and privileges. Some privileges granted to achieve a certain objective are not effective. Privileges encourage the establishment of industries in certain areas but they vanish or change names, ownership or place the business when the concessions facilities expire. The incentives provided to special industries are not energetic. For this kind of concessions, no body will be encouraged to open the industries in remote area. So, the provision of investment allowances in the form of accelerated depreciation should be introduced, the investment allowances should be 25 % per annum of the depreciable capital assets on straight line basis. Similarly, for the purpose of industrial development of remote area a separate special package should be introduced.
7. 10% of tax rebate should be provided to the taxpayers who submit true income statement within the specified period of time.

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

9. Double taxation on dividend must be eliminated.

10. Income tax act has mentioned the organization, which are tax free. Act has exempted a social, religious, educational or charitable organizations of a public character registered without having profit motive. In case of non-transparent private business like boarding schools, NGOS or other entities. Where profits are earned, but the sake of tax planning is called retained or something else. So, they should be taken into tax net.

11. Retirement contributions are nothing else than the product of sacrifice of present earning. These are the base for living standard of oldness of employees. So, they should be excluded from income tax.

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

13. The provision of special fees must be eliminated.

14. Donations given to a political parties registered with the election commission is allowed for deduction. But it is not able to solve the voice of people of "Transparency of donations amount given by businessman to political parties". So, donation amount given to political parties must be transparent.

15. Deductions allowed from an employee income are not sufficient. So, the following deduction should be provided to the tax payers whose source of income is only the remuneration

    ➢ Expenses for better education of their children.

- Medical expenses made by taxpayer.
- Expenses made for house rent.
- Educational expenses for taxpayers himself if he is still studying in educational institutions.
- Life insurance premium of taxpayers.

16. Clear provisions should be made in the case of education. All the items of deductions should be clearly defined in the act.
17. Deductions allowed from business or investment incomes are not sufficient. So, the following deduction should be provided to the taxpayers whose source of income is business or investment.

- In the case of exempt controlled resident, entity, full deduction of interest expenses is not allowed it is not lawful step to the businessmen who operate the business with loan/ debt amount. So, it should be fully allowed for deduction within an income year.
- The provision of adding any excess cost or part of repair and maintenance cost, to the depreciation basis amount is not contextual and lawful provision because it shows that the repair or improvement cost of a depreciable assets has not get full approved of deduction. So, it should be fully allowed for deduction within an income year.
- To control pollution control and then protection of environment, research and development is more essential and must be expended on it, expenses made on it must be approval and should be fully allowed for deduction, within an income year. Government should not make standard limit on it.

- There should be specific provision of depreciation of assets which are taken on lease and installment basis. Act should not silent on it. Provisions made on depreciation allowance must be generally understandable by all people.
- Carry forward of losses for 4 years is not sufficient as compared to other countries. So it must be extended up to five or six years. The provision of carry forward of losses should be considered because the accounting system of Nepal is not so standard to apply this provision.

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

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

- It should be progressive ensure social justice
- It must be consistence with tax administration capacity.
- It should not militate against national priorities and efficient resource use.

5. The success of effectiveness of any system entirely depends upon implementation a provision which is the major responsibility of administration in Nepal, one of the most important reasons for unsound income tax system is efficient and unscientific income tax administration. Following suggestions are made for the improvement of income tax administration in Nepal.

- ➢ All the tax personnel should be given comprehensive training on various aspects of taxation on regular base for this; a separate training section with in tax department should be established.
- ➢ The performance, responsibilities, authorities and duties should be clearly defined.
- ➢ Financial benefit ad extra incentives should be provided to the personnel to decrease corruption.
- ➢ Effective reward and punishment system should be established.
- ➢ Delays in assessment should be reduced as soon as possible.
- ➢ The system of recording by computer should be developed in income tax administration.
- ➢ Tax deduction should be provided to tax payers on regular basis.

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

- The language should be simple and clear. In spite of using of vague meaningful words, clear cut provisions should be made.
- The definition made in income tax should be further clarified and well defined.
- The assessment and tax collection provisions should be made clear and simple.
- The provisions of fines, penalties and punishment should be made at higher rate for income tax evaders.
- The reward, prizes, incentives provisions should be introduced in the act to encourage the taxpayers to pay the tax voluntary rather than coercive measures.
- As per the income tax act 2058 the flat rate is levied both to resident and non-resident companies in Nepal. In many countries like, India, Belzium, Germany Indonesia and New Zealand foreign companies are taxed at the higher rate than domestic companies. I feel in Nepal also tax rate should higher say 40% in case of foreign countries as against 20 To 25 percent in case of domestic companies.

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APPENDIX : I

Dear Sir / Madam,

At First, I would like to introduce myself as a student of Nepal commerce Campus, Tribhuvan University, MBS final year. In order to fulfill the partial requirement of Master Degree in Business Studies of Tribhuvan University of Nepal , I am conducting the research work entitled, "Business Exemption and Privileges provided by Income Tax Act 2058".

I have sent this questionnaire to spare some of your valuable time to provide your valuable experience, Suggestions and opinions concerning the income tax in Nepal, Which will be very much appreciated if you could provide your important time for filling this questionnaire.

I assure that the information you provide me will solely be utilized in research work. I hope for your kind co-operation and support.

Yours truly,

Suresh Shah

APPENDIX: II

QUESTIONNAIRES:

Name : Designation :

Office/Organization : Occupation :

You are requested to tick (√) the answer of your choice or from the following questions or wherever appropriate. Please give points them in order of preference from 1 to last on the basis of number of alternatives. No 1 stands for least important and last number for the most.

1. Do you consider that the Income Tax Administration of Nepal Is sound and efficient?

   a) Yes ☐ b) No ☐

   If no, what are the causes, which are responsible for the creation of unsound Tax Administration?

   a. Defective Income Tax Act
   b. Lack of Public Participation
   c. Lack of Trained Employees
   d. Faculty Organizational Structure of Tax Administration
   e. Weakness in Government Policy
   f. Other (If any, specify)

2. What is your opinion about the current income tax rate? The current income tax rate is.

   a) High b) Medium c) Low

3. Do you think that the exempted items of income are sufficient?

   a) Yes b) NO

   If no, what kind of incomes should be exempted? Please write in the following numbers

   a) b) c) d) e)

4. Do you think that the current Income tax exemption limit is appropriate?

   a) Yes b) No.

   If no, how much the exemption limit should be for an individual unit?

   a) 115,000 b)140,000 c) 160,000 d) 200,000

   e) Rs. Others (if any specify)

5. Similarly, how much exemption limit should be for a family?

   a) 140000 b) 200,000 c) 250000 d) 300000

   e) Rs. Others (if any specify)

6. Do you feel that exemption limit should be adjusted according to the inflationary situation of the country?

   a) Yes b) No.

7. Do you agree that family exemption must be provided according to the numbers of dependent?

   a) Yes b) No

8. What is your opinion on providing exemption on agriculture income?

   a) Yes, it should be exempted b) No

   c) It should be treated as other income

   d) Others (if any specify)

9. Do you think that itemized deductions are sufficient?

   a) Yes b) No

10. Do you suggest for itemized deductions in income tax?

a) Yes b) No

11. In your, opinion what kind of expenses should be prioritized for deductions?

Please, write in the following number

a) b) c)

d) e) f)

12. What are the need for deduct the expenses? Please , specify in the following no:

a) b) c)

d) e) f)

13. Do you know about the present description system of Income Tax Act?

a) Yes b) No

14. What are the major problems and weaknesses in Nepalese income tax system?

a) b) c)

d) e) f)

15. In your opinion are the provisions made under the Nepalese tax act sufficient in all respect?

a) Yes b) No

16. Business exemptions and privileges provided by ITA 2058 is sufficient?

a) Yes b) No