CHAPTER -1

INTRODUCTION

1.1 Background of the Study

Most of the developing countries are characterized by problems of poverty, low productivity, population growth, unemployment, primary product export dependence and international vulnerability (Todaro and Smith).Achievement of high rate of economic growth rate, reduction of income disparities and poverty and improvement of living standard of people are some development strategies towards which most of thegovernment efforts have been directed in developing countries. In addition, for meeting day-to-day expenditure, thegovernment requires some sources of income.In addition, economic development has been one of the important macroeconomic goals of Nepal.To achieve the above objectives alongside to meet the day to day expenditure of a country, government of Nepal needs to mobilize its resources, both internal and external.

To fulfill its responsibility towards its nation and people, for a government of a country, there is a necessity for raising a large volume of funds for the development and administration expenses (Shakya, 2009).Revenue is one of the major sources of income to finance the expenditure. But revenue collection is a challenging task in itself which demands increasing necessity of regular expenditure in general and development expenditure in particular. However, in the context of Nepal, resource mobilization is very low compelling the government to rely heavily on foreign assistance. Development expenditure has been dependent almost entirely on the foreign aid.

Although foreign aids are not bad for economic development of the nation but the experience of the most of the developing countries shows that there are negative effects of increasing international grants and loans to finance the public development activities. This is because external assistance is uncertain, precarious, inconvenient and not conducive to the healthy and overall development should there be heavy dependence on it. Thus the government should depend on its own resources for generating revenue in order to finance these regular and development activities (Shakya, 2009).

Public revenue of the country comes from tax as well as non-tax sources (MOF, 2012). Tax includes the amounts which are compulsorily contributed by taxpayers to the government, whereas non tax revenue includes fees, penalty, gifts and grants. Non-tax revenue is inconvenient and uncertain. On the other hand, tax revenue not only contributes in national capital formation but also helps in redistribution of income in a country. It helps to reduce unequal distribution of wealth and income. So taxes are the better sources of public revenue and it has been taken as an effective tool for raising the public fund.

Taxes are major fiscal policy instruments and important government policy tools which have a major role in increasing the rate of capital formation and thereby a high rate of economic growth can be achieved.Increase in taxes may be directed to increase in saving through the postponement of consumption. The increase in saving means a higher volume of resource is available for making useful and productive investments.

Taxation may play dual role. On one hand, it may be used to make the maximum volume of resource available to public sector.On the other hand, taxation may be used to promote useful investment in the private sector and to prevent these sources from being dissipated over speculative and unproductive investment as well as over lavish and luxurious consumption.

Taxes in developing countries serve as the means of raising revenue. Therefore, Taxation may be utilized by the government as an effective tool for giving incentive to the proper growth of saving, investment and gross domestic product. In Nepal, tax policy is mostly guided toward revenue generation. Government can collect revenue from taxable and non taxable sources. Nevertheless, Tax is a key source for revenue generation and mobilization.

Different persons have defined taxation in different ways. In this respect, it would be better to take the definition given by Prof. Seligman. In his words, “Tax is the compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred."

Developing countries like Nepal, having low per capita income highly depends on the indirect tax than the direct tax. The share of income tax is much low in the composition of direct tax revenue. In the initial stage of economic development indirect tax plays a significant role but after a certain stage of economic development is reached, direct tax has a significant role.

In the words of Dr. Dalton, "A direct tax is really paid by the person on whom it is legally imposed". (cited in Dhakal, 2001:2) Usually each individual's tax liability is assessed separately. Some examples of direct taxes are briefly described below individually. Examples of direct tax are Income tax, Corporate tax, Capital gain tax, Property tax, Vehicle tax etc.

Direct tax is actually paid by a person, natural or artificial, on whom it is imposed while indirect tax is imposed on one person but is paid by another person partly or wholly. Some of the indirect taxes are sales tax, excise duties, value added tax, entertainment tax, hotel tax, custom duties etc.The merit of direct tax over indirect tax is that it is progressive and assessed according to the individual's circumstances; they ensure that the heaviest burdens are placed on the broadest backs. Their progressive character also gives additional weight to their role as built-in-stabilizers.

Remuneration tax is a part of an income tax hence it is a direct tax. According to Income Tax Act 2058, salary, wages, allowance for specific works, other allowances, reimbursement of expenses, fees, commission, overtime payments, awards, prizes, gifts, bonus or incentives, amount received as compensation payment for termination of employment, employer's contribution to the retirement fund and retirement payments, retirement payment from GoN and any other payment by the employer are considered as remuneration. Remuneration tax is an important component of direct tax revenue which can play a crucial role to raise tax revenue for a country.

1.2 Statement of the Problem

In Nepal, internal resources mobilization is very low compelling the government to rely heavily on foreign assistance, loans-internal and external. Development expenditure has been dependent almost entirely on the foreign aid. Although foreign assistance on various development efforts have been of significant importance, External assistance is uncertain, precarious, inconvenient and not conducive to the healthy and overall development should there be heavy dependence on it(Shakya, 2009).

The foreign aids are not bad for economic development of the nation *per se*. But the experience of the most of the developing countries shows that there are negative effects of increasing international grants and loans to finance the public development activities. Thus the government should depend on its own resources for generating revenue in order to finance these regular and development activities.

The role of revenue in the development of a country is not less important than the role of oxygen for the existence of human body. In this context, a government needs to mobilize a lot of internal resources to fulfill its responsibility towards its nation and people. In the developing country like Nepal, there is a necessity for raising a larger volume of funds for the development and administration expenses. The government can collect revenue from taxable and non taxable sources.

Nevertheless, the gap between revenue mobilization and government expenditure is widening.Fiscal deficit, the result of imbalance between expenditure and the revenue is being financed through foreign loan, domestic borrowing and cash reserve. As such, fiscal deficit that was in decreasing trend since the fiscal year 2001/02 started showing an increasing trend again from 2004/05. The ratio of fiscal deficit to GDP, which was 3.6 percent in FY 2010/11 stood at 3.5 percent in FY 2011/12 and it is expected to increase to 3.7 in FY 2012/13. The persistence of fiscal deficit is due to less receipt of revenue and foreign grants as compared to the level of expenditure(MOF, 2012).

Tax is a key source for revenue generation and mobilization. In most of the developed economies, the direct tax as the proportion of total tax revenue is more than the proportion of indirect tax.Among the direct taxes, corporate tax is levied upon the profit of companies. There are obvious arguments in favor of raising a large amount of corporation tax because corporations are easily identifiable, keep accounts and cannot escape tax liabilities. A further point is that tax collected in this way often appears an easy way to tax administrators. Similar is the case for other direct taxes like capital gain tax and capital transfer tax.

However, the case of income tax, particularly remuneration tax, may be different from those of corporate, capital gain and capital transfer taxes. This is because it is levied on those who work as employees and receive remuneration in return for their work. Also the number of people who receive remuneration from the employers is large as compared to the number of existing corporations in Nepal.

1.3 Objectives of the Study

The main objective of this study is to ponder into theoretical knowledge of remuneration tax and to analyze its practical aspects of its implementation in Nepalese context. The general objective of the study is to examine the various issues relating to remuneration tax and to provide useful views as well as suggestion. However, specific objectives of the study are:-

1. To analyze trend and structure of remuneration tax in Nepal
2. To find out the contribution of remuneration tax in GDP, total revenue and tax revenue.
3. To identify the major problems and weaknesses of the effective implementation of remuneration tax in Nepal.
4. To study the major facilities and benefits provided by Income Tax Act 2058 on the remuneration tax.

1.4 Significance of the Study

The scope of this study is to explore the present scenario of remuneration tax in Nepal. In addition, it also tries to find out the contribution of remuneration tax to Gross Domestic Product with the help of data since the remuneration tax was implemented in Nepal. Moreover this study reveals share of revenue in total tax revenue. Also, this will evaluate the effectiveness and shortcomings of implementing remuneration tax in Nepal. Another objective of this research is to find out the problem of effective implementation of remuneration tax and its possible correction measures. So the research is significant in the sense that its thorough study may facilitate the government making policy and solving the implementation problems and income tax related issues. It may be helpful for the employers and the employees who play vital role in generating remuneration tax revenue. They will also keep themselves informed about the current condition of remuneration tax in Nepal. Furthermore, it will help other researchers as well who are interested indoing research in this particular topic “Income tax in Nepal”.

1.5 Limitations of the study

The study has a limited area of investigation. It is only a part and partial analysis of the corpus of Tax system. The comprehensive study of the tax system is not possible in this research work due to its certain deadline for completion. While talking about Remuneration tax, it implicitly concerns about a part income tax. The information and data were collected from the IRD office, MOF and other concerned offices.

Most of the data were taken from Economic Survey(2011/12). Due to time and resource limitation mainly secondary date were used in this study. So, it is largely dependent on the reliability of secondary data. The literature on Remuneration is in adequate and scattered. These all constraints have limited the boundary of the study. Despite such limitations, the attempthas been made to make it profitable.

This study has been concentrated about the study of Remuneration tax in Nepal thus it is not a complete study of the whole tax system in Nepal. Also the views of respondents are collected only in the Kathmandu Valley only so the study mainly represents the view of people in Kathmandu. In addition, due to time and resource constraints, this study could not cover the wide range of respondents for their views on Remuneration tax in Nepal.

1.6 Organization of the Study

This study is divided into six chapters. Prior to the body of the thesis, several pages of preliminary materials such as title page, Viva-voce sheet, Recommendation, Declaration of the researcher, Acknowledgements, Table of contents, List of tables, List of figures and Abbreviations used have been included.

The first chapter is introduction which includes background of the study, brief description about taxation, statement of the problem, objectives of the study, needs and significance of the study, review of literature and limitations of the study.

The second chapter is the review of related literature which includes concept of Remuneration Tax, Historical Background of tax in Nepal, Legal Provision for income tax and review of related previous studies.

The third chapter is research methodology. This chapter includes the detail framework of the study, such as research method of population and sample, variable, research design, data collection procedure and presentation and analysis tools and techniques.

The fourth chapter comprises data presentation & analysis of data. In this chapter the secondary data collected from various sources have been presented in a systematic format: such as tables, charts, and figures. These collected data have been analyzed by using different mathematical, statistical and analytical tools. In addition, the major findings of the study have been presented.

The fifth chapter explores the problems of involved in remuneration taxation in Nepal. These problems are identified and ascertained through an opinion survey collected with a semi-structured questionnaire designed for the purpose of opinion survey.

The sixth chapter is concerned with the output of the study in the form of summary, conclusion and recommendation. This chapter consists of summary of the major findings of the study, concluding it with major recommendations and suggestions for future improvement and betterment of Remuneration tax in Nepal from both administrative and revenue perspective which may be a good reference to the tax administrators, employers and employees, students, researchers and other professionals in the field of taxation in general .

At the end of the study, references and appendices have also been incorporated.

CHAPTER-II

REVIEW OF LITERATURE

2.1 Review of Related Studies

In the course of the study various books, articles, dissertations and other reference materials were reviewed. Some useful ones are mentioned below.

Jenkins and Khadka (2000) mentioned that the reform process in Nepal that converted the domestic indirect tax system from a nineteenth century style system of excise taxes into a modern VAT and excise tax system has been fundamental in nature. Both the tax policies and the tax administration have had to be reengineered. The design of the new tax structure and administration took into consideration, the nature of the economy and the country's present stage of development. Many of the issues faced in the design of the indirect tax system and its administration are common to most poor developing countries that are modernizing their tax systems. Only time will decide whether this reformed tax system will take root and become the foundation for future improvements, or slide back to the excise tax approach that has historically characterized taxation in Nepal.

Pant (2004) had comprehensively explained about the problems and their remedies related with tax revenue and major types of practical problems and challenges in tax administration. Writer mentioned in article that showed limited amount of transaction showing low selling price, lack of issuing and taxing bills, lack of showing the factory cost, commercial trend, lack of co-operation in tax auditing, legal ambiguity and complexity in implementation and lack of coordination between Inland Revenue Department 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; coordination between Inland Revenue office with various entities of government revenue investigation department and its related unit should play the important roles.

Amatya, (2006) wrote an article entitled "*Taxation of Employment income in Nepal, concept, computation and contribution*" in Pravaha, A Journal of Management Vol 16, July, 2006. Writer had mentioned about Nepalese income Tax law, income year and assessment year, sources of income, concept and sources of income, concept of employment, computation of income from employment non chargeable incomes under employment common reductions income tax exemption assessment of income tax liability on employment income, surcharge and contribution of employment income to Tax revenue of Nepal. Writer has also shown about estimation and collection of employment income tax during the past decade. In this study he has clearly pointed that actual collection of employment tax is satisfactory.

Dhakal, (2008) had written an article entitled "*Historical perspective on income tax in Nepal*". This article has described previous income tax act and shown main factors of income tax act 2058 are as follows:

- Provision of set and carry forward of losses.
- Classification and pooling of depreciable Assets.
- Tax on capital gain
- International taxation
- Medical tax credit
- With holding payment and quantification allocation and characterization of the amounts.

Dahal, (2010) wrote an article entitled “*Taxation in Developing Economies: Theoretical Underpinnings and Dimensions*”, in website: http://www.telegraphnepal.com/news, 2009. Writer had mentioned that the subject of taxation has undergone an extensive metamorphosis since last many years. With the advent of supply side economics the role of taxation has become even more crucial. Taxation is not only an effective instrument for resource mobilization - a ‘boot-strap’ operation for financing economic development - but also a ‘tool-kit’ for revenue collection to sustain growth and maintain equity and stability in the economy. If blood circulation is desirable to keep the human body alive so is taxation to keep the economy alive. The laws of blood circulation and of taxes are tantamount to each other. In developing economies resource gap is critical and widening resulting to huge fiscal and budgetary deficits. The growing resource gap is frequently off-set by mobilizing internal and external borrowings and consequently shifting the burden of debt to posterity. Therefore, revenue mobilization is challenging proposition in developing economies where a majority of the people live in abject poverty and the people engaged in economic activities have extremely limited taxable capacity. In addition, legal base of taxation is compressed with unlimited tax shelters and tax administration lacks innovative mechanism to identify new taxpayers and bring them into tax-net. In developing economies unsanctioned economic activities have greatly increased over the years resulting to poor voluntary compliance due to indifferent attitude of the taxpayers towards government spending. Thus, interface between diminishing efficiency of tax administration and delinquency on the part of taxpayers is becoming critical.

- The writer mentioned that the role of indirect taxes became prominent after the dissolution of traditional society. Nevertheless, the debate on direct vs. indirect taxes is sterile, for both taxes have intrinsic values with tremendous potential to mobilize revenue in developing economies. This is tantamount to walking on two legs – a balancing factor. When a country passes through a level of comparative economic backwardness to one of self sustained growth and economic maturity, the tax system will have to rely, in spite of severe political and administrative limitations, largely on elasticity or built-in flexibility of taxation. The international comparison of taxation showed that average Tax/GDP ratio in OECD countries found to be 36.3% in 2004, while it was 50.7% in Sweden, 50.6% in Denmark, 45.6% in Belgium, 35.1% in New Zealand, 29.6% in USA, 27.1% in Japan, 24.6% in S. Korea, 18.5% in Mexico, 16% in India, 12.9% in Pakistan and around 12% in Nepal during the same period, and estimated to be 15.7% in FY 2008/09.

Rana, (2011) wrote an article entitled " *Nepal tax system Issues, problems and options*", in The Himalayan Times, 2010. Writer had mentioned that the process of Nepalese tax system started in the mid-1980s as a major component of the structural adjustment program (SAP). This process accelerated in the 1990s after the restoration of democracy. However, some adjustments had been made in the tax systems (in terms of rates and number of taxes) before the reform process started. The Nepalese reform policy before the restoration of democracy in 1990 focused more on more restrictive, regulative and protective policies to meet the basic need of the people and to achieve various goals viz resource generation, maintaining equity, growth and stabilization of the economy. As a result, it encouraged tax evasion, corruption, difficulty in tax administration creating considerable distortion in the economic incentive during 1980s. Further, the tax base remained narrow due to large exemptions and incentives under various taxes. However, these policies have been replaced by a more liberal, open and market oriented policies based on the distinctive features of globalization, liberalization and privatization after the restoration of democracy in 1990. For economic dynamism, an elastic system is highly advantageous for public expenditure activities which help to balance growth, equity and efficiency. However, the performance of the Nepalese tax system in terms of responsiveness, productivity, efficiency and equity was very low. After the tax reform, there has been a desperate attempt to improve resource mobilization, reduce fiscal deficit through broadening tax base, rationalizing tax structure and strengthening revenue administration from the late 1980s and 1990s.

Rana, (2011) wrote an article entitled " *Elasticity, buoyancy of taxes in Nepal: A perusal*", in The Himalayan Times, 2010. Writer had mentioned that in developing economies, resource gap is grave and broadening leading to massive fiscal and budgetary deficits. The growing resource gap is compensated by mobilizing internal and external borrowings. Therefore, revenue mobilization has a crucial role in fiscal policy implementation especially in a developing economy like Nepal, where the necessity of public resources for public disbursement is highly sought-after. It is a better source of revenue mobilization than the alternative sources such as loan, grant, foreign aid and deficit financing. In addition, legal base of taxation is compressed with unlimited tax shelters and tax administration at the same time lacking innovative mechanism to categorize new taxpayer and bring them into tax net.

The study showed that the interface between diminishing efficiency of tax administration and delinquency on the part of taxpayers is becoming serious. As tax revenue is one of the vital sources of domestic revenue in Nepal, the calculation of tax elasticity and buoyancy would be significant in the context of structural reforms along with administrative reforms. To evaluate the tax performance of a developing country, one should go beyond the static index and introduce more dynamic concepts such as tax elasticity and buoyancy. The tax elasticity indicates the income elasticity of a tax. The performance of tax in economy is viewed on the basis of elasticity and buoyancy. The estimates of these are dynamic tools for measuring the tax performance. This knowledge of degree of responsiveness of tax revenue would facilitate the government to make more precise forecast of revenue in order to recover fiscal management. Elasticity would indicate what size or magnitude of a tax would have been over a period of time when there would have been no change in tax rates and legal bases. It provides the basis for natural growth of revenue to GDP.

Prasai, (2008), has presented a thesis " *Revenue collection from income tax in Nepal: problems and prospects*" included focusing effect of different income sources of government revenue. The main objectives of the study were:

- To study the structure and trend of income tax in Nepal.
- To analyze the contribution of income tax to national income of Nepal.
- To provide suggestions for improvement of income tax system of Nepal

Major findings of the study were:

- His study includes historical perspective and legal aspect of income tax in his study.
- Tax evasion; inefficient tax administration and dominated role of indirect tax are the major necessity in development of income tax system.
- Tax on consumption and product of goods and service has occupied first place regarding its contribution to total revenue of Nepal. The average contribution of tax on consumption and product of goods and services aver the ten years period is 34.66%of the total revenue of Nepal.
- Land and revenue registration has the lowest average contribution percent in total revenue of Nepal. Total revenue of Nepal consisted of tax revenue and non-tax revenue.
- Nepalese income tax structure is formed by contribution of income tax from public enterprises, semi-public enterprises, private corporate bodies, individuals, tax on employment, tax on interest and other taxes. Contribution of individuals has occupied first position in total income tax revenue.

Dhakwa (2009), presented a thesis entitled "*Contribution of income tax to government revenue of Nepal*". The study was done with basic objectives of analyzing the income tax structure of Nepal, identifying and predicting the share and trend of corporate income tax on government revenue of Nepal. The main objectives of the study were:

- To explore the contribution of income tax in government revenue,
- To analyze tax administration system in Nepal and
- To analyze the problems of tax in Nepal.

Major findings of the study were:

- The major problems existing in Nepalese tax system, recognized by her, are the inefficient income tax administration, mass poverty, lack of tax consciousness, low numbers of tax payers, lack of co-operation between tax payers and department, narrow coverage, assessment deficiency etc.
- Problems can be solved and resources are efficiently utilized, the future of income tax would be bright.
- The exemption limit should be separated to couple and family and tax rate and exemption limit should be elastic, scientific and progressive.

Lamsal, (2010), had also presents a thesis entitled "*A study on contribution of income tax on government revenue*". The study had mainly focused on the removing and controlling income tax evasion for better resource mobilization. The main objectives of the study were:

- To analyze the assessment process of income tax.
- To identify the problem of income tax management.
- To provide suitable recommendations for improving existing scenario of income tax management.

Major findings of the study were:

- The role of income tax as economic growth, equitable distribution and stabilization growth.

- Tax evasion, delay in assessment, normal role of income tax, lack of public information, complicated act and other defects in income tax act.
- Progressive tax, honest, efficient administration, research units in tax offices and penalties of taxpayers who do not maintain accounts.
- From that it was found that there was widespread evasion of income tax in Nepal and income tax is a suitable means for raising domestic resources. The study had recommended for controlling tax evasion by controlling illegal business activities, increasing penalties and fines to tax evaders, compulsory maintenance of accounts etc.

Shrestha (2010), had presented a thesis entitled, "*Revenue collection from income tax in Nepal*”. In this study, researcher had conducted an opinion survey in respect of problem and prospects of income tax in Nepal. The main objectives of the study were:

- To examine historical background,
- To examine tax structure in Nepal
- To find the contribution of income tax to economic development of Nepal.

Major findings of the study were:

- Actual collection of revenue through income tax was lower than its estimated targets because of the poor taxpaying habit of Nepalese taxpayer, poor tax administration system wide spread evasion of income tax.
- To make effective personnel management, increasing habit of taxpaying of Nepalese taxpayer through proper tax education and better public communication system.
- To minimize tax evasion, and reduction tax collection cost.

Kafle (2011), presented a thesis entitled "*Income tax contribution from Nepalese public enterprises with reference to Nepal electricity authority*". The main objectives of the study were:

- To analyze the causes of heavy reliance on direct tax,
- To analyze the volume of indirect tax revenue and direct tax revenue in total tax structure.

Major findings of the study were:

- The contribution of direct tax and indirect tax in the national revenue.
- Cause of government inefficiency in income tax administration.
- The income tax to GDP, total revenue and direct tax revenue was in increasing trend. To bring program oriented fiscal policy and recommended that VAT be a major source of indirect tax in liberalized economy.
- For small taxpayers he suggests for door-to-door services.
- The study found that lack of clear, transparent and progressive economic policy is the main reason for unsatisfactory with sound effectiveness of income tax system of Nepal. Existing corporate tax rate has been found unsuitable and single rate for all types of corporation is preferred.

There is gap between this study and the previous study most of the previous have focused the contribution of various income in the government revenue, structure of the government revenue and the income tax from various sources, tax structure etc. They have found that the contribution of income tax in government revenue is significant and it should be mobilized to economic development of Nepal. Almost all of them have indicated that the tax administration is inefficient and there is high level of tax evasion. Most of the researchers have suggested improving the tax administration increasing the contribution of income tax in resource mobilization and widening the tax base. But they had not studied about the remuneration tax. It also gives appropriate suggestion for correcting and improving these problems and weakness based on the primary data collected through an opinion survey with the selected people from the related area such as employees and tax experts.

CHAPTER- III

Income Tax in Nepal: Act and Policies

3.1 Brief Outline of Nepalese Tax System

The idea of introducing income tax in Nepal originated along with the first 'Budget' on 4th February, 1952. The then finance minister in his first budget speech said it 'a proposal to levy an income tax including tax on agricultural income is under consideration.' Several attempts were made to introduce income tax in subsequent years. For the first time, the finance act-1959 imposed tax on business profit and remuneration in Nepal.

The firstelected (B.P. Koirala led)government finally introduced 'Business Profit and Remuneration Tax Act-1961 to impose income tax on remuneration and business profit in Nepal. The underlying reasons for the introduction of income tax were to generate more revenues in order to finance development activities and to help establish social justice through redistribution of income. 'Business Profit and Remuneration Tax Act-1961' had so narrow coverage that income tax was imposed only two sources- business profit and Remuneration. Since this act could not cover all the sources of income, it was replaced by the 'Nepal Income Tax Act 1963 to avoid such drawbacks. The base was extended through this act which had nine sources: income from business, profession/occupation, Remuneration, house and land rent, agriculture, investment, insurance business, agency business and other sources. After a year, 'Nepal income tax rules-1964 was enacted with the view of implementing the objectives of the income tax act. As 'Nepal Income Tax Act 1963' was incapable in fulfilling the needs of the time, it was replaced by another Income Tax Act-1974.

'Income Tax Act, 1974' had 66 section and classified the sources or heads of income into 5 headings namely (1) Agriculture, (2) Industry, business profession or vocation, (3) Remuneration, (4) House and land rent and (5) Other sources. The act had identified the chargeable incomes and admissible expenses of each head of income. The other features of this act are provision of registration, provision of carry forward of loss, provision of common expenses, provision of self assessment of tax, provision of small taxpayer's tax assessment, provision of fine, penalty and appeal, provision of tax deduction at source, provision of tax refund, provision of tax exemptions by different other acts and rules, provision of avoidance of double taxation etc. The government also issued 'Income Tax Rules 1982' for effectively implement objectives of the Income Tax.

In the sources of development and modernization of income tax system, the new, 'Income Tax Act, 2002 has been enacted. Similarly, the new 'Income Tax Rules 2002' have also been enacted for the effective implementation of the objectives of the Act. This Act was effective from 10^{th} June, 2002. This act has classified the heads of income into three headings viz. income from employment, income from business and income from investment.

3.1.1 Tax

Every government requires sufficient revenues to launch development programs to handle the daily administration to keep peace and security and to launch other public welfare programs. The government or public revenues are collected through various sources. These sources can be tax revenue, non-tax revenue (fees, charges, fines and penalties, dividend, royalty etc.) and other sources of financing are foreign grants, foreign loan and domestic loan. Among them, tax is the main sources of collecting the public revenues because it occupies the most important part of the government treasure. In Nepal, about 79% of total revenue comes from tax revenue and the rest 21% from non-tax revenues. Broadly, all sources of government revenues can be divided into two parts i.e. Tax and Non-tax.Tax is a major source covering most part of the government revenue. It is a type of money paid by every citizen of the nation. Almost all the economists agree that tax is a compulsory duty to pay to the government without any expectation of some specific return.

3.1.1.1 Meaning of Tax

Tax is a compulsory contribution from people to government to undertake work of public good. Many tax experts have given the definition of tax in their views.

According to Prof. Seligman, "Tax is 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" (cited in Dhakal, 2002).

According to Plehn,-"Taxes are general contributions of wealth levied upon benefit upon persons, natural or corporate, to defray expenses incurred in conferring common benefit upon the resident of the states" (cited in Dhakal, 2002).

According to Taylor,-"A tax is a compulsory payment to the government without expectation of direct benefit in return to the payer" (cited in Amatya, 2003).

Similarly, Bastable (1917) defines- "A tax is compulsory contribution of wealth of a person or body of persons for the service of public power" (cited in K.C. 2007).

From above definitions, it is clear that tax is imposed on the person by the government according to the law of the country. The person on whom tax is imposed must pay taxes. Otherwise the law punishes him. The government does not provide any corresponding benefit to the tax pays for the amount of tax he pays. It is used for the common goods of the country. This means the government provides no special benefit to tax payers. Hence the feature of tax can be summarized as:

- A tax is a compulsory contribution to the state from a person,
- The natural person and artificial person (entity or corporate body) having tax liabilities pay the taxes to the government,
- The taxpayer does not received the equivalent benefit form the government,
- There is no discrimination among the taxpayers other than specified by the law,
- 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

3.1.1.2 Classification of Taxes

Taxes are constituents of human life and are paid from birth to death. Now-a-days, a human activity cannot separate from taxes. It means there are many taxes and these are paid knowingly or unknowingly and directly or indirectly. Moreover, these are impossible to signify individually. Thus, economists have classified a long list of different types of taxes into five classes. These may be grouped on the basis of their form, structure, nature, essence and volume.

On the basis of form, economists have divided taxes into two categories: direct and indirect. Specially, these taxes are based on place of payment.

3.1.1.2.1 Direct Tax

The direct tax on whom it is legally imposed cannot be transferred to others i.e. the person paying and bearing tax is same.

According to Dalton "A direct tax is really paid by the person on whom it is legally imposed (cited in Amatya, 2003).

According to Mill (1903) "A direct tax is one, which is demanded from the very persons who, it is intended or desired, should pay it(cited in K.C,2007).

Some of the examples of direct taxes are as follows: a) Income Tax, b) Property Tax, c) Interest Tax, d) Gift Tax, e) Vehicle Tax and f) Death Tax

3.1.1.2.2 Indirect Tax

The indirect tax on which it is legally imposed can be transferred to other, which means in direct tax the person paying and bearing tax is same.

According to Dalton -"An indirect tax is imposed on one person but paid partly or wholly by another" (cited in Amatya, 2006).

According to Mill (1903) -“ Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another" (cited in K.C., 2007).

Some of the examples of indirect taxes are: a) Sales Tax, b) Value Added Tax (VAT), c) Entertainment Tax,d) Excise duty, e) Hotel Tax and f) Export and Import Tax.

3.2 Income Tax Act 2002(2058)

Since 1st April, 2002 income tax act 2002 has been introduced in Nepal. This income tax act is introduced to avoid the defects of income tax act-1974, to widen the taxation area and market Nepalese taxation system in international standard.

In this way on 1st April, 2002 income tax act-1974 was dismissed and new income tax act 2002 is implemented. For implementing this act effectively Income Tax Regulation, 2002 was formulated and issued using the power mentioned in section 138. Similarly, this act has been amendment two times by the finance order on 8th July, 2002 and 6th January, 2003.

3.2.1 Features of Income Tax Act, 2002

The 1950's concept of the high incentive high tax rate is changed to the concept of low rate, wide net. This tread of tax system is followed by most of the countries of the world. After 1990's, there is re-emergence of the liberalization; globalization and privatization system adopted by must of developing countries of the world and Nepal also could not stay away from this change. This new system mainly focuses on the minimum intervention of the state on private economic matters. Similarly, country like Nepal which mostly dependent on foreign aid, loan and donation adopted the economic policy guided by World Bank, International Monetary Fund, Asian Development Bank and Other International agencies (Kandel, 2006:12).

Tax system is changed with the change in economic policy of the country, world economy. Even Advancement of information technology has vast impact of Nepalese economy. As a result income tax act 2002 is prepared and issued. The main features of income tax act 2002 are as follows:

a) All the tax related matter with in one act

Income tax act 2058 has abolished all tax related provision given in other acts and confined all income tax related matter with in one act. Before the introduced of income tax act 2058, there were nearly one and half dozen acts related to income tax which used to create confusion even to the tax experts.

b) Abolition of various tax related tax concession, rebates and exemptions.

One of the main reasons of being the Nepalese tax system in effective was due to the concession, rebates and exemptions provided by various taxes in the past. These tax related concession; taxpayer for the purpose of tax avoidance and tax evasion used rebates and exemptions. But income tax act -2058 abolished most of the confusion tax facilities and introduce a fair tax system.

c) Specification of Stock Valuation Methods

Income tax act 2002 has made the clear provision of stock valuation method. Under this act only one method of stock valuation is allowed to adopt. It should not be changed without the approval of concerned authority of tax office of the taxation purpose.

d) Specification of tax rates

Income tax act 2002 has clearly specified the tax rate applicable to the various forms of business and taxpayers. Such tax rates are given in Appendix 1 of the act

e) Simplification of depreciation related provisions

Income tax act 1974 had categorized the assets into around three dozens and different rate of depreciation were allocated for different types of assets. As a result there was confusion relating to the depreciation. But income tax act 2002 has specified the diminishing balance method of depreciation system based on pool system with five categories of assets. In this tax system is far clearer in respect of depreciation.

f) Taxing capital gain and dividend

Income tax act 1974 had no provision of taxing capital gain and dividend. But income tax act 2002 has made clear provision abut the tax rate charged to the income earned from capital gain and dividend.

g) Generous loss set off and carry forward provision

Income tax Act, 2002 has made the provision of carry forward of losses of a business for four subsequent years. Similarly for financial sector the provision is more liberal providing the facility of recovering the losses from previous five years and carry forward up to five subsequent years.

h) Provision of international taxation

Modern economy is advanced and complicated. Most of the country's economy is open. Business transactions are operating worldwide. So, this income tax has made provision of internal taxation such and transfer pricing, foreign trade credit, double taxation avoidance agreement etc.

i) No submission of income statement by a person who does not have taxable income

This act has made provision of not necessary of submission of income statement by a person who does not have taxable income or income from remuneration.

j) Provision has been made for the deduction of all the expenses relating to income earned.

k) Provision of tax incentives for infrastructure development project, employment generating business, electricity project and for special industry.

l) Provision made to claim for deduction of pollution control device and research and development expenses.

m) It has accepted self-assessment taxation system absolutely, provision has been made to accept the statement submitted by taxpayer as payment made by taxpayer is taken as assessed tax amount.

n) It has clearly defined eight and duties of taxpayer and power of tax office.

3.2.2 Features of Income Tax Rules, 2002

Income tax regulatory act 2002 is issued on 10th June, 2002, using the power mentioned in sec 138 of income tax act 2002. The major features of income tax regulation 2002 are as under:

a) Provision and definition of permanent Account Number (PAN).
b) Tax deduction procedure.
c) Payment of patty expenses.
d) Calculation of tax amount and system of accounting.
e) Provision relating to bad debt and doubtful debt of financial institution.
f) Provision of contract.
g) Provision in connection with the use of vehicle for private purpose.
h) Provision in connection with the use of building for private purpose
i) Provision relating to approved medical expenses and its limitation
j) Provision relating with the facility of deduction of losses from the previous income year of banking and general insurance company.
k) Provision of approved retirement fund
l) Provision relating to the method and place of payment of tax.
m) Provision of tax deduction at source.

3.2.3 Exempt Organizations

The Inland Revenue Department is responsible to decide whether an organization is liable to pay tax or not. For getting tax-exempt facility, the organization should apply to the Inland Revenue Department with necessary document that prove the organization.

Here, exempt organization means any entity that should not pay the tax. Social organizations that are not operated for profit earning are provided with such facilities. Income tax act 2002 (sec. 78) has included the following entities with tax-exempt organizations:

a) A religious, educational or charitable organization of public character.
b) An amateur sporting association formed for the purpose of promoting social or sporting amenities not involving in the acquisition of gain by the association or by its individual members.
c) A political party registered with the Election Commission.
d) A village development committee, district development committee, metropolitan city, Sub-metropolitan city or Municipality.

e) Nepal Rastra Bank.

f) Government of Nepal.

g) An entity that has been declared as exempt organization, issuing notice by the government.

h) The assets and amount derived by an entity not providing benefit to any person except as payment for assets or service rendered to the entity in pursuit of the work related to tax exempt.

3.2.4 Head and sources of income

Income Tax Act, 2058 has classified the heads of income into the three main groups for the purpose of tax assessment. According to the Income Tax Act 2058 the head of income are:

a) Income from business

b) Income from employment

c) Income from investment

The sources of income are domestic and foreign sources, which are described below.

3.2.5Income from business

If any person or corporate body earns income by running any business industry or trade with in an income year such income is included while computing taxable income (as per the sec. 7, 22, 24, 26, 27, 29, 31, 56, 60). Following are the heads of Business Income.

a) Service fees

b) Income earned from the disposal of trading stock.

c) Income earned from the disposal of business assets or liabilities.

d) Income earned from the disposal of depreciable assets.

e) Gift received in connection with business.

f) Income received by accepting any restriction of business.

g) Income received from business related investment.

h) Income received from various agents as commission.

i) Income earned due to the change in exchange rate of currency.
j) Recovery of bad debt and doubtful debts.
k) Recovery of bad debt and doubtful debts.
l) Income received from the completion of long-term contract in part.
m) Income earned by the interest expenses paid for a long at lower rate then the actual marker rate.
n) Income earned in respect of compensation.
o) Other income to be included in profit or benefit.

3.2.6 Income from employment

Incomes received by an employee in the form of salary, allowances, any facilities and benefits etc. are included under this head. Similarly, any expenses born by employer in respect of employee are also included as the source of income from employment. From such accumulated income, life insurance premium, donation to the philanthropic purpose and contribution to recognized provident fund, up to 7% of insured sum, 5% of net income and 10% of gross salary respectively are admissible expenses. From such amount exemption limit is deducted according to the marital status of a person to compute taxable income. In this taxable income tax rate is charged @ 15% for first 75000 and rest in charged @ 25% to compute total tax liability.

According to income tax act 2058 sec. 8, 24, 25, 27, 29, 30 and 31 following are the source of income from employment (ITA, 2058).

a) Salary and wages.
b) Paid leave.
c) Income received from over timework.
d) Commission and charge earned.
e) Gift and reward received in connection of employment.
f) Bonus income.
g) Payment made for facilities enjoyed by employee but paid by employer.
h) Rent expenses born by employer.
i) Entertainment and transportation expenses born by employer.

j) Expenses paid by employer in respect of employee or his/her relatives.

k) Income earned by employee in respect of accepting any contract between employer and employee.

l) Any payment made by employer to employee in respect of employment.

3.2.7Income from investment

Investment income includes income earned by any person or organization from dividend, interest, Rent royalty income from insurance investment, income received from registered retirement fund, gift and any other non business taxable income.

Income Tax Act 2058, section 9, 24, 25, 27, 29, 30, 31 has stated the following heads of income under investment income (ITA, 2058).

a) Dividend (Gross)

b) Interest (Gross)

c) Payment received in relation to natural sources.

d) Income from royalty (Gross)

e) Benefit received from insurance investment.

f) Rent income (Gross)

g) Benefit received from unrecognized retirement fund.

h) Income received from disposal of non-business assets.

i) Gain earned while disposal of depreciable assets of investment.

j) Any gift received in connection with investment.

k) Amount received by accepting any restriction in connection with business.

l) Amount received from compensation.

m) Amount received from joint investment.

3.2.8Tax –free Income /Tax exempted income

According to Income tax Act 2002, section 10, the following incomes are tax-free incomes or tax exempted income even though they seems income from Business or Employment.

a) Income earned by a person due to the bilateral or multilateral treaty between Nepal government and foreign country or International organization.

b) Income earned by a person working as foreign government servant on foreign land is non –taxable income.

c) A person hired by Nepal government for the service of Nepal government making agreement of non-payment of tax.

d) Allowances distributed by Nepal government to the widow, handicapped or old persons are tax –exempted income.

e) Donation, Gift and present etc received by tax-free organization is tax-exempted income. Similarly income earned by Nepal Rastra Bank is also tax-free income.

f) Amount received in the form pension by a Nepalese Ex-Army or police worked in foreign land.

3.2.9Tax Incentives

Tax incentives are concessions, facilities and rebates granted to corporate bodies. Those incentives reduces then tax burden of an organization. It may imply a partial or full exemption from one or variety of taxes and special allowances for a certain period to motivate the new as well as existing organization for balanced regional development, encourage for the production of primary good and to develop the corporate bodies. It increases the habit of saving and encourages the investment by the means of equity shares, purchasing of an organization. Thus tax incentives are a phenomenon developed specially to accelerate the slow rate of investment is most of the developing countries.

The increase in corporate investment is the sign of economic development of the nation. Basically, offering of tax incentives become necessary due to the two reasons, stretching the scope of tax beyond its revenue objectives to achieve certain socio economic need and to mitigate the adverse impact of high taxation on corporate saving and investment activities.

Developing country like Nepal mist have to encourage investor to invest on factors and industries for economic well being of nation, creating employment opportunity and to reduce foreign dependency. But the investor are ready to invest only in such a case when the after tax profitability becomes high.

The desires of inventor to invest in new project can be partly fulfilled by the tax inventories and finally it helps the government to increase its revenue. Some of the popular ways of providing tax incentives by the government in different countries in the world are tax holiday, tax credit accelerated depreciation, deduction in tax rate, carry forward of losses etc. Tax holiday is the tax-free for a certain period. Any industries getting such type of incentive need not to pay tax for a certain period of time.

Similarly, another technique of tax incentive is tax reduction that means lowering the tax rate. This type of incentives is mostly provided to those industries operating in particular place with particular kind of goods or service. However sometime such types of tax inventive is equally provided to all types of corporations whether large or small, new or old, capital incentives or labor incentives and located at rural or urban areas. It has mine adverse affects to the government as reduces the government's revenue.

Another method of providing tax incentive is to provide tax credit facility. In this system tax incentive is provided capital investment. It is granted in the first year's investment on assets. Such type of inceptive is mostly beneficial to the large-scale investors rather than small investor. Similarly another method of providing incentives to the large-scale investor in accelerated depreciation charging facility. In this system higher depreciation is charged in the beginning year and gradually decreases in later year on the fixed assets of an organization. Due to this, taxable income of the corporation become lower and saves the amount of tax. For the accelerated depreciation, sum of the year's digit (SYD) and double declining method of depreciation are commonly used (Poudyal, 2004:2)

The last method of providing incentive is to carry forward of losses. In this technique the losses of the previous year can be deducted from the subsequent year's profit. Mostly of the country in the world allow to deduct losses or carry forward of losses from subsequent year profit. Income tax act 2058 of Nepal has allowed carry forward of losses of general business for 4 year and bank and insurance business for 5 subsequent years.

Among these various types of tax incentives policy of government, investment allowance is widely used by Srilanka, Canada, Australia, Belgium, Germany, Japan, United Kingdom, Brazil, Malaysia, Singapore, Taiwan and other industrialized country. (Kandel, 2004:61)

Developing countries like Philippines and Mexico etc are using tax tax Act 2058,Nepal has adopted a combination of at holiday, investment allowance, deduction in tax rate and carry forward of losses etc. in order to provide incentives to the investor.

3.2.10 Essential Features of Remuneration

The essential features of Remuneration from employment may make clear idea in order to understand the meaning of Remuneration. These features are as follows (Amatya, 2004:69):

a)Relationship of employer and employee

Any Remuneration of an individual is regarded as Remuneration from employment, if there exists a relationship as employer and employee between the payer and payee. It means there must be the master and servant relationship. If such a relationship does not exist, then the income falls outside the scope of the head 'income from employment'. A master is one who not only directs what and when a thing is to be done but also how it should be done. A servant, generally, is not only a person who receives instructions from the master but is also subject to the master's right to control the manner in which he/she carries out instructions. If a person is acting as a agent for a principle during the course of carrying no business, there is no relationship between them as master and servant and there exists a relationship of principal and agent. Therefore, any commission or Remuneration earned by the agent is chargeable to business income of the agent. Any person of entity that employs others for work and pays them is known as an employer.

b)Mode of Payment

It should identify whether the mode of payment accrues with the passage of time or it depends on some job being performed or completed by the assessed. In a contract services, the employer can direct and control as to what is required to be done by the employee and as to how it should be done by the employee. In such a case, there exists employer and employee relationship and the Remuneration of the contractor (employee) is chargeable under income from employment. As against this, in a contract for service, the contractor (employer) can best specify what is to be done and the contractor independently achieves the details of work and executes the same. In this case income earned by the contractor for his service is chargeable under income form business and not as salary income since there does not exist any employer and employee relationship.

c)Remuneration income and professional Income

Remuneration income is derived with the passage of time but not depended on some job being performance or completed. A radio singer and an actor are ordinary not employees and therefore, the Remuneration they receive for jobs performed of jobs completed will be taxed under income form business. But in case there respective employers employ any of them on the time basis, the amount is taxed as salary.

d)Income received from the employer

As already mentioned that it is essential to be the Remuneration form employment, the Remuneration should be received from employer. So any payment made by employer to employee for services is included in the income from employment of the employee. The payment may be salary. Allowances, differed payments and fringe benefit valued as per laws. However, sometimes income received from employer is not chargeable under income form employment. For example, loan received from the employer is not chargeable under income from employment because it is a capital receipt.

e)Income received from an associate of the employer

Sometimes, an associate of the employer pays remuneration. Such Remuneration derived from the associate of the employer is included in the employee's Remuneration from employment. For example, Remuneration paid to the employee by the managing director of a company.

f)Income received from third party

Sometimes, a third party pays remuneration under an arrangement with an employer. Remuneration derived from the third party on behalf of the employer is also chargeable remuneration income to an employee.

g)The amount paid should be of regular nature

As discussed earlier, the remuneration received on the basis of passage of time is chargeable under income form employment. It is accruing periodically for service rendered by an employee as result of expressed of implied (indirect) contract. And if the employee receives such periodic accrued remuneration, then it becomes chargeable income from employment.

3.2.11 Some Basic Points for Consideration

There are some basic considerations while computing assessable income from employment. These considerations may be as follows (Amatya, 2004:71):

a) Remuneration, salary & wages are not conceptually different. But the remuneration income and profession income are conceptually different.

b) Salary may be received from more than one employer.

c) Salary from a former employer, present employer & prospective employer in included in the income from employer.

d) Salary income bust be real but not fictitious.

e) Remuneration income is taxed on the receipt basis: Tax accounting of remuneration is cash basis. Hence, it is obvious that advance salary and arrears of salary may be taxed in the year of receipt part from the current year's salary.

3.2.12 Remuneration from employment (Chargeable Remuneration)

The chargeable income under income from employment is specified in section 8 of income tax Act. As per the act, the following payments made to a natural person from the employer are included in calculating the person's remuneration from employment (Amatya, 2004:71):

a) Payment of wages, salary, leave pay (including salary in lieu of leave and encashment of accumulated home, sick etc level), overtime pay, fees, commissions, prizes, gifts (as per market valuation case of prize and gift is not in cash), bonuses, and other facilities i.e. Dasain Expenses. Tihar Expenses, telephone facility, transportation facility etc;

b) Payments of any personal allowances including any cost of living, subsistence allowance, rent allowance, entertainment allowance and transportation allowance.

c) Payments providing any discharge of reimbursement of costs incurred by the individual or an associate of the individual. For example, reimbursement of medical expenses, payment of life insurance premium and private trip expenses etc.

d) Payment for the agreement to any conditions of the employment. For example: in case an employee receives Rs. 5000 per month for not working in other organization as per the agreement made on the request of the employer.

e) Payment for termination or loss of service of compulsory retirement (redundancy). For example, amount derived as golden hands shake scheme.

f) Retirement contribution including those paid by the employer to a retirement fund in respect of the employee and retirement payments. For example, gratuity, encashment of medical expenses at the time of termination, employer's contribution to provident fund.

g) Other payment made in respect of the employment; and

h) Amounts required to be included in remuneration from employment as per tax accounting.

i) In addition to above stated items of Remuneration, the following types of perquisites are also included in Remuneration from employment of a person.

1. **Transfer of the asset [27 (a)]:** In case of the transfer of the asset from employer to employee, the market value of such asset is included in the employee's income. For example; if an employer provides 100 liters of petrol as a fuel facility to an employee and market value of petrol per liter is Rs. 54, its total market value of Rs. 5400 should be included in the employee's income from employment.

2. **Vehicle of personal and official purpose and Rent-free accommodation for personal purpose [27 (b)]:** Payments consisting of the following facilities determined in accordance with the rules are included in the income of the employee:

   I) Vehicle Facility: Availability of vehicle wholly consisting purpose. However, such amount will be limited only to 0.5 percent of annual salary {13}. In case the facility is not provided as fringe benefit but is paid as transpiration allowance of paid certain amount as transportation facility, such allowance of amount should be included in the employee's income.

   It is not that partly personal purpose also refers to the facility of vehicle provided to go to office and to return to home from office. It is common phenomenon that any vehicle will not run without driver and fuel. Therefore, if once the above perquisite is charged in the income of employee, the payment or facility of driver and fuel should not included in the employee's income.

   If the driver and fuel facilities are provided for employee's own vehicle used for his personal purpose, the amount of driver's salary and amount of fuel are included in the employee's income.

II) **House facility (including rent-fee accommodation) for personal purpose**: Provision of housing to the employee. However, this amount is limited to only 2 percent of annual salary {13}. But in case the facility is not provided as fringe benefit but is paid as house rent allowance or paid certain amount as fringe benefit but is paid as house rent allowance or paid certain amount as residence facility, such allowance or amount is included in the employee's income.

In case a maintenance expense is provided to employee's own house the amount of such payment is included in income of the employee's.

3. **Expenses incurred by employer for the provision of domestic assistants, food house household utilities for the employee [20(c)]:** The amount of expenses incurred by the employer for provision of following facilities for the employee (but any contribution of the employee for provision of such facilities is not included in income):

   I) Services for housekeeper, cook, chauffeur (driver), gardener or other domestic assistants;

   II) Any meal, refreshment or entertainment;

   III) Drinking water, electricity, telephones and like utilities in respect of employee's place of resident.

4. **A reduced amount of interest paid to employer as per concession rate with compared to prevailing rate [27(d)]:** In case the amount of interest on loan paid by the employee to the employer with a concession rate, the difference amount of interest that is lower then the interest to be paid as per the standard higher rate is included in the employee's income. For example, if a manager if a bank has received a housing loan of Rs. 1000000 to construct a house with a concession interest rate of 6% interest of the standard interest rate of 10% for housing loan in the same bank and pays interest of Rs. 60000, the difference amount of Rs. 40000 with compared to the interest of Rs. 100000 as per standard rate is added to income from employment.

5. **Compensation [31(a)]:** in case a person or an associate of a person derives a compensation amount including a payment under insurance that compensates for income from employment, it is included in calculating the income from the

employment at the time the compensation amount is derived. The compensation for an income that the person derived or expected to driver from employment or compensation form an amount to be included in calculating the income from employment is included in such category. For example, compensation to an employee from insurance company on termination from the jib from which the employer has insured for his purpose in included in the employee's income from employment. It is noted that compensation or gain from the investment insurance from resident person is subject to final withholding payment and is not included in the individual's income but the compensation or gain from investment insurance from the non-resident person is included in the individual's income.

6. **Amount for bill directly paid by the employer [17(e)]:** For the payment other than stated above, the value of benefit of the payment bade by the employer to a third person instead of employee is included in the income of the employee. For example: School fee of the children of the employee is directly paid by the employer to the school, life insurance premium paid by the employer, etc.

3.2.13 Non-chargeable Incomes

Some incomes are not included in calculating a person's remuneration from employment even of they are derived from the employment. These income are treated as tax-free income. The following amounts are excluded in calculating as individual's remuneration from an employment: The following incomes are exempted from income (Amatya, 2004:74).

a) **Exempt amount [8.3(a) and 10]:** The following payments are not included while calculating the income form employment as per section 10 of the act:

- Remuneration exempted under a bilateral or a multilateral agreement (treaty) with a foreign government or an international organization.
- Remuneration under the employment of public service of foreign government.

- Remuneration derived by foreign national from foreign government.
- Remuneration paid by Government to foreign national on the term and conditions of tax exemption.
- Allowance paid by Government to widows, senior citizen or disabled individuals.
- Gift, bequest, inheritance of scholarship except as required to be included in income from employment.
- Pension received by retired Nepali army/police from public fund of foreign government.

b) **Final withholding payments [8.3 (a) and 92]:** If a person receives the final withholding payments after tax deduction at source, they are not included in the person's income. The following income received after deduction tax at source as final withholding payments are not included while calculating income:

- Dividends paid by a resident company
- Rent for the lease of land or a building and associate fifing and fixtures having a source in Nepal, and that is received by an individual other then in conduction a business.
- Payment made by a resident person for gains from investment insurance
- Payment made by a resident unrecognized retirement fund to the beneficiary for gains from interest on unrecognized retirement fund
- Interest that is sourced in Nepal and not related to person's business paid by a resident bank or financial institution to the natural person.
- Payment made to non-resident persons that are subject to tax withholding by employers, withholding from investment returns and service fees, withholding form contract payment under 87, 88 and 89 respectively.
- Retirement payment made by Government or recognized retirement fund

- Meeting allowance (Payment for part-time teaching, payment for setting question papers and payment for examining answer books from FY 2060/2061 and onwards.)

c) **Meals and refreshments on similar terms:** Meals or refreshments provided in premises operated by or on behalf of an employer to the employer's employees that are available to all the employees on similar terms. [8.3 (b)]

d) **Discharge or reimbursement of expenses used for employer's business purpose or employer's admissible deductions from business or investment [8.3 (c.1 & c.2]:** Any discharge of reimbursement of costs incurred by the employee that serve the proper business purpose of the employer or that are or would otherwise be deductible in calculating the employer's income from any business or investment. For the detailed analysis of chargeable and non-chargeable income received as reimbursement of expenses incurred by an employee, it should be identified whether or not the expenses in deductible expenses from business or investment of the employer or is used for proper business of the employer. To make clear idea about it, expenses of domestic of personal nature that are expressly disallowed for deduction are clearly identified as mentioned in the clarification of section 21 of the act.

e) **Payments of small amounts [8.3 (d)] {6}:** Payments of the prescribed small amounts which (after taking into account and frequency with which the employer makes similar payments) are so small as to make accounting for them unreasonable or administratively impracticable. [8.3 (d)]. As per the rule 6, an employer may make a payment of an amount not exceeding Rs. 500 at a time as the payment of small amount in this respect for a provision of tea, stationary, gifts, reward, awards, emergency medical treatment or other similar expenses approved by the Department {6}.

f) **Special provision of exemption for retirement payment and leave pay [20.6 (a) & (b)]:** The following amounts, which are preciously exempted from tax, are also exempted:

- The amount accrued prior to the commencement of 'Income Tax Act, 2058' (till 2058/12/18) to any natural person as principal, interest and bonus in consideration of employee's and employer's contribution in Employees Provident Fund and Citizen Investment Trust (Recognized Retirement Funds) are exempted. However, the interest accrued on the same amount is taxed after that date as final an employee as gratuity and amount of accumulated home and sick leave are also exempted. [20.6 (a)]
- Medical expenses up to Rs. 180000 payable at the time of discharge of retirement to that employee who was working on job at the commencement of the act. [20.6(b)]

3.2.14 Other Considerations

A) Common Deductions [13 & 63] [21}

The amounts that are deductible while computing taxable income are follows (Amatya, 2004:76):

a) Retirement contribution: Retirement contribution to the approved retirement fund within the limit is allowed to deduct to obtain the taxable income of natural person [63]. The limit is Rs. 300000 or one third of assessable income of the person whichever is less {21}.

b) Donation: Gift amount to a tax exempt organization equal to 5 percent of taxable income or Rs. 100000 or actual, whichever is less or as prescribed by Government in notification is allowed to deduct to obtain the taxable income [21].

B) Exemptions [1.1, 1.5 & 1.9 of Schedule 1 of ITA 2002]

a) **Statutory Exemption limit**: Statutory exemption limit of Rs. 80000 for individual (single) and Rs. 100000 for couple is allowed to deduct while computing taxable income from the income year 2060/061.

b) **Remote area allowance as an additional exemption limit**: Remote area allowance is applicable to all natural person as an exemption in additional to the statutory-exemption limit for income from employment, business or investment (i.e. Rs. 30000, 24000,18000, 12000 and 6000 for A, B, C, D and E class areas respectively).

c) **Additional exemption for pension for pension income:** In case of pension income, an additional amount of 25% of statutory exemption limit (Rs. 80000 or Rs. 100000) is allowed to deduct while computing taxable income of an individual or a couple from the income year 2060/061. It means that the total exemption limit world be Rs. 100,000 for an individual (single) and Rs. 125000 for a couple for the income year 2060/61.

d) **Life insurance premium as admissible deduction from the income year 2060/61:** Finance ordinance, 2060 had provided the facility of exemption for the premium @ 7% of insured policy amount or Rs. 10000 or actual amount, whichever is less from the assessable income to the natural person.

C. Medical Tax credit [51] {17}

The medical tax credit facility is available to the all taxpayer while computing the tax liability of the natural persons. The medical tax credit of 15% of the approved medical costs plus carried forward of medical tax credit (excess amount of medical tax credit over Rs. 750+ the amount of medical tax credit not used by reason of lack of tax payable) from previous income years [51]. However, upper limit of medical tax credit for one year is Rs. 750 per year and the remaining balance of medical tax credit can be recouped in next year [17]. Furthermore, if the medical tax credit up to Rs. 750 is used due to the lack of tax payable in the relevant income year, such unused amount of medical tax credit can also be carried forward to next income years.

D) Foreign tax credit [17]

Amount of income tax paid in a foreign country is deductible as tax credit from the tax liability of foreign source income. However, such amount does not exceed the average rate of Nepal Income Tax. For this purpose, the average tax rate is calculated as follows:

$$\text{Average tax} = \frac{\text{Tax Liability before deducting foreign income tax}}{\text{Taxable income of the person}} \times 100$$

E) Special Fee as Additional Tax

The finance Ordinance, 2059 had prescribed a special fee @ 3% on taxable income of a person. However, this provision is applicable to that slab of taxable income where 25% tax rate is applicable. It means special fee is not levied on that slab of taxable income where income tax rate is 0% and 15% in the case of a resident individual or couple. Similarly, it is also levied on and realized from any taxable income in the case of an entity and a non-resident person. It is noted that special fee is not income tax. However, the Finance ordinance, 2060 has prescribed the special fee @ 105% on such taxable income to be applicable for the income year 2060/061 and onwards. It means the rate of special fee has been decreased to 1.5% in the income year 2060/061. (Please refer to section 17.2 of Finance ordinance 2059 and Section 16.2 of Finance Ordinance 2060).

F) Special Provision for Retirement Savings

a)Retirement Contributing to Approved (Recognized) Retirement Fund [2bh, 2d, 2f, 63.1, 63.2] and {20} {21}

The act has defined the term 'retirement contribution' as a payment made to a retirement fund for the provision or future provision or future provision of retirement payments [2 (f)]. In the same way, the act has defined the term 'retirement fund' that if means any entity established and maintained solely for the purposes of accepting and investing retirement fund contributions in order to provided retirement fund payments to individuals who are beneficiaries of the entity or a dependant of such individual [2 (d)].

According to section 63.2, a natural person who is the beneficiary of an approved retirement fund may claim to reduce the taxable income by retirement contribution made to the fund by the natural person during the year. For this purpose, the upper limit of the deductible amount of retirement contribution is Rs. 300000 or 1/3 of the assessable income; whichever is less {21}.

It is noted that the assessable income includes income from employment, business and investment sourced in Nepal. It is also noted that natural person includes a couple (husband and wife with or without minor children) by electing themselves as a single unit of taxpayer. In such case, they can deduct their retirement contributions from their combined assessable income as mentioned above.

As per sections 2(bh) and 63.1 'approved retirement fund' includes any retirement fund related to a resident person having recognizes approved by the Inland Revenue Department as complying with the requirement prescribed by the Rules. However, it is noted that Employee Provided Fund and Citizen Investment Trust should not requiredto approve so that they are known as approved retirement funds.

For this purpose, 'recognized (approved) retirement fund' means retirement fund for which the Inland Revenue Department approves as to comply the following terms and conditions: a) The amount of which is invested in recognized investment; b) The fund is managed by independent person other than the employer; c) The amount spent as retirement fund is deposited within one month in case of Ashadh and within 15 days in case other month; d) Repayment of the amount to employee is made only in case of retirement or completion age of 58 years, death or physical payment handicap of the employee and the retirement or fund is audited by the auditor recognized by Auditor General's Office. {20}

Here, recognized investment means investment made to Citizen Investment Trust or Employee Provident Fund or Government securities or recognized bank or instruction co-financed with bank or investment made to the beneficiaries other than the shareholders.

b)Retirement Payment [65] {20.6}

In the broad sense, retirement payment includes pension, gratuity, refund of provident fund contributions, refund of citizen investment trust contribution, refund of other retirement contributions and other payment on the termination of the job, such as accumulated home and sick leave payment, payment or medical expenses etc. Among of them, pension is a stream of income paid over a period of time on monthly basis while gratuity and other payments are lump sum incomes are in one time. As per the act, 'retirement payment' means a payment made either to an individual in the event of retirement or to a dependant of the individual in the events of death [2(e)].

For the purpose of calculating the income of a natural person, in case the retirement payments are made from the person's interest in an approved retirement fund or from government, the following provisions are applied: (a) There is included any retirement payment made by the fund in respect of the beneficiary's interest and; (b) Where the payment is in the form of lump sum, it is treated as a gain from the disposal of a non-business chargeable asset of an investment of the person.

For this purpose, the gain is determined after deducting Rs. 500000 of 50% of the total retirement payment, whichever is higher from the total retirement payment and is taxed as final withholding tax at the rate of 6%. For example, gratuity, amount of accumulated home leave and sick leave and medical expenses at the termination of job etc. altogether paid by government and refund of principal whit interest and bonus from Employees Provident Fund.

For the purpose of calculating the gain of natural person from an interest in an unapproved retirement fund, the following provisions are applied: (a) In the case where the proceeds are paid by a resident person, it is taxed in the hands of the form of a final withholding tax; (b) In the case where a non-resident person pays the proceeds, it is included in calculating the income of the individual beneficiary.

It is noted that the retirement payments, which were subject to exempt from the tax net previously, are also exempted by the current laws to the extent of the payments as follows {20.6(a) (b)}:

- The amounts accrued prior to the commencement of 'Income Tax Act 2058' (till 2058/12/18) to any natural person as principal, interest and bonus in consideration of employee's and employer's contribution in Employee provident Funds and Citizen Investment Trust (Recognized Retirement Funds) are exempted. However, the interest accrued on the same amount is taxed after the date as final withholding payment. Similarly, the amount accrued till the date to an employee as gratuity and amount of accumulated home and sick levels are also exempted from income tax.

- Medical expenses up to Rs. 180000 payable at the time of discharge or retirement to the employee who was working on job at the commencement of the act.

c)Taxation of Retirement Fund [64}

For the purpose of calculating the income of a retirement fund, amounts required to be included and deducted are included the deducted under other provisions of the 'Income Tax Act 2058 but: (a) Retirement contribution received by the fund is not included in the calculation and is not an incoming of the fund; (b) Retirement payment is not deductible in the calculation and is not an outgoing of the fund; and (c) The interest of a beneficiary in a retirement fund is not a liability of the fund.

The income of an approved retirement fund is exempted from tax. If an approved retirement fund ceases to be an approved retirement fund, it has to pay income tax in an amount equal to company tax rate applied to the amount remained after subtraction the amount of paragraph (b) From the amount of paragraph (a) as follows:

a) All retirement contributions derived by the fund during the period from its most recent approval as an approved retirement fund to when it ceases to be so approved and chargeable income during the period while the fund is become unapproved, less;

b) All retirement payment made by the fund from its most recent approval as an approved retirement fund to when it ceases to be so approved.

CHAPTER-IV

RESEARCH METHODOLOGY

The basic objective of this study is to evaluate the effectiveness of remuneration tax in Nepal. To achieve the predetermined objective, an effective research methodology has been adopted. This includes research design, nature and sources of data, population and sample of the study, tools and methods of data analysis that are used for the accomplishment of desired objectives are explained below.

4.1 Research Design

This is an explanatory study and it has attempted to study problems and prospects of Remuneration tax based on historical prospective of Nepalese Taxation System. This has also included the views of different stakeholders of Remuneration Tax.

4.2 Nature and Sources of Data

Both primary and secondary data have been used in the study.The primary data were collected though opinion survey of tax experts and employees of Inland Revenue Department, GoN.

A semi structured questionnaire was designed for the purpose of opinion survey. In addition, as secondary sources of data, Budget speeches, Economic Survey and Reports, related previous studies, reports and records of IRD have been used.

4.3 Population and Sample Size

The population for empirical study comprised the tax experts and employees of Inland Revenue Department, GoN. A sample size of 50 has been purposively selected from the different groups of respondents. Table 4.1, shows the group of respondents and sample size.

4.4 Method of Analysis

Data collected from primary and secondary sources were first categorized and then tabulated for analysis.For the purpose of analysis, simple averages and percentages were used.Trend analysis is done through the use of tables. Summary tablesare presented in appendix to show the overall picture of remuneration tax in Nepal.

CHAPTER-V

TREND AND STRUCTURE OF REMUNERATION TAX IN NEPAL

This chapter presents the trend and structure of remuneration tax between FY 2002/03 and FY 2011/12. It includes trend and composition of total revenue, tax revenue and direct tax revenue separately. It also presents the trend of share of income tax and personal income tax on GDP for the study period. In addition, it also shows the share of total income tax and personal income tax to total tax revenue along with the components and composition of total income tax.

5.1 Trend and Composition of Total Revenue

Total revenue consists of tax and non-tax revenues. Tax revenue contributes about three quarters of total revenue while non-tax revenue only a quarter of total revenue. This is shown in table 5.1.

Table 5.1

Composition of Total Revenue

Rs, in ten millions

Fiscal Year	Total Revenue	Tax Revenue	Non-Tax Revenue	Percentage on Total Revenue	
				Tax Revenue	Non-Tax Revenue
2002/03	5433.89	4089.60	1364.29	75.26	24.74
2003/04	6233.10	4817.30	1415.80	77.72	22.72
2004/05	7012.27	5410.47	1601.80	77.16	22.84
2005/06	7228.20	5743.04	1485.16	79.45	20.55
2006/07	8771.22	7112.67	1658.55	81.09	19.91
2007/08	10762.25	8515.55	2246.70	79.12	20.88
2008/09	14347.45	11705.19	2642.26	81.58	18.42
2009/10	17799.19	15978.53	1820.56	89.77	10.23
2010/11	19837.63	17722.72	2114.91	89.33	10.77
2011/12	24437.41	21172.18	3265.23	86.63	13.37

Economic Survey,MoF (2011/12)

Table 5.1 shows that during the study period, both tax and non-tax revenues in absolute terms have increased. In the FY 2002/03, the amount of tax and non-tax revenue in absolute were Rs. 4089.60 ten millions and Rs. 1364.29 ten millions respectively which increased to Rs.21172.18 ten millions and 2365.23ten millions respectively in the FY 2011/12. Thus in just a duration of ten years, tax revenue has increased approximately by three folds while non tax revenue increased more than double.

The shares of tax and non-tax revenues on total tax revenues for the study periodare also shown in table 5.1. For the FY 2002/03, the shares of tax revenue and non-tax revenue were 75.26 percent and 24.74 percent respectively. But the share of tax revenue increased to 89.77 percent while the share of non-tax revenue decreased to 10.23 percent in the FY 2009/10. Towards the end of the study period, the share of indirect tax slightly decreased to 86.63 percent and the direct tax increased to 13.37 percent.

For the study period, the share of indirect tax on total tax revenue averaged to around 80 percent. This shows that there is a dominant role of tax revenue over non- tax revenue throughout the study period. Throughout the study period, tax revenue in absolute term has an increasing trend. Also the non-tax revenue in absolute term has also increased significantly than non-tax revenue over the period 2002/03 to 2011/12.

Despite having some scope for generating more revenue through the rationalization of non-tax sources particularly by improving pricing policies and operational performances, these sources cannot be used effectively as a revenue raiser since most of these sources are levied not for revenue purposes.

5.2 Trend and Composition of Tax Revenue

Total tax revenue consists of direct tax and indirect tax. In Nepalese context, although direct tax seems to be justified, indirect tax is unavoidable. The direct tax is justified because it helps to mobilize revenue for the national exchequer and also assists to narrow the gap by the distribution of income and wealth between the richer and poorer sections of the society.

Under existing circumstances, direct tax cannot generate sufficient revenue to the national exchequer. It is only through the indirect tax that adequate revenue can be mobilized can also been helpful to hinder investment in unproductive sector and prevent the consumption of demerit goods. Thus, though Nepalese government is supposed to rely upon the direct tax, indirect tax has greater role for revenue mobilization.During the study period, there has been upward trend in total, indirect and direct tax revenues. This is shown in table 5.2.

Table 5.2

Composition of Tax Revenue

Rs, in ten millions

Fiscal Year	Tax Revenue	Direct Tax	Indirect Tax	Percentage of Tax Revenue	
				Direct Tax	Indirect Tax
2002/03	4089.60	1088.19	3001.41	26.61	73.39
2003/04	4817.30	1191.26	3626.04	24.73	75.27
2004/05	5410.47	1307.18	4103.29	24.16	75.84
2005/06	5743.04	1396.81	4346.23	24.32	75.68
2006/07	7112.67	1898.03	5214.64	26.69	73.31
2007/08	8515.55	2308.77	6206.78	27.11	72.89
2008/09	11705.19	3432.07	8273.12	29.32	70.68
2009/10	15978.53	4039.60	11938.93	25.28	74.72
2010/11	17722.72	4672.03	13050.69	26.36	73.64
2011/12	21172.18	5777.02	15395.16	27.29	72.71

Economic Survey,MoF (2011/12)

In FY 2002/03, the total, direct and indirect tax revenues were Rs.4089.60 ten millions, Rs. 1088.19 ten millions and Rs.3001.41 ten millions respectively. These amounts were increased to Rs.21172.18 ten millions and Rs.5777.02 ten millions respectively in the FY 2011/12. Both the direct and indirect taxes in absolute term have increasing trends during the study period.

Although the indirect tax has increasing trend during the study period, its contribution in total revenue in percentage term fluctuated between 70.68 percent and75.84 during the study period. It was 73.39 in FY 2002/03 which increased to 75.84 percent in FY 2004/05. It again decreased to 70.68 percent in FY 2008/09. Toward the end of the study period, it has remained at 72.71 percent.

Nevertheless, the indirect tax revenue still contributes about three quarters of total tax revenue while direct tax revenue stands only about one quarter of total tax revenue. It is obvious that the indirect tax has got the lions share in the total tax revenue. This is because industries have not developed adequately. Also Nepalese economy is highly dominated by subsistence sector whose per capita income is very low.

5.3 Trend and Composition of Direct Tax

In Nepalese tax structure, the main components of direct tax are income tax and land registration tax. The trend and composition of direct tax is shown in table 5.3.

Table 5.3

Trend and Composition of Direct Tax

Rs, in ten millions

Fiscal Year	Direct Tax	Income Tax	Land &Reg Tax	Other Taxes
2002/03	1088.19	1027.41	60.78	16.58
2003/04	1191.26	1021.51	169.75	26.86
2004/05	1307.18	1127.26	179.92	30.67
2005/06	1396.81	1178.70	218.11	56.67
2006/07	1898.03	1672.68	225.35	69.78
2007/08	2308.77	2014.70	294.07	176.66
2008/09	3432.07	2980.74	522.33	210.50
2009/10	4039.60	3382.13	551.10	106.37
2010/11	4672.03	4206.01	357.25	108.77
2011/12	5777.06	5285.84	358.84	132.38

Economic Survey,MoF (2011/12)

In FY 2002/03, their contributions of Income tax and Land and Registration taxand other taxes in total direct tax revenue were Rs.1027.41 ten millions, Rs.60.78 ten millions and 16.58 ten millions respectively as shown in table 5.3. These taxes increased to Rs.5285.84 ten millions and Rs.358.84 ten millions in FY 2011/12. These taxes have increasing trends in absolute terms for the study period.

5.4 Trend and Composition of Total Income Tax

Until 2050/51, income tax was classified under three heads; corporate income tax, individual income tax and remuneration tax. After 2050/51, interest tax and house & land rent tax was added to the tax base. Corporate income tax is collected from government corporation, public/private limited companies and partnership firms. Personal income tax is collected from remuneration, business, profession and vocations. Interest tax is collected from bank and financial institutions. House and Land rent tax is levied on income obtained from letting house and land on rent. The composition of Total Income tax is given in table 5.4.

Table 5.4

Trend and Composition of Total Income Tax

Rs, in ten millions

Fiscal Year	Income Tax	Personal Income Tax	Corporate Income Tax	House, Land , rent Interest& other Taxes
2002/03	1027.41	395.95	485.23	146.23
2003/04	1021.51	492.46	358.79	170.26
2004/05	1127.26	560.22	380.02	187.02
2005/06	1178.70	599.88	360.00	218.82
2006/07	1672.68	724.23	673.68	274.77
2007/08	2014.70	883.22	739.11	392.37
2008/09	2980.74	1307.31	1038.42	635.01
2009/10	3382.13	1545.30	1336.62	500.21
2010/11	4206.01	1949.07	1524.73	732.21
2011/12	5285.84	1384.78	2393.11	650.03

From table 5.4, we can see that the share of personal income tax to total income has an increasing trend. In addition, about 45 percent of income tax is collected from personal income tax.

In contrast, the share of corporate tax in total income tax has a decreasing trend. It has decreased to 20.1 percent in FY 2010/11 from 55.7 percent in FY 2001/02. Moreover, the shares of remuneration tax and house & Land rent tax have increased significantly during the period. But the share of Land & House rent tax has not exceeded 8.4 percent during the study period. Contribution of income tax from individual is more than the income tax from remuneration.

5.5 Share of Total Income Tax and Personal Income Tax and Remuneration Tax onTotal Tax Revenue

In table 5.4, the income tax and personal income tax as a percentage of total tax revenue is given.

Table 5.5

Share of Total Income Tax and Personal Income Tax to total Tax revenue

Rs, in ten millions

Fiscal Year	Tax Revenue	(ITR)	PITR	Remuneration	Percentage of TTR		
					ITR	PITR	Remuneration
2002/03	4089.60	1027.41	395.95	59.73	25.12	9.68	1.46
2003/04	4817.30	1021.51	492.46	139.12	21.20	10.22	2.89
2004/05	5410.47	1127.26	560.22	167.59	20.83	10.35	3.10
2005/06	5743.04	1178.70	599.88	176.41	20.52	10.44	3.07
2006/07	7112.67	1672.68	724.23	200.79	25.52	10.18	2.82
2007/08	8515.55	2014.70	883.22	245.10	23.66	10.37	2.88
2008/09	11705.19	2980.74	1307.31	319.56	25.46	11.17	2.73
2009/10	15629.49	3382.13	1545.30	441.31	21.64	9.89	2.82
2010/11	17277.76	4206.01	1949.07	586.33	24.34	11.28	3.39
2011/12*	21172.26	5285.84	2236.36	1007.78	24.97	10.56	4.76

Economic Survey,MoF (2011/12)

Both the share of income tax and personal income tax on total tax revenue show increasing trend. Share of income tax on total tax revenue remained between 20.52 and 25.52 percent during the study period.The share of income tax has increased significantly in between FY 2001/02 and FY 2010/11. Similarly, the share of personal income tax revenue averaged to 10 percent during the study period. Likewise the share of remuneration tax remained around 3 percent during the study period. Surprisingly, it is only 4.76 percent in FY 2011/12. It may be due to reclassification of headings of revenue, where it includes only taxes on payroll and workforce which comprises of social security taxes on payroll only.

5.6Share of Total Tax, Direct Tax and Indirect Tax Revenues on GDP

Table 5.6 shows total tax, direct tax and Indirect tax revenue as a percentage of GDP.

Table 5.6

Tax Revenue as Percentage of GDP

Rs, in ten millions

Fiscal Year	Nominal GDP	Tax Revenue	Direct Tax	Indirect Tax	Taxes as Percentage of GDP		
					TR	Direct	Indirect
2002/03	46032.5	4089.60	1088.19	3001.41	8.88	2.36	6.52
2003/04	50069.9	4817.30	1191.26	3626.04	9.62	2.38	7.24
2004/05	54848.5	5410.47	1307.18	4103.29	9.86	2.38	7.48
2005/06	61111.8	5743.04	1396.81	4346.23	9.40	2.29	7.11
2006/07	67585.9	7112.67	1898.03	5214.64	10.52	2.81	7.71
2007/08	75525.7	8515.55	2308.77	6206.78	11.28	3.06	8.22
2008/09	90952.8	11705.19	3432.07	8273.12	12.87	3.77	9.10
2009/10	108341.5	15629.49	4175.00	11454.49	14.42	3.85	10.57
2010/11	125648.5	17277.76	4865.51	12412.25	13.75	3.87	9.88
2011/12	139613.9	21172.26	5777.06	15395.16	15.16	4.14	11.02

Economic Survey,MoF (2011/12)

From table 5.7, we can see that the share of total tax revenue on GDP has an increasing trend with an exception on FY 2010/11. It was 8.88 percent on FY 2002/03 which grew to 14.42 in FY 2009/10. However, share of direct tax revenue on GDP remained between 2.36 and 3.87 during the study period. It was highest on FY 2010/11 and lowest in FY 2005/06. But indirect tax revenue as a percentage of GDP is more or less increasing. It has increased from FY 2002/03 to 2004/05. In FY 2005/06 it decreased and again increased till FY 2009/10. After FY2009/10, it has decreased.

5.7Share of Total Income Tax and Personal Income and Remuneration Taxes on GDP

The gross domestic product of a nation depends upon the income tax of the Nation. Government can collect more income tax revenue if its GDP is high and vice versa. The contribution of income tax and personal income tax on gross domestic product of Nepal is shown in table 5.8.

Table 5.7

Share of Total Income, Personal Income and Remuneration Taxes on GDP

Rs, in ten millions

Fiscal Year	Nominal GDP	Total Revenue			Percentage of GDP		
		Income Tax (ITR)	Personal (PITR)	Remuneration (RTR)	ITR	PITR	RTR
2002/03	46032.5	1027.41	336.22	59.73	2.23	0.73	0.13
2003/04	50069.9	1021.51	353.34	139.12	2.04	0.71	0.28
2004/05	54848.5	1127.26	392.63	167.59	2.05	0.72	0.31
2005/06	61111.8	1178.70	423.47	176.41	1.93	0.69	0.29
2006/07	67585.9	1672.68	523.44	200.79	2.47	0.77	0.30
2007/08	75525.7	2014.70	638.12	245.10	2.67	0.84	0.32
2008/09	90952.8	2980.74	987.75	319.56	3.28	1.09	0.35
2009/10	108341.5	3623.89	1103.99	441.31	3.35	1.02	0.41
2010/11	125648.5	4508.26	1362.74	586.33	3.59	1.08	0.47
2011/12	139613.9	5285.8	1384.78	1007.08	3.79	0.99	0.72

Economic Survey,MoF (2011/12)

Table 5.8 shows that the total income tax revenue is increasing every year since the FY 2002/03. In FY 2002/03 the total tax revenue collected was Rs. 1027.41 ten millions which increased to Rs. 4508.26 ten millions in the FY 2010/11. The share of total income tax revenue on GDP has decreased until 2007/08. Nevertheless, it has remained between 2.04 to 3.19 percent of GDP during the study period. The personal income tax revenuewas Rs 336.22 ten million in FY 2002/03, which increased to Rs.1362.74 ten millions in the FY 2010/11. The share of Personal Income Tax on GDP remained between 0.76 percent and 1.30 percent during the study period. The contribution of personal income tax revenue has a fluctuating trend.Income tax is one of the major source of direct tax in Nepal. However, its contribution to the total tax revenue is still lower than in the developed nations.

CHAPTER: SIX

PROBLEMS OF REMUNERATION TAX IN NEPAL

For the effective implementation of tax policies, the government of a country needs to find out the problems and challenges it faces while formulating and implementing such policies.Remuneration tax being a relatively new heading of tax revenue, it is essential to find out the problems associated with it. In this chapter, the researcher has attempted to find such problems through an opinion survey which includes the experts and employees views towards remuneration tax in Nepal.

6.1 Contribution of Remuneration Tax to Income Tax Revenue of Nepal

In order to know whether remuneration tax has significant contribution the income tax revenue or not, a question was asked, “In your opinion, is remuneration tax contributing significantly to the income tax revenue of Nepal? The question was designed to know the respondents’ opinion towards the contribution of remuneration tax in the income tax revenue. The responses received from respondents are tabulated in Table 6.1.

Table: 6.1

Opinion towards the contribution of income tax in total revenue

Response / Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	25	50	0	0	25	50
Employees	25	50	0	0	25	50
Total	50	100	0	0	50	100

Source: Opinion Survey,2013

Hundred percent of the respondents accepted that the remuneration tax contributes significantly to the income tax revenue of Nepal. Thus it implied that remuneration tax is contributing significantly to the income tax revenue of Nepal.

6.2 Remuneration tax as a suitable means of collecting government revenue

To now the respondents’ opinion about the remuneration tax as a suitable means of collecting government revenue, a question “In your opinion, is the remuneration tax is a suitable means of collecting public revenue?" was asked. The responses of the respondents are tabulated in table 6.2.

Table: 6.2

Opinion towards the contribution of remuneration tax as a suitable means to collect govt. revenue

Response / Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	20	40	5	10	25	50
Employees	15	30	10	20	25	50
Total	35	70	15	30	50	100

Source: Opinion Survey,2013

From table 6.2, it is evident that 70 percent of the respondents approved remuneration tax as an important mean of collecting government revenue and only 30 percent of the total respondents denied it as a suitable means of collecting government revenue. Thus, it implies that remuneration tax as a suitable means of collecting government revenue.

6.3 Reasons for being a suitable means of collecting public revenue

A supplementary question was asked, "If yes, why it is a suitable means of collecting public revenue?" This question was designed to clarify the reasons for remuneration tax being a suitable means of collecting public revenue. The opinions of the respondents are presented in table 6.3.

Table:6.3

Reasons for remuneration tax being suitable means of collecting public revenue

S.N.	Alternatives	Percentage	Rank
1	It is transparent	27	2
2	As compared to other taxes, there is less chance of tax evasion	30	1
3	It is based on progressive taxation	21	4
4	Others	22	3
	Total	100	

Source: Opinion Survey,2013

From table 6.3, it is clear that most of the respondents responded that the main reason is " As compared to other taxes, there is less chance of tax evasion". Thus we conclude that the reasons for it being a suitable mean of collecting public revenue are ranked below in order of preference.

As compared to other taxes;

1. There is less chance of tax evasion.
2. It is transparent
3. Others
4. It is based on progressive Tax

6.4 Opinion about the Current Exemption Limit

To know respondents' view about the current exemption limit on remuneration tax, a question was asked, "Is the current exemption limit suitable?' The responses received from the respondents are tabulated in table 6.4.

Table: 6.4

Opinion towards the contribution of income tax in total revenue

Response Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	5	10	20	40	25	50
Employees	8	16	17	34	25	50
Total	13	26	37	74	50	100

Source: Opinion Survey,2013

From table 6.4, 26 % of the total respondents were satisfied in the current exemption limit, while 74% of total respondents were dissatisfied with the current exemption limit. Thus from the above result, we can conclude that current exemption limit is not suitable and it must be increased.

6.5 Suggestion for the exemption limit

A supplementary question was asked, “If not, how much amount would you suggest for the exemption limit?”The opinions for individuals and couples are shown below separately. The opinions are summarized in table 6.5(i) and 6.5 (ii).

Table: 6.5(i)

Suggestion for the exemption limit for individuals

Respondents	Range for exemption limit(Rs)					
	130000 to 150000		150000 to 200000		200000 to 250000	
	Number	%	Number	%	Number	%
Tax Experts	5	20	10	40	10	40
Employees	2	8	8	32	15	60

Source: Opinion Survey,2013

From table 6.5(i), 20% of the tax experts suggested that the exemption limit should be in the range between Rs. 130000 to Rs. 150000, 40% suggested between Rs150000 to 200000 and other 40% suggested between Rs. 200000 to Rs.250000. On the other hand, 8% of the employees suggested that the exemption limit should be in the range between Rs. 130000 to Rs. 150000, 32 % of them suggested between Rs. 150000 to

Rs. 200000 and the rest 60% suggested between Rs 200000 to Rs 200000 to Rs. 250000.Similarly the opinions of respondents about couples are presented in table 6.5(ii).

Table: 6.5(ii)

Suggestion for the exemption limit for couples

Respondents	Range for exemption limit(Rs)					
	150000 to 200000		200000 to 250000		250000 to 300000	
	Number	%	Number	%	Number	%
Tax Experts	8	32	12	48	5	20
Employees	5	20	10	40	10	40

Source: Opinion Survey,2013

From table 6.5(ii), 32% of the tax experts suggested that the exemption limit should be in the range between Rs. 150000 to Rs. 200000, 48% suggested between Rs 200000 to Rs.250000 and other 20% suggested between Rs. 250000 to Rs.300000. On the other hand, 20% of the employees suggested that the exemption limit should be in the range between Rs. 150000 to Rs. 200000, 40 % of them suggested between Rs. 200000 to Rs. 250000 and the rest 40% suggested between Rs 250000 to Rs 300000 to Rs. 250000.

6.6 Opinion about exemption limit for senior and disabled citizens

To know whether the current exemption limit for senior and disabled citizens should be more than that of other citizens or not, the question asked was " Do you think that the exemption limit for senior and disabled citizens should be more than that of other citizens?" The responses received from the respondents are tabulated in table 6.6.

Table: 6.6

Opinion towards the contribution of income tax in total revenue

Response Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	10	20	15	30	25	50
Employees	13	26	12	24	25	50
Total	23	46	27	54	50	100

Source: Opinion Survey,2013

From the table 6.6, 54% if the total respondents suggested that the exemption limit for senior and disabled citizens should be necessarily more than that of other citizens, While 46% of total respondents suggested that the current exemption limit should be more than that of other citizens. Thus, from above result, we conclude that current exemption limit for the senior and disabled citizens should not necessarily be more than that of other citizens.

6.7 Soundness and effectiveness of remuneration tax system in Nepal

To find out whether the remuneration tax system of Nepal is sound and efficient or not, the question asked was “Do you think that the remuneration tax system of Nepal is sound and efficient?” The responses received from the respondents are shown in table 6.7.

Table: 6.7

Opinion towards soundness and effectiveness of remuneration tax system

Response Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	2	4	23	46	25	50
Employees	5	10	20	40	25	50
Total	7	14	43	86	50	100

Source: Opinion Survey,2013

From the table 6.7, 86 % of the total respondents said that the remuneration tax system of Nepal is not sound and efficient. While 14 % of the total respondents agreed that the remuneration tax system of Nepal is sound and efficient. Thus, from the above result, we conclude that the remuneration tax system of Nepal is not sound and efficient. The remuneration tax system needs improvement.

6.8 Major problems against soundness and effectiveness of regarding remuneration tax system in Nepal

A supplementary question was asked, "If not, what are the major problems of remuneration tax system?" The opinions of respondents are presented in the table 6.8.

Table:6.8

Major Problems against soundness and effectiveness of remuneration tax system in Nepal

S.N.	Problems	Percentage	Rank
1.	Defective Tax rate	17	5
2.	It has high burden of tax on low income earners.	18	4
3.	Unfair & weak administration	22	1
4.	No provision of deducting any expenditure	19	3
5.	Complexity in income tax policy rules & regulation	21	2
6.	Other reasons	03	6
	Total		

Source: Opinion Survey,2013

From table 6.8, it is clear that the main problem of the remuneration tax system of Nepal is unfair and weak administration. The reason behind the problems of soundness and effectiveness of remuneration tax system are ranked below in order of preference.

1. Unfair and Weak administration
2. Complexity in income tax policy rules and regulation
3. No provision of deduction any expenditure
4. It is high burden of tax on low-level income earners
5. Defective tax rate.
6. Others

The respondents said that inappropriate exemption limit and unawareness of the public as other reasons.

6.9 Reasons for low contribution of remuneration tax to Income tax revenue of Nepal

To learn about the reasons behind the low contribution of remuneration tax to income tax revenue of Nepal, the question asked was “In your opinion, what are the reasons behind low contribution of remuneration tax to income tax revenue of Nepal?’ The responses from the respondents are summarized in table 6.9.

Table:6.9

Reasons for low contribution of remuneration tax to income tax revenue of Nepal

S.N.	Alternatives	Percentage	Rank
1.	Low pay scale of the employees	26	1
2.	Tax evasion	21	3
3.	Less number of employees having tax liability	14	5
4.	Ineffectiveness in the implementation of the act	23	2
5.	Others	16	4
	Total	100	

Source: Opinion Survey, 2013

From the table 6.9, it is obvious that the main reason behind the low contribution of remuneration tax to Income tax revenue of Nepal is low pay scale of the employees. The other reasons of the low contribution of remuneration tax are ranked below in order of preference.

1. Low pay scale of the employees
2. Ineffectiveness in the implementation of the act
3. Tax evasion
4. Others
5. Less number of employees having tax liability

In other reasons, most of the respondents said that the lack of proper reward and punishment system for the taxpayer, lack of rebate, concession, facilities to the taxpayers, incapability of the tax administration to find real taxpayers and increase in unemployment rate.

6.10)Things to do to increase the contribution of remuneration tax

To find out the factors that increase the share of remuneration tax to the income tax revenue of Nepal, the question was asked, “What reforms should be initiated to increase the share of remuneration tax in Nepal?” Table 6.10 shows the rank-wise summary of the responses.

Table:6.10

Things to do to increase the share of remuneration tax in income tax revenue

S.N.	Alternatives	Percentage	Rank
1.	Making tax deduction at source (TDS) effective	22	1
2.	Bringing new taxpayers into tax	21	3
3.	net	16	4
4.	Reduction in exemption limit	14	5
5.	Increasing tax rates	21	2
	Reform in the income tax policy,		
6.	rules and regulation	06	6
	Others		
	Total		

Source: Opinion Survey, 2013

From table 6.10, it is clear that the main factor that should be initiated to increase the share of remuneration tax in Nepal is making tax deduction at source (TDS) effective. The reforms to be initiated to increase the share of remuneration tax in Nepal are ranked in order of preference.

1. Making tax deduction at source (TDS) effective
2. Reform in the income tax policy, rules and regulation
3. Bringing new taxpayers into tax net
4. Reduction in exemption limit
5. Increasing tax rates

6. Others

Among other factors were making self-assessment of tax easier and reliable, provide various facilities to taxpayers and increasing pay scale of employees.

6.11 Contribution of income tax from remuneration tax to the public revenue

In order to know whether the contribution of income tax from remuneration tax to the public revenue is effective and satisfactory or not, a question was asked, “Do you think that contribution of income tax from remuneration tax to the public revenue is effective and satisfactory?” Respondents’ opinions are tabulated in table 6.11.

Table: 6.11

Opinion towards the contribution of income tax from remuneration to public revenue

Response / Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	22	44	3	6	25	50
Employees	20	40	5	10	25	50
Total	42	84	8	16	50	100

Source: Opinion Survey,2013

Table 6.11 depicts that about 84% of the total respondents agreed that contribution of remuneration tax to the public revenue is not effective and satisfactory. However, 16 % of them accepted that the contribution of remuneration tax to the public revenue is effective and satisfactory.

6.12 Provision of deduction of expenses from employment income

To know the views of respondents about the provision for deduction of expenses form employment income is suitable or not, a question was asked, “Income Tax Act,2058 has not made provision of deduction for expenses while computing remuneration income. Is this provision suitable?” The responses are tabulated in table 6.12.

Table: 6.12

Opinion towards provision of deduction of expenses from employment income

Response Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	15	30	10	20	25	50
Employees	16	32	9	18	25	50
Total	31	62	19	38	50	100

Source: Opinion Survey,2013

From table 6.12, it is evident that majority of the respondents, that is, 62% of the total respondents agreed that the provision of deduction of expenses is required while 38 % of the total respondents had an opposite view in this regard.

6.13) Provisions for deduction of expenses required from remuneration income

A supplementary question was asked to identify the reasons for the provision of deduction of expenses from remuneration income. The question asked was, "If not, what types of deduction would you expect to be provided?" Responden**ts'** opinions in this regard are given in table 6.13.

Table:6.13

Opinion towards the provisions for deduction of expenses required from remuneration income

S.N.	Alternatives	Percentage	Rank
1.	Medical expenses incurred for the treatment of the employee.	19	1
2.	Education expenses and books and reading materials purchased for the job.	15	3
3.	Transportation expenses to go to office and back.	17	2
4.	House rent paid	12	6
5.	Leave salary	13	4
6.	Amount received from life insurance	13	5
7.	Other expenses as of previous Act	11	7

Source: Opinion Survey, 2013

From table 6.13, it is clear that the main item for deduction is medical expenses incurred in the treatment of the employee. The different items of deductions suggested by respondents are ranked below in order of preference.

1. Medical expenses incurred for the treatment of the employee.
2. Transportation expenses to go to office and back.
3. Education expenses and books and reading materials purchased for the job.
4. Leave salary
5. Amount received from life insurance
6. House rent paid
7. Other expenses as of previous Act

6.14 Opinion towards the income tax evasion in Nepal

To know the views of respondents about the income tax evasion in Nepal, a question was asked," Do you believe that income tax evasion is being practiced in Nepal?" The responses to this question are tabulated in table 6.14.

Table: 6.14

Opinion towards income tax evasion in Nepal

Response Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	19	38	6	12	25	50
Employees	11	22	14	28	25	50
Total	30	60	20	40	50	100

Source: Opinion Survey,2013

From table 6.14, it is clear that about 60% of the respondent accepted that the income tax evasion being practiced in Nepal. Remaining 40% denied it.

6.15 Opinions towards the reasons to increase the tax paying habit of Nepalese people

In order to know about the appropriate method to increase the tax paying habit of Nepalese people, a question was asked, "How can the government we increase the tax paying habit of Nepalese people?" The responses are tabulated in table 6.15.

Table:6.15

Reasons to increase the tax paying habit

S.N.	Alternatives	Percentage	Rank
1.	Education taxpayers	20	3
2.	Simplifying tax laws	25	1
3.	Fines and penalties	15	5
4.	Timely assessment of tax	17	4
5.	Incentives to regular tax payers	23	2
	Total	100	

Source: Opinion Survey, 2013

From table 6.15, it is clear that the main method to encourage the tax paying habit of Nepalese people is by simplifying laws. The different reasons suggested by respondents are ranked below in order of preference.

1. Simplifying tax laws
2. Incentives to regular tax payers
3. Education taxpayers
4. Timely assessment of tax
5. Fines and penalties

6.16 Opinions towards making some taxable income tax exempted

To know the respondents' opinion towards tax exemption for admissible income, the question asked was "What types of income heads included in remuneration tax would you expect to be made tax- exempted?" The responses received from the respondents are shown in table 6.16.

Table:6.16

Opinion towards some taxable income to be made tax-exempted

S.N.	Alternatives	Percentage	Rank
1.	Remote are allowance	21	3
2.	Dashain allowances	19	4
3.	Pension Income	23	2
4.	Medical expenses paid by the employer	24	1
5.	Others	13	5
	Total		

Source: Opinion Survey, 2013

From the table 6.16, we find that the most important head of income to be made tax exempted is medical expenses paid by the employer. While ranking together the opinions of both the groups, the corresponding prioritized reasons for making some taxable incomes tax-exempted are as follows.

1. Medical expenses paid by the employer
2. Pension Income
3. Remote are allowance
4. Dashain allowances
5. Others

6.17 Opinions towards the tax on pension income

To know the view of respondents' opinions towards the tax on pension income received by retired employees, a question was asked, "Do you think that that tax on pension income should be levied?" The responses received from the respondents are tabulated in table 6.17.

Table: 6.17

Opinion towards tax on pension income

Response / Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax Experts	15	30	10	20	25	50
Employees	0	0	25	50	25	50
Total	15	30	35	70	50	100

Source: Opinion Survey,2013

Table 6.17 shows that about 30% of the total respondents opined that the tax on pension income should be levied. However 70% of them denied taxation on pension income. Thus, majority of the respondents are not in favor of taxing pension income.

6.18 Problems faced by employees while paying remuneration tax

Regarding the problems faced by employees while paying remuneration tax, respondents were asked "What types of problems that the tax payers face while paying remuneration tax?" The responses received from the respondents are listed in table 6.18.

Table:6.18

Opinion towards problems faced by employees while paying remuneration tax

S.N.	Problems	Percentage	Rank
1.	Hesitation to pay income tax due to low income	15	5
2.	Weak and immature treatment by tax	15	4
3.	administration	20	1
4.	Procedural complications	19	2
	Tax personnel discourage giving tax clearance		
5.	certificate	18	3
	Due to lack of taxation knowledge, employees do		
6.	not know how to file returns.	13	6
	Others		
	Total		

Source: Opinion Survey, 2013

From table 6.18, we find that the most important problem faced by employees while paying remuneration tax is procedural complications. While ranking together the opinions of the respondents, the problems are listed below in the order of urgency.

1. Procedural complications
2. Tax personnel discourage giving tax clearance certificate
3. Due to lack of taxation knowledge, employees do not know how to file returns.
4. Weak and immature treatment by tax administration
5. Hesitation to pay income tax due to low income
6. Others

CHAPTER

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Summary and Conclusion

The ultimate goal of the underdeveloped countries like Nepal is to achieve the economic development and ensure the rapid rate of economic growth. It calls for a huge amount of investment in economic overheads and other development activities for which taxation is undoubtedly a primary source of in-land revenue for the government. Taxation may be considered as a basic tool in the path of economic development for the underdeveloped countries.Recently, developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy, efficient and self sufficient to a larger extent.

The review of Nepalese tax reform and policy reveals that GoN focused on more restrictive and protective policies to meet the basic needs of the people including other goals viz. revenue generation, maintaining equity, growth and stabilization of the economy before the restoration of democracy in 1990. However, these policies have been replaced by a more liberal, open and market oriented policies based on the distinct feature of globalization, liberalization and privatization after the restoration of democracy in 1990. Now the emphasis is on broadening the tax base, rationalizing the rate and structure and improving the tax administration.

In Nepal, a large part of revenue is spent on regular expenditure leaving a small amount for development expenditure. This situation has become even more critical in recent years. Non-tax revenue cannot be used as an effective tool of revenue mobilization. Attempts must be made to mobilize more tax revenue through the reform of the tax system.

In this context, Government revenue comprises of different taxes such as customs, excise, sales tax (VAT), income tax, land registration, miscellaneous taxes and non-tax revenues. Of all taxes, tax on consumption of goods and services has the highest contribution to the total revenue of Nepal. The custom duties occupy the second place among the tax revenue. Income tax is one of the most important resources of the government revenue and it is considered as a good remedy to cure growing and serious resources gap problems of Nepal. Contribution of income tax in total tax revenue has significantly increased in recent years.

Furthermore, Income tax from remuneration has insignificant contribution in total revenue of Nepal. In FY 1993/94, its share on total revenue was only 0.60 percent. However, its share on total revenue has increasing trend. This has increased to 2.23 percent in FY 2002/03.Similarly, it increased to 4.76 percent in FY 2011/12. In this context, both tax experts as well as employees have recognized it as an important source of collecting government revenue.

This study has made an attempt to find the prospects and problems of remuneration tax in Nepal.This study is based on both secondary and primary data. With the aid of secondary information from different sources, trends on various aspects of remuneration tax have been analyzed for the period FY 2002/03 to FY 2011/12. Based on secondary information, the contribution of remuneration income tax to public revenue,contributions of income tax and remuneration tax to total revenue have been analyzed. While to find out theproblems associated with collection and mobilization of remuneration income tax primary information, a set of questionnaire was developed and administeredto 60 respondents, which comprised government officials working at different departments and employees working in private sector. It was then analyzed. 50 out of 60 people responded. Out of the 50 respondents, 25 were tax administrators and the rest were employees on different sectors. The major findings of this study have been put at the later part of this chapter.

Total Income tax has increased significantly during the study period. In general, it has an increasing trend except for FY 2003/04. In addition, income tax contribution of individuals has occupied the first position in total income tax revenue of Nepal. Similarly, income tax from public enterprises and private enterprises occupy the second and the third positions respectively. Income tax from remuneration has occupied the fourth position. Tax on interest has occupied the fifth position in total income tax revenue

To sum up, the effectiveness of tax system depends on the existing management and leadership. A vigilant and transparent tax administration is necessary for the effective implementation of tax policies in a country. Timely review of policy is a pre-requisite for sustaining the gains in revenue front. Tax payers should always be kept at high priority while providing them the essential and sincere support from the tax officials. Also the fiscal policies should remain consistent with other policies of the government. Regarding remuneration tax, its share in total tax revenue can be increased by generating more employment opportunities in different sectors of the economy while bringing those who are not in tax net into it through proper policies.

Recommendations

On the basis of above study, the following recommendations have been made regarding remuneration tax in Nepal:

- There is high portion of indirect tax revenue as compared to direct tax revenue. However, for economy development, it is necessary to increase the share of direct tax in total revenue. Direct tax plays more significant role in economic development as compared to indirect tax. Resource mobilization through direct taxation should be focused.
- Out of the total tax revenue, the contribution of income tax revenue is very low. So, to increase the contribution of income tax in the public revenue, government should focus on various tax- incentive programs through sound tax planning.
- Income tax from remuneration has been very low in total revenue. So it should be increased. However, the contribution of remuneration tax in income tax revenue has been increasing in recent years as compared to previous years. It is recommended that the income tax slabs should be re-adjusted in such a way that high income earners should be made to pay higher taxes.
- Income Tax Act, 2002 is vague in its nature on various aspects. So it should be made effective in implementation aspect. Also, it should be amended on unclear provisions and they should be clarified. Employees should be provided

with taxation knowledge, so that, they will be aware of the existing provisions in force of the income tax act regarding remuneration taxation.

- The Income Tax Act 2002 has no provision of deduction of any expenses while calculation remuneration income. The provision for deduction of expenses should be provided from employment income as on previous Income Tax Act 2031. Medical expenses, expenses incurred to newspapers and magazines, transportation expenses to go to office and come back home, house rent paid by the employees, education expenses etc should be allowed for deduction.
- Dashain allowance, medical expenses paid by employer, remote area allowances, contribution to provident fund by the employer, life insurance premium paid by employer, leave encashment etc should be tax exempted so that employees will be relieved from heavy income tax burden imposed on them.
- There are various types of problems that the employees (tax payer) faced while paying remuneration tax. The problems faced by them should be minimized. Tax administrators should be made more responsible. Procedure should be simplified. Tax clearance certificate should be provided to the tax payer. Refund of tax should be made without delay. Unclear and cumbersome provisions of the tax act should be simplified and made understandable to all.
- Employees should be provided with tax knowledge such that they would feel their contribution to the nation by paying the tax.
- The collection and tax assessment provision should be made clear and simple so that taxpayers are encouraged to pay income tax.
- The provision of fines, penalties and punishment should be implemented effectively against income tax evaders.
- Proper co-ordination between tax policy maker, tax personnel and other departments should be established.
- Tax base should be enlarged by bringing informal sectors like home tutoring, private medical services etc into tax net.

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Appendix:A

Questionnaires

Name of the Respondents:

Name of the organization:

Department:

Position:

Tenure of Service:

In your opinion, Is Remuneration tax contributing significantly to the income tax revenue of Nepal?

a) Yes b) No

In your opinion, is the remuneration tax a suitable mean of collecting public revenue?

a) Yes b) No

If yes, why?

a. It is transparent
b. As compared to other taxes, there is less chance of tax evasion
c. It is based on progressive taxation
d. Others

If not, why ?

Is the current exemption limit suitable?

a) Yes b) No

If not, how much amount would you suggest for the exemption limit?

a) For Single Rs…………………… b) For Couple/Married Rs……………………

Do you think that the exemption limit for senior and disabled citizen should be more than that of other citizens?

a) Yes b) No

Do you think that the remuneration tax system of Nepal is sound and efficient?

a) Yes b) No

If no, what are the major problems of remuneration tax system?

a. Defective Tax rate
b. There is high burden of tax on low income earners
c. Unfair and Weak Administration
d. No provision of deducting any expenditure
e. Complexity in income tax policy rules and regulation

In your opinion, what are the reasons behind low contribution of remuneration tax to Income tax Revenue of Nepal?

a. Low pay scale of the employees
b. Tax evasion
c. Less number of employees having tax liabilities
d. Ineffectiveness in the implementation of the act
e. Others

What reforms should be initiated to increase the contribution of remuneration tax in Nepal?

a. Making tax deduction at source (TDS) effective
b. Bringing new taxpayers into tax net
c. Reduction in exemption limit
d. Increasing tax rates
e. Improve the income tax policy, rules and regulation
f. Others

Do you think that contribution of income tax from remuneration tax to public revenue is efficient and satisfactory?

a) Yes b) No

Income Tax Act, 2058 has not made a provision of deduction for expenses while computing remuneration income, Is this provision suitable?

a) Yes b) No

If not, what types of deductions would you expect to be provided?

a. Medical expenses incurred for the treatment of the employee.
b. Education expenses and reading materials purchased for the job
c. Transportation expenses to go to office and come back home
d. House rent paid
e. Leave Salary
f. Amount received from life insurance
g. Other expenses as of previous Acts.

Do you believe that income tax evasion is being practiced in Nepal?

a) Yes b) No

How can we increase the tax paying habit of Nepalese people?

a. Educating taxpayers
b. Simplifying tax laws
c. Penalties and fines
d. Timely assessment of tax
e. Incentives to regular taxpayers

What types of income heads included in remuneration tax would you expect to be made tax-exempted?

a. Remote area allowance
b. Dashain allowances
c. Pension income
d. Medical expenses paid by the employer
e. Others

Do you think that the income tax on pension income should be levied?

a) Yes b) No

What types of problems that the employees faced while paying remuneration tax?

a. Hesitation to pay income tax due to low income
b. Weak and Immature treatment by tax administration
c. Procedural complications
d. Tas personnel discourage getting tax clearance certificate
e. Due to lack of tax- knowledge to file tax returns
f. Others

Do you have any suggestion to increase the tax revenue from remuneration tax? Please specify.

Appendix:B **Summary Tables**

Table: A

Fiscal Year	Percentage of Tax Revenue				
	Direct Tax	Indirect Tax	Income Tax	PITR	Remuneration Tax
2002/03	26.61	73.39	25.12	9.68	1.46
2003/04	24.73	75.27	21.20	10.22	2.89
2004/05	24.16	75.84	20.83	10.35	3.10
2005/06	24.32	75.68	20.52	10.44	3.07
2006/07	26.69	73.31	25.52	10.18	2.82
2007/08	27.11	72.89	23.66	10.37	2.88
2008/09	29.32	70.68	25.46	11.17	2.73
2009/10	25.28	74.72	21.64	9.89	2.82
2010/11	26.36	73.64	24.34	11.28	3.39
2011/12	27.29	72.71	24.97	10.56	4.76

Table:B

Fiscal Year	Percentage of GDP					
	Tax Revenue	Direct Tax	Indirect	ITR	PITR	Remuneration
2002/03	8.88	2.36	6.52	2.23	0.73	0.13
2003/04	9.62	2.38	7.24	2.04	0.71	0.28
2004/05	9.86	2.38	7.48	2.05	0.72	0.31
2005/06	9.40	2.29	7.11	1.93	0.69	0.29
2006/07	10.52	2.81	7.71	2.47	0.77	0.30
2007/08	11.28	3.06	8.22	2.67	0.84	0.32
2008/09	12.87	3.77	9.10	3.28	1.09	0.35
2009/10	14.42	3.85	10.57	3.35	1.02	0.41
2010/11	13.75	3.87	9.88	3.59	1.08	0.47
2011/12	15.16	4.14	11.02	3.79	0.99	0.72