INCOME TAX AND ITS CONTRIBUTION TO THE NATIONAL REVENUE OF NEPAL

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RECOMMENDATION

This is to certify that the thesis

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Entitled:

INCOME TAX AND ITS CONTRIBUTION TO THE NATIONAL REVENUE OF NEPAL

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

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VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis

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And found thesis to be original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for **Master Degree in Business Studies (MBS)**

Viva-Voce Committee

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Member (Thesis Supervisor) …………………………….

Member (External Expert) …………………………….

DECLARATION

I hereby declare that the work reported in this thesis entitled **"Income Tax and its Contribution to the National Revenue of Nepal "** submitted to Shanker Dev Campus, faculty of management, Tribhuvan University is my original research work done in the form of partial fulfillment for the requirement of Master of Business Studies (MBS) under the supervision and guidance of **Mr. Joginder Goet,** lecture of Shanker Dev Campus.

……………………………………

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This thesis is prepared as dissertation for the partial fulfillment of the requirements for the master degree course in management. It has been tried to cover empirical findings concerning tax in the context of Nepal. This study is mainly concerned with and analysis of contribution of income tax in national revenue collection of Nepal.

First of all, I like to express my sincere gratitude to my thesis supervisor respected sir Joginder Goet of Shanker Dev Campus, T.U. for their generous encouragement, proper guidance, timely comments and suggestions and undertaking of the supervision of my entire research work. I would also like to extend my sincere gratitude to all my respected teachers, all administrative staff, and library staffs of Shanker Dev Campus for providing valuable suggestions, information and comments.

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Effort has been made to avoid all type of errors and mistake. I am sorry for the unknown mistake that I made in this research work.

Prabin Kumar Adhikari

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LIST OF ABBREVIATION

ADB	-	Agricultural Development Bank
&	-	And
B.S.	-	Bikram Sambat
CEDA	-	Center for Economic Development and Administration
DCs	-	Developed Countries
Etc.	-	and the others
GAAP	-	General Accepted Accounting Principle
GDP	-	Gross Domestic Product
GNP	-	Gross National Product
IMF	-	International Monetary Fund
IRD	-	Inland Revenue Department
Ltd.	-	Limited
MBS	-	Master in Business Studies
MOF	-	Ministry of Finance
No.	-	Number
Pvt.	-	Private
Rs.	-	Rupees
S.N.	-	Serial Number
SAARC	-	South Asian Association for Regional Co-operation
T.U.	-	Tribhuwan University
UDCs	-	Undeveloped Countries
UK	-	United Kingdom
UN	-	United Nations
US	-	United States
VAT	-	Value Added Tax
VDC	-	Village Development Committee

CHAPTER-1
INTRODUCTION

1.1 Background of the study:

Nepal is a sovereign and independent kingdom located on the southern part of Asia continent. Nepal is landlocked country covering an area of 147,181 sq. km., which covers 0.03% of world and 0.3% of Asian Area. Majority of the population are depending upon agriculture. Therefore, Nepalese economy is an agro-based developing economy. Agricultural sector provides employment majority of the total population. So Nepal has predominantly agriculture based economy. The major portion of population of Nepal is village area and most of them live below the poverty line. Wide spread poverty, rapid population growth, low income level, extreme disparity in the distribution of wealth and income, heavy dependence on agriculture, lack of adequate industries, lack of needed saving and capital, dependence on foreign aid, unemployment, unexploited resources, lack of infrastructure, adverse balance etc. are the main characteristics of Nepalese economy and it shows poor performance of economy.

Europe, America, Japan are the three giant economic blocks of the world creating huge amount of surplus that ultimately enhances the per capita income of the people. Rests of the economies strive for the access to these economic blocks. Most of the third world countries are lagging behind in the path of economic development. Such countries are characterized by rampant corruption, widening poverty, increasing budget deficit, low rate of capital saving, ever widening resource gap, unemployment, lack of resources, agrarian economy, dependency on donors and like others. All the things, mentioned above sentences, features impede the process of economic development. Specially, the budget deficit creates resource gap. Governments are in a dire need of fiscal policies for solving the unabated problem of mass poverty. Government does have some alternatives to overcome this problem. Government can whether cut down expenditure go for the high in revenue. Cutting down regular expenditure requires downsizing which faces obstacles in the process of its implementation. Procrastination of development projects due to the lack of fund is no excuse from the socio economic point of view. Boost in government revenue is the best alternatives in meeting the development objectives. Foreign loan can bridge resource gap but it is not panacea of all difficulties. Debt financing entangles in a long term debt payment schedule. Whether it is financed from internal or external sources, by non inflationary or inflationary means, the accumulation of capital in any developing economy requires the mobilization of an economic surplus.

Accomplishment of Millennium Development Goals (MDG) promulgated by the United Nations deserves the combined effort of all the nations developed as well as the developing world. Poverty is the ultimate concern of economics and economists. Alleviation of the mass poverty that still prevails in most countries has become a worldwide campaign in which virtually every nation rich or poor is involved. Redistribution of public spending is an essential requirement for poverty reduction. Public is a non negligible instrument of policy in developing countries. Vicious circle in developing countries can be broken through capital formation for which fiscal policy can be adopted as a crucial tool for the promotion of the highest possible rate of capital formation. Fiscal policy is a powerful instrument of stabilization [Jhingan, 2000:646]. In the absence of well organized and locally controlled money markets, most developing countries have had to rely primarily on fiscal measures to mobilize domestics' resources. Revenue mobilization is amplified through the application of fiscal policy measures.

Now days, prime concern of every nation is rapid and sustainable economic development and Nepal are also no exception to this continuous process. Nepal aims for self-reliant economic system to upgrade its living standard and prosperity of people. Thus a lot of money has to be spent to achieve maximum national objectives. "The constitution of Nepal 2047" has clearly directed Nepalese government for a self-reliant economic system, encouragement to national enterprise, prevention of economic exploitation as well as upgrading the standard of the people. For self-reliant, rapid and sustain economic system, sound infrastructure for the development, the government should generate sufficient government revenue. Government revenue is the most important sources of financing government expenditure and investment. To achieve the national objectives, the government is required to make and implement various planning, policies, acts and procedures. Revenue mobilization is one of the most important functions of the government. The income of the government is called public revenue. In order to meet the public expenditure, the government has to raise fund through external and internal sources. The internal sources of fund of government are income tax, VAT(value added tax), custom duty, property tax, fees, royalty, fines and penalty etc and the main external sources of government are foreign aid, grants, borrowing and loan. External sources of fund are uncertain, inconvenient and not good for healthy development of nation most of they are loan and have to pay after certain time will with expensive interest. There is always better to mobilize internal sources rather than external sources. The sources of internal revenue are tax and non tax revenue.

Taxes are broadly divided into two categories. They are direct and indirect tax. If a person must have to pay directly the tax liability to the government, such tax is known as direct tax. According to Dr. Dalton 'a direct tax is really paid by the person on whom legally imposed.' Tax liability of direct tax cannot be transferred to other and must be paid by taxpayer who is legally levied. The impact of direct tax is limited within the taxpayer who is liable to pay such tax. Income tax, gift tax, interest tax, property tax, vehicle tax, house and land tax, inheritance tax, contract tax, death tax etc are the typical example of direct tax. The government collects and realized such taxes directly from taxpayers. In Nepal direct taxes contribute about 21% in the tax revenue of the government. Equitable, certainty, elasticity, economy, public awareness etc. are the main merits of direct tax and economic burden, possibility of tax evasion, lack of mass participation, discourages saving and investment, inconvenience etc. are the demerits of direct tax. Indirect tax is the tax that is collected from other person by transferring the tax liability. According to Dr. Dalton, 'an indirect tax is imposed on one person but paid partly or wholly by another'. It is levied on one person who does not bear it from his\her own income. Instead, the tax liability is transferred by collecting it from customers by adding it to the price of goods or services. Thus, government indirectly collects such taxes from the general public. Sales tax (turnover tax), entertainment tax, excise duty, customs duty, value added tax, hotel taxes, passenger tax etc. are the typical example of indirect tax. In Nepal indirect tax contribute about 79% in the tax revenue of the government. Convenient, mass participation, elasticity, less chance of tax evasion, control in consumption etc. are the main merits and uncertainty, inequitable, bad effect, lack of awareness consumer exploitation etc. are the main demerits of indirect tax.

Income tax is a direct tax that is imposed on the earning of individual and corporation. The underlying reason for the imposition of income tax is to generate more revenue to finance development activities and to help in achieving social justice. Income tax should be justifiable to achieve maximum social and economic objectives. It helps in redistribution of economic means by the transformation wealth from person with higher economic level to lower economic level. It should minimize gap between haves and haves not. Regional economic imbalances may also reduced by providing incentives and concession in income tax for promoting industries in backward areas. It has become an effective instrument ensure balanced socio economic growth.

The objectives of sound financial position creation of unexploited society cannot be achieved until the mobilization of economic resources effectively operated through direct tax like income tax. Taxes on income and revenue are the most important single source for governments of developed and developing countries, because they have the potential for increasing the yield of the tax system and achieving a system of taxation that satisfies the demand for equity and social justice.

Income tax is based in the cannon of equity and it may be levied on the individuals as well as entity. It is imposed on the basis of income level and paying capacity of taxpayers. It will reduce the gap in income distribution by imposing higher rate to those who are having higher income and from that collected amount, providing necessary assistance to the people with very poor economic condition.

1.2 Focus of the Study:

Most of the developed countries like USA, UK, Japan, and Italy etc are able to collect major portion of their revenue through income tax but developing countries like Nepal still have been unable to collect adequate revenue from income tax. Share of income tax to the revenue structure is very low in comparison to other countries. There are many components related to the study of income tax. This study is focused on contribution of income tax in the government revenue and on analyzing the problem behind its facts and finding measures to overcome the problems associated with income tax systems as to raise its contributions towards public revenue.

1.3 Statement of the problem:

Income tax is the main source of government revenue. For the development of nation, every government needs high revenue. The economy of a country flourishes with the flourish of government revenue and collection of income tax and it deteriorates with unsatisfactory performance of government function in the country. Therefore periodical review and analysis of income tax in the country very essential. Performance of income tax is very constructive for all stakeholders closely attached with the government revenue as well as for a prosperous economic future of the country. Generation income by any individual or institution is the main sources of the income tax. If income is favorable then collection of income tax is also favorable. Lower contribution of income tax in government revenue negatively affects the country's development. The variation of income tax contribution brings the variation of government revenue and government development function. Country's economic development and government revenue are the closely related parts. For higher revenue, economic development is necessary and for better economic development of a country, high government revenue is necessary.

Nepal is landlocked country. The trend of collection of income tax is not satisfactory. As maintained above, sustainable economic development and good political environment is necessary for the growth of the income. Income is source of income tax. Currently, political situation of Nepal is not good. From one decade it's being worse. Here is no good environment for income generating functions. Previously running organization also can't perform better. They are going downwards. Individual's income is also not a good increasing trend. It affects directly income tax and government revenue as well as government activities. The data of income tax may suffer a lot in lack of proper view and analysis practice of it. Currently, contribution of income tax in government revenue of Nepal may not be sufficient for development of the nation. During the analysis period of the data of income tax collection remained below the expected level due to various national and international reasons. Therefore, this research study is concentrated on trend of income tax collection, to review and analysis the contribution in government revenue and to draw recommendation for coming period.

For the economic development of the country, contribution of direct tax is more essential rather then indirect tax. But the main tax structure of Nepal is dominated by indirect tax. Among the direct tax, income tax plays significant role, but it is unpleasure to quote that the contribution of income tax to national revenue is very low in Nepal. To increase its contribution to national revenue, many research and analysis should be conducted in the field of income tax, but the studies and research work is lacking in the area of income tax. So to identify the problem and to overcome them and to improve income taxation, study in the field if income tax is essential. To raise government revenue there is necessary to raise its internal resources of revenue. An internal resource of revenue includes tax and non-tax revenue. Government implemented self assessment system to strengthen the revenue structure of Nepal. However, there is higher tendency of income tax evasion and delinquency. To increase its contribution to national revenue, research and analysis should be done in the field of income tax. So, to identify the problems and to overcome them and to improve income taxation, study in the field of income tax is essential.

This study has attempted to highlight the real condition and contribution of income tax in the government revenue of Nepal. Specially, this study can answer the following research questions:

- What is the proportion of income tax in government revenue?
- What is the trend of income tax collection?
- How much is the difference in estimation and actual collection of income tax in Nepal?
- What is the structure of income tax in Nepal?

1.4 Objective of the study:

The objectives of this study is to analyze the effect/impact of income tax evasion on government revenue of Nepal and give appropriate suggestion and information to improve the tax system so that the government can collect more than more revenue and use it in the way of economic development of the country. General objective of the study is to analyze the contribution of income tax in government revenue of Nepal. Main objectives of this study are as follows:

- To analysis the contribution of direct tax and indirect tax in the total revenue.
- To analyze and view the structure of government revenue and position of income tax.
- To know the differences between estimates and actual collection of income tax.
- To provide appropriate suggestions and recommendations.

1.5 Significance of the study:

In Nepal the relation of tax with gross domestic product (GDP) and gross national product (GNP) are the lowest among SAARC countries and among the world as well. It indicates the poor performance of income tax contribution and its management. There are many institutions and individuals that may contribute for government revenue through income tax. But their ability and willingness is not good. The proportion of income tax in government revenue is not appropriate. The trend of income tax collection also is not sustainable and satisfactory. Many income tax acts and rules were implemented and some of them are active at present. But they are not properly implemented. Tax policies, administrative bottlenecks, mass poverty, negative view of taxpayers etc. are the main problems for income tax collection.

This study aims to find out the effectiveness of income tax collection and contribution of it in the government total revenue. The area of this study will be helpful to the all who are interested towards tax system in Nepal.

1.6 Limitation of the study:

The study on “income tax and its contribution in the national revenue” is not free from limitations such as:

- Mostly secondary data and information are analyzed.
- The area of income tax is very wide; so all the part of it may not be covered.
- This study has been limited by the non-availability of the data.
- Reliability of the secondary data has not been tested.
- Tax planning and tax avoidance are not taken in to consideration in this study.

Being a student, different types of resources constraint are another important factor, which has limited the scope of the study.

1.7 Organization of the study:

This study has been divided into five chapters, which are:

Chapter I: Introduction

This chapter is about introduction, which includes general background, statement of the problems, objective of the study, significance of the study limitation of the study and organization of the study.

Chapter II: Review of literature

This chapter includes two parts. The first one is about the conceptual framework and legal provision regarding income tax. It includes concept, origin and development of income tax in Nepal. This chapter is also about review of literature. For this, review and study of past work, related available books, related articles, reports etc have been presented.

Chapter III: Research methodology

This chapter includes types of research, research design, nature and sources of data, data collection procedure and data processing and analysis procedures and methods.

Chapter IV: Presentation and analysis of data

This is the main body of research, which covers presentation and analysis. This chapter basically includes structure of public revenue in Nepal, tax and non tax revenue of Nepal, resource gap in Nepal, ratio with GDP and GNP of tax in Nepal, contribution of income tax in the government revenue and GDP, estimate and actual collection of income tax in Nepal and major findings of this study.

Chapter V: Summary, Conclusions and Recommendations

This is the last chapter, which includes summary, conclusions and recommendations for related and interested bodies.

Besides these, proper arrangement of bibliography at the end of thesis.

CHAPTER-2

REVIEW OF LITERATURE

2.1 Historical Perspective and legal provisions of income tax:

2.1.1 Concept of tax:

Every government needs fund to run properly. Money is like a blood circulation in the body for every nation. The resources of fund of government revenue can be divided into two parts – tax revenue and non tax revenue. The government of any country requires sufficient revenues to launch the development programme, to handle the daily administration, to keep peace and security and to launch other public welfare programme. The government collects revenue from various sources. These sources can be: i) taxes ii) revenue from government corporation and public enterprises iii) fees iv) special assessment v) fine and penalties and vi) foreign grants and loan. Income tax is one of the most important sources of national revenue for every government, whether it is developed or developing countries. In Nepal, nearly by 77 percent of total revenue comes from tax revenues and the rest 23 percent from non tax revenue.

Great Britain is the first country to introduce income tax in the world. The British government introduced income tax in 1799 in order to generate revenues to finance the war against France. The Great Britain imposed the income tax regularly from 1860. Income tax is introduced in Switzerland in 1840, Austria in 1849, India in 1860, USA in 1862, Italy in 1864 and Nepal on 1959.

Implementation of income tax in Nepal is not so long history. Even, before 1951, the government of Nepal did not have any plan and policies for the development of the country. Because of the family and autocratic rule of the Rana, income source and expenditure project of government is not made public. The idea of introducing income tax in Nepal originated along with the first Budget on 21st Magh 2008 B.S. (1952). The finance minister in the first budget speech said ‘a proposal to levy an income tax including tax ohm agriculture is under consideration.’ Several attempts were made to introduce income tax in subsequent years. However, it could not be introduced until 2016 due to political instability. For the first time, the finance act 2016(1959) had imposed tax on business profit and remuneration in Nepal. In Nepal, after the democracy of 2007 B.S., deliberate planning process began only after 2013 B.S. and huge amount of revenue is required for the process of economic development, a lot of capital is needed.

Tax is a compulsory payment to the government from a person or an entity according to law. It is contributed to the government without expectation of direct benefit to tax payer. The government mobilizes these taxes for public interest. There is no universal definition of tax. For the best concept of it, some definition can be quoted:

A tax is a compulsory contribution from person to the government to defray the expenses incurred in the common interest of all without reference to special benefit (Amatya, et al., 2004:3).

A tax is a compulsory payment to the government without expectation of direct benefit in return to the taxpayer (Amatya, et al., 2004:3).

A tax is a compulsory contribution of wealth of person or body of persons for the service of public powers (Amatya, et al., 2004:3).

“Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefit upon the resident of the states.” (Dhakal, 2001:2)

From the above definitions, it can be said that:

- A tax is a compulsory contribution to the state from a person or corporate.
- The tax payers do not receive the equivalent benefit from the government.
- There is no discrimination among the taxpayers other then specified by the lax.
- Tax is paid to the state to perform the functions of the government.
- The amount of tax is spent for common benefits and interest for people. etc.

Tax revenue constitutes direct tax and indirect tax revenue. According to Dr. Dalton, “An indirect tax is imposed on one person but paid partly or wholly by another.” It is levied on one person who does not bear it from his\her own income. The tax liability is transferred by collecting it from customers by adding it to the price of goods or services. The government indirectly collects such taxes from the general public. The examples of indirect tax are customs tariff, excise duty, sales tax, value added tax, entertainment tax, hotel tax, passenger tax etc. in Nepal; indirect tax contribute about 79% in the tax revenue of the government. Indirect tax is more flexible than other. There is uncertainty about the collection of indirect tax. Every person either rich or poor pays equal amount of tax on the use of goods or services. Convenient, mass participation, elasticity, less chances of tax evasion, control in consumption etc. are the main merits of indirect tax and uncertainty, inequitable, bad effect, lack of awareness, consumer exploitation etc. are the main demerits of indirect tax.

On the other hand, according to Dr. Dalton, “Direct tax is really paid by the same person on whom it is legally imposed.” Taxpayer cannot collect direct tax form other person. The impact of direct tax is limited within the taxpayer who is liable to pay such tax. Income tax, gift tax, interest tax, property tax, vehicle tax, house and land tax, contract tax, death tax etc. are the example of direct tax. The government collects and realizes such taxes directly from the taxpayers. In Nepal direct taxes contribute about 21% in the tax revenue of the government. Equitable, certainty, elasticity, economy, public awareness etc. are the main merits of direct tax and economic burden, possibility of tax evasion, lack of mass participation, discourage saving and investment, inconvenience etc. are the main demerits of direct tax.

Income tax is a direct tax. In Nepal, income tax is the major source of direct tax revenue.

2.1.2 Concept and definition of income tax:

To know the term ‘income tax’, it is to know the term ‘income’ and ‘tax’ separately. According to Henry Simons, “Income as economic gains received by the person during the particular period.” It includes the person’s consumption during a particular period of time as well as the net increase in the individual’s personal wealth during the same period of time. Symbolically, he describes as follows:

$Y = C + \Delta W$

Where,

Y, C and Δ W refer personal income, consumption and net changes in personal wealth, respectively.

The term ‘tax’ refers a compulsory contribution from income holder to the government. “Taxation is the compulsory contribution from a person to the government to defray expenses occurred in the common interest of all without reference to special benefit conferred” (Dhakal, 2001:2).

In this way, income tax, as the single word itself refers to a tax levied on income. In a broader sense, income tax is a levy based upon the production or receipts or gain of the taxpayers within a definite period of time. From the beginning, income tax has been always regarded as a tax based on the cannon of ability. The tax could be adjusted as to exempt the lowest income groups from the operation of the tax and make the richer groups bear the burden of the tax according to their income. Apart from such considerations as revenue productivity, income tax has been regarded as the ideal tax from the point of view of equity (Andly, 1964:213).

An income tax is imposed upon the incomes of an individual after the exemption limit. Only the taxable income is object to tax, otherwise, the objectives and principles of taxation will not be fulfilled. Income tax is imposed upon excessive income over limit. All income above the tax exemption level is subjected to income tax that is based on the income tax acts of the concern country. Different countries may have different concepts on income tax. For example, sec 2 of the Indian tax act, 1961, keeps profits and gains, dividend, voluntary contributions received by charitable trust, value of any perquisite or profit on lieu of salary, any capital gain, winning from lotteries, cross word puzzles etc. are under the head of income for tax.

In Nepal, according to income tax act 2002, section 2(h), “Income means a person’s income from any employment, business or investment and the total of that income as calculated in accordance with this act and tax imposed under this act is known as income tax.”

2.1.3 Development of Income taxation in Nepal:

Tax has been one of the major sources of government revenue from the ancient time in Nepal. But reliable records about taxation in ancient and medieval Nepal are not available. At that time, tax on agriculture income is called ‘Bhaga’ and tax on business income is called ‘kara’. At that time the government could not collect huge amount of money in the form of taxation and taxes were levied to the merchant, travelers and farmers of cash, kind or labor. In some occasion, gold and agricultural products were also paid as taxes but the nature of these taxes were temporary and taxes were raised for special purpose.

During the period of 1763-1846 A.D., taxation had a broad sense in Nepal and different types of taxes were levied to generate maximum revenue. During 1864-1950 A.D., the period of Ranas, there was no formal provision for taxation. Under the family rule of Ranas, for all practical purpose, there was no difference between the personal income of the Prime Minister and government fund. The main sources of the revenue in Nepal were land tax, Custom tax and Excise duties in the form of lump sum contracts, royalties on forest, royalty’s supply of porters and soldiers, entertainment tax and few other minor taxes.

There was no direct tax in Nepal except Land tax collected on a contractual basis and ‘Salami’ which the government employees used to pay out of their salary at a very small percentage (Poudel & Timalsina, 1990:10).

After the introduction of Democracy (2007 B.S0 in Nepal, the role of government changed. Since then the government was enforced to implement development activities.

A sound and efficient income tax system is necessary to maximize the revenue collection from income tax. Whole income tax system is made of three-sub system: Income tax policy, Income tax laws and income tax administration.

The history of modern income tax in Nepal is not very long. The idea of introducing income tax in Nepal originated along with the first ‘Budget’ on 21st Magh 2008 B.S, (1952). Then finance minister in the first budget speech said ‘A proposal to levy an income tax on agricultural income is under consideration.’ Several attempts were made to introduce income tax in subsequent years. However, it could not be introduced until 2016 B.S. due to political instability. For the first time, the Finance Act 2016(1959) had imposed tax on business profit and remuneration in Nepal. Finally the first elected government introduced “Business profit and Remuneration Act 2017” to impose income tax on remuneration and business profit in Nepal. Due to narrow coverage of that act, it was replaced by the “Nepal Income tax act 2019”. The coverage of income tax was extended through this act. This act divided the heads of income into nine parts: income from business, profession\occupation, remuneration, house and land rent, agriculture, investment, insurance business, agency business and other sources. For the fulfilling the needs of time, it was replaced by another act, ‘Income tax act 2031.’

In the course of development and modernization of income tax system, the new, ‘Income Tax Act 2058’ become effective since Chaitra 19, 2058(1st April, 2002). It is also applicable to residents wherever outside Nepal.

Parliament makes the laws to implement the various policies. The government levies and collects the income tax in accordance with law. The constitution of the kingdom of Nepal, 1990 has made the clear provision about it. No taxes shall be levied and collected except the accordance with law. Present legal provision of income tax is associated with constitution of the Nepal, 1990, income tax act 2002, income tax rules 2002, Finance Act of concerned financial year and other Finance ordinance etc. The development of income tax in Nepal can be presented with the implementation of different income tax acts with the flow of time.

2.1.3.1 Business Profit and Remuneration Tax Act 1960(2017 B.S.):

The government of Nepal introduced a formal tax act for the first time in Nepal in 1960 (2017 B.S.) in the form of, "Business profit and Remuneration Tax Act 1960". An ordinance was issued by the king to collect the tax. According to this act, only Business profits and Remuneration on income were subjected to tax but the revenue for these taxes should not be collected properly according to originals estimates. This act consisted of 22 sections.

Following were the main features of Business profit and Remuneration Tax Act 1960:

- The coverage of income tax was very narrow because, only business profit and remuneration income were subject to tax.
- There were no deductions specified for the purpose of calculation the taxable income.
- Tax on remuneration was to be deducted at source.
- The basis of calculating the tax liability for remuneration was income of the current year, and for business profit, it was the profit at preceding year fiscal year.
- There was a provision of tax exemption on salary of foreign citizen, dividend of shareholders, profit to be spend in religious of public welfare activity, crop from own land, allowances granted by HMD to prime minister, ministers assistant minister, chairman, speaker, amount drawn from provident and saving fund.
- In case of default, fines ranged from rs. 500 to rs, 5000 were prescribed.
- The taxpayer was given the right to appeal against tax officer and assistant to local Magistrate, "Bada Hakkim". Appeal could be judged at Revenue Court. Every appeal was to be accompanied by the security deposit or guarantee for the amount of tax payable.

Because of narrow coverage vague, this act was replaced by new 'Income Tax Act 1962' (2019B.S.)

2.1.3.2 Income Tax Act 1962(2019 B.S.):

This act had implemented form July 1962. The main purpose of implementation of this new act was not only to raise government revenue but also to reduce inequality of income and wealth distribution with social justice and to create tax-paying habit of the taxpayers. The income tax act had 29 sections. It was amended only one time in 1972 (2029 B.S)

Following were the main features of Income Tax Act 1960:

- There were nine sources of income for tax purpose: income from business. Remuneration, profession or occupation, house and land rent, investment in cash or kinds, agriculture, insurance business agency and any other sources.
- The personal as well as residential status of the taxpayer for tax purpose was defined.
- The act had defined basic terminology such as taxpayer, tax officer, company, firm, profit, remuneration, tax assessment, resident, and nonresident etc.
- Provision was made to carry forward of losses for a period of two years.
- Certain deductions were allowed to calculate net income and taxable income.
- The provision was made to constitute the net income assessment with five members.
- Provision was made for payment of tax in installment as well as for advance payment of tax.
- Provision was made for reassessment of tax as well as rectification of arithmetic errors.
- Provision was made for the exemption of income tax for new industries for certain period.
- Income tax assessment and collection procedure were specified along with the method of computing net income.
- Agriculture income was brought under the scope of income tax for the first time. But the Finance Act 2023 B.S. exempted this income fully from income tax. The finance act 2030 B.S. again brought agriculture income under the scope of tax. The finance act 2034 again exempted agriculture income from income tax because of heavy political pressure.

2.1.3.3 Income Tax Act 1974 (2031 B.S.):

The basic framework of this act was derived from previous Income Tax Act 1962. It had 66 sections. This act was amended for eight times in 1977, 1979, 1984. 1985, 1986, 1988, 1998 and lastly 1993 to make it more practical and to eliminate confusing terms and conditions. His Majesty's government enacted the Income Tax Rule 1982 (2039-01-27 B.S.) in accordance with the authority given under the section 65 of Income Tax Act 1974.

Following were the other main features of Income Tax Act 1974:

- This act had certain definitions, especially relating to tax, assessment of tax, income, income year, personal status of taxpayer, resident and non resident taxpayers, firm, company, family, philanthropic work etc.
- The sources or heads of income into five headings: a) Agriculture, b) Industry, business, profession or vocation, c) Remuneration d) House and Land rent and e) other sources.
- The methods of computing net income from various sources had been specified.
- The deduction allowances for computation of net income were specified for all sources of income.
- Certain types of income were exempted from income tax under sec.42.
- This act had made provision for self assessment of tax for the first time in Nepal.
- Carry forward of losses were allowed for three years.
- Life insurance premium and donation were allowed for deduction as common expenses with some restrictions.
- Appointment rights and duties of tax officers and tax payers had provided and mentioned clearly.
- Rights, duties forms, appeal were specified.
- Provisions of penalty up to rs.5000 in case of failure of maintain or preserve accounts for the period of six years.
- Progressive rate of tax were applied.
- The process of assessment, reassessment, appeal, advance payment of tax,

deduction of tax at source and refund f tax were clearly specified.

2.1.3.4 Income Tax Act 2002 (2058 B.S.):

The income tax act 2002 (2058 B.S.) become effective since 1st April 2002. The act governs all income tax matters and is applicable throughout the country Nepal. This act consists of 143 sections along with 24 chapters. The objectives of introducing the new tax act are to enhance the revenue mobilization through effective revenue collection procedures. To promote the economic development of the nation is the main motto of this act. This new tax act has imposed the tax on income realized from every person; a foreign permanent establishment of a non resident person situated in Nepal and has repatriated income for the year, a person who has received a final withholding payment during the year and who has taxable income for the year. The existing Income Tax Act, 2058 became effective since Chaitra 19, 2058 (01, April 2002). The Act governs all income tax matters and is applicable throughout the Kingdom of Nepal. It is also applicable to residents residing wherever outside Nepal.

Objectives of Income Tax Act 2002 (Neupane, 2004:4):

- To increase the tax coverage.
- To make income tax related provisions clear and transparent.
- To interlink Nepalese tax system with tax system of other countries.
- To make tax system based on account.
- To minimize tax avoidance, tax evasion and tax delay payment.
- To make tax system compatible to modern economy.
- Separating administrative and judicial responsibilities.
- Reducing the scope of discretionary interpretation of tax administration thereby ensuring simplicity, uniformity and transparency.
- Defining the power as well as authority of the tax administration.
- Distinguishing taxpayers’ violation of civil duties and criminal offences/
- Making more effective and responsibility to tax administration.
- Making more responsible to tax payer by emphasizing on self tax assessment

systems.

The special features of income tax act 2002:

- The Act has broadened the tax base. Tax rates are spelled out in the Act itself and the tax rates and concessions are harmonized on equity grounds.

- A full-fledged self-assessment system is implemented and the presumptive taxation and current year taxation system are strengthened.

- A full-fledged self-assessment system is implemented and the presumptive taxation and current year taxation system are strengthened.

- The scope of discretionary interpretation of the tax administration is drastically reduced ensuring simplicity, uniformity and the transparency. The Act has also defined the power and authority of the tax administration

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

- The appeal system is further streamlined by making it mandatory for the taxpayers to file an objection with the Inland Revenue Department for administrative review before appealing to the Revenue Tribunal.

- This act has classified all income intro three headings under section 3: a) Employment b) Investment and c) Business.

- Pension, gratuity, Dashain allowance, refund of retirement fund etc. also treated as taxable income for the first time in Nepal.

- All natural persons are given right to claim medical tax credit and extra exemption limit has been provided for the taxpayers of different remote areas.

- The rate and method of charging depreciation is fixed for all the depreciable assets.

- As proposed to previous tax acts, Income Tax Act 2002 has specified the tax rate applicable to the taxpayers of different categories. It was practice in the past that the rate of tax used to be given in Finance Act of each year.

Income Heads:

The Act imposes tax on those activities contributing toward the creation of wealth. Wealth is created with the help of labor, capital and capital-labor mix activities that generate income from employment, investment and business respectively. The Act makes broad classification of income encompassing almost all income-earning activities. They are:

- Employment (an individual`s remuneration income from an employment for an income year).

- Investment (profits and gains of a person from conducting an investment for an income year)

- Business (profits and gains of a person from conducting a business for an income year)

- Income and gains are ascertained only after deducting the corresponding expenses. The income from each business and investment needs to be calculated separately.

Taxing Subjects:

- The taxpayers on whom income tax is imposed are persons. A person can be a natural person, who is an individual or a couple but includes also a proprietorship, or it can be an artificial person, i.e. an entity. An entity means a partnership, trust, company, and foreign permanent establishment or government body.

- The Act distinguishes between resident and non-resident persons. A resident person is an individual whose normal place of abode is in Nepal and who is present at any time of the year, or who is present in Nepal for 183 days or more, or who is an employee of Government of Nepal posted abroad at any time during the year.

- A trust is a resident person if it is established in Nepal, or has a resident person as a trustee, or is controlled by a resident person. A Company residing in Nepal and if it is incorporated under the laws of Nepal or has its effective management in Nepal. Partnerships are always resident persons. Permanent establishments are places where a person carries on a business and are subject to tax if they belong to a non-resident person and are situated in Nepal.

Income year:

For every person the tax is imposed and calculated for an income year. The income year corresponds with Government's Fiscal Year, i.e. the period from the start of Shrawan of a year to the end of Ashad of the following year (mid-July to mid-July).

Assessable Income:

The assessable income of a person for an income-year from any employment, business, or investment is:

- in the case of a resident person, the person`s income from the employment, business, or investment of the year irrespective of the location of the source of the income and

- in the case of a non-resident person, the person`s income from the employment, business, or investment of the year but only to the extent the income has a source in Nepal.

The assessable income does not include any income exempt under sections 11 or 64 of the Act (such as income from non-business agriculture and agriculture business conducted in the land of the type that is mentioned in clauses (d) and (e) of section 12 of the Land Act, 2021; income of cooperative society from business mainly based on agriculture and forest products and cooperative saving and credit scheme based on rural community; and income of approved retirement fund).

Taxable Income:

The taxable income of a person for an income-year is equal to the amount as calculated by subtracting reduction, if any, claimed for the year under section 12 (gifts to an exempt organizations) or 63 (retirement contribution to an approved retirement fund) from the total of the person`s assessable income for the year from each of the following income heads: Business, Employment and Investment.

Tax Rates:

- The taxable income of a resident individual for an income-year 2066/67 will be taxed at the following rates: Up to Rs.160,000 - 1% From Rs.160,000 - up to Rs.260,000- @ 15 % plus Rs. 1600 Above Rs. 260,000 - @ 25% plus Rs.16600.

- The taxable income of a couple, if they chose to be treated as a couple will be taxed at the following rates; Up to Rs.200,000 - 1% From Rs.200,000 - up to Rs.300,000- @ 15 % plus Rs. 2000 Above Rs. 300,000 - @ 25% plus Rs.17000.

- The business person who have registered own Proprietary firm should not pay above 1 (one) % tax.

- Any individual or couple having pension income can enjoy 25 percent of the normal exemption limit as an additional basic exemption.

- Any individual working in prescribed remote area is entitled to deduct prescribed amount as remote area allowance from taxable income.

- Any individual is entitled to deduct the following amount from taxable amount, if he is having investment insurance policy: "Rs. 20,000 amount or the actual premium paid, whichever is less."

- For the purposes of the Act, net gains from the disposal of non-business chargeable assets will be taxed at the rate of 10 percent.

- The presumptive tax for individuals conducting small businesses (who have a turnover of Rs.2 million or an income of Rs.200, 000) in the Metropolitan or Sub-Metropolitans, Municipalities and anywhere else in Nepal amounts to Rs 5,000 Rs. 2,500 and Rs.1,500 respectively.

  - The taxable income of a non-resident individual is taxed at the rate of 25 percent.

  - The taxable income of an entity will be taxed at the rate of 25 percent unless prescribed otherwise.

  - The taxable income of a bank, or financial institution, or general insurance business, or an entity conducting petroleum work under Petroleum Act, 2040 for an income-year is taxed at the rate of 30 percent.

  - Gain from Lump sum retirement payment made by an approved retirement fund or GON is taxed at the rate of 5 percent as a final withholding tax. Gain is calculated by deducting 50 percent of the payment or Rs. 500,000 whichever is higher from the total lump sum payment.

- The taxable income derived by an individual from special industry or export business will be taxed at the rate of 20 percent.

- The taxable Income derived by an entity engaged in an industrial enterprise or export business or derived from operating any road, bridge, tunnel, ropeway, or flying bridge. Construction business or any trolley bus or tram manufacturing business is taxed at the rate of 20 percent.

- The taxable income of an entity engaged in power generation, transmission, or distribution is taxed at the rate of 20 percent.

- The taxable income of an estate of a deceased resident individual or trust of an incapacitated resident individual will be taxed at the normal tax rate as though the estate or trust was a resident individual.

- The repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal will be taxed at the rate of 10 percent.

- The taxable income of a non-resident person deriving income from providing shipping, air transport or telecommunication services in Nepal will be taxed at the rate of 5 percent.

- The taxable income of an entity wholly engaged in the projects conducted by any entity so as to build public infrastructure, own operate and transfer it to the HMG/N in power generation, transmission, or distribution for an income-year shall be taxed at the rate of 20 percent.

Business Exemptions, Exempt Amounts and Other Concessions:

The following amounts are exempt from tax:

- Amounts derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between Government and a foreign country or an international organization;

- Amounts derived by an individual from employment in the public service of the government of a foreign country, provided that, the individual is a resident person solely by reason of performing the employment or is a non-resident person; and the amounts are payable from the public funds of the country;

- Amounts derived from public fund of the foreign country by an individual who is not a citizen of Nepal or by a member of the immediate family of the individual.

- Amounts derived by an individual who is not a citizen of Nepal from employment by Government on terms of a tax exemption;

- Allowances paid by Government to widows, elder citizens, or disabled individuals;

- Amounts derived by way of gift, bequest, inheritance, or scholarship, except as required to be included in calculating income under this Act;

- Amounts derived by an exempt organization by way of gift; or other contributions that directly relate to the organization's function, whether or not the contribution is made in return for consideration provided by the organization, and

- Pension received by a Nepali citizen retired from the army or police service of a foreign country provided the amounts are payable from the public fund of that country.

An agricultural income derived from sources in Nepal during an income-year by a person, other than the income from an agriculture business derived by a registered firm, or company, or partnership, or a corporate body, or through the land above the land holding ceiling as prescribed in the Land Act, 2021, is exempt from income tax.

Incomes derived by cooperative societies, registered under Cooperative Act, 2048 (1991), from business mainly based on agriculture and forest products such as sericulture and silk production, horticulture and fruit processing, animal husbandry, diary industries, poultry farming, fishery, tea gardening and processing, coffee farming and processing, horticulture and herb processing, vegetable seeds farming, bee-keeping, honey production, rubber farming, floriculture and production and forestry related business such as lease-hold forestry, agro-forestry, cold storage established for the storage of vegetables and business of agricultural seeds, insecticide, fertilizer and agricultural tools (other than machine operated)and rural community based saving & credit cooperatives are exempt from tax. Dividends distributed by such societies are also exempt from tax.

Deductions:

- Basically, all actual costs to the extent incurred in generating income from the business or investment are deducted while calculating a person`s income. This generalization, however, are taken into consideration in conjunction with the special provisions made in the Act. For example, interests paid by exempt controlled entity to the parent in the course of conducting a business or investment, are deductable with some limitations. Other costs such as cost of trading stock, repair and improvement cost of owned and used depreciable asset, pollution control, research and development are also deductable with some limitations.

- Depreciation allowances are granted for depreciable assets, which are categorized in 5 classes. The classes are based upon the average useful life of the assets belonging to one class. The assets of each class are placed in a pool and a depreciation rate applies to each pool.

- Allowable limit for repair and improvement cost of owned and used depreciable asset is raised to 7% of depreciation bases.

- No deductions are granted for the expenses that are of a domestic personal nature, income tax, government penalties costs in deriving exempt amounts or final withholding payment, dividends distributed by an entity, costs of a capital nature and cash payment above Rs. 50,000 under prescribed conditions.

Setoff, Carry forward and Carry back of Losses:

- Losses are in principle deductable but are treated differently depending on whether they result from conducting a business or an investment and whether they are of domestic or foreign nature. Losses from a domestic business can be offset against all types and sources of income, whereas losses from a domestic investment can be offset only against any type of investment income. Foreign losses can be offset only against foreign income. Foreign business losses can be offset against foreign business income or investment. Losses from foreign investment can only be offset against foreign investment income.

- Unrelieved business losses of previous 4 years are allowed to carry forward.

- In case of electricity projects involving in building power station, generating and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own, operate and transfer to the Government, any unrelieved loss of the previous seven years are allowed to carry forward.

- If a person incurs a loss for an income-year from any banking and general insurance business, the person may carry back the loss and deduct it in calculating the income from the business for any of the five preceding income-years.

- Special provisions exist in the Act on how to deal with losses incurred in conducting a business of global long-term contract.

Tax Accounting and Timing:

- For tax purposes, an individual is required to maintain his accounts on a cash basis in calculating the individual`s income from an employment or investment and a company is required to maintain its accounts on an accrual basis within the basic framework of generally accepted accounting principle.

- Bad debts are allowed to be written off if a debt claim of a bank or financial institution has become bad debt as determined in accordance with the prescribed standards.

- Inclusions and deductions under a long-term contract are calculated according to the percentage of the contract completed during the year.

Quantification, Allocation and Characterization of Amounts:

- Cash payments are quantified as equivalent to the amount of transferred money or the market value of the asset. In case of a kind payment, it is equivalent to the value of the benefit of the payment. Compensations, including payments under insurance for income and losses are to be included in the calculation of income from employment, business or investment.

- Payments under an annuity, an installment sale or a finance lease are aggregated and the total is divided into a capital portion and an interest portion calculated according to the Act.

- Finance lease has been defined either as an agreement with the transfer of ownership at the end of the agreement or the option of the lessee to purchase the leased asset for a fixed price, or a contract with a lease term exceeding 75 percent of the asset's useful life.

- The Department is given the right to correct and recharacterize arrangements targeted at minimizing the taxable income or payable tax. This refers to indirect payments, transfer pricing and other arrangements between associates if the agreement has not been conducted at arm's length, cases where persons attempt to split income with other persons, arrangements carried out as part of a tax avoidance scheme or without any substantial economic effect or of which the form of the arrangement does not reflect its substance.

Special provisions for Individuals:

- A resident natural person and a resident spouse of the person may, by notice in writing, elect to be treated as a single individual for a particular income-year.

- Each spouse of a couple making an election as above with respect to an income-year is jointly and separately liable with the other spouse for any tax payable by the couple for the year.

- A resident individual may claim a medical tax credit for an income-year not exceeding Rs 750 for any approved medical costs paid by the individual him/herself or through others during the year in respect of the individual. Tax credit limit of Rs. 750/- is calculated by multiplying the total approved medical cost by 15%. Any unrelieved medical costs are carried forward. Medical Tax Credit facility is equally applicable to all individual taxpayers.

Special provisions for Entity:

- An entity is liable to tax separately from its beneficiary who is defined as any person having an interest in an entity. Unless stated otherwise in the Act, transactions between an entity and its managers and beneficiaries are recognized.

- The profit of entities can either be retained or distributed to its beneficiaries such as shareholders. The entity can also repay capital or grant collateral benefits to them. Collateral benefit, which can be characterized as a kind of hidden distribution of profit. Distributions of profits and collateral benefits are dividends representing a return of interest in capital, and need to be distinguished from repayment of capital, which is the return of the capital itself. For that the Act provides a profit first rule saying that a distribution is a return of capital to the extent that it is not a distribution of profits. If the entity repays capital it is free of tax.

- Dividends of a resident company are taxed to the company's shareholders in the form of a final withholding tax. The re-distribution of such taxed dividend is tax free. Dividends of a non-resident entity, which are distributed to a resident beneficiary, are taxed by inclusion in calculating the income of the beneficiary.

- Besides these general provisions the Act contains detailed provisions for liquidations of entities, for dealings between an entity and a beneficiary, for changes in control of an entity and for dividend stripping.

Special Provisions for Retirement Savings:

- The Act distinguishes between the treatment of approved and unapproved retirement fund. In case where a resident person files an application with the Department intending to get approval for establishing a retirement fund, the Department shall pronounce the approval as prescribed.

- An individual who is a beneficiary of an approved retirement fund may claim a reduction of retirement contributions made to the fund for an income-year the limit of the claim is the lower of Rs. 3, 00,000 or one third of his assessable income for the year. Contributions to an unapproved retirement fund are not deductable. The income of an approved retirement fund is free of tax where as an unapproved fund itself is subject to full income tax.

International Taxation:

- For taxation purposes, all payments and gains need to be considered on the basis of the source country of the payment. Details of the circumstances under which the source rules are defined are given in the Act.

- Tax is imposed on the repatriated income of a foreign permanent establishment of a nonresident person situated in Nepal.

- A non-resident person carrying on a business of charterer or air transport operator are taxed at a flat rate on their amounts derived from carriage of passengers, mail or goods which embark in Nepal. The provision is also applied to nonresident persons who transmit messages by any technical means if the apparatus is established in Nepal.

- A tax credit may be claimed for any foreign income tax paid with respect to foreign source income. The tax credits are calculated separately for assessable foreign income sourced in each country and will not exceed the average rate of Nepal income tax applied to the assessable foreign income.

Administration and Documentation:

The Department is charged with the responsibilities of administering the Act and the provisions thereto. Government is empowered to enact Rules. Accordingly, the Department may also issue public circulars serving the purpose to achieve consistency in the administration of the Act and to provide guidance to persons affected by the Act.

Record Keeping and Information Collection:

- The Department may specify the form of documents required under the Act. It may issue a Permanent Account Number and require the taxpayer to show it in any return, statement or other documents used for the purposes of this Act.

- Every taxpayer is required to maintain, in Nepal and in Nepali or in English language, documents as prescribed by the Department, which are necessary to explain information to be provided in a return, enable an accurate determination of the tax payable and substantiate deductions and outgoing. The documents must be retained for at least 5 years after the end of the income year to which they are relevant. If the documents are not in Nepali or English, the taxpayer may be requested to provide at his expense a Nepali translation by an approved translator.

- The Act grants, every officer with authorization from the Department, comprehensive rights to access to information, such as, full and free access to any premises, place, document or other assets situated in Nepal and right for seizure of any document that may be material in determining the tax liability of the taxpayer. Every officer of the Department will regard and deal with all documents and information coming into his possession or knowledge as secret and will not disclose it to a court, tribunal or other person except in cases explicitly allowed in the Act.

Installment Payment:

There is a provision of payment of Income Tax of the current year by 3 installments i.e. 40%, 70% and 100% by the end of Poush, Chaitra and Ashad respectively.

Annual Statement of Estimated Tax Payable:

Every person who is an installment tax payer for an income year is required to file annual statement of estimated tax by the end of Poush. Presumptive taxpayer and those who have only income from final withholdings need not file the estimate.

Returns of Income and Assessments:

- In general, every taxpayer should file a signed return of income not later than 3 months after the end of each income year.

- Unless explicitly requested by the Department, no returns are required from taxpayers who have no tax payable for the year or are resident individuals who have income exclusively from an employment having a source in Nepal, who have only one resident employer at a time during the year and who do not claim a deduction of their taxable income by gifts to exempt organizations.

- Unless an assessment has been amended or reduced by order of the Revenue Tribunal or of a court, the Department may amend an assessment within 4 years in order to adjust the assessed person's liability to tax in such manner as, according to the Department's best judgment, is consistent with the intention of the Act. An assessment may be amended at any time in cases of fraud.

- Where the department makes a jeopardy or amended assessment, it will serve a written notice on the taxpayer.

Administrative Review and Appeal:

A taxpayer who is aggrieved by a review able decision may file an objection within 30 days after the decision is made. In doing so, such Taxpayer has to deposit 50% of due amount. The Department may extend this period for another 30 days upon request. The Department may stay or amend or do necessary corrections with regard to these review able decisions. If the Department fails to serve a taxpayer with a notice of an objection decision, within 90 days, the taxpayer may elect to treat the Department as having refused his objection and appeal to the Revenue Tribunal.

Offences:

Offences are dealt with in the Act in a sense of criminal offences of taxpayers as well as tax administrators. They lead to punishment in the form of fines and imprisonment on conviction. The offences attracting both a fine and the imprisonment include failures to comply with the Act, failures to pay tax, maintaining documentation or filing income returns and statements of estimated tax, making false or misleading statements, impeding or coercing the tax administration, offences by the authorized and unauthorized persons, offences of aiding or abetting, etc. In case if the Tax return file is not submitted within the period prescribed by the act, the late fee will be charged at the rate of 0.1% per year of the turnover.

The Super Act:

The Act is made super in regard to all income tax matters. No other Acts except this Act shall be made capable to make changes, amendment and other tax related provisions other than the provisions relating to imposition, assessment, reduction, increment, exemption, or remission of tax to be made by amending this Act itself by annual Finance Acts.

2.1.4 Source of Income:

Income Tax Act 2002 imposes tax on those activities contribution toward the creation of wealth. Wealth is created with the help of labor, capital and capital-labor mix activities that generate income from employment, investment and business respectively. The act makes broad classification of income encompassing almost all income earning activities. They are:

2.1.4.1 Income from Employment \Remuneration:

Income tax act 2002 has defined the remuneration income for income tax purpose. According to sec.8 of 'Income tax act 2002', an individual income from employment for an income year is the individual's remuneration from employment of individual for the year. According to this sec., the remuneration received by a person from the employment is as following payments made by the employer:

- Payments of wages, salary leave pay (including salary in lieu of leave and encashment of accumulated home, sick etc. leave), overtime pay, fees, commission, prizes, gifts (as per market value in case of prize and gift is not in cash), bonuses and other facilities i.e., Dashain expenses, Tihar expenses, telephone facility, transportation facility etc;

- Payment of any personal allowances including any cost of living subsistence allowance, rent allowance, entertainment allowance and transportation allowance.

- Payments providing any discharge or reimbursement of cost incurred by the individual or an associate of the individual.

- Payment for the agreement to any conditions of the employment.

- Payment for termination or loss of service or compulsory retirement (redundancy). For eg. Amount derived as golden hands shake scheme.

- Retirement contribution including those paid by the employers to a retirement fund in respect of the employee and retirement payments. For eg.

Gratuity, encashment of medical expenses at the time of termination, employer's contribution to provident fund.

- Other payments made in respect of the employment; and
- Amounts required being included in remuneration from employment as per tax accounting.

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

- The amount of difference of the interest of the interest on loan paid by employer lower rate then the market rate;
- Market value of assets in case of the transfer of the assets.
- For the payment other then stated above, the value of benefit of the payment to a third person.

Non-chargeable income

Some incomes are not included in calculating a person's remuneration from employment even if they are derived from employment. These incomes are treated as tax- free income. The following amounts are excluded in calculating an individual's remuneration from employments;

- Amounts exempt under section and final withholding payments under sec 8.3 (a) and 92.
- Meals or refreshment provided in premises operated by or behalf of an employer to the employees that are available to all the employees in similar terms.

- Payments of prescribed small amount, which are so small and thus unreasonable or administratively impractical to make accounting for them.

- Remuneration exempted under bilateral or multilateral agreement.

- Any discharge or reimbursement of cost incurred by the individual cost
  -that serves the proper business purpose of the employer.
  -that are or would otherwise be deductible in calculating the individual income from any business or investment.

2.1.4.2 Income from Business:

Business is an activity by a commercial enterprise engaged for the purpose of making profit on a continuous and repetitive basis. In other words business means use of factor of production for the purpose of earning profit. According to section 2 (a) (r) of Income tax act 2002, business means an industry, a trade, a profession, or the like isolated transaction with a business character and includes a past, present, or prospective business.

Income from business is the maximum revenue earner with large number of taxpayers. The amounts that are included in computation of "Income from Business" are as follows:

- Service fees [sec 7.2 (a)]
- Amount derived from the disposal of trading stock [sec.7.2 (b)]
- Net gains from the disposal of the person's business assets or liabilities of the business as calculated under Chapter 8 [sec7.2 (c)]
- Amounts treated as derived from the disposal of depreciable assets [sec 7.2(d)]
- Gifts received by the person in respect of the business [sec 7.2(f)]

- Amounts derived as consideration for accepting a restriction on the capacity to conduct the business [sec 7.2(f)]
- Amounts derived that are directly connected with the business and that would otherwise be included in calculating the person's income from an investment [sec 7.2(g)]
- Amounts to be included by reason of change in the accounting system [sec22.6]
- Amounts to be included by reason of timing [Sec24.3]
- Excess amount received by reason of timing [sec 24.3]
- Recovered amount received by reason of exchange rate [sec 24.4]
- Amounts to be included as per contract completion basis in the case of a long term contract [sec 26.1]
- Difference of actual interest and interest as per market rate in case of a soft loan [sec 27.1 (d)]
- Amounts paid to third person instead of actual payee [sec 29]
- Amounts derived as compensation [sec 31]
- Other amounts required to be included as per provision of tax accounting and timing under chapter 6 or the provision of quantification, allocation, and characterization of amounts under chapter 7 or the provision of dealings between an entity and a beneficiary under section 56, or the provision of general insurance business under section 60.

However, income from business does not include exempt amounts under section 10, tax exempted dividends under section 54 and dividend distributed by a foreign controlled entity under section 69.2 and final withholding payments under section 92.

The following expenses are allowed for deduction while computing income from business:

- Donation\ Gift [sec 12]
- General deduction [sec 13]
- Manufacturing (production \ factory) expenses

- Administration and office expenses
- Selling and distribution expenses
- Interest [sec 14]
- Cost of trading stock [sec 15]
- Repair and improvement costs [sec 16]
- Pollution control costs [sec 17]
- Research and development costs [sec18]
- Depreciation allowance [sec 18]
- Expenses with respect to provision of risk bearing fund [sec 59] (a)]

2.1.4.3 Income from Investment:

According to section 2 (a) (1) of 'Income tax ac 2002', investment means an act of holding or investing one or more assets of a similar nature that are used in an integrated fashion. It excludes the act of holding assets, other than non business chargeable assets, primarily for personal use by the person owing the asset or investing amount on such asset. It also excludes employment or business.
The following amounts derived by a person during an income year are included in calculating profit and gains from conducting the investment for the year:

- Dividends other then final withholding, gain from investment insurance other then final withholding, interest other than final withholding , rent other then final withholding, payment derived for natural resource royalties, gain from an interest on unrecognized retirement fund and retirement payment from recognized retirement fund other then final withholding. [sec 9.2 (a)]
- Net gain from the disposal of non business chargeable assets of a natural person [sec 9.2 (b)]
- Amounts treated as derived from the disposal of depreciable assets of any investment [sec 9.2 (c)]
- Gift received by the person in respect of investment [sec 9.2 (d)]
- Retirement contribution and retirement payments with respect to investment

[sec 9.2 (e)]

- Amounts derived as consideration for accepting a restriction on the capacity to conduct the investment [sec 9.2 (f)]
- Amounts to be included by reason of changes in the accounting system or method [sec 22.3]
- Amounts to be included by reason of timing [sec 24.3]
- Excess amount received by the reason of exchange rate [sec 24.4]
- Recovered amounts of bad debts deducted earlier related to investment [sec 25.1]
- Difference of actual interest and interest as per market rate in case of a soft loan used in the investment [sec 25.1]
- Amounts paid to third person instead of actual payee [sec 29]
- Amounts derived from joint ownership investment [sec 30]
- Amounts derived as compensation [sec 31]

However, investment income does not include tax exempt amounts under section 10, tax exempted dividends under section 54, and dividend distributed by a foreign controlled entity under section 69.2 and final withholding payments under section 92.

The following expenses are allowed for deduction while computing income from business:

- Donation \ Gift [sec 12]
- General deductions [sec 13]
- Interest expenses [sec 14]
- Repair and improvement costs [sec 16]
- Depreciation allowance [sec 19]
- Loss from investment [sec 20]

The following expenses are not allowed for not allowed for deduction from the taxable income from business and investment:

- Expenses of domestic or personal nature.

- Tax payable as per this act,
- Penalty or any other fines payable as per any acts.
- Expenses incurred to derive the amount exempted under section 10 or final withholding payments.
- Cash payment for more than Rs. 50,000 at the time to particular person by a person having annual transaction more than Rs. million.
- Distribution of income.
- The amount where the deduction is not allowed by any sections.

2.1.5 Capital Gain Taxation in Nepal:

Capital gain means excess of sales price over the book value of the fixed assets. Capital gain tax is the tax levied on the gain individual of corporate bodies from the sale of the assets. Previous income tax acts had no provision of taxing capital gain of individual nature. The capital gains of business organization were taxed under normal tax rate. However, the 'income tax act 2002' has also not clearly pronounced the term 'Capital Gain'. But in implication, there is capital gain tax under this act. The tax on the gain of non business chargeable assets i.e. profit on the sale of the fixed assets except used in business and securities comes under this category as per this act.

Basically, there are two types of rates used in different countries of the world for taxing the capital gain. Some favor taxing capital gain at special tax rate, where other favor ordinary treatment. Ordinary treatment means taxing the capital gain whereas some others are using special rate for the purpose [kandel, 2003:108].

In Nepal, capital gain tax as such was introduced only from the budget of 2058/59. The rate of tax is 10% as per the act. Chapter 8 of income tax act 2002 has made detailed provision in relation to the gain from sale of the assets. This act has classified all the assets into five categories:

- Trading Stocks

- Depreciable Assets
- Business Assets
- Non business Chargeable Assets
- Other Assets (in residual sense)

An assets not used for generation of business income is also included in the category of capital gain. Capital gain is the gain on non business chargeable assets i.e.; land, building and securities. Profits from the sale of stock of goods, assets used in business and depreciable assets do not fall under this head. Profit from disposal of motorcar, gold and silver etc. also do not come under this head. In case of natural person, profit from the sale of residential land building owned for more than 3 years and land and building sold for less than rs. 1 core also does not come under this head. Accordingly, assets transferred within 3 generation by other then purchase and sale is not taxable under income tax act 2002. It means in case of sale of land & building of a natural person, the land & building should be sold for more than rs. 1 core and if it is transferred within 3 generation, there should be purchase and sale and it should not be that type which is resided or owned for more than 3 years, to come under the head of capital gain taxation. The capital gain or loss is calculated by deducting total outgoings from total incomings of assets. The tax rate of capital gain is 10% for natural person but ordinary rate applicable for an entity.

The loss from non business chargeable assets can be recovered in any year of future profit from non business chargeable assets. It cannot be recovered from business or other investment income. However, the previous and present loss from business and present loss from investment can be recovered from this head. In case of natural person, if a person has both capital gain and other income. The exemption is allowed under ordinary income and at 10% for capital gain.

2.1.6 Methods of Income Tax assessment:

Basically the procedure of ascertaining tax liability of a person and tax payable by the person is known as tax assessment. Nepalese value added tax is based on self tax assessment system. Income Tax Act 2002 provides for the following major methods of assessing income tax.

Self tax Assessment:

The act has fully applied the self assessment of tax system. It has made more responsible to tax payer. It reduces the compliance cost. Under this system, taxpayers himself determines his tax liability with fine and penalty if any and submit it to the tax officer along with the tax due as per return mentioned above within specific time. If tax authority doubts the income of taxpayer, tax authority can investigate on revenue risk basis. Otherwise, that becomes the final.

Amended / Management Assessment:

The management assessment may be made on the basis of proof of transaction, a tax audit report or tax paid on a similar transaction by another person as well as market value or any other information and notice related to the transaction of which tax is to be determined. Tax department may amend an assessment made by the taxpayer under section 99 and section 100. Department may be amended assessment. The department not amends as assessment if the assessment has been amended or reduced pursuant to an order the Revenue Tribunal or court of competent jurisdiction except where the order is reopened.

Jeopardy Assessment:

Under the section 100 of income tax act 2002, the provision of jeopardy assessment is made. The tax official may make jeopardy assessment in case of doubtful situation. Whenever there is a reason to believe that the collection is in risk because any person is about to leave Nepal or to transfer the person's property to anybody or to remove conceal assets a tax officer, with the approval of the Director General, may immediately assess and control the tax due, or about to because due.

2.2 Review of Related Materials:

The research and study based on income tax in Nepal is not an easy tax to perform as a whole. Because, time to time, the concept and rules are changing rapidly. Income tax is directly affected by national and international environment. In Nepal there is no long history of income tax. But it does not mean that the history of it is very short. It is not easy task to collect all the information about income tax in Nepal. Reviews of available materials, based on income tax, are helpful regarding to the actual subject matter in the tax system and its actual condition in Nepal. For this study, various books, articles, thesis, dissertations etc have been reviewed for the study. The main and important books, dissertations and thesis reviewed for the study are as follows:

2.2.1 Review of Related Books:

The idea of introducing income tax in Nepal originated along with the final budget on 21st Magh 2008 B.S. (1952 A.D.). The finance minister in the final budget speech said, "A proposal to levy an income tax including tax on agriculture income is under consideration." For the first time, the finance act 2016 (1959) had imposed tax on business profit and remuneration in Nepal. The first elected government finally introduced 'Business profit and remuneration tax act 2017' to impose income tax on remuneration and business profit in Nepal.

Amatya, K.B (1965), presented a book named, "*Nepal ma Aaykar Byabastha*" where he has presented the description of income tax and legal provisions related to income tax. Basically he has analyzed the legal aspect of income tax in Nepal at that time.

Khadka, Rup (1994), has presented a book entitled "*Nepalese Taxation: A path of Reform*", where he had discussed the economic policy of Nepal, VAT as a long term tax for Nepal, Income tax, improving tax administration, tax reform strategy. He had analytically described about development, existing structure, main problems and possible direction of reform of income tax. About his conclusion narrow coverage of income tax, unscientific tax assessment and collection, defective system from the perspective of international taxation, weak tax administration imbalance and inadequate organizational pattern, inadequate physical and other facilities, insufficient tax training, lack of coherent tax policy, predominance of low level non technical posts debatable scope of revenue investigation department, lack of information system are the major problems of tax administration of Nepal.

Dhakal (2001), has presented a course book based on the syllabus of BBS third year and MBS second year, '*Income tax and house and compound tax: law and practice with vat'*. He had described historical aspect of income tax and legal provisions relating to income tax with mathematical expression. His book is more useful to know about general information and provisions made under "Income tax act 1974".

Tiwari (2001), has also presented a book, "*Income tax system in Nepal*". This book is useful to know the theoretical as well as practical knowledge about income tax. This book is based on the "Income tax act 1974". Due to change in income tax act, this book is no use with present context of income tax.

Adhikari (2003), has presented a book '*Income Tax Law: then and now'*. He has presented historical aspect and development of income tax in Nepal. He also explained legal provisions of newly implemented "Income Tax Act 2002". As an advocate and legal advisor, Mr.Adhikari has presented both positive and negative aspect of new income tax system very clearly, which has helped a lot for conducting this research study.

Mallik (2003), has published a book "*Nepal lo Aadhunik Ayakar Pranali*", which is fully based on newly income tax act of Nepal. He played a vital role in the literature of modern income tax system in Nepal by presenting the complicated provisions of new income tax system in Nepal by presenting the complicated provisions of new income tax by simplest way with theoretical as well as numerical illustrations where necessary.

Adhikari (2059), has also presented a book named *"Modern taxation in Nepal, (Theory and practice)"* which basically written for the students of B.B.S., L.L.B., M.B.S., M.P.A. and C.A., however, it is equally important to tax export, tax administrator and tax payer. In this book he has described the old and modern (1974 and 2002) income tax act and other corrections of income tax act 2002 (2058 B.S.), which were corrected in 2059B.S. and 2060 B.S. He has described the administrative structure and problems of new income tax act. Therefore this book has contributed a lot for conducting this research study.

2.2.2 Review of Research Reports:

Agrawal (1978), started the new phase of Nepalese income tax study from the widely explained research work "*Resources Mobilization for Development; the reform of income tax in Nepal*", published by center for economic development and administration (CEDA). He presented details about income tax in Nepal. His study analyzing vividly about role of income tax from legal aspect and administrative aspect, role of income tax for resource mobilization and other important facts. He has given his second contribution towards income tax in 1980 through his report 'Resource Mobilization in Nepal'. He has focused his efforts towards the new dimension in the side of Nepalese income tax. His study is the first comprehensive scientific study on the income taxation in Nepal. His facts and figures are very helpful to find out the condition of taxation in Nepal at that time. He had identified the major problems of income tax system as inefficiency of tax administration and income tax evasion though other many have been also shown. Various mathematical calculations have been shown as per capita burden of income tax, buoyancy coefficient of income tax, elasticity coefficient of income tax etc. His study may be the first comprehensive scientific study on the field of taxation.

In 2001, Revenue Consultation Committee Report has studied the overall taxation in depth. It emphasized to simplify the tax policy to voluntary compliance. This report recommended for written communication between taxpayer and tax administration rather than the informal relation. This report suggested to widen the income tax base by including all kinds of taxpayer and income and to find out the taxpayers of new sector. This report suggested making the acts more transparent and clear in order to attract the foreign and domestic investors.

Many of master's degree research works is conducted related to income tax of Nepal and tax system in Nepal. These research works are helpful for this study. **Shakya's (1995)** "*Income tax in the structure of Nepal*", **Bhattarai's (1997)** "*Effectiveness of Corporate income tax in Nepal*", **Serchan's (2003)** "*An analysis of fine and penalties regarding to income tax system of Nepal*", **Neupane's (2004)** "*A study on role of income tax in revenue collection of Nepal"* are the main dissertation which are related for this study.

Neupane (2004), in his dissertation entitled, *"A study on Role of Income Tax in collection of Nepal"*, collected view from income tax administration, income tax export and income tax payers through field survey in his dissertation. His major findings from his opinion survey are:

- Income tax is a suitable means of raising fund.
- Income tax paying habit of Nepalese people is poor.
- Fine and penalties can help to increase tax- paying habit of Nepalese people to some extent but it should not be used as only one tool for increasing taxpaying habit of Nepalese people.
- Tax education is must necessary in Nepal to increase the tax consciousness of taxpayer and voluntary compliance.
- Most specific objective of income taxation is to increase the public revenue and to promote economic development of the country.
- The income tax system of Nepal is not efficient, basically due to inefficient income tax administration, lack of consciousness of taxpayer and increasing habit of tax evasion.
- Inefficient tax administration, reluctance of taxpayers to maintain account, poor tax mentality and taxpayers' compliance are the major causes to tax evasion in Nepal.

- Clear act, rules and regulations are the most important factor for the effectiveness of income tax in Nepal.
- Current income tax act is more effective than previous.

"Income Tax Act 2002" has been implemented from 1st April 2002. This act replaces the old income tax act, "Income Tax Act 1974". Similarly, the new "Income tax rule 2002" has also been enacted for the purpose of effective implementation of the new act. Newly issued Finance Ordinance has been also enacted. This study has been conducted under these acts and other related rules and regulation.

Besides these, many of the course books for Bachelor and master's level, related to tax system in Nepal, are published. These books are also helpful to know the history, development, present situation, rules, importance, practice etc. Dr. Chandramani Adhikari, Mr. Kamal Deep Dhakal, Girija Prasad Koirala, Surendra Keshar Amatya, Dr. Bihari Binod Pokharel, Rewanta Kumar Dahal, Bhagwati Prasad, Dr. Puspa Raj Khadka, Dr. Rup Khadka etc. are the main writers related to income tax and tax system in Nepal.

In this way, many books, dissertation, reports, articles published in journals and newspaper like Rajaswa, Gorkhapatra, Kantipur, The Kathmandu post, The Himalayan Times, Annapurna Post etc. publication of ministry of finance such as Budget Speech, Economy Survey, Income and Expenditure report etc and different websites were reviewed in the study.

2.2.3 Review of Previous research works:

Chalise (2007), in his thesis entitled *"A study on contribution income tax to Government revenue"*. has tried to show the growth of income tax collection.

His main objectives are:

- To study the historical development of income tax in Nepal.
- To identify the ways and causes of income tax evasion in Nepal.
- To make suggestion and recommendation for the elimination of income tax

evasion.

His major findings are:

- Contribution of income tax for the economic development of Nepal has been increasing significantly in recent years. so much effort should be made to increase it.
- New income tax act is very complicated for both tax payers and tax officials so the complicated procedure under the act should be simplified.
- For the economic development problems relating to income tax system should be solved. Tax education packages should be made.

Shrestha (2009), in his thesis "*Revenue collection from Income Tax and its practical difficulties in Nepal"* has tries to analyze the revenue collection from income tax and its difficulties in Nepal.

His main objectives are:

- To review the tax collection system.
- To find out the problems in tax collection system.
- To provide the suggestions for effective tax collection.

His study has the following major findings:

- The percentage share of income tax to government revenue is not satisfactory in comparison to other developing country.
- Various problems existed in the income tax such as increasing habit of tax evasion, inefficient income tax administration, defective income tax law are the reasons of lower contribution of income tax.
- The cost of tax collection to taxpayer, government and economy as a whole can be reduced to some extent.

Neupane (2008), in his thesis "*A comparative study on contribution of Direct and Indirect tax to national revenue of Nepal*", has focused on the direct and indirect tax and its contribution.

His main objectives are:

- To find the contribution of direct and indirect tax to national revenue.
- To provide the suggestions for effective collection of direct and indirect tax.

His study has the following major findings:

- Income tax evasion is the major problem of Nepal for income tax generation.
- Tax education is most necessary in Nepal to increase the tax consciousness of tax payers.

Bista (2008), in his thesis entitled "*Classification of Income Tax payers and Contribution of Tax to Govenrment Revenue*", has focused on the classification of tax payers and its contribution to government revenue of Nepal.

His main objectives are:

- To classify the tax payers according to tax act 2058.
- To analyze the contribution of direct and indirect tax to government revenue.
- To analyze the problems of income tax system in Nepal.

His major findings are:

- The resource gap of Nepal can be minimized through effective internal resource mobilization.
- It is necessary to increase the share of share of direct tax for the sufficient resource mobilizations.
- There must be better understanding relationship between tax payers, tax administrators and policy makers.

Khatiwada (2005), in his thesis entitled "*Contribution of Income Tax in the Government Revenue of Nepal*" has focused on the historical background of income tax and the structure of direct and indirect tax.

His study has the following main objectives are:

- To study the historical development of income tax in Nepal.
- To measure the ability of income tax to meet the government current

requirements.

- To analyze the problems of revenue collection from income tax.

His study has the following major findings:

- Tax education and training are to made to familiarized people about the income tax act.
- Contribution of Income tax for economic development is increasing.

2.2.4 Research Gap:

The budgetary system of Nepal is deficit budgetary system from the beginning of the development phase. The rate of government expenditure is exceeding the rate of government revenue almost every year. Mobilization of internal resources through income taxation is one of the vital solutions for more revenue collection. In this regard, this study on the "contribution of income tax on government revenue of Nepal" is conducted. Income taxation covers one of the parts of whole tax structure of Nepal. Collection of income tax is in increasing trend each year, even though; it is not satisfactory to meet the budget deficit. Therefore, this study has been undertaken analytically and in intensively to analyze the role of income tax in government revenue. Empirical analysis of primary data has done. This research will be equally beneficial to the policy maker, planners, tax administration researcher, students and the person interested in income tax of Nepal.

CHAPTER-3

RESEARCH METHODOLOGY

3.1 Types of Research:

The main objective of this study is to find out the contribution of income tax in the government revenue of Nepal. For that this study includes three types of research as descriptive, analytical and experimental.

3.2 Research design:

This research study is focused on role and contribution of income tax, direct and indirect tax in the total tax revenue; effectiveness of income tax revenue collection in Nepal. Most of the data and information of the research are related with past performance. So it can be regarded as historical research design. To achieve the stated objectives of the study, the study of income tax act, finance act and other related acts, rules and regulations are made for making the study. For an empirical research, an opinion survey, used in different research, has been conducted. The opinion of income tax administrators, tax experts and taxpayers are used in this research.Thus, the research study based on the analytical as well as descriptive research.

3.3 Nature and source of data:

Most of the data and information to describe this study has been collected from secondary data. The secondary sources of data are received from books, journals, newspaper, reports, web sites and dissertations etc. the major sources of secondary data are economic survey and budget speech of different years of Nepal government, books related to income tax, dissertation related to income tax available at central library TU and other library etc. Basically secondary data are collected from the flowing sources:

- Economic survey and Budget speech of different years, MOF, Government of Nepal.

- Reports and records of Tax department and Inland Revenue Department, MOF, Government of Nepal.

- Books related to income tax, tax system and public finance.

- Newspaper, magazines, journals, souvenir, websites etc. related to income tax.

- Different reports, publications and documents of National planning commission, Central bureau of Statistics.

- Rajaswa magazine, Revenue administration Training center, Kathmandu.

- Dissertations related to income tax, available at library of Shanker Dev Campus, TU and other library.

- Other published and unpublished relevant record, data, reports, journals and articles on the related subject etc.

3.4 Data collection procedure:

Most of data and information used in the study is collected from secondary source. Published data form IRD, MOF, and other related office are carried out from these offices and downloaded from official site of these offices. Some of other related data are borrowed from related dissertations, articles, magazines, and newspapers.

This is the age of information technology. Different tools of information like magazine, newspaper, radio, television, encyclopedias, and websites are the main sources of information and data. For this study, maximum secondary data are downloaded from websites of Inland Revenue Department of Nepal.

3.5 Data processing and analysis procedure:

The information and data received from different sources in different aspect were firstly arranged for tabulation and analysis. The data were tabulated into different tables, formats and conditions according to the required subject matter. Then, the descriptive tools and statistical tools such as percentage, simple averages, moving average, variation, graphs, charts, diagrams etc. have been applied in the way of analysis to create the actual and clear findings.

CHAPTER-4

PRESENTATION AND ANALYSIS OF DATA

This Chapter deals with the analysis and interpretation of data following the research methodology dealt in the third chapter. In course of analysis, data gathered from the various sources have been inserted in the tabular form according to their homogeneous nature. Presentation and analysis of data of this study has been presented in this chapter with the help of data, related figures and statistical tools. They have been arranged as follows:

4.1 Structure of Public revenue in Nepal:

The structure of public revenue of Nepal includes different sources such as income tax, sales tax (VAT), land revenue and its registration charge, custom duty, excise duty, and miscellaneous tax and non tax revenue. Sales tax, which is now known as Value Added Tax, is occupied supreme position among the tax revenue.

Customs includes imports, exports, Indian excise fund and other duty. Excise includes industrial product and liquor contract. Income tax includes tax from public enterprises, semipublic enterprise, private organization, individual, remuneration and tax on interest. Miscellaneous tax includes entertainment tax, hotel tax, air flight tax, contracts tax, road and bridge maintenance tax, urban house and land tax, vehicle tax and others.

Table 4.1

Structure of Government Revenue in Nepal

(Rs. in Millions)

Fiscal Year	Customs	Excise	Sales Tax VAT	Income tax	Land Revenue & Registration	Miscellaneous Tax	Non Tax Revenue	Total
2002/03	14236.43	4785.12	13459.7	7966.09	1414.30	725.29	13642.86	56229.79
2003/04	15554.80	6226.70	14478.9	9245.90	1697.50	969.20	14158	62331
2004/05	15701.60	6445.90	18885.4	10159.40	1799.20	1113.20	16018	70122.70
2005/06	15344	6507.60	21610.7	10373.70	2181.10	1413.30	14851.60	72282
2006/07	16707.60	9343.20	26095.6	15034	2253.50	1692.80	16585.5	87712.20
2007/08	21062.50	11189.58	29815.7	17311.22	2940.74	2835.80	22466.95	107622.50
2008/09	26792.90	16220.90	39700.9	25142.40	5223.30	3955	26422.60	143458

Source: Economy survey 2009/10 Ministry of Finance, Government of Nepal

Notes:

1. Customs includes Imports + Exports+ Indian Excise fund + other duty
2. Excise includes Industrial product + Liquor contract
3. Income tax includes tax from(public enterprises + semi public enterprises+ private organization + individuals + remuneration + tax on interest)
4. Miscellaneous tax includes (Entertainment tax + Hotel tax + Air flight tax + Contracts tax + Road and Bridge maintenance tax + Urban house and land tax + Vehicle tax + others)

Table 4.2

Structure of Government Revenue in Nepal

(In Percentage)

Fiscal Year	Customs	Excise	Sales Tax Vat	Income tax	Land revenue and registration	Miscellaneous tax	Non tax revenue	Total
2002/03	25.32	8.51	23.94	14.17	2.52	1.29	24.26	100
2003/04	24.96	9.99	23.23	14.83	2.72	1.55	22.71	100
2004/05	22.39	9.19	26.93	14.49	2.57	1.59	22.84	100
2005/06	21.23	9.00	29.90	14.35	3.02	1.96	20.55	100
2006/07	19.05	10.65	29.75	17.14	2.57	1.93	18.91	100
2007/08	19.57	10.40	27.70	16.09	2.73	2.63	20.88	100
2008/09	18.68	11.31	27.67	17.53	3.64	2.76	18.42	100
Average	**21.60**	**9.86**	**27.02**	**15.51**	**2.82**	**1.96**	**21.22**	

Source: Table 4.1

The structure of public revenue in Nepal is presented in table 4.1 and 4.2 from the fiscal year 2002/03 to 2008/09. The table shows the structure of public revenue of Nepal by different sources such as income tax, sales tax (VAT), land revenue and its registration charge, custom duty, excise duty, and miscellaneous tax and non tax revenue. Sales tax, which is now known as Value Added Tax, is occupied supreme position among the tax revenue. Revenue from sales tax (VAT) increased from Rs. 13459.7 million to Rs. 39700.9 million from 2002/03 to 2008/09. The average contribution of sales tax (VAT) to total revenue for last 7 years is 27.02 percent.

Among various tax revenues, custom occupies the second position. The revenue from customs varies from Rs. 14236.43 million to Rs. 26792.9 million from 2002/03 to 2008/09. The average contribution of custom to total revenue for last 7 year is 21.60 percentages. Similarly income tax occupies the third rank among tax revenue. Revenue from income tax increases from Rs. 7966.09 million to Rs. 25142.4 million from 2002/03 to 2008/09. On the basis of average contribution, income tax is in the third position. The trend of income tax revenue is in increasing trend. The average contribution of income tax to total revenue for the past 7 year was 15.51 percent. Revenue from excise is increasing in each year. It increases from Rs. 4785.12 million in the year 2002/03 to Rs. 16220.90 million in the year 2008/09. The average contribution of excise to total revenue from fiscal year 2002/03 to 2008/09 is 9.86%. Land revenue and registration also increases from Rs.1414.30 million to Rs. 5223.30 million from fiscal year 2002/03 to 2008/09. But the Percentage contribution of land revenue and registration to total revenue declines from 3.02 % in year 2005/06 to 2.73% in year 2007/08. The average contribution of land revenue & registration to total revenue in the 7 years is 2.82%.

In the above table 4.2 shows five taxes (custom, excise, Vat, income tax and Land revenue & Registration) are the major taxes in the structure of tax revenue. Revenue from miscellaneous tax is increasing trend from fiscal year 2002/03 to 2008/09. Similarly percentage contribution to total revenue is also in increasing trend. The revenue from miscellaneous tax is also increasing. Its contribution to total revenue in the fiscal year 2002/03 was 725.29 million and reached to 3955 million in the fiscal year 2008/09 which is maximum contribution over the study periods. The average contribution of miscellaneous tax to total revenue in the last 7 years is 1.96%.

Non tax revenue also constitutes a major part in the structure of public revenue on-tax revenue also increases from fiscal year 2002/03 to 2008/09 that it increases from Rs. 13642.86 million to Rs. 26422.6 million. But in 2005/06 it becomes in decreasing & become Rs.14851.06 million where it is Rs.16018 in year 2004/05. The average contribution of non-tax revenue to the total revenue for past 7 years is 21.22%.

4.2 Resource Gap in Nepal:

As other developing countries in the world, Nepal is suffering from resource constraint, mass poverty, rapid growth of population, dependence on agriculture, subsistence living standard etc. despite over 40 years planned developments effects. In Nepal, the source mobilization is still poor that does not cover the rapid growing expenditure. Fiscal deficit is due to the continuously growing expenditure of the government instead of the low revenue performance in Nepal.

Table 4.3

Resource Gap in Nepal

(Rs in Millions)

Fiscal year	**Total Public Expenditure (A)**	**Total Public Revenue (B)**	**Resource Gap (A-B)**	**Foreign Grants and loan (C)**	**Fiscal Gap (A-B-C)**
2002/03	84006.1	56229.8	27776.3	15885.5	11890.8
2003/04	8944.26	62331	27111.6	18912.4	8199.2
2004/05	102560.4	70122.7	32437.7	23657.3	8780.4
2005/06	110889.2	72282.1	38607.1	22041.8	16565.3
2006/07	133604.6	87712.1	45892.5	25854.3	20038.2
2007/08	161349.9	107622.5	53727.4	29300.6	24426.8
2008/09	219661.9	143474.5	76187.4	36351.7	39835.7

Source: Economic Survey 2009/2010 Ministry of Finance, Government of Nepal

As shown in the table, during the period 2002/03 to 2008/09, resource gap increases from Rs. 27776.3 million to Rs. 76187.4 million. Even if foreign grants and loan are included in revenue, the fiscal gap increases from Rs. 11890.8 million to Rs. 39835.7 million during the period. This increasing resource gap indicates that it is necessary to mobilize additional domestic resources. The increasing gap between government expenditure and revenue and high fiscal deficit causes economic distortion such as increase in prices, large flow of imported foods and services and low level of domestic saving and heavy balance on external debt. Increasing trend in government expenditure outpaces the growth in revenue collection in Nepal.

The table below shows clear indication of the serious financial resources problem in Nepal. The trend of resources and fiscal gap indicates that there is urgent for mobilization additional resources. Income tax is a major instrument to mobilize additional resources for achieving the desired objectives of the country.

In above table shows that the resource gap is increasing every year except in the year 2003/04. From the fiscal year 2002/03 to the fiscal year 2003/04, the resource gap decreases and reaches to Rs. 27111.6 million from Rs. 27776.3 million. Then it increases to Rs.32437.7 million. Again it starts to increase and reaches to Rs. 76187.4 million in the fiscal year 2008/09. Similarly, the fiscal gap is also increasing trend except in the year of 2003/04. Then it increases to Rs.8780.4 million in the fiscal year 2004/05. Again it starts to increase and reaches to Rs. 39835.7 million in the fiscal year 2008/09.

4.3 Structure of Tax and non tax Revenue of Nepal:

The composition of total revenue constitutes tax and non tax revenue. The share of tax revenue has always been greater than the share of non tax revenue. Contribution of tax revenue is very much important in revenue mobilization of Nepal. For the meeting of the increasing trend of government expenditure, tax revenue has been placed as a major source of government revenue of Nepal.

Table 4.4

Contribution of Tax and Non Tax Revenue in Nepal

(Rs. Million)

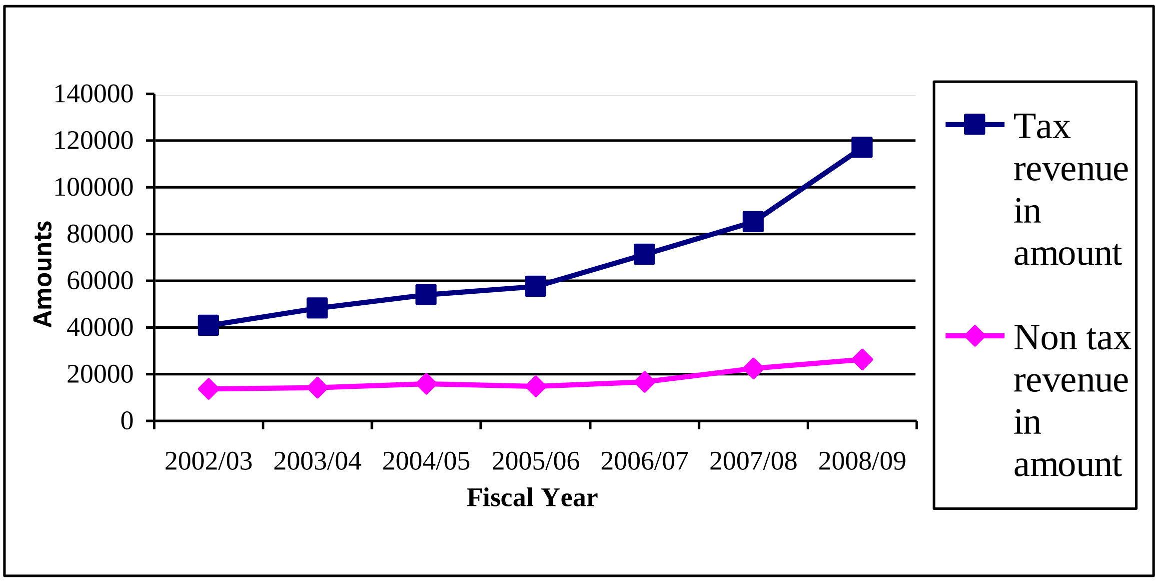
Fiscal year	Total Revenue in Rs.	Tax revenue		Non tax revenue	
		in amount	in %	in amount	in %
2002/03	56229.8	40896	72.73	13642.86	24.26
2003/04	62331	48173	77.29	14158	22.71
2004/05	70122.7	54104.7	77.16	16018	22.84
2005/06	72282.1	57430.4	79.45	14851.6	20.55
2006/07	87712.1	71126.7	81.09	16585.5	18.91
2007/08	107622.5	85155.54	79.12	22466.95	20.88
2008/09	143474.5	117051.9	81.58	26422.6	18.42

Source: Economic survey 2009/2010, Ministry of Finance, Government of Nepal

The above table shows that the amount of tax revenue increasing every year with amount of Rs. 40896 million to Rs. 117051.9 million, from the fiscal year 2002/03 to 2008/09. The percentage of tax revenue in total government is fluctuating in different years. The contribution of tax revenue to total revenue is maximum with 81.58 % in 2008/09 and minimum with 72.73% in 2002/03.

Figure 4.1

Trend of Tax & Non Tax Revenue



Similarly, the above figure exhibits the trend of non tax revenue is also fluctuating during the period from 2002/03 to 2008/09. It is Rs. 13642.86 million in the fiscal year 2002/03 and reaches to Rs. 26422.6 in the fiscal year 2008/09. The trend of non tax revenue is also increasing. The contribution of non tax revenue to the total revenue reaches to the maximum level of 24.26% in the fiscal year 2002/03 where as it is to the minimum level of 18.42% in the fiscal year 2008/09.

4.4 Tax-GDP ratio in Nepal:

There is proved statement that Nepal is one of the least developed country and it is one of the lowest taxed economy. Nepal's GDP growth is less than its population growth. Nepal is facing a problem of low revenue performance. Nepalese tax revenue as the percent of GDP is the lowest on all the low income economic countries. According to World Bank Report, the moderate Tax GDP ratio ranged from 15 to 18 percent in other developing countries. But in Nepal, it is obvious from the fact that Tax GDP ratio is around 12% in average throughout the fiscal year and Revenue GDP ratio is around 15% in average. Following table shows the scenario of tax GDP ratio for the period of 2002/03 to 2008/09.

Table 4.5

Tax GDP and Revenue GDP ratios in Nepal

(Rs in Millions)

Fiscal Year	GDP	Tax Revenue	Total Revenue	Tax GDP ratio	Revenue GDP ratio
2002/03	437546	40896	56229.8	9.73	12.85
2003/04	474919	48173	62331	10.14	13.12
2004/05	508651	54104.7	70122.7	10.64	13.79
2005/06	557869	57430.4	72282.1	10.29	12.96
2006/07	572719.13	71126.7	87712.1	12.42	15.32
2007/08	603489.67	85155.54	107622.5	14.11	17.83
2008/09	678084.84	117051.9	143474.5	17.26	21.16

Source: Economic survey 2009/2010, Ministry of Finance, Government of Nepal

Note: GDP is taken as nominal GDP at current market price

Above table shows that Tax GDP and Revenue GDP ratio in Nepal from fiscal year 2002/02 to 2008/09. Tax GDP ratio is increasing trend except in the year 2005/06. Revenue GDP ratio is slowly and gradually increases and reaches to 21.16 percent in the fiscal year 2008/2009 from 12.85 percent in the fiscal year 2002/2003.

4.5 Composition of Direct and Indirect Tax in Nepalese Tax Revenue:

Tax revenue is the principal source of the government revenue; however its contribution differs significantly in different countries. It is clear that the whole Nepalese tax structure is dominated by indirect tax revenue.

The trend and also in absolute value, total tax revenue, direct and indirect tax is increasing. Direct tax includes income tax, land revenue and registration, urban house and land tax, property tax, vehicle tax etc. whereas indirect tax includes customs, sales tax (VAT), entertainment tax, hotel, air flight tax, contact tax, road and bridge maintenance tax etc.

Table 4.6

Composition of Total Tax Revenue

(Rs in millions)

Fiscal year	**Total Tax revenue**	**Direct Tax Revenue**		**Indirect Tax Revenue**	
		In Rs.	**%**	**In Rs.**	**%**
2002/03	40896	10105.68	23.73	32481.25	76.27
2003/04	48173	11912.6	24.73	36260.4	75.27
2004/05	54104.7	13071.8	24.16	41032.9	75.84
2005/06	57430.4	13968.1	24.32	43462.3	75.68
2006/07	71126.7	18980.3	26.69	52146.4	73.31
2007/08	85155.54	23087.76	27.11	62067.78	72.89
2008/09	117051.9	34320.7	29.32	82731.20	70.68

Source: Economic Survey 2009/2010 Ministry of Finance, Government of Nepal

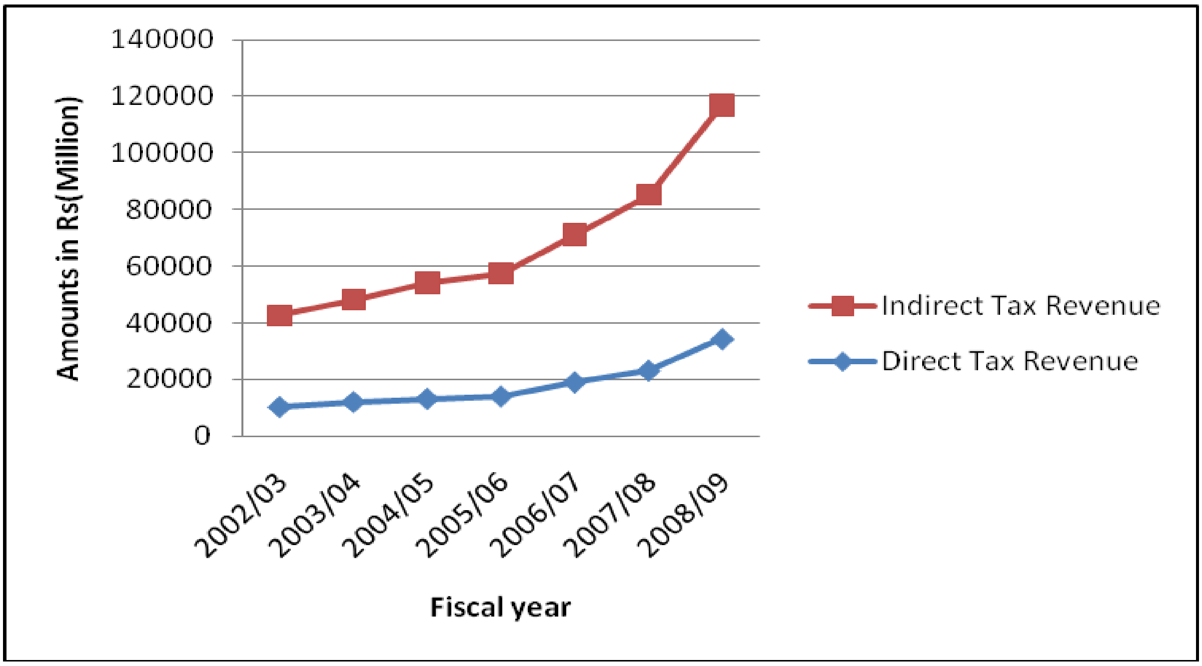
Table 4.6 reflects that the amount of direct tax is Rs. 10105.68 million in the fiscal year 2002/03, which covers 23.73 percent of total tax revenue, and it is increasing trend and reaches to Rs. 34320.7 million in the fiscal year 2008/09, which covers 29.32 percent of the total tax revenue.

Similarly, the amount of indirect tax is Rs. 32481.25 million in the fiscal year 2002/03, which covered 76.27 percent of total tax revenue, and it is also increasing each year and reaches to Rs. 82731.20 million in the fiscal year 2008/2009 and it covers 70.68 percent of the total tax revenue.

Comparison of direct and indirect tax reveals the heavy reliance of economy on indirect taxation. To divert the economy in the channel of development, it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax. Therefore, the attention should focus on the sufficient resource mobilization through direct taxation. The trend of direct tax and indirect tax revenue is shown in figure 4.2.

Figure 4.2

Trend of Direct & Indirect Tax Revenue



The above trend of direct and indirect tax revenue show that direct tax and indirect and direct is increasing. From the figure it is clear that indirect is increasing in higher ratio than the direct tax. The maximum indirect tax is 82731.20 millions in the fiscal year 2008/09 and the maximum direct tax is 34320.7 millions in the fiscal year 2008/09.

4.6 Structure of Direct tax in Nepal

A direct tax is really paid by the person or entity to which it is legally imposed. Direct tax includes income tax, land revenue and registration, gift tax, interest tax, property tax, vehicle tax, house and land tax, contract tax etc. Direct tax is a levy by the government on the income and wealth received by household and business enterprises in order to raise revenue. The data, provided by IRD has classified Direct tax into different major sections. Among various direct taxes, income tax has contributed the maximum position.

Table 4.7

Structure of Direct Tax in Nepal

(Rs in Millions)

Fiscal year	Income Tax	Land and Revenue Registration	Urban house and land Tax	Vehicle Tax	Other Tax	Total Direct Tax	%of Income Tax
2002/03	7966.09	1414.3	0.04	559.48	165.77	10105.68	78.83
2003/04	9245.9	1697.5	0	700.6	268.6	11912.6	77.61
2004/05	10159.4	1799.2	0	806.5	306.7	13071.8	77.72
2005/06	10373.7	2181.1	0	847.6	565.7	13968.1	74.27
2006/07	15034	2253.5	0	995	697.8	18980.3	79.21
2007/08	17311.22	2940.74	0	1069.21	1766.59	23087.76	74.98
2008/09	25142.4	5223.3	0	1850	2105	34320.7	73.26

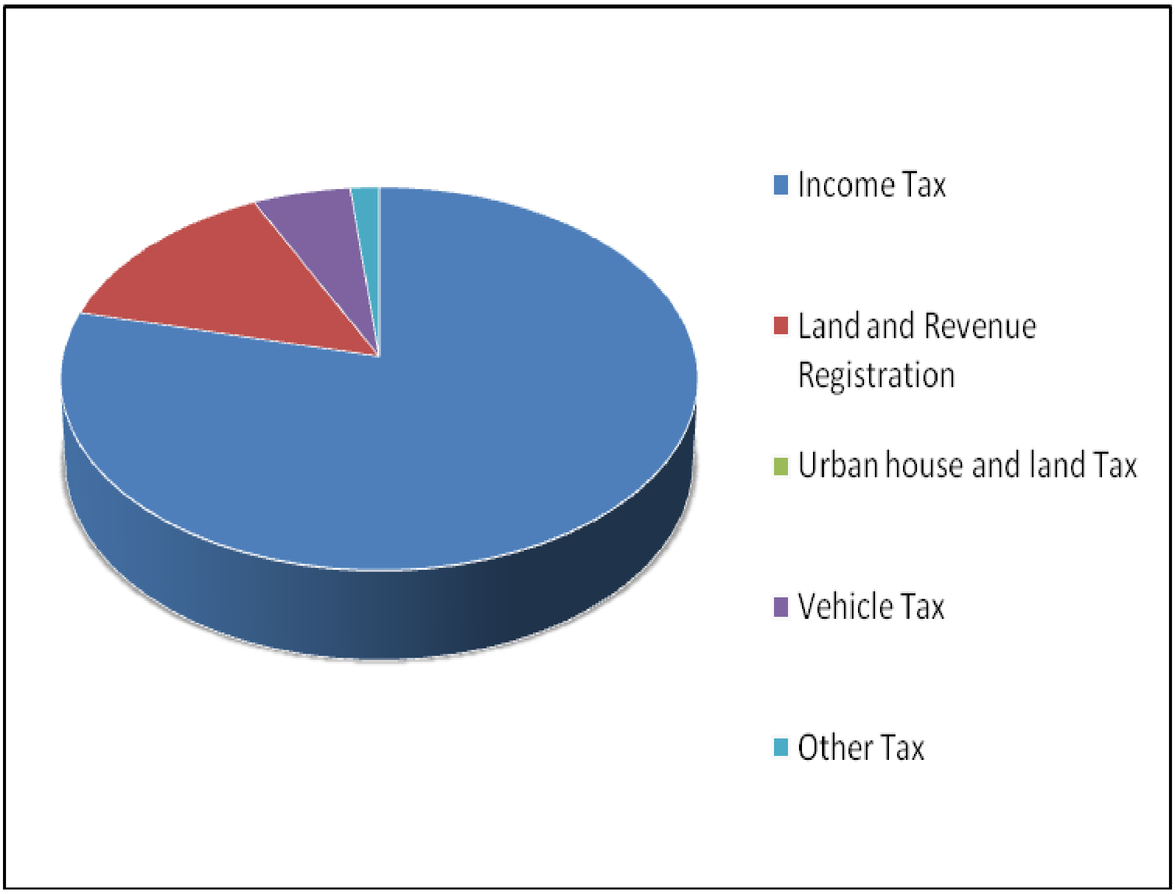
Source: Economic survey 2009/2010 Ministry of Finance, Government of Nepal

The composition of direct tax in Nepal presents in table 4.7 from the fiscal year 2002/03 to 2008/09. The revenue from direct tax varies from Rs. 10105.68 million to Rs. 34320.70 million from fiscal year 2002/03 to 2008/09. Similarly, the revenue from income tax also varies from Rs. 7966.09 million to Rs. 25142.40 million from the fiscal year 2002/03 to 2008/09. Trend of income tax collection is increasing.

The collection trend of direct tax is increasing every year. Normally other direct taxes are also good increasing trend. On the other hand, amount collected from vehicle tax is high increasing trend. It is Rs.559.48 million in the fiscal year 2002/2003 and increases to Rs. 1850 million in fiscal year 2008/2009. Due to the increases number of vehicles in Nepal, contribution of vehicle tax to total direct tax is increasing day by day.

Figure 4.3

Composition of Direct Tax



The direct tax is composed of income tax, land and revenue tax, urban house and land tax, vehicle tax and other tax. Above chart shows that income tax occupies the highest position in the structure of direct tax. The structure of land and revenue tax occupies in second position. Similarly vehicle tax occupies third position. Therefore contribution of income tax is higher than other taxes to the direct tax revenue.

4.7 Structure of Indirect Tax in Nepal:

An indirect tax is imposed on one person but paid partly or wholly by another. Indirect tax levied on the spending of goods and services and tax is not directly paid to the government by the real taxpayers. Indirect tax includes export/import duty (customs tariff), excise duty, sales tax (VAT). And Value Added Tax (VAT) includes entertainment tax, hotel tax, passenger tax, contract tax etc.

Table 4.8

Structure of Indirect Tax in Nepal

(Rs in Millions)

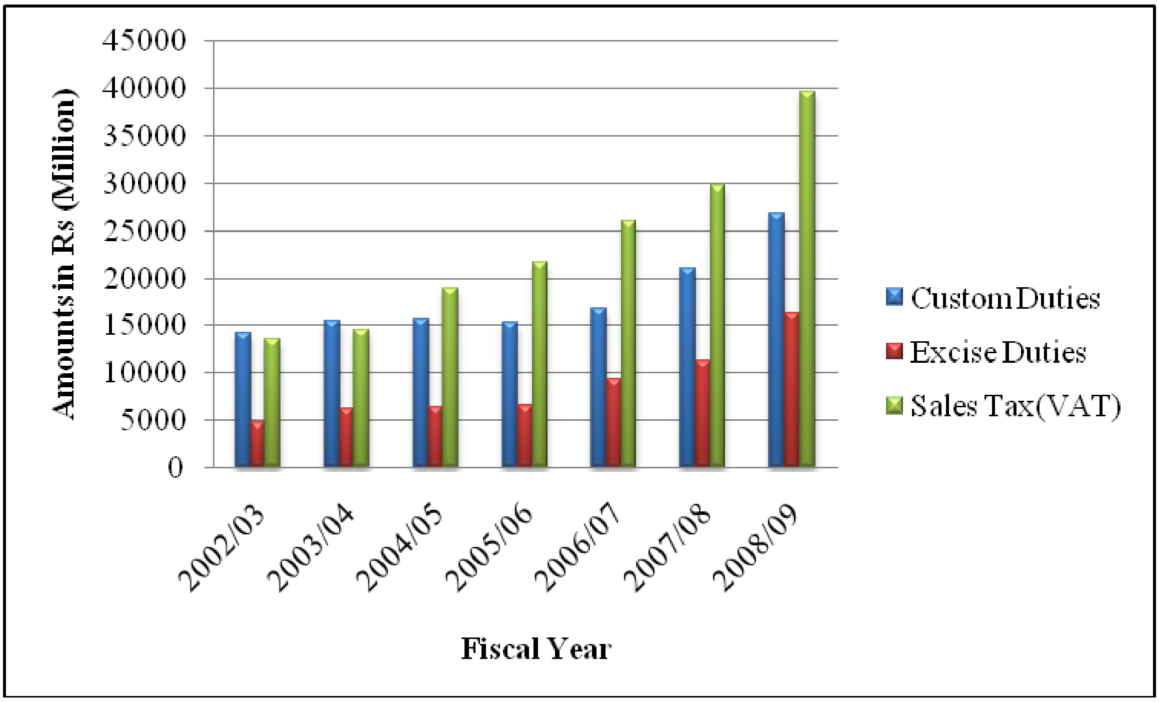
Fiscal year	**Total Indirect Tax**	**Custom Duties**		**Excise Duties**		**Sales Tax(VAT)**	
		in Rs	**In %**	**In Rs**	**In %**	**In Rs**	**In %**
2002/03	32481.25	14236.43	43.83	4785.12	14.73	13459.70	41.44
2003/04	36260.40	15554.80	42.90	6226.70	17.17	14478.90	39.93
2004/05	41032.90	15701.60	38.27	6445.90	15.71	18885.40	46.03
2005/06	43462.30	15344.00	35.30	6507.60	14.97	21610.70	49.72
2006/07	52146.40	16707.60	32.04	9343.20	17.92	26095.60	50.04
2007/08	62067.78	21062.50	33.93	11189.58	18.03	29815.70	48.04
2008/09	82731.20	26792.90	32.39	16220.90	19.61	39700.90	47.99

Source: Economic survey 2009/2010 Ministry of Finance, Government of Nepal

The above table reflects that the composition of direct tax in Nepal from the fiscal year 2002/03 to 2008/09. The revenue from indirect tax varies from Rs. 32481.25 million to Rs. 82731.20 million from fiscal year 2002/03 to 2008/2009. Indirect tax is slow increasing trend. Major part of indirect tax is custom duty then sales tax (VAT) and excise duties.

Figure 4.4

Structure of Indirect Tax in Nepal



Indirect tax includes the custom duties, excise duties and sales tax (VAT). Among which sales tax contribute highest and custom duties. Above figure shows the structure and contribution of custom duties, excise duties and sales tax to the indirect tax revenue. In the most of the fiscal year contribution from custom duties and sales tax is higher. The contribution of excise duties to the indirect tax is small in most the fiscal year.

4.8 Structure of income tax revenue in Nepal:

Income tax is the direct tax and it is important source of direct tax. Nepal is levying three different taxes: Individual income tax, corporate income tax and interest tax. Individual income tax covers all individuals having income of taxable capacity. Corporate income tax is levied on the profit of corporation. Interest tax is levied on the interest received from investment.

The structure of income tax revenue from recent 7 years is presented in the table 4.9 and 4.10 and figures 4.5, 4.6 and 4.7. Income tax is increasing each year.

Table 4.9

Structure of Income Tax Revenue in Nepal

(Rs in Millions)

Fiscal year	Total Income Tax	Income tax from public Enterprises	Income tax from Semi public Enterprises	Income tax from private Corporate Bodies	Income Tax from Individuals	Income tax from Remunerations	Tax on Interest
2002/03	7966.09	1251.02	0.00	1236.27	3362.20	1252.60	864.00
2003/04	9245.90	2056.60	0.00	1531.30	3533.40	1391.20	733.40
2004/05	10159.40	1332.40	0.00	2467.80	3926.30	1675.90	757.00
2005/06	10373.70	195.70	0.00	3404.30	4234.70	1764.10	774.90
2006/07	15034.00	1019.70	0.00	5717.10	5234.40	2007.90	1054.90
2007/08	17311.22	204.58	0.00	7186.46	6381.21	2451.04	1087.93
2008/09	25142.40	959.10	0	9425.10	9875.10	3195.60	1685.10

Source: Economic survey 2009/2010, Ministry of Finance, Government of Nepal

Table 4.10

Structure of Income Tax Revenue in Nepal

(In Percentages)

Fiscal year	Total Income Tax	Income tax from public Enterprises	Income tax from Semi public Enterprises	Income tax from private Corporate Bodies	Income Tax from Individuals	Income tax from Remunerations	Tax on Interest
2002/03	100.00	15.70	0.00	15.52	42.21	15.72	10.85
2003/04	100.00	22.24	0.00	16.56	38.22	15.05	7.93
2004/05	100.00	13.11	0.00	24.29	38.65	16.50	7.45
2005/06	100.00	1.89	0.00	32.82	40.82	17.01	7.47
2006/07	100.00	6.78	0.00	38.03	34.82	13.36	7.02
2007/08	100.00	1.18	0.00	41.51	36.86	14.16	6.28
2008/09	100.00	3.81	0.00	37.49	39.28	12.71	6.70

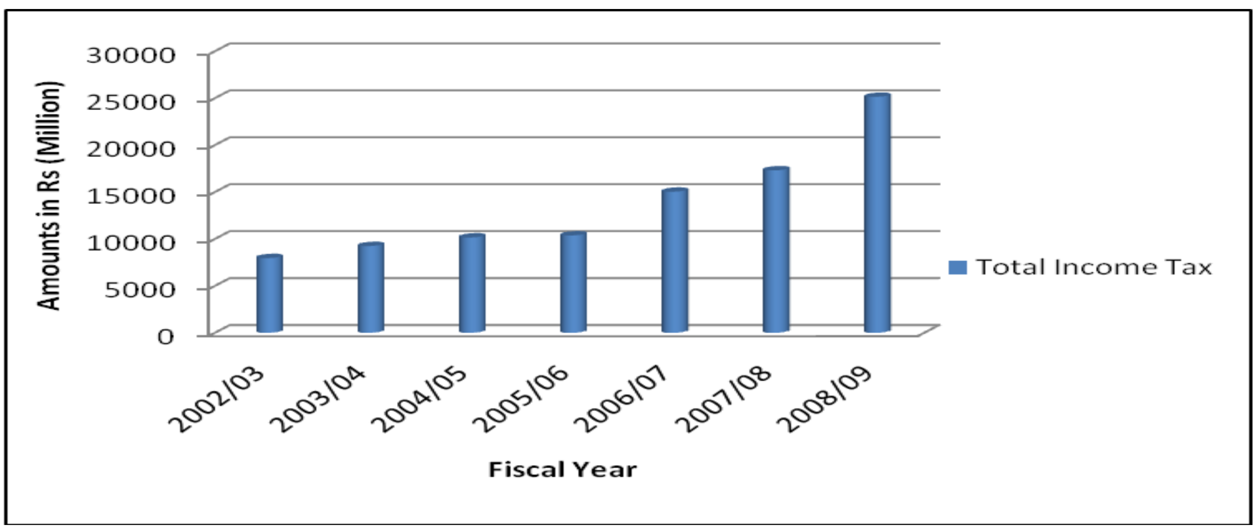
Source: Table 4.9

Above tables show that the total income tax is Rs. 7966.09 million in the fiscal year 2002/03 and reaches to Rs. 25142.40 million in the fiscal year 2008/2009. This is the highest collected amount of income tax over the study period. These all are accumulated of all types' income tax.

Contribution of total income tax from public enterprises is fluctuated from Rs.195.70 million, lowest, to Rs.2056.60 million highest. From last few years, its trend is in decreasing. Similarly, contribution of total income tax from semi public enterprises is not satisfactory that means trend is in fluctuate situation. Even, it is lowest then other. After restructuring the source of income in the fiscal year, share of semi public enterprises are not clear. Normally, the trend of income tax from private corporate bodies is increasing. It is Rs. 1236.27 million in the fiscal year 2002/03 and reaches to highest value Rs. 9425.10 million in the fiscal year 2008/09. Contribution of individuals' tax to total income tax is increasing each year. Share of individual tax is Rs. 3362.20 million in the fiscal year 2002/03. The highest contribution of individual tax over the study period is Rs 9875.10million in the fiscal year 2008/09. In the same way, remuneration tax revenue is increasing every year. The highest contribution of remuneration tax over the study period is Rs 3195.60 million in the fiscal year 2008/09. Similarly interest tax is also increasing every fiscal year and reaches to Rs. 1685.10 million which is highest in the fiscal year 2008/09 from Rs. 864.00 million in the fiscal year 2002/03.

Figure 4.5

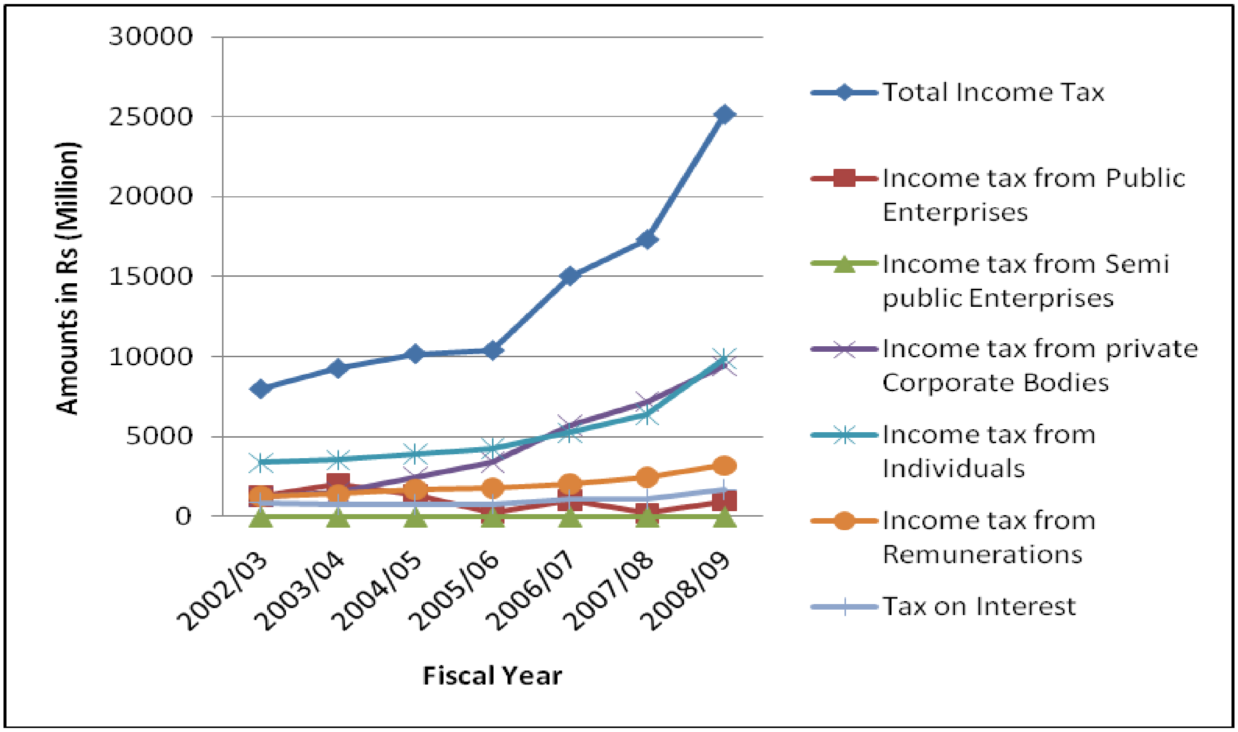
Trend of Total Income Tax Revenue



Above figure shows the trend of total income tax revenue from the fiscal year 2002/03 to 2008/09. It shows the increasing trend of total income tax revenue. In the fiscal year 2002/03 total income tax is 7966.09 millions and it increases to 25142.40 million in the fiscal year 2008/09. From the above figure it is clear that total income tax increased every fiscal year.

Figure 4.6

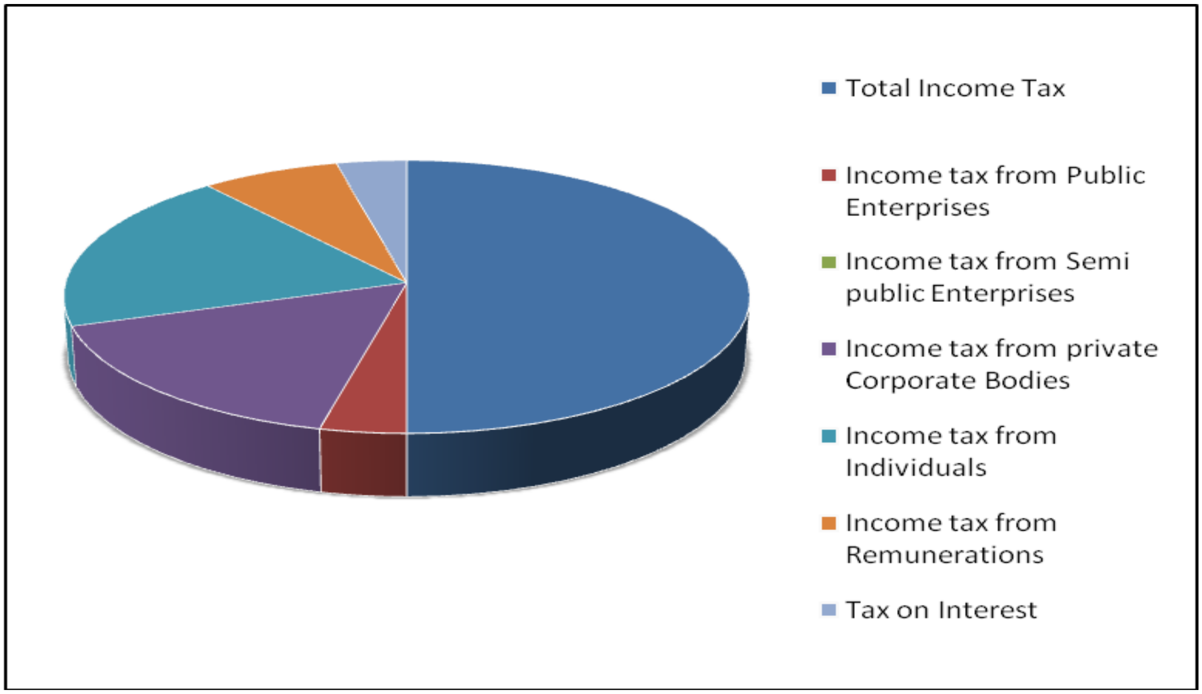
Trend of Income Tax Revenue



Above figure shows the trend of income tax revenue from the fiscal year 2002/03 to 2008/2009. Total income tax revenue includes the income tax from public enterprises, income tax from semi public enterprises, income tax from private corporate bodies, income tax from individuals, income tax from remunerations and tax on interests. Contribution of income from public enterprises is fluctuated. The contribution of income tax from semi public enterprises is not satisfactory. But the trend of income tax from private corporate bodies is increasing. The contribution of income tax from individual is also fluctuated. Income tax from remuneration is increasing every year. Similarly income tax on interest is also in increasing trend.

Figure 4.7

Average Contribution of Income Tax



Above figure shows the average composition of income tax revenue. Income tax revenue includes the income tax from public enterprises, income tax from semi public enterprises, income tax from private corporate bodies, income tax from individuals, income tax from remunerations and tax on interest. Among these average contribution of income tax from individuals is higher. After this, the composition of income tax from private corporate bodies is second higher. And then contribution of income tax from remuneration, income tax from public enterprises and tax on interest is satisfactory. But the contribution of income tax from semi public enterprises is not satisfactory.

4.9 Contribution of Income Tax

Income tax is one of the important sources of government revenue of Nepal. Its contribution to the total revenue, total tax revenue, direct tax revenue and GDP, and ratios to other sources of total revenue is showed as below.

Table 4.11

Contribution of Income Tax

(Rs in million & percentage)

Fiscal year	Income tax Revenue	Total Revenue	Total Tax Revenue	Direct Tax Revenue	GDP	% of Income tax on Total Revenue	% of Income Tax on Total tax Revenue	% of Income Tax on Direct Tax Revenue	% of Income Tax on GDP
2002/03	7966.09	56329.79	42586.93	10105.68	437546.00	14.14	18.71	78.83	1.82
2003/04	9245.90	62431.00	48173.00	11912.60	474919.00	14.81	19.19	77.61	1.95
2004/05	10159.40	70222.70	54104.70	13071.80	508651.00	14.47	18.78	77.72	2.00
2005/06	10373.70	72382.00	57430.40	13968.10	557869.00	14.33	18.06	74.27	1.86
2006/07	15034.00	87812.20	71126.70	18980.30	572719.13	17.12	21.14	79.21	2.63
2007/08	17311.22	107722.49	85155.54	23087.76	603489.67	16.07	20.33	74.98	2.87
2008/09	25142.40	143474.50	117052	34320.70	678084.80	17.52	21.48	73.26	3.71

Source: Economic survey 2009/2010 Ministry of Finance, Government of Nepal

Table 4.11 shows the contribution of income tax from the fiscal year 2002/03 to 2008/2009. In the fiscal year 2002/03 total revenue is Rs. 56329.79 million. Out of which total tax revenue is Rs. 42586.93 million, direct tax revenue is Rs. 10105.68 millions and income tax revenue is Rs. 7966.09 millions. And the GDP for the fiscal year 2002/03 is Rs. 437546 millions. Where, percentage of income tax on total revenue, on total tax revenue, on direct tax revenue and GDP are 14.14%, 18.71%, 78.83% and 1.82% respectively. The above data shows that the there is continuous incensement of income tax revenue and direct tax revenue. The income tax revenue is increasing and reached to maximum at 2008/2009 of Rs. 25142.40 millions. Total revenue and total tax revenue is continuously increasing throughout the years.

4.9.1 Contribution of Income Tax to Total Revenue

Total revenue includes total tax and non tax revenue. Tax revenue has contributed the maximum part of public revenue. Contribution of income tax is Nepalese total revenue is presented in table 4.9 and its trend shows in the figure 4.8.

Figure 4.8

Income Tax as % of Tax on Total Revenue

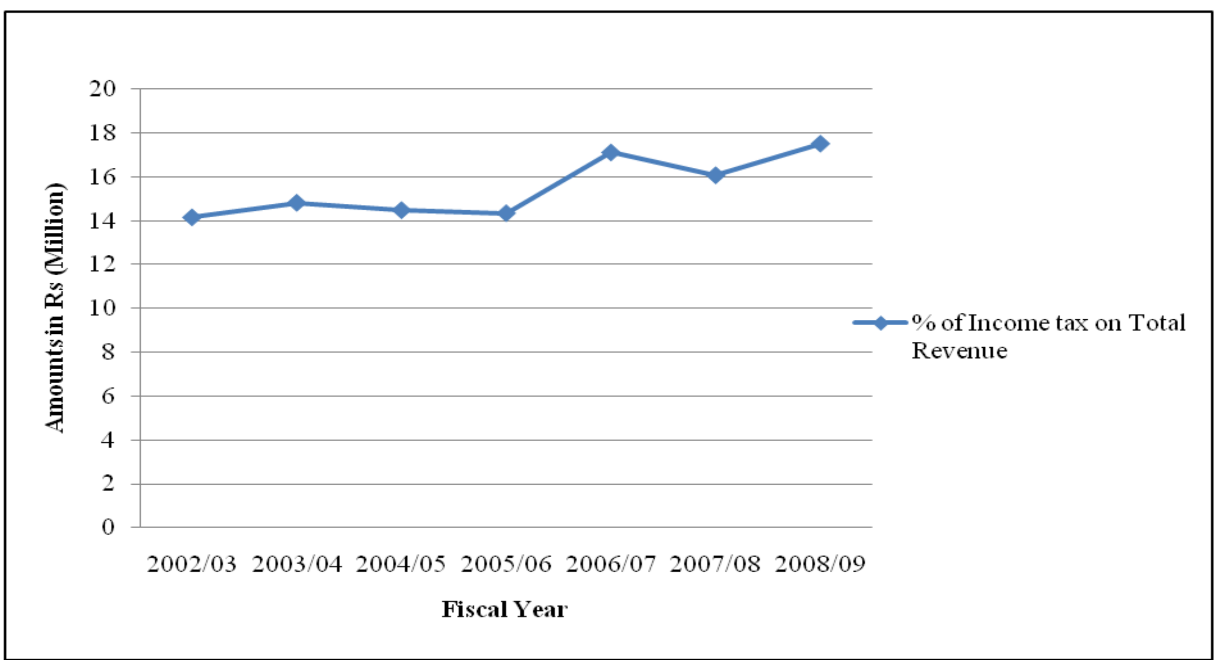


Table and figure shows contribution of income tax to total revenue is fluctuating from 14.14 percent to 17.52 percent over 7 years. Contribution for the fiscal year 2004/05 is 14.47 percent and it declines to 14.33 percent in the fiscal year 2005/2006. There is fluctuating every fiscal year.

4.9.2 Contribution of Income Tax to Total Tax Revenue

Total tax revenue includes direct tax and indirect tax revenue. Indirect tax revenue has contributed the maximum and dominant part of tax revenue. Contribution of income tax in Nepalese total tax revenue is presented in table 4.11 and its trend shows in the figure 4.9.

Figure 4.9

Income Tax as % of Tax on Total Tax Revenue

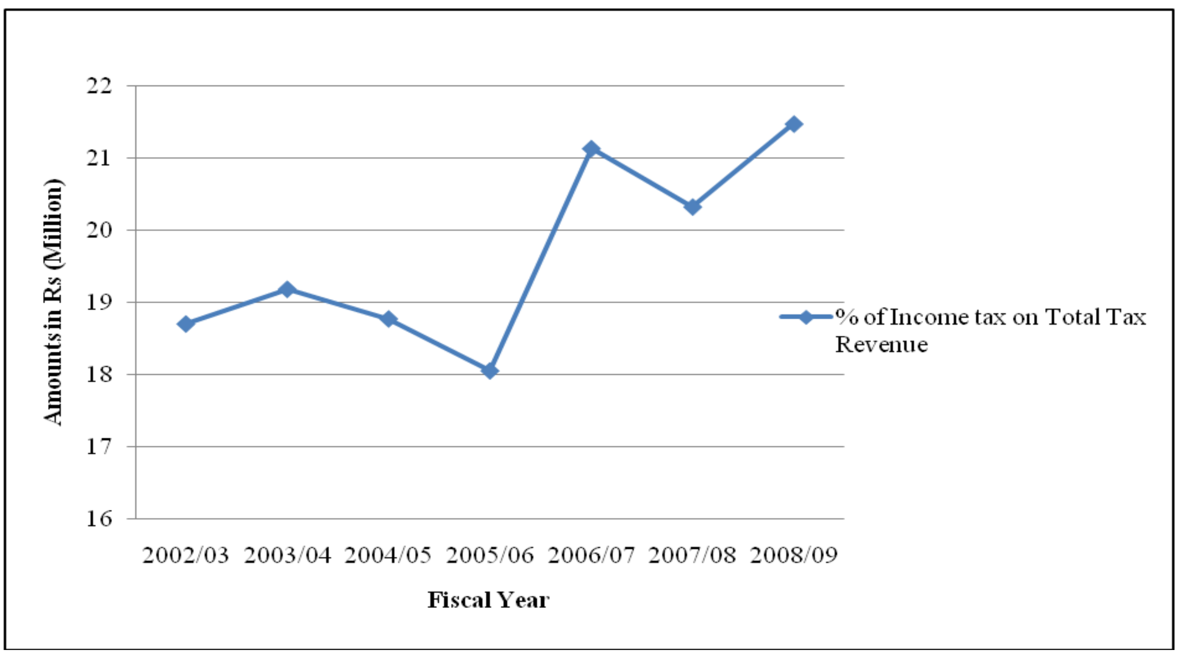


Table and figure shows the average contribution of income tax to total tax revenue is 19.67 percent. It is fluctuating from 18.78 percent to 21.48 percent over 7 years.

Contribution for the fiscal year 2004/05 is 18.78 percent but it has decline to 18.06 percent in the fiscal year 2005/06, which is minimum contribution over the study period. Then it is in increasing trend and reaches to 21.14 percent in the fiscal year 2006/07. Again it starts to decline and reaches to 20.33 percent in the fiscal year 2007/08 and then it starts to increase to 21.48 in the fiscal year 2008/09 which is maximum contribution over the study period.

4.9.3 Contribution of Income Tax to Direct Tax Revenue

Direct tax revenue includes: Income tax, land revenue and registration, urban house and land tax, vehicle tax (property tax) and other taxes. Income tax revenue has contributed the maximum and dominant part of Nepalese direct tax revenue is presented in table 4.11 and its trend shows in the figure 4.10.

Figure 4.10

Income Tax as % of Tax on Direct Tax Revenue

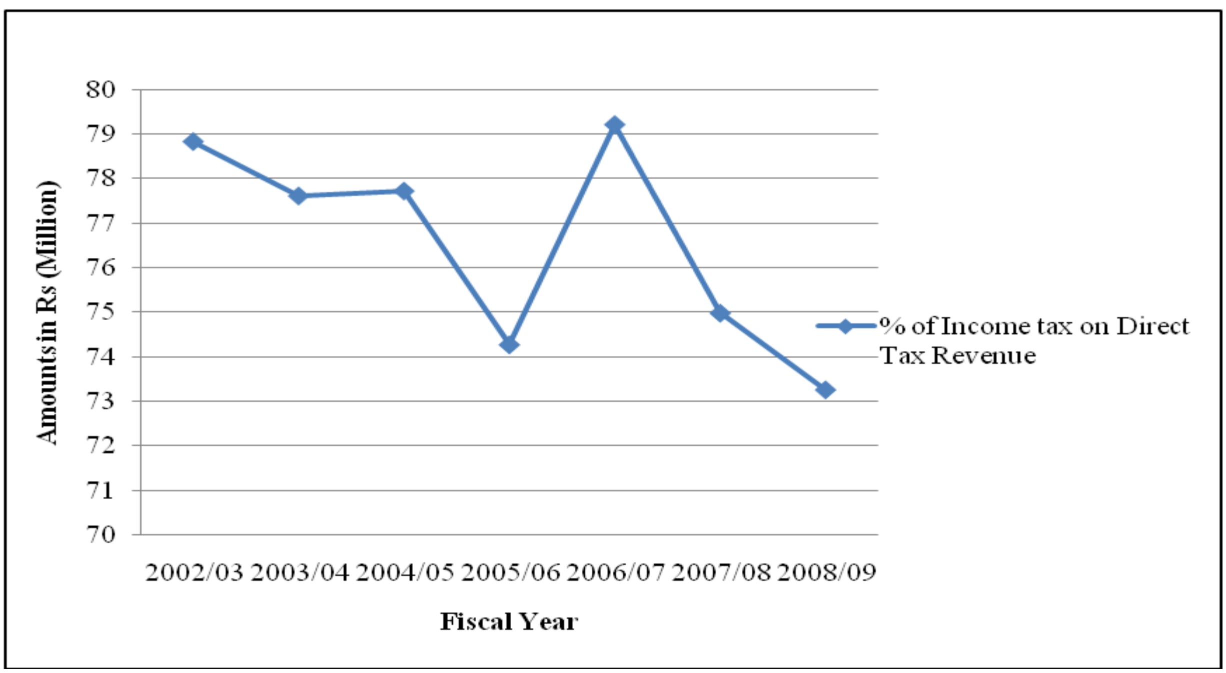


Table and figure shows the average contribution of income tax to direct tax revenue is 76.55 percent. It is fluctuating from 77.61 percent to 73.26 percent over 7 years. Contribution for the fiscal year 2002/03 is 78.83 percent but it declines 77.61 percent in the fiscal year 2003/04. Then it is increasing trend and reached to 79.21 percent in the fiscal year 2006/07, which is minimum contribution over the study period. Again it starts to decline and reaches to 73.26 percent in the fiscal year 2008/2009. It shows that the contribution of income tax to direct tax revenue is not less than 73 percent in any study period.

4.9.4 Contribution of Income Tax to GDP

Contribution of income tax in gross domestic product (GDP) is presented in table 4.11 and its trend shows in the figure 4.11. Table clearly shows that the percentage contribution of income tax in the GDP is very low and not more than 3.71 percent over the study period of 7 years.

Figure 4.11

Income Tax as % of GDP

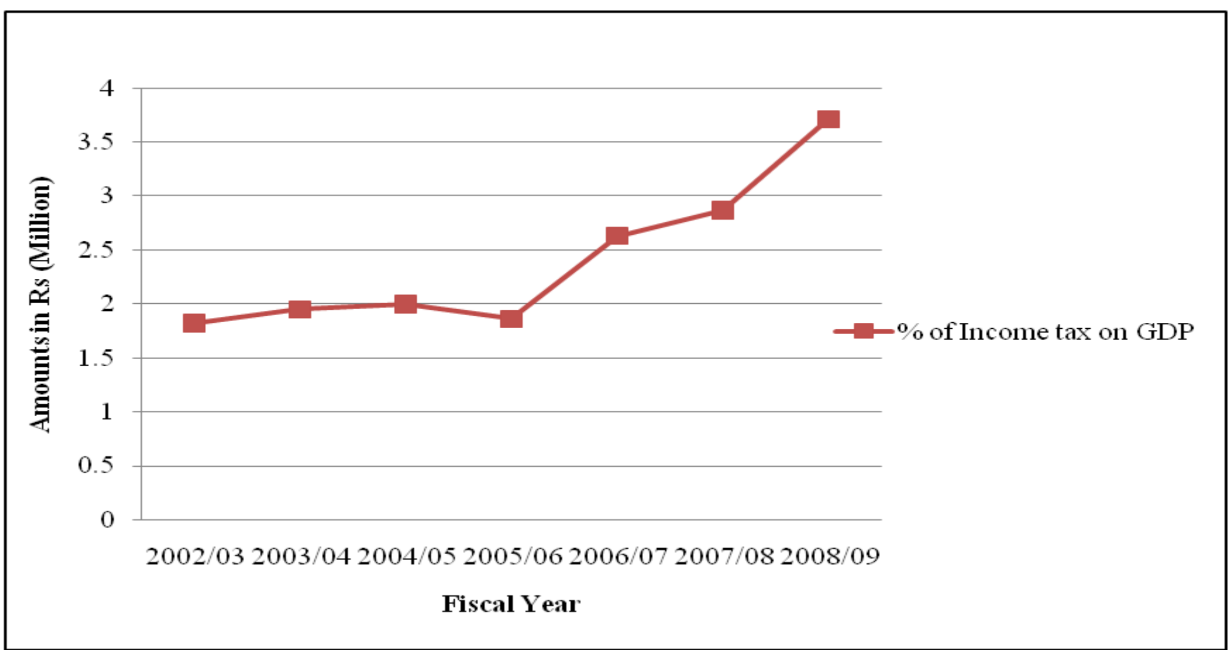


Table and figure shows the average contribution of income tax to GDP is 2.41 percent. It fluctuates from 1.82 percent to 3.71 percent over 7 years. Contribution for the fiscal year 2002/03 is 1.82 percent, which is minimum contribution over the study period. Then it is in the increasing trend and reached to 3.71 percent in the fiscal year 2008/09, which is highest contribution over the study period.

Figure 4.12

Average Contribution of Income Tax

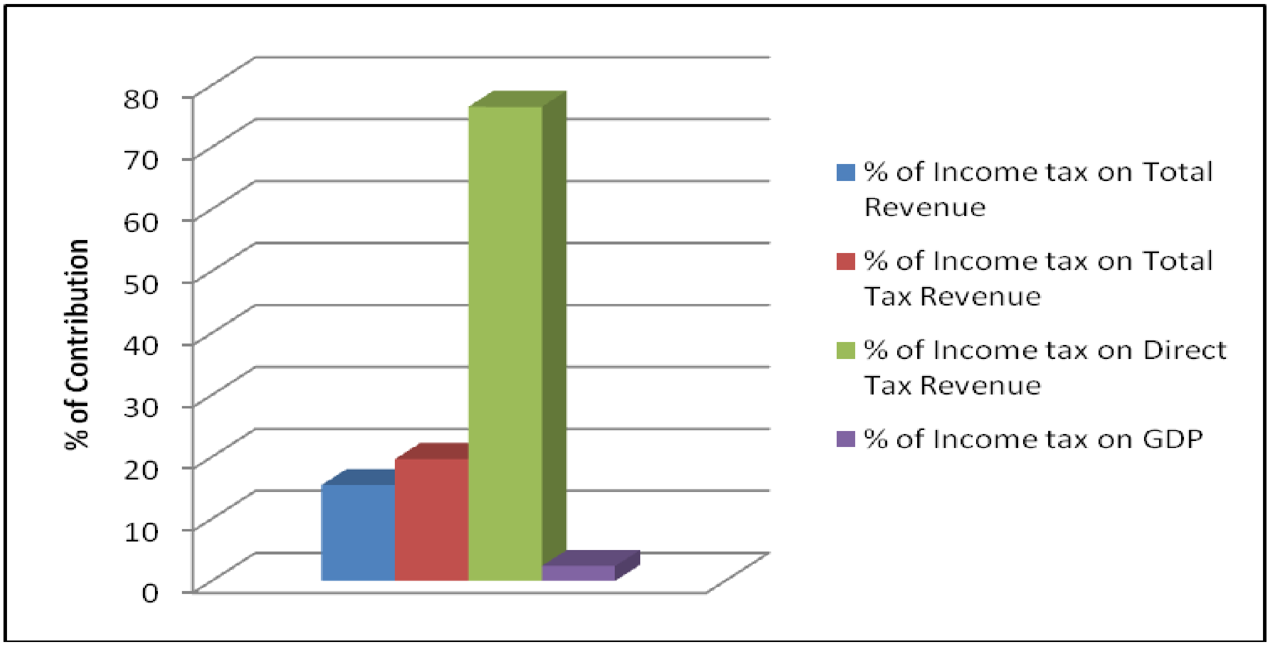


Figure 4.12 shows the average contribution of income tax in total revenue, total tax revenue, direct tax revenue and GDP, which is 15.54, 19.67, 76.55 and 2.41 percent respectively. It shows that average contribution of income tax on direct tax revenue is higher and average contribution of income tax on GDP is lower. Therefore from the above table and figure we can know that Income tax revenue is contributed the maximum and dominant part of Nepalese direct tax revenue. After that total indirect tax is contributed the maximum part of tax revenue. The percentage contribution of income on GDP is very low.

4.10 Performance of Income Tax Collection in Nepal

In Nepal, performance of income tax collection is not satisfactory; even it is in increasing every year.

Table 4.12

Performance of Income Tax Collection in Nepal

(Rs in million & Percentage)

Fiscal Year	Estimates	Actual Collection	Difference	Collection as % of Estimates	Collection Above (Below) as % of Estimates
2002/03	9862.50	7966.09	(1,896.41)	80.77	(19.23)
2003/04	8697.50	9245.90	548.40	106.31	6.31
2004/05	10500.00	10159.40	(340.60)	96.76	(3.24)
2005/06	11800.00	10373.70	(1,426.30)	87.91	(12.09)
2006/07	12682.00	15034.00	2,352.00	118.55	18.55
2007/08	16869.00	17311.22	442.22	102.62	2.62
2008/09	17921.31	17994.58	73.27	100.41	0.41

Source: for actual collection; Economic survey 2009/2010 Ministry of Finance, Government of Nepal

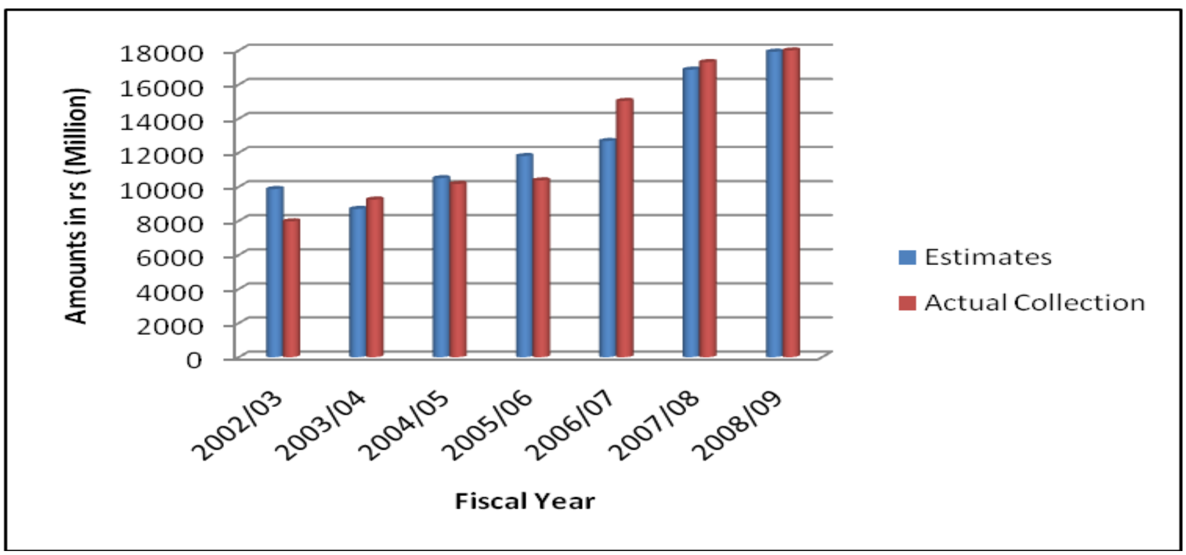
For estimates: Various budget speeches and annual reports

Note: Figure in bracket ( ) indicates negative values

Table 4.12 shows the income tax collected Rs. 7966.09 million in the fiscal year 2002/03, which is 80.77 percent of estimate i.e. 19.23 percent below the estimate. This is the minimum negative collection performance over the study period. For the period of study, in the fiscal year 2003/04 actual collection of income tax is 9245.90 million. This is 6.31 percent more than the estimates. Again actual collection of income tax is below the estimates in the fiscal year 2004/05 and 2005/06, which is 96.76 percent and 87.91 percent of estimate in the fiscal year 2004/05 and 2005/06 respectively. In the fiscal year 2006/07 actual collection of income is 18.55 percent above the estimate, which is maximum collection performance over the study period. The performance of income tax collection is only 2.62 percent above the estimate in the fiscal year 2007/08. The performance during the fiscal year 2008/09 is 0.41 percent above the estimates. Over the study period, maximum years' (3 years) performance is below the estimate and minimum years' (4 years) performance is above the estimates.

Figure 4.13

Estimated & Actual Collection of Income Tax in Nepal



The above figure shows the bar chart of estimated and actual collection of income tax in Nepal from the fiscal year 2002/03 to 2008/09. It figures out that actual collection is less as than the estimation. Although the income tax collection is increasing every year, its performance is not satisfactory. In the fiscal year 2006/07, 2007/08 and 2008/09 actual collection of income tax is above the estimation which shows the satisfactory performance.

4.11 Exemption Limit in Nepalese Income Tax Act

Exemption limit system for calculating the taxable income and tax liability is introduced, when income tax act is introduced. Till the fiscal year 1966/1967, exemption limit allowed as same amount for all kinds of taxpayers. But from the fiscal year 1967/68, exemption limit allowed as differently for different types of taxpayers. Now days, it is allowed only to personal income i.e.; for natural person and sole proprietor business.

Table 4.13

Exemption Limit in the Nepalese Income Tax

(Figure in Rs.)

Fiscal Year	For Individual	For Couple	For All taxpayers
1959/60-1962/63	-	-	7000
1963/64-1964/65	-	-	6000
1965/66-1966/67	-	-	5000
1967/68-1973/74	3000	4500	-
1974/75	4500	6000	-
1975/76	5500	6500	-
1976/77-1978/79	6500	7500	-
1979/80-1980/81	7500	10000	-
1981/82-1982/83	10000	15000	-
1983/84-1989/90	15000	20000	-
1990/91-1991/92	20000	20000	-
1992/93-1996/97	25000	35000	-

1997/98	30000	40000	-
1998/99	40000	50000	-
1999/00	50000	60000	-
2000/2001	55000	75000	-
2001/02-2002/03	65000	85000	-
2003/2004/05	80000	100000	-
2005/06	100000	125000	-
2006/07 to 2008/09	115000	140000	-
2009 up to now	160000	200000	-

Source; Finance Acts of various years, Ministry of Finance

Table 4.13 shows the exemption limit provided in various years. Generally, government has raised the exemption limit every year. It is Rs.7000 for all taxpayers in the fiscal year 1959/60. It gradually decreases and reaches to Rs. 5000 from the fiscal year 1965/66 to 1966/67. After the fiscal year 1967/68, exemption limit is allowed only for individual, couple and family separately and form the fiscal year 1979/80, the couple and family are provided for the income tax exemption limit equally. After the implementation of "Income Tax Act 2058", the word 'family' has been removed for the purpose of exemption limit. At present time the individual having the taxable income up to Rs. 160000 are exempted from tax and that for couple is Rs.200000.

4.12 Major Findings:

On the basis of above analysis and data presentation, many important findings can be drawn. Major findings of this study are as followings:

- As other developing countries in the world, Nepal has been suffering from resource constraint, mass poverty, rapid growth of population, dependence on agriculture, subsistence living standard etc. despite over 40 years planned developments effects. In Nepal, the source mobilization is still poor that does not cover the rapid growing expenditure. There is serous resource gap and fiscal gap in Nepalese economy. Nepalese government expenditure is increasing at the faster rate than the increasing rate in revenue.

- Income tax is one of the most important and suitable sources of government revenue.

- Government revenue is the composition of external and internal revenue. Tax and non tax revenue are the sources of internal revenue. Among various tax revenues, the average contribution of custom, excise duty, sales tax (VAT), income tax, land revenue and registration, miscellaneous tax and non tax revenue 21.60%, 9.86%, 27.02%, 15.51%, 2.82%, 1.96% and 21.22% respectively over the study period.

- The composition of total revenue constitutes tax and non tax revenue. The share of tax revenue has always been greater than the share of non tax revenue. Contribution of tax revenue is very much important in revenue mobilization in revenue of Nepal. For the meeting of the increasing trend of government expenditure, tax revenue has been placed as a major source of government revenue of Nepal.

- Nepal's GDP growth is less than its population growth. The tax revenue as percent of GDP is very low than other under developed countries and developed countries. Tax GDP ratio has fluctuated from 9.73% to 17.26%. Revenue GDP ratio is slowly and gradually increased and reached to 21.16 % in the fiscal year 2008/08 from 12.85% in the fiscal year 2002/03.

- Tax revenue is principle source of government revenue, however its contribute differs significantly in different countries. Nepalese tax structure is dominated by indirect tax revenue. The amount of direct tax is 10105.68 million in the fiscal year 2002/03, which covered 23.73 % of total tax revenue and it is increasing and reached to 34320.7 million in the fiscal year 2008/09, which covered 29.32 % of the total tax revenue. Similarly, the amount of indirect tax is Rs. 32481.25 million in the fiscal year 2002/03, which covered 76.27 percent of total tax revenue, and it is also increasing each year and reached to Rs. 82731.20 million in the fiscal year 2008/09 and it covered 70.68 percent of the total tax revenue.

- The collection trend of direct tax is increasing every year. Normally other direct taxes are also good increasing trend. On the other hand, amount collected from vehicle tax has high increasing trend. It is Rs.559.48 million in the fiscal year 2002/03 and increased to Rs. 1850 million in fiscal year 2008/09. Due to the increased number of vehicles in Nepal, contribution of vehicle tax to total direct tax is increasing day by day.

- Indirect tax levied on the spending of goods and services and tax is not directly paid to the government by the real taxpayers. The revenue from indirect tax varied from Rs. 32481.25 million to Rs. 82731.20 million from fiscal year 2002/03 to 2008/09. Major part of indirect tax is custom duty, then sales tax (VAT), and excise duties.

- Income tax is increasing each year. Total income tax is Rs. 7966.09 million in the fiscal year 2002/03 and reached to Rs. 17311.22 million in the fiscal year 2008/09. This is the highest collected amount of income tax over the study period. These all are accumulated of all types' income tax. Contribution of total income tax from public enterprises has fluctuated from Rs.195.70 million, lowest, to Rs.2056.60 million highest. From last few years, its trend has in decreasing. Similarly, contribution of total income tax from semi public enterprises is not satisfactory. Even, it is lowest then other. After restructuring the source of income in the fiscal year, share of semi public enterprises are not clear. Normally, the trend of income tax from private corporate bodies is increasing. It is Rs. 1236.27 million in the fiscal year 2002/03 and reached to highest value Rs. 9425.10 million in the fiscal year 2008/09. Contribution of individuals' tax to total income tax is increasing each year. Share of individual tax is Rs. 3362.20 million in the fiscal year 2002/03. The highest contribution of individual tax over the study period is Rs 9875.10 million in the fiscal year 2008/09. In the same way, remuneration tax revenue is increasing every year. The highest contribution of remuneration tax over the study period is Rs 3195.60 million in the fiscal year 2008/09. Similarly interest tax is also increasing every fiscal year and reached to Rs. 1685.10 million which is highest in the fiscal year 2008/09 and minimum is

Rs. 733.40 million in the fiscal year 2003/04.

- The average contribution of income tax in total revenue, total tax revenue, direct tax revenue and GDP, which is 15.49 19.67, 76.55, and 2.41 percent respectively.
- Generally government has raised the exemption limit every year. It is Rs.7000 for all taxpayers in the fiscal year 1959/60. It is gradually decreased and reached to Rs. 5000 from the fiscal year 1965/66 to 1966/67. After the fiscal year 1967/68, exemption limit is allowed only for individual, couple and family separately and form the fiscal year 1979/80, the couple and family are provided for the income tax exemption limit equally. After the implementation of "Income Tax Act 2058", the word 'family' has been removed for the purpose of exemption limit. At present time the individual having the taxable income up to Rs. 160000 are exempted from tax and that for couple is Rs.200000.

CHAPTER-5

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The government of any country requires sufficient revenues to lunch the development programs to handle the daily administration to keep peace and security and the lunch other public wale fare programs. The government collects revenue from various sources such as, taxes, fees, special assessment, fine and penalties, foreign grants etc. Among them tax is the main source of collecting the public revenues because it occupies the most important part of the government treasure. Developing country Nepal has lack of sufficient finances resources. It is the main constraints for national economic development sufficient und are needed to meet the additional financial requirements for the development activities of the country.

Tax is the compulsory payment to the government from a person according to law. Tax is the contributed to the government without expectation of the direct benefit in the board sense there are two types of taxes direct and indirect tax income tax, gift tax, interest tax, property tax, vehicle tax, house & land tax, contract tax etc are the example of direct tax export/import duty, excise duty, sales tax, value added tax, entertainment tax, hotel tax, passenger tax are example of indirect tax.

The idea of introducing income tax in Nepal originated along with the first budget on 21 Magh 2008 (1952). Then the first elected government introduced "Business profit and remuneration Act 2017" to impose income tax on remuneration and business profit in Nepal. Business profit and remuneration tax act 2017 had so narrow coverage that income tax is imposed only on business profit and remuneration. It is replaced by the Nepal income tax act 2019 after two years. After that income tax rule 2020 were enacted with the view of implementations the objective of the income tax act. As "Nepal income tax act 2019" is incapable in fulfilling the needs of the time, it is replaced by another income tax act 2031. In the course of development and modernization of income tax system the new income tax act 2058 has been enacted. Similarly the new income tax rules 2059 have also been enacted for the effective implementation of the objective of the act. Income tax act 2058 has classified the heads of income in to three categories viz. employment, business and investment.

Income tax is lived on taxable income that is obtained by subtracting deductable expenses from chargeable incomes. But sometimes a taxpayer may face the situation of loss due to the occurrence of deductable expenses in excess of chargeable incomes. In respect of business or investment a taxpayer is entitled to set off or carry backward on forward of such unrelieved loss as per tax law. The unrelieved loss of an income year incurred by a person from any business or investment is calculated as calculated as the excess of deductable expenses over chargeable income ignoring the treatment of unrelieved losses. Income tax assessment refers to the procedure of ascertaining the taxable income and tax liability of a person and tax payable by a person. Income tax is assessed adopting different methods the methods of tax assessment practiced in Nepal are self assessment, jeopardy assessment and amended assessment. To fulfill the general objective of this study different source of data are use to find out the accurate and actual conclusion. Mainly the secondary data are collected from economic survey, published by ministry of finance Nepal government annual report published by Inland Revenue department and other publicities.

Nepal has been suffering from capital shortage to accelerate the economic growth the expenditure of Nepalese government is increasing year by year to meet the additional capital requirements. Nepalese government has been using external and internal resources. Internal resources are preferable for sustainable economic development. Nepal has been unable for prop of mobilization of internal resources. This, fiscal deficits and resource gap of Nepal have been increasing very years the collection of income tax has been affected by the widespread tax evasion one hand and the lack of proper tax system and exegetic tax administration on the other hand. To solve these problems, income tax is the most important source for internal revenue generation, which occupies the major portion in revenue collection of Nepal, Regarding this fact, this study attempts to analyze the role of income tax in revenue collection of Nepal. After giving general introduction about it, review of literature has been observed from various books, journals, articles and thesis.

5.2 Conclusions

- There are different kinds of constraint for sustainable economic development. In developing countries like Nepal, lack of financial and natural resources is the main constraint. A lot of funds are needed to meet the additional financial requirement for the development activities and budget deficit of the country. Nepal cannot successfully manage massive poverty, hunger, disease, unemployment, heavy dependency on agriculture, lack of adequate industries, low income level and social political and geographical constraints. Yet, Nepalese economy is suffering from ineffective and effortless plan, programme and policy of development and is also fighting against whatever bottlenecks identified before the starting of planned period. Nepal has been suffering from capital shortage to accelerate the economic growth. Nepal has been heavily relying on foreign loans and grants. Similarly, Nepal has been unable for proper mobilization of internal resources. Fiscal deficit of Nepal has been increasing every year.

- Nepalese tax administration has been attempting to modify to meet the every recent challenges brought about by change in technology, economic policies and other rules. However, still its working procedures are almost traditional and the cost of administration is also not satisfactory. The government of Nepal introduced a formal tax system for the first time in Nepal in 1960(2017 B.S) in the form of "Business Profits and Remuneration Tax". The "Business Profits and Remuneration Act 1960" governed it. According to this act only business profits and remuneration on income were subjected to tax but the revenue for these taxes should not be collected properly according to originals estimates. Currently, income tax revenue of Nepal is collected according to newly enacted Income Tax Act 2002(2058 B.S). There are many new provisions that are aimed to enhance revenue mobilization through effective revenue collection procedures. Income tax system of Nepal has come a long way along with the newly enacted Income Tax Act. Many provisions are included. The newly enacted Income Tax Act has brought most of the sources of income under the tax act. In the new Income Tax Act, sources of Nepalese income are classified into Business income, Investment income and Employment income for the tax purpose.

- For achieving the maximum objective of the nation, the government need maximum amount of revenue. Nepal has facing serious problem of resource gap and maximum dependency on foreign loan and grants. Resources gap is increasing at a faster rate of revenue increasing. It is widening with the increment of total expenditure in respect to total revenue collection. For solving the serious problem, income tax should play important role. Contribution of income tax for economic development of Nepal has been increasing significantly in recent years as compared to past years but it is not satisfactory and resource mobilization mechanisms in Nepal still very poor.

- The success and effectiveness of income tax system, the tax administration needs to be responsible. Income tax system of Nepal has ever blamed as not efficient and proper. Everybody think that if anyone can join tax office as employee, he will earn wealth then other office. Tax education and training are to be made and implemented to recognize and familiarized people about the income tax act and other related laws. For economic development of Nepal, the problem relating to income tax system in Nepal should be solved and resource should be effectively mobilized.

5.3 Recommendations

Income tax is an important source of government revenue of Nepal. For the development of nation and Nepalese economy, maximum income tax revenue should be needed. The contribution of income tax revenue is likely to be significant in the future but there are many problems. As the findings of the present study, the following recommendations are made for the sound and effective income tax system and improvement of income tax collection for government revenue:

- The terms and procedure under Income Tax Act, Rules and Regulation should be simplified so that everybody could understand it.
- Income Tax Act should be liberal with broad sense.
- A nationwide campaign should be launch to inform and explain tax laws, tax planning with the view of simulation enthusiastic participations of the public to pay taxes through the media like radio, television, newspaper, website and speech programme.
- The members involved in formulating Income Tax Act, rules and policies should have deep knowledge about related subject matter.
- Timely revision should be made in the matter of income tax policy according to the economic policy of the nation and analysis of existing situation.
- Income tax ratio should be increased gradually on long run basis to meet the deficit in budget. Tax based should be widened.
- The principle of tax should be adopted according to ability to pay.
- The provision of rewards, prize, and incentives should be introduced to encourage the taxpayers to pay the tax through self assessment.
- The provisions of fine and penalties and punishment should be made at higher rate for income tax evader and such provisions should be strictly followed.
- Strong political commitment is necessary for the modernization and effective implementation of income tax system.

- The existing provision for exemption limit should be adjusted according to inflationary situation, income level and other economic condition of the country.
- The government should be imposed tax on agriculture income after providing the special exemption limit.
- The provisions of foreign income and tax should be clear and universal.
- Capital gain tax should be effectively implemented in investment for non business purpose as well.
- Clear provisions should be made for the case of deduction. All the items of allowable deduction should be clearly defined in the act.
- Separate income tax department should be established so that the specialization could be achieved.
- The research and intelligence center should be established in tax office for proper planning, implementation of tax law.
- Income tax policy should be made such that the main goal of imposts income tax can be achieved.
- Timely revision should be made in the matter of income tax policy according to the economic policy of the country. The system of changing income tax policy with the change of government should better be avoided.
- To develop the region, regional concession should be introduced.

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