Chapter 1
Introduction

1.1 Background

Tax simply means a liability to pay an amount to the *government.* It is the compulsory contribution to national revenue from taxpayers according to law, taxation in its various forms affects the ability and willingness of an individual to work, save and invest. To collect income taxes, governments have to specify what counts as income and what kinds of income they will tax. The most widely accepted definition of income was developed by American economists Robert M. Haig and Henry C. Simons in the 1920s and 1930s. According to this definition, income is the money value of the net (overall) increase over a period of time in a person's potential to consume. Consumption, in economics, refers broadly to the purchase or acquisition of goods and services of any kind. The increase in potential to consume equals actual consumption plus saving. According to Goode "A tax is a compulsory contribution to government made without reference to a particular benefit received by the tax payer. It is a personal obligation to pay tax and there is no direct relationship among tax, benefit and individual tax payers. Goode, R (1984). Income taxation in it's historical perspective in early days taxes were not collected in monetary terms but were collected in terms of kinds, animals and other things for communal service and at time of emergencies. In Hindu tax system, tax was levied in the basis of the welfare of the people and people were eager to pay tax because not to pay tax was taken as a great sin. According to Hindu's holy scripture, Vedas, the duty of king was to serve and secure people, maintain peace and carry out social works. In order to perform all these activities, the king used to crops and cattle from farmers, gold, silver, copper from traders. These ancient from of taxation were expanded from time to time under the influence of various economic, political and ethnical forces.

Taxation in ancient Nepal, in the ancient time, tax had been taken as the major source of government revenue. At that time government had collected the tax for defense and administrative purpose and taxes were then levied. Although the taxes were collected in various forms in ancient era, the history of modern income tax is not very old in Nepal. The idea of introducing income tax in Nepal originated in the early 1950s when a multi-party democratic political system was introduced. In 1951, the finance minister in his budget speech declared the intention of the government to levy an income tax.

1.2 Statement of problem

Finance fuels the development activities. To finance government development activities it collects taxes, borrow the loans, gets subsidies and prints money. Among them tax is the only source that enables government activities sustainable with out violating or creating future liabilities. Government of Nepal fails to collect revenue (tax) according to their potentiality and at the same time it is observed that potential tax payers are also not interested to deposit the tax money. Tax collection is become difficult due to the behaviors of tax payers and tax administration. The tax rate is low, tax base is narrow so the study will be an advantage. Many specific problems affect the Nepalese income tax system. These problems include:

(1) Deciding what income to tax,

(2) The management of tax loopholes and shelters,

(3) The effects of inflation,

(4) Inequities in the taxation of people who pay under different filing statuses, and

(5) The taxation of capital gains.

Income tax systems in other countries share some of the same problems and have different problems of their own. These problems, along with the overall complexity of tax laws, have prompted citizens and politicians in many countries to regularly call for income tax reform. Most governments periodically review and amend their tax laws, often in response to the concerns of particular industries or groups of people.

1.3 Objectives of the study

The overall complexity of tax laws, have prompted citizens and politicians in many countries to regularly call for income tax reform and this study focus on the following objectives:

- To find out the problems and difficulties in the income tax act and rules.
- To find out the necessary reform for income tax system .
- To find out the contribution of income tax to our national economy.

1.4 Importance of study

Tax policy is a symbol of national sovereignty and part of a country's overall economic policy, helping finance public spending and redistribute income. Nepal is an agro-based developing country with no gear in industrialization process. There are only a limited number of corporate bodies, tax payers, induviduals and their economic performance is very dismal. So, there is need to growth and development of these sector in our nation. The government needs huge amount of funds to spend on daily expenses as well as development activities. Every year, Nepal has been presenting deficit budget, there is increment in resource gap. Most of the development activities depend on bilateral and multilateral grants and loans. The nation is hardly bearing the loan and the internal source of revenue is not sufficient even to meet the ordinary expenses. In this context, the easy and long lasting way to increase revenue to strengthen the internal source is trough income tax is one of the major components. Thus, the contribution of income tax on government revenue and problems and difficulties on income tax laws on fulfilling this gap has been chosen as a relevant topic for the study.

The study is useful to economists, lawers, chartered accountants, registered auditors, planners, tax officers, tax administrators, government and other interested persons about the structure of income tax and its contribution in national economy, natural resources and the problem and prospects of these sector. It also provides the information about trends and projection of national budget and reform of Nepalese income tax system.

1.5 Limitations of the study:

This study is prepared for the thesis of the partial requirements of the MBS, II year. So, it concentrates mainly on those existing provisions of the Nepalese tax act and regulation regarding income tax and its relevancies. The purpose of this study is to enlighten the approach of the income tax. This study has gone through comparatively, where necessary, foreign countries and other International organizations provisions. National and international instruments relating studies are on this study. The study has tried to make valuable, achievable and relevant under the limitations of resources, means and time of an individual student.

1.6 Organization of the Study

The entire study has been designed into five main chapters. They are:

Introduction

Review of literature

Research methodology

Presentation and analysis of data

(i) Secondary Source of Date

(ii) Empirical Study

Summary, conclusion, recommendations

The first introduction chapter includes: statement of problem, objectives of the study, need and significance of the study, limitations of the study and organization of study.

The second chapter review of literature is done to know what research had been done in the related topic in previous days and what is to be done at present or in future. This chapter has been divided into two main aspects:

(1) Conceptual framework and

(2) Review of related materials i.e. review of books, review of thesis, review of newspapers, magazines, journals etc.

Research methodology is mentioned in the third chapter. It includes research design, population and sampling, sources of data, procedure of data collection and tools used for analysis.

Presentation and analysis of data have been made in the fourth chapter .The data collected from various sources have been tabulated in their sequential order and data have been described and analyzed with statistical tool as well as general accounting and taxation principle. Empirical Investigation has been done on the basis of primary data collected from different taxpayers, tax experts and tax officers through questionnaire to address the problems/difficulties of current Income Tax Act 2002 (2058).

The fifth chapter consists of brief summary, conclusions and recommendations of the study. Lastly, essential bibliography has been presented at the end of the study.

Chapter 2

Review of literature

2.1 Conceptual Frame work

2.1.1 Concept of Taxes

Government is a very powerful institution with threat power, which is the center point of the country. The primary purpose of the modern government both developed or developing, is to uplifting the living standards of their people, through the development process. In order to achieve this goal, every government launch different economic, social, cultural and other development activities. To carry out these activities, government requires various kinds of resources i.e. manpower, financial resources, information, technology materials, etc. Among them financial resources is very essential because acquires other resources. Both external and internal financial resources are utilized to fulfill the government requirements. However the internal resources are more preferable than external one for sustainable & independent economic development.

WHAT MAKES A "GOOD" TAX?

Taxes, then lower economic welfare. Yet other means of financing lower economic welfare as well, and are on balance worse. Thus, we can paraphrase a famous Winston Churchill assessment of democracy in discussing taxation: "Taxation is the worst form of financing government - except all others." While taxes in general impose some burden on society in the form of lost individual economic welfare, some taxes are better than others. Policymakers should try to minimize the economic and social problems that taxation imposes. What criteria should be used in evaluating whether a tax minimizes harm to the members of society? While several have been suggested, only three criteria are universally accepted by experts in public finance. A good tax is:

1. Not costly for either government or taxpayers to calculate or administer; on the other hand, tax avoidance is difficult and risky.
2. Neutral in its impact on resource allocation decisions, minimizing negative effects on economic growth; it does not lead to unproductive economic activity that is tax-induced.
3. Fair; people believe that the tax burden is equitably distributed amongst the tax-paying Population. While there is less than universal agreement on a fourth principle, basic principles of representative democracy would suggest that:

4. A good tax is one that is transparent; people are aware of its existence and know the burden that it imposes; one objection to deficit financing is that it imposes disguised or wealth taxation; this should be avoided in using tax financing. Some experts in public finance suggest other criteria that might be applicable. Joseph Stiglitz, for example, has suggested that a good tax is one whose revenues demonstrate flexibility. As he puts it, "Change s in economic circumstances require changes in tax rates." Yet this criterion is highly debatable. It is true, for example, that a tax whose revenue is highly "elastic" with respect to the growth in real incomes will grow constantly in revenues over time, alleviating the need of legislative bodies to approve new taxes. Yet many would consider this a defect and a violation of the fourth principle above: tax revenues are increased without the approval of the people's representatives, a form of taxation without representation. Many politicians looked favorably on the hidden tax increases that accompanied the "bracket creep" associated with high inflation and progressive federal marginal income tax rates in the era before the mid-1980s, in USA and Europe, as they reduced the political costs to themselves of financing growing government. There is, however, good evidence that the high and partially unvoted tax rates on middle-class Americans slowed down economic growth and subverted the workings of the democratic process.

5. Tax Administration Resources are needed to administer a tax system. Some of those resources are explicit costs to the government. Others are explicit costs to taxpayers, such as the monies spent on tax preparation. Many of the costs, however, are implicit or hidden costs. The millions of hours spent annually in gathering tax records, filling out forms, etc., are a cost to society. These costs are hard to measure but nonetheless real. Nepalese would spend tens of millions of rupees, conservatively, to avoid the time spent, the frustrations, and the anger associated with preparing their income tax. Other things equal, then, a tax is better the lower these explicit and implicit costs are - both to government and to taxpayers. Another dimension of the tax administration problem relates to evasion and tax avoidance. A tax is "good," other things equal, if it is difficult to evade - that is to say where the costs to evaders (criminals) are high, and the costs to tax enforcers are low. Not only do uncollected taxes lower tax revenues forcing higher tax rates to raise any given amount of money, there is an extreme inequity associated with increased tax burdens to honest persons imposed by dishonest individuals who evade their fiscal responsibilities.

6. Neutrality and Economic Growth by their human actions in demanding and supplying goods, individuals in a market economy decide on how resources will be allocated among alternative uses. That allocation reflects the desires and constraints facing consumers and producers. Thus it is usually bad for the tax system to distort resource allocation, because that will tend to lead to a below-optimal use of our material bounty. Only where activities have spillover effects - impacting on persons other than the buyers and sellers involved - does it make any sense to distort the way people want resources allocated in a market economy. Yet we have a highly complex tax code that favors some activities over others. We tax returns to capital resources much higher than returns to labor, leading to a lower level of capital formation than is desirable. We favor real estate investment over investment in machines. All of these things violate the basic principle of neutrality. Moreover, as Browning and Browning put it: "In addition to distorting the way taxpayers receive or spend their incomes, tax preferences may be responsible for other types of welfare costs. A multitude of special tax provisions adds greatly to the complexity of the tax law. This probably increases administrative costs. " These concerns make most tax experts hesitant about most fiscal policies that alter human behavior. A good tax minimizes the negative effects on economic growth - the increase in incomes and output over time. Empirical evidence suggests that taxation in most modern industrialized societies tends to have negative effects on output. Not only do taxes replace private sector with public sector activity, but they typically reduce the overall amount of activity. Yet some taxes seem to have a less inimical impact than others. Care should be taken to try to have a menu of taxes in place that minimizes the loss of income to our children and grandchildren of our fiscal actions.

7. Equity or Fairness while virtually everyone agrees that a good tax should be fair, there is far less agreement on what is fair. A 20 percent flat rate tax appeals to some people as extremely fair, as everyone is treated equally (except possibly the poor who could be made exempt from taxation). Others believe that fairness means that those with a greater "ability to pay" should face a disproportionate tax burden. Aside from issues of vertical equity (people of differing incomes), there is an issue of horizontal equity - treating people of similar economic circumstance equally. Virtually everyone agrees, for example, that if two persons have roughly the same financial circumstances, but one pays far more tax than the other, than this is unfair. Vertical equity is a subjective concept, yet there is some evidence supporting the position that many people, probably a significant majority, do not favor a tax system that has a "soak the rich" dimension to it. The proportion of

peoples believing that government should "be involved in reducing income differences between the rich and the poor" has declined significantly. Twice as large a proportion of people think the middle class is being "squeezed" more by the costs of welfare than tax breaks for the rich or business. Study done indicate that state Value added taxes are perceived as fairer - and are more far more popular - than the income tax. Moreover, the gap in popularity between VAT and income taxes has grown over time. As the income tax code becomes more complex, there is a greater probability of creating significant horizontal inequities. Tax credits and deductions lead to lower tax burdens for favored taxpayers than for others. Thus some married couples are favored over non married ones because of the choices to select favorable one implicit in the current tax system. People who buy homes pay lower taxes than those who rent. If you donate some rupees to state recognized organization non profit, you get a tax break, but if you give that money in cash to a homeless person on the street, you pay taxes on that money. You can get a tax break if you pay insurance company, but not if you buy an encyclopedia for your child to use. These tax provisions not only promote horizontal inequities, but they violate the principles of tax neutrality discussed above.

8. Transparency and Accountability The essence of democracy is having major public policy decisions made after public debate by the people or their representatives. "No taxation without representation" was the rallying cry for the Nepalese Revolution. The complexities of our income tax system have been used on occasion to reduce transparency, leading to policy changes without public discussion or even, in some cases, legislative action.

9. Changing the Tax System The problems outlined above, there are strong arguments for making major changes in the existing tax apparatus. A new direction in tax policy would radically reduce the complexity of the existing system, lowering administrative costs and coincidentally reducing the problems of non neutrality and horizontal inequity endemic with the income tax. The resulting new tax system should feature greater uniformity of treatment between different types of income, avoiding the multiple taxation of saving. Indeed, from the standpoint of both tax neutrality/economic growth and from a standpoint of fairness, the basis of taxation perhaps should be shifted from income to consumption. The social engineering encouraged by tax credits designed to promote activities favored by some policy-makers would be curtailed. With respect to social insurance and perhaps Medicare, greater transparency can be obtained by more closely tying payments to individual benefits, perhaps by establishing individual retirement accounts (and possibly

medical savings accounts) which receive some or all of the Social Security and/or medicare contributions of recipients.

A variety of existing or proposed legislative initiatives deal with varying degrees of effectiveness with the problems outlined above. There are sometimes tradeoffs between equity and growth considerations, or between simplicity and fairness. One thing is fairly certain, however. The existing tax code has grown incrementally over time, with little consideration in the aggregate as to how it comports with basic principles of administrative simplicity, economic neutrality, fairness, and transparency. These principles should guide future reform of the tax system. The importance of tax as the four "R"s.

Taxation has four main purposes or effects: Revenue, Redistribution, Repricing , and Representation, The main purpose is revenue : taxes raise money to spend on roads, schools and hospitals, and on more indirect government functions like market regulation or legal systems. This is the most widely known function. A second is redistribution . Normally, this means transferring wealth from the richer sections of society to poorer sections.

A third purpose of taxation is repricing taxes are levied to address externalities: tobacco is taxed, for example, to discourage smoking, and many people advocate policies such as implementing a carbon tax. A fourth, consequential effect of taxation in its historical setting has been representation. The American revolutionary slogan "no taxation without representation" implied this: rulers tax citizens, and citizens demand accountability from their rulers as the other part of this bargain. Several studies have shown that direct taxation (such as income taxes) generates the greatest degree of accountability and better governance, while indirect taxation tends to have smaller effects. Alternatives to taxation taxes are a device to enable governments to take command over or redistribute resources. They are not, however, the only device. Two other major means borrowing and printing money have been used historically to achieve the same objective as taxes, as well as several minor methods. All of them, however, seem inferior to taxes for a variety of reasons, which is why most governmental activity is tax financed.

Borrowing is the most important alternative method of financing. For beginning fiscal years from 2008 through 2065, the government financed at least part of its expenditures through budget deficits, meaning the government borrowed to meet its obligations.

Whenever government takes command over resources, this will crowd out private sector spending, whether it is financed by taxes, borrowing, or printing money. With taxation, the mechanism by which resource transfer occurs is transparent, so the persons responsible for new tax financed government spending are accountable to the public through the political process. With borrowing or with the printing of money (or its modern equivalent, monetizing of debt through purchases of Treasury obligations), the burden on the private sector is largely disguised, avoiding the accountability desirable in a democratic society. Borrowing reduces private spending because of increases in interest rates and/or an increase in the rate of inflation induced by deficit financing. With printing money or debt monetization, rising prices reduce real incomes and wealth to holders of obligations with fixed principal or interest payments.

Additionally, there is an argument that is sometimes used that debt financed spending imposes a burden on future generations that is morally untenable, particularly if the debt is issued to finance governmental consumption expenditures, such as income transfers, crowding out private capital formation. It is no doubt true that future generations face the need to finance the payment of interest on public debt incurred through deficit financing. A good case can be made, however, that taxes also burden future generations, in as much as there is an abundance of literature that suggests that they tend to lower the rate of economic growth, reducing the incomes of our children. Borrowing imposes a hidden burden upon taxpayers in the short run and an explicit burden in the long run, while taxes impose an explicit short-run burden and a more hidden burden in the long run.

To the extent government is financed through inflationary finance (especially debt monetization by the central bank), this has additional negative effects on the economy. Positive and variable rates of inflation reduce the clarity of the signals that the pricing system gives with respect to the allocation of resources. It leads to unproductive activity, such as individuals becoming obsessed with buying precious metals or land rather than creating wealth by capital formation financed by paper securities. It increases investment uncertainty, particularly among foreigners as the dollar declines in value relative to other currencies. The inflation problem also applies to borrowing. Often, the upward pressure on interest rates from substantial borrowing leads to political pressure being placed on the central bank to monetize debt.

2.1.2 Classification of Tax

Basically, tax can be classified into two broad categories i.e. direct and indirect tax.

2.1.3 Direct tax

Direct taxes: They are paid and borne by the taxpayer and include income tax,corporation tax, wealth tax and most local taxes.

2.1.4 Indirect taxes

Indirect taxes: These are levied on production and consumption and are not borne by the 'taxable persons' (traders or industry) who pay them, collecting the tax on behalf of the government and passing it on in the price to the final consumer on whom the burden falls (examples include VAT and excise duties).

Income tax:

The term 'income' is the focal point in the study of income tax anywhere in the world. Unless the amount belongs to the category of 'income'. It cannot be taxes under income tax act. (Bhagwati Prasad: 1999-2000). Income is a broad sence, income of any economic gain a person has experienced during the period. (Due and Friend larnder : 1977) in general individual income is defined as the function of the consumption of an individual plus net increase in wealth. An optimal income tax should have the following characteristics (Due & Friend lardner : 1977) All income should be treated uniformly regardless of source, in view of the equal treatment of equals or horizontal equity rules.

Just as equals should be treated equally, unequal should be treated unequally in a pattern consistent with accepted goals equity. The tax structure should be consistent with society's view towards income equality and redistribution. The structure of the tax must be designed for efficiency reasons in such fashion as to facilitate compliance and enfoldment, consistent with other objectives.

Generally, income means the inflow of cash to the person or firm. Most of the people do not take the kind as an income. It is a best measure of economic well being of a person as well as of nation. Higher income denotes the high living standard and lower income from rendering various types of services, selling goods and producing crops for their own use. Thus, income may be cash or kind that is received by a person for livelihood.

Economists define the term 'income' in a broad sense. It is an economic gain or receipt to a person during a particular time by way of wages, interest, profit and rent. The money income of the people is generally used for two purposes. Part of income is spent on consumption and part is saved. This definition can be expressed in the formula as follows:

$Y = C + S$

where,

Y = Income

C = Consumption

S = Saving

But for the purpose of taxation, the definition of income is somehow different from the aforesaid definition. According to Income Tax Act 1974 (2031) Income means the income earned or received in cash or kind from the sources mentioned in sec.5. In this section five different heads of income were mentioned. They were as follows: [ITA, 1974]

1. Agriculture
2. Industry, Business, Profession or Vocation
3. Remuneration
4. House and land rent
5. Other sources

The existing income tax act 2002 (2058), which has been enacted since 2058 Chaitra 19, (April 1, 2002), has defined income in section 2\a as "person's income from any employment business as calculated in accordance with this act (ITA, 2002). It includes all sorts of income received for the provision of labor or capital or both of whatever form or nature in the taxable income. Tax, in simple terminology, is a liability to pay an amount to the government It is a compulsory contribution to the national revenue from the taxpayers according to law. In the word of Seligman, taxation is the "compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred." From the definition given above it can be said that firstly, a tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government. Secondly, taxpayer cannot receive any quid pro quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. Thirdly, the tax is paid to the government for running it. Fourthly, in case of tax, the amount is spent for common interest of the people. The tax is collected from haves and basically, spent for the interest of have-nots in the society. Fifthly, a natural or an artificial person pays the tax. (Kandel,

2004) In conclusion, it can be said that tax is a liability to pay an amount to the state. The basis of a minimum amount from certain specified or that they own certain tangible or intangible property or that they carry-on certain activities which have been chosen for taxation. (Kandel, 2001) Income tax refers to the tax levied on the income of a person and profits of corporation for the specific time period, particularly one year. Income tax is levied on the taxable income of a person or a company after deducting allowable expenses. Accounting profits may differ from taxable profits. For the computation of taxable income, generally incomes are added and expenses are subtracted and losses, which are allowed to deduct under the provision of income tax act are also subtracted. Then, tax-free incomes allowances and common expenses are also deducted to get taxable income. After giving the exemption limit as per law, the amount of tax to be levied on this computed income is the income tax.

2.1.5 Evolution of Taxation

In early days, taxes were collected at the time of emergencies, to finance wars and to provide communal services. Taxes were levied on the basis of welfare of the people. At that time tax was not compulsory payment. People voluntarily paid the tax because non-payment of tax was taken as sin in the Hindu tax system. According to Hindus' scripture, the duty of king was to serve and secure his people, maintain peace and harmony and carryout social works. For those purpose king used to levy tax by collecting crops and cattle from farmers, gold and silver and other metallic goods from traders. Great Britain was the first country in the world to introduce the income tax in 1799. It imposed income tax in order to finance war with France. Similarly, in U.S.A. the first federal income tax was imposed in 1862 with the same objective (to finance civil war). However, in the beginning these countries imposed income tax as temporary until 1862. Thereafter, since 1913 it was accepted as permanent tax. This, income tax was adopted by different countries gradually. Italy started it in 1864, and Newzealand adopted in 1891, Australia and Canada have followed the income tax in 1915 and 1917 respectively. After the world war, the income tax became an important source of tax revenue in many developed countries. By 1939, it had become the most important source of revenue in most developed countries and had made appearance in a number of developing nations (Agrawal,1980) In our neighboring country India, the income taxation was started in 1860 by the British government to relief from economic burden created due to first democratic revolution. It was then regularly collected after the publication of income tax act 1886

(Dhakal, 2057). In this way, income tax has become the regular source of national receipts for many developed and developing countries of the world. In the beginning, income tax was generally levied at a flat rate. The principle of progressive rate of income tax had been adopted by the United Kingdom and Newzealand since 1909. Now a days the progressive rate is commonly used rather than flat rate in all over the world.

2.1.6 Taxation in Ancient Nepal

Reliable records about taxation in ancient and medieval Nepal are not available. However, tax has been one of the major sources of government's revenue from the ancient time in Nepal. Taxes were then levied on the merchants, travelers and farmers in the form of cash, kind and labour. On some occasions gold and agricultural products were also paid as taxes; but the natures of these taxes were temporary. In the Lichhavi's regime, income taxes from agriculture and business were introduced as a direct tax for the first time in Nepal. Agricultural income tax was called "Bhaga". The 1/6, 1/8, and 1/12 quality of the land that they owned. Income tax, which was levied on business income, was called 'kara'. There was irrigation and religious tax also in existence during the regime of king of Ansubarma of Nepal.

2.1.7 Taxation in Unified Nepal (1768-1846)

After unification of kingdom of Nepal, expenses for administration, military and other operational activities were increased significantly. During that period, taxation has been taken as main source of revenue and different types of taxes like land tax, transit tax, market duties, various levies and fines, forest product tax and mining tax were levied. Local administrations were directed "to take whatever is paid willingly by the people." Taxes were collected from the three levels (Agrawal, 1980).

a. Royal Palace: To finance occasional and ceremonial needs. The taxes were broad based and progressive.

b. Government: To finance administrative, military and other purposes assessed on official functionaries, occupational groups and other people.

c. Local: Prerequisites of local officials, functionaries and mendicants. The various taxes levied during this period were narrow in base and were imposed primarily on occupations and economic activities, not on income or property. The system of direct taxation was confined to land tax and special levies like "Darshanbhet", "Salami", "Walal" etc. After the unified period, land revenue system was divided into five main forms: Raikar, Birta, Guthi, Sera and Kipat. The main sources of revenue from land were Birta and Kipat. King Prithvi Narayan Shah had introduced 'Pota' tax in 1772, which was regarded as a revolutionary measure in the fiscal system of Nepal. It was based on flat rate system and limited on small Birta owners. There was no taxation of income in the sense of modern income tax.

2.1.8 Taxation in Rana Regime (1846-1950 A.D.)

Imposition and collection of taxes during 104 years oligarchic rule of the Rana family in Nepal prior to 1951 was the prerogative of the feudal rulers. Only those taxes, which suited the objectives, needs and whims of the ruling Prime Minister, were imposed. No budget was framed during the Rana regime. Taxes were collected at the time of requirement due to lack of Income Tax Act and finance act. The collected taxes were directly deposited into the Prime Minister's Account.

Land tax, custom and excise duties in the form of lump sum contracts, royalties on felling trees, royalty on supply of porters and soldiers, entertainment taxes were the major source of revenue. There was no direct tax in the country except land tax collected on a contractual basis and "Salami" which the government employees used to pay out of their salaries at a very small percentage. Rana Prime Minister levied taxes for meeting specific expenditure of the royal household or extraordinary expenditure necessitated by war or other crisis rather than mobilizing revenue in the nation. During Nepal-Tibet war (1855/56), the first Rana Prime Minister Jung Bahadur had imposed a tax on the income of selected groups. Similarly, Bir Shamsher imposed a levy of 1% in the official value of Jagir assignment of government employees in 1891, to finance the transportation of water pipe supply in the capital. Ranoddip Singh imposed a 50% tax in the income made by fishermen in Deukhuri from the sale of fish in 1882.

2.1.9 Income Tax in Modern Nepal

Actually, the modern income tax act was started in the year 1959 in Nepal. After the political revolution in February 1951 (2007 B.S. Falgun), the role of government has increased to developmental as well as philanthropic works. The government of Nepal had presented its first budget in 1952 (2008,Magh 21). The first five-year plan started in 1956. The planned activities of the government needed huge amount of source and means. So, huge revenue was demanded and Nepalese government started to levy tax on income as permanent source. As a result, it issued first finance ordinance in 1959(2016) to impose tax on business profit and remuneration. In 1960(2017) the income tax act named

"Business Profit and Remuneration Act, 2017 was made with the provisions of finance ordinance 1959. That was the first income tax act, which had 22 sections. But that act was found narrow and vague. So, it was replaced by the Income Tax Act 1962(2019). That act continued for 12 years and it was also replaced by the Income Tax Act 1974 (2031. That act was amended for eight times. That tax act was replaced by new Income Tax Act, 2002 (2058). This is the fourth income tax act of Nepal.

2.2 Income Tax Act 2002

To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend integrates the law relating to income tax, the Parliament of Nepal enacted the income tax act 2002 (2058). This act has replaced Income Tax Act 1974, which was amended for eight times and existed for a period of twenty-eight years. The act is quite advance in modern concept. According to the size, contents and style of presentation it is a big departure of the previous act 1974. The act is enacted from 1st April 2002, and first rule of this act is also published in same year and affected from 10 June 2002. To make the act more practical and to eliminate confusion and confusing terms the act has been composed in 143 sections within 24 chapters plus schedules of provision. According to the policy maker and tax experts the objectives of the Act could be pointed out as follows:

a. To bring all the income generating activities within tax net.

b. To increase the base of taxation,

c. To bring all the income tax related provisions within one act.

d. To make income tax related provisions clear and transparent.

e. To interlink Nepalese tax system with tax system of other countries.

f. To make the system based accounting.

g. To minimize tax avoidance and evasion.

h. To make tax system compatible to modern economy.

i. Reducing the scope of discretionary interpretation of the tax administration thereby ensuring simplicity, uniformity and the transparency.

j. Defining the power as well as authority of the tax administration.

k. Separating administrative and judicial responsibilities.

l. Distinguishing tax payers' violation of civil duties and criminal offence, and

m. Further streamlining the appeal system by making it mandatory for the taxpayers to file an objection with the Department of Taxation before appealing to the Revenue Tribunal.

The act has following features:

1. All the related matter within one act Abolition of all tax related concessions, rebates and exemption provided by different act.
2. Specifications of tax rates appendix for tax rates embracement of the tax rates applicable to all the sources of income.
3. Specification of stock valuation methods according to the act 1974 approval of the concerned authority is required to change the stock Evaluation method once one method is adopted, but the act 2002 has made clear provision regarding the valuation of stock for tax purpose.
4. Provision of tax accounting Prescription of the method and basis of tax accounting. Cash basis or accrual basis accounting for different income heads and persons.
5. Provision for quantification, allocation and characterization quantification of amount of transfer of assets and amount of any fringe benefit allocation of income from joint owned investment characterization of payment under annuities, installment sales, financial leases and arrangement of transfer pricing provision against the splitting the income.
6. Simplification of depreciation related provision categorization of assets into five pools Pool based depreciation of assets specification of Diminishing Balance Method as the depreciation method for the purpose of taxation depreciation of intangible assets and approved method of depreciation is Straight Line Method. Specification of depreciation rate for five pool individually.
7. Taxing capital gain and dividend specification of tax rate for natural person and entity Provision of withholding payment for this attempt generous loss set-off and carry forward provision.
8. Inter-head and intra-head adjustment of losses both are clearly defined provision of carry forward as well as back ward of losses for the financial sector.
9. Provision of international taxation provision of transfer pricing, foreign tax credit, double taxation avoidance agreements global income of resident is made taxable.
10. Stringent fine and penalty provision high amount of fine and penalty provision of imprisonment.

11. Other all expanses relating to income is admissible, no submission of income statement from the person not having taxable income no submission of income statement by the person, who has income from remuneration only taxpayers' right to appeal against departmental action clear address of time, palace and procedure of collection, remission and refund of tax every assessment treats as self-assessment.

2.2.1 Definition of Terms and Terminology

Terms and terminology used in the act has been defined by this act itself because of such definition confusion and misunderstandings regarding the Act has minimized. Some of the terms defined by the Act are as follows:

a. Assessment: The process of ascertaining the tax liability.

b. Person: Person means an individual or an entity. Individual means a natural person and entity means an organization established under the law, may be profitable or non-profitable. For example partnership firm, trust, VDC, DDC, Municipality etc.

c. Income year: The year during that the income is received or earned.

d. Company: Company means, company established under company law or act. The following institutions shall also be treated as company for the tax purpose, any un-incorporated association, and committee.

e. Business: Business means industry, trade, profession, vocation etc,

f. Employment: Employment includes present, past as well as future employment.

g. Investment: Investment means holding one or more assets of similar nature and investment.

h. Resident:

[i] Individual:

Whose normal place of abode in Nepal, Who is present in Nepal for 183 days or more in any period of 365 consecutive days of an income year.

Who is an employee as on an official of HMG posted aboard at any time during the income year.

[ii] Any partnership firm

[iii] Company:

A company that is incorporated or formed under laws of Nepal having effective management in Nepal during the income year.

[iv] Incase of trust:

A trust established in Nepal

Has a trustee that is a resident person for the income year Is controlled directly or through one or more interposed person or person one of whom is resident person for income year.

[v] VDC, DDC and Municipality

i) Retirement fund, retirement contribution, and retirement payment: retirement fund means any entity established solely for the purpose of accepting and investing retirement contribution in order to provide retirement fund payment to individual who are beneficiaries of the entity or a dependent of such an individual.

Retirement payment means a payment to, an individual in the event of individual's retirement or a dependent of an individual in the event of the individual's death.

Retirement contribution means a payment made to a retirement fund for the provision or future provision of retirement payment .

j) Exempt organization:

A social, religious, educational or charitable organization of public character registered without having profit motive An amateur supporting association formed for the purpose of promoting social or sporting amenities not involving in the acquiring of gain Political party registered with election commission Village Development Committee, District Development Committee

Nepal Rastra Bank

Government of Nepal

An entity getting tax relief as per personal ruling.

2.2.2 Source of Income

The new Income Tax Act 2002 has subjected the taxpayer's income into three categories. The act defines income in terms of the sources only. The act defines income as "a person's income from any employment business or investment and the total of that incomes."

1. Employment Income:

Under this source of income, all payments and benefits received by the employee including past, present, as well as future employment are taxable. The examples of employment benefits are salary, house rent, pension, gratuity, dearness allowance, medical allowance etc. It also includes payments relating to the change of terms of employment, fringe benefit, various types of allowances , payment received through third parties etc.

A. Incomes include in employment income:

As per section eight following payments made to the employee from the employer are included in employment income. Payments of wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts, bonus and other facilities.

Payment of any personal allowance including any cost of living, subsistence, rent, entertainment, and transportation allowance Payment providing any discharge or reimbursement of cost incurred by the individual or an associate of the individual payment for the individual's agreement to any condition of the employment payment for termination or loss of service or compulsory retirement, retirement contribution including those paid by the employer to a retirement fund in respect of the employee and retirement payments. Other payment made in respect of the employment Other payment made in respect of tax accounting such as transfer of the assets (sec27.a), vehicle facility and house facility (sec 27.b), expenses made by employer for the provision of domestic assistants, food, house-hold utilities of the employee (sec. 27.c), reduced amount of interest paid to employer as per concession rate with compared to standard rate (sec. 27.d), compensation (sec.3.a, 62and 92) and amount of bill directly paid by the employer (sec 27.e)

B. Exempt amount and other concessions:

1. General exemption (sec. 10) An amount derived by a person entitled to privilege under a bilateral or multilateral treaty conducted between HMG Nepal and foreign country or an international organization. An amount derived by an individual from employment in the public service of a foreign company provide that, the individual is a resident solely by the reason of employment to a non resident person, and the amount is paid from public fund of the country.

Allowances paid by the way of gift, bequest, inheritance or scholarship. Amount derived by an exempt organization by the way of, gift or donation, and other contribution that directly related to the organization's function weather or not the contribution is made in return for consideration provided by the organization.

Amount received by Nepal Rastra Bank as its objectives.

Amount received as pension from foreign government treasury by Nepalese citizen as a retired army or police. Amount derived by an individual who is not a citizen of Nepal, who is employed by Government of Nepal in terms of tax exemption.

2.Gift and donation to exempt organization: As per section 12 a person may claim to have their taxable income for an income year reduced by gifts and donation made by a person during the year to an exempt organization that are approved for the purpose of this section by the department.

3. Final withholding payments (sec. 8.3 a &92).

4. Meals and refreshment expenses paid by the employer (sec. 8.3b).

5. Discharge or reimbursement of expenses used for employer's business purpose or employer's admissible deductions form business or investment (sec. 8.3).

6. Payment of small amounts (sec. 8.3 b).

7. Special provision of exemption for retirement payment and leave pay (sec. 20.6 a &b).

8. Other, common deductions (sec. 12 & 63), exemptions, medical tax credit (sec.51), foreign tax credit (sec. 71) and special fee (sec.16.2 of Finance Ordinance 2060).

C. Special provision for retirement savings:

As per section 63.2, a natural person who is the beneficiary of an approved retirement fund may claim to reduce the taxable income by retirement contribution made to the fund by the natural person during the year In case an approved retirement fund ceases to be unapproved, the amount of contribution made in such retirement fund taxed as company tax rate (sec. 64.3).

Interest payment made by the retirement fund is taxable @ 6%, and if the payment is made as a lump sum payment, it is treated as a gain from the disposal of a non-business chargeable asset of an investment (sec 64.1 & 2).

The incomings for an asset being an individual's interest in an approved retirement fund includes reductions claimed by the individuals as per the section 63.2 for retirement contribution made with respect to the interest.

2. Business Income:

The source of income 'business' includes industry, trade, profession, vocation or isolated transaction with a business character and a past, present or prospective business. But, this source does not include employment income.

A. Inclusions of business income:

Service charge (sec. 7.2a).

Sales or disposal of business or trading stocks (sec.7.2b).

Net profit or gain by disposal of business assets or liabilities (sec.7.2c).

Amount received against disposal of depreciable assets (sec. 7.2d).

Prizes or gifts received in connection to the business (sec. 7.2e).

Amount received by any investment that is directly related to the business (sec. 7.2g).

Amount received instead of any restriction regarding to the business (sec. 7.2f).

Amount included under the charge of accounting system (sec. 22.6).

Amount included by reason of timing (sec. 24.3).

Excess amount received due to exchange rate (sec. 24.4).

Recovery of bad debts (sec. 25.1).

Proportionate amount under long-term contract (sec. 26.1).

Amount received for compensation (sec. 31).

Difference amount of interest paid with the standard rate of interest (sec. 27.1 d).

Amount paid to third person instead of actual payee (sec.29).

Other amount including under business income.

B. Admissible expenses and other consideration:

General deduction includes all the expenses relating to the business that the expenses are made by the taxpayer to produce business income during the year. Example if such expenses are manufacturing expenses, administrative expenses, selling and distribution expenses etc (sec. 13) .

All the interest derived by the entity during the year included in calculating the entity's taxable income 50% of the entity's Taxable income for the year calculated without including any interest derived or incurred by the entity (sec. 14).

After calculating value of opening stock adding total purchase during the year and subtracting the closing stock the remaining is cost of business stock and is admissible (sec. 15).

Repair and maintenance cost equal to 5% of the depreciation base of respective asset is admissible. If it exceeds the limit then the balance amount is added to the depreciation base writing off in the subsequent year (sec. 16).

Actual or 50% of taxable income calculated without deducting cost of research and development and ignoring the limitation whichever is less is eligible expenses for research and development. Excess amount of such cost is added to the assets category 'D'. In the same way in case of pollution control cost taxable income is calculated without deducting the cost and ignoring the limit, then excess amount is transferred to pool 'D' of assets as done for research and development cost (sec.17 & 18).

Rs. 100000 or actual or 5% of taxable income calculated without deducting gift and donation and ignoring the limitation whichever is less is allowable deduction for donation (sec. 12).

The depreciation made as per five categories of depreciable assets is admissible expenses for depreciation (sec. 19, sch. 2).

Set off of losses from the profit of any business or investment to the subsequent four year can done by ordinary business. In case of electricity project, public infrastructure building with the motive to transfer in near future to HMG can carry forward its losses up 10 next 7 years. And, in case of bank and general insurance business carry back ward up to 5 years and forward up to 4 years for its business losses can be done. But the losses in investment cannot be carried forward and backward, (sec. 20).

Business exemptions and facilities (sec. 11). Common deductions such as retirement contribution (sec.63). Statutory exemption limit, remote area allowance as an additional exemption limit, additional exemption for pension income and life insurance premium. Medical tax credit (sec 51), foreign tax credit (sec 71) special fee 1.5% as prescribed by the Finance Ordinance 2060.

C. Inadmissible expenses (sec.2J)

Personal or domestic expenses Income tax paid, bribe, fine and penalty paid to the government or political subdivision of any country by breaching of any law Expenses incurred in acquiring tax-free income or exempted amount or final withholding payment Distribution of profit by entity whatever in the way by capitalizing the profit or issuing bonus share Capital nature expenditure and foreign income tax except as specified by the tax laws.

Any cost incurred in cash exceeding Rs.50000 is not allowed if the taxpayer lives in the plane where banking service is available within 10 kilometers area and if annual turnover of taxpayer is more than 20 lakhs; unless the payment is made to HMG, constitutional bodies, government owed corporation, former producing agricultural product, retirement contribution, banking service and closed payment made to bank account of payee. Any other amount, which is denied by other provisions of the law.

2.2.3. Investment Income

The investment means holding one or more assets of similar nature or investing in such assets. However, the non-business chargeable assets hold for personal use by the owner himself and the employment or business is not investment.

A. Inclusion of investment income:

Dividend other than final withholding (sec. 9.2a).

Gain from investment insurance other than final withholding (sec. 9.2a). Interest income, rent received, receipt income, royalty income not deducted tax at source and amount received in respect of in-approval retirement fund as per sec. 9.2a.

Amount received from disposal of depreciable assets (sec. 9.2c).

Amount received as consideration for accepting restriction on investment (sec. 9.2f).

Income including under investment due to change in accounting method (sec. 22.6).

Amount of income included by the reason of timing (sec. 24.3).

Under paid amount of interest as per market rate (sec. 27.1).

Recovery of bad debts (sec. 25.1).

Income received as compensation (sec. 31).

Income received form joint investment (sec.30).

Net gain from the disposal of non-business chargeable assets of a natural person (sec.9.2b)

Gift received in respect of investment (sec. 9.2d).

Other amount to be included under investment income :

B. Admissible expenses and other consideration:

General deduction (sec. 13).

Interest expenses (sec. 14)

Repair and maintenance cost (sec. 16)

Depreciation allowances (sec. 19)

Others, common deduction (sec. 12 & 63), exemption, medical Tax credit (sec. 51), foreign Tax credit (Sec. 71), final withholding payment (sec. 92), & special fee as per section 16.2 of Finance Ordinance 2060.

2.2.4 Return of Income Tax Assessment

A. Return of income:

Every taxpayer should file return no later than 3 months after the end of each financial year at the place prescribed by the department. The law has prescribed that following items should be-included in filing the return. The person's assessable income from business, investment in the year and the source of that income. The person's taxable income for the year and the amount of tax payable with respect to that income. Incase of foreign permanent establishment of a non-resident person situated in Nepal, foreign permanent establishment's repatriated income for the year and the tax payable with respect to the income. Any tax paid by the person by the way of withholding, installment to assessment for which credit is available. The amount of tax still to be paid after deducting the tax already paid. Any other information that the department prescribes.

• Return of income not required

A person who does not have taxable income may not required to file return. This provision is applicable to resident person who has income exclusively from employment having source in Nepal, who has only one resident employer at a time during the year, who does not claim a deduction from his taxable income by gift to exempt organization.

• Extension of file of return

A person who is required to filed the return of income makes written request to the department by the due date for filing return, the department may on such terms and condition as prescribed by the department, and where reasonable clause is shown shall extend the date by which the return is to be filed. The department may grant extension, which shall not in total exceeds three months.

Special provision for individual & entity:

2.2.5 Individual

A resident natural person and resident spouse of the person may, by notice in writing, elect to be treated as a single individual for particular income year. According to section 50, resident couple can elect to file return jointly by having joint request for particular year. In such case they would be collectively responsible for filing return.

A resident natural person may claim a medical tax credit not exceeding Rs.750 per year. Any amount exceeding the limitation is carry forward to subsequent year. This facility is equally applicable to all the taxpayers.

2.2.6 Entity

Transaction between an entity and its manager is tax free. Repayment of capital by the entity such as to shareholders is tax free. Payment of dividend tax deducted at source is tax free.

B. Income tax assessment procedure

The meaning of assessment is determine something for specific purpose. The word assessment is used in a number of provision in a comprehensive sense and it can comprehend the whole procedure for ascertaining and imposing liability upon the taxpayer and the machinery for enforcement there of. Income tax assessed under different method viz. Official assessment Committee assessment and Self-assessment system. Traditionally, income tax is assessed under the official assessment system, where taxpayers are required to submit their tax return to the tax officer and tax officials are required to make an assessment of taxable income (Khadka, 2001:71). In the Income Tax Act 1974, the term assessment is used with different aspects in different places. Sometime it is used as a meaning of the computation of income, sometime the determination of tax liability and sometime the whole procedure laid down in the act for imposing liability upon the taxpayers. The assessment procedure of income tax according to the Actl947 is as follows:

1. Submission and filing of income statement
2. Assessment of net income
3. Assessment of tax liability
4. Tax assessment order

Income Tax Act 2002 has focused on self -assessment system. Under this law, every assessment is treated as self-assessment. Basically, in the Act, three types of assessment system is mentioned namely Self-assessment, Jeopardy assessment and Amended assessment in section 99,100 and 101 respectively.

2.2.7 Self-Assessment (section 99)

Assessing the tax liability by the taxpayer himself is known as self-assessment of tax. According to the Act, where a person files a return for income year, an assessment is treated as made on the due date of filing the return. This type of assessment is to be made by the taxpayers' who actually have:

Taxable income

Income not exempted from tax.

Income is not of that type where final with holding is made.

In such assessment the taxpayer should show,

a. Tax payable by the person

b. Amount of tax still to be paid by the person for the year being the amount shown in the return.

If incase, a person fails to file a return by the due date, the person is even treated to have made an assessment on the due date for filing the return and his assessed tax for the year will be equal to the sum of tax withheld and tax paid in installment. The Department may, and then, proceed for an amended assessment.

2.2.8 Jeopardy Assessment (section 100)

In some doubtful situation the tax officials may make jeopardy assessment. The assessment is initiated prior to the date of filing an income return. The assessment is actually made according to the best judgment basic under the special circumstances as when,

a. The person becomes bankrupt, is wound -up or goes into liquidation
b. The person is about to leave Nepal indefinitely
c. The person is otherwise about to cease activity in Nepal, or
d. The Department otherwise considers it appropriate

Jeopardy assessment can be made either for the whole year or for the part of the year. If the assessment is made for whole year the taxpayer is not required to file the return for the year. But, if the assessment is made for the part of the year then the taxpayer is required to file the return of income for the year on due date.

The Department may give the 7 days of time to the taxpayer to produce proof, if any, in own favor with respect of the jeopardy assessment. Moreover, if the tax officials made the jeopardy assessment, they are required to provide written notice of the assessment to the taxpayer mentioning the total tax liability, tax payable, payment date, manner and reason of the assessment, place and manner of objecting of the assessment.

2.2.9 Amended assessment (section 101)

The Department may amend an assessment made by the taxpayer to adjust the assessed person's tax liability. It is done according to the intention of the Act. The tax officials may amend both the self-assessment and Jeopardy assessment so as to adjust the tax liability. Amended assessment is carried out after filing return or after the expiry of due date for filing income return. The tax officials may amend an assessment according to the best judgment for as many times as the tax officials think appropriate. The Department may amend an assessment within four years at any time where the assessment is inaccurate by the reason of fraud or any un willful neglect by or on the behalf of the assessed person.

The tax officials may not amend an assessment if the assessment has been amended or reduced assessed tax by the Revenue Tribunal or a court of competent jurisdiction except where the order is reopened. This provision should not be a barrier to amend in the case where an order for reinvestigation is issued. Where the Department makes amended assessment the Department shall be required to serve a notice of the assessment to the person stating,

a. Tax payable by the person, tax still to be paid for the income year or the period to which assessment is made.

b. The manner in which the assessment is calculated.

c. The reason why the Department has made assessment.

d. The date on which the assessment is payable, and.

e. Time, place and manner of objecting to the assessment.

2.2.10 Income Tax Collection Procedure

Collection basically refers to the collection of tax from defaulters. Collection is one of the important functions of the modern tax administration, which needs to follow up continuously on non-fillers and non-payers. Tax officials should remind non-fillers and non-payers regularly about their liabilities and conduct tax collection visits. In the absence of such measures, the number of non-filler would increase and the due amount will swell. This may lead to a situation where the good taxpayers may turn into bad taxpayers and government will lose revenue in both nominal and real term (Khadka, 2001:80). According to the Income Tax Act 2002, a tax officer can recover due amount but adopting any or all of the following methods.

1. By impounding or sequestering or auctioning the movable and immovable property owned by the taxpayers.

2. By impounding the deposit held by the taxpayers in his name in any government officer or any corporate body controlled by HMG or the amount due to taxpayer from such office or body or by directing the payment of such amount to the tax officer.

3. By suspending the business and exports and imports of the taxpayer In the Income Tax Act 2002 following measures for the recovery of the due amount is mentioned in chapter 20.

a. Section 103: Collection through withholding The withholding agent required to withhold from the payment remains first charge on that payment and should be deducted prior to any other deduction even the deduction to be made according to the order of the court. Tax deduction at source cannot be attached to debt or liability of the agent. Incase of liquidation, the withheld tax doesn't become the part of asset of the agent.

b. Section 104: Charge Over Asset

If the taxpayer is-not able to pay tax on or before the due date, the government can create charge over the asset of the taxpayer by servicing notice to him stating: Details of the asset auction The extent of charge (tax payable, interest occurred etc.) Any cost of charge and auction If the charge on land and building is taken, the government files application to register the charge in Land Revenue, who shall suspend the sale or transfer of ownership.

c. Section 105: Auction of Charged Asset

The Department may notify the tax debtors as regards to the Department's intention to sell charged asset held by the debtors, and the proposed method and timing of sale. Auction of land and building may be held within 30 days after taking possession auction of tangible assets other than land and building within 10 days after taking possession and perishable goods within 1 day after taking possession. Procedure of Auction A 15-day notice is published at least in one local daily newspaper. Market price of the asset determined in presence of representative of the local auction officer and representative of local government officer. Auction is done in presence of representative of local administrative officer. The auction should realize at least market price of the asset determined. If the amount is not realized a 70 days notice is published and auction is done. If the amount offered is still less than market price of the asset, a 3 day notice is published. The proceed amount is first paid to cover the cost of charge and sale of asset, then to pay the tax payable, interest occurred and the remainder shall be paid to the debtors. If the proceed of the sale is not sufficient to pay in full the cost, tax and interest, the Department shall proceed to collect the outstanding amount from the tax debtors with fresh auction.

d. Section 106: Departure Prohibition Order

If a person did not pay tax within payable time, the Department can serve notice to the Immigration Office to prevent the person from leaving the country (Nepal) for a period of 72 hours from the time of the notice served. If the person pays the tax or makes an arrangement for payment, tax administration may be notice in writing served on the office, withdraw the order.

e. Section 107: Liability of the officer of the Entity

Every person who is officer at the time of payment or six-month before of the entity is jointly or severally liable to pay tax.

f. Section 108: Recovery of Tax from Receiver Receiver refers to:

A liquidator.

A receiver appointed out of or by court of an asset or equity.

A mortgage.

An administrator or executor or a direct heir of decreased individual estate.

Any person conducting the affairs of incapacitated person.

g. Section 109: Recovery of Tax from person owing money to Tax Debtors. If the tax debtors fail to pay tax on or before the date it is payable, the department may serve notice in writing to any person to pay tax, the person who owes or subsequently owe money to the tax debtors.

h. Section 110: Collection of tax from the Agent of Non - resident

The Department may by services of a notice in writing require a person who is in possession of an asset owned by the tax debtor to pay the tax on the behalf of the tax debtor up to the market value of the asset. Incase of such payment, the person may recover the payment from the tax debtor an amount not exceeding the payment. The tax debtor may not make claim against the person with respect to the retention.

i. Section 111: Suit for unpaid tax, The Department can recover the unpaid amount of tax from tax debtor by suing in the competent court.

j. Section 112: Remission, If the Department is satisfied and certified writing that the tax or interest or penalty cannot be effectively collected, GON may remit in whole or part of such amount payable by the person.

k. Section 113: Refund and set off, If the Department is satisfied that a person has paid tax in excess of the person's tax liability, the Department shall apply life excess in reduction of any tax payable but unpaid by the person and refund the reminder if any, to the person.

2.2.11 Tax Rates

The Act 2002 has simplified the tax rates applicable for the different groups of taxpayer's or all the source of income. A schedule for income tax rates has been managed in the Act. Applicable tax rates for individual or natural person, entity, and special industry are as follows. 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- upto 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, which ever 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 GON in power generation, transmission, or distribution for an income- year shall be taxed at the rate of 20 percent.

B. Entity:

(i) Bank and financial institution @ 30%.

(ii) Industrial enterprise engaged in an industrial activities which is concerned with any road, bridge, rope way or any trolley bus or tram manufacturing entity is taxed at 20%.

(iii) Entity wholly engaged in power generation, transmission or distribution is taxed at 20%.

iv) The taxable income of a non-resident person with respect to shipping, air transport or tele-communication service is taxed at the rate of 5%.

(v) The taxable income of a foreign permanent establishment of a nonresident person situated in Nepal is taxed at 10%

(vi) Other entity taxed at 25%

C. Special industry:

(i) Industry that provides employment to 600 or more Nepalese citizens during each day of the income year shall be taxed at 90% of the rate or only 10% of tax payable amount otherwise applicable to that income tax rate is same as other entity

(ii) Industry operating in a remote area, under-developed or undeveloped areas will be taxed at 70%, 80% & 75% respectively of the rate applicable for the period of 10 income year. Commencing from and including the year in which the operation commences.

2.2.12 Depreciation Rates

To manage the allowable deduction of depreciation a schedule has been included in the Act 2002. For the purpose of depreciation the assets are divided into five categories. The rate of depreciation, category of assets and brief of assets in each pool are as follows:

Depreciation Rates and Assets Category

Depreciation rate	**Asset category**	**Assets**
5%	A	Building, structure and similar work of permanent nature etc.
25%	B	Computer, data handling equipments, fixture, office furniture etc.
20%	C	Automobile, bus, minibuses
15%	D	Construction and earth moving equipments and any other assets not included under A, B and C
Assets/useful life	E	Intangible assets

Suggestion of the Taskforce/NG (2003) Regarding Income Tax Act 2002: With respect to income tax act, 2002, the task force/NG(2003) explained its demerits vague, complicated and use of difficult language. In this connection the taskforce stated: (Dhakal, 2004: 66-67).

"Many people regard income tax act 2002 to be complicated. There are many reasons behind it. For example, with the intention of modernizing the income tax, there has been the use of various tedious, new and difficult concepts and definitions. Similarly, the presentation of this act was also different from previous. At times, there is the need to refer to different sections and sub- sections. From the legal point of view, this type for presentation however has its own importance. The language used in the act is also not simple. Selection of new words has also made this act difficult to understand in the beginning. Due to difficulty in understanding the act, it has created an environments of fear among the taxpayers" (Task force/HMG, 2003: 47).To overcome the problems of the act the taskforce/HMG (2003) has suggested: Simplification of the difficult points. Publication and distribution of booklets and guidelines. Publication of articles, advertisements and notice about tax in journals and newspapers. Launching tax programs on radio, T.V., etc for providing information to the public. Conducting interaction and workshop program etc.

In this regard, in "Public statement on income and expenditure of the fiscal year 2003/04", the finance minister expressed: "A income tax act, 2002 has been enacted recently; it will take some time to know its implications. Nevertheless, efforts have been made to make the act simple and understandable to eliminate taxpayer grievances on ambiguity contained in the language. Similarly, making manual and directives public within six- month period will make income tax system taxpayer oriented" (Public statement on, Income and expenditure of five fiscal year 2003-2004: 41, GON).

2.3 Review of Thesis

Durga Prasad Ghimire has studied " Income tax in Nepal : It's structure and contribution from public enterprises to government revenue." with the following Objectives:

To analyze the structure of income tax in Nepal.

To examine the administrative aspects of income tax in Nepal.

To examine the proposal of revenue collection from income tax.

To analyze the contribution of income tax from PES to government revenue of Nepal.

his findings are:

There is a heavy budget deficit because of low revenue collection compared to the total expenditure.

The contribution tax revenue is greater than non-tax revenue, thus tax has been a major source of revenue mobilization.

The contribution of tax revenue to GDP was lowest among the SAARC countries and the contribution of direct tax revenue is less than indirect tax.

Income tax rates and slabs have been charged radically in certain years. Personal income tax rates, which ranged from 5% to 50% in seven slabs in 1982/83 was reduced to any two rates, 15 percent and 25 percent in 2001/02 and corporate tax has been reduced from 55% in 1984/1985 to 20%, 25% and 30%.

Contribution of income tax from PES is a major source of cooperate income tax. There are problem in income tax system, basically due to increasing habit of tax evasion, lack of consciousness of tax administration, lack of training facility and sufficient incentive to the employee and complexity in income tax act, rules and regulations.

There are poor tax paying habit of Nepalese people because of little knowledge of tax and it's importance; wide spread practices of illegal business, defective tax administrative system and complexity of tax laws and policy.

Daya Raj Tripathee had presented a thesis entitle, "Income Tax System in Nepal and Some Potential Areas for Reform." in 1995. Deficit annual budget and deficit financing of the nation were his main concern of the study where he had tried to show the tax structure in Nepal, role of income tax in Nepalese economy, income tax administration and tax evasion in Nepal along with reforms.

Mr. Tripathee had conducted his research using the 15 years data since 1974/75 to 1989/90. Primary data were also used which were collected through opinion survey within Kathmandu valley. Simple statistical tool such as mean and time series were used to analyze the data Graphs, charts and diagrams were also used as necessary. From that research, he had concluded that income tax from individual sector had provided maximum contribution in income tax structure and about 80% of total revenue was collected through taxation. Tax evasion had increased due to poor tax administration and delay in tax assessment process. Lastly, he had recommended levying tax on agriculture income, tax holiday should be given to the firms and administration should be sound and efficient.

In 1995, Krishan Kumar Shakya had presented his thesis entitled, "Income Tax in Tax Structure of Nepal" and had tried to give origin and meaning of income tax with its historical review, structure of government revenue in Nepal, importance of income tax, contribution of income tax to total tax revenue and total revenue. In his study, he stated that the structure of the government revenue in Nepal is a composition of the tax revenue and non- tax revenue. The tax revenue is the most important sources of government revenue that occupies 80% share in the total government revenue in the year 1993/94. The ratios of income tax to GDP, total revenue, total tax revenue and direct tax revenue had an increasing trend. But the increasing rate was low in comparison to other countries. He further added that the change in tax rate and exemption limit had made the assessment of income tax more complicated, which had given plenty of opportunities to evade income tax, which exist as a major problem.

Lastly, he had recommended many suggestions for the sound and effective income tax such as honest and effective tax administration scientific method in tax collection and encouragement of self- assessment of tax.

Parmeshwor Panta had presented a thesis entitled, "A Study on Income Tax Management in Nepal "in 1996. His main objectives of research were to find out the share of income tax to government revenue, to review the income tax system and to identify the problem of income tax management. His research was based upon secondary as well as primary data. The primary data were collected within Kathmandu valley through interview, questionnaire etc. He had concluded that income tax was a major source of internal resource mobilization, the income tax system was not efficient and income tax assessment was not efficient. Evasion of income tax was major constraint for resource mobilization. He also added that corporate tax rate was found high and exemption limit was not sufficient.

Lastly, he had recommended that income tax net should be widened, assessment procedure must be improved and income from agriculture and capital gain should be taxed.

In 1998, Karna Beer Poudyal 'Kshetry' had submitted a Ph. D. thesis entitled, "Corporate Tax Planning in Nepal". This thesis report was aimed to examine the implications of tax factors in strategic planning, project planning and operational planning in Nepalese companies. He had found that the majority (90%) of the companies (sample size of the study) considered tax factors while selecting the lint of business. He also found the positive co relation (+0.8) between tax rate and the debt equity ratio because of interest paid on debt is a tax-deductible item. Similarly, the correlation coefficient between average fixed assets and corporate tax was (0.75) in large companies and (+0.12) in medium size companies. As against this, in large companies, there was a negative correlation (-0.2), which showed that increase in fixed assets in large companies resulted in decrease in the corporate tax. He addressed that the tax planning should be considered while making corporate planning and so companies should set up separate tax section to get maximum benefit of provisions, provided by tax law. However, tax assessment under the best judgment blocked the application of tax planning in corporate planning. He had recommended that tax incentives should be given to non- industrial companies too, and tax rate should be differentiated for resident and non- resident companies. Puspa Raj Kandel also presented the Ph. D. thesis entitled, "Corporate Tax system and Investment Behaviour in Nepal" in 2000. He undertook the research work to find out the problems relating to corporate tax, which blocks the development of the private investments. The main objectives of his study were to evaluate the corporate tax system in general, to examine the sensitivity of certain policy like inflation, capital gain tax, dividend tax and interest tax etc. based on their impact on tax burden. He showed the relationship of private investments with average effective tax rate, marginal effective tax rate and tax incentives in Nepal. He found that it's for debt-financed project are almost negative i.e.-17% and positive for equity financed project and debt- equity project by 27% and 19% respectively. He had also found the impact of inflation to the METR. According to him, the statutory tax rate deduction had impact on private investments by 60% to 20%. In his regard, he had showed the adjusted value 0.87 at 5% level of significance. He had concluded that the statutory tax rate was in moderate level under the financing options: debt: mix and equity i. e. it was not much destructive. The relationship between inflation rate and effective tax burden in Nepal was negative.

2.4 Review of Books

Dr. Rup Bahadur Khadka had written a book entitled, "Nepalese Taxation: A Path for Reform", in 1994. The book dealt with both national and international taxes. The writer had detailed describe the scenario of Nepalese tax system from origin of income tax, adoption of quasi-global or a limited scheduler system, segregation of corporate income tax from individual income tax, increasing dependence on the presumptive basis, basic allowance and progressive rate structure, move from joint taxation to individual taxation and shift from itemized to flat system of standard expenses, experiment with an advance tax on impacts and the existing structure, commodity taxes and poverty taxes. He had evaluated the Nepalese tax system base on conventional, theoretical concepts and suggested various measures for its improvement. The book had not been directly focused on corporate tax only but explains the whole Nepalese taxation system and structure for its reform.

Bidhyadhar Mallik had written a book entitled, "Nepalko Adhunik Aayakar Pranali" in 2003. This book especially deals with the thorough analysis of income tax act, 2058 with example. Every section of income tax act has been clarified with suitable examples. He had written about the development of existing income tax and need and importance of income tax system in Nepal. The new provision made by income tax, 2058 about tax base, computation of income ,tax exempt amount, deduction allowable, accounting of tax , capital gain, retirement saving and tax, dividend tax, capital gain and international taxation tax auditing have been clarified precisely in his book. Similarly, the book had also explained about tax administration, documentation, information collection payment of tax, installment tax, income statements, tax-assessment, tax collection, review and appeal, fees and interest, fine and penalties, tax rates and determination of provision of depreciation etc.

K. P. Aryal and S. P. Paudel had written a book entitled, "Taxation in Nepal" in 2004. They had explained about the income tax system in Nepal along with house and land tax and value added tax. The book has been designed based on the curriculum of B.B.S. It had been divided into three parts. In the first part of the book introduction and development of income tax, capital and revenue nature expenses and income items, entity and retirement saving, dividend tax, computation of income from business, remuneration and investment have been explained with numerical and theoretical examples. House and land tax and value added tax have been explained in the second and third part respectively, the book also included proper bibliography and adequate appendix where various income tax, house and land rent and vat related forms, schedules and format had been described. Lastly, he had recommended to mobilize additional domestic resources through taxation, tax structure should be redesigned in order to increase the role of direct tax; income tax should be reformed in Nepal etc. A senior researcher in the field of Nepalese taxation, Dr. Govinda Ram Agrawal had conducted a research entitled, "Resource Mobilization for Development: The Reform of Income Tax in Nepal "published by CEDA in July, 1978. The main objective of his study were to examine the problem of growing resource gap in Nepalese finance in the context of the role of income tax, to examine the buoyancy and elasticity of income tax in Nepal including projection if income tax, to examine the ways and means for increasing tax consciousness in Nepalese people etc.

In 1980, Dr. Govinda Ram Agrawal had written a book entitled, "Resource Mobilization in Nepal" published by CEDA. The book had been divided into eight chapters; the first chapter deals with special reference to Nepal. The second chapter deals with fiscal policies in developing nation and Nepal and third chapter looks at income tax in Nepal from the historical perspective, the fourth chapter deals with structure of Nepalese taxation. In the fourth chapter related to tax structure, the writer had concluded that taxation trend in Nepal have shown that role of indirect taxes have been predominant in the tax structure. More than 60% of tax revenue was derived from foreign trade alone. However, since 1974/75 the role of income tax had been increasing.

Dr. Agrawal had made an empirical study taking tax policy makers, tax experts, tax administration, tax lawyers and accountants and taxpayers of different parts of Nepal.

From that study he had concluded that Nepalese taxpayers were favorably disposed to income tax. However, the major constraints in the effective functioning of tax system seem to be administrative deficiencies, poor tax paying habits, lack of taxpayers education, complex rocedures and defective tax information system.

2.5 Review of Research Reports and Articles

Damber Bahadur Pant had written an article entitled, "Problems in Tax Administration and their Remedies" published in Journal of finance and development 'Rajaswa' 2004, April vol. 1. He had comprehensively explained about the problems and their remedies related with tax revenue. The major types of practical problems and challenges, in tax administration. He had mentioned in his article were showing limited amount of transaction showing low selling price, lack of issuing and taking bills, lack of showing the real factory cost, commercial fraud, lack of co-operation in tax auditing, legal ambiguity and complexity in implementation and lack of coordination between Inland Revenue Department and Revenue Investigation Unit. Meanwhile, he had recommended some valuable suggestions to solve the problems and to overcome the challenges. They were: statistical and information system should be properly managed, fixed norms and standards should be used to assess selling price and factory cost, the billing system should be made compulsory, coordination between Inland Revenue Office with various entities of Government, Revenue Investigation Department and its related units should play the important role.

Dr. Puspa Raj Kandel had written an article entitled, "Are Tax Incentives Useful? If so, which one?" published in Journal of Finance and Development, 'Rajaswa', Volume1 2004, April. In that article he had tried to seek the answer from the survey of various empirical studies earlier done in Nepal, India, Pakistan and other western countries. He found that the tax incentives are still the controversial matter whether they promote the investments or not. But he argued that most of the developing countries need tax incentives. As per the empirical studies done in various countries the conclusion that among different types of tax incentives, investment allowance or investment tax credit and accelerated depreciation are superior to other types of tax incentives.

Tax holiday is the most inferior type of tax incentive, which causes revenue loss without enhancing the investment environment. Meanwhile, most of the researchers have opposed the tax holiday system both within Nepal and outside Nepal.

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

United Nation published a journal on public finance entitled, "Guidelines for improving tax administration in developing countries" in 1977. The study was divided into four separate parts. Among them reforming the structural organization of the tax administration and explained in two separate sub topics i.e. guidelines for appropriate initiatives and underlying consideration and explanatory commentary. Functions of tax administration are identification and registration of taxpayer's education, information provider and assistance etc. The study had explained these two functions and the study had recommended some valuable suggestions to the developing countries. Principle of income taxation:

Principle of global income taxation

Principle of scheduler income taxation

Principle of source income taxation

Principle of worldwide income taxation

Principle of presumptive income taxation

Principle of tax withholding

Principle of resident and non-resident

Theories of income tax:

Theory of equity or equality

Theory of certainty

Theory of convenience

Theory of economy

Theory of productivity

Theory of elasticity

Theory of diversity

Theory of simplicity

Theory of neutrality

Theory of co-ordination

Canons of Taxation:

The government of a country adopts various principles while formulating suitable tax policy. Those principles or canons of taxation are discussed below. Adam Smith, in his book 'Wealth of Nation', has mentioned some Canons of taxation:

Canon of Equality of Equity :

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

Canon of Certainty:

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

Canon of Convenience:

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

Canon of Economy:

The collection expenses of tax should be less than the amount of tax collected so that a surplus to public revenue is generated and the country will be benefited. The amount that goes from the taxpayers pocket should not differ greatly with the amount that actually goes to government's treasury. In addition to Adam Smith's principles of taxation, Bastable has added two other principles which are discussed below:

Canon of Productivity:

The fund raised through taxes should be utilized by the government in productive sector of the economy so that the taxpayers can see the utilization of their hard-earned money paid as taxes.

Canon of Elasticity:

The government should easily change the tax rates as per the need of the country. Instead of being rigid, tax rates should be made flexible as per the changes in taxpayers' income, properties and transactions. Other modern Economists have added some other canons of taxation. They are:

Canon of Diversity:

The tax system should not totally depend on one source of revenue. It is risky for the government to depend on a single source. So, The government should levy various taxes instead of imposing a single tax. This ensures smooth collection of taxes in different years.

Canon of Simplicity:

A good tax system should be easily understood by general public. There should be no administrative hassles. The tax payment procedure should not be too lengthy.

Canon of Neutrality:

The tax system should not affect badly to the production and distribution aspect of the nation rather it should facilitate them. The government should impose heavy taxes on harmful products and less tax or no tax on basic goods in such a way that the total tax revenue is not affected.

Canon of Co-ordination:

There should be coordination among various taxes raised in the country. Tax payers should not be imposed various similar nature taxes.

Chapter 3

RESEARCH METHODOLOGY

3.1 Introduction

A sound research study needs to follow a proper methodology in order to achieve predetermined objectives. Research methodology is a sequential procedure and methods to achieve the objectives of the study. In this chapter, an appropriate research methodology has to be followed. Thus, this chapter deals with the research design, nature of data, data collection and processing and statistical tools used.

3.2 Types of Research

This study includes three types of research as descriptive, analytical as well as empirical.

a. Descriptive research includes surveys and fact-finding inquires of different kinds. The major purpose of descriptive research s the description of the statue of affairs as it exist at present. The study of income tax act, income tax rules, and finance act were made for descriptive research. This thesis is mostly based on this type of research.

b. Analytical research has to use facts or information already available and analyze these to make a critical evaluation of material. As per this research type the chapter four has been composed.

c. The empirical research relies on observation alone after without due regards for system and theory. It is data based research coming up with conclusion, which is capable of being verified by observation. In such a research it is necessary to get at facts first hand, at their source and actively to go about doing certain things, to stimulate the production of desired information. Following the research type the chapter four has been composed where an opinion survey had been conducted.

3.3 Research Design

To achieve the stated objective of the study, the study of income tax administration, income tax act, finance act and other related acts, rules, regulations and policies are made for descriptive and analytical research. For an empirical research an opinion survey has been conducted. The opinion of the various 50 respondents associated with distinct denomination i.e. tax administrators, tax experts and taxpayers were collected through structured questionnaire with reference to income tax system in Nepal. The questionnaire includes the causes which are responsible for creation of unsound income tax system in Nepal, comparison of income tax act 2002 and 1974 regarding its effectiveness and simplicity in the provision and procedure, major problem of income tax administration, essential factors for making income tax administration effective, remedies to minimize corrupt practice existed in Nepalese income tax administration and reason of all these existence, examine the effectiveness of income tax policies, tries to find out its effectiveness and suitable principle of income tax policy for Nepal, reasons for income tax evasion, remedies to control the income tax evasion, difficulties and appropriate methods of assessing the income tax, consciousness of taxpayer for voluntary compliances and examine the contribution of income tax to national revenue of Nepal is satisfactory or not. Hence, the research methodology followed in the study can be termed as survey cum analytical and descriptive research design.

3.4 Population and Sample

In order to achieve the objective of the study, 50 samples from Palpa, Butwal and Kathmandu valley is selected.

3.5 Nature and Source of Data

Data, which is essential to describe this study are collected from two sources i.e. primary and secondary source.

a. Primary data: The primary data have been collected from the responses of persons representing from various sectors through structured questionnaire. The same questionnaire was distributed to three group i.e. tax administrator, tax experts and taxpayers. Tax administrators are selected from tax department, various sectors of tax offices in Kathmandu valley. Tax experts are CAs, lecturers, reputed auditors lawyers who have knowledge and ideas about income tax. Taxpayers are selected from different field i.e. manufacturing companies, trading companies, banks and finance companies, solo business and employee etc.

b. Secondary data: The secondary sources of data are the information received from books, journals, newspapers, reports, dissertation, website etc. The major source of secondary sources of data are as follows:

Economic survey and budget speech of various years, ministry of finance/Nepal government.

1. Publication of CEDA, T.U.
2. Publication of central bureau of statistics/NG and department of Inland Revenue.
3. Publication of UNO and World Bank etc.
4. Books related to income tax and public finance.

5. National newspapers, journals, souvenir and news magazines.
6. Website of IRD www.ird.gov.np
8. Library of different offices and campuses.

3.6 Data Collection Procedure

Data of this study are collected from two sources. Primary data are collected from tax administrators, tax experts and taxpayers by using questionnaire. A total eighty sets of questionnaires were distributed to the three distinct types of eighty respondents. Distribution was done personally through field visit rather than sending by any means to get accurate and actual information in time. Out of the eighty questionnaires distribute sixty were received. Secondary data are collected from published reports of different organizations.

3.7 Data Processing and Analysis Procedure

The information received in different aspects of income tax from primary and secondary sources of data were first processed for tabulation and analysis. For the purpose of analysis generally simple statistical tools have been used which are as follows:

i. Simple percentage
ii. Graphs, charts and diagrams

3.8 Weight of Choice

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

Chapter 4

Presentation and Analysis of Data

4.1 Introduction

A researcher collects data possession original character himself or through agent for the first time from related field, such data are called as primary data. And when such primary data are reused by anybody else they are called secondary data. Once primary data have been used, it loses its originality or primary characteristics and becomes secondary. In this study, this part is entirely related with primary source of data.

An empirical investigation has been conducted in order to find out various aspects of problems and difficulties of Income Tax Act, 2058 in Nepal from the real life experience. For this purpose, questionnaire was developed and responses were collected from the respondents. A set of 35 questionnaires was received out of 50 questionnaires distributed to the respondents. Respondents were tax experts, Tax consultants, tax administrators/ Tax officers, Chartered accountants, registered auditors and taxpayers. The responses received from various respondents have been arranged, tabulated and analyzed in order to facilitate the descriptive analysis of the study. The questionnaire was asked for a yes/no response or asked for ranking of the choices according to the number of alternatives where first choice was the most important and the last choice was the least important. For analysis purpose, choices were assigned weight according to number of alternatives. If the number of alternatives were 5 then the first preferred choice got five points and the last preferred choice got one point. Any alternative, which was not ranked, didn't get any point. The total points available to each choice were converted into percentage in reference to the total points available for all choices. The choice with the highest score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as last choice.

4.2.1 Opinion towards people's have information about income tax system of Nepal.

To know the respondents opinion about the first question, "Do you think that people are well informed about the income tax system of Nepal?" was asked. The responses received from respondents are presented as under: The entire respondent shakes their head to say no and write the same in the questionnaire form. We can conclude that there is no more education awareness and information about income tax law & tax system of Nepal.

4.2.2 Opinion towards people's satisfaction with the existing income tax system of Nepal.

To know this the researcher had asked "Are you satisfied with the existing income tax system of Nepal? The responses received from respondents are tabulated as under:

Table 4.1

Satisfaction on existing income tax system of Nepal.

Inadequate economic policy	4	9	7	5	1	
Inefficient income tax system	3	3	3	9	3	
Complicated income tax rules and regulation	2	4	9	4	2	2
difficulty in maintaining account for tax purpose	10	5	4	8	7	
Lack of awareness to tax payers	1	6	6	2	8	1
Lack of training and sufficient incentives to employees	8	8	5	10	9	
Lack of expertism in tax management	7	10		7	4	3
Illigal business activities	6	1	1	1	5	
Practice of tax evasion	5	2	2	3	6	
Inappropriate rate and exemption unit	9	7	10	6	10	4

Source: Opinion Survey 2011

Out of 36 respondents 8 respondents are satisfied with the existing income tax system of our country, where 26 are not satisfied with this system. We can conclude the existing income tax system is not sufficient it seeks some improvement, they wants some improvement and rank like this:

chart 4.1

Satisfaction on existing income tax system of Nepal.

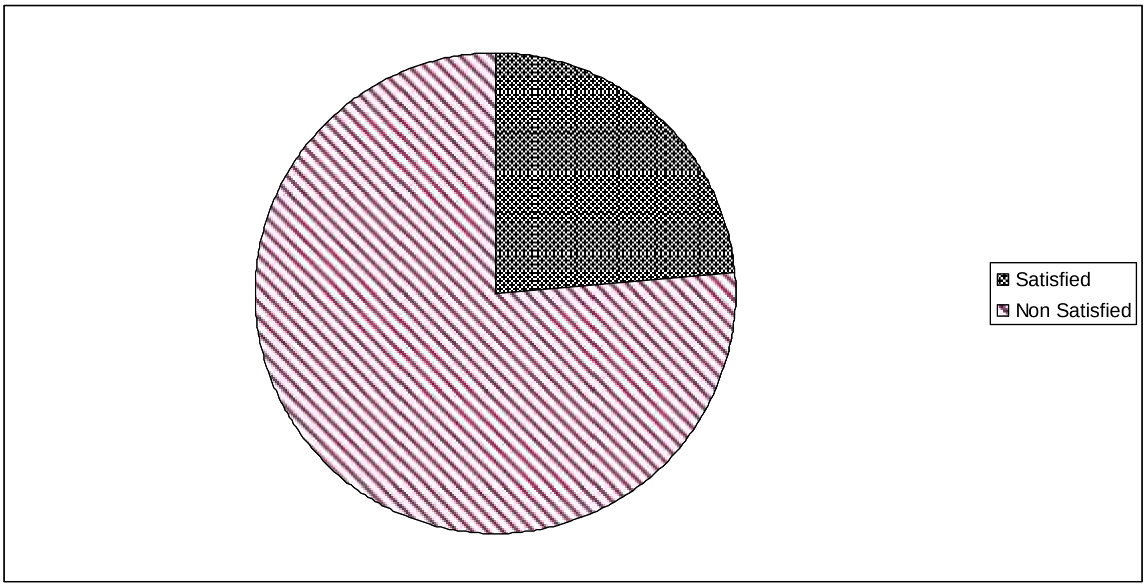
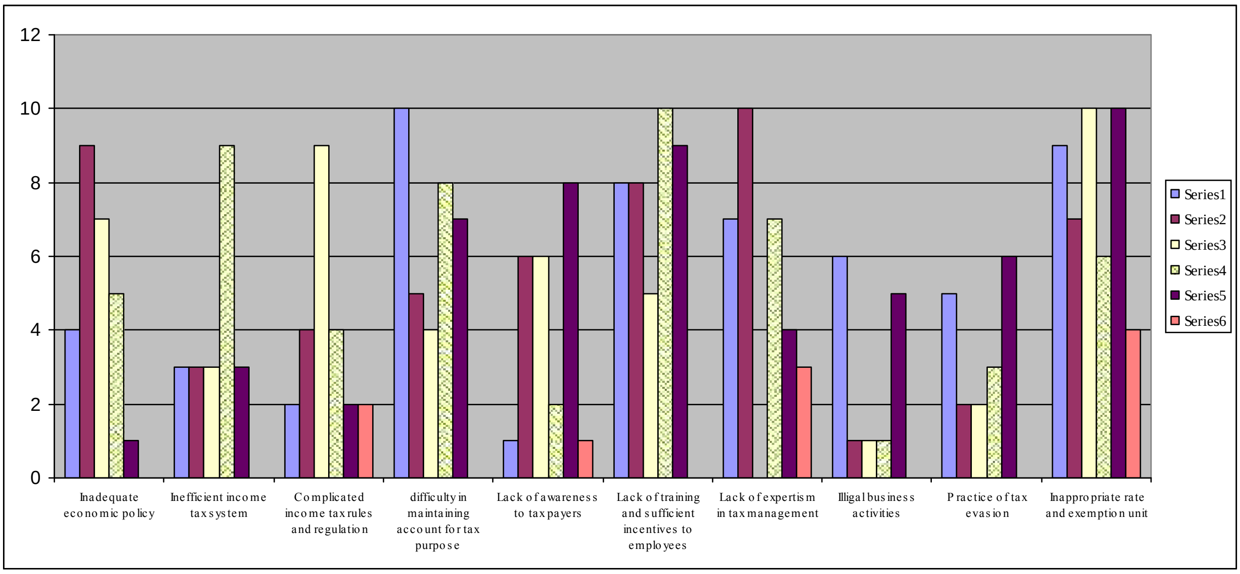


Chart 4.2

Satisfaction on existing income tax system of Nepal



4.2.3 Opinion towards the appropriateness to assess income tax. Which method is more appropriate in Nepal to assess income tax?

Table 4.2

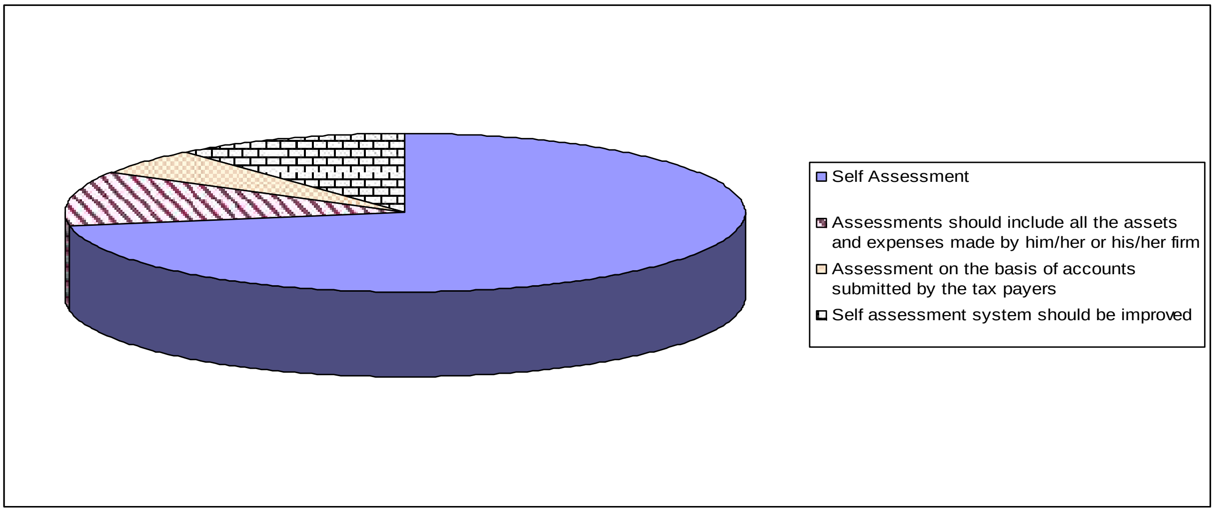
Appropriateness in method of income assessment.

S.N	Description	Response	Percentage
1	Self Assessment	26	72.22%
2	Assessments should include all the assets and expenses made by him/her or his/her firm	4	11.11%
3	Assessment on the basis of accounts submitted by the tax payers	2	5.55%
4	Self assessment system should be improved	4	11.11%
	Total	36	100 %

Source: Opinions Survey, 2011

chart 4.3

Appropriateness in method of income assessment.



- 26 respondents (72.22 %) like self assessment by tax payer which is existing method of tax assessment.
- 4 respondents (11.11%) like responded that assessments should include all the assets and expenses made by him/her or his/her firm.
- 4 respondents (11.11 %) want to improve the self assessment method.

- Only 2 respondents want assessment on the basis of accounts submitted by the tax payers which is 5.55%.

Our existing tax assessment method is more appropriate because of its democratic nature. Under the self assessment method tax payers provides all the information about his/her income and solely responsible for to the provided information.

4.2.4 To know whether there is tax evasion or not and a question was asked "In your opinion is there a major problem of tax evasion in Nepal?"

Table 4.3

Tax evasion or not

S.N	description	Result	Percentage
1	Tax evasion	33	94.29%
2	Tax not evasion	2	5.71%
	Total	35	100%

Source: Opinions Survey, 2011

Only 2 respondenents (5.71 %) can't seen any evasion on income tax system where 33 respondents (94.29 %) seem evasion on tax collection.

Chart 4.4

Tax evasion or not

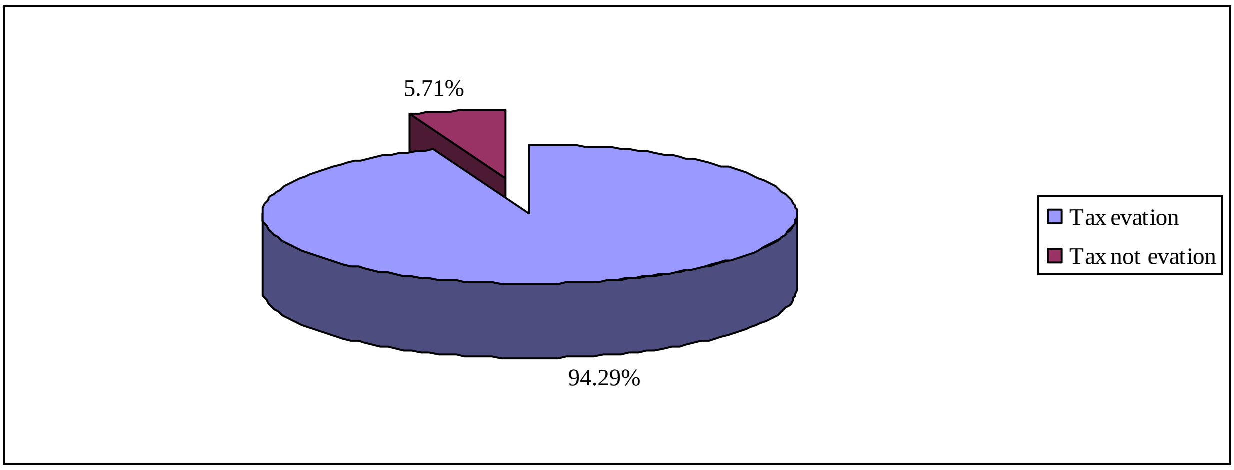


Table 4.4

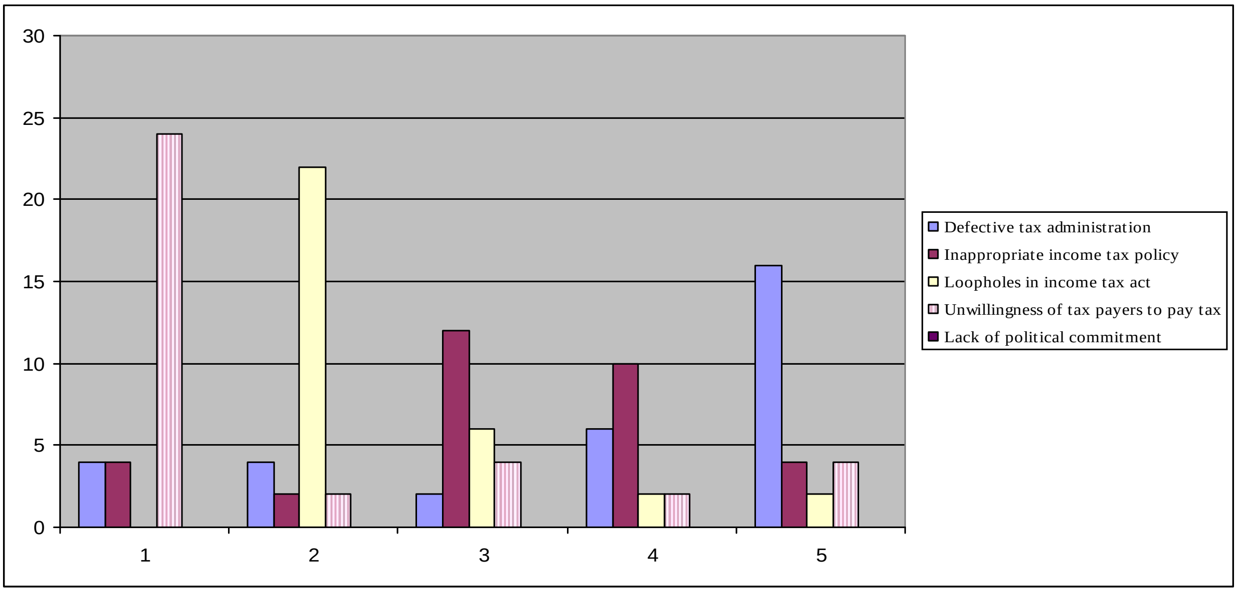
Causes of Tax evasion

Causes of Tax evasion	Rank				
	i	ii	iii	iv	v
Defective tax administration	4	4	2	6	16
Inappropriate income tax policy	4	2	12	10	4
Loopholes in income tax act	0	22	6	2	2
Unwillingness of tax payers to pay tax	24	2	4	2	4
Lack of political commitment	0	0	0	0	0

Source: Opinion Survey, 2011

Chart 4.5

Causes of Tax evasion



Some of the respondents say that unwillingness of tax payers to pay tax is only one factor for evasion of income tax.

Likewise, lack of nationality of tax payers and tax administration is equally responsible for lack of sufficient tax net system.

Almost 95% people believe that tax payers are not honest. Likewise, our existing government mechanism which is not also honest. So, according to the respondents the researcher's observation, discussion and interaction with the stakeholders there is a huge problem .Tax evasion is more common. Due to administrative structure, loopholes in tax laws, unwillingness of paying tax, weak and narrow tax net, difficult tax laws, corruption and bribery are widely accepted in the society, untransparent judicial activities etc are the major phenomenon of tax evasion.

4.2.5 Opinion towards the efficiency of income tax system a question was asked "What do you feel about the current income tax administration of Nepal whether it is efficient of not efficient, inefficient or satisfactory income tax administration?"

Table 4.5

Efficiency of income tax administration

S.N	Description	Result	Percentage
1	Efficient	2	5.71%
2	Inefficient	13	37.14%
3	Satisfactory	20	57.14%
	Total	35	100%

Source : Opinions Survey, 2011

Chart 4.6

Efficiency of income tax administration

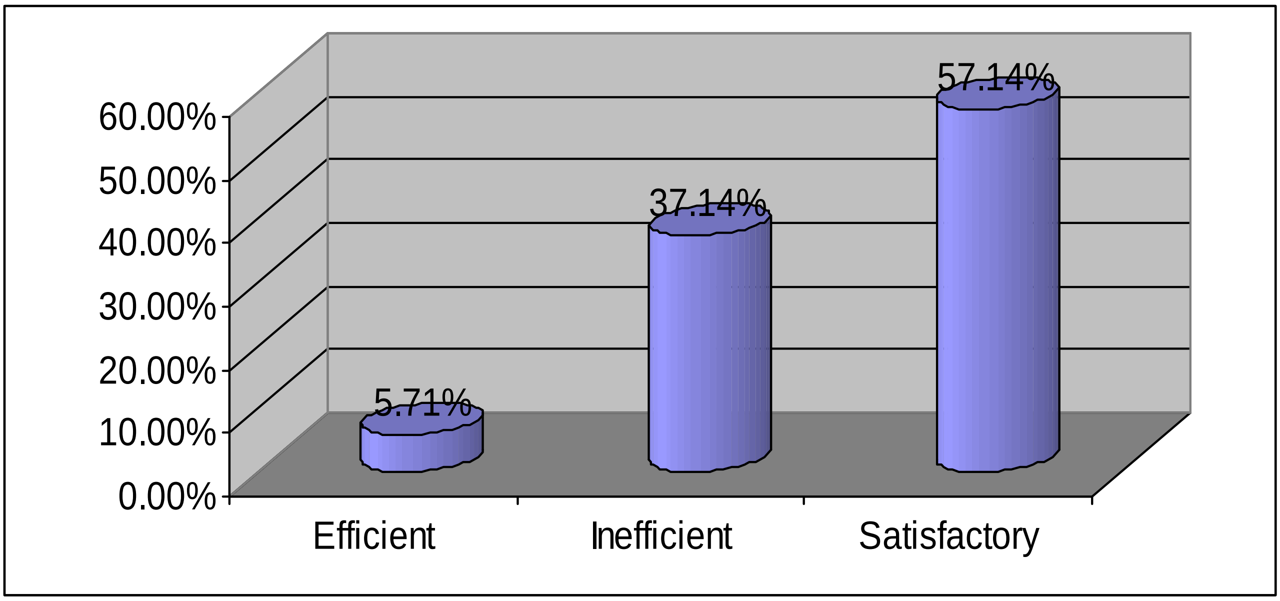


Table 4.6

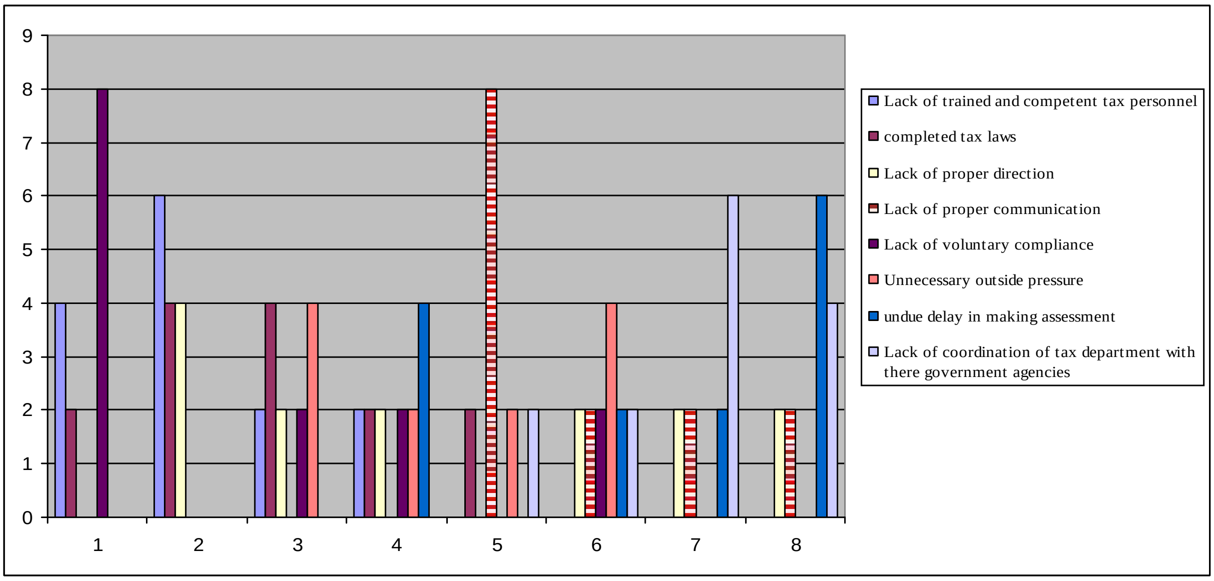
Causes Efficiency of Tax Administration

Causes	Rank							
	i	ii	iii	iv	v	vi	vii	viii
Lack of trained and competent tax personnel	4	6	2	2				
completed tax laws	2	4	4	2	2			
Lack of proper direction		4	2	2		2	2	2
Lack of proper communication					8	2	2	2
Lack of voluntary compliance	8		2	2		2		
Unnecessary outside pressure			4	2	2	4		
undue delay in making assessment				4		2	2	6
Lack of coordination of tax department with there government agencies					2	2	6	4

Source: Opinion Survey, 2011

Chart 4.7

Causes Efficiency of Tax Administration



Other embezzlements/corruption/bribery/corrupted mind set on personnel due to social support it should be improved in the areas of above points.

Nepalese Income tax administration was satisfactory more than 57 % of respondents and rest need some improvement in it. There should be improvement; improvement in personnel's behavior, they should be taxpayer friendly, the personnel should be trained and familiar with information, communication and new technology, there should be well defined communication and documentation system, proper income tax policy and it's implementation is another fields of improvement. Likewise, timely assessment, coordination with other government agencies as well as private and non- governmental organization, at the same time corrupt personnel are the headache of income tax administration so it also needs carrot and stick policy i.e. punish the corrupt and pries the efficient and honest one.

4.2.6 To know the opinion towards the effectiveness of income tax system a question was asked "What is the most important factor for effectiveness of income Tax in Nepal? Please rank."

Table 4.7

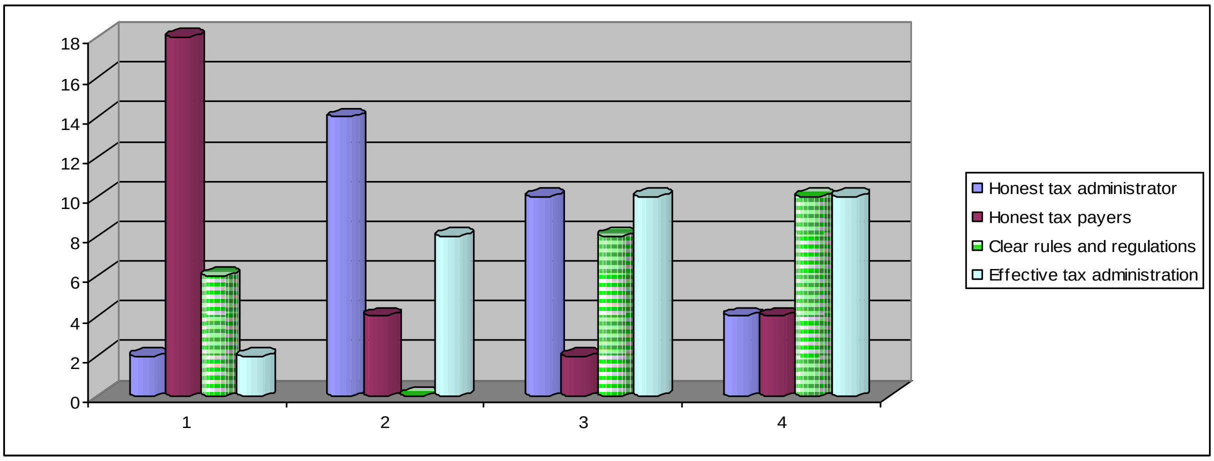
Factors for effectiveness of income tax in Nepal

Factors	Rank			
	i	ii	iii	iv
Honest tax administrator	2	14	10	4
Honest tax payers	18	4	2	4
Clear rules and regulations	6	0	8	10
Effective tax administration	2	8	10	10

Source: Opinion Survey, 2011

Chart 4.8

Factors for effectiveness of income tax in Nepal



Other Suggestions

- Praise the tax payers and punish the tax averters.
- People consensus toward anticorruption.
- Effective tax control system.
- Honesty on tax payers.

Honesty on the tax payers is the most effective factor for effectiveness in income tax system. If efficient and effective tax administration, clear rules and regulation, honesty on tax payer exists then, the effectiveness will be automatically improved.

4.2.7. To know suggestions for the betterment of tax system a question was asked " Do you have any other suggestions for achieving effectiveness of income tax in Nepal? Mention please"

An open question was asked to the respondents to know their suggestions regarding effective administration of Income Tax in Nepal. The responses received from them are presented below: All income should be in tax net, low tax rate, computerization of tax system, tax awareness, proper implementation of the tax law, carrot and stick policy of tax administration and punishment for tax averters.

4.2.8 Opinion towards the appropriateness of rate of income tax we have asked the following question. The rate of income tax is appropriate?

Table 4.8

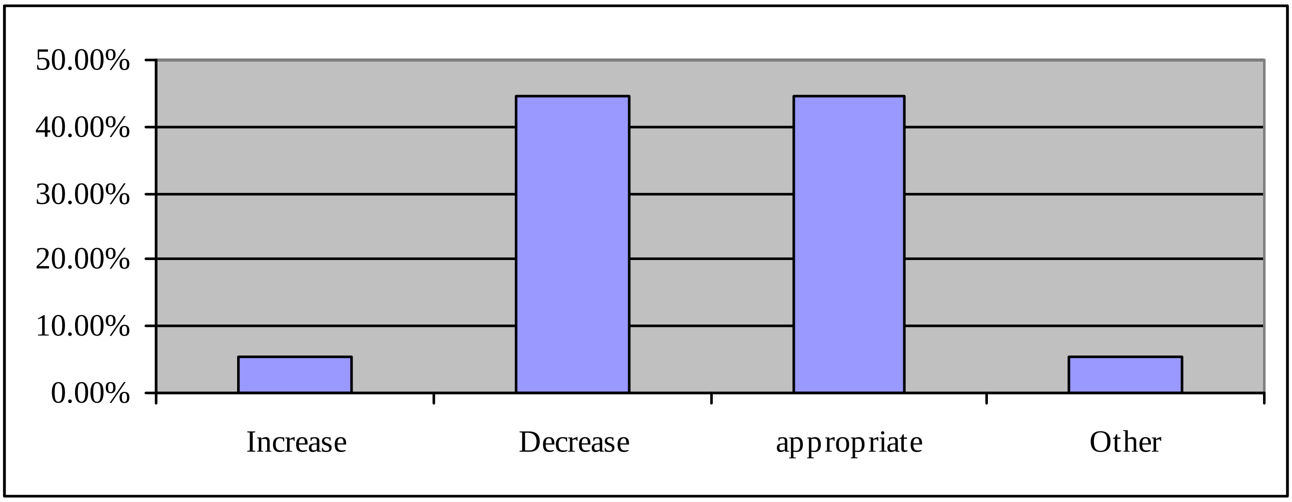
Appropriateness of income tax rate

S.N	Description	Result	Percentage
1	Increase	2	5.55%
2	Decrease	16	44.44%
3	appropriate	16	44.44%
4	Other	2	5.55%
	Total	36	100%

Source : Opinion Survey, 2011

Chart 4.9

Appropriateness of income tax rate



The existing rate of income tax is : Individual 15 & 25 %, Company & partnership firm 25 %, Bank & Insurance Company 30 %, Industry (special categories) 20 %. We find there is a dilemma in field of appropriateness of existing income tax. Some of the respondents are not satisfied with the present tax rate and some of they want to see increment and some wants to decrease in this rate. Increase and decrease in the rate of income tax is not crucial.

4.2.9 To know the behavior of tax administration a question whether tax administration is friendly or not was asked.

Table 4.9

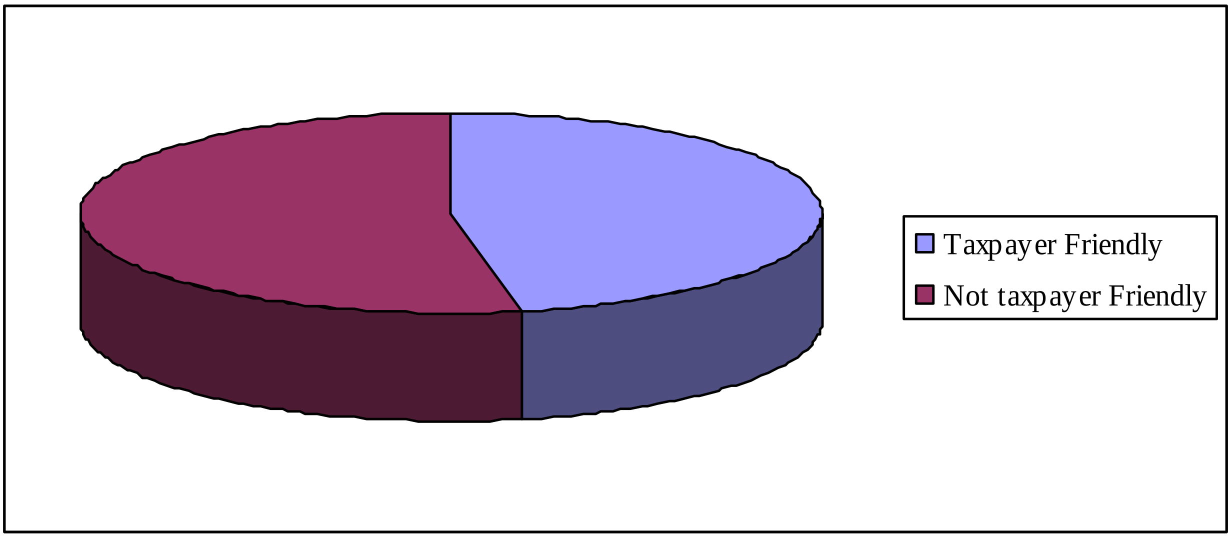
Tax payer friendly tax administration

S.N	description	Result	Percentage
1	Taxpayer Friendly	16	47.05%
2	Not taxpayer Friendly	18	52.95%
	Total	34	100%

Source : Opinion Survey, 2011

Chart 4.10

Tax payer friendly tax administration



Almost 53 % respondents say that the tax administration system is not taxpayers friendly and 47 % respondents say it is tax payers friendly. Interestingly the tax officials feel it is tax payer friendly whereas taxpayer do not feels so. We can conclude that there should be some improvement in behavior of both tax officials and tax payers itself too.

4.2.10 To know the Limit of Tax exemption whether it should raised or not. and the result is tabulated.

Table 4.10

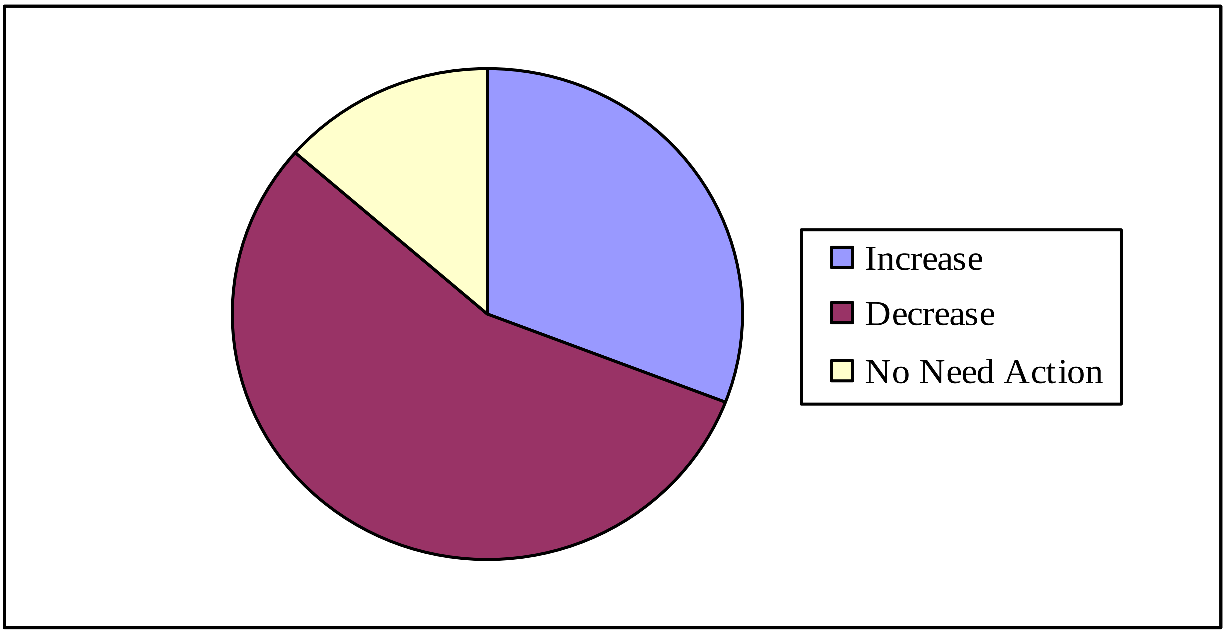
Limit of tax exemption

S.N	Description	Result	Percentage
1	Increase	10	27.77%
2	Decrease	18	50%
3	No Need Action	8	12.23%
	Total	36	100%

Source : Opinion Survey, 2011

Chart 4.11

Limit of tax exemption



There is dilemma among people that whether the tax exemption limit should decrease, increase or no change the existing limit.

Some respondents think that there should be increase in this limit. In their view only the high income people will be charged and other small income people excluded from the tax net. This will help to make small, well managed and taxpayers get good service, at the same time low income people will excluded they do not have to pay tax and benefited by the provision of income tax law. Those people who are in favors of decrease in tax limit exemption supports broaden the tax net. While decrease in the limit a huge amount of tax payers will be in the tax net and it supports to generate high amount of revenue which supports the national development activities. Being most people into the tax basket ownership created to the national economy and significantly increment in tax collection. This will help to bust up the national economy. Bigger the participation it brings interest in national development activities, interest in expense of public money. And we already discuss that tax is the sustainable source of national income.

4.2.11 what will be the most important factor for increasing income tax contribution on the national economy?

- Tax administration
- Tax payers
- Tax policy including tax act and rules
- Others
    - ➢ Economic growth and development
    - ➢ Sound economic condition

4.2.12 Whether the provisions of fees, fines and penalties under the income tax system is reasonable or not.

Table 4.11

Fees, fines and penalties

S.N	Description	Result	Percentage
1	Resonable	5	13.88%
2	Not Resonable	31	86.12%

Source : Opinion Survey, 2011

Chart 4.12

Fees, fines and penalties

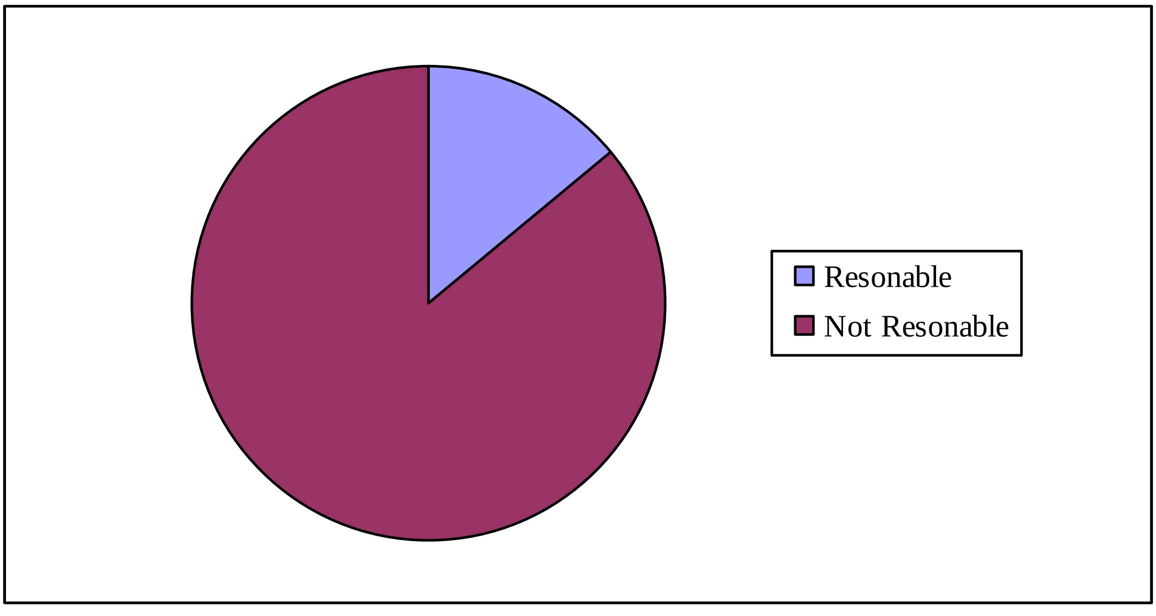


Table 4.12

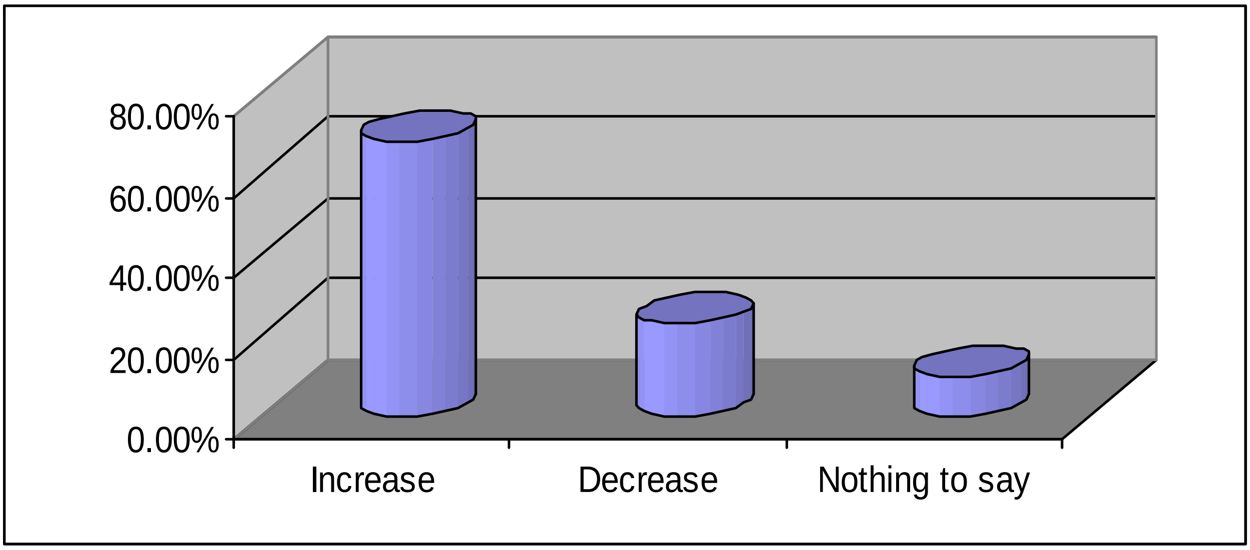
Rate of Fees, fines and penalties

S.N	Description	Result	Percentage
1	Increase	21	67.75%
2	Decrease	7	22.58%
3	Nothing to say	3	9.67%
	Total	31	100%

Source : Opinion Survey, 2011

Chart 4.13

Rate of Fees, fines and penalties



Fees, penalties and interest rate is another significant issue of income tax laws(income tax act, rules).The income tax law uses the varies penalties, interest, fees and charges to the people on fraud, late submission of income statement. The researcher question was that whether the rate of fees, fines and penalties are appropriate or not? It should be raised or decreased or remain same? Most of the respondents want to raise its current position. 67.75% respondents like to raise the present rate. Only 22.58% respondents want to decrease and 9.67% respondents do not want to change the current rate. Finally we conclude that due to low rate of fines and penalties tax payers has no hurry and no fear to file tax return forms timely.

4.2.13 An open question was asked to the respondents to know major problems and difficulties faced by Nepalese tax administration in collection of income tax from tax payers.

The answer of respondents are presented below :

- Unwillingness of tax payers
- Illegal business activities
- Tax evasion through auditors, tax administrator and tax payers and complicated tax laws
- Tax evasion becomes very general and widely accepted by the community as well as nation.
- Lack of knowledge of the income tax rules and regulation
- Weak record system
- No belief to the people about the proper utilization of tax money.
- Lack of tax advocacy.
- High recognition of non tax prayers.
- Lack of social security for the employee and other people.
- Weak political commitment
- Lack of any banking system to pay income tax.
- Lack of full computerization of the income tax.
- Lack of proper training and development.
- Lack of tax payers' education.
- Complication of tax law and rules.
- Inefficient tax administration.
- Limited tax sectors.
- Political instability.
- Lack of ethics on tax administration and tax payers.
- Undue political protection/bribery
- Tax payers are less learned on the tax related issue/ no voluntary compliance
- Lack of proper communication between tax administration and tax payers.

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Table 4.13

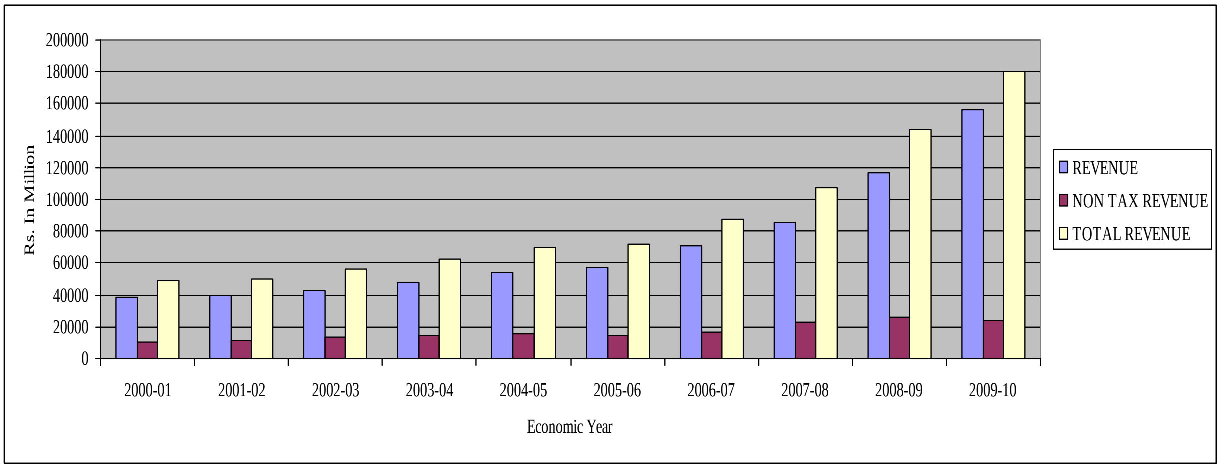
Contribution of Income tax in the national economy (Rs. in million)

YEAR	TAX REVENUE	NON TAX REVENUE	TOTAL	Percentage	
				TAX REVENUE	NON TAX REVENUE
2000-01	38865.10	10028.80	48893.90	79.49	20.51
2001-02	39330.60	11115.00	50445.60	77.97	22.03
2002-03	42586.92	13642.07	56228.99	75.74	24.26
2003-04	48173.00	14158.00	62331.00	77.29	22.71
2004-05	54104.70	16018.00	70122.70	77.16	22.84
2005-06	57430.40	14851.70	72282.10	79.45	20.55
2006-07	71126.70	16585.50	87712.20	81.09	18.91
2007-08	85155.54	22466.95	107622.49	79.12	20.88
2008-09	117051.9	26422.6	143474.5	81.58	18.42
2009-10	156294.9	23650.9	179945.8	86.86	13.14

Source : Economic survey,2010/11

Chart 4.14

Contribution of Income tax in the national economy



Income tax contributes the important role in national economy, especially like Nepal. The above table shows that the combination of tax revenue and non tax revenue in the national economy last 10 years since 2000-01 to 2009-10.The amount of tax money has been increasing from Rs. 38865.10 million 2000-01 to 2009-10 Rs. 156294.9 million in this 10 year tax revenue is increase by 302.15% and at the same time non tax revenue has increase from Rs. 10028.80 million to Rs. 23650.9 Million at this period non tax revenue has been increased by 135.83 % and it is significant improvement.

In 2000-01 tax revenue 79.49 % and non tax revenue 20.51 %, In 2001-02 tax revenue 77.97 % and non tax revenue 22.03 %, In 2002-03 tax revenue 77.54 % and non tax revenue 24.26 %, In 2003-.04 tax revenue 77.29 % and non tax revenue 22.71 %, In 2004-05 tax revenue 77.16 % and non tax revenue 22.84 %, In 2005-06 tax revenue 79.45 % and non tax revenue 20.55 %, In 2006-07 tax revenue 81.09 % and non tax revenue 18.91 %, In 2007-08 tax revenue 79.12 % and non tax revenue 20.88 %, In 2008-09 tax revenue 81.58 % and non tax revenue 18.42 %, In 2009-10 tax revenue 86.86 % and non tax revenue 13.14 % . We conclude that in this 10 years period about 80 and 20 percent contribution has been seen in national economy. Thus major source of national economy is on tax revenue.

Table 4.14

Contribution of Various Taxes Since 2000-01, 2009-10

Tax Headings	Year									
	2000-01	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**
Customs	12552.1	12658.8	14236.4	15554.8	15701.6	15344	16707.6	21062.41	26792.9	35150.8
tax on consumption and product of goods and services	16153.6	16074.3	18244.8	20705.6	25331.3	28118.3	35438.8	41005.28	55938.3	79394.1
land revenue and registration	612.9	1131.82	1414.3	1697.5	1799.2	2181.1	2253.5	2940.74	5223.3	5511.1
tax on property , profit & income	10546.5	9465.72	8691.38	10215.1	11272.6	11787	16726.8	20147.02	29097.4	36238.9

Source : Economic survey, 2010/11

Chart 4.15

Contribution Income tax in the national economy

Contribution of various taxes since

2000-01, 2009-10 percentage

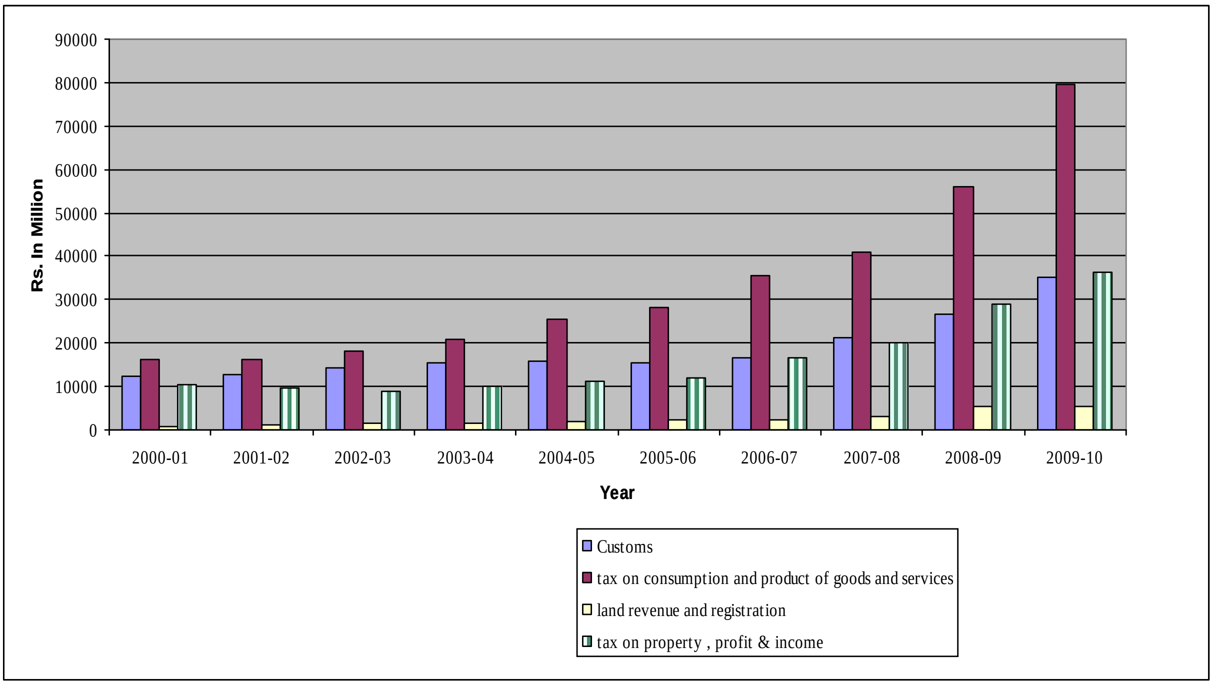
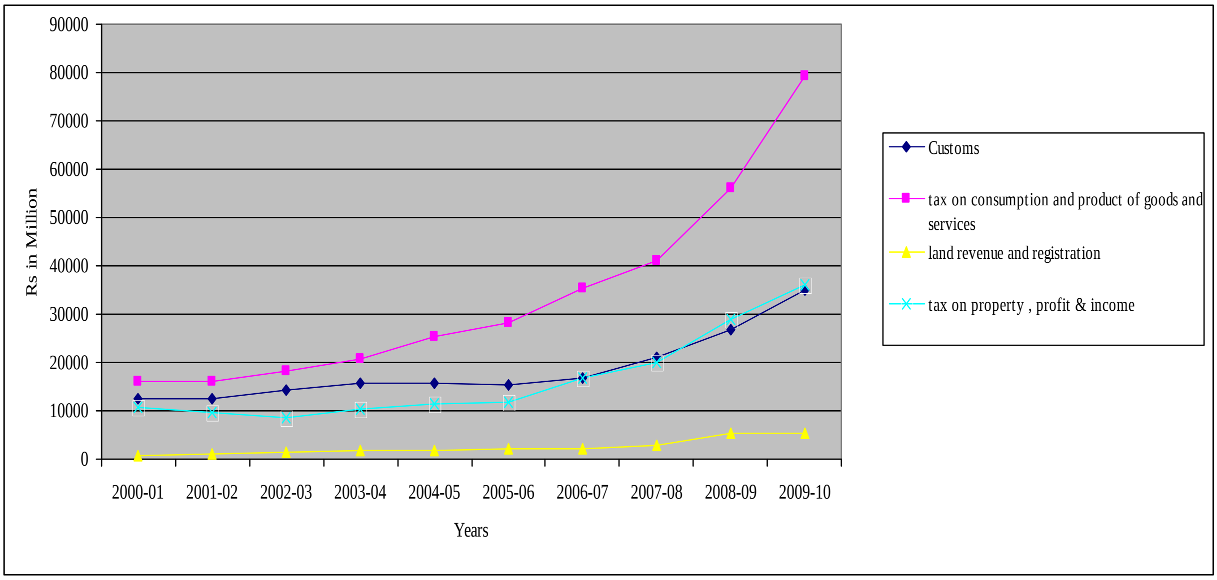


figure 4.1

Tax on property, profit and Income during 10 years since 2000-01 to 2009-10



The trend of revenue mobilization has remained satisfactory in recent years. To maintain this, there is a challenge to control tax leakage after identifying the possible leakage areas and increase the revenue mobilization especially the VAT and income tax, which are the major instrument of tax revenue. Since, there is a need to enhance work efficiency, effectiveness and professionalism of revenue administration , a strong challenge has been there to make necessary arrangements for achieving desired results.-"Economic survey 2010/11 Government of Nepal, MOF, July 2011

Table 4.15

Contribution of Tax and Non tax Revenue

Economic Year / Sources	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**
Tax revenue	79.45	81.09	79.12	81.58	86.86
Non tax revenue	20.55	18.91	20.88	18.42	13.14

Source : Economic survey, 2010/11

Chart 4.16
Contribution of Tax and Non tax Revenue

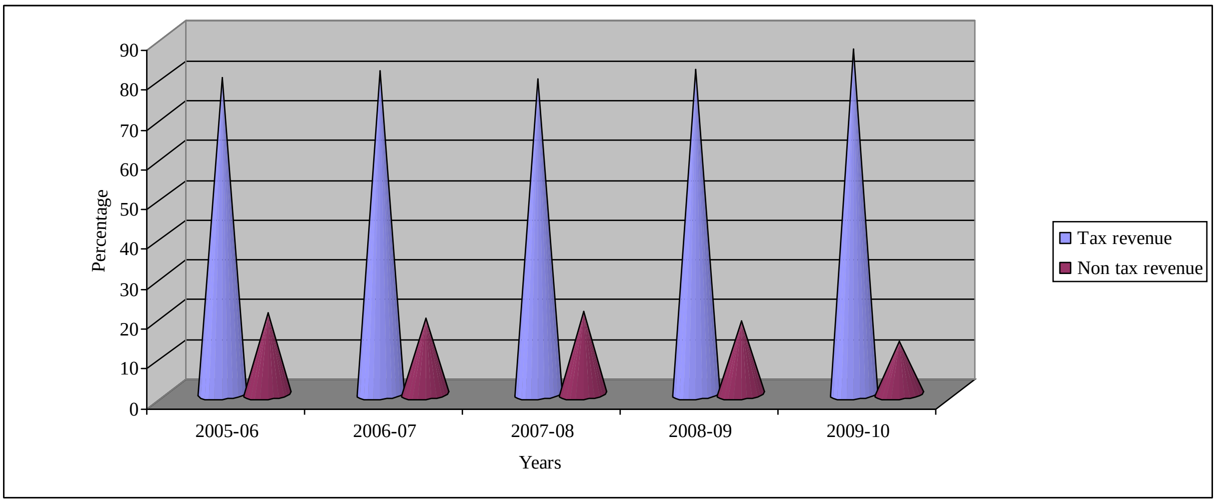
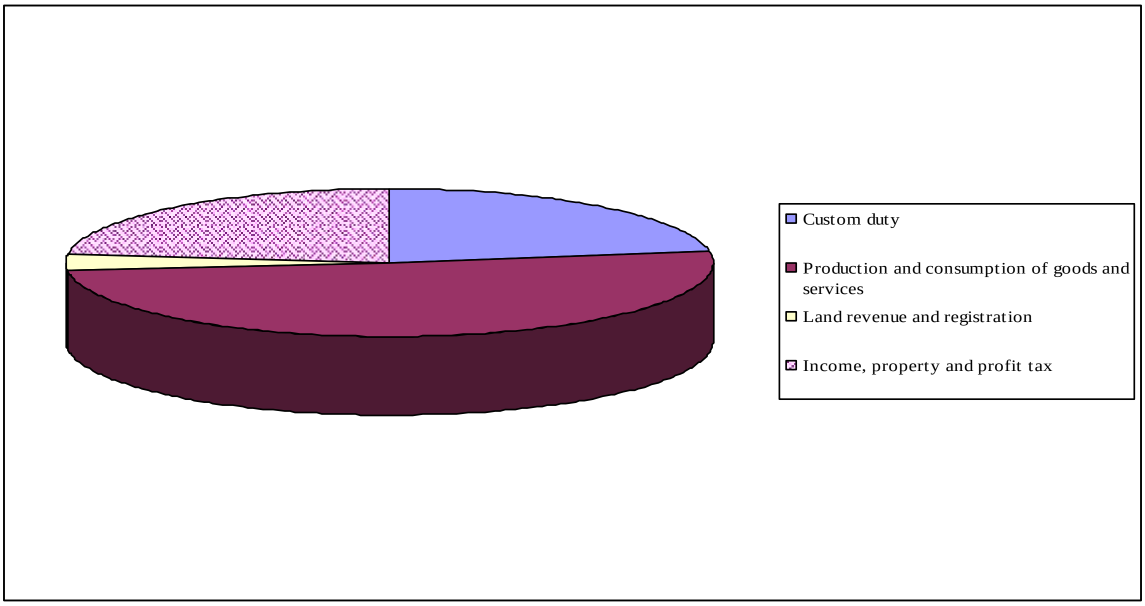


Table 4.16
Contribution of taxes in 2009-10

Tax headings	**Percentage**
Custom duty	22.49
Production and consumption of goods and services	50.80
Land revenue and registration	3.52
Income, property and profit tax	23.19

Source : Economic survey, 2010/11

Chart 4.17
Contribution of taxes in 2009-10



Contribution of various tax revenue on since 2000-01 to 2009-10 in these 10 years total Rs.156294.9 million amount has been collected in various headings of income tax. Where custom share Rs. 35150.8 million, Tax consumption and products goods and service shares Rs.79394.1 million, land revenue and registration contributes Rs.5511.1 million and tax on property, profit and income shares Rs.36238.9 millions. It shows that the largest contributor was from tax on consumption and product of goods and services 50.80%, Second largest contribution of income tax was tax on property, profit and income 23.19%, The third contribution was from custom which is 22.49% and fourth contributor was land revenue and registration which is 3.52%.According to figure we can conclude our national economy was heavily dependent on consumption and custom sector. Land revenue and registration has least contribution. Tax on Property, profit and income has significant contribution but it not satisfactory. To improve its share there should be broad tax base and progressive tax. Total revenue had increased by 25.42 percent in FY 2008-09 compare to its proceeding fiscal year of the total tax revenue in FY 2009-10 .TAX revenue increased by 25.10 percent in FY 2009-10 compared to that of the previous Fiscal year. Share of custom duty was 22.49 percent while the share of tax on production and consumption of goods and services was 50.80 percent likewise, the share of laved revenue & registration was 3.52 percent and that of income, profit and property tax was 23.19 percent.

Major Finding of the study

1. With respect to the causes for unsound income tax system in Nepal, there are variation in the views of respondents group. Though in ranking together the views of all respondents from each group, complicated income tax act, rules and regulation, defective income tax administration, corruption and evasion as well as lack of tax consciousness are the main problems regarding unsoundness of income tax system in Nepal.
2. The Income Tax Act 2002 seems effective to create sound income tax system in comparison to previous act 1974 because the new tax act has features of provision of international taxation, taxing capital gain and dividend income. Abolition of various tax related concession, rebates and exemption, which were not covered by the previous Act 1974 as prescribed by the respondents. Except these others features are speciation of stock valuation method, stringent fine and penalties etc. However all these features are included in the act, the act is not free from it's drawbacks. Difficulty in language, long procedure and ineffective income tax administration for the proper improvement of the act are the major reasons for its ineffectiveness. Inappropriate rules and regulations and ineffective reward and punishment system are also the negative aspect of the act.
3. With respect to the major reason of weak income tax administration the views of respondent groups were different as per one overall ranking. Measure of power by tax administrator, 'corruption', and lack of trained and competent staff were recognized as the major reason behind weak income tax administration.
4. With respect to the essential factors for making income tax administration effective as per the overall ranking "proper training to tax personnel, tax education to taxpayer's and Increment of salary/incentives of tax personnel were the important factors to make income tax administration effective and reliable.
5. Corruption is the major problem in the income tax administration but income tax administrator deny that there is not corruption in administration however some administrator agree regarding this point informally but they doesn't want to express. So, if we go through the views regarding tax experts and taxpayers there is still corruption in income tax administration. Their views regarding measures to minimize corruption is different but if we got though overall ranking, strong action against corrupt personnel, declaration of property of tax personnel each year and regular supervision of tax personnel were the essential factors to

minimize corruption.

6. With respect to ineffectiveness of income tax policy, the supervision of respondents were varied from each other if we go though overall ranking administrative ineffectiveness for proper implementation of the income tax policy, Income tax policy has not been formulated as per economic policy of the country and 'lack of far-sighted' were the main reasons for ineffectiveness of income tax policy.
7. Opinions regarding reasons for Income Tax evasion differs among respondents therefore through overall ranking 'administrative inefficiency', 'inefficiency use of fine and penalties' and 'high corruption' were main reasons behind income tax evasion. Income tax evasion is the crucial problem to generate revenue so this problem should be minimized and solved. So, the measures to control the income tax evasion were, 'formulating strict law to tax evaders', removing complexities in tax law, and providing education and incentives to tax payers were the overall views given by respondents.
8. With respect to the difficulties faced by tax payers while assessing income tax, complex legal process, high expectations of taxable income by tax personnel and lack of cooperation from tax administration were main reason regarding difficulties of assessment procedure.
9. Taxpayers play the vital role in the field of taxation so taxpayer should be educated regarding various aspect of tax. Opinion regarding suggestion for educating taxpayers differ among respondents, therefore through overall ranking ''introducing tax education in school curriculum', provide incentive to tax payers', and 'opening more branches of tax offices in different places' were the main suggestion given by respondents.
10. With respect to reasons for low contribution of income tax to national revenue, 'lack of tax consciousness', 'increasing habit of tax evasion' and 'ineffective income tax administration' were main reasons declared by respondents. Tax revenue was increased by 302.15% and non tax revenue was increase by 135.83 % in the 10 year period from 2000-01 to 2009-10. The national economy has been contributed by tax revenue and non tax revenue is measured signification. But still our economy is dependent in foreign assistance (i.e. Grant, Loan, Technical assistance, remittance from foreign employment).

11. In the ten years period almost 80% revenue was collected from tax revenue where non tax revenue contributes about 20% in the national economy.
12. The contribution of product, good & service tax was 50.80%, contribution of custom was 22.49% where tax on property, profit and income contributes 23.19% and land revenue and registration contributes only 3.52%.To improve the national economy there should be increased percentage of contribution of tax on property, profit and income.

Chapter 5

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

In developing countries like Nepal, shortage of sufficient financial resources is the main constraint for national development. A lot of fund is required to meet the additional financial requirements for the development activities of the country. 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 proper mobilization of internal revenue. Thus, fiscal deficit and resource gap of Nepal has been increasing every year.

To solve this problem, Income Tax is the most important source for internal revenue in which better Income Tax system assist to achieve that goal. Regarding this fact, this study attempts to analyze the of Income Tax acts problem and difficulties in income tax laws and income tax system as well as income tax policy to create flourishing income tax system in Nepal. After identifying introduction about it, review of literature has been observed to address core element like Income Tax and its development and other element regarding Income Tax system.

Descriptive cum historical research design has been used to search its objectives. Difference interaction method and strategy have been used to collect secondary data as well as primary data were also collected by using survey method. Analytical tools such as table, percentage, bar graph are used for research methodology.

In the contest of globalization the developing countries are seen to suffer because of less efficient tax administration due to lack of understanding and faith between taxpayers and income tax administration. It seems they are failure to walk in parallel way, within the boundary of coordination. So, it is essential to make respectable relationship between taxpayers and tax administration to avoid the obstacles for the fluent operation of income tax system in Nepal.

Similarly, the laws should be well defined and firm. The loopholes in laws should be immediately eliminated. The first elected government in 1959 A.D. finally introduced Business Profits and Salaries Tax Act, 1960 in Nepal. At the time, income tax laws levied only on business profit and salaries. About after three years experience of Income Tax, the government replaced the prevailing tax act by income tax act, 1962. The coverage was extended in the act. In 1974, Income Tax Act 1974 A.D. (2031 B.S.) was enacted. The act remunerated income sources into five groups (a) Agriculture (b) Industry, Trade, Profession or Occupation (c) remuneration (d) House and Companies rents (e) other sources. However agricultural income was kept outside the tax net except few years through the finance acts.

To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend and integrate the laws relating to income tax, the parliament of Nepal enacted Income Tax act, 2002 A.D. (2058 B.S.). This act has replaced Income Tax Act 1974 (2031 B.S.) which was amended for eight times and existed for a period of 28 years. Government of Nepal formed income tax rules, 2059 B.S. in 2059 B.S. to help clarifying the act.

Lastly, a good Income Tax System is one which is as little burden some to people as possible, simple and clear tax laws, sound and effective income tax administration, tax consciousness on general public, adoption of principle of equity and ability to pay principle, appropriate income tax policies, minimum cost of collection etc. are the major characteristics of effective income tax system. Though, efforts have been made to hold these characteristic in Nepalese Income Tax System, the complete success has not been achieved until proper implementation of these major characteristic. So let's take a vow to make better Income Tax System to change the nation into developed country.

5.2 Conclusion

Taxes are the backbone of the nation without strong backbone government of the nation can not stand properly. So, now a days taxation has become a really of life without which government can not sustain itself. Taxation is a suitable means for the government to rise revenue and mobilization of the domestic resources. To achieve the goal of national development and for the economic growth of the country it is a duty of every taxpayer to voluntarily comply the tax. It may be only possible form conscious, responsible and educated taxpayers. So, the government of the nation should lunch the programme to make taxpayer conscious and responsible apart form this the government should make them clear and satisfied that the revenue is going to utilize in proper way in the productive sector for the welfare of the every citizen of the nation. The proper and effective implementation of Tax Laws is necessary to create a welfare state, equalities among the people and to avoid evil consequences of tax evasion ad tax avoidance.

Nepalese tax structure is the combination of various tax within this Tax Structure Income Tax plays significant role on revenue. To meet the government expenditure, achieve the goal of national development not only that, to decrease poverty and illiteracy has equally important role of Income Tax. After the great revolution of 2007 B.S. Most of the development activity have been conducted with the foreign grants and loans because of poor performance of internal revenue collection and mobilization, we have passed the long journey but still we were reliance on foreign grants and loans. The example of the other nation reversals that the dependency on foreign loan for long period may be very dangerous; country like Canada has also used foreign lone if we study her history but Canada used it properly and achieved her goal in the short term period now Canada is one of the developed country in the world. so, we should not depend on the external sources for the long- term it doesn't mean that we have to stay alone in the world but we should learn to stand on our own foot for our existence, sovereignty and freedom of a country.

Income tax is one of the important measure to collect the internal revenue and to turning the gap between have and haves not to reduce the social imbalance. This goal can not be achieved without sound and effective income tax administration because without healthy brain the body can't work properly. So, there are various challenges towards income tax administration. Tax payer are the centre point without their proper support the goal can not achieve. So, they should made conscious though proper tax education. The effort should be made to bring all potential new taxpayers into tax net on regular basis tax administration should play friendly role towards taxpayers. Because the tax administration is the bridge between taxpayer and the government. To make the taxpayer and tax administrator clear the Tax Laws should be well defined and firm. The loophole in laws should be immediately eliminated. Another core problem of the Nepalese Income tax system is Income tax evasion so only the sound administration can minimized and solve this problem.

A sound income tax system is the combination of simple and clear tax laws and policies income tax administration. Conscious tax payers are the four strong pillars of the good income tax system. Though efforts have been made these pillars strong and effective to move towards the path of success. We are still in the half-way of the road many things remained to be reformed in Nepalese Income Tax System. We are in the era of New Nepal so let's make commitment with word and the action to make our nation developed, advanced and powerful through proper utilization of our own internal revenue and resources.

5.3 Recommendations

Nepalese Income Tax System is not free from problems many challenges has been coming in it's way but also the good sign of prospects has been seen after Income Tax Act reform in 2002. As mentioned earlier a system is mainly composed of three interrelated parts; policy, laws, and Administration. Regarding these sub-system following suggestions may be recommended.

5.3.1 Income tax policy

1**.** Tax policy should be formulated on the basis of feedback system of existing situation what are the problems and weaknesses of existing period should be recognized and the tools to minimize such problems should be formulated for this purpose an income tax reform commission of high level with adequate and proper representation from all concerned sectors should be established including the following members:

• Chairman: Minister of Finance.

Secretary: Secretary or additional secretary of minister of finance.

Members: Chairperson, chamber of commerce.

- Member: Taxpayer's representative.

  Member: Director general, department of taxation.

  Member: Member, national planning.
- Member: Legal expert in taxation.
- Member: Head of the department of taxation T.U.

  Member: President, finance committee of parliament.

  Member: Accounting expert.

  Member: Administrative expert.

2. To meet the resource gap and the budget deficit the tax base should be widened but the principle of ability to pay should be considered.

3. To achieve the goal as per Income Tax Policy, Income Tax Administrative should implement these policies effectively.

4. Income tax policy should be for sighted and should be formulated as per the economic policy of the country.

5. For the improvement of industrialization tax holiday has been provide. But it is seen in practice that taxpayers have evaded or avoided tax by registering a name of industry which is provided with Income Tax holiday under the law but they run other business transaction. So, this kind of illegal activity should be strictly watched. To solve this problem the top level committee should formulate special policy to minimize misuse of tax holidays.

6. Income Tax Policy should be progressive and appropriate rebate should be provided to the taxpayers who submit true income statement within the defined time limit.

5.3.2. Income Tax Administration

The success and effectiveness of income tax system entirely depends upon implementation of provisions which is the major responsibility of Income Tax Administration. On the basis of the study, the following recommendations are made for the improvement of income tax administration in Nepal.

1. All the tax personnel should be given comprehensive training on various aspect of taxation on regular basis. For this it is better to establish 'Tax Training centre' within the tax department with highly qualified, experienced trainers in sufficient number.

2. The rights and duties of Tax Administrator should be clearly defined and their evaluation should be done with the principle of "Management by objectives".

3. There should be fair, scientific and transparent system regarding the promotion of tax personnel. Basically the following criteria should applied. (i) Job performance (ii) Honesty (iii) Merit and academic qualification (iv) Leadership (v) Seniority

4. Tax personnel should be motivated through punishment and reward system. Reward should be given for better performance and penalty should be given to poor performance. The current salary scale should be increased, working environment of the tax offices should be improved and vehicle and necessary machinery should be provided.

5. The tax administration should be made free from corruption for this strong action should be taken against the corrupted employee, up to date records from the time of recruitment to the present about income and property of each tax personnel, his family and near relatives should be maintained. The internal audit and control system should be clearly defined and applied in real sense. The tax administration should be made entirely free from the unnecessary pressure and interference of influential persons.

6. The Tax Administration should use computerized system effectively. It's own software should be developed and implement property to achieve the goal of e-governance.

7. The administration should try to increase effective public participation to minimize the income tax evasion. For this, proper education in regard to taxation should be provided to general public.

8. The administration should pay great attention to bring the income from consultant services, NGOs and private boarding school/colleges, tuition institute into Income Tax net. In this sectors Income Tax has been highly evaded for this purpose coordination with chamber of commerce, FNCCI, Banks, customs and local governments should be done.

9. A research and intelligence sector should be established in each tax office for proper planning and to collect the information in regard to Income Tax evaders, potential new taxpayers and non-resident who have conducted business without registration.

10**.** The provision made under the act for departmental action to using doors should be really, fairly and effectively implemented in practice.

5.3.3. Income Tax Laws

The law is the path on which the system have to move to make the way smooth the laws should be clear, comprehensive and simple. It should not contain any loopholes and ambiguity therefore it should be reviewed frequently and reformed. The following recommendation are made regarding income tax act in Nepal.

For the effective implementation of an Act, first the entire Act should be understandable to the taxpayers as well as tax administrators. However the attempts are made in the Act 2002 composition of the Act is difficult. A reader has to turn out the pages here to there to understand the Act. If the Act is composed as per head of the incomes, individuals and entities it will be easier to understand whether the taxpayer is individual or entity and other related provision should be given with schedules.

1. The income tax Act 2002 could be a effective means to generate more revenue from income taxation if the act is effectively implemented since the Act has so many features. It has included so many new Provisions and procedures which cannot found and which were excluded by the Act 1974. Provision and procedure of the Act 2002 is an average type in terms of simplicity such as language, time consumption. The confusions and mis-understandings regarding such provisions can eliminate providing orientation to taxpayers and training to tax administrator.

2. If there is enough reason that the taxpayers has earned from illegal business and corruption the income should be made liable to tax net at high rate without exemption limit. It does not mean he may escape from punishment.

3. The rate of fine and penalties should be increase.

4. The special package of reward, prize, incentives should be introduced in the act to encourage the taxpayers, to pay voluntarily.

5. Pollution control expenses should allow deducting fully while such expenses are directly concern with the human well being.

6. The assessment and tax collection provisions should be made clear and simple so that taxpayers would been encouraged to pay income tax.

7. The revenue tribunal should be fully developed as legal authority for appeal and its decisions should be made final in most of the case. Only the series cases should be entered in the appellate court. The cases concerning with high amount and violation of legal rights of taxpayers should be defined as serious cases.

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Questionnaire in income act and rules

Name:

Office/Organization:

Designation:

Places insert the right mark, the answer of your choice or wherever appropriates put in order of preference from first to last number on the basis of alternatives. Number one stand for the most important vice-versa.

1. Do you think that people are well informed about the income tax system of Nepal ?

   1.1 Yes

   1.2 No

2. Are you satisfied with the existing income tax system of Nepal ?

   2.1 Yes

   2.2 No

   If not, what are major problems created in income tax system ?

   2.2.1 Inadequate economic policy

   2.2.2 inefficient income tax administration

   2.2.3 Complicated income tax act, rules and regulation

   2.2.4 Difficulty in maintaining account for tax purpose

   2.2.5 Lack of awareness to tax payer

   2.2.6 Lack of training and sufficient incentives to employees

   2.2.7 Lack of export in tax management

   2.2.8 Illegal business activities

   2.2.9 Practice of tax evasion

2.2.10 Inappropriate rate and exemption unit

2.2.11 Other, specify ....

3. What method is more appropriate in Nepal to access income tax?

3. 1 Assessment on the basis of accounts submitted by tax payers

3.2 Self assessment by tax payers

3.3 Assessment by expert committee

3.4 Other, Please specify........................

4. In your opinion is there a major problem of tax evasion in Nepal ?

4.1 Yes

4.2 No

If yes, what are the factors responsible for income tax evasion? Please, rank the following according to the priority.

4.1.1 Defective tax administration

4.1.2 Inappropriate income tax policy

4.1.3 Loopholes in income tax act

4.1.4 Unwillingness of tax payers to pay tax

4.1.5 Lack of political commitment

4.1.6 Other, please specify

5. What do you feel about the current income tax administration of Nepal ?

5.1 Efficient

5.2 Inefficient

5.3 Satisfactory

If inefficient what are the major causes of inefficient of the income tax administration of Nepal ? Please rank according to the priority.

5.2.1 lack of trained and competent tax personnel

5.2.2 Complicated tax laws

5.2.3 Lack of proper direction

5.2.4 Lack of proper communication

5.2.5 Lack of Voluntary compliance by tax payers

5.2.6 Unnecessary outside pressure

5.2.7 Undue delay in making assessments

5.2.8 Lack of Coordination of tax department with other government agencies.

5.2.9 Other, Please Specify ....

6. What are the most important factor for effectiveness of income tax

in Nepal ? Please rank.

1. Honest tax administrators
2. Honest tax Payers
3. Clear rules and regulations
4. Effective income tax administration
5. Other, please specifies ?

7. Do you have any other suggestions for achieving effectiveness of income tax in Nepal ? Mention please.

8. Is the rate of income tax appropriate ?

1. Should be increase
2. Should be Decrease
3. It is appropriate now

9. Do you feel that the income tax administration behave tax payers friendly ?

Yes

No

If not, how it will be better ?

By code of conduct

Increment in remuneration of employees

10. Limit of tax exemption should be

I. increase

II.decrease

III. no action needed

11. What will be the most important factor for increasing income tax contribution on the national economy ?

I. Tax administration and tax employee

II.Tax payers

III.Tax policy including tax act, rules and regulation

IV.Others

12. Are the provisions of fees, fines and penalties under the income tax

system is reasonable ?

I. Yes

II.No

If no, how can it be made reasonable ?

By increasing

By decreasing

No thing to say

13. In your opinion what are the major five problems and difficulties faced by Nepalese tax administration in collection of income tax from tax payers.

1

2

3

4

5

6

Thank You for your warm cooperation List of respondents, Policy makers (joint secretary level ministry of finance and IRD) Experts (Chartered accountants, registered auditors) Tax Administrator/Tax officers, Tax payers.

Appendix-1

Contribution of Income tax in the national economy

YEAR	TAX REVENUE	NON TAX REVENUE	Total RS In million	Percentage	
				TAX REVENUE	NON TAX REVENUE
2000-01	38865.10	10028.80	48893.90	79.49	20.51
2001-02	39330.60	11115.00	50445.60	77.97	22.03
2002-03	42586.92	13642.07	56228.99	75.74	24.26
2003-04	48173.00	14158.00	62331.00	77.29	22.71
2004-05	54104.70	16018.00	70122.70	77.16	22.84
2005-06	57430.40	14851.70	72282.10	79.45	20.55
2006-07	71126.70	16585.50	87712.20	81.09	18.91
2007-08	85155.54	22466.95	107622.49	79.12	20.88
2008-09	117051.9	26422.6	143474.5	81.58	18.42
2009-10	156294.9	23650.9	179945.8	86.86	13.14

Source : Economic survey,2010/11

Appendix-2

Contribution of Various Taxes Since 2000-01, 2009-10

Tax Headings	Year									
	2000-01	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**	**2006-07**	**2007-08**	**2008-09**	**2009-10**
Customs	12552.1	12658.8	14236.4	15554.8	15701.6	15344	16707.6	21062.41	26792.9	35150.8
tax on consumption and product of goods and services	16153.6	16074.3	18244.8	20705.6	25331.3	28118.3	35438.8	41005.28	55938.3	79394.1
land revenue and registration	612.9	1131.82	1414.3	1697.5	1799.2	2181.1	2253.5	2940.74	5223.3	5511.1
tax on property , profit & income	10546.5	9465.72	8691.38	10215.1	11272.6	11787	16726.8	20147.02	29097.4	36238.9

Source : Economic survey, 2010/11