

**"A STUDY ON INCOME TAX ASSESSMENT PROCEDURE  
IN NEPAL UNDER INCOME TAX ACT, 2002"**

A THESIS

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## **RECOMMENDATION**

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**A STUDY ON INCOME TAX ASSESSMENT PROCEDURE IN NEPAL  
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## DECLARATION

I, hereby, declare that this thesis entitled "A study on Income Tax Assessment Procedure in Nepal under Income Tax Act, 2002" submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Degree of Master of Business Studies (MBS) under the supervision of Associate Prof. Surendra Keshar Amatya of Nepal Commerce Campus, T.U.

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Date:-

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## ABBREVIATIONS

A.D.	:	Anno Domini
B.S.	:	Bikram Sambat
CSR	:	Corporate Social Responsibility
DTR	:	Direct Tax Revenue
F.N.	:	Figure Number
F.Y.	:	Fiscal Year
G.D.P.	:	Gross Domestic Product
IRD	:	Inland Revenue Department
IRO	:	Inland Revenue Office
IT	:	Income Tax
ITA	:	Income Tax Act
MOF	:	Ministry of Finance
NG	:	Nepal Government
PAN	:	Permanent Account Number
SAARC	:	South Asian Association Regional Cooperation
STAS	:	Self Tax Assessment System
T.N.	:	Table Number
T.U.	:	Tribhuvan University
TDS	:	Tax Deduction at Source
TR	:	Tax Revenue
TTR	:	Total Tax Revenue
VAT	:	Value Added Tax
VOL	:	Volume

# **CHAPTER-I**

## **INTRODUCTION**

### **1.1 Background of the Study**

Nepal is a poor landlocked country situated in between two large countries, China and India. Among south Asian countries Nepal is the least developed country with almost 30 million populations. Nepal is adopting mixed economy and is one of the members of non-alignment movement but after the restoration of multiparty democracy in 1990 A.D. Nepal is slightly entering into the market economy by means of economic liberalization and privatization.

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

Public expenditure may upgrade the people's income level. To increase the public activities, there must be a good mechanism for revenue collection. To mobilize the limited resources the state has to comply with such rules and regulations. It is obvious that the law should be simple and understandable and such acts must have the potentialities of broadening the tax net, which is the main concern of the fiscal policy of our country. Along with the time the Income Tax Act, 1974(2031) has been terminated.

The main objective of the tax system in a developing country is the promotion of saving and investment and also growth in industry including exports. Nepal has been mobilizing resources for capital formation and plugging back private saving and investment. Taxation in the modern age has been taken as the best device to raise the ratio of saving to national income.

Tax policy has two major objectives. One is economic and another is the revenue collection. Tax policy may influence the saving, investment, production and labour. The revenue objective of tax is to raise more revenue. The vision of Nepalese income taxation is not clear. Sometimes it looks like economic tools and sometimes it is presented as a revenue tool. In recent year, it is playing the role of revenue tool more than that of economic tool. Other objective is to broaden the income tax base by bringing all income generating economic activities in to its fold. It is the example of tax policy being used as a revenue tool.

The Income Tax Act, 2002 (2058) has replaced the old one to fulfill aforesaid objective of introducing the new act to enhance the revenue mobilization through revenue collection procedures. The main motto of this act is to promote the economic development of the nation. This act has amended and integrated all the laws relating to income tax in Nepal. To broaden the tax net, it has clarified about the base of tax, in case the new Income Tax Act, 2002 yet there is the provision of installment payment basis. Tax payer is liable to file their income assessing their taxes according to the existing tax laws. This is completely self assessment system. It is supposed that when they file their tax incomes, it is said to be tax assessment on the part of tax payers. This is the milestone that would curtail the part of discretionary power of tax officers, which was mostly charged in previous period of time.

In order to get out from the several problems, the government has declared the following objective for the current revenue policy;

- To increase productivity, simplicity, uniformity and flexibility.
- To improve effectiveness of the policies
- To facilitate to stakeholders.
- To encourage investment and saving by the treatment of friendly environment with tax payers.



## **1.2 Focus of the Study**

Revenue from income tax is very essential for the well development of our country. These taxes constitute primary source of income to the government of Nepal. Like the other countries, Nepal government also aims at making huge revenue and willing to have more and more revenue by making and implementing income tax policies and effective income tax assessment procedures.

Income tax assessment procedure is the major problem faced by Nepalese tax payer due to complexity on understanding its procedures. On the one hand, income tax motivates tax payers for self assessment of their income, tax, interest, fine and penalties but on the other hand tax payers feel tedious and burden by its confusing provisions and procedures.

This study will be mainly focused on income tax assessment procedure. This project will also study the contribution of income tax to the total revenue of the country, views of tax administrators, tax experts, auditors and tax payers on its provision, rate and fines.

In this study, income tax assessment procedure and other important information relating to this study are to be presented, analyzed, summarized and findings and recommendations also be stated.

## **1.3 Statement of the Problem**

Nepal is a least developed country among the developing countries of the world. Nepal has been facing serious financial problems in its economic development process. Nepal is following a liberal, open and market oriented economy policy. It has not been able to invest adequately in its social and economic development. Development policies have been largely ineffective, economic growth has decline even after liberalization. To improve the living standard, economic growth is very essential which needs short and very long heavy investment. This is possible when there is sufficient resource in the hand of government.

Nepal is facing serious resource gap problem. It has incurred in Nepalese finance because the expenditure of government of Nepal has been increasing at a faster rate than the increase in revenue. Contribution of income tax revenue to total revenue is also very low in the recent year as compared to developed countries. Undue delay in tax assessment procedures is the serious problem of income tax system in Nepal. Tax authorities are inefficient and ineffective in enforcement. There are no sufficient integrate programs for tax payers' education, assistance, guidance and counseling.

There is high dependency of income tax evasion and low level of income tax payment in the country. The tax policy and revenue administration is not effective for the collection of taxes, the tax acts, and other related acts, rules, regulations and tax rates are not stable too. Although the government has granted income tax holidays, incentives, rebates, exemptions, there is not significant effect in tax collection. Tax payers are ready to provide illegal benefit to the tax administrators but they are not ready to pay small amount as tax. They do not lie within the tax net. This is the major problem of Nepalese income tax system. This problem is largely related to income tax assessment procedure. In such condition to be imperative to make a study of income tax assessment procedure system and suggest ways to improve it.

#### **1.4 Objectives of the Study**

Major objectives of this study are as follows:

- To make review of legal provisions relating to income tax assessment procedure in Nepal
- To analyze the contribution of income tax to national revenue of Nepal.
- To educate and make tax payers feel proud by paying income tax at time as per government directions.
- To analyze the view of tax payers, auditors, tax experts, and tax officers about income tax.
- To examine the reason for poor tax-paying habit of tax payers.
- To recommend possible measures to the government.

### **1.5 Scope of the Study**

Major areas covers by this study are as follows:

- A brief introduction of income tax assessment procedure system of Nepal.
- Related provisions with income tax assessment procedure under ITA, 2002.
- Related laws and income tax rate, exemption limit in ITA, 2002.
- Present position of income tax assessment in Nepal etc.

### **1.6 Need and Importance of the Study**

Developing country like Nepal needs high magnitude of financial resource for the development programs. For the development programs, domestic resource plays vital role than the external resource. Among the domestic resources, income tax plays significant role. Without adequate financial resource like revenue of nation, developing activities cannot go ahead. Having sufficient fund with country like Nepal minimizes the economic inequality in the society and increases the domestic resource mobilization effectively. It measures the economic standard for the people. The income tax assessment procedure system of Nepal is going through various problems. So it is very essential to find best remedies to improve it.

### **1.7 Limitations of the Study**

There are some limitations in this study that are as follows:

- This study is limited to Nepalese law, acts, rules and regulations to the income tax.
- Due to the small size, it may not fully represent the Nepal as a whole.
- Due to lack of authoritative secondary data and transparent income tax assessment system, the study has covered mainly theoretical aspect of tax assessment.
- This study has covered data only fiscal year 2000/01 to 2010/11(data of 2011/12 was not included because it was published when research work is about to complete).
- Sample technique is exercised due to time and finance limitation. The Sample has been selected only from Kathmandu, Hetauda and Itahari.

## **1.8 Organization of the Study**

This study has been organized in to five chapters which are as follows:

- **Chapter-I Introduction**

This chapter generally covers the general background regarding the income tax assessment procedure. It also includes focus of study, statement of the problems, objectives of the study, scope of the study, need and important of the study and limitation of the study.

- **Chapter-II Conceptual Framework and Review of Literature**

It discovers what other research in the area of income tax assessment procedure and left over in this regard. It includes conceptual framework and review of previous studies. The legal provision regarding income tax in Nepal and tax administration in Nepal is also included in this chapter. While reviewing literature, various tax experts, auditors, tax officer and tax payers will be taken in to account and being considered.

- **Chapter-III Research Methodology**

Descriptive as well as analytical research methodology has been taken into account to carry out this study under this chapter in research. This chapter also includes research design, population and sample, nature and sources of data, data collection procedure and data processing and analyzing procedures.

- **Chapter-IV Presentation And Analysis of Data**

This chapter analyzes the impact of income tax assessment procedure system in Nepal. This chapter deals with analysis and presentation of data and empirical investigation which includes resource gap in Nepal, structure of government revenue in Nepal, tax and non-tax revenue in Nepalese tax structure, contribution of income tax to GDP, total revenue and total tax revenue, exemption limits in Nepalese income tax, income tax-payers in Nepal and methods of income tax assessment in Nepal.

- **Chapter-V Summary, Conclusion And Recommendations**

Based on above analysis, findings and achievement, in terms of quality have been made after the analysis. The needful recommendations have been stated.

## **CHAPTER-II**

### **CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE**

#### **2.1 Conceptual Framework**

##### **2.1.1 Concept of Tax**

The government of every nation requires sufficient revenue to carry out development plans, to handle day-to-day administration, maintain peace and security and launch other public welfare activities (Bhattarai & Koirala, 2009:5). To fulfill such objectives, every government collects tax from different sources with different rate basis, charges for providing goods and services by the government, fees, fines, penalties, and foreign grants etc. Main sources of government revenue can be divided into two categories; tax and non tax. Among them, tax is the main source which covers most part of government revenue.

Tax is a legal duty imposed by the government of every nation to the people. It is paid to the government by the tax payers without expecting any direct benefits. But it is also a duty of government to invest collected revenue into the developing activities so that tax payers indirectly benefited. According to Prof. Seligman-“A tax is compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit” (Bhattarai & Koirala, 2009:5)

According to Adam Smith, “A contribution from citizens for the support of the state” (Bhattarai & Koirala, 2009:5).

According to Plehn-“Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred to conferring common benefit upon the residents of the states” (Bhattarai & Koirala, 2009:5).

From the above definition, it is obvious that tax is not a voluntary contribution by the tax payer but it is compulsory in nature. The tax is paid to state to perform the function of the government. The tax payers do not get corresponding benefits from the government for

paying tax. Amount of tax is redistributed in the form of development and services provided by the government for common interest of the people. It is collected from haves and spent for the interest of have-nots in the society.

Many economists have classified taxes into several categories but the major categories of taxes may be direct and indirect taxes. If a person must have to pay directly the tax liability to the government, such tax is known as direct tax. A direct tax is a form of tax paid by a person on whom it is legally imposed. It is collected directly by the government from the person who bears the tax burden. Tax payers need to file tax returns directly to the government. Therefore, direct tax cannot be transferred. Income tax, gift tax, interest tax, property tax, vehicle tax, house & land tax, and contract tax are some examples of direct tax. Direct tax is paid according to the income or property earned by a person. So it is found equal with the property. Direct tax has quality of certainty; the taxpayers are informed about the amount, time and procedure of payment. Taxpayer can easily estimate his tax liability. The government can easily increase or decrease according to proper economic situation of the country. Taxpayers pay tax from their own property, so they are conscious about their contribution.

An indirect tax is a form of tax imposed on one person but partly or wholly paid by another. It is collected by mediators who transfer the taxes to the government and also perform functions associated with filing tax returns. Hence indirect tax can be transferred. The examples of indirect taxes are customs, excise duty; value added tax, entertainment tax, hotel tax, passenger tax etc. Indirect tax is transferable. People pay tax when they receive or consume goods or services. Therefore, they don't feel burden to pay lump sum. There is mass participation because every person who receives goods or services, pay tax. The government encourages domestic products and discourages foreign goods through higher rates of indirect tax.

### **2.1.2 Concept, Meaning and Definition of Income Tax**

The term 'income' may be defined as the best measure of ability in the sense of economic well being, for income is the primary determinant of the level of living, which a family

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

$$Y = C + W$$

Where, Y=Income

C=Value of consumption

W=Increase in wealth

In fact, this is the most satisfactory definitions of income in light of the objective as, but it is not the approach used in tax laws. The usual is in terms of flow of money to a limited extent of commodity of a person. This is a concept somewhat easier for the non-economists to understand; it is an agreement with the everyday nations of income, and what counts as income and what kinds of income they will tax.

The most widely accepted definition of income was developed by American Economist, Robert M. Haig and Henry C. Simons in the 1920 and 1930. According to this definition, a person's income during the period in an economic sense consists of the algebraic sum of two items i.e.

- The person's consumption during the period and
- The net increase in the individual's personal wealth during the period.

Symbolically,  $Y = C + \Delta W$

Where,

Y, C and  $\Delta W$  refers personal income, consumption and net increase of personal wealth respectively.

According to the Dictionary of Economics Terms, income means, "The wealth measured in money, which is at the disposal of an individual or a community, per year or other unit of time; it may be regarded as a flow of purchasing power which may be expended at



once on goods or services or retained for the purpose of capital accumulation (Gilpin, 1977).

It is very difficult to define income precisely and clearly. So, income exemplified rather than defined income tax laws of various countries. According to Indian Income Tax Act, 1961 section 2, under the head of income keeps profits and gains, dividend, voluntary contributions received by charitable trust, value of any perquisite of profit on lieu of salary, any capital gain, winning from lotteries, cross word puzzles etc.

According to Income Tax Act, 2002 section (h), income means a person's income from any employment, business or investment and the total of that income as calculated in accordance with this act.

The concept of income tax differs in different countries. In United Kingdom, the original concept of tax was applied to five schedules. In United States of America, income tax is viewed, as a matter of practice, recurrent is not relevant to the tax status. Hindu families unregistered firm and other associations of person (Due & Fried Under, 1977:111).

Income tax as the word itself refers a tax on income. In a broad sense, income tax is a levy based upon the production or receipts or gain of the taxpayers within a definite period of time (Encyclopedia of America, Vol. 14:749).

This income tax is chargeable on any person who is a tax payer and whose total income exceeds the maximum exemption limit, at the prescribed rates and from the very beginning, income tax has been always regarded as a tax has based on the cannon of ability. The tax could be adjusted as to exempt the lowest income group from the operation of the tax and make the richer groups bear the burden of the tax according to their income. A part from such considerations as revenue productivity, income tax has been regarded as the ideal tax from the point of view of equity (Andely, 1964:213) and tax economists have an idea that an income tax is a levy tax upon the incomes of an individual after the exemption limit. Only the taxable income is subject to tax, otherwise the objective & principle of taxation will not be fulfilled.

The above discussion cleared that the concept of income tax is different in different countries. The reason for difference may be due to the difference in economical structure, nature of government, status of the individual etc. However, almost all country follows the principle of ability to pay as the basic principle while determining the tax policy. Income tax cannot be shifted forward or backward and the taxpayer on whom the tax is imposed must bear the burden of tax.

Income tax can easily be modified to give elasticity in raising revenue and is highly productive, in a developing country like Nepal. Income tax is the major contributor towards government treasury among direct taxes.

### **2.1.3 Development of Income Tax in its Historical Perspective**

In the history of modern income tax, the first country to enact a general income tax was Great Britain in 1799 to finance the Napoleonic wars with France. But after 1980s it was accepted as social instrument. In early days taxes were not collected in monetary terms but were collected by tribal rulers, community heads etc. for communal services and at time of emergencies.

In Hindu tax system, tax was levied on the basis of welfare of the people and people were eager to pay tax because not to pay tax was taken as great sin. The ancient Hindu philosopher and writer Kautilya; Manu and Yogyablaka argued “As the ripe fruit is picked from the garden leaving out the unripe to pay. In the earlier period, income tax was levied at a flat rate but the principle of progressive income tax has been applied today. There are very few countries where income tax is levied as global and progressive tax on ability to pay. 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 those activities, the King used to collect crops and cattle from farmers; gold, silver, copper from traders. These ancient forms of taxation were expanded from time to time under the influence of various economic, political and ethical forces.

In the early Roman society, the citizens had to pay tax even for the Polling rights. “Ancient Athens used to derive its revenue from taxes like customs, sales and poll tax on aliens and slaves. One who was taxed and failed to pay was guilty of a capital offence” (Gronic, 1975). After the end of Punic war in 146 B.C., they were relieved from the pool tax. They started to levy tax on the people of the captured areas instead of their citizens. At the time of Julius Caesar, 1% sales tax was imposed to the people and he was the first ruler who started to collect taxes through government institutions.

Kautilya’s “Arthashastra” of the fourth century B.C. has classified the tax receipt into three types:

- Income earned through taxes on goods produces within the country.
- Income earned through taxes on goods produced in the capital.
- Income earned through taxes on imports and exports.

Land revenue was important sources of taxation in ancient India. Kautilya mentioned, “The tax system should be such as not to prove a great burden on the public (Prajā), the king should act like the bee which collects honey without inconveniencing the plant”. His economic thought was guided by social welfare concept. He suggested heavy taxation for luxuries and other articles, which were not in favor of public welfare. Kautilya classified the main items of public expenditure,

- National defense.
- Public administration
- Salaries of Ministers and expenditure on government departments.
- Expenditure incurred on maintenance of armies.

#### **2.1.4 The History of Income Tax System in Nepal**

Nepalese ancient tax system was based on Vedas, Smritis, and Puranas. Directives propounded by Manu, Yagnabalka, Chanakya etc. guided the taxation system. At that time, the principle of collecting tax from people was imposition of tax without harming the activities of the people (Kandel, 2004:9).

The function of revenue collection has remained one of the key activities of the government from ancient time in Nepal. During that time, very few economic activities were operated on the country, hence, government could not collect huge amount of money in the form of taxation. At that time, taxes levied to the merchant, travelers and farmers in the form of cash, kind or labor. In some occasion, gold and agricultural products were also paid as taxes but the nature of these taxes were temporary and taxes were raised for special purpose.

In the Lichhavis regime, income taxes from agriculture and business were introduced as direct tax for the first time in Nepal. Tax on agriculture income was called "Bhaga" and tax on business was called "Kara". Irrigation tax and religious monument preservation taxes also existed at the time of King Ansubarma of Nepal. During the period of 1768-1846 A.D., different types of taxes were levied to generate maximum revenue. The major sources of revenue were Birta and Kipat, taxes on land, monopolies customs transit and market duties, mines and mints and the export of forest products, birds, animals and various laciest and fines. Taxes were collected at three levels were Royal Palace, Government and Local Authorities. There was contract provision for the collection of customs and transit, market and excise duties. The various taxes levied during that period were narrow base and were imposed primarily on occupations and economic activities not in income or property. There was no taxation of income in the modern sense income tax.

During the period of Rana regime, there was no formal provision for imposed and collection of taxes. Taxes were imposed according to the objectives, needs whims of the ruling Rana Prime Minister. There was not provision of separating personal income of Prime Minister and State treasury. There was not system of preparation of government budget. The surplus of revenue over expenditure was considered the personal income of the Rana Prime Minister.

The major source of revenue in Nepal till 1951, were land tax, custom and excise duties in the form of lump sum contracts, royalties on forest, royalties on supply of porters,

soldiers and a few other minor taxes. Income were not taxed for raising regular revenue of the State treasury but for meting special expenditure of the household of extra ordinary expenditure necessitated by war or other emergencies.

There was no direct tax in the country except land tax collect on a contractual basis and "Salami" which the government employees used to pay out of their salaries at a very small percentage. The Salami was abolished in 1951. The Rana rules did not think of development of effective revenue administrative system.

The concept of income tax was brought only by the first budget. The budget introduced in 2008 B.S. stated about the introduction of income tax system in Nepal. However, it was actually introduced only in 2017 B.S. in the form of "Business Profits and Remuneration Tax". According to this act only business profit and remuneration on income were subjected to tax but the revenue for these taxes should not be collected properly according to originals estimates (Dhungana, 1976:66).

Main features of Income Tax Act, 1960 (2017) were as follows:

- Only business profit and remuneration income were subject to tax. Thus the coverage of income tax was too narrow.
- The remuneration was to be deducted at source.
- The basis for calculating the tax liability for remuneration was the income of the current year whereas for business profits, it was the profit of the preceding fiscal year.
- There was a provision of tax exemption on salary of reign citizen, dividend of shareholders, profit to be spend in religious or public welfare activity, crop from own lad, allowance granted by NG to Ministers, Assistant Ministers, Chairman, Speaker and Deputy Speaker, amount drawn from provident of saving fund.
- The tax officer was empowered to assess tax on best judgment estimation only in case of false statement of in absence of income tax return.
- There was a provision of fines ranged from Rs. 500.00 to Rs. 5000.00 in case of defaults.

- The first Court of Appeal against the tax officer's assessment was local "Bada Hakim" or Magistrate. Thereafter taxpayer could appeal to the "Revenue at tax Court" but they need to deposit fixed amount of tax.

Since, the income tax was imposed only on income from business and remuneration; the act could not cover all the sources of income and so was replaced by the Income Tax Act, 1962 in 1962. Income Tax Act, 1962 with 29 sections divided the head of income into nine parts covering business profession and occupation, remuneration, house and land rent, cash or kind investment, agriculture, insurance, business, agency and other sources. The objective of this Income Tax Act was to reduce unequal distribution. The Act was amended only one time in 1972.

The main features of Income Tax Act, 1962 (2019) were as follows:

- Act has defined basic terminology such as taxpayer, tax officer, company, firm, profit, remuneration, tax assessment, non-resident etc.
- Status of taxpayer was defined on personal as well as residential for the tax purpose.
- Procedure for income tax assessment and methods of calculating net income were stated.
- Provision was made to carry forward of losses for a period of two years.
- The provision was made to constitute the net income assessment committee with five members.
- The basis was specified for assessing tax on the best judgment estimate of the officers.
- To broaden the tax coverage, agriculture income was brought under the income tax net for the first time. But the Financial Act, 1966 (2023) exempted this income fully from tax net. Again it was brought into tax net by Financial Act, 1973 (2030). However, it was again exempted from 1977.
- Provision was made for assessment of assessment of tax as well as rectification of arithmetic errors.

Considering this act incapable of fulfilling the needs of the time, existing act was replaced by another act "Income Tax Act, 1974". This new act was brought in practice from October 1974 A.D., this act having 66 sections. This act was also amended in 1977, 1979, 1984, 1986, 1988, 1989, and 1992 A.D. to make it more practical and to eliminate confusing terms of wealth with social justice and establish tax-paying habit. His majesty's government enacted the Income Tax Rules, 1982 in according with the authority given under section 65 of Income Tax Act, 1974.

Main features of this act as amended are as follows:

- It had clarified the certain terminology used in Act e.g. income tax, tax payer, non-resident, tax assessment, income year, gross income, net income, agriculture income, remuneration income, loss etc.
- Income head was classified into five categories: a. Agriculture income, b. Industry, trade, profession or vocation, c. Remuneration, d. House and compound rent, and e. other sources.
- The methods of computing net income from various sources had been specified.
- Appointment rights of tax officers had provided to NG and rights of tax officers had mentioned clearly.
- The right & duties of taxpayer had mentioned clearly.
- This act had made the provision of self-assessment of tax for the first time in Nepal.
- The provision of carry forward of loss for three subsequent years was made.
- The act had made it obligatory for taxpayers to register their industry, business profession or vocation in the tax office before starting the work.
- The expenses allowed for deduction while computing net income had clearly specified for all sources of income.
- Procedure for assessment, reassessment, jeopardy assessment, tax deduct at source, payment and refund of tax had specified.
- Provision relating to make agreement for Avoidance of double taxation.
- Provision relating to maintenance of accounts.

- Provision of penalty up to Rs. 5000.00 in case of failure of maintain or preserve accounts.

A sound and efficient income tax system is necessary to maximize the revenue collection from income tax. Whole income tax system is made of three sub system i.e. income tax policy, income tax laws and income tax administration. The government itself through Ministry of Finance determines income tax policy. Income Tax Policy should be such that the main objectives of the income tax can be attained. Parliament makes the laws to implement the various policies. The government levy and collect the income tax in accordance with law. The constitution of the Kingdom of Nepal, 1990 (2047) has made the clear provision about it. "No taxes shall be levied and collected except in accordance with law" (Constitution of Kingdom of Nepal, 1990). Since, 19<sup>th</sup> Chaitra, 2058 B.S., "Income Tax Act, 2058" has been introduced in Nepal to replace the old one. This act has been brought in Nepal to avoid the following defects of Income Tax Act, 2031:

- Income Tax Act, 2031 had a narrow tax base, Global income of residents were not brought into tax net. Only the incomes originated in Nepal were taxed.
- Income tax related matters were governed by various Acts. Dispersion of tax related Acts had raised confusion in the effective implementation of the Act, such as Employee Provident Fund Act, 1962, Electricity Act, 1992 etc.
- There were no clear provisions regarding taxation of capital gains. The Act was to also silent with regard to international taxation.
- The terminology and provision in the act were inadequate.
- The fine and penalty imposed by the Act was very low. As a result, the level of voluntary compliance had decreased substantially.
- There was a weak mechanism to control the tax avoidance scheme of taxpayers. The taxpayers used to evade tax through transfer pricing, splitting of income, etc.
- Tax accounting method as not prescribed in the Act. Despite the provision of self-assessment in the Act, it had not been implemented properly. The self-assessment was more in name than in practice.
- The Act had not distinguished civil liabilities of tax payers from criminal liabilities. The tax authorities were empowered to act as a Court.



- There was a double appeal system in the Act; the taxpayers were allowed to lodge an objection against assessment with the Revenue Tribunal or the Director General. The Director General was empowered to act as a Court and there were complaints that he used to make decisions in favor of tax officers. There were no provisions for administrative review.
- Act became incapable to fulfill the need of time. So, it became compulsory to replace it by a new Act.

As given by the policy makers, the objectives of the new Act are:

- To bring all the income generating activities within tax net.
- To increase the base of taxation.
- To bring all the income tax related provisions within one act.
- To make income tax related provisions clear and transparent.
- To interlink Nepalese tax system with tax system of other countries.
- To make tax system based on account.
- To minimize tax avoidance and tax evasion.
- To make tax system compatible to modern economy.
- Reducing the scope of discretionary interpretation of the tax administration thereby ensuring simplicity, uniformity and the transparency.
- Separating administrative and judicial responsibilities.
- Defining the power as well as authority of the tax administration, distinguishing taxpayer's violation of civil duties and criminal offences.
- 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 (Kandel, 2004:11).

The new Income Tax Act has 143 sections. Income Tax Rules, 2059 is also implemented under the provision of this Act. As stated in objectives, the new act has many new provisions in comparison to Income Tax Act, 2031. Besides this act and the proper rules, the current Finance ordinance act is also equally applicable for the proper administration of income tax in Nepal.

## Features of Income Tax Act, 2002

Tax system is the main system of collecting government revenue. Every government has its own tax system. Tax system is amended with the change in economic policy of a country. Since the time Nepal introduced income tax act, it has been amended with the changes in economic policy every year. Change in world economic policy and advancement in information technology also has vast impact on Nepalese economy. Nepal being a small economic country has to adopt the economic policy followed by World Bank, International Monetary Fund, Asian Development Bank, and other international agencies. Especially, after 1990s, there is re-emergence of the liberalization, globalization and privatization system that focus on the minimum intervention of the state on private economic matters. The 1950's concept of 'high incentive', 'high tax rate' is changed to the concept of 'low rate, wide net'. This trend in tax system is followed by most of the countries of the world. Nepal also is not an exception in this respect and Nepalese administrators and policy makers too have tried to change the tax policy of the country. Income Tax Act, 2002 is the result of the change in all these matters (Kandel, 2004:20).

Following are the main features of Income Tax Act, 2002:

- Income tax related provisions are included within one act.
- This Act has classified all income into three headings under section 3; Business, Employment and Investment.
- Act has clearly specified the amount should be included while calculating a person's gain or profit from conducting business or investment for an income year.
- All the expenses are allowed to deduct from a person's income of the same year. Expenses must be incurred in production of income.
- There is the provision of carry forward of loss for subsequent four years. The Act has also provided the facilities to carry backward of loss for five subsequent years in case of bank, insurance and long term contract.
- Incentives are provided to infrastructure constructor, hydropower projects and special industries.

- Now the economy of the most of the countries in the world is upon one. The provision has introduced in the tax law related to International Taxation, Transfer Pricing, Foreign Tax Credit, Double Taxation Avoidance Agreement etc. are the provision of International Taxation.
- The Act has given the option for husband and wife as a separate natural individual until they do not accept as a couple.
- Capital gain, dividend etc has brought in tax net.
- Authorities of tax payer have specified.
- To control the tax evasion, provision of transfer pricing, thin capitalization dividend stripping is made.
- Provision of fines and penalties has made more stringent in the new Income Tax Act, 2002.
- This Act has made a provision of relating the submission of income statement by a person who doesn't have taxable income or who has derived income only as final withholding payment.
- There is a special provision for deduction of pollution control cost (Sec.17), research and development cost (Sec.18) and repairs and improvement cost (Sec.16).
- The income of an approved retirement fund is free from tax. But retirement payments in hands of employees are taxable.
- Resident persons are taxed on their worldwide income while non-resident persons are taxed only in their income source in Nepal.
- The Act has introduced a block system of charging depreciation. A provision has also been made for depreciating intangible assets.
- The Act has provided the facility of medical tax credit under which resident individuals may claim a medical tax credit of 15 percent of the amount of approved medical cost. Unabsorbed medical tax credit amount can carry forward forever.
- The Act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.

- This Act has made a provision for income returns; every taxpayer is required to fill up the return of income in the prescribed format and file to the concerned internal revenue office within three month after the expiry of the income year.
- Completely based on self-tax assessment system, if a person submits an income return for an income year on the due date indicating the amount of total taxable liability for the year and the amount of tax still payable by the person, it is treated as a self-tax assessment.
- The Act has prescribed the method and basis of tax accounting. It has clearly indicated the cash basis, accrual basis accounting for different income heads and persons, such as cash basis for employment income and investment income and accrual basis for a company (Mallik, 2003:26).

## **2.2 Legal Provisions Relating to Income Tax**

Income Tax Act, 2058 is implemented from 19<sup>th</sup> Chaitra, 2058 B.S. This Act replaces the Income Tax Act, 2031, and other Acts related to income tax.

### **2.2.1 Source of Income**

Income Tax Act, 2058 has classified the sources of income for the purpose of assessment under the following headings:

- Income from Employment
- Income from Business
- Income from Investment

#### **2.2.1.1 Income from Employment**

According to Section 2. (a).(j). of ITA, 2058, the Act has given a definition that employment includes a past, present or prospective employment. It can be said that remuneration means the income received by any natural person in respect of any employment or service rendered by the person from the employer in any income year.

An individual's income from an employment for an income year is the individual's remuneration from the employment of the individual for the year. The following

payments made to the individual by the employer during the year should be included in calculating an individual's remuneration from an employment:

- Payment of wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts, bonuses and other facilities.
- Payments of allowances included any cost of living, rent, entertainment and transportation cost.
- Payment of reimbursement of cost incurred by the individual or an associate of the individual.
- Payments for the individual's agreement to any conditions of the employment.
- Payments for the termination or loss or compulsory retirement.
- Retirement contribution included those paid by the employer to the retirement fund in respect of the employee, and retirement payments.
- Other payments in respects of the employment.
- Other amounts required to be included.

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

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

Following items are excluded in calculating an individual's remuneration from an employment:

- Amounts exempts and final withholding payments.
- Meals or refreshments provided in premises operated by or on behalf of an employer to the employer's employees that are available to all the employees or similar terms.

- Any discharge or reimbursement of costs incurred by the individual that serve the proper business purpose of the employer, or that would otherwise be deductible in calculating the individual's income from any business or investment.
- Payment of the prescribed small amounts which are so small and thus unreasonable or administratively impracticable to make accounting for them.

### **2.2.1.2 Income from Business**

Business is a commercial activity undertaken by a commercial enterprise engaged for the purpose of making profit on continuous and representative basis. In other words, business means the use of factor of production for the purpose of earning profit. According to section 2.(a).(r). of Income Tax Act, 2058, business mean an industry, a trade, a profession, or the like isolated transaction with a business character and includes a past, present or prospective business. The term business does not include employment. A person's income from a business for an income year is the person's profits and gains from conducting the business for the year. The following amount derived by the person during the year should be included:

- Service fees including commission, meeting management or technical service fees.
- Amount derived from the disposal of trading stock.
- Net gain from the disposal of business assets or liabilities of the business.
- Amount treated as derived in respect of excess depreciation on the disposal of the person's depreciable assets of the business.
- Gift received by the person in respect of the business.
- Amounts derived as consideration for accepting restriction on the capacity to conduct the business.
- Amounts derived that are effectively connected with the business and that would otherwise be included in calculating the person's income from the investment.
- Excess amount received due to exchange rate variation of currency.
- Bad debts recovered.
- Under payment of interest amount according to market rate.
- Amount included under change of accounting method.

- Other amount received under business income.

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

- Exempt amounts under Income Tax Act, 2058 Section 10.
- Dividends under Income Tax Act, 2058 Section 54 and 69.
- Final withholding payment under Income Tax Act, 2058 Section 92.

### **2.2.1.3 Income from Investment**

According to Section 2.(a).(1) of ITA, 2058, investment means an asset of holding or investing one or more assets of a similar nature that are used in an integrated fashion. It excludes that act of holding assets, other than non-business chargeable assets, primarily for personal use by the person owing the assets or investing amount on such assets. It also excludes employment or business.

For the purpose of computing any person's income from investment and the person's profit & gain from conducting investment for the year, following amounts derived by the person during the year should be included:

- Any dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from an unapproved retirement fund, interest on retirement payment made by an approved retirement fund.
- Net gains from the disposal of the person's non-business chargeable assets of the investment.
- The excess amount of incoming over the depreciation basis including outgoing on the disposal of depreciable assets of the investment of the person.
- Gift received in respect of the investment.
- Amounts derived as consideration for accepting restriction on the capacity to conduct the investment.
- Retirement contribution including those paid to a retirement funds in respect of the person and retirement payments in respect of investments.
- Amount included under change of accounting method.

- Excess amount received due to exchange rate variation of currency.
- Bad debt recovered.
- Proportionate amount under long term contract.
- Under paid interest amount according to market rate.
- Amount received as compensation.
- Other amounts required to be included on tax accounting or quantification, allocation and characterizations of amounts or transaction between any entity beneficiary and general insurance business.

Following items are excluded in calculating a person's profit and gains from conducting an investment:

- Exempt amounts under Income Tax Act, 2058 Section 10.
- Dividend under Income Tax Act, 2058 Section 54 and 69.
- Final withholding payment under Income Tax Act, 2058 Section 92.
- Amounts those are included in calculating the person's income from any employment or business.

### **2.3 Return of Income**

- The person's assessable income for the year from each employment, business and investment and the source of that income.
- The person's taxable income for the year and the tax payable with respect to that income for the year.
- In the case of a foreign permanent establishment of a non-resident person situated in Nepal, the foreign permanent establishment's repatriated income for the year and tax payable with respect to that income.
- Any tax paid by the person for the year by withholding, installment or assessment for which a tax credit is available.

Any other information that IRD prescribes return of income refers to the statement of income filled up in a prescribed format. According to Section 96 of ITA, 2058, every tax payer should file at the place prescribed by the Department, a return of income not later



than three months after the end of each financial year. The law has mentioned that the following items should be included in filling income tax return with tax payer's signature.

Following things should be attached to the returns of income:-

- Any withholding certificate supplied to the person under Section 91 with respect to payment derived by the person during the year for which the return filed.
- Any statement provided to the person where a person refuse to sign a return which, in return for payment, he has prepared or assisted in the preparation of a return of income or attachment to a return of income.
- Any other notice or information prescribed by the Department.

When a person files a return of income for an income year, an assessment is treated as made on the due date for filling the return of the tax payable by the person for the year in the amount shown in the return; and the amount of that tax still to be paid for the year being the amount shown in the return.

When a person fails to file a return of income for an income year than, until such time as the return is filed, an assessment is treated as made on the due date for filling the return that the amount tax payable by the person for the year is equal to the sum of any tax withheld from payments derived by the person during the year any tax paid by the person by installment for the year' and there is no tax payable on the assessment.

In the circumstances like the person becomes bankrupt, is wound-up or goes into liquidation; or the person is about to leave Nepal indefinitely; or the person is otherwise about to cease activity in Nepal; or the Department otherwise considers it appropriate the Department may, according to the Department's best judgment, make an assessment of the amounts for the income year or part of the year; and the amount of tax, still to be paid for the year or part of the year.

### **2.3.1 Return of Income not required**

Unless requested by the Department by notice in writing or by publishing a public notice, the following persons are not required to file a return of income:

- a. A person who has not tax payable for the year under Section 3(a).
- b. A residential individual;
  - Who has only one employer at a time during the year and all of whom are resident employers and
  - Who claims only a medical tax credit with respect to medical costs borne by the employer and reduction for retirement contribution made by the employer but does not claim a reduction for donation.
- c. A person who receives a final withholding payment.
- d. If vehicle owner paying flat taxes as per Section 11(schedule 1) is an individual.

### **2.3.2 Extension of Time to File Return of Income**

A person who is required to file a return of income may make a written request to the Department within the date for filling the return, the Department may, if there is reasonable cause extend the date by which the return is to be filed; by serving the applicant with a written notice of the Department's decision on the application. The Department may grant multiple extension not exceeding three months in total by which the return is to be filed. The department will inform the person by writing its decision on the application.

### **2.4 Tax Assessment**

Assessment means "to determine" or "to compute". Income tax assessment means the determination of the amount of income tax imposed on the tax payer for a specified period. The word assessment comes from the Latin words "adsedereassessere" meaning 'to sit through, to fix a rate' or impose a tax. In the most common sense the imposition of a tax listing on person and property to be taxed and a valuation of the property if each person as basis of apportionment and levy such acts usually performed by administrative officers and sometimes by legislature (Ballentines law Dictionary, 1969:99). Thus income tax liability on a person is determined on the basis of state act. Assessment of income tax means the computation of total income tax liability and procedures for imposing income tax liability as well. The World assessment means computation of total

income, determination of the amount of tax payable and whole procedure laid down in the act for imposing liability upon the taxpayer.

Income Tax Act 2058 has defined the term "assessment" as an assessment of tax to be paid under this Act and it includes an assessment of interest and penalty made under this Act. However, the term does not include an assessment that has been replaced with an amended assessment.

#### **2.4.1 Tax Assessment Procedure**

The revenue collection from income tax is also based upon the income tax assessment procedure followed. Income Tax Assessment Procedure is a significant aspect of the income tax administration. The quality of income tax assessment procedure is highly depends upon the quality of income tax personnel, taxpayers, tax laws and policies. If income tax is fairly assessed the amount of collection may increase. An efficient and effective assessment procedure reduces the corruption, evasion and increase the morality which assists to generate additional financial resources through income taxes.

The assessment starts with return of income filed by the taxpayer. It is scrutinized, verified, investigated or audited by the tax officer in order to determine, whether the information contained in it, is accurate and complete. The income tax assessment procedure generally proceeds through four stages:

- Return of income statement
- Assessment of taxable income.
- Determination of tax liability, and
- Collection of net proceeds after deducting his advance tax payment.

#### **2.4.2 Methods of Income Tax Assessment**

Income Tax Act, 2058 has provided the following major methods of assessing Income tax:

## **A. Self Tax Assessment**

Self Tax Assessment is the system in which the tax payer pays himself his income tax by calculating his tax to pay on the preparation of his income and showing his every detail (Joshi, 2044:61)

The first amendment on 1977 of Income Tax Act, 1974 had made the provision of self-tax assessment for the first time. This provision aims to increase awareness among taxpayers about their tax liability and to facilitate the collection of tax. The eight amendment of Income Tax Act has mentioned many provisions in this regard and has given high priority to self-tax assessment. But it was not properly implemented in practice before the enforcement of Income Tax Act, 2002.

According to the Act, if a person submits an income return for an income year on the due date indicating the amount of total income, tax liability and tax still payable for the year; it is treated as an assessment has been made. Such assessment is known as an assessment has been made. Such assessment is known as self-tax assessment. The tax official validates Self-assessment only when the person submits the income return in prescribed format on the due date along with the tax payable in a proper way without any error and motive of fraud.

Since the current tax laws have fully adopted self-tax assessment system, it is supposed to be assessed tax on due date until such time as the income return is to be filed although a person fails to file the return. So in case of failure to submit the income return in the due date, the total sum of any tax withheld for payment derived by the person during the year and any tax paid by the person in installments for the year is treated as paid on the due date. It means only the remaining tax is treated as tax arrears until such time as the return is filed and tax arrears is recovered along with penalty, interest, and fine through amended assessment (Amatya, Pokheral & Dahal 2004:261).

For the development of healthy and enriched tax administration, there is a completion of keeping the account of transaction, public consciousness towards the tax administration

to pay tax previously, the provision of measuring the previous paid tax while paying and self-tax assessment are supposed to be the important aspects. Tax administration should assess the tax timely otherwise problem may emerge. To overcome the problem the system of self-tax assessment can be supposed as the most important tools, by means the revenue could be collected within specific time. It is a system that makes feel the tax payer their responsibility of paying tax. In the mean time, it is also a helpful to the tax administration to assess tax timely. For the Self-Tax-Assessment, three procedures are to be followed by the tax payers.

- Preparation of income & expenditure as prescribe format.
- Declaration of net income of each source of income.
- Showing the taxable income

### **B. Jeopardy Assessment**

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

- The person becomes bankrupt, is wound-up, or goes into liquidation;
- The person is about to leave Nepal indefinitely;
- The person is otherwise about to cease activity in Nepal;
- 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 the whole year the taxpayer is not required to file the return for the year. But if the assessment is made only for the part of the year, then 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 a tax official makes a jeopardy assessment, the tax official is required to provide written notice of the assessment to the tax payer mentioning the total tax liability, tax payable along with the

date of payment and the manner and reasons of the assessment. The notice should include the time, place and manner of objecting to the assessment.

### **C. Amended Assessment**

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 person of fraud or any willful neglect by or on the behalf of the assessed person.

The tax official 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 serving a notice of the assessment to the person stating the following matters:

- Tax payable by the person, tax still to be paid for the income year or the period to which assessment is made.
- The manner in which the assessment is calculated.
- The reason why the Department has made assessment.
- The date on which the assessment is payable and
- Time, place and manner of objecting to the assessment.

The Department may give the 15 days of time to taxpayer to produce proof, if any, in own favor with respect of the assessment.

## **2.5 Payment, Collection and Refund of Tax**

Income Tax Act 2002 has established two major method of collecting tax. One is voluntary payment of tax and another is collection of tax. If a taxpayer voluntarily pays tax within specified time limit, it is known as voluntary payment of tax. If a taxpayer does not pay tax voluntarily within the specified time limit, the tax official collects the tax special effort and it is known as collection of tax.

According to the Act, the tax is to be paid in the form and at the place prescribed by the tax authority. In case a person is required to pay tax at a place as per a notice issued by IRD or IRO, the person has to submit the tax payable to the Inland Revenue Office or recognized bank. Each person is allowed to make the payment of tax in cash within specified limit. But the person is required to pay the tax by cheque or draft in the case above such limit. Generally in practice, the Inland Revenue Office accepts the amount of tax in cash only up to Rs. 10,000.00, so the amount of tax more than Rs. 10,000.00 is to be submitted through cheque or draft to the IRD or through a recognized bank.

### **2.5.1 Voluntary Payment of Tax**

The tax laws have explicitly focused on the voluntary payment of tax. It is the main obligation of the taxpayers that they have to pay tax voluntarily.

#### **A. Payment of tax as Withholding**

Every person who is subject to withhold tax with regard to withholding payment is required to deduct tax at source while making such payment. Such person is known as a withholding agent. The withholding payments encompass certain remuneration payments, certain payment of investment returns such as interest, a natural resource payment, rent, royalty, retirement payment or payment of certain contract. The payments also include service fee such as legal fee, audit fee and other similar fees.

Every withholding agent has to file a statement in the prescribed manner and form to be concerned IRO within 15 days after expiry of the month during which the amount of payments was made by the agent to a withholder.

## **B. Payment of Tax as per Installment Basis**

An individual or an entity having assessable income during an income year from a business or investment is required to pay tax in three installments:

- By the end of Poush:- 40% of estimated tax
- By the end of Chaitra:- 70% of estimated tax
- By the end of Ashad:- 100% of estimated tax

While paying tax in installment, the taxpayer should pay remaining amount after deducting the amount of tax paid earlier. If the amount of calculated installment is less than Rs. 2,000.00, the amount of the installment is not required to be paid.

## **C. Payment of Tax as per the Assessment**

The taxpayers who are under obligation of payment of tax as per self-tax assessment system are required to pay tax along with the submission of income return. In such cases, the time limit for submission of income return is specified up to 3 months after the expiry of income year or extended time up to 3 months. Similarly, in case of tax payable on assessment with respect to jeopardy assessment and amended assessment, the tax should be paid within the time limit specified in the notice of respective assessment.

### **2.5.2 Collection of Tax**

If a taxpayer does not pay tax voluntarily within the due date, the tax official collects the tax outstanding through special efforts. According to the present laws, collection of tax refers to the recovery or realization of tax outstanding through such special effort made by the tax official. The Act has stated the following measures for the recovery of the due amount:

#### **2.5.2.1 Recovery of Tax from person owing money to tax debtor (Sec.85)**

The tax administration may recover due amount of tax from the following person on account of and to the extent of the tax payable by the tax debtor:

- Person owing money to the tax debtor;
- Person holding money for, or on account of tax debtor.



- Person holding money on account of a third person for payment to the tax debtor or
- Person having authority from a third person to pay money to the tax debtor.

A person making a payment to the government will be treated as making the payment to tax debtor. The tax debtor or any other person may not make a claim against the payer with respect to such amount.

#### **2.5.2.2 Departure Prohibition Order (Sec.106)**

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 country Nepal for a period of 72 hours from the time of notice served. If the person pays the tax or makes an arrangement for payment, tax administration may notice in writing served on the office, withdraw the order.

#### **2.5.2.3 Recovery of Tax from Agent of Non-resident (Sec.110)**

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

#### **2.5.2.4 Recovery of Tax from Receiver (Sec.108)**

Receiver refers to:

- A liquidator
- A receiver appointed out of or by court of an assets or equity
- A mortgage
- An administrator or executor or a direct near of a deceased individual estate.
- Any person conducting the affairs of an incapacitated individual.

#### **2.5.2.5 Charge over Assets (Sec.104)**

If the payer is not able to pay tax on or before the due date, the government can create charge over the assets of the tax payers by serving notice to him stating;

- Details of the assets auction;
- The extent of charge (tax payable, interest occurred etc.);
- Any cost of charge an auction;
- If the charge on land and building is taken, the government files application to register the charge the charge Inland Revenue, who shall suspend the sale or transfer of ownership.

#### **2.5.2.6 Legal Action against Unpaid Tax (Sec.111)**

The department can recover the unpaid amount of tax of tax debtor by suing in the competent court.

#### **2.5.3 Remission (Sec. 112)**

If the department is satisfied and certified writing that the tax or interest or penalty cannot be effectively collected, Government of Nepal may remit in whole or part of such amount payable by the person.

#### **2.5.4 Refund and Set Off (Sec.113)**

If the department is satisfied that person has paid tax in excess of his tax liability, the department may apply the excess in reduction of any tax payable but unpaid by the person under the Act and refund the remainder, if any, to the person.

### **2.6 Tax Accounting and Timing**

#### **2.6.1 Method of Tax Accounting**

On the basis of this Act, the determination of when a person derived on income or incurs an expense is made according to the generally accepted accounting principles. In calculating the individual's income from an employment or investment for tax purpose, the accounting should be done on cash basis. A company required to maintain its accounts on an accrual basis within the basic framework of generally accepted accounting

principles. Other entity operating business or having investment may adopt either cash or accrual basis for maintaining its accounts. Similarly, a natural person operating business may adopt either cash or accrual basis for maintaining the accounts. However, it is noted that a person enjoying a facility of selecting tax accounting may select cash or accrual basis unless the department prescribes otherwise by written notice.

#### Application of Tax Accounting

Person	Heads of Income	Tax Accounting
Natural Person	Employment or Investment	Cash Basis
Natural Person	Business	Cash or Accrual Basis
Company	Business or Investment	Accrual Basis
Other Entity	Business or Investment	Cash or Accrual Basis

*Source: Income Tax Act 2002*

#### **2.6.2 Accounting on Cash Basis**

A person who accounts for calculating the income for employment, business or investment on cash basis for tax purpose has to treat an amount as derived and include in income only when payment is received or made available to the person and treat an expenses as incurred and deduct in that calculation only when payment is made.

#### **2.6.3 Accounting on Accrual Basis**

A person who accounts for calculating the income on an accrual basis for the tax purpose has to treat an amount as derived and include in income when the person becomes entitled to the payment. For the purpose of deduction in calculating the income, the following expenses are treated as incurred when the person is obliged to make the payment, the value of the obligation can be determined with reasonable accuracy and the other payment has been received.

In the case of accrual basis accounting, an appropriate adjustment should be made at the time the payment is received or made so as to account for the inaccuracy that may happen in both income and expenditure including by reason of a change in currency valuations. If

a particular timing of payment is chosen in order to defer or reduce the total tax payable, the Department may adjust the time at which the payment is recognized for tax purpose to prevent the deferral or reduction.

## **2.7 Appeal**

Income Tax Act, 2002 has made provision for two types of appeal system: first to the Inland Revenue Department or an administrative and, second is to Revenue Tribunal.

### **2.7.1 Appeal to Director General (Administrative Review)**

Income Tax Act, 2002 has introduced a concept of administrative review that will allow the tax administration to correct mistakes, if any, made by the administration internally. The administrative review may be conducted only on reviewable decisions. In other words, the Director General may review the reviewable decisions made by the tax officers. A person who is not agreeing with the reviewable decision may file an objection to the decision with the Department within 30 days after the decision is made. The objection must be in written form that specifies in detail the cause and the ground upon which it is made. If a person makes an application for extension for time limit as a result of its expiry within a period of 7 days from the expiry, the Department may extend the time limit if there any reasonable cause is shown. The period of extension may be not exceeding 30 days from the date by which an objection must be filed. For purpose of the Act, the administrative review may be conducted on the following decisions:

- Advance ruling issued by IRD.
- An estimate by IRD or the decision to make an estimate of a person's estimated tax payable.
- A decision by IRD to require a person to file a return of income.
- A decision by IRD on an application by a person to extend the due date by which the person must file a return.
- An assessment of income tax payable by a person or determination of the costs of auction of charge assets or interest and penalties payable by a person.
- Notification by IRD of an amount to be set aside by a person as a receiver.
- A decision by IRD to require a person to pay money owing to a tax debtor to IRD.

- A decision by IRD to require a person to pay tax on behalf of a non-resident person.
- A decision by IRD on an application by a person for a refund a tax.
- A decision by IRD on an application by a person for an extension of time within which to file an objection.

The enforcement of a reviewable decision is not affected by the filing of an objection. However, the Department may stay or otherwise affect the enforcement of a reviewable decision until an objection filed by a person is settled. It is noted that in case of application filed for administrative review against an assessment of income tax payable by a person under jeopardy or amended assessment or interest and penalties payable by a person or an assessment of expenses incurred in auction of charged assets of a tax debtor, the person has to deposit 50% of debatable tax and full amount of un-debatable tax.

After consideration of a person's objection filed, the Department may allow or disallow the objection in whole or part. The Department has to provide a written notice of the decision on an objection to the person. If the Department fails to provide the notice of the decisions on an objection within 90 days of an objection filed, the person may treat the objection as disallowed by the Department.

### **2.7.2 Appeal to the Revenue Tribunal**

Section 116 of the ITA, 2002 has specified that a person who is aggrieved by an objection decision may appeal to the Revenue Tribunal in accordance with the Tribunal Act, 2031. If the person has appealed, he/she should file a copy of the notice of appeal with the department within 15 days. However, the operation and enforcement of an objection decision is not stayed or otherwise affected by appeal. If Director General of the Department has made the decision relating to administrative review, the appeal to Revenue Tribunal would be effective.

## **2.8 Penalties, Interest, Offence and Prosecution**

### **2.8.1 Penalty Provisions for Not Complying**

For making a law effective, there should be provision of penalties against various types of offences. It is found from different studies that there is negative relationship between extent of penalty and the tax offence. That is why every law has provision of penalties against different types of offences. Income Tax Act, 2058 is also not an exception. Under this Act, certain penalties and prosecution have been providing to minimize the tax evasion. Such provisions are necessary to increase the number of voluntary compliance. The penalties as prescribed by Income Tax Act, 2058 are divided into two parts namely, fees and interest, and offence & prosecution.

#### **2.8.1.1 Penalty for failure to maintain Documentation or file Statement or Return of Income (Sec.117)**

A person who fails to maintain proper documentation for an income year or file a return for an income year is liable to pay fees for each month and part of a month during which the failure continues. The rate of fees would be as the higher of 0.1 percent per annum on the basis of a person's income, gross of any deduction or Rs. 1000.00 per year, whichever is higher. Accordingly, any withholding agent who fails to file a statement is liable to pay fees for each month and part of a month during which the failure continues.

The rate of fees would be as 1.5 percent per annum applied to the amount of tax required to be withheld from payment made by the agent during the month to which the failure relates.

#### **2.8.1.2 Interest for Understating Estimated Tax Payable (Sec.118)**

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

### **2.8.1.3 Interest for Failure to Pay Tax (Sec.119)**

If a taxpayer fails to pay tax within stipulated time, he is liable to pay interest for each month and part of a month for which any of the tax is outstanding. The rate calculation would be as the standard interest rate, i.e. 15 percent applied to the amount outstanding. For the purpose of calculating the interest payable, any extension granted is ignored. Furthermore, a withholding agent may not recover from a withholder, the interest payable by the agent in respect of a failure to comply.

### **2.8.1.4 Fees for Making false or Misleading Statement (Sec.120)**

A person who makes a statement to the Department that is false or misleading or omits from a statement any manner or a thing, without which the statement is misleading, is liable for a penalty. The rate of fees would be 50 percent of the under payment of tax where the statement or omission is made without reasonable excuse. Accordingly, where the statement or omission is made knowingly or recklessly, 100 percent of the underpayment of tax is to be imposed as fees. Here, fake or misleading statement includes statement in writing to the Department covering an application, notification, return, objection, statement or other documents made, prepared, given or filed under this Act. Same rate of fees is imposed for a misleading or false answer to a question asked to person by the Department or officer or another person with the reasonable knowledge that the statement will be conveyed to the Department or officer or another person.

### **2.8.1.5 Aiding or Abetting (Sec.121)**

A person who knowingly or recklessly aids or abets another person to commit an offence related to failure to comply with this Act, failure to pay tax, makes false or misleading statements or impedes tax administration or counsels or include another person who commit such an offense, is liable for fees. The rate of fees is equal to 100 percent of the under payment of tax that is the Department's view may have resulted if the offence had been committed and had gone unnoticed.

## **2.8.2 Offence and Prosecutions**

### **2.8.2.1 Offence of Failure to Pay Tax (Sec.123)**

Any person who, without reasonable excuse, fails to pay any tax on or before the date on which tax is payable, should commits an offence and is liable on conviction to a fine. The rate of fine in this respect is not less than Rs. 5,000.00 and not more than Rs. 30,000.00, or an imprisonment for a term of not less than one month and not more than three months or both.

### **2.8.2.2 Offence of Making False or Misleading Statement (Sec.124)**

A person who, without reasonable excuse obstructs or attempts to obstruct an authorized officer of the Revenue Department acting in the performance of duties under this Act, fails to comply with a notice or otherwise, impedes or attempts to impede the administration of the Act, commits an offence. In such case, the person is liable to a fine of not less than Rs. 5,000.00 and not more than Rs. 20,000.00 or imprisonment for a term of not more than three months or both. If a person has tried to commit such offence but not succeeded, is liable to face the penalty equivalent to the half of the penalty imposed on the person who has committed such offence.

### **2.8.2.3 Offences by Authorized and Unauthorized Person (Sec.126)**

If an unauthorized officer of the Revenue Department performing his duty under Income Tax Act 2058, collects or attempts to collect an amount of tax payable under this Act or an amount that the person describes as such tax commits an offence, he is liable to a fine. The provision of fine in this case are a fine of not less than Rs.80,000.00 and not more than Rs. 2,40,000.00 and imprisonment for an term not exceeding one year, or both.

### **2.8.2.4 Offence of Aiding or Abetting (Sec.127)**

Any person who knowingly or recklessly aids or abets another person to commit an offence under this Act or counsels or induces to commit such an offence is liable to a fine equivalent to the half of the penalty to be imposed on the person who commits the offence. However, if the person inducing to aid or abet is a government employee, he will



commit the offence, and is liable to a fine equivalent to the penalty imposed on the person who commits the offence.

#### **2.8.2.5 Offence of Failure to Comply with Act (Sec.128)**

Any person who fails to fulfill with any provision of this Act commits an offence and is liable to a fine of not less than Rs. 5,000.00 and not more than Rs.30,000.00.

#### **2.8.2.6 Compounding Offences (Sec.129)**

If any person commits an offence at any time prior to the commencement of Court proceedings, the Inland Revenue Department may compound the offence and order the person to pay a sum of money specified by the Department. However, such compounding will not happen in case related to offence of abetting or aiding (Kandel, 2004).

### **2.9 Studies in Related Field**

Various Books and Articles are published by different individual and institutions in concerning to income tax conduct researches. Most of them are concentrated on historical backgrounds, administrative problem, legal aspects & trends of income tax. Some of the books, articles and dissertations that are reviewed during this study are as follows.

#### **2.9.1 Review from Books**

Khadka, R.B. (1994) has described about national and local taxes and tax administration in Nepal in his study titled "Nepalese Taxation: A Path for Reform". The study mainly focuses on the process by which the Nepalese tax system was adopted and developed. He examined the structure and operation of the Nepalese tax system of that period in more detail. He has covered existing major problem of income tax possible direction for reform. The major problems are as follows; unscientific tax assessment and collection, narrow tax coverage, weak tax administration, imbalance and inadequate organizational structure, inadequate tax training programs, lack of information on tax system. His possible direction for reform was extension of tax coverage, improvement in tax assessment, extension withholding tax, inflation adjustment etc. He has also identified some possible direction for administration reform. They were reorganization and

expansion, research until on taxation. His book is very useful to know about various aspect of income tax in Nepal. He has not any numerical illustrations and has not mentioned the legal provision relating to income tax.

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

Dhakal, K.D. (2002) published a revised education book entitled "Income tax, House & Compound Tax law and Practice with Vat". This book was extremely based on the syllabus of B.B.S. third year and M.B.S. second year as prescribed by Tribhuvan University. He has described about historical aspect and the legal provision relating to income tax with numerical examples. This book is more helpful to know about general information and provisions made under ITA, 2031. His book is informative rather than analytical. This book has not analyzed the role of income tax, structure of income tax and defects and problem of income tax system of Nepal.

Adhikari, B.D. (2002) published a book entitled "Income Tax Law: Now & Then". He has discussed the legal provision relating to ITA, 2058 with critical analysis. He has also included the decision made by Supreme Court of different case relating to income tax. This book has only focused on the legal aspect of income tax. Agreement and protocol in relation to avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income between different countries had also included in his book. His book is informative rather than analytical.

Mallik, V.D. (2003) published a book entitled "Nepal ko Adhunik Ayakar Pranali". He has described the legal provision relating to Income Tax Act 2058 in detail. He has also described historical prospects, weakness of Income Tax Act, 2031, some practical

problem and different section of Income Tax Act, 2058. He has also discussed the need and importance of modern income tax. His book is divided into twenty six chapters with eight annexes. Although he presented the new Income Tax Act, 2058 with some numerical examples, he has not mentioned the role of income tax structure.

Kandel, P.R. (2004) wrote and published a book entitled "Tax Laws and Tax Planning in Nepal". He has described the meaning, objective and historical development of income tax in Nepal, and other provision relating to Income Tax Act, 2058 like calculation of income, exemption amounts, deductions, capital profit, dividend, interest on retirement saving and tax etc. He has also focused the tax planning with scope and significance of tax planning under Income Tax Act, 2058. The process, provision and methods of income tax assessment have been illustrated with numerical example.

Amatya, S.K., Sapkota, P.P. & Thapa, K.B. (2013) published a book entitled "Taxation in Nepal". They have described about the legal provision relating to Income Tax Act, 2058 with numerical examples. Their book is very useful to know the general information of income tax and it is also informative and analytical. This is extremely based on the syllabus of B.B.S. third year and M.B.S. second year as prescribed by Tribhuvan University.

Bhattarai, I and Koirala, G.P. (2009) published a book named "Taxation in Nepal with Tax Laws & Tax Planning". They have described about the meaning, objectives and historical development of income tax in Nepal. This book is extremely based on M.B.S. second year syllabus as prescribed by the Tribhuvan University and Chartered Accountancy Course. They have also focused the tax planning with scope and significance for tax planning under Income Tax Act, 2058.

Aryal, K.P. and Poudyal, S.P. (2011) published a book entitled "Taxation in Nepal with Tax and Tax Planning". They have described the theoretical and practical aspect of income tax and VAT. This book is extremely based on B.B.S. third year syllabus as prescribed by Tribhuvan University. This is very useful to get knowledge about Income

Tax Act, 2058, although it is unable to describe the tax structure of Nepal and the problem of income tax system.

### **2.9.2 Review from Thesis Reports**

Thapa, R.B. (1993) has examined the income tax assessment procedures, the problem of growing fiscal deficit, administrative aspect of income tax, reason of poor tax morality and tax payer's compliance, legal provision concerning income tax assessment procedure and also reviewed the legal provisions relating to income tax assessment procedure prevailing in SAARC countries. His major findings are as follows:

- Adhocism in tax personnel
- Lack of adequate information about tax payers
- Negligence by tax officers.
- Administrative harassment and complicated procedure due to complex tax laws.

He has conducted opinion survey of income assessment procedure. He has suggested following solutions:

- Tax payers' assistance, guidance and counseling service should be provided.
- Incentives to regular tax payers should be provided every year.
- Capital gain should be taxed.
- Granting tax holiday to new industries as investment allowances and agriculture income should be taxed

But he has not identified the other aspect of income tax clearly. Since he has described about income tax and related topics under Income Tax Act, 2031, they are not fully relevant today.

Kharel, S.K. (1996) prepared a thesis entitled "Self Tax Assessment under income tax act in Nepal". His has studied with basic objectives review of tax laws about self tax assessment, analyzed the problems faced by the tax payers while doing the self tax assessment of their own income. In his study, he has identified that tax administration is not effective due to lack of skill of tax personnel, lack of meaningful taxpayer's

information and lack of knowledge about tax assessment procedure to the tax payers. He has suggested that self tax assessment procedure should be simplified; incentives and rewards to regular tax payer, timely assessment of tax, adoption of scientific accounting system and self tax assessment system should be imposed compulsory to all types of tax payers. There have been considerable changes in income tax since his study, and his study is based on Income Tax Act, 2031.

Shreshta, B. (2001) has described the historical background, conceptual framework and legal provisions, structure of income tax in Nepal, income tax administration in Nepal, an empirical investigation and problem of income tax in Nepal. Her findings are that there is dominant share of tax revenue in Nepalese government. But the contribution of tax revenue shows the decreasing trends. The tax/GDP ratio is not finding satisfactory with compare to other SAARC countries. There is serious and growing financial resource gap problem in Nepal seems to be never ending problems for Nepalese economy. There is dominant role of indirect tax revenue in Nepalese tax revenue.

The estimation and collection of income tax seems to be satisfactory as the collection has been 106.75% of estimation in 1989/99. She has also found various problem of income tax system in Nepal. There are narrow tax coverage, mass poverty of Nepalese people, lack of consciousness of taxpayer, widespread evasion and avoidance of income tax, unscientific tax assessment procedure, inefficient tax administration, complicated tax laws and procedures, instability in government policy.

Her recommendations are to broaden the Nepalese income tax base by bringing agricultural income, capital gain and other sources of income under the income tax net. For the success of Nepalese income tax system, emphasis should be given highly to income tax policies, law and administration. Income tax policy should be formulated according to the economic policy of the country. Income tax laws should be simplified for the purpose of facilitating compliance and endorsement. Self assessment system should be encouraged increasing the voluntary compliance by tax payer. Continuous effort should be done by tax authority in order to develop the taxpayer's positive attitude towards taxation. Her suggestions for minimizing tax evasion are; control illegal business

activities, enforce proper auditing and investigation. He has not taken any investigation about the provision of fine and penalties and future prospects of income tax.

Singh, B.K. (2002) has described the brief on application of best judgment on income tax assessment with reference to Income Tax Act, 2031. He has described the types of assessment; use of best judgment in income tax assessment, types of best judgment assessment, necessary conditions for best judgment assessment, natural justice and best judgment, punishment, legal remedies, role of best judgment assessment in income tax assessment in Nepal He has also conducted an opinion survey about the best judgment assessment.

He has found that the income tax assessment in Nepal was mainly performed by committee above 70% of the total income tax assessment was occupied by committee assessment. Best judgment assessment has occupied second position i.e. 18.36% in 1997/98. The most appropriate and reliable method of income tax assessment was on the basis of account. But in Nepal, very few income tax assessments were performed on the basis of accounts that were only 3.98% in 1999/00. The assessment procedure is often delayed in Nepal. One of the major reasons behind the application of best judgment is taxpayer's tendency to evade or avoid the incidence of tax. Complexity in tax laws and administrative incompetence are other two major parameters of best judgment assessment.

He has found the major factors which are responsible for making best judgment assessment unsatisfactory. They were; lack of clear provision in income tax, lack of knowledge of tax rules and regulation to the tax payers and tax personnel, tendency of corruption, wrong utilization of power by tax officers and interruption from outsiders.

He has suggested that income tax should be assessed on the basis of accounts, supervisor committee should be established for the review of tax assessment, compulsory provision of submitting income statement within due dates, the time of assessment in general condition should be reduced to 3 month from one year, the provision of auditing of

account should be made compulsory, reward and punishment system should be really and strictly implemented in practice, and integrated information should be developed. He had more emphasized on study of application of best judgment assessment, although, he has not mentioned legal provision relating to income tax and tax structure of Nepal.

Magar, D.B.P. (2003) has described the role & structure of income tax, exemptions & deductions provided in the law. He has identified that there was dominated share of tax structure in Nepalese government revenue. Income Tax has occupied third position in his study period and it has increasing trend. The tax/GDP ratio was not found satisfactory. With the income tax, there was the dominated role of corporate income tax, but it was in decreasing trend and contribution of individual income tax was in second position and it was in increasing trend. He has also found that lack of trained employees, shortage of income tax experts/professional in tax administration, lack of public participation, weakness in government policy, defective Income Tax Act were the major causes of inefficient tax administration.

He has suggested that exemption limit should be increased, double taxation should be eliminated on dividend, and income tax rate slab should be increased. Besides above suggestion, his suggestion about deduction were clear provisions for deduction, fully allowed interest expenses, pollution control expenses, repair & improvement expenses, research & development expenses.

Gautam, K.R. (2004) has described about contribution of income tax to national revenue of Nepal. He has mainly focused about conceptual framework, legal provision and structure of income tax. He has conducted an empirical investigation about various aspects of income tax in Nepal. He has taken 60 persons as a sample as tax experts, tax payers, and tax administrators.

He has found out that the contribution of direct and indirect tax revenue were 20.63% and 79.40% respectively in 2002/03. Income tax revenue has occupied third position on the basis of mean contribution among other sources of revenue; the contribution of income

tax to total revenue was 8.84%. It may enhance the revenue of government, promote to distribute justice and encourage private system investment. Nepalese government expenditure is increasing at the faster rate than increasing in revenue, the resource gap has existed in Nepalese economy and it is in increasing trend, tax/GDP ratio of Nepal is found satisfactory, the exemption limit is not satisfactory. He has made the specific promotion for a sound and effective income tax system. They were establishment of promotion and reward system to efficient and honest tax personnel, increase public participation to minimize the tax evasion, strict action against corruption, income tax rules and regulation should be clear and simple to understand by general tax payers, the provision of fines, penalties and punishment should be made at higher rate for income tax evaders, more deduction should be provided for export promotion and separate income tax department should be established.

Bhandari, D.R. (2006) has described about various aspect of income tax. This study emphasized the role, importance and problems of income tax. He also mentions that income tax is additional domestic sources of resource mobilization and factor for the increment of taxpaying habit of Nepalese people.

Pokhrel, S.K. (2009) has examined various factors presenting in the income tax. He has described about the contribution to the government revenue, role of income tax in Nepal, income tax structure, income tax rate, exemption limit etc. He has identified that the delay in assessment and high level of tax evasion are the major problem of Nepalese income tax system. There is high use of best judgment assessment method, no compulsion to maintain books of accounts and auditing of accounts of all type of business, ineffective use of fines and penalties. He has suggested for honest and efficient administration, research unit in tax office, penalties for tax payers who do not maintain accounts, the time limit for assessment should be reduced.

Baidawal, K.B. (2009) has described the effectiveness of income tax system in Nepal. He found that the composition of tax and non tax revenue is still less satisfactory in Nepal. He also found that total revenue, total tax revenue and direct tax revenue have an



increasing trend in Nepal but in low rate. He has mentioned that tax evasion as the major problem of income tax system in Nepal. In his study, inefficient tax administration unconsciousness of tax payer, lack of scientific method of tax assessment and collection are identified as the major reasons for tax evasion at high level. He has not mentioned the legal provision relating to income tax & numerical examples.

Yadav,S.K. (2009) has studied income tax and presented a dissertation "A study on income tax contribution to government revenue in Nepal". In his study, he mentioned growing resource gap problem in Nepalese fiscal system. He emphasized to mobilize additional resource through income tax system to release this resource gap. The legal aspect and problems of income tax are also shown in his study but other aspects like evasion, exemption, income tax assessment have not been discussed.

Sapkota, U. (2010) has critically examined the resources mobilization through income tax. His study has been conducted with purpose of examining role of income tax in overall tax structure, analyzing the problem and prospects of income tax in Nepal and highlights the future prospective of the Nepalese income tax.

Adhikari, K.P. (2011) has mainly concentrated his study on the income tax assessment and its procedures. He has described about the income tax, contribution of income tax, assessment methods, self tax assessment methods, tax administration, income tax provisions, rules and regulation, acts and laws, and satisfaction level of income tax to national revenue in Nepal. He has also conducted opinion survey found that:

- Due to lack of education about tax, tax collection is not that much satisfactory, so tax education must be provided to the tax payers.
- Tax evasion has become the major problem in Nepal. So, proper recording systems, meaningful information about tax payers, and effective tax administration should be managed.
- Provisions in acts and rules are not simple to understand by general tax payers, therefore, that should be simplified in simple and clear language.

- Income tax policy is not effectively, so, effective tax policies should be formulated by the team of tax experts.
- To collect more tax revenue, customer service is the most important aspect which should be improved by the tax administration.
- Tax assessment procedures should be clear so that tax payers easily understand and follow it.

### **2.9.3 Review form Reports and Articles**

Lent (1968) has critically analyzed the income tax rate structure for individual and company. He has suggested that increment in personal income tax rate at lower taxable income and reduction of rate at intermediate income bracket are desirable.

Agrawal (1978) has presented a report "Resource mobilization for development and reform of income tax in Nepal". It has mainly dealt with necessity of resource mobilization in Nepal through income tax. It showed the growing resource gap since the fiscal year 1951/52 onward and sought the way of filling it up. The main reason for this resource gap has been the lop-sided growth of government expenditure as compared to revenue generation from domestic sources. He has also discussed about the historical background of income tax, legal administrative aspects and role of income tax in Nepal. He also calculated the elasticity and buoyancy of major Nepalese taxes with base GDP, using the double log linear mode.

Agrawal (1984) gave his second contribution towards income taxation. He has explained in details about resource mobilization through income in Nepal, role of income tax, administrative and legal aspect of income tax in Nepal. He has pointed out some problems about Nepalese income tax system they are as follows:

- Tax officers did not like to make assessment on the basis of account whereas the tax payers did not like to prepare account for income tax purpose.
- Non-gazette officers seem to have working for quite a number of years without being transferred.

- There has been no significant increase in the number of income taxpayers despite substantial increase in business activities.

To solve the above problems in income tax, his suggestions were:

- Income tax of small taxpayers should be assessed door to door basis.
- The coverage of income taxpayers should be increased.
- Transfer of non-gazette officers should be made in every three years.

In additions to these, he also suggested for:

- Self assessment by taxpayers
- Effective taxpayer's information system to be developed.
- Exemption limit of income tax to be tied up with the cost of living index.
- Additional deduction for the education of two children and medical expenses.
- Political and undesirable pressure in tax administration should be minimized.
- Capital gain should be included under income for the purpose of income tax.

Ghimire (1993) has described the classification of tax, base of income tax or expenditure tax, base of tax in Nepal, procedure of computing net income, classification of tax rate, index of income tax in Nepal, contribution of tax income to national revenue, errors of past provisions, some steps of administrative improvement etc. He found that the tax covered very low portion of total revenue base of no taxation in agriculture income, narrow base of income of retail business, high exemption limit on remuneration income etc. He has also noticed some errors of provisions relating to income tax. They were; progressive tax has not played an effective role for equal distribution of income, unproductive tax concession holiday and rebate, provision of low additional fee as compare to market interest rate etc. He has suggested that some administrative improvement were; provision of income assessment committee, flat rate of tax to small taxpayers, established of tax office.

Revenue Consultation (2001) report has studied the overall taxation situation in depth. It highly emphasized to simplify the tax policy to increase voluntary compliance. This

report recommended for written communication between taxpayers and tax administration rather than the informal relation. This report suggested to widen the income tax base by including all kinds of taxpayers and income and to find out the taxpayers of new sector. For this, the report suggested to make the act more transparent and clear in order to attract foreign and domestic investors. It was further suggested to increase income tax exemption limit with considering purchasing power and inflation rate.

Adhikari (2001) described the need of tax policy that plays a vital role in the whole fiscal policy. He further said that the little attention on tax administration has minimized the role of tax policy. He has presented the issue in Nepalese tax administration. Such issues are: tax structure, major sector of income tax, trend and growth of income tax. He has accepted that Nepalese income tax system is waiting for a comprehensive and integrated taxation plan and a scientific implementation of the same by way of reform.

In his study Adhikari explained the types of income tax gap, which are investigation and identification gap, return filling gap, assessment and collection gap. He tried to declare the mission, vision and activities of internal revenue department. He suggests, achieving all the practical purpose, objectives and goals, tax administration should be regarded as an important component of tax policy.

Kandel (2002) has criticized the Income Tax Act, 2002 in several grounds. Exemption of agriculture income from income tax, export duties levied on export, inequality between different capitals earned income (i.e. tax on investment, dividend and capital gain), withdrawal of provision of exemption on export goods and services, suddenly and no adjustment for inflation are the major issues, has rose in his article.

Thapa (2002) has described the tax system, features of tax, and causes of reform the tax. He has characterized the tax system as too many and too high rates, multiple objectives of taxes scheduler rather global approach to income taxation, too many income brackets and high progressively, complicated and ambiguous tax law. He has identified the areas of

reform tax system in Nepal. There were: low rates on broad base, simplicity and neutrality, gradual abolition of exemptions, deduction and tax holidays to broad tax base, few rates or single rate, few taxes with high revenue productivity, emphasis on the compliance rather than coercive, incentive to saving and investment, conversion of sales and service taxes into VAT, excise duties, only cigarette, tobacco, alcohol, automobiles, petroleum and automobiles spare parts, abolition of surcharge and additional duty system or make the tax system simple, making the tax system internationally compatible or attract foreign investment.

Pant (2004) has described the problem arise in tax administration and reform in Nepal. He has identified the following problems on tax administration.

- Low amount record in transaction.
- Low amount record in sales.
- Unhelpful in tax auditing by assesses.
- Lack of clear provision of tax law complicated in implementation.
- License revenue without tax clearance.
- Ineffective reward punishment system.
- Lack of the mobilization of experience personnel.
- Lack of effective coordination between Inland Revenue Office and Revenue Research Unit.

He has suggested the following points to reform above problems.

- Data and information system should be managed systematically.
- Coordination should be made between different offices of government of Nepal and Inland Revenue Department.
- Legal provision should be made simple and clear.
- Time duration should be limited in tax auditing.

Khadka (2003) has described about the revenue administration reform in Nepal at present context. He suggested the following points:

- Integration of Value Added Tax and tax.

- Functional organization structure should be made.
- Tax administration should follow the system of government.
- Transparency should be made in work.
- Provision should be made in grievance handling.
- Develop the scientific performance evaluation system.
- Increase convenience to tax payers and tax administrators.
- Change in attitude and working style.

In the above review of books, reports, thesis, and articles published in journal and newspaper, it is observed that most of their study has focused on tax administrative, income tax system, assessment procedures, and structure of tax in Nepal. Some of them have discussed about income tax, provisions, acts and rules, and income tax laws. Some of them have focused their study on the syllabus of the master degree. Most of the research studies have identified the major issues of Nepalese income tax system like tax evasion, ineffective tax administration, lack of proper recording system, lack of proper auditing system, lack of tax education, and lack of clear provision of law. It is also identified that by making tax administration effective, most of the problems can be solved promptly. There are few research studies concentrated on the income tax assessment system and its procedures which play an important role in income tax collection in Nepal. Therefore, finding a lack of study in income tax assessment procedure, this study has focused on the income tax assessment procedures in a more specific way.

## **CHAPTER-III**

### **RESEARCH METHODOLOGY**

This chapter is dedicated to research methodology applied in the study for the achievement of desired objectives.

#### **3.1 Types of Research**

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

#### **3.2 Research Design**

To achieve the above stated objectives of the study, the opinion of the various 60 respondents associated with distinct denomination i.e. tax administrators (officers), auditors (registered auditors and chartered accountant), tax experts (except RA & CA, lawyers working in corporate tax ) and tax payers have been collected through structured questionnaire. The questionnaire covers the role of income tax to national revenue, provision of fine and penalty, effectiveness of income tax assessment system, important factors for the effectiveness of income tax in Nepal, income tax administration in Nepal etc. Similarly, various information published by organization about income tax, are used for this study. In this way, the research designs of this study are descriptive, analytical and empirical.

#### **3.3 Population and Sampling**

To achieve the objectives of the study 60 samples from Kathmandu, Hetauda and Itahari is selected. Persons covering this sampling have been selected carefully. The respondents are categorized into four groups like income tax administrators, auditors, tax experts and tax payers respectively.

Table 3.1  
Group of Respondents and Size of Sample

S.N.	Group of Respondents	Size of Sample
1	Group of Tax Administrators	15
2	Group of Tax Experts	15
3	Group of Auditors	15
4	Group of Tax Payers	15
Total		60

### **3.4 Nature and Sources of Data**

Primary and secondary sources of data have been collected in order to achieve the real and factual result for this research. The collection is done in accordance with the availability and usefulness of data during this study. Main sources of data as follows:

#### **A. Primary Sources of Data**

The primary sources of data are collected in accordance with the responses received from the questionnaire survey. The questionnaire is distributed to four categories of respondents which are tax administrator, auditors, tax experts and tax payers. Tax administrators are selected from the various sectors of Inland Revenue Department and offices. Auditors are selected among registered and chartered accountant. Tax experts are selected from the lecturers of Tribhuvan University, Trainer of Revenue Administration Training Centre, and the academic persons having well knowledge of income tax. And last but not the least, tax payers are selected from different sectors like manufacturing, trading, banking, airlines, department stores and professional fields like doctor, engineer, professors etc.

#### **B. Secondary Sources of Data**

The secondary sources of data will cover the following subject:

- Budget Speech and Economic Survey up to 2010/11 fiscal year, Ministry of Finance, Nepal.



- Annual Reports of Inland Revenue Department, Nepal.
- Dissertation related to income tax.
- Books related to income tax and public finance.
- Websites related to income tax like [www.ird.gov.np](http://www.ird.gov.np) of IRD Office.
- Various magazines, newspapers and journal relating to income tax.
- Other relevant records and data related to this study.

### **3.5 Date Collection Procedure**

The data of this study is collected from two sources. Primary data are collected by using questionnaire. First of all questionnaire is developed and distribution is done through personally field visit. Secondary data are collected from published reports of different organization.

### **3.6 Data Processing and Analyzing Procedure**

The data that are collected through primary as well as secondary sources are first processed for tabulation. Data is tabulated into various tables according to the subjects in order. Then it is presented and analyzed in descriptive way using suitable statistical tools.

The statistical tools used for the analysis are as follows:

- Simple percentage
- Simple average
- Graphs, Charts & Diagrams
- Other statistical and financial tools etc.

## **CHAPTER-IV**

### **PRESENTATION AND ANALYSIS OF DATA**

#### **4.1 Nepalese Government Revenue Structure**

Government revenue includes income taxes; value added tax, rental tax, custom duty, land tax, registration fees, fines, forfeiture, royalties etc. which is called public revenue. It has been divided into two groups.

- Tax Revenue
- Non-tax Revenue

In general, Tax is the compulsory contribution to the government which has to be paid by the people. Tax is the main source of income of the government. Due to lack of internal resources, Nepal has to depend on foreign aid which contributes raising government revenue. Tax revenue includes compulsory, unrequited, non-payable receipts collected by government for public purposes. It includes interest collected on tax arrears and penalties collected on non-payment or late payment of taxes. Tax revenue is the principal sources of government revenue however its contribution differs significantly in different countries. In the context of Nepalese economy tax revenue is major source of government to mobilize internal sources effectively and properly as it has been dominating the government revenue by contributing around three quarters of total revenue.

Following table shows the overall view of the total revenue of different fiscal year.

Table 4.1  
Composition of Total Revenue

(Rs. In Ten Million)

Fiscal Year	Total Revenue	Revenue		% on Total Revenue	
		Tax Revenue	Non-tax Revenue	% of Tax Revenue	% of Non-tax Revenue
2001/02	5044.66	3933.06	1111.60	77.96	22.04
2002/03	5453.89	4089.60	1364.27	74.99	25.01
2003/04	6233.10	4817.30	1415.80	77.29	22.71
2004/05	7012.27	5410.47	1601.80	77.16	22.84
2005/06	7228.19	5743.04	1485.16	79.45	20.55
2006/07	8771.21	7112.67	1658.55	81.09	18.91
2007/08	10762.25	8515.55	2246.70	79.12	20.88
2008/09	14347.45	11705.19	2642.26	81.58	18.42
2009/10	17994.58	15629.49	2365.09	86.86	13.14
2010/11	19837.63	17277.79	2559.84	87.10	12.90

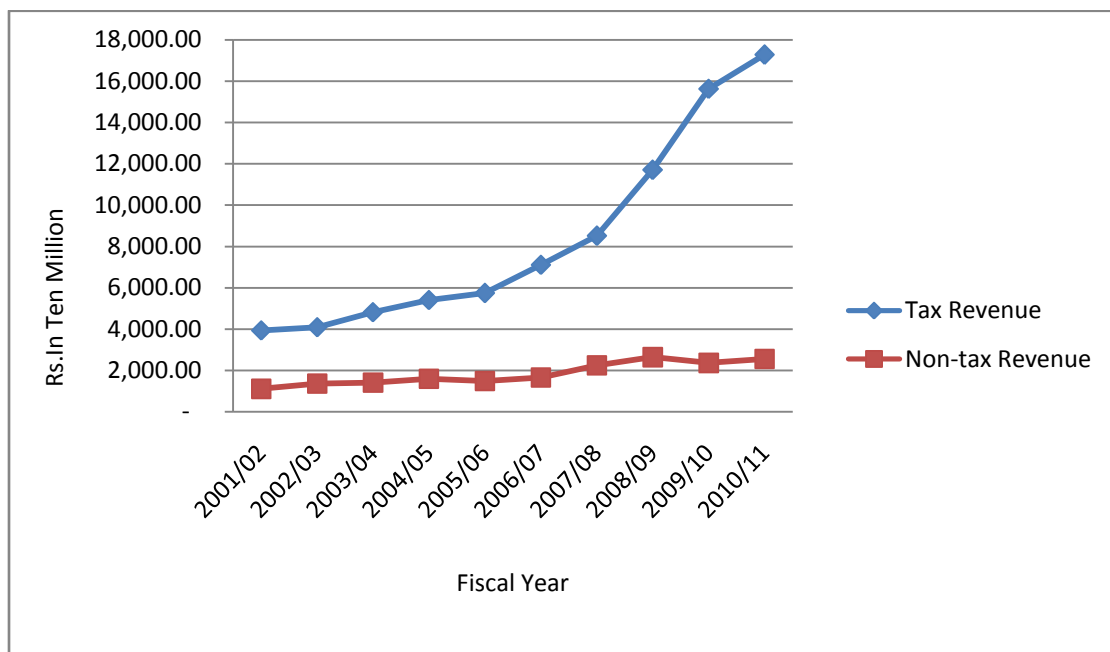
*Source: Economic Survey, 2009/10 and 49th Annual Report of Auditor General, 2010/11*

The trend of tax revenue collection has been increasing during the period selected for the study (fiscal year 2001/02 to 2010/11) like Rs. 3933.06 to Rs. 17277.79 (Ten Million). Non-tax revenue collection has increased from fiscal year 2001/02 to 2004/05 and has decreased in the fiscal year 2005/06 by Rs. 116.64 as compared to the fiscal year 2004/05. From the year 2006/07 to 2008/09 it has increased from Rs. 1658.55 to Rs. 2642.26 but decreased to Rs. 2365.09 in the year 2009/10 and has increased to Rs. 2559.84 in the year 2010/11. The percentage contribution of tax revenue has been in increasing trend but non-tax revenue has been in fluctuation till 2007/08 and then started decreasing continuously. The share of tax revenue has always been greater than the share of non-tax revenue.

Composition of total revenue of Nepal from the fiscal year 2001/02 to 2010/11 is shown in the figure 4.1 below.

Figure 4.1

Composition of Total Revenue



#### 4.2 Resource Gap in Nepal

It is very clear that every government has to perform numerous functions for the betterment of the people in the country. A government needs huge volume of income to fulfill various types of expenditure. For this purpose government collects revenue from different sources like tax, borrowing, fees, donation etc. Nepal is facing serious resource gap problem in the finance from the beginning on the development phase to the present time. A large amount of external aid, loan and internal loan was borrowed to fulfill this growing resource gap. But scarcity seems to be never ending problem for Nepal. The resource mobilization is still poor that does not cover the total expenditure. Fiscal deficit is growing because expenditure is more than the revenue. By this reason, Nepal is facing the increasing burden of foreign loan widening trend of the resource gap is shown in the table below.

Table 4.2  
Resource Gap in Nepal

(Rs. In Ten Million)

Fiscal Year	Total Expenditure (A)	Total Revenue (B)	Resource Gap (A-B)	Foreign Grant (C)	Resource Gap (A-B-C)	Foreign Loan (D)	Resource Gap (A-B-C-D)
2001/02	8007.22	5044.66	2962.56	668.61	2293.95	769.87	1524.08
2002/03	8400.61	5453.89	2946.72	1133.91	1812.81	454.64	1358.17
2003/04	8944.26	6233.10	2711.16	1128.34	1582.82	762.90	819.92
2004/05	10256.04	7012.27	3243.77	1439.12	1804.65	925.61	879.04
2005/06	11088.92	7228.19	3860.73	1382.75	2477.98	821.43	1656.55
2006/07	13360.46	8771.21	4589.25	1580.08	3009.17	1005.35	2003.82
2007/08	16134.99	10762.25	5372.74	2032.07	3340.67	897.99	2442.68
2008/09	21966.20	14347.45	7618.75	2638.28	4980.47	996.89	3983.58
2009/10	25968.91	17994.58	7974.33	3854.59	4119.74	1122.34	2997.40
2010/11	29536.34	19837.63	9698.71	4592.22	5106.49	1207.56	3898.93

*Source: Economic Survey, 2009/10 and 49th Annual Report of Auditor General, 2010/11*

As shown in the above table, resource gap in 2001/02 was Rs. 1524.08 (Ten Million) and it was decreasing till to the year 2003/04. In 2003/04 it was decreased by Rs. 704.16 as compared to the year 2001/02. From the year 2004/05 it was increasing from Rs. 879.04 to Rs. 3983.58 in the year 2008/09. It was increased by Rs. 3104.54 which is very serious for the country. It was decreased in the year 2009/10 but increased in the year 2010/11. From the above tabulated data, we can clearly point out that the resource gap problem has been becoming serious problem for our country and it will harm our economic system if it is not controlled.

### 4.3 Composition of Tax Revenue Structure in Nepal

Tax is a compulsory payment to the government imposed by a public authority of a country. Tax revenue is the major source of government revenue however its contribution differs significantly in different countries. In the context of Nepalese economy tax revenue is the major source to mobilize internal resource effectively and properly as it

has been dominating the government revenue by contributing around 80% of total revenue. On the basis of form, the classifications of taxation are

- Direct Tax
- Indirect Tax

In developing country like Nepal indirect tax is considered as principal sources for a complete solution of estimated tax revenue because of lower per capital income. So the contribution of indirect tax is higher than the contribution of direct tax. The trend and composition of tax revenue for 10 years is presented in the table below.

Table 4.3

Trend and Composition of Tax Revenue

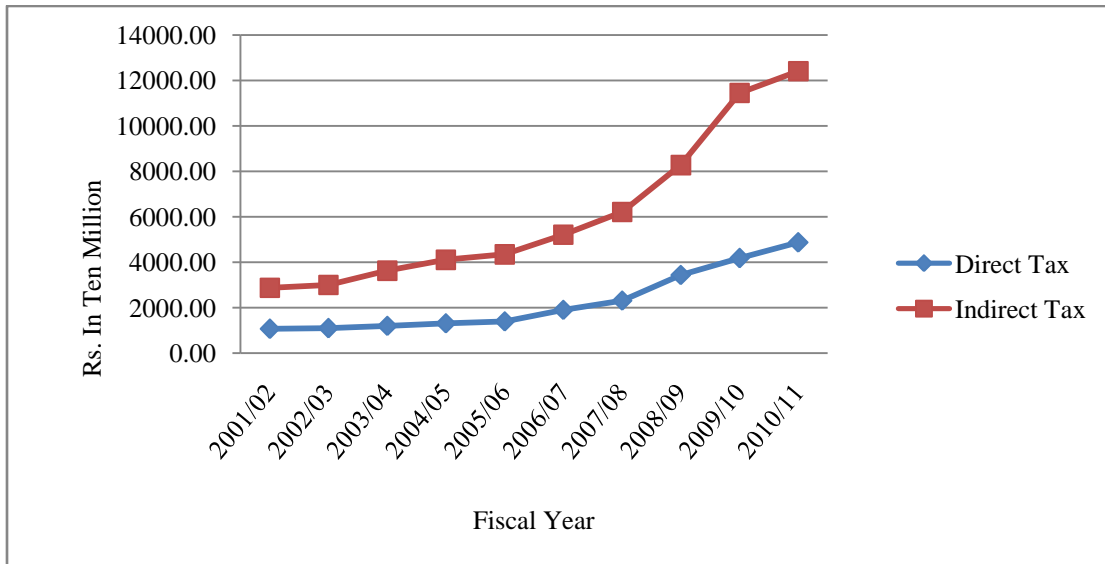
Fiscal Year	Total Revenue	Tax Revenue		% of Total Tax Revenue	
		Direct Tax	Indirect Tax	% of Direct Tax Revenue	% of Indirect Tax Revenue
2001/02	3932.18	1059.75	2872.43	26.95	73.05
2002/03	4089.60	1088.19	3001.41	26.61	73.39
2003/04	4817.30	1191.26	3626.04	24.73	75.27
2004/05	5410.47	1307.18	4103.29	24.16	75.84
2005/06	5743.04	1396.81	4346.23	24.32	75.68
2006/07	7112.67	1898.03	5214.64	26.69	73.31
2007/08	8515.54	2308.77	6206.77	27.11	72.89
2008/09	11705.19	3432.07	8273.12	29.32	70.68
2009/10	15629.49	4175.00	11454.49	26.71	73.29
2010/11	17277.79	4865.53	12412.26	28.16	71.84

*Source: Economic Survey, 2009/10 and 49th Annual Report of Auditor General, 2010/11*

In the above table, the trend and also in absolute value of total tax revenue, direct tax and indirect tax has been in increasing trend. Direct tax includes land revenue tax, house and land registration tax, income tax, urban house and land registration tax, vehicle tax, tax on interest and other taxes. Likewise indirect tax includes customs, excise on industrial products, VAT and other taxes. In Nepalese tax revenue share of indirect tax is larger than the direct taxes; the average contribution of direct tax in total tax revenue is 26.95% to 28.16%

Figure 4.2

Composition of Tax Revenue



In comparison to these developed countries like UK, USA, Japan etc. contribution of direct taxes in Nepal is very low. Being an undeveloped country most of the Nepalese people live in the level of subsistence and all of their income is spent on consumption; this could be a reason that direct tax is not producing more revenue than indirect tax. The amount of direct tax in 2001/02 is Rs. 1059.75 (Ten Million) with 26.95% of total revenue. It is highest in percentage contribution in the year 2008/09 but not satisfactory in comparison with indirect tax contribution to total revenue. The percentage contribution of indirect tax revenue is 73.05% of total tax revenue in the year 2001/02 and it is highest with 75.84% in the year 2004/05. The trend of indirect tax is also decreasing gradually.

#### 4.4 Composition of Direct Tax Revenue

Direct tax is such tax which is paid by the person on whom it is legally imposed. It is collected by the government by the person who bears the tax burden directly. This kind of tax is levied on income and property of the person which is increased in course of employment, investment and business activities. In Nepalese tax structure the major component of direct tax are income tax, urban house and land tax, vehicle tax, tax on interest.

Table 4.4

## Composition of Direct Tax Revenue

(Rs. In Ten Million)

Fiscal Year	Total Direct Tax	Land Revenue & Registration				Tax on Property, Profit and Income					
		Land Tax	House & Land Reg. Tax	Total	% of Total Direct Tax	Income Tax	Urban House & Land Tax	Vehicle Tax	Other Tax	Total	% of Total Direct Tax
2001/02	1059.75	0.08	113.10	113.18	10.68	890.37	0.23	55.97	0.00	946.57	89.32
2002/03	1088.19	0.00	60.78	60.78	5.59	967.58	0.29	42.96	16.58	1027.41	94.41
2003/04	1191.26	0.00	169.75	169.75	14.25	924.59	0.00	70.06	26.86	1021.51	85.75
2004/05	1307.15	0.00	179.92	179.92	13.76	1015.94	0.00	80.62	30.67	1127.23	86.24
2005/06	1396.81	0.00	218.11	218.11	15.61	1037.37	0.00	84.76	56.57	1178.70	84.39
2006/07	1898.03	0.00	225.35	225.35	11.87	1503.40	0.00	99.50	69.78	1672.68	88.13
2007/08	2308.77	0.00	294.07	294.07	12.74	1731.12	0.00	106.92	176.66	2014.70	87.26
2008/09	3432.07	0.00	522.33	522.33	15.22	2514.24	0.00	185.00	210.50	2909.74	84.78
2009/10	4175.00	0.00	551.11	551.11	13.20	3128.56	0.00	241.79	253.54	3623.89	86.80
2010/11	4865.53	0.00	357.25	357.25	7.34	3886.85	0.00	302.26	319.17	4508.28	92.66

Source: Economic Survey, 2009/10 and 2010/11, Ministry of Finance



In the above table direct tax is classified into land revenue and registration and tax on property, profit and income. Land revenue and registration is further divided into land tax, house and registration. House and registration is higher than land tax in each year. Another source of direct tax revenue is tax on property, profit and income. The share of property, profit and income tax to direct tax revenue is not less than 84.39% and not more than 94.41 % over the study period. It is in fluctuating trend.

#### 4.5 Composition of Income Tax Revenue

Income tax is an important source of the direct tax. In the present situation, Nepal is levying five different types of income tax. They are income from public enterprises, semi-public enterprises, private corporate bodies, individuals, income tax from remuneration. Here public enterprises means 100% government ownership, semi-public enterprises means more than 50% government ownership, private corporate bodies means public limited companies and remuneration refers to salary earned from government or non-government sectors. The composition of income tax revenue for recent 10 years is presented in the table 4.5. The amount of income tax is gradually increasing without any disturbance.

Table 4.5  
Composition of Income Tax Revenue

(Rs. In Ten Million)

Fiscal Year	Total Income Tax Revenue	Public Enterprises	Semi-public enterprises	Private Corporate Bodies	Individual	Remuneration	Tax on Interest
2001/02	890.37	176.93	0.00	141.20	441.91	83.56	46.77
2002/03	967.58	292.80	0.00	192.43	336.22	59.73	86.40
2003/04	924.59	205.66	0.00	153.13	353.34	139.12	73.34
2004/05	1015.94	133.24	0.00	246.78	392.63	167.59	75.70
2005/06	1037.37	19.57	0.00	340.43	423.47	176.41	77.49
2006/07	1503.40	101.97	0.00	571.71	523.44	200.79	105.49
2007/08	1731.12	20.46	0.00	718.65	638.12	245.10	108.79
2008/09	2514.24	95.91	0.00	942.51	987.75	319.56	168.51
2009/10	3128.56	113.18	0.00	1223.44	1103.99	441.31	246.64
2010/11	3886.85	128.18	0.00	1396.55	1362.74	586.33	413.05

Source: Economic Survey, 2009/10 and 2010/11, Ministry of Finance

In the above table, income tax revenue from public enterprises is in highly fluctuating trend. It was very low in the year 2005/06 and high in the year 2002/03 having Rs. 19.57 (in ten million) and Rs. 292.80 respectively. Public enterprises have very low contribution to the total income tax revenue in comparison to other income. Income tax revenue from private corporate bodies has the second highest contribution to the total income tax revenue. It is increasing from Rs. 141.20 to 1396.55 (ten million) from the year 2001/02 to the year 2010/11. Income tax revenue from individual sources has the highest contribution to the total income tax revenue. It is in increasing trend over the study period having Rs. 441.91 to 1362.74 (ten million) from the year 2001/02 to the year 2010/11. Income tax revenue from remuneration is in increasing trend during whole study period. It was Rs. 83.56 in the year 2001/02 and Rs. 586.33 in the year 2010/11 which has third highest contribution to the total income tax revenue. Share of tax from interest is also in increasing trend. It was Rs. 46.77 in the year 2001/02 and Rs. 86.40 in the year 2002/03 and decreased to Rs. 73.34 in the year 2004/05 and continually increasing trend. The percentage contribution of all components is shown in the table 4.6 below.

Figure 4.3  
Composition of Total Income Tax Revenue

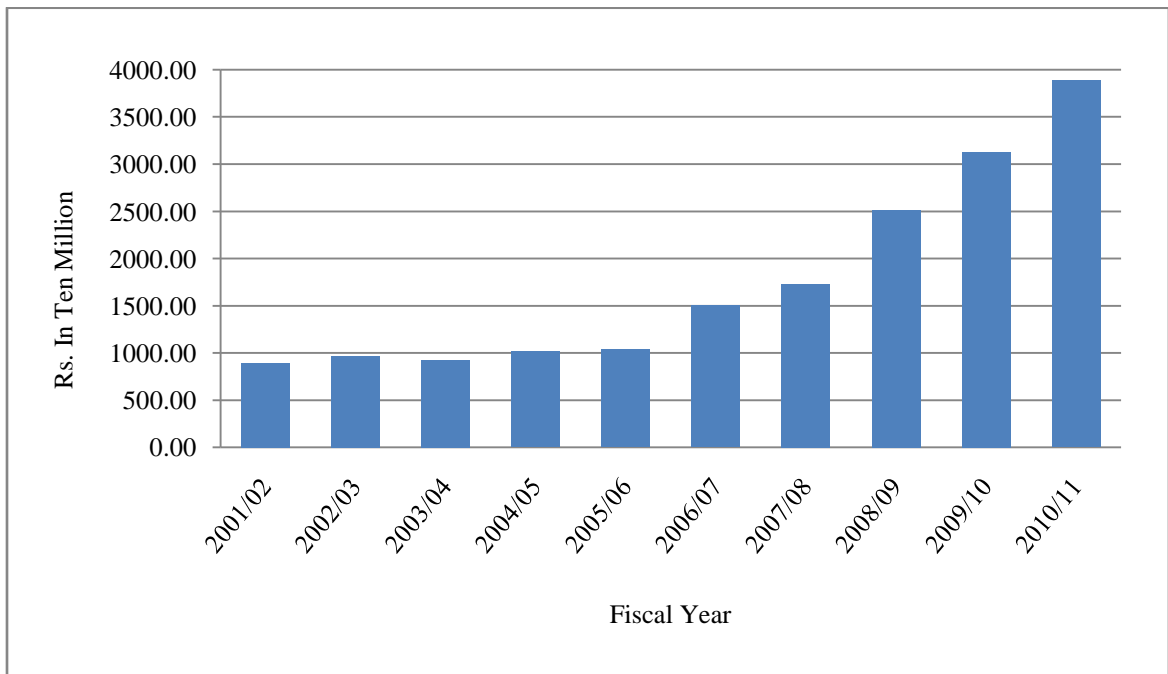


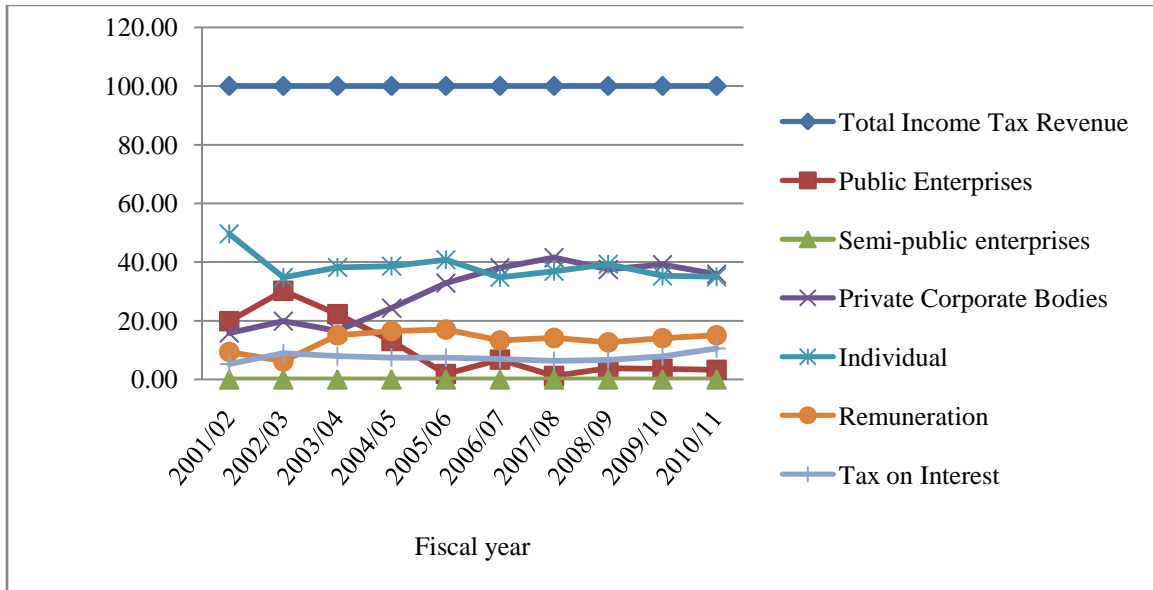
Table 4.6  
Composition of Income Tax Revenue

(In Percentage)

Fiscal Year	Total Income Tax Revenue	Public Enterprises	Semi-public enterprises	Private Corporate Bodies	Individual	Remuneration	Tax on Interest
2001/02	100.00	19.87	0.00	15.86	49.63	9.38	5.25
2002/03	100.00	30.26	0.00	19.89	34.75	6.17	8.93
2003/04	100.00	22.24	0.00	16.56	38.22	15.05	7.93
2004/05	100.00	13.11	0.00	24.29	38.65	16.50	7.45
2005/06	100.00	1.89	0.00	32.82	40.82	17.00	7.47
2006/07	100.00	6.78	0.00	38.03	34.82	13.36	7.02
2007/08	100.00	1.18	0.00	41.51	36.86	14.16	6.28
2008/09	100.00	3.81	0.00	37.49	39.29	21.71	6.70
2009/10	100.00	3.62	0.00	39.12	35.29	14.11	7.88
2010/11	100.00	3.30	0.00	35.98	34.98	15.10	10.64

Source: Table 4.5

Figure 4.4  
Composition of Income Tax



#### 4.6 Contribution of Income Tax

Nepal is facing a serious resource gap problem and it has urgency to mobilize additional financial resources through taxation to fulfill the gap. Tax structure of Nepal is

composition of direct and indirect tax. Income tax is pivot (central part) of direct tax. It is playing an important role to generate government revenue for the development of national economy. In this section an attempt to analyze and check the contribution of income tax to GDP, total revenue, total tax revenue, and direct tax revenue is made.

Table 4.7

Contribution of Income Tax to GDP, Total Revenue, Total Tax Revenue and Direct Tax Revenue

(Rs. In Ten Million)

Fiscal Year	GDP	Total Revenue	Total Tax Revenue	Direct Tax Revenue	Income Tax Revenue	% of IT on GDP	% of IT on TR	% of IT on TTR	% of IT on DTR
2001/02	43039.7	5044.66	3932.18	1059.75	890.37	2.07	17.65	22.30	84.02
2002/03	46032.5	5453.89	4089.60	1088.19	967.58	2.10	17.74	23.66	88.92
2003/04	50069.9	6233.10	4817.30	1191.26	924.59	1.85	14.83	19.19	77.61
2004/05	54848.5	7012.27	5410.47	1307.18	1015.94	1.86	14.49	18.78	77.72
2005/06	61111.8	7228.20	5743.04	1396.81	1037.37	1.70	14.35	18.06	74.27
2006/07	67585.9	8771.22	7112.67	1898.03	1503.40	2.22	17.14	21.14	79.21
2007/08	75525.7	10762.25	8515.54	2308.77	1731.12	2.29	16.08	20.33	74.98
2008/09	90930.9	14347.45	11705.19	3432.07	2514.24	2.77	17.52	21.48	73.26
2009/10	106088.1	17994.58	15629.49	4175.00	3128.56	2.95	17.39	20.02	74.94
2010/11	121911.6	19981.90	17277.79	4865.53	3886.85	3.18	19.43	22.47	79.78

Source: Economic Survey, 2009/10 and 2010/11, Ministry of Finance

#### 4.6.1 Contribution of Income Tax to GDP

Table 4.7 shows the percentage contribution of income tax in gross domestic product (GDP). It is clear that the portion of income tax in the GDP in Nepal is very low and it has not exceeded by 3.18% throughout the period of 10 years. The lowest contribution was 1.70% in 2005/06 and highest was 3.18% in 2010/11. It has been in increasing trend from 2005/06 to 2010/11. This result is not satisfactory for the government of Nepal in context of contribution however it has been in increasing trend. It has also been shown in following figure.

#### **4.6.2 Contribution of Income Tax to Total Revenue**

Total revenue represents tax and non-tax revenue. Income tax revenue occupies the most part of public revenue in the revenue structure of Nepalese Government. In the above table 4.7, share of income tax as percentage of total revenue is presented. Income tax on total revenue in percentage shows the fluctuating trend. It was lowest in fiscal year 2005/06 having 14.35% and highest in fiscal year 2010/11 having 19.43%. It has also been shown in following figure.

#### **4.6.3 Contribution of Income Tax to Total Tax Revenue**

Total tax revenue consists of direct and indirect tax. In Nepal, there is dominant role of indirect tax on total tax revenue structure. The contribution of income tax to total tax revenue is presented in table 4.7. As per the contribution shown in percentage in above table, it is clear that the contribution is in fluctuating trend. The lowest contribution in percentage was 18.06% in the fiscal year 2005/06; highest contribution was 23.66% in the fiscal year 2002/03 and average contribution is 20.86%.

#### **4.6.4 Contribution of Income Tax to Direct Tax Revenue**

Direct tax revenue have been playing vital role in income tax revenue in Nepal. In the above table 4.7, it had highest contribution 88.92% in the year 2002/03; lowest contribution 73.26% in the year 2005/06 and average contribution 81.09%. During this 10 year, it was also in fluctuating trend but has been in increasing trend from the year 2008/09 to 2010/11.

Figure 4.5  
Income Tax as a Percentage of GDP

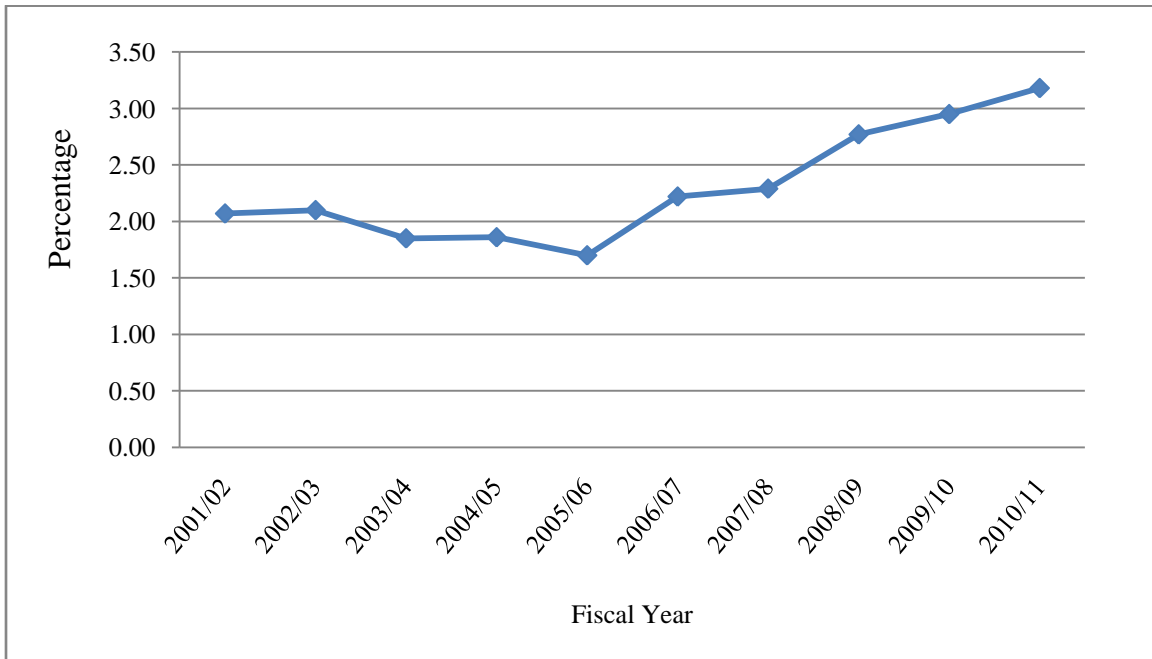


Figure 4.6  
Income Tax as a Percentage of Total Revenue

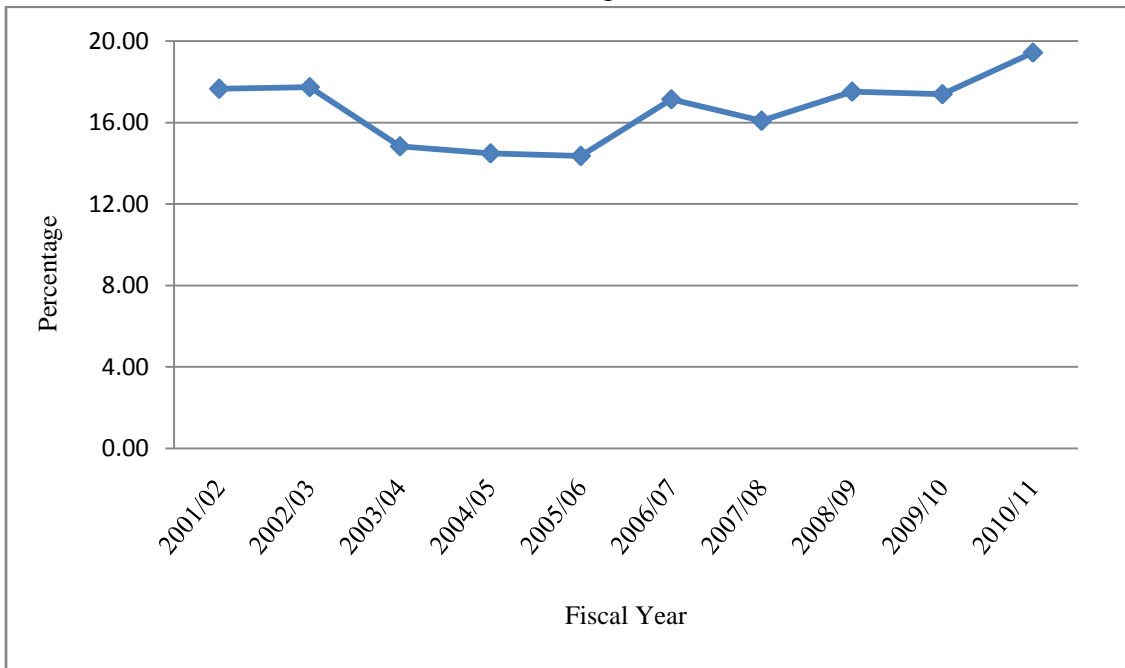


Figure 4.7

Income Tax as a Percentage of Total Tax Revenue

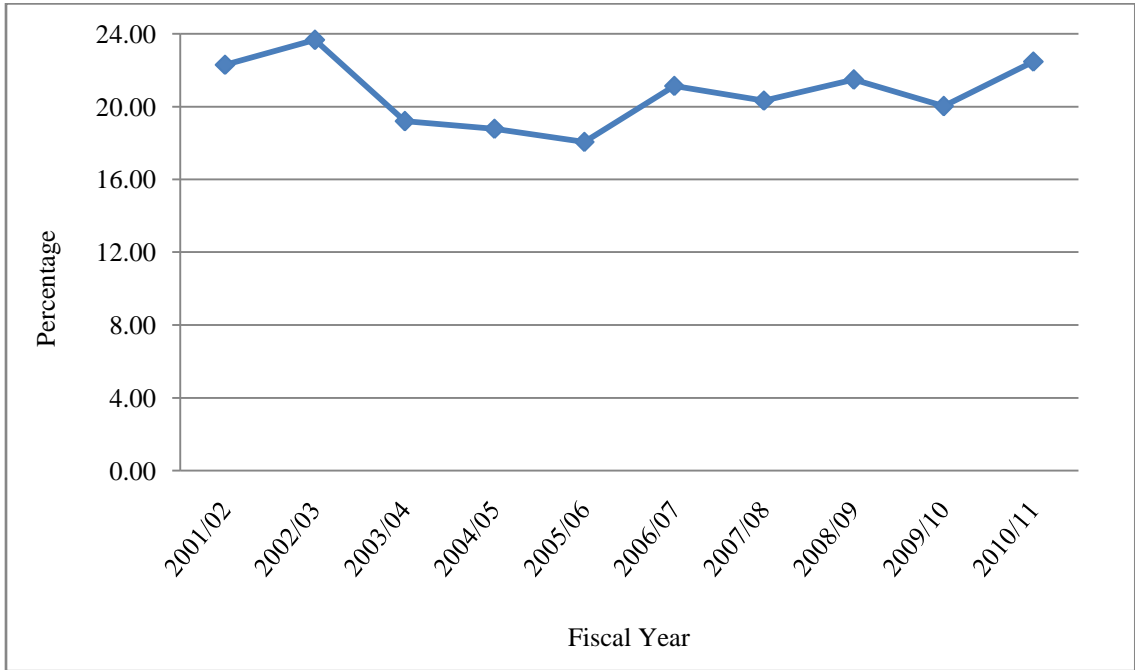
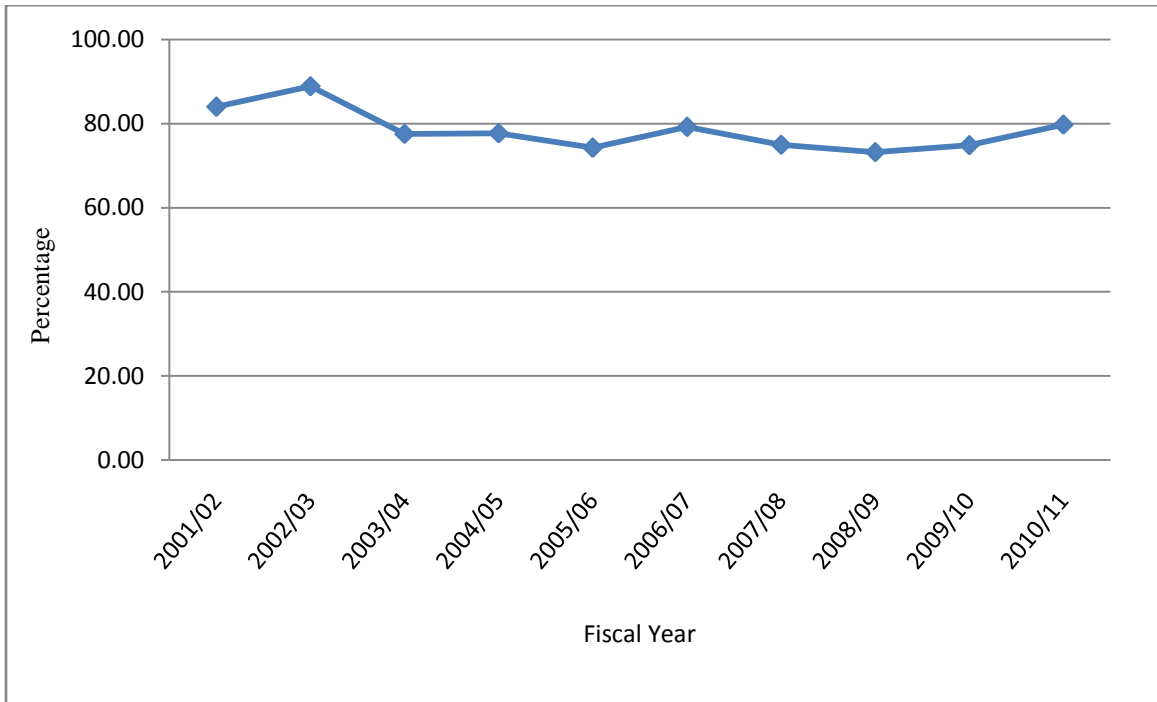


Figure 4.8

Income Tax as a Percentage of Direct Tax Revenue



From the above table and its figure presentation, we can clearly state that there is significant role of income tax to increase GDP, total revenue, total tax revenue and direct tax revenue. We can also conclude that increment in income tax increase the GDP, total revenue, total tax revenue and direct tax revenue and vice-versa.

#### 4.7 Estimation and Collection of Income Tax

During last three year, the revenue from income tax has been in increasing trend but the performance of income tax collection is not satisfactory. There are many factors which plays negative role and performance seems weak. Estimation and collection of income tax in Nepal is presented in the following table 4.8 and figure 4.9.

Table 4.8  
Estimation and Collection of Income Tax

(Rs. In Ten Millions)

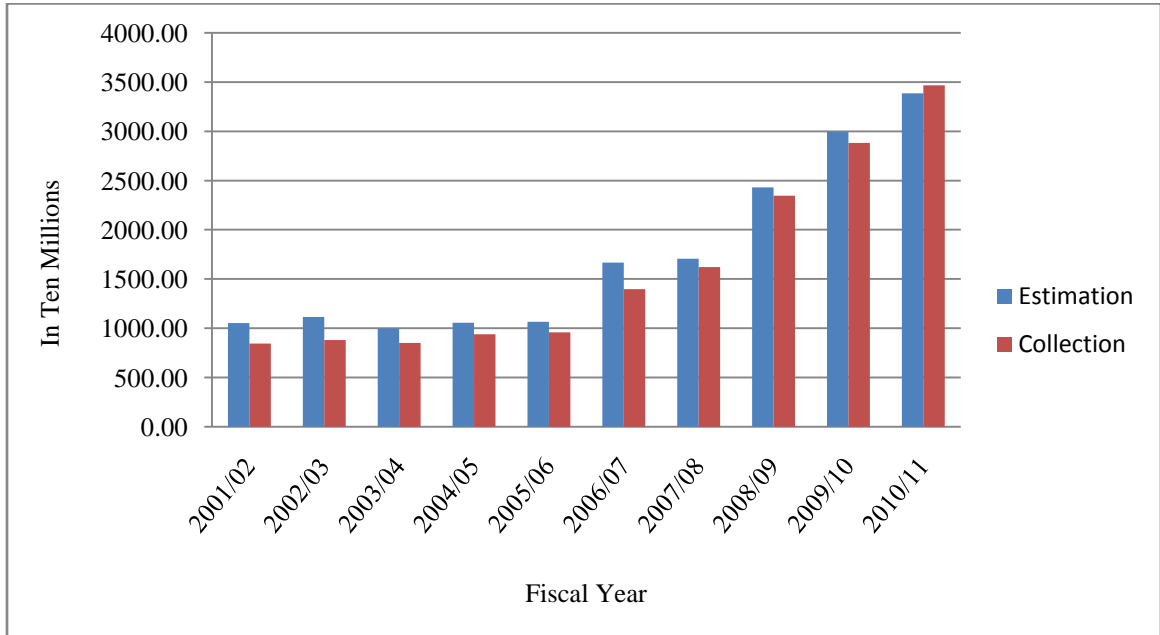
Fiscal Year	Estimation	Collection	Difference	% of Collection on Estimation
2001/02	1052.79	890.37	209.19	80.13
2002/03	1114.01	967.58	232.83	79.10
2003/04	998.65	924.59	147.40	85.24
2004/05	1056.74	1015.94	116.50	88.98
2005/06	1064.76	1037.37	104.88	90.15
2006/07	1665.57	1503.40	267.66	83.93
2007/08	1705.38	1731.12	83.05	95.13
2008/09	2431.06	2514.24	85.33	96.49
2009/10	2994.80	3128.56	112.88	96.23
2010/11	3384.42	3886.85	-84.27	102.49

Source: Budget Speeches, Economic Survey, 2010/11

At the beginning of the study period 2001/02, collection of income tax was 80.13% of estimated income tax. During the study period collection is found over the target in fiscal year 2010/11 collecting extra 2.49% on estimated income tax which is good signal for the Nepalese economy. During the study period, the lowest collection was 79.10% in the fiscal year 2002/03 and the highest collection was 102.49% in the fiscal year 2010/11. It can also be shown in the following figure.



Figure 4.9  
 Estimation and Collection of Income Tax



#### 4.8 Exemption Limit

Exemption limit is very important factor in managing income tax. Tax payer having low tax paying capacity should exclude from the tax net for the social justice and economic balance between rich and poor. Every year finance act prescribes the exemption limit for individual, families; corporate tax payer was curtailed from the fiscal year 1965/66, non-resident tax payer from 1974/75 and partnership from 1975/76. From the following table 4.9, we can clearly state that the exemption limit is extended according to the need of time and income condition.

Table 4.9  
Exemption Limit  
From Fiscal Year 2001/02 to 2010/11

Fiscal Year	Individual	Couple/Married
2001/02	55,000.00	75,000.00
2002/03	65,000.00	85,000.00
2003/04	80,000.00	100,000.00
2004/05	80,000.00	100,000.00
2005/06	80,000.00	100,000.00
2006/07	80,000.00	100,000.00
2007/08	80,000.00	100,000.00
2008/09	115,000.00	140,000.00
2009/10	160,000.00	200,000.00
2010/11	160,000.00	200,000.00

*Source: Finance Acts of Various Years up to 2010/11*

At present time, individuals having remuneration taxable income up to Rs.160, 000.00 and couple having taxable income up to Rs.200, 000.00 are taxed only at 1% compulsory tax as social security tax. If individuals and couples run proprietorship firm, then 1% tax is also exempted.

#### **4.9 Income Tax Rate**

Rate structure of income tax has been changing continuously since its introduction in 1959/60. In 1959/60, rate of income tax was divided into 11 brackets. Income over Rs.7000.00 a year was subject to graduated rates ranging from 5% to 25%. Exemption limit for corporation was not allowed. The tax rate was reduced to 35% for banks, finance companies and financial firms and 25% for others (including partnership firms) in fiscal year 1999/00.

Under new income tax Act, 2002, individual income tax is levied with two rates of 15% and 25% for individuals and couples. Having annual income Rs. 200,000.00 or Rs. 20,00,000.00 turnover from any kind of business in metropolitan or sub-metropolitan cities, municipalities and other area of Nepal are subject to pay Rs. 3,500.00, Rs. 2,000 and Rs. 1,250.00 as annual flat rates respectively. Under new income tax Act 2002, the corporate income tax is levied with single rate of 25%, for banks and financial institutions tax rate is 30% of taxable income, industrial enterprise are subject to the

maximum rate of 25% on taxable income. Current income tax rate for personal income is applicable as follows:

For Individual	For Couple	Tax Rate
Basic Exemption: Up to Rs. 160,000.00	Basic Exemption: Up to Rs. 200,000.00	1%
Next Rs. 100,000.00	Next Rs. 100,000.00	15%
Next Rs. 22,40,000.00	Above Rs. 22,00,000.00	25%
Above Rs. 25,00,000.00	Above Rs. 25,00,000.00	25% + 40% Additional

*Source: Income Tax Act, 2058, Amended by Financial Act, 2068 (2011)*

#### Income Tax Rate for Entity

S.N.	Types of Industry	Tax Rate
1	General Industry	25%
2	Bank, Financial Institutions, General Insurance Business, Petroleum Business and Cigarette & Beverage Business	30%
3	Entities operating as special industry and entity that has operated road, bridge, tunnel, ropeway, sky bridge etc.	20%
4	Entities engaged in building and operating public infrastructure to be transferred to the Government of Nepal.	20%
5	Entities wholly engaged in power generation, transmission or distribution for an income year	20%
6	Industries operated by non-resident person	25%
7	Industries doing export business with source in Nepal	20%
8	Income derived from shipping, air transport or telecommunication by non-resident person	2%
9	Repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal	10%
10	Entity providing dividend	5%

*Source: Income Tax Act, 2058, Amended by Financial Act, 2068 (2011)*

Tax Rate In Case of Special Industry (sole-entity) and IT Industry

S.N.	Condition	Tax Rate	Rebate	Net Tax Rate	Period
1	If providing direct employment to 300 or more Nepali citizens throughout the whole year.	20%	10%	18%	Forever
2	If providing direct employment to 1200 or more citizens throughout the whole year	20%	20%	16%	Forever
3	If providing employment to 100 Nepali citizens including 33% women, dalit and disabled person during the whole year	20%	20%	16%	Forever
4	If operating in a most undeveloped zone.	20%	30%	14%	First 10 Years
5	If operating in an undeveloped zone.	20%	25%	15%	First 10 Year
6	If operating in an underdeveloped zone.	20%	20%	16%	First 10 Years
7	If operating in a special economic zone other than mentioned in point 6.	20%	100%	Nil	First 5 Years
			50%	10%	Forever
8	The Industry established under Himalayan district and under special economic zone specified by Nepalese Government	20%	100%	Nil	First 10 Years
			50%	10%	Forever
9	If operating in a remote zone specified by NG	20%	100%	Nil	First 10 Years
			20%	16%	Forever
10	Information technology intensive industry (established within IT park)	20%	25%	15%	Forever

11	Industry which construct and operate road, bridge, tunnel, ropeway, flying bridge, trolley bus, tram etc.	20%	40%	12%	Forever
12	Industry based on commodity export	20%	25%	15%	Forever
13	Industry involved in investigation of petroleum and natural gas.	20%	100%	Nil	First 7 Year
			50%	10%	Next 3 Year
			0%	20%	Forever
14	Any hydropower industry start construction before 2071 Bhadra 7 and start commercial transaction before Chaitra 2075 (B.S.)	20%	100%	Nil	First 10 Years
			50%	10%	Next 5 Years
			0%	20%	Forever
15	Foreign investor generated industry established in SEZ providing service such as foreign technology, management fee and royalty.	20%	50%	10%	Forever
16	Industry exporting intellectual property, sale and transfer.	20%	50%	10%	Forever

Source: Income Tax Act, 2058, Amended by Financial Act, 2068 (2011)

Note: 1.If any taxpayer qualifies to claim two or more concession, s/he can select only one for that purpose.

### Classification, Pooling and Rates of Depreciable Assets

Block	Types of Depreciable Assets	Rate
A	Buildings, Structure & Similar works for permanent nature	5%
B	Computer, data processing equipment, furniture, fixture and office equipments	25%
C	Automobiles, bus and minibus.	20%
D	Construction and earth moving equipments, capitalized PCC, R & D cost and any tangible assets not included in above block A, B & C i.e. Plant & Machinery	15%
E	Intangible assets such as patent right, software, trademark etc.	Cost/life

*Source: Income Tax Act, 2058, Amended by Financial Act, 2068 (2011)*

#### **4.10 Empirical Analysis**

To find out the various aspects of income tax and income tax act 2002, an empirical study has been conducted. The major tool used for this purpose is an opinion survey through structured questionnaire. A total of sixty set of structured questionnaire (see the format of questionnaire in an appendix B) was distributed to the respondents associated with distinct denominations i.e. tax administrators, tax experts, auditors and tax payers. All of the sixty set of questionnaires were successfully filled up and received. The respondents were asked either to response Yes/No or for ranking of choices according to number of alternatives where first choice was the most important and last choice was least important. If the numbers of alternatives was five, the first preferred choice got five points and the last preferred choice got one point. The total points available to each choice were converted into percentage in reference to the total points available for all choices. The responses received from respondents have arranged, tabulated and analyzed in order to facilitate the descriptive analysis of the study with the help of different suitable statistical tools as per the objective.

The group of respondent and number from each group is presented as below:

Table 4.10  
Group of Respondent and Number from each Group

S.N.	Group of Respondent	Number (No)
1	Tax Administrators	15
2	Tax Experts	15
3	Auditors (RA & CA)	15
4	Tax Payers	15
	Total	60

#### 4.10.1 Result of Empirical Investigation

##### Income Tax as Suitable Means of Increasing Government Revenue

To know whether income tax as a suitable means of increasing government revenue in Nepal, a question was asked, “Do you think that the income tax is a suitable means of increasing government revenue in Nepal?” to the respondents and requested to give their answer in the form of “Yes” or “No”. The respondent’s responses are tabulated as follows:

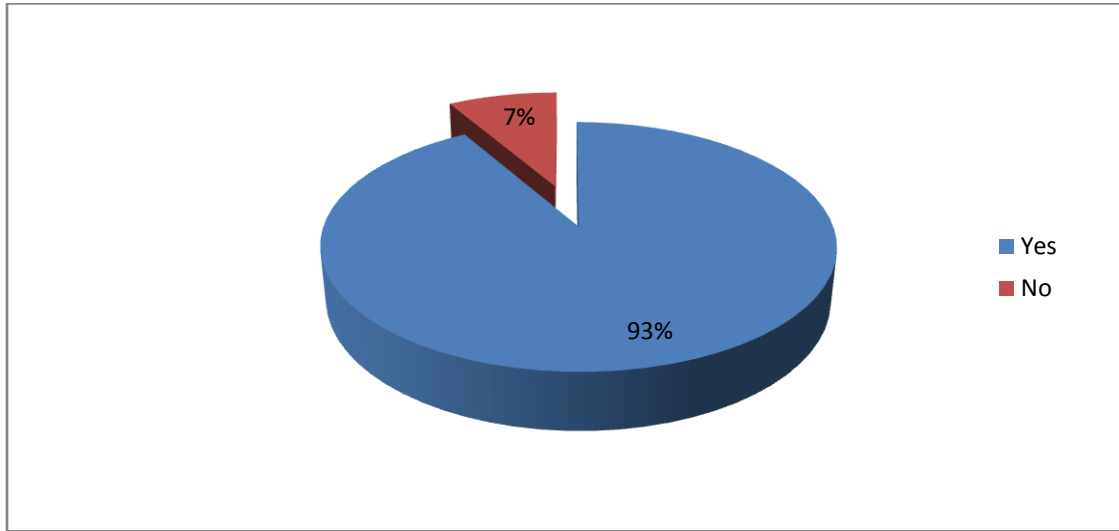
Table 4.11  
Income Tax as a Suitable Means of Increasing Revenue

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	14	93	1	7	15	100
Tax Experts	13	87	2	13	15	100
Auditors	15	100	0	0	15	100
Tax Payers	14	93	1	7	15	100
Total	56	93	4	7	60	100

*Source: Opinion Survey, 2013*

Figure 4.10

Income Tax as a Suitable Means of Increasing Revenue



From the opinion survey, it is found that 93% of tax administrators and taxpayer, 87% of tax experts and 100% of auditors recognize income tax as a suitable means of increasing government revenue. Only 7% of tax administrators and tax payers and 13% of tax experts do not recognize income tax as a suitable means of increasing government revenue in Nepal. In average, it is found that 93% respondents are in favour that they accepted income tax as suitable means of increasing revenue and only 7% are against on it. Thus, it is concluded that income tax is a suitable means of raising government revenue in Nepal. Hence the government of Nepal must lunch more effective programs to collect more revenue from this resource.

#### 4.10.2 Necessity of Public Awareness Program

To know opinion of respondents about the need of public awareness program in Nepal for raising government revenue, the question was asked, “Do you think that public awareness program is necessary in Nepal for increasing government revenue?” to the respondents and their responses have been tabulated as below:

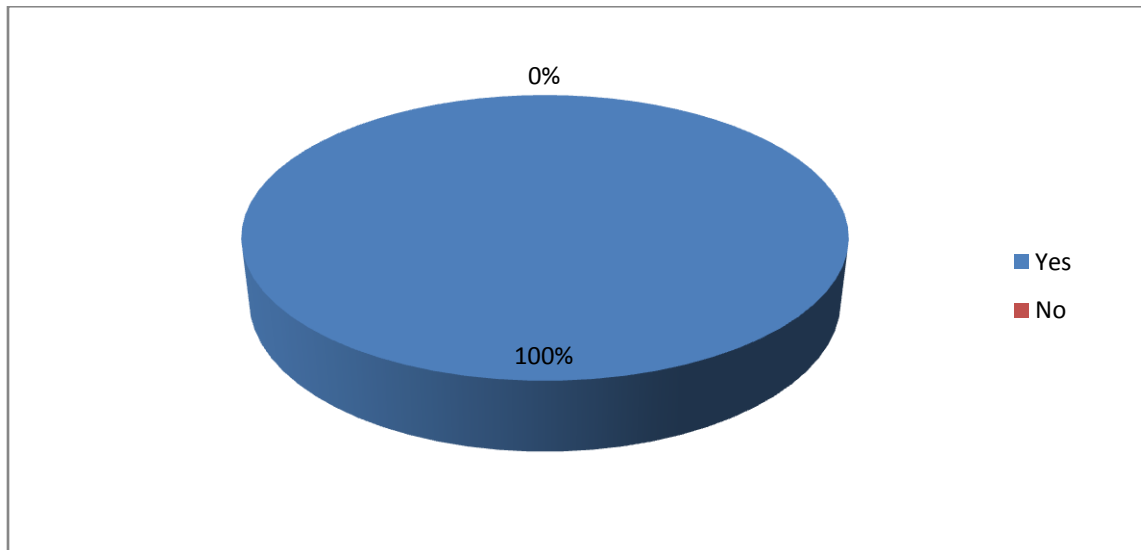


Table 4.12  
Necessity of Public Awareness Program

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	15	100	0	0	15	100
Tax Experts	15	100	0	0	15	100
Auditors	15	100	0	0	15	100
Tax Payers	15	100	0	0	15	100
Total	60	100	0	0	60	100

*Source: Opinion Survey, 2013*

Figure 4.11  
Necessity of Public Awareness Program



From the opinion survey presented in the above table 4.12, it is found that All the respondents from different four groups have positive response that public awareness program is necessary for increasing government revenue. There were no even a single respondent who did not favour the public awareness program. Thus, it is concluded that the public awareness program is very necessary to increase government revenue in Nepal.

### 4.10.3 Contribution of Income Tax to National Revenue

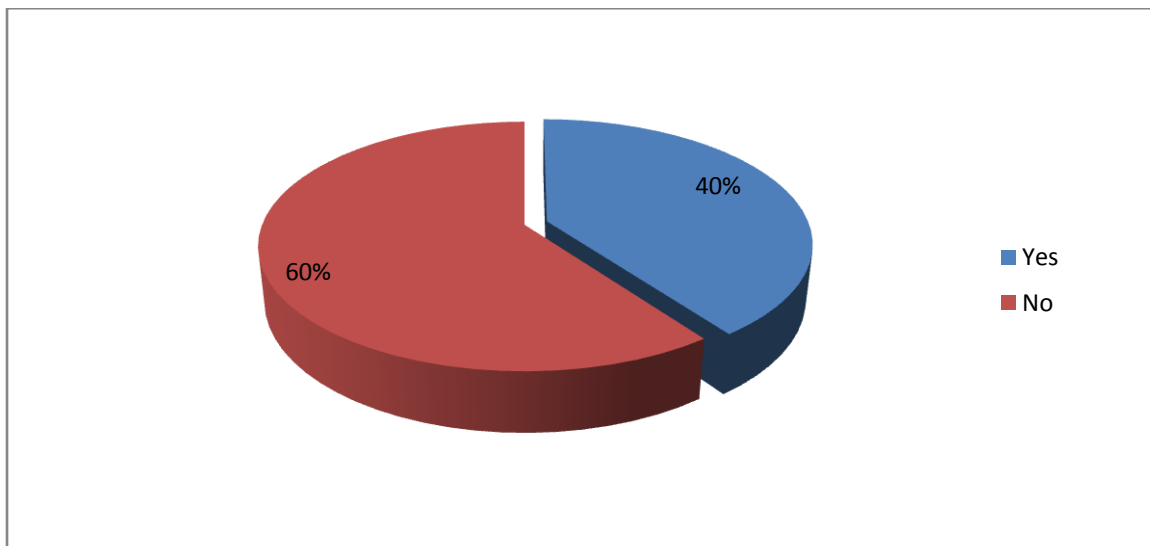
The respondents were asked, “In your opinion, is contribution of income tax to national revenue of Nepal satisfactory?” to know about the satisfaction level of income tax contribution to national revenue and the result have been tabulated as below:

Table 4.13  
Contribution of Income Tax to National Revenue

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	2	13	13	87	15	100
Tax Experts	5	33	10	67	15	100
Auditors	6	40	9	60	15	100
Tax Payers	11	73	4	27	15	100
Total	24	40	36	60	60	100

Source: *Opinion Survey, 2013*

Figure 4.12  
Contribution of Income Tax to National Revenue



From the opinion survey presented in the table 4.13, it is found that 13% of tax administrators, 33% of tax experts, 40% of auditors and 73% of tax payers agree that the contribution of income tax to national revenue is satisfactory whereas 87% of tax administrators, 67% of tax experts, 60% of auditors and 27% of tax payers do not agree with this statement. In aggregate, 40% respondents of different four groups are positive but rests 60% have negative response. To know the fact of negative responses regarding unsatisfactory contribution of income tax to national revenue, all the respondents having negative responses were asked an additional question, "If no, what are the major reasons?" and their responses have been tabulated as below:

Table 4.14  
Reasons for Unsatisfactory Contribution of Income Tax

S.N.	Reasons	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Defective of Income Tax Act	30	17	31	5	83	15
2	Mass poverty & low income level	63	42	34	20	159	29
3	Increasing habit of tax evasion	53	39	35	13	140	26
4	Inefficient income tax administration	33	31	22	13	99	18
5	Inappropriate rate & exemption limit	25	21	13	9	68	12
	Total					549	100

*Source: Opinion Survey, 2013*

As per the ranking of the reasons as its priority from the respondents of different groups not supporting for satisfactory contribution of income tax to national revenue are listed as follows:

- Mass poverty and low income level.
- Increasing habit of tax evasion.
- Inefficient income tax administration.
- Defective of income tax Act.

- Inappropriate rate & exemption limit.

From the above presentation, it can be concluded that mass poverty and low income level of people is the most important reason for the unsatisfactory contribution of income to national revenue in Nepal. In the same way, increasing habit of tax evasion and inefficient income tax administration are also the major reasons for unsatisfactory contribution of income tax.

#### 4.10.4 Effectiveness of Income Tax Assessment Procedure

It is very clear fact that effectiveness of income tax assessment procedure plays vital role for raising income tax revenue which is very necessary for the well development of the nation like Nepal. Therefore, a question, "Do you think that income tax assessment procedure in Nepal is effective?" were asked to the respondents of different groups selected to know the fact about effectiveness of income tax assessment procedure in Nepal and their responses are tabulated as follows:

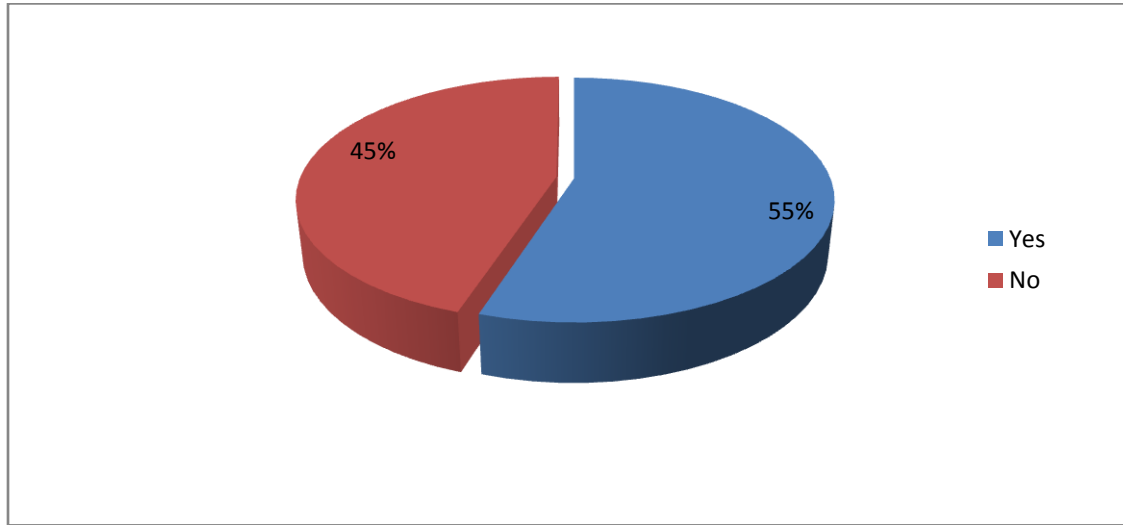
Table 4.15  
Effectiveness of Income Tax Assessment Procedure

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	12	80	3	20	15	100
Tax Experts	6	40	9	60	15	100
Auditors	5	33	10	67	15	100
Tax Payers	10	67	5	33	15	100
Total	33	55	27	45	60	100

Source: *Opinion Survey, 2013*

Figure 4.13

Effectiveness of Income Tax Assessment Procedure



From the above table 4.15, it is found that majority of tax administrators and tax payers i.e. 80% and 67% respectively have positive responses on the effectiveness of income tax assessment procedure whereas majority of tax experts and auditors have disappointment on this statement. Therefore, those respondents who have disappointment on this statement were asked an additional question, "If no, what may be the problems?" to know the problems and their responses are tabulated as below:

Table 4.16

Problems for Ineffectiveness of Income Tax Assessment Procedure

S.N.	Problems	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Maintain ad hock books of account.	7	21	32	13	73	18
2	Taxpayer's do not maintain their books of account.	6	30	34	18	88	22
3	Lack of adequate information about income assessment.	9	29	35	19	92	23
4	Taxpayers want to escape for paying tax.	15	29	24	16	84	21
5	Lack of proper recording system in tax.	8	26	25	9	68	17
	Total					405	100

Source: *Opinion Survey, 2013*

On the basis of the study of the problem of ineffectiveness of income tax assessment procedures, the most important reasons as per the priority given by respondents are as follows:

- Lack of adequate information about income assessment.
- Taxpayers do not maintain their books of account.
- Taxpayers want to escape for paying tax.
- Maintain ad hock books of account.
- Lack of proper recording system in tax.

From the above presentation, it is concluded that most important reason for ineffectiveness of income tax assessment procedure is the lack of adequate information about income tax assessment in Nepal.

#### **4.10.5 Suitability of Self Tax Assessment System in Nepal**

The main part of the current ITA, 2002 is the self tax assessment system. Under this system, tax payers are requested and inspired to calculate income tax by themselves and file it to the tax office at the prescribed time frame. Therefore, to know the opinion about suitability of self tax assessment system, a question, “Do you think that Self Tax Assessment System (STAS) is suitable in Nepal?” was asked to the respondents of different group selected and their views are presented as below:

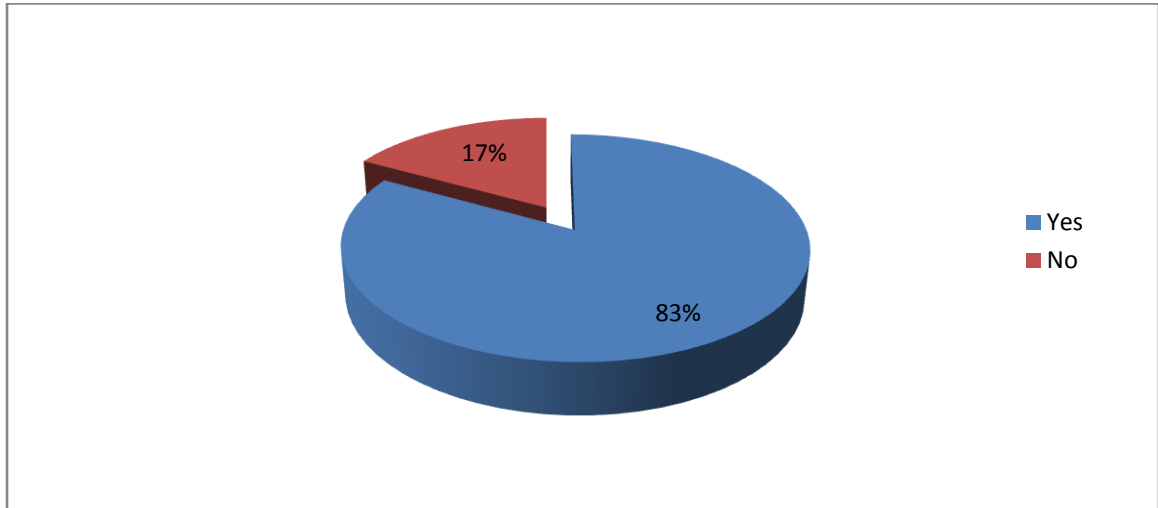
Table 4.17  
Suitability of Self Tax Assessment System in Nepal

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	13	87	2	13	15	100
Tax Experts	12	80	3	20	15	100
Auditors	13	87	2	13	15	100
Tax Payers	12	80	3	20	15	100
Total	50	83	10	17	60	100

*Source: Opinion Survey, 2013*

Figure 4.14

Suitability of Self Tax Assessment System in Nepal



In the above table 4.17, it is found that 87% of tax administrators and auditors and 80% of tax experts and tax payers have accepted the suitability of self tax assessment system in Nepal whereas 13% of tax administrators and auditors and 20% of tax experts and tax payers have not accepted it. In totality, 83% accepted and 17% not accepted. It can be concluded that self tax assessment system is suitable system in Nepal.

Those respondents, who did not accept this statement, were asked an additional question, “If no, what are the reasons?” and their responses are tabulated as below:

Table 4.18

Reasons for Not Suitability of Self Tax Assessment System

S.N.	Reasons	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Lack of proper accounting system.	5	8	5	12	30	30
2	Lack of knowledge about self tax assessment procedure.	6	6	8	9	29	29
3	Lack of correct auditing system.	5	7	5	6	23	23
4	Lack seminar, meeting & conference about self tax assessment.	4	9	2	3	18	18
	Total					100	

Source: *Opinion Survey, 2013*

From the above table, it can be concluded that lack of proper accounting system is the most important reason for unsuitability of self tax assessment system. These reasons can be presented according to the priority in the following way:

- Lack of proper accounting system.
- Lack of knowledge about self tax assessment procedure.
- Lack of correct auditing system.
- Lack of seminar, meeting & conference about self tax assessment.

#### **4.10.6 Provisions of Self Tax Assessment in ITA, 2002**

It is noted that self tax assessment system was introduced in 1977 at the first time in Nepal and now it is fully adopted in current income tax act. Under current income tax act, various provisions have been introduced for successful implementation of self assessment tax system. To know the sufficiency of the provision regarding self tax assessment system, a question was asked, “Do you think that the provision given for self tax assessment in the new income tax act is sufficient?” The responses provided by respondents are tabulated as below:

Table 4.19  
Sufficiency of Provision of Self Tax Assessment in ITA 2002

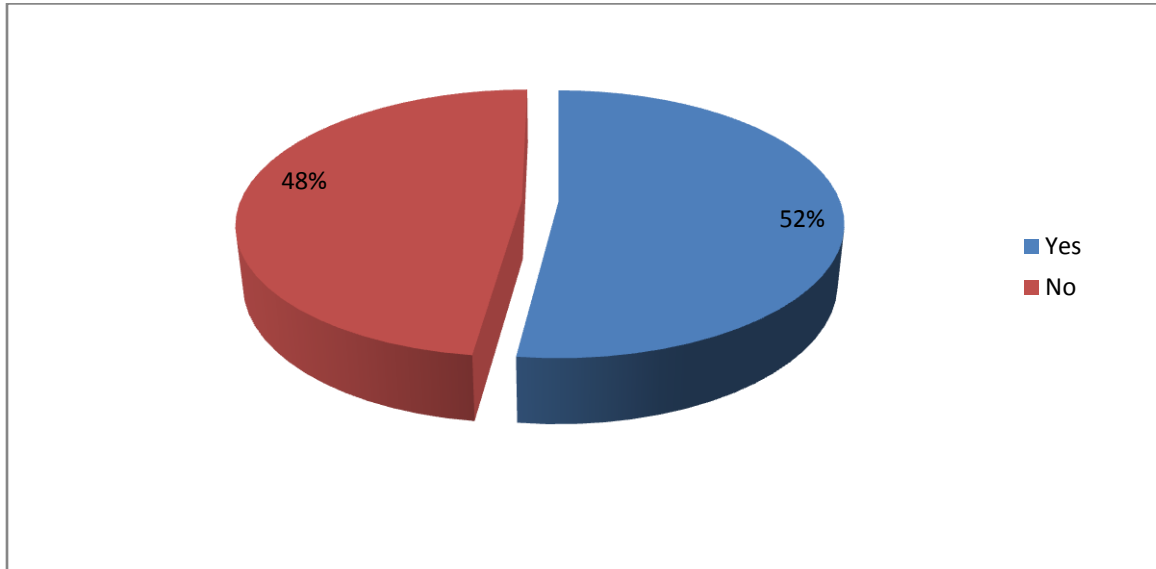
Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	10	67	5	33	15	100
Tax Experts	6	40	9	60	15	100
Auditors	7	47	8	53	15	100
Tax Payers	8	53	7	47	15	100
Total	31	52	29	48	60	100

*Source: Opinion Survey, 2013*



Figure 4.15

Sufficiency of Provision of Self Tax Assessment in ITA 2002



In the above table 4.19, it is found that 67% of tax administrators, 40% of tax experts, 47% of auditors and 53% of tax payers are in favour of the statement where as 33% of tax administrators, 60% of tax experts, 53% of auditors and 47% of tax payers are against the statement. In an average, 52% respondents accepted the sufficiency of provision of self tax assessment while 48% did not accepted it. Those respondents, who did not support it, were asked an additional question to know how it can be made sufficient. The responses provided by the respondents are tabulated as follows:

Table 4.20

Method for Improving Provision of Self Tax Assessment

S.N.	Method of Improvement	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Income tax rules regards self assessment should be made simple.	11	19	19	14	63	36
2	Encourage the taxpayer for self assessment by providing incentives.	11	19	18	15	63	36
3	Assessment of tax should be made in time.	8	16	11	13	48	28
						174	100

Source: *Opinion Survey, 2013*

To improve self tax assessment, following points should be mentioned in the provision of new income tax act as per the priority of respondent given in above table.

- Income tax rules regarding self tax assessment should be made simple.
- Encourage the taxpayer for self assessment by providing incentives.
- Assessment of tax should be made in time.

From the above study, it can be concluded that provision for self tax assessment should be made simple and easily understood by the normal taxpayers so that they feel their duty to submit income statement at a time. Taxpayers should be encouraged for self assessment by providing incentives and assessment should be made in time.

#### 4.10.7 Knowledge about Jeopardy Assessment

In Income Tax Act 2002, there are three assessment methods out of which one is Jeopardy assessment. To know about the knowledge of jeopardy assessment, a question, “Do you know about Jeopardy Assessment?” was asked to the respondent of four different group of tax administrators, tax experts, auditors and tax payers and their responses are tabulated as below:

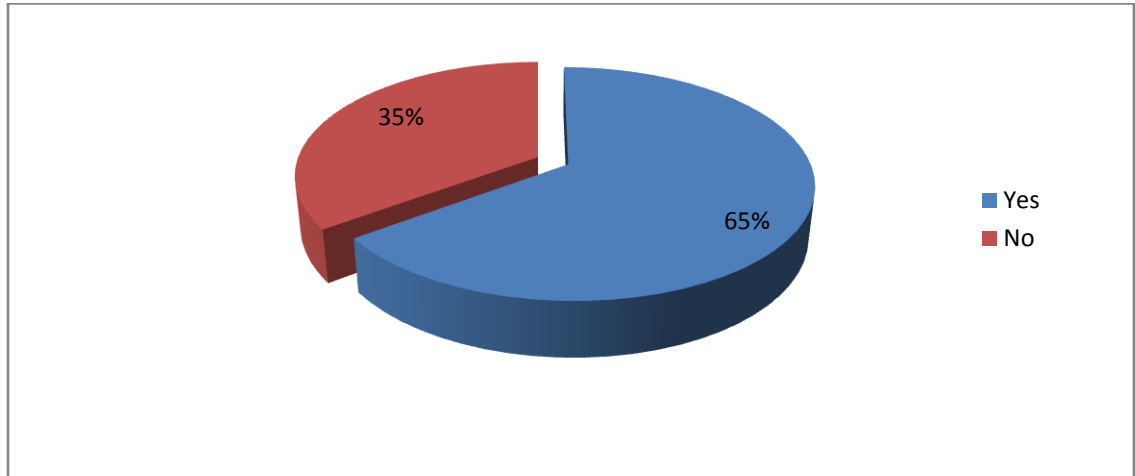
Table 4.21

Knowledge about Jeopardy Assessment

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	13	87	2	13	15	100
Tax Experts	12	80	3	20	15	100
Auditors	11	73	4	17	15	100
Tax Payers	3	20	12	80	15	100
Total	39	65	21	35	60	100

Source: *Opinion Survey, 2013*

Figure4.16  
Knowledge about Jeopardy Assessment



From the above table, it is found that majority of the respondent from the group of tax administrators, tax experts and auditors have knowledge about jeopardy assessment method whereas only 35% respondents of tax payers don't have idea about jeopardy assessment. In aggregate, 65% respondents have knowledge about jeopardy assessment but 35% respondents have no knowledge about it.

#### **4.10.8 Application of Jeopardy Assessment**

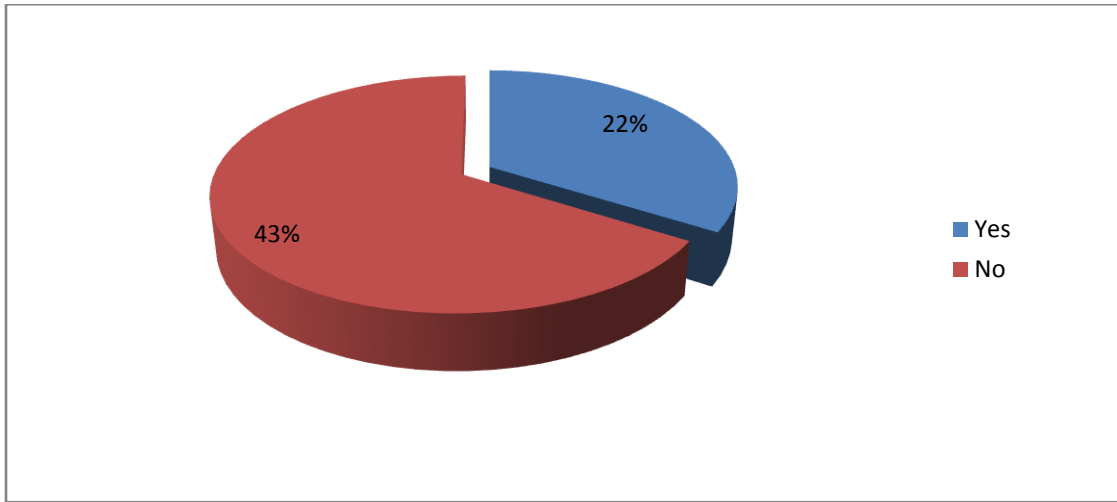
With the introduction of jeopardy assessment method in new income tax act it has been also in use in case of its necessity. Here to know whether jeopardy assessment has been applied satisfactorily or not, a question, "Do you consider that jeopardy assessment has been applied satisfactorily in income tax assessment?" was asked and their responses are tabulated as below:

Table 4.22  
Application of Jeopardy Assessment

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	7	47	6	40	15	100
Tax Experts	3	20	9	60	15	100
Auditors	2	13	9	60	15	100
Tax Payers	1	7	2	13	15	100
Total	13	22	26	43	60	100

*Source: Opinion Survey, 2013*

Figure 4.17  
Application of Jeopardy Assessment



In the above table 4.22, all the respondents who know about jeopardy assessment have given their views. As per their opinion, it is found that only 22% of the total respondent agreed with the satisfactory application of jeopardy assessment where as 43% of total respondent said that it has not been applied satisfactory in Nepal.

From the above table and figure, it is clear that jeopardy assessment method has not applied satisfactory in income tax assessment in Nepal.

In order to know the major causes about unsatisfactory, an additional question was asked to the respondents who are against satisfactory application of jeopardy assessment and their responses have been tabulated as follow:

Table 4.23  
Major Causes Making Jeopardy Assessment Unsatisfactory

S.N.	Causes	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Lack of information about tax payer to the tax officers.	20	28	30	8	86	33
2	Lack of clear provisions in income tax laws.	20	26	21	6	73	28
3	Unwillingness of tax officers.	12	20	23	4	59	23
4	Tendency of tax officers towards high corruption.	8	16	16	2	42	16
	Total					260	100

*Source: Opinion Survey, 2013*

The major causes that make jeopardy assessment unsatisfactory according to the priority of respondents are given below:

- Lack of information about tax payer to the tax officers.
- Lack of clear provisions in income tax laws.
- Unwillingness of tax officers.
- Tendency of tax officers towards high corruption.

In conclusion, it is stated that lack of information about tax payers to the tax officers is the main cause that plays vital role for the unsatisfactory application of jeopardy assessment in Nepal. There are also other causes like lack of clear provisions in income tax laws, unwillingness of tax officers and tendency of tax officers towards high corruption.

#### 4.10.9 Application of Amended Assessment

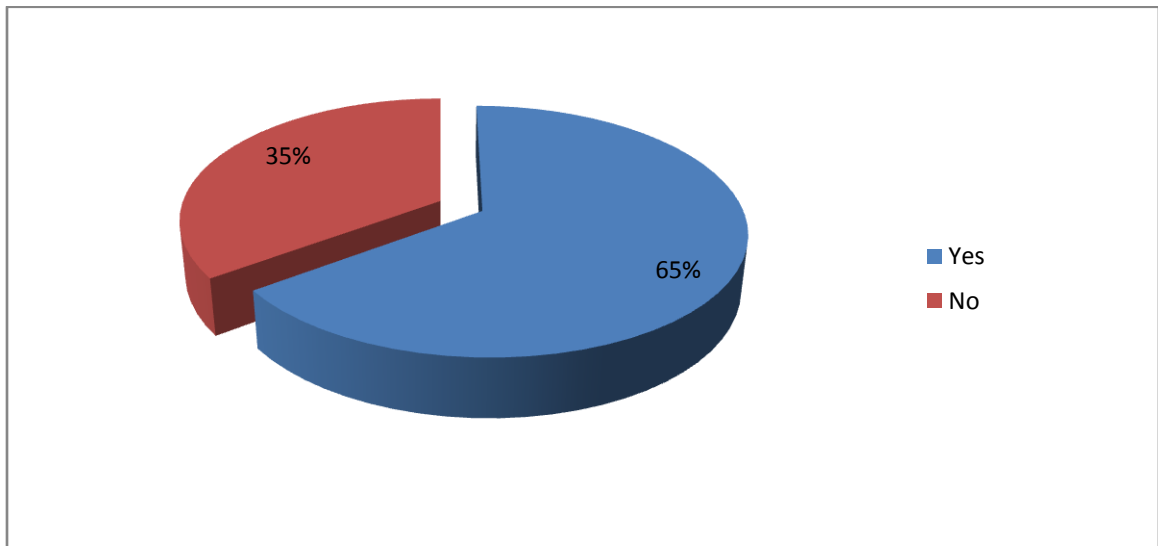
Before fully application of self tax assessment method, the best method for tax assessment was amended assessment method. To know view about the wide application of amended assessment method, a question, “Do you think that the amended assessment has been widely applied in income tax assessment in Nepal?” was asked to the respondents. The responses provided by the respondents have shown in the following table.

Table 4.24  
Application of Amended Assessment

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	8	53	7	47	15	100
Tax Experts	11	73	4	27	15	100
Auditors	9	60	6	40	15	100
Tax Payers	11	73	4	27	15	100
Total	39	65	21	35	60	100

Source: *Opinion Survey, 2013*

Figure 4.18  
Application of Amended Assessment



From the above table 4.24, it is found that more than 50% of all respondents are positive on wide application of amended assessment in income tax assessment system in Nepal and vice versa.

#### 4.10.10 Problems in Income Tax Assessment Procedure

In order to know the problems in current income tax assessment in Nepal, a question, “What are the problems in income tax assessment procedures in Nepal?” was asked to the respondents and their responses are tabulated as below:

Table 4.25  
Problems in Income Tax Assessment Procedure

S.N.	Problems	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Maintain ad hock books of account.	38	35	38	23	134	23
2	Lack of adequate information about the tax assessment.	43	48	47	52	190	33
3	Assesses do not maintain books of account.	35	42	39	34	150	26
4	Lack of proper recording system in tax offices.	24	25	26	31	106	18
	Total					580	100

*Source: Opinion Survey, 2013*

From the above table, it is found that 33% respondents say that lack of adequate information about the tax assessment is the main problem. All the problems as per respondent’s preference are presented as follows:

- Lack of adequate information about the tax assessment.
- Assesses do not maintain books of account.
- Maintain ad hock books of account.
- Lack of proper recording system in tax offices.

#### 4.10.11 Appropriate Time Limit for File Return

As per the provision of new ITA, 2002, every taxpayer should submit file of return to the tax office prescribed by the department not later than 3 months after the income year. If the time limit passed, then application must submit with reason for delay and maximum extra 3 months time may be provided if necessary.

To know opinion of the respondents selected about the appropriate time limit for file return, a question, “In your opinion what should be the time limit to be given for the file return after passing the income year?” was asked. The responses provided by the respondents selected are tabulated as follows:

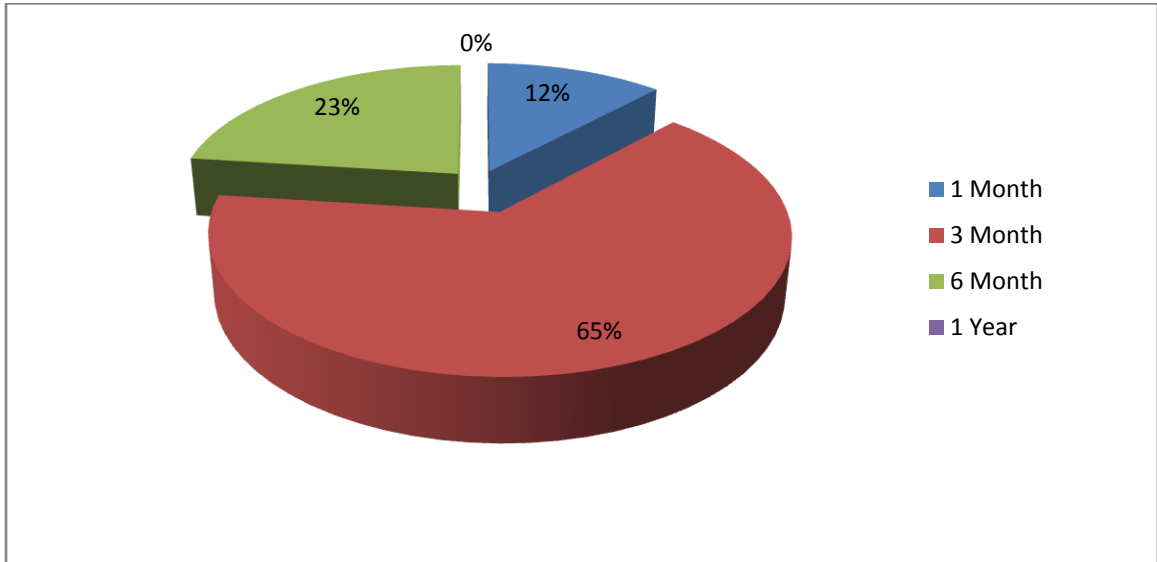
Table 4.26  
Appropriate Time Limit for File Return

S.N.	Time Limit	Response					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	1 Month	1	2	0	4	7	12
2	3 Month	13	13	10	3	39	65
3	6 Month	1	0	5	8	14	23
4	1 Year	0	0	0	0	0	0
	Total	15	15	15	15	60	100

Source: *Opinion Survey, 2013*



Figure 4.19  
Appropriate Time Limit for File Return



In the above table 4.26, it is found that 12% respondents select 1 month for time limit, 65% respondents select 3 month for time limit and rest 23% respondents select 6 month as the time limit for file return after passing the income year. It can be concluded that majority of respondents think 3 month as the best time limit which is already in current income tax act and 6 month is also the option suggested by the respondents.

#### **4.10.12 Attitude of Respondents towards Penalty for Submitting False Statement**

It is a big problem in Nepal that taxpayers having bad intension used to submit false statement which is offence. Some tax payers think that income tax provided by them have not been used in the necessity of people so that they do not want to pay actual file return. But it is treated as sentiment of people and rule is rule which should not be breach. To know the respondents' opinion on this topic, a question, "Do you favour heavy penalty on those tax payers who submit false statement of self tax assessment?" was asked and their responses are presented in the following table.

Table 4.27

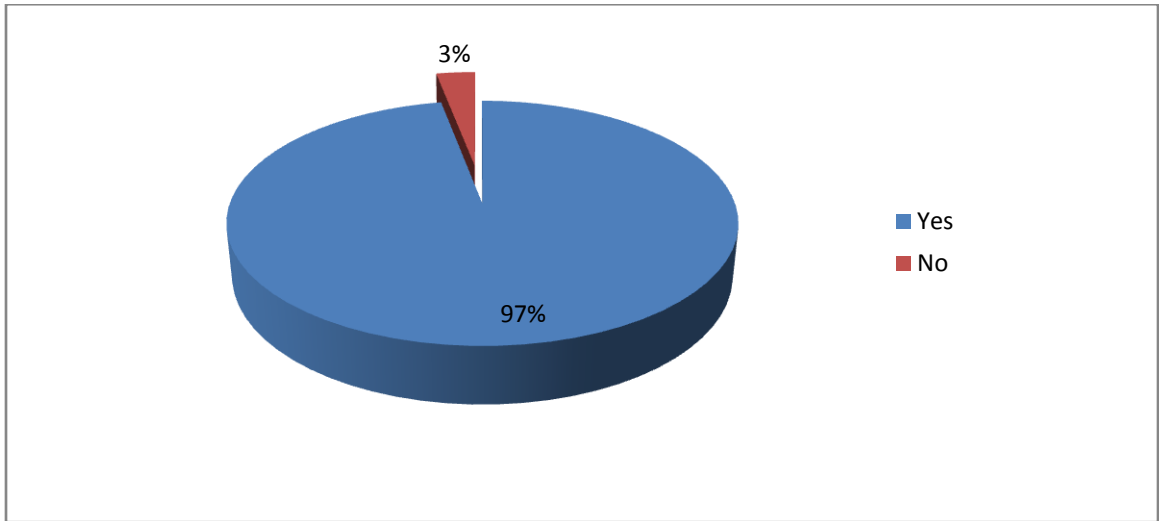
Attitude of Respondents towards Penalty for Submitting False Statement

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	14	93	1	7	15	100
Tax Experts	15	100	0	0	15	100
Auditors	14	93	1	7	15	100
Tax Payers	15	100	0	0	15	100
Total	58	97	2	3	60	100

Source: *Opinion Survey, 2013*

Figure 4.20

Attitude of Respondents towards Penalty for Submitting False Statement



From the above table 4.27, it is observed that 100% of tax administrators and auditors and 93% of tax experts and tax payers are in favour of imposing heavy penalty on those tax payers submitting false statement of self tax assessment for tax purpose meanwhile only 7% of tax administrators and auditors are against of this statement. In average, 97% respondents are in favour and 3% are not in favour. It can be concluded that imposing heavy penalty on those tax payers for submitting false statement of self tax assessment for tax purpose is necessary.

#### 4.10.13 Attitude of Respondents on Fine & Penalty for Non Submission of Account

As per the current income tax act, every tax payer should maintain their books of account and submit to the tax office prescribed on demand. But lack of awareness of tax laws, rules and regulation most of the tax payers do not maintain their books of account though it is compulsory in the act. To know the respondents view about imposing fines and penalty on those tax payer who do not submit account for tax purpose, a question, “Do you favour heavy fines and penalty on those tax payers who do not submit account for the tax purpose?” was asked and the responses are tabulated as below:

Table 4.28

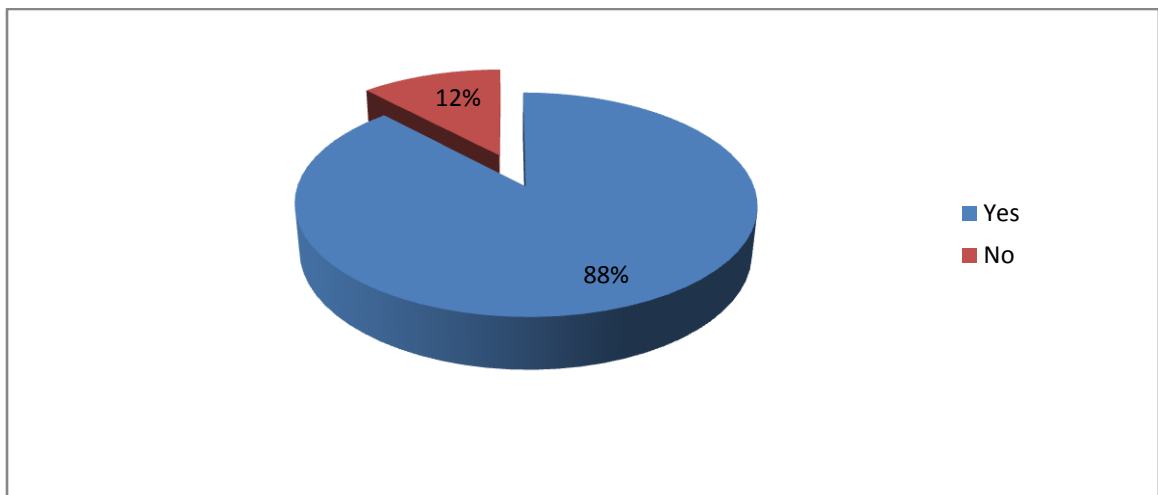
Responses on Heavy Fine & Penalty for Non Submission of Account

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	12	80	3	20	15	100
Tax Experts	14	93	1	7	15	100
Auditors	14	93	1	7	15	100
Tax Payers	13	87	2	13	15	100
Total	53	88	7	12	60	100

Source: *Opinion Survey, 2013*

Figure 4.21

Response on Heavy Fine & Penalty for Non Submission of Account



From the above table 4.28, it is observed that 88% respondents are in favour of such fine and penalty on those tax payers who do not submit account for tax purpose. They think that it is their duty to maintain books of account and submit for tax purpose whenever demanded by department. Only 12% respondents are in against of such provision. It can be concluded that fines and penalty should be imposed on those tax payers who do not maintain and submit books of account for tax purpose while demanded by concern department.

#### 4.10.14 Attitude towards Problems While Paying Income Tax

We have heard and sometimes faced with problems while paying income tax in tax office. There are varieties of problems but it defers according to the place of tax offices and nature of workers. In order to find out problems faced by tax payers, a question, “In your opinion what types of problems are facing by the tax payers while paying income tax?” was asked to the selected respondents of different four groups and their responses have been tabulated as below:

Table 4.29  
Problems Faced by Taxpayer While Paying Income Tax

S.N.	Problems	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Consuming unnecessary time.	58	64	57	70	249	28
2	Expecting illegal incentives by tax personnel.	35	54	53	54	196	22
3	Vague provisions in income tax laws.	49	32	39	37	157	17
4	Lengthy process.	47	39	37	36	157	18
5	Lack of co-operation by tax administrators.	36	36	39	28	139	15
	Total					900	100

Source: *Opinion Survey, 2013*

From the above table 4.29, major problems faced by the taxpayers while paying income tax as per the preference of the respondents are as follows:

- Consuming unnecessary time.
- Expecting illegal incentives by tax personnel.
- Lengthy process.
- Vague provisions in income tax laws.
- Lack of co-operation by tax administrators.

#### 4.10.15 Suggestion for Improving Tax Paying Habit or Tax Payers' Compliance

With the view to find out opinion and suggestion for the improvement of taxpaying habit of people or taxpayers' compliance, a question, "What is your suggestion to improve the taxpaying habit or tax payer's compliance in Nepalese people?" was asked. The responses provided by the respondents are tabulated as per their preference as follows:

Table 4.30

Suggestion for Improving Tax Paying Habit or Tax Payers' Compliance

S.N.	Suggestions	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Simplification of tax assessment procedure.	58	74	69	62	263	21
2	Tax education to tax payers/assesses.	75	70	79	73	297	24
3	Simplification of tax law and rules.	70	70	64	63	267	21
4	Incentives to regular tax payers.	49	43	49	51	192	15
5	Better public relation by tax officers.	39	39	37	40	155	12
6	Heavy fines & penalties to defective tax payers.	24	19	16	26	85	7
	Total					1259	100

Source: *Opinion Survey, 2013*

From the above table 4.30, it is observed that Tax education to tax payers is the most important suggestion to improve taxpaying habit or tax payers' compliance. All the suggestion as per the preference of the respondents is presented in the following way.

- Tax education to tax payers/assesses.

- Simplification of tax law and rules.
- Simplification of tax assessment procedure.
- Incentives to regular tax payers.
- Better public relation by tax officers.
- Heavy fines and penalties to defective tax payers.

Finally it is concluded that improvement is necessary and these suggestions provided by the respondents are very important for the betterment of taxpaying habit and tax payers' compliance.

#### 4.10.16 Effectiveness of Tax Administration

There are different kinds of opinion on tax payers about the effectiveness of tax administration in Nepal. Some says it is effective whereas some says it is not that much effective as it would be. Many tax payers who faced problems while paying taxes have dissatisfaction towards tax administration because of its vague process, time consuming and intension to have illegal incentives by the tax personnel. Therefore, to know the view of the respondents selected, a question, "Do you think tax administration in Nepal is effective?" was asked. The responses provided by them are tabulated as below.

Table 4.31

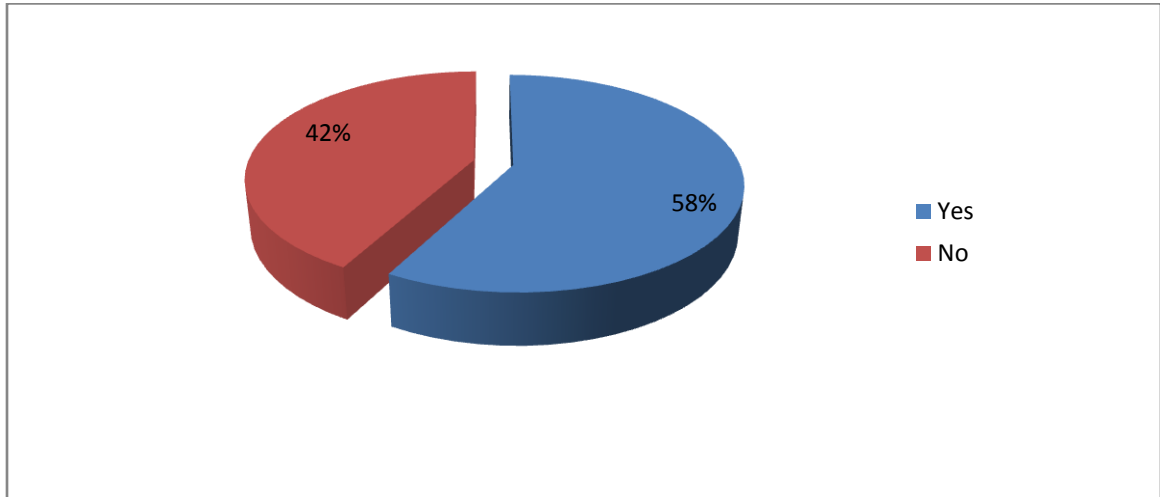
Effectiveness of Tax Administration

Response Respondent	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Administrators	12	80	3	20	15	100
Tax Experts	7	47	8	53	15	100
Auditors	8	53	7	47	15	100
Tax Payers	8	53	7	47	15	100
Total	35	58	25	42	60	100

Source: *Opinion Survey, 2013*

Figure 4.22

Effectiveness of Tax Administration



From the above table 4.31, it is found that 58% of the respondents accepted the effectiveness of tax administration in Nepal while 42% did not accepted it. As per the opinion of the respondents, it is clear that tax administration in Nepal is effective. Those respondents who have not accepted the effectiveness of tax administration in Nepal, were asked an additional question, " If no, what are the possible reasons?" with some possible reasons for ranking. Their responses are tabulated as follows:

Table 4.32

Reasons for Ineffective Tax Administration

S.N.	Reasons	Point received					%
		Tax Adm.	Tax Experts	Auditors	Tax Payers	Total	
1	Lack of knowledge about tax assessment procedures.	7	27	27	25	86	23
2	Lack of meaningful taxpayer information.	10	32	27	25	94	25
3	Lack of proper incentives to tax personnel.	9	28	19	26	82	22
4	Lack of co-ordination within department.	8	18	18	16	60	16
5	Unnecessary outside pressure.	11	15	14	13	53	14
	Total					375	100

Source: *Opinion Survey, 2013*

In the above table 4.32, responses of the respondents are presented in the form of number as per their preference which can be listed in the following way as per ranking of priority given by the respondents:

- Lack of meaningful taxpayer information.
- Lack of knowledge about tax assessment procedures.
- Lack of proper incentives to the tax personnel.
- Lack of co-operation within department.
- Unnecessary outside pressure.

Among the given possible reasons, majority of the respondents denoted lack of meaningful information of taxpayers as the main reason for ineffective tax administration in Nepal. As per the responses of the respondents, other reasons like lack of knowledge about tax assessment procedures, lack of proper incentives to the tax personnel, lack of co-operation and unnecessary outside pressure also plays negative roles for the ineffectiveness of tax administration in Nepal.

#### **4.10.17 Suggestion for Improving Income Tax Assessment Procedure under ITA, 2002**

An open question, "Do you have any other suggestion for improving income tax assessment procedure under New Income Tax Act 2002?" was asked to the respondents if they have any suggestion improving income tax assessment in current income tax act. Some respondents have given their suggestions which are given below:

Suggestions from the Group of Tax Administrators:

- Contribution of income tax to national revenue is not satisfactory because Nepal has less economic development, political instability and feeling of insecurity.
- Tax administration is not effective in Nepal because of lack of professionalism, specialization and specialist, security and institutional problem.
- Simplification of tax laws and rules.
- Following cannons of taxation with automation computerization of the tax system.



- Rules and procedures should be in clear language as per the understanding of taxpayers.

Suggestions from the Group of Tax Experts:

- Exemption limit for natural person should be increased.
- Corporate social responsibility (CSR) is the major responsibility of the company but there is no clear provision for deduction amount which is mentioned in CSR. Also section 101 provides the unlimited power to tax offices which can be harmful.
- Tax evasion should under control.
- Tax principles should be applied.
- Tax assessment procedure is not effective because tax revenue has not been properly used for necessity of people.

Suggestion from the Group of Auditors:

- An income tax assessment procedure is not effective in Nepal because of the problem created by tax offices.
- Tax administration is not effective because of unnecessary rules and regulation on tax assessment procedure.
- Environment should be made to come and register at PAN. Rate should be low and area of tax should be widened. Excess tax deposited should be returned promptly. Exemption calling for natural person is to be increased.
- Public awareness program should be increased and widened.
- Payment of tax should be taken from any branch of the bank prescribed.

Suggestion from the Group of Tax Payers:

- Political commitment should be important for effectiveness of tax administration and tax assessment procedures.
- Reward and punished system should be applied effectively.
- Tare rate should be progressive.
- Tax laws, rules and regulation should be in simple language which can be easily understood.

## **4.11 Major Findings from Data Analysis**

### **4.11.1 Major Findings from Primary Data Analysis**

For primary data, first of all, an opinion survey has been performed to find out the respondents view regarding income tax administration, assessment procedure, provision, rules and regulation and some other aspects of income tax. Following are the major findings from primary data analysis which have been drawn through opinion survey of various respondents i.e. tax administrators, tax experts, auditors and tax payers:

1. Income tax is a suitable means for increasing government revenue in Nepal.
2. Public awareness program is very necessary for increasing government revenue in Nepal.
3. Present level of income tax contribution to national revenue is not satisfactory. There are many reasons playing important role to decrease income tax contribution. The main reason is mass poverty and low income level of the tax payers. Increasing habit of tax evasion, inefficient income tax administration, defective income tax act, and inappropriate rate and exemption limit are other reasons for decreasing contribution of income tax to national revenue in Nepal.
4. Income tax assessment procedure is getting effective in Nepal but it has also been facing many problems. Lack of adequate information about income tax assessment, not maintaining books of account, increasing habit of escaping from paying income tax, maintaining ad hoc books of account, and lack of proper recording system in tax offices are the major problems faced by income tax assessment procedures.
5. Self tax assessment system is suitable in Nepal. Lack of proper accounting system, lack of knowledge about self tax assessment procedure, lack of auditing system, and lack of seminar, meeting & conference about self tax assessment are some reasons which can be obstacle for its successful implementation.
6. The provision given for self tax assessment in the new income tax act is sufficient. To make more sufficient, tax rules regarding self tax assessment should be made simple, tax payers should be encouraged for self tax assessment by providing incentives, and assessment of tax should be made in time.

7. Tax payers are familiar about newly introduced jeopardy assessment as the method of income tax assessment and its provision. Application of jeopardy assessment is not satisfactory in income tax assessment in Nepal because of lack of information about taxpayer to tax officers, lack of clear provisions in income tax laws, unwillingness of tax officers, and tendency of tax officers towards high corruption.
8. The amended assessment method has been widely applied in income tax assessment in Nepal.
9. Income tax assessment procedure in Nepal has been facing various problems from the time of its inception. Lack of adequate information about tax assessment, habit of not maintaining books of account by the tax payers, maintaining ad hock books of account, and lack of proper recording system in tax offices are the major problems faced by tax assessment in Nepal.
10. The time limit to be given for the file return after passing income year is 3 month but not more than 6 month.
11. Heavy fine and penalty should be imposed to those tax payers who submit false statement of self tax assessment.
12. Heavy fines and penalties should be imposed to those tax payers who do not submit account for tax purpose.
13. Tax payers have been facing by various types of problems while paying income tax. Consuming unnecessary time, expecting illegal incentives by tax personnel, lengthy process, vague provisions in income tax laws, and lack of co-operation by tax administrators are the major problems faced by the tax payers while paying income tax to tax offices.
14. Taxpaying habit and tax payer's compliance in context of Nepal is low. To improve such issue, some improvement has to be done. Tax education to the tax payers, simplification of tax laws and rules, simplification of tax assessment procedure, incentives to regular tax payers, better relation by the tax officers, and heavy fines and penalty to the defective tax payers are the major remedies to be done for the improvement.

15. Tax administration is effective in Nepal but it has been facing various problems. Lack of meaningful tax payers information, lack of knowledge about tax assessment procedure, lack of proper incentives to the tax personnel, lack of co-ordination within department, and unnecessary outside pressure are the main reason which should be solved for the more effectiveness of tax administration in Nepal.

#### **4.11.2 Major Findings from Secondary Data Analysis**

It is a clear fact that income tax is one of the most important means of increasing government revenue and mobilizing internal resources in Nepal. To meet government development expenditure, income tax is a major tool. Promoting distributive justice, minimizing regional disparity, and caring resource gap problem are the main factors to be performed for the well development of economic condition of Nepalese people. Income tax also plays important roles to reduce poverty and illiteracy.

1. Contribution of tax revenue on total revenue has dominant role than non tax revenue. The trend of tax revenue collection has been increasing. It has been increasing from the fiscal year 2007/08 to fiscal year 2010/11 from Rs. 79.12 (ten million) to Rs. 87.10 (in ten million) whereas non-income tax revenue has been increasing from the fiscal year 2007/08 to 2010/11.
2. Nepal has been facing serious resource gap problem in the financial sector from the beginning to the present time. It was Rs. 1656.55 (in ten million) at fiscal year 2005/06 and from that fiscal year it has been continuously increasing up to the year 2010/11 at Rs. 3898.93 (in ten million). There are various reasons by which it has been increasing. The main causes of resource gap are lack of mobilization of other domestic resources, government expenditure is increasing at a faster rate than the increase in revenue, increasing inflation rate, increasing burden of debt serving, defective government expenditure program, political instability and commitment, and weak management functions.
3. Tax revenue includes direct tax and indirect tax in Nepal. Indirect tax has dominant role in tax revenue in Nepal. The contribution of direct tax and indirect

tax to tax revenue in Nepal are Rs. 26.95 and Rs. 73.05 (in ten million) respectively in the fiscal year 2001/02. Up to fiscal year direct tax and indirect tax contributed Rs. 28.16 and Rs. 71.84 (in ten million) respectively. This trend clearly shows the dominant role of indirect tax over direct tax.

4. Income tax revenue is the composition of business tax which includes tax from public enterprises, semi-public enterprise, private corporate bodies and individual remuneration and tax on interest.
5. The contribution of income tax from public enterprises sector has been increasing from Rs. 20.46 (in ten million) in the fiscal year 2007/08 to Rs. 128.18 in the fiscal year 2010/11 in term of collection but percentage contribution of public enterprise to total income tax revenue has been in decreasing trend during last three year of the study period from 3.81% to 3.30%.
6. The contribution of income tax from private corporate bodies has been increasing from Rs. 153.13 (in ten million) in the fiscal year 2003/04 to Rs. 1396.55 in the fiscal year 2010/11 in term of collection continuously but percentage contribution to total income tax revenue has been in fluctuating trend between 15.86% to 41.51% during the study period.
7. The contribution of income tax from individual bodies has been increasing from Rs. 336.22 (in ten million) in the fiscal year 2002/03 to Rs. 1362.74 in the fiscal year 2010/11 in term of collection but its percentage contribution to total income tax revenue is in decreasing trend from 39.29% of the fiscal year 2008/09 to 34.98% of the fiscal year 2010/11 during the study period.
8. The contribution of income tax from remuneration has been increasing from Rs. 59.73 (in ten million) in the fiscal year 200/03 to Rs. 586.33 in the fiscal year 2010/11 in term of collection whereas percentage contribution to total income tax revenue is in fluctuating trend in between 34.75% to 40.82% during the study period.
9. The contribution of income tax from tax on interest has been increasing from Rs. 73.34 (in ten million) in the fiscal year 2003/04 to Rs. 413.05 in the fiscal year 2010/11 in term of collection. Percentage contribution of income tax to total

income tax revenue has been also increasing from 6.28 % in the fiscal year 2007/08 to 10.64% in the fiscal year 2010/11 during the study period.

10. The contribution of income tax on GDP, total revenue, total tax revenue, and direct tax revenue in the fiscal year 2001/02 is 2.07%, 17.65%, 22.30%, and 84.02% respectively. They are 3.18%, 19.43%, 22.47%, and 79.78% respectively in the fiscal year 2010/11. Contribution of income tax to GDP has been in increasing trend from the fiscal year 2006/07 to 2010/11 but its portion is very low that others. Contribution of income tax to total revenue, total tax revenue and direct tax revenue is in fluctuating trend.

## **CHAPTER-V**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

Nepal, a landlocked country situated in between two large developing countries China and India, has been facing many problems basically financial problems. Due to lack of financial resources, development activities has been very low at it would be. Therefore, it is the reality that Nepal has been depending on foreign grants and debt. Every year foreign grants and debt have been increasing but resource gap problem has not been solved instead it has been increasing. Over 60 years of our reliance on foreign aid could not deliver satisfactory result on economic front. Foreign aid may work as a cetamol to get fever down for a short time, but to cure the country's economic illness, we need a strong national revenue source. To fulfill resource gap tax revenue is one of the most important sources of internal revenue. Reliable and strong tax revenue is prerequisite for economic development. The contribution of income tax revenue to total tax revenue is very low in Nepal because of low economic activities and less development in corporate sectors. The reason for low tax revenue collections are; marginal high tax rates, limited tax base, poor voluntary compliance, leakage in tax collection, rigid income tax provisions, corrupted employees of tax department, and lack of service and education to taxpayers about self tax assessment procedures.

In order to find out the problems faced by taxpayers and tax officers about the income tax assessment in Nepal, a set of question was distributed among the selected four group; tax administrators, tax experts, auditors, and taxpayers. On the opinion survey, empirical investigations have found the strengths and weakness of income tax act, tax administration, income tax assessment and its procedures.

93% of the total respondents believed income tax revenue as a suitable means for increasing government revenue and 100% respondents considered necessity of public awareness programs for raising government revenue in Nepal. 40% of the total respondents accepted the satisfactory contribution of income tax to national revenue

whereas remaining 60% did not accept it due to mass poverty and low income level, increasing habit of tax evasion, and inefficient income tax administration in Nepal. 55% of the total respondents trusted on the effectiveness of income tax assessment procedures in Nepal but 45% did not trust because of taxpayers' habit of not keeping their books of account and lack of adequate information about income assessment. 83% respondents believed that self tax assessment system is suitable in Nepal. 52% of the total respondents accepted the sufficiency of existing provision regarding self tax assessment whereas 48% respondents wanted improvement on the provisions. 65% of the total respondents are known about jeopardy assessment among them 22% accepted on the satisfactory application of it where as 43% did not accept it due to lack of information about taxpayers to tax officers and lack of clear provision in income tax laws. In the same way, 65% of the total respondents also believed on the wide application of amended assessment in Nepal.

As per the opinion of the respondents, lack of adequate information about tax assessment, lack of maintaining books of account, maintaining ad hock books of account by the taxpayers, and lack of proper recording system in tax offices are the main problems in income tax assessment procedures in Nepal. 65% of the total respondents preferred existing time limit (3 month), 23% preferred 6, and only 12% preferred 1 month as the time limit to be given for the file return after passing the income year. 97% of the total respondents supported imposing heavy fine and penalty on those taxpayers who submit false statement of self tax assessment. In the same way, 88% respondents also supported imposing heavy fine and penalty on those taxpayers who do not submit account for tax purpose.

As per the opinion of the respondents, consuming unnecessary time, expecting illegal incentives by the personnel, lengthy process and vague provision in income tax laws, and lack of co-ordination by the tax administrators are the major problems faced by the taxpayers while paying income tax. Tax education to the taxpayers, simplification of tax laws and rules, simplification of tax assessment procedure, providing incentive to the regular taxpayers, and heavy fines and penalties to defective taxpayers are the major



improvements to be done for improving the taxpaying habit or taxpayers' compliance in Nepal. 58% of the total respondents accepted the effectiveness of tax administration whereas 42% did not accept it due to lack of meaningful information about taxpayers, lack of knowledge about tax assessment procedures, lack of proper incentives to the tax personnel, lack of co-ordination within department, and unnecessary outside pressure in Nepal.

From the study of the secondary data, it has been found that the percentage of tax revenue and non tax revenue were 87.10% and 12.90% respectively in the fiscal year 2010/11. This clearly shows that the share of tax revenue is greater than non tax revenue. The percentage of direct tax to total tax revenue was 28.16% and the percentage of indirect tax to total tax revenue was 71.84 in the fiscal year 2010/11. Indirect tax found to have dominant role over direct tax it is because of low income level and less improvement in public and private sectors. The contribution of income tax to direct tax is higher than other taxes as it covered large portion of direct tax. It was 79.88% of direct tax in the fiscal year 2010/11. The contribution of total tax revenue to gross domestic product (GDP) was 14.24% and contribution of income tax revenue to GDP was 3.18% in the fiscal year 2010/11 which are found to be very low.

Income tax collection has been increasing gradually from the fiscal year 2006/07 to 2010/11 of the study period. However it could not meet the estimated level of income tax collection from the fiscal year 2001/02 to 2009/10, it has crossed the limit in the fiscal year 2010/11 by 2.49% of estimated collection of income tax. This figure clearly shows the improvement in income tax collection but this is not the end we should still work hard.

Income tax exemption limit has been changing time to time as per the income and expenditure level of the taxpayers in Nepal. Currently exemption limit for individual is Rs. 160,000 and for couple Rs. 200,000. The exemption limit is only for resident individual and couple.

Personal income tax rate for resident individual and couple are progressive to 25%. In the same way, corporate tax rate is flat at present and it is based on the nature of the entity. Income tax rate is 25% for normal business, 30% for banks and financial institutions, and 20% for special industries.

## **5.2 Conclusion**

Nepal has many problems facing due to lack of sufficient financial resources to meet well development of the country. However it has tremendous natural resources, lack of appropriate fund and technology to utilize such resources it has been facing many problems like poverty, hunger and diseases, unemployment and heavy dependency on traditional agriculture, lack of adequate industries, low income level of people, socio-political and geographical constraints. Economic development is also very low in Nepal in spite of applying long term plans because of lack of sufficient fund, political ups and downs, and insecure feeling by the foreign investors. Plans and programs have not been effectively formulated and implemented. Due to shortage of capital resource, resource gap problem has become a major issue of Nepal. Foreign aid has been increasing year by year but it has not accelerated the economic growth of Nepal. For sustainable economic development and growth, proper utilization and mobilization of available internal resources is necessary but Nepal has failed on this.

Before 1959/60, there was no any specific law relating to income tax. Many traditional systems have been used for income tax collection. Modern income tax system was firstly introduced in 1959/60 in the form of business profit and remuneration tax. In 1962, income tax act introduced a comprehensive income tax and it was replaced by another income tax act in 1974 with some extra facilities and provisions. The income tax act of 1974 was also replaced by the Income Tax Act 2002 as well as Income Tax Rules 2002. These are the existing laws regarding income tax administration.

It is very obvious that tax is the main internal source for generating government revenue but it does not mean that the government should only concentrate in to tax revenue collected from tax payers. It should not be generalized that taxes should be taken only

from the taxpayers. Tax should not be the burden for people and they should be encouraged and motivated for paying tax. To minimize dependency upon foreign grants and debt, tax revenue can play a significant role in Nepal.

Income tax has covered major part in tax revenue of the government. It is found that income tax has been increasing year by year in Nepal. It is very necessary to collect income tax for the development of the nation but it should not be burden to the people. Income tax should be levied with the purpose of equal distribution of the income and well development of the country. It should be collected with the purpose of minimizing gap between poor and rich. Therefore, tax payers should be encouraged and motivated for paying tax by providing incentives to the regular tax payers. In the say way, tax acts and laws should be simple and clear to understand, tax administration should be effective, policies should be sound and fair, and income tax rates should be appropriate and wide base as per the income level of the taxpayers in Nepal.

Effective tax administration is the prerequisite for effective implementation of the income tax act and rules. As per this study, it is found that there are almost 50-50 percent people supporting for effectiveness and ineffectiveness of tax administration in Nepal. To collect more and more revenue from tax, effective tax administration is the main requirement for any country. Due to lack of meaningful information about tax payers, lack of knowledge about tax assessment procedures, lack of proper incentives to the tax personal, lack of co-ordination within department, and unnecessary outside pressures are the major causes because of that tax administration could not progress in that range which it should obtain. Although tax administration has many issues to improve for effectiveness, it has been working hard and good results have been displaying year after year.

Income tax assessment plays important role in collection of income tax revenue. For income tax assessment, there are mainly three methods have been introduced in the current income tax act; self tax assessment, jeopardy assessment, and amended assessment. Among this tax assessment method, existing income tax act specified self tax assessment method. Self tax assessment method is widely applied in income tax

assessment in Nepal. It is found that there is not satisfactory implementation of self tax assessment method due to lack of proper accounting system, lack of knowledge about self tax assessment procedure, lack of correct auditing system, and lack of tax education about self tax assessment through seminar, meeting and conference. For increasing government revenue from income tax, simplification of self tax assessment system is required. There should be simple and clear provision which can be easily understood by the general tax payers. Effectiveness of income tax assessment entirely depends on proper implementation of provision of income tax assessment. Therefore, provisions should not be confusing and vague. Proper, fair and reasonable income tax assessment method not only helps to increase the revenue but also minimize gap between different levels of people in the society.

Income tax collection also depends on the effective implementation of income tax assessment procedures. Effective implementation of income tax assessment procedure also depends on the quality of income tax personnel, tax payers and tax law and policies. Assessment procedure is the main part of tax administration through which good result can be achieved. Nepal has been facing many problems on the way to effective implementation of income tax assessment procedures. Lack of adequate information about income tax assessment, not maintaining books of account by tax payers, maintaining ad hoc books of account, and lack of proper recording system in tax offices are the major problems faced by the Nepalese Government. If the assessment procedures were made simple and clear to understand, it could increase its effectiveness.

For the betterment of the country's economy, increasing revenue is the main task to be performed. For that, various issues have to be managed at time and go ahead. Many other countries facing problems like Nepal have progressed in a faster ratio. To increase government revenue, tax education to the people is the basic need which has to be provided with full motion. Simplification of tax laws, policies, and rules should be done effectively. Better public relation should be maintained. Heavy fines and penalties should be imposed to those tax payers who do not submit income statement at time and who

submit false statement. Another most important aspect is to provide incentives to the regular tax payers and hard working honest tax personnel in a regular basis.

### **5.3 Recommendations**

Following recommendations have been found from this study:

1. For effective use of taxation and its application, cannons of taxation should be effectively applied in tax administration.
2. Acts and rules regarding taxes should be made simple and clear so that normal tax payers can easily understand.
3. Unused and unproductive acts and rules should be amended in time as per the demand of time.
4. Unnecessary provisions which are complex and vague to understand by normal tax payers should be revised and should be made as per the necessity and demand of time.
5. Tax laws should be effective and practical. Policies should be formulated according to the economic policy of the country by the effective team of tax experts which should be simple, clear, and reasonable for the country and tax payers.
6. The rate of income tax should be progressive. It should be reformed as per the income and expenditure level of the tax payers. Area of taxation should be widened.
7. Exemption limits for resident individual and couple should be increased as per the ratio of inflation and income and expenditure level of the tax payers.
8. Since tax administration is the main body of government for collecting government revenue, it should be free from corruption and unnecessary outside pressure. Tax administration should have sufficient knowledge about tax assessment and meaningful information about tax payers. Proper incentives should be provided to the regular tax payers and there should be healthy relation within department for the effective tax administration.
9. For effective income tax assessment, tax administration should have sound information about tax payers. Tax payers should be regulated for maintaining

books of account as per the standard accounting system. Appropriate auditing system should be developed and implemented.

10. For the effective use of self tax assessment system in Nepal, proper accounting system should be developed, should have sufficient knowledge about income tax assessment, and correct auditing system should be applied. Seminar, meeting and conference should be organized time to time so that tax payers and tax personnel can understand about income tax assessment.
11. For the sufficiency of the provisions given for self tax assessment, income tax rules regarding self assessment should be made simple and clear, tax payers should be encouraged for self assessment by providing incentives, and tax assessment should be made in time.
12. For satisfactory application of jeopardy and amended assessments in Nepal, tax offices should have adequate information about tax payers, provisions should be clear to understand, tax personnel should be encouraged, and tendency of tax officers towards high corruption should be controlled in time.
13. For effective application of income tax assessment procedures, tax payers should be encouraged and motivated for maintaining their books of account, adequate information about income tax assessment should be obtained by the tax administration, habit of escaping from paying income tax should be controlled, system of maintaining ad hock books of account should be controlled, and proper recording system in tax offices should be developed.
14. Contribution of income tax to national revenue should be made satisfactory by increasing income level of tax payers, decreasing poverty, controlling increasing habit of tax evasion, improving inefficient income tax administration, reforming income tax laws, and revising rate and exemption limit time to time.
15. Tax education should be provided to the tax payers by using media like televisions, newspapers, fm stations, and internet.
16. Fines and penalties should be imposed on those tax payers who submit false statement for self tax assessment and who do not submit account for tax purpose.

17. Tax personnel should be encouraged, punished and transferred on the basis of their work and experience. Regular and effective training system, reward and punishment system should be established for effective tax administration.
18. Excess payment of tax by the business organizations should be refunded prompt.
19. System and technology used in tax offices should be updated in time so as to make work simple and easy. Computer link between tax offices and custom offices should be maintained.
20. Provision relating to deduction should be simplified and all items of deduction should be clearly defined in Act.
21. A research and intelligence depart should be established in each tax office for proper planning and to collect meaningful information regarding income tax evaders, potential new tax payers and the business operating without registration.
22. House owner providing house in rent, doctors, lawyers, consultants and other professional persons should be effectively monitored and made them responsible for paying income tax.
23. Capital gain should be calculated after adjusting time value of money for the tax purpose.

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**APPENDIX I**  
**(COVERING LETTER)**

Dear Sir and Madam,  
Namaste!

First of all, I would like to introduce myself. I am a student of Nepal Commerce Campus, currently engaged in the research work on “A Study on Income Tax Assessment Procedure in Nepal under Income Tax Act 2002” for the fulfillment of my dissertation paper on management for the Master’s Degree in Business Studies (MBS), Tribhuvan University at Kathmandu. To fulfill my thesis work, I do need a kind help from you. I request you to fill up the following questionnaire. I look forward to your kind co-operation and also assure you that whatever information you provide me solely be utilized in the research work.

Thanking you.

Regards,  
Mohan Sapkota  
Nepal Commerce Campus  
Minbhawan, Kathmandu, Nepal

## QUESTIONNAIRE

Name:-

Designation:-

Office/Organization:-

Occupation:-

Please tick (√) the answer of your choice and whenever appropriate put in order of preference from 1 to last number of alternatives providing number 1 for the most important and the last number for the least important.

1 Do you think that the income tax is a suitable means of increasing government revenue in Nepal?

a. Yes [ ]

b. No [ ]

2. Do you think that public awareness program is necessary in Nepal for increasing government revenue?

a. Yes [ ]

b. No [ ]

3. In your opinion, is contribution of income tax to national revenue of Nepal satisfactory?

a. Yes [ ]

b. No [ ]

If no, what are the major reasons? (Please rank according to the priority from 1 to 5)

a. Defective of Income Tax Act. [ ]

b. Mass poverty and low income level [ ]

c. Increasing habit of tax evasion. [ ]

d. Inefficient income tax administration. [ ]

e. Inappropriate rate & exemption limit. [ ]

If any, please specify.....

4. Do you think that income tax assessment procedure in Nepal is effective?

a. Yes [ ]

b. No [ ]

If no, what may be the problems? (Please rank according to the priority from 1 to 5)

a. Maintain ad hock books of account. [ ]

b. Taxpayers do not maintain their books of account. [ ]

c. Lack of adequate information about income assessment. [ ]

d. Taxpayers want to escape for paying tax. [ ]

e. Lack of proper recording system in tax. [ ]

If any, please specify.....

5. Do you think that Self Tax Assessment System (STAS) is suitable in Nepal?

a. Yes [ ]

b. No [ ]

If no, what are the reasons? (Please rank according to the priority from 1 to 4)

a. Lack of proper accounting system. [ ]

b. Lack of knowledge about self tax assessment procedure. [ ]

c. Lack of correct auditing system. [ ]

d. Lack of seminar, meeting & conference about self tax assessment. [ ]

Any other, please specify.....

6. Do you think that the provision given for self tax assessment in the new income tax act is sufficient?

a. Yes [ ]

b. No [ ]

If no, how can it be improved? (Please rank according to the priority from 1 to 3)

a. Income tax rule regards self assessment should be made simple. [ ]

b. Encourage the taxpayer for self assessment by providing incentives. [ ]

c. Assessment of tax should be made in time. [ ]

If any, please specify.....

7. Do you know about Jeopardy Assessment?

a. Yes [ ]

b. No [ ]

8. Do you consider that jeopardy assessment has been applied satisfactory in income tax assessment?

a. Yes [ ]

b. No [ ]

If no, what are the major causes? (Please rank according to the priority from 1 to 4)

a. Lack of information about tax payer to tax officers. [ ]

b. Lack of clear provisions in income tax laws. [ ]

c. Unwillingness of tax officers. [ ]

d. Tendency of tax officers towards high corruption. [ ]

9. Do you think that the amended assessment has been widely applied in income tax assessment in Nepal?

a. Yes [ ]

b. No [ ]

10. What are the problems in income tax assessment procedures in Nepal? (Please rank according to the priority from 1 to 4)

a. Maintain ad hock books of account. [ ]

b. Lack of adequate information about the tax assessment. [ ]

c. Assessors do not maintain books of account. [ ]

d. Lack of proper recording system in tax offices. [ ]

If any, please specify.....

11. In your opinion what should be the time limit to be given for the file return after passing the income year?

- a. 1 month. [ ]
- b. 3 month. [ ]
- c. 6 month. [ ]
- d. 1 year. [ ]

12. Do you favour heavy penalty on those tax payers who submit false statement of self tax assessment?

- a. Yes [ ]
- b. No [ ]

13. Do you favour heavy fines and penalty on those tax payers who do not submit account for the tax purpose?

- a. Yes [ ]
- b. No [ ]

14. In your opinion what types of problems are facing by the tax payers while paying income tax? (Please rank according to the priority from 1 to 5)

- a. Consuming unnecessary time. [ ]
- b. Expectation illegal incentives by tax personnel. [ ]
- c. Vague provisions in income tax laws. [ ]
- d. Lengthy process. [ ]
- e. Lack of co-operation by tax administrator. [ ]

If any, please specify.....

15. What is your suggestion to improve the taxpaying habit or tax payer's compliance in Nepalese people? (Please rank according to the priority from 1 to 6)

- a. Simplification of tax assessment procedure. [ ]
- b. Tax education to tax payers/assesses. [ ]
- c. Simplification of tax law and rules. [ ]



- d. Incentive to regular tax payers. [ ]
  - e. Better public relation by tax officers. [ ]
  - f. Heavy fines & penalties to defective tax payers. [ ]
- If any, please specify.....

16. Do you think tax administration in Nepal is effective?

- a. Yes [ ]
- b. No [ ]

If no, what are the possible reasons? (Please rank according to the priority from 1 to 5)

- a. Lack of knowledge about tax assessment procedures. [ ]
  - b. Lack of meaningful taxpayer's information. [ ]
  - c. Lack of proper incentives to tax personnel. [ ]
  - d. Lack of co-ordination within department. [ ]
  - e. Unnecessary outside pressure. [ ]
- If any, please specify.....

17. Do you have any other suggestion for improving income tax assessment procedure under New Income Tax Act 2002? If yes, please specify.....