

CHAPTER – I

INTRODUCTION

1.1 Background of the study

Nepal is a landlocked country situated in south Asia, the middle part of northern hemisphere of the world map. It is bordered to the north by the Tibet, the autonomous region of the People's Republic of China, and to the south, east, and west by the Republic of India. Nepal's population is about 30 million with an area of 147,181 square kilometers (56,827 sq mi). Nepal is rich in biodiversity. The Himalaya, the northern part, has eight of the world's tallest fourteen mountains, including the highest point on Earth, Mt. Everest. It contains more than 240 peaks over 20,000 ft (6,096 m) above sea.

The country is divided in three regions; Mountain, Hill and Tarai accommodating 15, 68 and 17 % of its total land area respectively. Based on area of districts these regions constitute 7, 49 and 44 % of the population respectively. There are 5 development regions and 75 administrative districts. Currently, there are 3914 VDCs and 58 Municipalities in the country. There are number of peaks, rivers and lakes in the country. Nepal is the member of the United Nations and has established diplomatic relations with 119 countries of the world. Major export commodities are ready-made garments, Carpets (Hand-knitted carpets), hides and skins, vegetable ghee, zinc Sheet, jute goods, textiles, toothpaste, pashmina, juice, and handicrafts.

Nepal's gross domestic product (GDP) for 2011 was estimated at over US\$ 17.311 billion (adjusted to Nominal GDP), making it the 115th-largest economy in the world. Agriculture accounts for about 35.68% of Nepal's GDP,

services comprise 50.31% and industry 14.02%. Agriculture employs 76% of the workforce, services 18% and manufacturing/craft-based industry 6%. Industry mainly involves the processing of agricultural produce, including jute, sugarcane, tobacco, and grain. Agricultural produce, mostly grown in the Tarai region bordering India, includes tea, rice, corn, wheat, sugarcane, root crops, milk and meat. (IMF2010). Net plan resource gap of the country has been widening from the beginning to recent year. In this situation, one of the main objectives of every nation of the world is to achieve faster economic development and Nepal is no exception to this ever-continuing process. The Government of Nepal is trying to raise the living standard of peoples conducting various economic development activities. Our country needs to manage the various resources like; man, money, machine and materials. To obtain these particular resources the government receives income through external and internal sources.

To achieve economic development, government accounts responsibilities towards their citizens, such as security, health, education, reduce social inequalities and other development activities. It needs to accumulate huge amount of revenue. Every year the government spends more portion of the fund for the protection of common people and creation of various socio-economic infrastructures like; transportation, drinking water, electricity, communication, irrigation etc. To meet the growing expenditure, government has to manage funds from different sources.

Income can be collected from both internal and external sources. External resources can be obtained as grants and loan bilaterally or through international institution. External resources are uncertain and guided by, socio-political motives of the donor countries. So, it is not good for healthy development if there is highly dependency on them used for economic

development, reconstruction, foreign exchange, to recover from crisis condition etc. Internal sources include public borrowing, government bonds, surplus on public under taking and taxation. The internal sources should be mobilized effectively due to weakness of external sources. Nepal government has to mobilize internal sources for regular and development activities.

Internal source of fund is own source derived within the country. Internal source of fund includes both tax and non-tax sources. Tax sources include the amounts which are compulsorily contributed by tax payers to the government. Taxes are imposed by on all countries developed as well as developing countries because they have the option for increasing the yield of tax system. It shows that taxes are the better sources of public revenue and it has been taken as the best effective tool for raising the public fund.

Among internal resources, taxation is a prime factor. It is the pillar of the fiscal policy. It is the backbone of welfare of the state. The government mostly imposes tax to finance, various welfare and social services. The amount which is legally collected from the people to manage the expenditure of the government is called tax. According to the Income tax act 2058(2002), income includes all the income which is received from business, investment and employment.

Tax may be classified into two types; direct and indirect taxes. Direct tax is a tax which is directly paid by a person on whom it is legally imposed. Some of the direct taxes are income tax, property tax, interest tax, death tax and vehicle tax. Indirect tax is that tax which is imposed on one person but paid partly or fully by another. Some of the indirect taxes are sales tax, entertainment tax, passenger tax, hotel tax, import-export duty, excise duty, Value Add Tax (VAT) etc. Income tax is one of the main components of direct tax. It is collected from public enterprises, semi-public enterprises, private

corporate bodies and individuals. In other words, tax is collected by both direct and indirect ways.

Developing countries like Nepal, having low per capita income highly depend on indirect tax rather than on direct tax. The share of income tax is much lower in the composition of direct tax revenue. In the initial stage of economic development, indirect tax has its own significant role. Similarly, after a certain stage of economic development, direct tax plays a vital role.

To build up sound financial status and achieving social justice, economic sources should be mobilized effectively, through direct tax like income tax. It has given high preference to the developed and developing countries. People who have paid tax are invested on public expenditure, although they cannot get any direct benefit from their income taxes. They can observe the use of collected fund through it has significant role. Nepal still has been unable to maximize the collection of income tax. At present the contribution of income tax is minimum. Income tax is only about 17.36% on total revenue in the fiscal year 2066/2067 (2009/10).

1.2 Statement of the Problem

Economic development is the prime concern of every nation of the world. Underdeveloped countries are facing serious problem in the process of economic development. Nepal is also not an exception to this condition. The majority of people have not been able to get even basic facilities. The government wants to fulfill the basic needs of the people and accelerate development activities one at a time. Thus, every nation of the world is accomplishing various activities to fulfill these objectives. It needs huge amount of capital. Despite the various measures adopted by the government to boost revenue collection, there is still a substantial resource gap between expenditure and revenue. The rate of government expenditure is exceeding the rate of growth revenue almost every year. In other words, Nepal has been facing

persistent budget deficit from the beginning of her development phase. External deficits, currency depreciation, inflationary pressure, rising interest rates which may cause crowding out effect and reduction in economic growth are the consequences of the budget deficits. The mobilization of revenue has not increased to the level in which the level and speed of our expenditure is rising. Raising the government revenue helps to overcome from the serious bottleneck of resource gap in the process of economic development programs by mobilizing additional resources from domestic sources.

Income tax is one of the component of taxation and major sources of government revenue. Income tax in developing nations has been regarded as an instrument of growth and social justice. But Government of Nepal is being unable to mobilize the expected income tax from personal as well as corporation. Most of the personal taxpayers do not reveal the income sources even they earn significant amount. They hardly keep and show their proper accounts. Similarly, many research reports have addressed that tax evasion has become a serious problem as a result the actual collection of income tax is being very low. So, the role of corporate income tax revenue is justifiable. Corporations are easily identifiable, keep their accounts and cannot escape tax liabilities. But corporate sector is still in initial state of development in Nepal. The performance of corporate sector, especially, the industry is very poor. Their number, profitability, investment in fixed assets, share in market transaction are all in weak position. There is no agreement as regards to various issues in corporate tax area. The debate is going on as regards to base of tax, method of taxing corporation, method and rate of depreciation, use of appropriate type of tax incentive, treatment of tax inflation etc.

The main issues addressed for the study are:

- a. Whether the government collect significant amount from the income tax or not?

- b. In the composition of direct tax, income tax plays vital role or not?
- c. Whether Nepalese taxpayer are aware about tax system or not?
- d. Whether the resource gap of Nepal is increasing or decreasing trend?

1.3 Objectives of the Study

The main objective of this research is to provide some feedback to national policy makers and the concerned authorities for formulating appropriate income tax policies to enhance the contribution of income tax to the government revenue in Nepal. Specially, this research has conducted to study the following objectives:

1. To study the structure and trend of income tax in Nepal.
2. To analyze the contribution of income tax to national income of Nepal.
3. To know the composition of direct tax and indirect tax.
4. To provide suggestion and recommendation for improvement of income tax system of Nepal.

1.4 Significance of the Study

The rapid population growth, the appearance of strong local and central level awareness and emerging globalization have been contributing to the strong pressure on the small economy to make huge investment in infrastructures, socio- economic activities and so many other areas for the development of the nation. Nepal, being a least developed country (LDC) in the map of the world, has been facing the resource gap in national economy seriously every year. One the other hand, she has huge trade deficits with neighboring countries as well as all other trading partners after the policy reform period.

The resources gap was 23180.40 million in the fiscal year 1996 /97 and it was 79743.10 million in fiscal year 2009/10. The rate of government expenditure exceeding the rate of revenue growth almost every year, Expenditure has 50723.7 million in fiscal year 1996/97 and 151019.1 million in fiscal year 2009/10. It shows that Nepal has been facing persistent budget deficit from the beginning. External deficit, currency depreciation, inflationary pressure, rising interest rate which may cause crowding out effect and reduction in economic growth are the consequence of the budget deficits. Raising the government revenue helps to overcome from the serious bottleneck problem of resource gap in the process of economic development programs by mobilization additional resource from domestic sources.

Income tax is one of the component of taxation and major sources of government revenue. It has only 1.69% of GDP in fiscal year 1996/97 and 2.94% in fiscal year 2009/10. It is fluctuated time to time but GDP regular increases from 2006/2007. It was increased from 2.23% to 2.94%. It has 2.94% of GDP In fiscal year 2009/10 which was greatest in the recent 13 years period.

Income tax in developing nations has been regarded as an instrument of growth and social justice. But Nepal Government is being unable to mobilize the expected income tax from person as well as corporation. It was 49.88% in 1996/97 and 49.37% in 2009/10 from persons. It was 49.88% in 1996/97 and 49.37% of total income tax in 2009/10. It is in the decreasing trend.

For the development of the country, income tax is more essential. In the recent years it was around 17% -18% of tax revenue. It was fluctuated from time to time. It was 14.87% in the fiscal years 1996 /97 and it was increased to 18.64% in fiscal year 2000/01 but it was 17.36% in the fiscal year 2009/10.

So the study has tried to identify problems and to overcome them so as to improve income tax system which is essential for revenue collection for Nepal.

Most of the individual taxpayers do not reveal the sources of income even they earn significant amount. They hardly keep and show their account. Past experience shows that there is poor taxpaying habit in Nepalese people. Similarly, tax evasion has become a serious problem in Nepal. Awareness of tax payers, lack of training and education to tax personnel, delay in making assessment, irresponsible tax administrators in their duties, inconvenient tax system and existence of corruption are main causes for low contribution of income tax to national revenue.

In this context, the easy and long lasting way to increase revenue to strength the internal source is income tax. So, the importance of income tax cannot be minimized for reducing economic inequality as well as development activities. Thus," An analysis of the income tax structure and its contribution to government revenue in Nepal" has been chosen as a relevant topic for the study.

The study might be fruitful for all policy makers, planners, tax officer, tax administrators, researchers, students and all the interested people who want to know about income tax.

1.5 Limitation of the Study

Any research study is limited by the information and data, time period and area of the study. This study has also some limitations they are as follows.

1. The study has covers only recent thirteen years' data and the focus is given to income tax.

2. Basically, the secondary data were used in the study.
3. The study has been based on the availability of reliable data.
4. Primary data have been collected from opinion survey.
5. The Filed study the limited to Katmandu Valley for primary data proposes. So it may not represent the country as a whole.

1.6 Organization of the Study

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

1. Introduction
2. Review of literature
3. Research methodology
4. Presentation and analysis of data
5. Summary, conclusion and recommendations.

The first introduction chapter includes statements of the problem, objectives of the study significance of the study, limitations of the study. The second chapter review of literature includes theoretical framework and review of related books articles, and thesis. Research methodology has been mentioned in the third chapter. It includes research design, nature and sources of data; data collection precedes population and size of sample tools and techniques for data analysis. Presentation and analysis of data have been the presented in the fourth chapter. Collected data from various sources were tabulated in sequential order and data has described, analyzed and projected using various statistical tools. The fifth chapter consists of brief summary, conclusions and recommendation of the study. Lastly bibliography and appendices were also presented.

CHAPTER – II

REVIEW OF LITERATURE

2.1 Introduction

Literature review is a process to find what other authors, researchers and scholars have covered and what are the issues left in the subject area. It deals with the review of literature that includes research gap, theoretical framework and review of related books, concerned websites, articles, booklets, newspapers, and thesis reports. It is also a way to avoid investigation problems that have already been definitely answered. The purpose of literature review is to find out what research studies have been conducted in one's chosen field of the study and what remains to do. The primary purpose of the literature review is to learn from other scholars contributions in the related subject area. It enables the researcher to know what research has been done in the subject?. What others have been done in the study? What theories have been advanced? the approach taken by the other researcher , area of agreement or disagreement? And whether there are gaps that can fill through the proposed research? (Wolf and Pant, 2005: 40).

2.1.1 Historical Development of Income Tax in world

Great Britain is the first country to introduce Income Tax Act in the world. The British Government introduced Income Tax Act in 1799 in order to generate revenue for finance for the war against France. The Income Tax Acts were introduced in USA in 1862, Italy in 1862, India in 1886, Switzerland in 1869 and in Nepal in 1959 (Bhattarai and Koirala, 2004:5).

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 a great sin. According to Hindu's Holy Scripture and 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 developed countries (DCs), the most important feature of the tax policy has been the rise of the personal income tax to a significant proportion in the revenue structure. The income tax was introduced to finance the war in most of these countries. But it remained in place after the war, primary as a relatively modest tax on higher incomes and latter became a mass-tax during or soon after the second world war, since then, the personal income tax revenue has a trend of unparalleled increase in real and especially in nominal terms.

Historical Development of Income Tax in Nepal

2.1.2 Taxation in ancient Nepal:

In ancient Nepal, taxes were levied in the form of kind, cash and labor services. Special portions of agricultural produce were payable to the king as tax. There also existed tax payable in gold. Fixed taxes were levied in the villages. Compulsory manual work from all artisans and laborers were also a common way of paying taxes.

In the Lichhavi period the main source of revenue was tax. At that time taxes were known as “Trikar” which means three kinds of taxes. The three kinds of taxes were Bhaga, Bhoga and Kara. The Bhaga tax was levied on agriculture, the Bhoga tax was on animals and the Kara tax on business income. Irrigation tax and religious monuments preservation tax also existed at the time king Ansubarma of Nepal. Fixed portions of agricultural product were payable to the king as tax. Compulsory labour work from all artisans and laborers were also common way of paying taxes.

2.1.3 Taxation in unified Nepal (1768-1846)

During the Period 1768-1846, the following unified period, land tenure system was divided into five main forms: Raikar, Birta, Guthi, Sera and Kipat. The major sources of revenue were: Birta and Kipat taxes land; Royal palace levies like Darsan Bhet, Salami, Local levies in forests and water source: commercial taxes like customs, transit and market mines and mints; export of forest products like wild life, herbs, drugs, wax, birds, elephants and judicial fines. Maximization of revenue was the prime objective of the fiscal policy during the period. Taxes were collected at three levels:

- a. Royal Palace levies: to finance occasional and ceremonial and ceremonial needs. The taxes were broad based and progressive.
- b. Government levies: to finance administrative, military and other purposes assessed on official functionaries, occupational groups and other people.
- c. Local levies: Perquisites of local officials, functionaries and medicates (Mallik, 2003:15).

Collection of customs, transit, market, and excise duties was given on contracts. In some parts of Terai, taxes were collected at specific rates on jewellery, textiles, falcons, horses, elephants, homespun cloth, yarn, blankets, borax, wax copper, iron, paper, tobacco, herbs, drugs, cotton, salt, musk, sheep and goat, yak's tail etc are levying duties on timber exports derived revenue from forests,

The various taxes levied during that period were narrow in base and were imposed primarily on occupations and economic activities, not on income or property. "Walak" was collected from each family on a regular basis and in periods of national celebration or festivals or ceremonial occasion. "Gadimubarak" was collected to finance for coronation ceremony of a King. "Chuman and Giddhawa" was collected of finance the sacred thread investiture and marriage ceremonies of royal princes and princesses. "Godan" was levied to finance funeral expenses when a reigning King

died. The system of direct taxation was confined to land tax and special levies like “Darshan-Bhet”, “Salami” etc. Darshan-Bhet was collected from both civil and military employees at the time of their appointment and confirmation and Salami was collected from local revenue collection functionaries in the Tarai region as an annual payment. There was no taxation of income in the modern sense of income tax.

Taxes were imposed primarily on occupations and economic activities not on property. Tax base was very narrow. The Birta owner class had much influential role in political and administration. However, Pota tax introduced by Prithivi Narayan Shah in 1772 was regarded as revolutionary measure in Nepal’s fiscal system. It was not based on progressive tax principle. It was limited on small Birta owners and privileged members of the nobility did not pay Pota. Only common people who lived on Raikar lands paid the homestead taxes and other Pota levies. There was no taxation of income in the modern sense of income.

2.1.4 Taxation in Rana Regime in Nepal (1847-1951)

Imposition and collection of taxes during the 104 year oligarchic rule of the Rana family in Nepal prior to 1951 was the prerogative of the feudal rulers. Only those taxes, which suited the objectives, needs, and whims of the then ruling, prime minister, were imposed. There was no any hard and fast rule relation to taxation. However, the main aim of the rules was to earn as much as transparent. No budget was ever framed at that time. There was no difference between the income of the state and the income of the prime Minister.

The major sources of revenue in Nepal till 1951 were land tax, custom and excise duties in the form of lump contracts, royalties on felling of trees, royalty on supply of porters and soldiers, entertainment tax and a few other minor taxes. There was no direct tax in the country except land tax collected on a contractual basis and “Salami” which the government employees used to pay out of their salaries at a very small

percentage. The Salami was abolished in 1951. The Rana rules did not think of developing an effective revenue administration system.

2.1.5 Income Tax in Modern Nepal:

The modern history of income tax is not so long in Nepal. It has formally introduced through legal basis in late fifties. Idea of introducing Income Tax Act in Nepal originated along with the first 'Budget' on Magh 21, 2008 B.S (1952). In the first budget speech the finance minister said, 'a proposal to levy an income tax including tax on agriculture income is under consideration'. Several attempts were made to introduce income tax in subsequent years. However, it could not be introduced until 2016 due to political instability. For the first time finance Act 2016 had imposed tax on business profit and employment in Nepal (Amatya, 2004:13).

In 2017 (1960) "Business Profit and Remuneration Act 2017" was enacted. This was the first income tax act in Nepal. This act was not broad and detail. There were only 22 sections in the act.

Following were the main feature of this act:

- a. Only remuneration and business profit were subjected to tax.
- b. Deductions were not specified for the purpose of calculating the taxable income.
- c. Tax on remuneration was to be deducted at source.
- d. The cases of default fines were prescribed.
- e. The tax payer was given the right to appeal against tax assessment to local "Bada Hakim".
- f. Government employer was the main income tax payer.

The experience of three years indicated that this act was narrow. So, it was replaced by Income Tax Act 2019 (1962).

2.1.6 Income Tax Act 2019 (1962)

The main purpose of the imposition of this act was not only raise government revenue but also reduce inequality in distribution of income and wealth with social justice. Create taxpaying habit of the taxpayers also the purpose of this act. There were 29 sections in the act. It was amended in 2029 (1972).

The main features of this act were as follows.

- a. Income tax was defined as all kinds of income such as, profit from business, profession, remuneration occupation, house and land rent, agriculture, insurance agency and other sources of incomes in addition to business profit and employment incomes.
- b. Tax assessment was specified on the basis of best judgment estimate to the tax officers.
- c. For the first time, provision was made for the installment basis of tax and agriculture income was brought under the scope of income tax but finance Act 2023 B.S. made provision that income from agriculture was fully exempted from the income tax. Again finance Act 2030 made agriculture income taxable.
- d. Provision for reassessment of tax as well as rectification of arithmetical errors was made again exempted from tax in 2034.
- e. Carry forward of loss was allowed for a two years period.
- f. Taxable income calculation methods and deductible expenses were specific.

This act has some weakness so; this act was replaced by “Income Tax Act 2031 (1974)” so as to cope with the changing needs of the country.

2.1.7 Income Tax Act 2031(1974)

Income Tax Act 2031 had 66 sections. It was amended for eight times to make it more practical and to eliminate confusing term.

Key features of this act were as follows:

- a. Clarified certain definitions relating to tax such as assessment of tax, income year personal status of the tax payers, non-resident persons, firm, company, family, philanthropic work etc.
- b. Head and sources of income were classified into five categories for the income tax assessment. i. agriculture ii. Industry, trade, profession or occupation iii. Remuneration iv. House and compound rent v. other sources.
- c. This act had identified the chargeable income and admissible expenses of each head of income.
- d. Provision of self assessment ,small tax payers tax assessment, fine/penalty appeal, tax deduction at source, tax refund, tax exemption, avoidance of double taxation etc.

2.1.8 Income Tax Act 2058(2002)

In 2058, ITA2058 (2002) was enacted by the parliament by replacing the existing Act. This Act is broad as compared to the previous Act and has been made in accordance with the global standard. ITR 2059 was framed by the government of Nepal (so called HMG/N during that period) to clarify some provision of the Act. Finance ordinances have been making slight amendments in the Act every year. This Act has classified the heads of income into three categories VIZ, employment, business and investment. The main objectives of this act are as follows,

- a. To bring all income generating activities into tax net

- b. To widen the tax base
- c. To harmonize tax rates and concessions on equity grounds
- d. To make income related provision clear and transparent
- e. To minimize tax avoidance and tax evasion
- f. To interlink Nepalese tax system with the tax system of foreign countries
- g. Reducing the scope of discretionary interpretation of the tax authorities
- h. To confine all the income related matters within the Act
- i. Make income tax elastic and revenue productive
- j. To make tax payers more responsible by enforcing the self assessment systems
- k. To make tax system based on account.

This act was broad, scientific and international standard the differences of this act with other act are made clear by its key features, they are as follows (Bhattarai and Koirala, 2004: 5).

- a. All income tax related matters are confined within the Act by abolishing all tax related concessions, rebates and exemption provided by different Acts. This Act has been made super in regard to all income tax matters.
- b. The Act has broadened the tax base. Unlike previous tax Act, tax rates have been spelled out in the Act. The tax rates and concessions have been harmonized on equity grounds.
- c. The Act has introduced a pool system of charging depreciation. A provision has also been made for depreciating intangible assets.
- d. The act has first introduced the taxation of capital gains.
- e. The act has provided liberal loss set-off and carry forward/back ward provisions. Interned adjustments of losses have been clearly specified. Such provision has been made from international perspective.

- f. The Act has first introduced a provision for administrative review to allow the tax administration to correct mistakes made by the tax administrators internally.
- g. The Act has made provisions for a stringent fine and penalty for the defaulters. There have been made provisions for punishment in the fines up to Rs 300000 and imprisonment on conviction up to 3 years.
- h. Global incomes of a resident are made taxable. Non residents are also taxed on their incomes with source in Nepal.
- i. List of expenses are inclusive. All expenses relating to income have been made admissible.
- j. The act has made provision for international taxation. Foreign tax credit has been introduced for the first time.
- k. The Act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.

2.1.9 Tax: Meaning and Classification

Instruments of government to intervene the public economy are revenue and expenditure polices. These two aspects of the fiscal policy are guided by different philosophy. On the one hand, available budget margin is a hypothetical construct than determines the size of the permissible increase in government expenditure. In contrast to budgetary philosophy in most countries, it is the hypothetical growth of revenue at the trend level of output and not the actual anticipated growth of revenue that guides expenditure planning in a given period (Aryal and Paudel, 2004:42).

The principal components of fiscal policy to mobilize public resources have been government tax policies. The relation between taxation and economic development has long been a matter of concern to policy makers.

The government of any country requires sufficient revenues to launch development programs to handle the daily administration to keep peace and security and to launch other public welfare. The government or public revenues are collected through various sources. These sources can be i. Taxes ii. Revenues from government iii. Fees iv. Special assessment v. Fines and penalties vi. Foreign grants. Among them tax is the main source of collecting the public revenues because it occupies the most important part of the government treasure. In Nepal about 77% of total revenue comes from tax revenue and the rest 23% from non-tax revenues (Amatya, 2004: 40).

Tax is any compulsory levy from individual, household as and firms to central or local government. It is simply a liability to pay an amount to the government. It is a compulsory contribution from the taxpayers (Bhattarai and Koirala, 2064:1).

Seligman (N.D) defines “a tax is compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred”(Dhakal, 2057:2).

According to Plehn “taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conforming common benefits upon the residents of the states”(Dhakal, 2058: 2).

According to Taylor “A tax is compulsory payment to the government without expectation of direct benefit in return to the payers”(Amatya, 2060: 25).

From the above definition it is clear that tax is compulsory contribution to the state from a person the natural person and artificial person having tax liabilities pay the taxes to the government otherwise the laws punish him. The government doesn't provide any corresponding benefit to the tax payers for the amount of tax he pays. Tax is paid to the state to perform the function of the government and the amount of tax is spent for common benefits and interest of the people (Achraya, 2008:15).

The source of government to revenue is a conditional source. Duty and fees, penalty, fines and forfeitures, receipt from sale and rent of government property and services, dividends, interests, royalty and sales of government property, principal repayment, donation and miscellaneous income etc are the sources of non tax revenue. Income tax, sales tax, custom duties, hotel tax, revenue from land registration etc are the sources of the tax revenue. Of them, tax revenue is major sources off the internal revenue as well as the macroeconomic fiscal instrument of the government.

A tax is a compulsory contribution to government made without reference to a particular benefit receives by the taxpayer. It is a personal obligation to pay tax and there is no direct relationship among tax, benefit and taxpayers. The primary purpose of taxation is to direct control of economic resources from the payers to the state for its own use or transfer to others. Bringing about economic growth, elasticity in the tax structure, control of inflationary and reduction of inequality are the main objectives of a tax policy. For underdeveloped countries to achieve economic growth and equality at the same time is rarely possible task. The imperative of economic growth still overshadows other objectives in these counties (Aryal and Paudel, 2004:57).

Taxes are broadly classified into two groups:

- a. Direct tax
- b. Indirect tax.

a. Direct tax:

It is a personal tax. If the impact and incidence of tax is borne by the some person to whom the tax is legally imposed and there is no possibility of shifting then it is called direct tax. In the word of Dalton “a direct tax is really paid by the person on whom it

is legally imposed. Examples include income tax; profit tax, property tax, expenditure tax, gift tax, interest tax, death tax, contract tax, vehicle tax etc.

b. Indirect tax:

It is a commodity tax. If any tax is legally imposed for one person but the incidence of the tax is borne by another person through backward and forward shifting process, then it is called indirect tax. According to Dalton “an indirect tax is imposed on one person but paid partly or wholly by another.” Value added tax, entertainment tax, passenger tax, hotel tax, export and import duties, excise duty etc are some of the indirect taxes

Income tax:

Income tax may be understood very easily if we first define the term ‘income tax’. Income is generally regarded as the best measure of ability the sense of economic well-being, for income is the primary determine of the level of living, which a family.

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 same period.

Henry Simons defines income tax as the sum of two items, saying “income, as economic gains received by the person during the particular period” of

- I. Personal consumption during the period
- II. Net increase in individual personal wealth during the period.

Symbolically,

$$Y = C + W$$

Where, Y = Income

C = Value of consumption

W = Change in wealth

Therefore, according to above definition income is the sum of consumption and change in wealth during the period. Income tax can consist of three broad items:

- a. The total amount of income received from one person less the expenses directly incurred in gaining this amount.
- b. The value of goods enjoyed by person which are owned by him such as the use value of home owned, hence produced goods such as vegetables, and
- c. The increase in the value of assets held during the period.

Generally, income tax is imposed on net income. Net income comes after deducting the cost of production from gross income. In practice the expense incurred in earning the income and appropriate exemptions are deducted to find out taxable income. Net income may be real income or money income. Real income is more comprehensive and includes not only money income but also other incidental advantages. Real income should, therefore, be the true index of ability to pay. So income tax should be charged on real net income of an individual and not on his net money income (Agrawal, 1980:104).

Income tax is a personal tax imposed on the net incomes of individuals and corporations. By this method of taxation, such as in accord with the tax paying ability of the individual may be called for by blending various personal deductions with the progressive rates although not completely natural, it possesses a number of economic advantages. It is widely accepted that an income base represents the most appropriate single measure of taxable capacity. If appropriately constructed, it ensures equal taxation of persons with equal ability and increasing taxation of persons with higher income.

Where special encouragement or discouragements are desired, preferential or penalty income tax provisions are convenient and effective. The built in flexibility of this tax

helps reduce cyclical fluctuations in employment and production. It encompasses a large and elastic revenue yield potential (Goode, 1964)

2.1.10 Income Tax in the Nepalese Contest:

More and more financial resources are needed to meet the increasing expenditure for growing development and regular activities; Emphasis has been given to the fulfillment of financial needs from internal resources specially the taxes. But it does not mean that there are no other sources to meet such needs. Because of some reasons, the tax revenue is emphasized. The objective of revenue collection is not only to finance growing expenditure, but achieve other goals also like: social justice, balance regional development and distributive motives etc. For this purpose, the direct tax basically income tax is assumed as a best weapon. Income tax also considers the 'ability to pay'. Hence, income tax is pushed up as the effective instrument for development, stability and equality in the developing countries.

People in developing nations tend to have greater propensity to evade taxes. This is so because the probability of being caught and the consequences of it are not very serious. Rich people resort to avoidance of taxes by recourse to legal loopholes and by making advantage of administrative deficiencies. Self-employed sector is more prone to evasion and avoidance. In Nepal, the evasion of income tax seems to be pronounced especially by people which enjoy better economic positions. Indeed, the income tax potential is much higher than that realize presently.

In Nepal, however, the coverage of this tax has remained very low. Taxpaying habit is undeveloped and there is general lack of tax consciousness in the people. There is no proper climate of voluntary compliance by the taxpayers. Tax authorities have been ineffective in enforcement. There are no integrated programmers for taxpayer's education, assistance guidance and counseling. Tax officers are looked upon as

havens for inefficiency, delays, unfair dealings, and harassment and nonprofessional personnel.

The major problem in taxation is “who bears the tax”. Traditionally has been advocated that the incidence of an indirect tax is largely shift forward and that of a direct tax is on those on whom it is levied. The process of the transfer of tax is known as “shifting” of the tax, while settlement of the burden on the ultimate taxpayer is known as “incidence”. The incidence of the tax is generally measured by the reduction in real income that results from the imposition of that tax. This incidence of tax has far reaching implications for distributions of income and wealth.

2.1.11 Tax Evasion

Tax evasion refers to the reduction or elimination of tax liability through means contrary to law. It means fraudulent, illegal, and deliberate acts of taxpayers culminating in the violation if the civil or criminal provisions of the tax laws. It implies maneuvers involving an element of concealment deceit, misrepresentation of facts, falsification of accounts, and downright fraud resulting from conscious efforts of the taxpayers to evade payment of tax legally due. Tax evasion is illegal.

The United Nation has defined, “Evasion is a term which is frequently used to describe deliberate not-compliance with the tax laws, by such means as failure to notify the tax administration of taxable assets or income activities giving rise to taxable income etc. or failure to pay tax legally due, or the use of fraud to conceal the existence of taxable income etc or to obtain allowances or repayment of tax” (United Nations 1984:11).

Methods of Tax Evasion:

The important methods used in evasion of taxes may be as follows:

1. Concealment of source of income.

2. Concealment income within a source of income (understatement of income)
3. Misrepresentation of facts and information.
4. Falsification of accounts and records (rigging of invoices, fictitious payments, payment of bills twice, etc.).
5. Incorrect claim for allowances and deductions.
6. Profit shifting, cost shifting or price transfer
7. Artificial contracts, (for commission, etc.)
8. Over and under invoicing
9. Overstatement of expenses
10. Fraudulent transactions
11. Fictitious transactions.
12. Non-reporting of income earned from illegal activities like smuggling, corrupt business practices, etc.
13. Maintenance of multiple sets of books of accounts and submitting the manipulated set for taxation purposes.
14. Deliberate failure to maintain accounts and records and get the assessment done on a “committee” or “best judgment” basis, etc. (Agrawal, 1980:124)

Reasons for Tax Evasion:

According to Govinda Ram Agrawal, the main reasons for widespread evasion of income tax in Nepal can be listed as follows:

1. Corruption by tax officials:
2. Widespread illegal business activities
3. Reluctance of taxpayers to maintain accounts
4. higher marginal rates of taxes
5. ineffective use of fines and penalties
6. Inadequate auditing and investigation
7. Difficulties in locating taxpayers

8. Lack of support from public
9. Poor development of corporate sector
10. Poor development of corporate sector
11. Unnecessary interference by influential persons
12. unlimited convertibility of Indian currency
13. Prevalence of scheduler taxes on income.

Income Tax Evasion in Nepal:

Income tax plays an important role for the economic development of a country. It can achieve the objective of growth, equity and stability. It checks the inequality between high and low-income people. It helps government in the movement of resources from the private to public sector.

Income tax can only achieve the above goals if its evasion is controlled. Income tax evasion has been paralyzed all over the world, whether it is developed or underdeveloped countries. But the people of the underdeveloped countries have high practice to evade taxes as compared to avoidance. The people in underdeveloped countries do not have greater propensity to avoid taxes as compared to advanced countries. It is only the actual evasion of taxes, which is larger in developed countries because the probability of being caught and the consequences of it are not the same in advanced countries (Tripathy, 1968:183).

Income tax evasion is in very high degree in undeveloped countries because no men keep their account of income and expenditure. If it is compulsory by law at that situation they keep two or more sets of accounts of a business operation. They use one for their internal purpose and other for the tax department. In this regard Mr. Tripathy mentions, “in the underdeveloped countries many business man keep no books at all and other maintain two or more sets to evade taxation”.

There is a large amount of income tax evasion in Nepal, which is in an unpredictable scale. According to Mr. C.L. shrestha, “in Nepal also the trend of income tax evasion is huge but the percentage of income tax actually evaded has not been calculated”. By the observation of different opinions of the respondents Mr. Agrawal, concluded that “there is widespread evasion in income tax in Nepal, especially due to poor taxpaying habit, administrative difficulties and defective laws. The evasion of income tax is more pronounced especially by the people of high-income business class.

According of Mr. Tripathy, “income tax law should be simplified so that assessment collection and tax compliance may be made easier and the administrative cost may also be reduced. This will also help in reducing the element avoidance and evasion”(Tripathy, 1968:188). He has given above suggestions to control income tax evasion.

So this study tries to find out the impact of income tax evasion on government revenue and those aspects which could attempt in minimizing income tax evasion in long run.

2.2 Review of Related Studies

Since 1959/60, income tax was started in Nepal. After its establishment, many individuals and institutions have studied in this subject regarding legal aspect, administrative problems, historical aspect, trend of income tax and income tax structure etc. they have made appreciable efforts in the field of income tax.

Many dissertations, books, articles and newspapers reviewed while preparing this thesis. Many books in this field are written to fulfill the course requirement of Tribhuvan University. An attempt is made here to review some of the books, thesis, articles, and reports, which have been written in field of income taxation in Nepal.

2.2.1 Review of Research Reports & Articles

Kedar Bahadur Amatya (1965) wrote a book entitled “*Nepal ma Ayakar Byabashta*”. In this book, he gave a simple description of “Nepal Income Tax Act 1962” with some examples how taxable incomes are derived from different sources of income. He has also analyzed basically the legal aspect of the income tax. This book is old concept and all things mentioned in it are not suitable at present. But it becomes the historical document in the field on income tax.

Govinda Ram Agrawal (1978) had conducted a research entitled, "Resource Mobilization for Development: The Reform of Income Tax in Nepal". The main objective of his study were to examine the problem of growing resource gap in Nepalese finance in the contest of the role of income tax, to examine the buoyancy and elasticity of income tax in Nepal including projection of income tax, to examine the ways and means for increasing tax consciousness in Nepalese people etc. He concluded that mobilization of additional resources from domestic sources to finance rising expenditure is the better options to fulfill resource gap. Domestic resource can be mobilized either through tax or through non-tax measures. Taxation contributes more than 80% of total government revenue in Nepal. He had recommended mobilizing additional domestic resources through taxation, tax structure should be redesigned in order to increase the role of direct tax, and income tax should be reformed in Nepal.

Rup Bajadur Khadka (1994) had describe the scenario of Nepalese tax system from origin of income tax, adoption of quasi-global or a limited scheduler system, segregation of corporate income tax from individual income tax, increasing dependence on the presumptive basis, basic allowance and progressive rate structure, move from joint taxation to individual taxation and shift from itemized to flat system of standard expenses, experiment with an advance tax on impacts and the existing structure, commodity taxes and poverty taxes. He had evaluated the Nepalese tax

system based on conventional, theoretical concepts and suggested various measures for its improvement. He had also explained the whole Nepalese taxation system and structure for its reform.

Govinda Bahadur Thapa (2000) has described the various causes of poor resource mobilization in Nepal. The agricultural income which contributed about 40% income of GDP being tax free, about 50% of total population being below the poverty line, tax holiday for new industries, lack of political commitment were the major causes which he concerned in his writing. He identified that one of the main problems of revenue mobilization was the narrow base and decreasing tax rates. He suggested improving the whole economic situation and the political commitment to mobilize resource efficiently. Otherwise any tax reform measures would be worthless.

Revenue Consultation Committee (2001) report had studied the overall taxation situation in depth. 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. This report recommended for written communication between taxpayers and tax administration rather than the informal relation. This report suggested to implement account based VAT more effectively. For small taxpayers having up to Rs. 2 million, tax collection should be based on sell and purchase description of their. For income taxation, self assessment was fully recommended. This report suggested bringing all potential taxpayers into the tax net to widen the tax coverage including agriculture, electricity and other sectors. To increase voluntary compliance this report highly emphasized to simplify the tax policy. Income tax exemption limit was suggested to increase taking into consideration of purchasing power and inflation. The report also certified Rs. 55000 for individual and Rs. 75000 for couples and family as exemption limit. The report gave suggestion for government

to expand the Permanent Account Number (PAN) outside the valley and reduce the land and house registration rate and to rationalize Tax Deduction at Source (TDS).

K. D. Dhakal (2001) has presented extended, enlarged and modified edition of his book named ***“Income Tax and House & Compound Tax Law and Practice”***. This book is extremely based on the syllabuses of B.B.S third year. In this book he has described the provision made under income tax and the methods of income tax assessment have been described with numerical examples. His book is informative rather than analytical. He has not analyzed the role of income tax, income tax structure and defects of income tax system of Nepal. His book is more helpful to know about general information and provision made under **“Income tax act 1974”**.

K.P. Aryal and Surya Prasad Paudel (2003) wrote a book entitled ***“Taxation in Nepal”*** This book is based on ITA 2002. This book is divided into three parts. It has described about tax, features of ITA 2058, capital receipts or revenue receipt, special provision for entities and retirement saving, classification of taxpayers, head and source of income, assessment, collection and recovery, tax authorities and their powers, rights and duties etc. This book is also based on the B.B.S. level. Method of income tax has been dealt with numerical illustration. This book is useful for academic purpose and practical point of view of income tax in Nepal.

Chandramani Adhikari (2003) wrote a book entitled, ***“Modern Taxation in Nepal”*** Adhikari has described the Provisions and laws related to income taxation of Nepal according to new ITA 2002. This book has been divided into five chapters. First chapter has described about theoretical concept of taxation. Second chapter has described about income tax system in Nepal. In this chapter, writer has described about head and sources of incomes, employment or remuneration income, tax on pension income, international taxation etc. VAT has been described in part three. Fourth part has been described about property tax, house and compound tax etc. windfall gain tax and other provision has been described in fifth chapter. This book is

written for students of TU, especially for BBS, MBS and MPA students. However, it is useful to taxpayers, tax administrators and others.

Puspa Raj Kandel (2003) wrote a book entitled “*Tax Law and Tax Planning in Nepal*” which is based on government rules & regulation. It is very timely work and extremely helpful for the Master and Bachelor level students. The second edition has attached unofficial transaction of the tax laws. Both acts and rules related to value added tax and income tax appendices. But, he had not analyzed the role of income tax, tax structure and problem of income tax.

Bidhyadhar Mallik (2003) had written about the development of existing income tax and need and important of income tax system in Nepal. This new provision made by Income Tax Act, 2058 about tax base, computation of income, tax exempt amount, deduction allowable, accounting of tax, capital gain, retirement saving and tax, dividend tax, capital gain, international taxation and tax auditing have been clarified precisely in his book. Similarly, he had explained about tax administration, documentation, information collection payment of tax, installment tax, income statements, tax-assessment, tax collection, review and appeal, fees and interest, fine and penalties, tax rates and determination of provision of depreciation.

Ishwor Bhattarai and Girija Prasad Koirala (2004) in their book “*Tax Laws and Tax Planning*” described the theoretical and practical aspect of income tax with related provisions. It was based on TU syllabus. They were unable to describe the tax structure of Nepal and problems of income tax system.

Amatya, sk et.all (2004) Taxation in Nepal had written an article entitled, "Problems in Tax Administration and their Remedies" published in Journal of Finance and development (Rajaswa). He had comprehensively explained about the problems and their remedies related with tax revenue. The major types of practical problems and challenges in tax administration, he had mentioned in his article were: showing

limited amount of transaction, showing low selling price, lack of issuing and taking bills, lack of showing the real factory cost, commercial fraud, lack of co-operation in tax auditing, legal ambiguity and complexity in implementation and lack of co-ordination between IRD and Revenue Investigation Unit. He had recommended that statistical and information system should be properly managed, fixed norms and standards should be used to assess selling price and factory cost, the billing system should be made compulsory, co-ordination between IRD with various entities of Nepal Government, Revenue Investigation Department and its related units should play the important role and auditing of tax should be widened.

K.P.Aryal and S.P. Paudel (2004) had explained about the income tax system in along with house and land tax and VAT. The book has been designed based on the curriculum of B.B.S. It has been divided into three parts. In the first part of the book: introduction and development of income tax, capital and revenue nature expenses and income items, entity and retirement saving, dividend tax, computation of income from business remuneration and investment have been explained with numerical and theoretical examples. House and land tax and CAT have been explained in the second and third part respectively. The book also included proper bibliography and adequate appendix where various income tax, house and land rent and Vat related forms, schedules and format had been described.

2.2.2 Review of Thesis

Gobinda Lal Shrestha (1967) in his thesis entitled “*Income Tax in Nepal.*” He has discussed about income tax act and rules, historical background and administrative aspects of income tax. In his research he has pointed out various recommendations, some remarkable recommendations of the researcher were as follows.

- a. Income tax should be made more scientific, systematic and the social and economic justifiable.

- b. Exemption limit should be determined on the basis of member of the family.
- c. Taxed should be charged on agricultural income.

Govind Ram Agrawal (1980) wrote a thesis entitled “**Resource Mobilization for Development**”, had described the resource mobilization through income tax, fiscal policy, and role of income tax, legal provision relating to income tax, legal aspect of income tax and administration aspects of income tax etc. He had shown per capita income, buoyancy coefficient of income tax, burden of income tax, elasticity and coefficient of income tax etc. He had identified the major problem in income tax system, which is inefficient for tax administration and tax evasion. He found that, there were no integrated programs for taxpayers, education, assistance, guidance and counseling. The major problems of taxes are inefficient tax administration, corruption, unfair dealing, harassment and incompetent personnel etc.

This study is a comprehensive and included various aspects of tax system of that period, but all things mentioned in it are not fully relevant today. Some of the problem identified in it is still in existence.

Chudamani Siwakoti (1987) has discussed in his thesis named “**An Analytical Study of Income Tax in Nepal**”, has focused his effort for scanning out various factors persisting in the field of income tax. The major problems identified by him are evasion at high level, delay in assessment and normal role of income tax, lack of public information, complicated act and other defects of existing income tax act. He has suggested for progressive tax honest and efficient administration and research units in tax offices. He has specially analyzed the income tax act 1974, which is outdated for present context of Nepal. In the same year Mr. P.P. Timsina in his thesis named “Income tax evasion in Nepal” has tried to show the evasion of income tax in Nepal and by identifying causes and ways. He has tried to give some suggestion for the correlation of evasion so that maximum resources could be mobilized from income tax but he has not proved it statistically.

Ram Bahadur Thapa (1993) found in his study that the fiscal deficit from 1980/81 to 1990/91 increased by 7.66 times more. He identified that the failure to locate new taxpayers, non-maintaining proper records and defective personnel management were the main problem of income tax administration. According to his study, the tax administration was unable to enhance the taxpayer's compliance because of the complicated and procedure, delay in tax

assessment, and rough behave of our tax personnel and so on. He recommended six months time for assessment and favored self-assessment.

Hari Bahadur Shrestha (1994) gave emphasis to find the historical development and the role of income tax structure of tax. He noticed the weakness of income tax regime to reduce the gap between rich and poor. He suggested taxing on the income of agriculture and capital gain from higher class. He found that Nepalese tax payers had positive attitude towards 10% of total house and rend deduction for repair in his study. He suggested for Management by Objective (MBO) technique to motivate the government personnel and for salary increment based on inflation.

Krishna Kumar Shakya (1995) has concentrated his study mainly on the contribution of direct tax and indirect tax and on causes of government inefficiency in income tax administration. He found the income tax to GDP, total revenue (TR), and direct tax revenue (DTR) was in increasing trend. He suggested for programme oriented fiscal policy and recommended that VAT be a major source of indirect tax in liberalized economy. For small taxpayers, he suggested for door-to-door services.

Shiva Narayan Shahu (1995) had found that only 0.35% of total population came under the categories of taxpayers during his study period. He also showed the contribution of income tax in the total tax revenue and total revenue was 9.95% and 7.94% respectively. Income tax had been gradually increasing except for 1990/91 and

1991/92 during his study period and income tax was in the fourth place in the tax structure. The individual taxpayers had higher contribution than the wage earners.

Puspa Kandel (2002) had criticized the Income Tax Act 2001 on several grounds. Exemption of agricultural income from income tax, export duties levied on export, inequality between different capital earned income (i.e. tax on interest, dividend and capital gain), and withdrawal of the provision of exemption suddenly and no adjustment for inflation are the major issues he raised in his article. He also said the tax regime creates more tax burden than the former one. He further criticized the Act for the provision of income tax from export as 0.5% of total export because it is not a good choice of income tax base.

Satyandra Timilsina (2001) had concentrated his study mainly on the analysis of exemption and deduction of income acts of Nepal. In his study he recommended to increase the exemption limit for an individual to a minimum of Rs 90000 and from family exemption based on the number of dependent children and parents. He further recommended levying income tax on agriculture, capital gains and other source to raise tax base. He emphasized on higher contribution of corporate income tax compared to the individual income tax.

Bibha Pradhan (2001) had conducted a research in the topic, “*Contribution of Income Tax from Public Revenue of Nepal with reference to Nepal Telecommunication Corporation*”. In this study, she has explained the conceptual framework of public enterprises and NTC, conceptual framework of income tax, contribution of income tax to the public revenue and share of NTC to the income tax. She also found that NTC has contributed highest income tax in total income tax revenue from PEs. NTC shared 44% share of total income tax revenue from PEs, which was 84% in the FY 1993/94. Except in FY 1991/92 and 1996/97, the collection of income tax from NTC has been increasing gradually during the study period. Her

suggestions are about the income tax system, promotion and reward to efficient and honest personnel motivation to personal tax education to tax payer and officers.

Rajendra Dulal (2004) found that the share of tax revenue of the TR was about 76 percent while that of NTR was about 24 Percent in 2002/03 which has been a major source of revenue mobilization. Out of the TR, the share of the indirect tax is 2/3 of the total tax while that of DT is nearly 1/3 only. Among the indirect taxes, custom and VAT are the two major sources while income tax is one of the major sources for DT. He also found that due to some problems like narrow coverage, unscientific tax assessment, deviation from the basic principle of income taxation, long time lag, defective system for the perspective of international taxation, weak tax administration etc. tax revenue collection has not been implemented to the optimum level.

Bharat Kumar Lamsal (2005) had mainly focused on the removing and controlling income tax evasion for better resource mobilization. As his main objective was to analyze the impact of income tax evasion in government revenue of Nepal, he set further objectives which were; to identify the ways and causes of income tax evasion, to estimate the volume and tendency of income tax evasion in small trade sectors and to examine the role of income tax utilizing the resources in Nepal.

He had conducted that research following analytical as well as descriptive research design. Most of the data were from secondary sources and some were from primary sources. Primary data were collected through opinion survey, field visit and interviews. Simple statistical analysis such as average and percentage were used as for data analyzing, tools; graphs charts and tables were used to interpret visually the finding of the research.

Jayanti Paudel (2006) had found that within the direct tax, income tax was the largest source, which contributed more than 88% in 1999/00. The contribution of

income tax to direct tax has increased significantly since its introduction. In terms of the composition of income tax, the share of corporate income tax was 59.8% and that of individual income tax was 31.2% in 1999/00. She had hope that the coverage of income tax would be widened after the implementation of Income Tax Act 2001.

She had added that the Nepalese tax administration has been attempting to modify itself to meet the pressing challenge brought about by change in technology and economic policies. However, still its wording is traditional and the cost of administration has not been brought to the satisfactory level.

All research studies mentioned above are concerned with study of structure of tax, role of income tax in economic development, laws, provisions, administration aspect. Most of them have indicated the inefficiency of tax administration, tax evasion. But, the researcher has not found the study done income tax contribution on government revenue in future. Or, what will contribution of income tax on government revenue in future? So, answer of above question has been taken analytically and intensively with income tax contribution on government revenue of IRD in Nepal. This study will be fruitful to those interested persons, students, teachers, scholars, Government and businessmen for academically as well as policy perspectives.

2.2.3 Final Withholding Payments

As per sec 92, following payments will be taxed as final withholding payments

- a. Dividend received from resident company.
- b. Rent for the lease or a building associated fittings and fixtures having a source in Nepal and individual other than in conducting a business receives that.
- c. Interest received by a natural persons from bank, financial institute (but not related business)
- d. Gain from investment insurance received from resident company.

- e. Amount received from recognize retirement fund.
- f. Gain from unrecognized retirement fund.
- g. Meeting fees.
- h. Amount received from accumulated home or sick leaves.
- i. Part time teaching salary, writing articles.

2.2.4 Tax Exempt Organizations

Exempt organization means any entity that should not pay the tax social and religious organization these are not operated for profit earning is provided with such facilities. ITA2058 sec (2) dha has included the following entities with tax exempt organization.

- a. A religious educational or charitable organization of public charter reregistered without having a profit motive.
- b. A political party registered with the election commission.
- c. A village development committee, municipality, or district development committee.
- d. An amuter sporting association forward for the purpose of promoting social or sporting amenities not involving the acquisition of gain.
- e. Nepal Rastra Bank.
- f. The government of Nepal.
- g. An entity that has been declared as exempt organization issuing notice by the government.

2.2.5 Source of Income in Nepal under Income Tax Act 2058 (2002)

Source of income are considered as focal point for tax system. Computation of taxation depends upon the type and nature of income source. In every income tax act sources of income should be well defined. “Income Tax Act 2058” has divided the sources of income into three categories which are as follows:

-) Income from employment
-) Income from business
-) Income from investment

2.2.5.1 Income from Remuneration /Employment

Income from remuneration or employment is one of the important sources of income under the current income Tax Act. Remuneration means amount given to employee against the service provided by him. In case of remuneration there used to be one getting service and another providing service. People who get service are called employer and person who provide service is employee. Certain conditions are required to come under remuneration; Income Tax Act 2058 has defined about employment as the past, present or prospective employment of future. Income Tax Act 2058 has specified the income from employment under section 8. As per the act, any type of income from any employment is taxable income. According to section 8 of the act, the remuneration received by a person from the employment is the following payment made by the employer:

- a. Wages, salary, leave pay, overtime pay fees, commission, gifts, prizes, bonus and other facilities.
- b. Amount received from retirement fund.
- c. Amount of contribution of the employer to a retirement fund.
- d. Amount received in reimbursement of personal expenses of the employee and related person.
- e. Amount received in lieu of acceptance of any condition with regarded to the terms of employment.
- f. Payment received for loss or termination of the employment.
- g. Other amounts as given is chapter 6 of the Act i.e. perquisites and any gains due to change in tax accounting required to be included.
- h. Any other payment made in respect of the employment.

- i. Dearness allowance, cost of living expenses, rent, retirement and transportation allowance and other personal allowances. However, according to section 38 of the “Income Tax Act 2058”. Remote area allowance up to Rs 30000 for ‘A’ class area, Rs 24000 for ‘B’ class area, 18000 for ‘C’ class area, Rs 12000 for ‘D’ class area and 6000 for ‘E’ class area is not included in taxable remuneration of the employee.

In addition to above items of remuneration, the following types of remuneration of person also are included.

- a. Market value of assets in case of the transfer of the assets.
- b. Value prescribed by Inland Revenue Department (Under section 27)
- c. The amount of expenses to be paid by the employer for following facilities of the employee as reduced by any contribution in this regard made by the employee.
- d. Service of housekeeper, cook, driver, and other domestic assistant.
- e. Service provided to the residence of the employee such as installation and cost of water, electricity and telephone.
- f. Any meal, refreshment or entertainment.
- g. Provision of residence to the employee. However, this amount is limited to only 2% of salary (sec 13 of Income Tax Rules)
- h. Availability of motor vehicles wholly or partly for private purpose. However such amount will be limited only up to 0.5% of this salary (sec 13, Income Tax Rules)
- i. Any facilities paid in cash or in kind as per chapter 7 of this Act.
- j. The amount of the difference of interest on loan paid by employee at concession rate from the standard highest rate.
- k. Discharge or reimbursement of costs incurred by the individual or his associates.

2.2.5.2 Non-taxable Income under 'Income from Employment'

The following account is excluded in calculating an individual's remuneration from an employment.

- a. Amount excluded under section 10 and final withholding payment.
- b. Remuneration under bilateral or multilateral agreement with foreign government.
- c. Remuneration under the employment of public service of foreign government.
- d. Remuneration paid by GOV/N to foreign national on condition of tax exemption.
- e. Allowance paid by GOV/N to widows, senior citizens or disable persons.
- f. Remuneration derived by foreign national from foreign government.
- g. Pension received by retired army or police from public fund of foreign government.
- h. Reimbursement of expenses incurred for the employer.
- i. Payment of an amount up to Rs 500 for such a purpose. The amounts, which are deductible while deriving the net income from employment , are as follows:
 -) Contribution to approved retirement fund with in the limit (sec.63)
 -) Rs 3 lakhs or one third of the employee's assessable income which ever is less]
 -) Donation amount equal to 5% of adjusted taxable income or 100000 or actual whichever is less. But HMG may notify through official gazette that donation given to such institution will be expected for deduction of to the notified limit. Such donation shall be allowed as per the notification.
 -) For computation of tax liability, medical tax of 15% of the approved medical cost plus carried forward excess amount greater than the limit can be adjusted. However upper limit of medical tax credit for is 750 per year.

The remaining balance of uncovered medical tax credit can be recouped in next year. Similarly, amount of tax paid in foreign countries provided that such amount do not exceed average rate of Nepalese income tax can be adjusted.

2.2.5.3 Income from Business

ITA, 2058 has defined business as an industry, a trade, a profession, or the like isolated transaction with a business character and includes a past, present, or prospective business. A person's income from a business for an income year is the person's profit and gain from conducting the business for the year. It is the income generated with the help of capital –labor activities (Bhattari and Koirala, 2004: 35).

Business income mainly refers to different types of income earned from different sources of business. The amounts that are included in computation of "Income from Business" are as follows:

- a. Service fees including commission, meeting management or technical service fees.
- b. Amount received from disposal of trading stock.
- c. Net gains from the disposal of business assets or liabilities of the business.
- d. Amount treated as net profit from disposal of depreciable assets of business. (I.e. capital gain from pool disposal of depreciable assets).
- e. Gifts received in respect of the business.
- f. Amount received in connection with business operation and not included in the income from investment
- g. Amount received in view of any restriction accepted in relation to the business operation.
- h. The Amount to be adjusted due to the change in accounting system.
- i. Any income derived proportionately from a long term contract (sec.26)

- j. Income of general insurance (sec.60)
- k. Income under chapter 7
- l. Interest charged on loan and advance at the rate lower than the prevailing market rate i.e. different amount (sec.27)
- m. Income deemed to be derived from transfer pricing and other arrangement between assets (sec.33)

2.2.5.4 Tax Exempted Income from Business

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

- a. **General Deduction:** For the purpose of calculating income from business all expenses incurred during the year, by the person and in the production of income from the business are deductible.
- b. **Interest:** The interest incurred during the year for the debt obligation of the person shall be available for the deduction to the extent that the borrowed money is used in that year or if the money is borrowed for purchase of an asset, that asset is used for that year. The debt obligation is created in the production of the income from business.
- c. **Cost of Trading Stock (sec. 15):** Trading stock includes raw material, chemicals, work in progress, finished goods, stores etc. the cost of trading stock is derived as follows:

	Rs.
Cost of opening stock	XXX
Add: Purchase or production during the year	XXX
Less: cost of closing stock	(XXX)
Cost of trading stock consumed or sold	XXX

The cost of trading stock should be taken at cost price or selling price whichever is lower. The person keeping account on cash basis can adopt either of the prime cost or factory cost basis for valuation. In case if actual cost could not be derived for the particular trading stock, either of the FIFO or weighted average cost can be adopted.

- a. **Repair and Maintenance Expenses (sec. 16):** The repair and maintenance expenses are allowed for deduction up to 7% of depreciation base of assets of each group and the rest of the expenses should be capitalized in respective group.
- b. **Pollution Control Expenses (sec.17):** This deduction should not be more than 50% of (Adjusted taxable income). The portions of the pollution control expenses are not allowed, as deduction shall be capitalized in Group D of the assets.
- c. **Research & Development Expenses (Sec.18):** This deduction should not be more than 50% of (taxable profit before R & D expenses plus donation plus pollution control expenses). The portion of the R & D expenses is not allowed, as deduction shall be capitalized in-group D of the asset.
- d. **Depreciation Expenses (sec.19):** Depreciation at the prescribed rate is allowed on used depreciable assets owned by the person. The group wise details and rate of depreciation are given as follows:
 - 'Group A' includes building, structures and similar works of permanent nature. Rate of depreciation for this group is 5%
 - 'Group B' includes computer, data processing equipments, fixtures, office furniture and office equipments. The rate of depreciation for this group is 25%
 - 'Group C' includes automobiles, buses and minibus and the rate of depreciation for this group is 20%

- ‘Group D’ includes construction and earth moving equipment and any tangible assets not included in above groups and portion of pollution control cost and research and development cost not absorbed. The rate of depreciation applicable for this group is 15%.
 - ‘Group E’ includes intangible assets like goodwill, patent rights, copyright etc. for this group; rate is calculated as divided by the useful life of assets in the pool at the time the assets is most recently acquired by the person and rounded down to the nearest half year.
- e. Donation and Contribution (sec.12):** Donation or contribution given to any tax exempted institutions, who have registered in the Inland Revenue Department, shall be deducted for the taxable income of the person subjected to the limitation of Rs. 100,000 or actual amount or 5% of taxable income which ever is less.

2.2.5.5 Income not Allowable for Deduction from the Taxable Income

- a. Expenses of domestic or personal nature,
- b. Tax payable as per this Act,
- c. Penalty or any other fines payables as per any Acts,
- d. Expenses incurred to derive the amount exempted under sec10 or final with holding payment,
- e. Cash payment for more than Rs. 50000 at a time to a particular person by a person having annual transaction more than Rs. 2 million,
- f. Distribution of income,
- g. The amount where the deduction is not allowed by any sections.

2.2.5.6 Income from Investment

According to Income Tax Act 2058, “Investment means an act of holding or investing one or more assets of a similar nature that are used in an integrated fashion”.

However, it excludes the act of holding assets, other than non-business taxable assets for personal use by the person owing the assets or investing amount in such assets or employment or business related income.

For the purposes of calculating income from investment, following income is to be included:

- a. Any dividend, interest, rent, royalty,
- b. Gain from investment insurance, gain from an unapproved retirement fund and amount received from an approved retirement fund,
- c. Net gain from disposed of the persons' non –business chargeable assets of the investment as calculated under chapter 8,
- d. The excess amount of incoming over the depreciation base including outgoing on the disposal of depreciable assets of the investment of the person
- e. Gifts received by the person in respect of the investment,
- f. Retirement contribution including those paid to a retirement fund in respect of the person and retirement payment in respect of the investment,
- g. Amount received in lieu of any restriction accepted in relation to the investment,
- h. But amounts those are included in calculating the person's income from any employment or business that should be excluded in calculating a person's profit from investment. Similarly, amount exempted under section 10 and divided as per section 54 and 69 and final with holding payment.

The following expenses are admissible for deduction while computing taxable income from the head of investment.

- a. Interest (Section 14)
- b. Loss from the investment (Section 20) or for

- c. Depreciation (Section 19)
- d. Related expenses (Section 13)
- e. Repair and maintenance expenses (Section 16)
- f. Donation (Section 12)

2.2.6 Objectives of Income Tax in Developing Countries like Nepal

Taxation has been a very essential element of a government from the very beginning of the state system. The main objective of taxation of any country was economic development. Income taxation is the best source of revenue generation in the hands of government for the purpose of internal resource mobilization in the developing countries. Appropriate taxation policy should help in promoting savings. Taxation services as major tool for transferring resources from the private to the public sector.

In Nepal, the broad objective of progressive taxation of income tax, property is to reduce the unequal distribution of wealth. It should be create the tax paying habits among the people rather than collecting the government revenue. The other specific objectives of income tax are as follows:

- a. To discourage the growing tendency to invest In unproductive real estate and levy increased taxes to property owners,
- b. To collect some resource from established industries,
- c. To promote industrial development providing tariff protection,

After more than 40 years of introduction of income tax, Nepal has not yet developed a proper system of tax assessment. Though at the time of first implementation of income tax, the objective was to create a habit of tax paying to general public yet it has not achieved the goal till now. However among direct tax, income tax is an important source of revenue in developed as well as developing countries. All people pay tax of proportion of their income.

2.2.7 Problems of Income Tax Administration in Nepal

From the very beginning, the contribution of income tax to the revenue of the government has been very minimum. This is because the income tax system in Nepal has been facing many problems. The inefficiency of income tax administration is one of the reasons. Income tax management in developing countries like Nepal has been facing many problems. The contribution of direct tax and income tax to the public revenue is very low to meet the growing public expenditure. Nepalese government has been using deficit financing. As the consequence of this, there is significant resource gap in Nepalese budget. The problem can be avoided only when the problems of tax administration is a complex technical matter. The major problems, which the income tax administration in Nepal has been facing, can be discussed as follows (Lamsal, 2002: 27).

- a. Failure to locate new taxpayer
- b. Assessment delay
- c. Poor tax payer's compliance
- d. Failure to maintain proper account and records
- e. Lack of motivation of tax personal
- f. Existence of corruption
- g. Instability in government policy
- h. Complicated tax laws and procedures
- i. Lack of trained and competent tax personnel

2.2.7 Income Tax Evasion in Nepal

There are different ways of reducing tax liabilities. Tax evasion is the way of reducing tax liability by illegal means. It is done through different ways like non-reporting income, under reporting of income, making fraudulent changes in accounts books, maintaining multiple sets of accounts, operating business transactions under different

names, opening bank account in dummy name. Over reporting of expenses fragmentation of income, transfer of pricing etc, tax evasion is unethical, illegal, uneconomic activity and not paying of tax is against of moral ethics. It is illegal because the law does not permit to evade the tax. It is unethical because the activity of not paying tax is against of moral ethics. In the same way, it is uneconomic because it promotes black money in a country.

Basically, there are three types of effects of tax evasion in the economy, ie loss of revenue to the state, redistribution of income that affects the efficiency of resources allocation in the economy and creating wrong statistics leading to errors in government policies. Evasion of income tax is also associated with the evasion of sales tax, excise duty, custom duty and so on. Since the government imposes higher tax rate to fulfill the growing need of the revenue, it is the honest taxpayers the really bear the burden of tax.

Income tax evasion should be controlled effectively because it has serious affects to the economy. Income tax evasion affects negatively to the economics position as well as the social status of a country. If income tax evasion is not controlled, Nepal can never solve its problems of resource gap either it increase its taxes rates or applies new sources of tax (Subedi, 1982: 17).

Income tax evasion has been paralyzed all over the world, whether it is developed or underdeveloped countries. But the people of the underdeveloped countries have high practice towards tax evasion. There is widespread evasion in income tax in Nepal, especially due to the poor tax paying habit, administrative difficulties and defectives laws. Tax evasion is increasing day by day due to the low standard of education of tax responsibility among taxpayers. In western and developed countries, the evasion is considered as a social crime. But in Nepal, this act is regarded as cleaver on the part of taxpayers (Siwakoti, 1987: 14).

2.2.7.1 Ways of Tax Evasion

The important ways or methods used in tax evasion in Nepal are as follows (Agrawal, 1980: 124).

- a. Concealment of income within a source of income,
- b. Misrepresentation on facts and information,
- c. Incorrect claim for allowances and deductions,
- d. Artificial contract for commission, discount etc,
- e. Falsification of accounts and records (rigging of invoices, fictitious payments, payment of bills twice etc.),
- f. Profit shifting, cost shifting, or price transfer,
- g. Over and under invoicing,
- h. Over statement of expense,
- i. Fictitious transaction,
- j. Fraudulent transaction,
- k. Maintenance of multiple sets of books of accounts and submitting the manipulated set for taxation purpose,
- l. Deliberate failure to maintain accounts and record and get the tax assessment done on a 'committee' or best judgment basic etc,
- m. Non-reporting of income earned from illegal activities likes smuggling corrupt business practice etc.

The committee on fiscal affairs of the organization for Economic Co-operation and Development (OECD) has observed that “With in tax evasion a distinction is sometime made between the less serious offence of omission e.g. failure to submit complete returns of income and more serious offence, such as false declarations, fake invoices etc”(OECD, 1980: 5).

2.2.7.2 Causes of Tax Evasion

The main causes for widespread evasion of income tax in Nepal can be listed as follows (Agrawal, 1980: 126).

- a. Corruption by tax officials:
- b. Widespread Illegal business Activities:
- c. Reluctance of Taxpayers to maintain Accounts:
- d. Higher Marginal Rates of taxes:
- e. Ineffective marginal rates of taxes:
- f. Inadequate Auditing and Investigation:
- g. Difficulties in Locating Taxpayers:
- h. Lack of support from public:
- i. Poor Development of Intermediaries:
- j. Unnecessary Interference by Influential persons:
- k. Unlimited Convertibility of Indian Currency:
- l. Poor development of corporate sector:

CHAPTER – III

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology refers to the various sequential steps which are adopted by a researcher in studying a problem. It would be appropriate to mention that research projects are not susceptible to be studied. Thus an entire process by which we attempt to solve the problem is called research methodology. This chapter is devoted to the methodology applied in the study to achieve the goals. Both primary and secondary sources of data were used in the study. Opinion survey techniques were adopted while collecting primary data. Questionnaires were distributed to income tax experts and tax payers (employees) so as to know their opinion towards various aspects of the study. Economic survey was used as the major sources of secondary data. Different financial and statistical tools were used to analyze the collected data. In this study, correlation, simple average, percentage and chi- square test for hypothesis have been used to analyze the collected data.

3.2 Research Design

The analysis of the study is based on certain research design keeping as the objectives of the study in mind. Generally, research design means definite procedures and techniques which guideline profound ways for research ability. Most of the materials of this study are concerned with past phenomena in numerical or theoretical terms. The study oriented to:

I) Analytical Research

In analytical research, the researcher uses the facts and the information already available and analyzes to make a critical evaluation of the materials. Analytical

research was carried in terms of role of total tax revenue, income tax revenue in composition of direct tax, tax/GDP ratio etc.

II) Descriptive Research

Descriptive research includes surveys and facts finding enquiry of different kinds. It is concerned with finding of facts relating to the subject matter, obtaining important data and getting new areas of knowledge by describing them descriptive research will be carried out in this study on contribution of income tax to national revenue of Nepal.

III) Empirical Analysis

An empirical analysis has been conducted in order to find out various aspects. Contribution of income tax to national revenue of Nepal and effectiveness in collection of income tax has been taken into consideration. To find the stated objectives opinion surveys of respondents were conducted. Respondents have been classified into tax experts, tax administrators and tax payers. For this, questionnaire was developed and responses were collected from the respondents regarding the subject matter.

3.3 Data Collection Procedure

A set of questionnaire was developed and distributed to the selected respondents in order to get actual accurate, fact and reliable information. Distribution work was done by personally rather than sending by any other means. Additional valuable information was also collected from interview with the respondents as well as group discussion with taxpayers.

3.4 Population and Sample

All the tax experts, tax administrator tax payers and other related persons of Nepal were considered as total population. Out of them tax experts, tax administrators and

tax payers of the Katmandu valley were consider as target sample. Out of target population 50-60 respondents have been taken as sample size.

Table 3.1: Groups of Respondents and Size of Sample

S.N.	Groups of Respondents	Sample Size
1.	Tax experts and tax administrator	30
2.	Tax payers	30
Total		60

3.5 Nature and Sources of Data

Both primary as well as secondary data have been used in this study. The primary data were collected from opinion of tax experts, tax administrators and taxpayers. Primary data were obtained through the questionnaire method. In most of the cases, face-to-face interview and discussion with selected persons included in the purposive sample. The secondary data have been obtained through economic surveys, budget speech, journals and newspaper.

3.6 Classification, Editing and Coding of Data

The collected data by different techniques were classified according to the nature or characteristics and then coded and edited. The editing data; the necessary information were put accordingly and unnecessary things were removed or rectified. The data has been classified according to the characters and attributes.

3.7 Procedures of Processing and Analysis of Data

After the classification, coding and editing of data, it was presented into tabulated form with separate format systematically in order to achieve the desire objectives. It has been presented into various tables, figures, and graphs according to the subject in order. Available and collected data has been presented and analyzed in descriptive

way with the help of sample statistical tools, such as percentage, average, correlation, chi-square test for hypothesis etc.

3.8 Period Covered

The research study has been based on historical data. So the study covers the data of past ten year's period i.e. from 1997/98 to 2006/07.

3.9 Selection of the Respondents

After carefully study of the subject matter, a set of questionnaire was developed and distributed to two respondents groups viz tax experts / tax administrators and tax payers. Tax experts comprises of chartered accountant, professors, policy makers, and lawyers. Taxpayers comprises of employees working in various government and private organization like banks, manufacturing organization etc.

3.10 Weight of Choice

The questionnaire asked either to give (yes or no) response or to give their opinion. Respondents were also given alternative to rank. For this case, the first preferred choice alternative got the highest points and the last preferred choice alternative got the lowest point. The total points got by each alternative were converted into percentage of total points available to the all alternatives. The alternative with the highest percentage has been ranked as most important and an alternative with the lowest percentage has been ranked as the least important. For example, if there are five alternatives, the most important ranked by the respondents gets five points and the least important alternative ranked by the respondents gets one points. The alternative, which is not ranked, does not get any points.

3.11 Respondents Profile

Questionnaires were distributed to sixty respondents. They are tax experts/tax administrators, tax payers (employees). Fifty-four responses out of total i.e.54 questionnaires were received, twenty-seven each from both groups. The following table reveals the different denominations, number and percentage of the respondents.

Table 3.2: Respondents Profile

S.N.	Respondents	Total sample		Response Received	
		No	%	No	%
1.	Tax experts and tax administrators	30	50	27	45
2.	Tax payers	30	50	27	45
	Total	60	100	54	90

3.12 Other Presentation and Analytical Tools

Various tools are applied while conducting this study, which are table, percentage, correlation, time series analysis.

- a. Table: Various tables are formulated to tabulate the data. A master table is also presented in the appendix 1.
- b. Chart and diagrams: These tools are used for visually description of the data. Trend lines, bar diagrams are used for this purpose.
- c. Correlation: Correlation may be defined, as the degree of linear relationship existing between two or more variables. Two variables are said to be correlated when the change in the value of one variables are accompanied by the change of another variable. Correlation analysis is defined as the statistical technique, which measure the degree and direction of relationship

between the variables. In other words, it helps in studying the covariance of two or more variables, which lies between $|\pm 1|$. If the value of correlation (r) is nearer to $+1$, this relationship is said to be perfectly positively correlated and vice-versa. We can compute the correlation simply by using direct method:

$$r = \frac{N \sum XY - \sum X \sum Y}{\sqrt{N \sum X^2 - (\sum X)^2} \sqrt{N \sum Y^2 - (\sum Y)^2}}$$

Where,

n = No. of observations

X = variables

Y = variables

- d. Analysis of time series: A series formed from a set of statistical data arranged in accordance with their time of occurrence is said to be a time series. A time series shows the relation between two variables one being the time. The size of the population in every decade, the price level of the different in every month the volume of population in every year indicate the relation between the time changes and the changes in the value of other variable. Time series analysis is mostly used in Business and Economics, by which we can predict the value of variable for the future. Mathematically, a time series is defined as the function relationship $Y=f(t)$, where Y is the value of the variable consideration in time. The time 'T' may be yearly, quarterly, monthly, weekly etc. There are various methods of analyzing time series, least square method is chosen as the best method in showing trend and prediction in our research.

A widely and most commonly used method to describe the trend line and predication is the method of least square. Under this method, a trend line is fitted to data satisfying $\sum (Y - Y_c) = 0$, and $\sum (Y - Y_c)^2$ is least where, Y is the actual value and Y_c the computed value of Y.

From that line obtained by this method is the line of best fit.

$$\text{Trend line } Y = a + bx.$$

Where,

$$\therefore a = \frac{\sum Y - b \sum X}{N}$$

$$\therefore b = \frac{\sum XY - \frac{\sum X \sum Y}{N}}{\sum X^2 - \frac{(\sum X)^2}{N}}$$

Where,

Y = Dependent variable

X = Independent variable

a = Y intercept or value of Y when X = 0

b = Slope of the trend line of amount change that comes in Y for a unit change in X.

CHAPTER – IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Analysis of Secondary Data

This chapter focuses on the presentation and analysis of secondary data. The secondary data have been obtained from economic survey, budget speech and other related newspapers. The available data related to the study have been tabulated, presented and analyzed and interpreted to reach at some findings. The data collected from economic survey and other related newspapers have been analyzed by dividing into various sub-headings. Structure of government revenue of Nepal, structure of income tax revenue of Nepal, contribution of income tax in total revenue, total tax revenue and direct tax revenue of Nepal tax and non tax revenue of Nepal, structure of direct tax revenue in Nepal, resources gaps of Nepal for the ten period i.e. 1997/98 to 2009/10.

4.1.1 Structure of Government Revenue of Nepal

Government revenue of Nepal is comprised of tax revenues and non-tax revenues. Tax revenue consists of customs, tax on consumption and production or goods and services, land revenue and registration and tax on property, profit and income. Similarly, non-tax revenue includes charges, fees, fines and forfeiture receipts from sales of commodities and services, dividend royalty and sales of fixed assets, principal and interest payment and miscellaneous items. The structure of government revenue in Nepal has been presented in table 4.1 for 13 years period from 1997/98 to 2009/10.

Table 4.1: Structure of Government Revenue in Nepal

(Rs. in millions)

Fiscal year	Customs	Tax on consumption & product of good & services	Land revenue and registration	Tax on property profit & income	Total tax revenue	Non tax revenue	Total revenue
1997/98	8502.20	11249.70	1004.20	5183.70	25939.80	6998.10	32937.90
1998/99	9517.70	11719.10	1003.20	6512.90	28752.90	8498.40	37251.30
1999/00	10813.30	13387.30	1015.90	7935.60	33152.90	9741.60	42893.70
2000/01	12552.10	16153.60	612.90	9546.50	38865.11	10028.60	48893.70
2001/02	12658.80	16074.30	1131.80	9465.70	39330.60	11114.90	50445.50
2002/03	14236.40	18244.80	1414.30	8691.50	42856.90	13642.90	56229.80
2003/04	15554.80	20705.60	1697.50	10215.10	48173.00	14158.00	62331.00
2004/05	15701.60	25331.30	1799.20	11272.60	54104.70	16018.00	70122.70
2005/06	15344.00	28118.30	2181.80	11787.60	57430.40	14851.70	72281.70
2006/07	16707.60	35438.80	2253.50	16726.80	71126.70	16585.50	87712.20
2007/08	21062.40	41005.30	2940.70	20147.00	85155.40	22467.00	107622.40
2008/09	26792.90	55938.30	5223.30	29097.40	117051.90	26422.60	143474.50
2009/10	35150.80	79394.10	5511.10	36238.90	156294.90	23650.90	179945.80
Average	214594.60	28673.88	2137.65	14063.18	61402.71	14936.78	76318.63

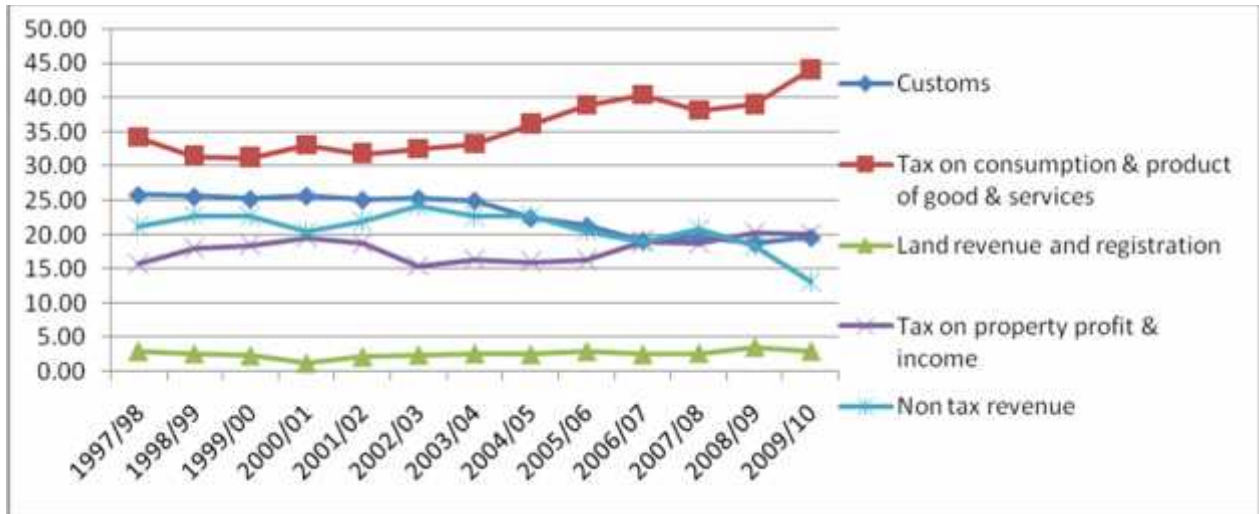
*Source: Economic Survey, 2067/68***Table 4.2: Structure of Government Revenue in Nepal (In %)**

(Rs. in millions)

Fiscal year	Customs	Tax on consumption & product of good & services	Land revenue and registration	Tax on property profit & income	Non tax revenue	Total revenue
1997/98	25.81	34.15	3.05	15.74	21.25	100.00
1998/99	25.55	31.46	2.69	17.98	22.82	100.00
1999/00	25.21	31.21	2.37	18.50	22.71	100.00
2000/01	25.67	33.03	1.25	19.53	20.52	100.00
2001/02	25.09	31.86	2.24	18.76	22.03	100.00
2002/03	25.32	32.44	2.52	15.46	24.26	100.00
2003/04	24.96	33.22	2.72	16.39	22.71	100.00
2004/05	22.39	36.12	2.57	16.08	22.84	100.00
2005/06	21.22	38.90	3.01	16.30	20.54	100.00
2006/07	19.05	40.40	2.57	19.07	18.91	100.00
2007/08	19.57	38.10	2.73	18.72	20.86	100.00
2008/09	18.67	38.99	3.64	20.28	18.41	100.00
2009/10	19.53	44.12	3.06	20.14	13.14	100.00
Average	22.93	35.69	2.65	17.92	20.85	100.00

Source: Economic Survey, 2067/68

Figure 4.1: Structure of Government Revenue in Nepal



From the above two table 4.1 and 4.2 and figure 4.1 it is observed various tax and non-tax revenues, tax on consumption and product of goods and services has the highest percent of contribution towards total revenue of Nepal. Its contribution in millions of rupees has been increasing per year except 2001/02. In fiscal year 1997/98, total revenue was 32937.9 millions and tax on consumption and product of goods and services was Rs 11249.7 millions which indicates 34.15% tax on consumption and product of goods and product of services to total revenue. In fiscal year 2009/10, out of total revenue Rs 179945.8 millions, tax on consumption and product of goods and services has the share Rs 79394.1 millions, which means 44.12% contributions. The average contribution of tax on consumption and product of goods and services over twelve years is 35.69% of the total revenue of Nepal, which indicates that its contribution was over the average and its goods.

The contribution of customs has been showing increasing trend. In the fiscal year 1997/98, out of the total revenue of Rs 32937.9 millions, Rs 8502.2 millions has raised from customs. It means 25.81% contribution made to the total revenue by customs. In fiscal year 2009/10, Rs 35150.8 has been raised from customs out of total

revenue of Rs 179945.8 millions. In this year it is decreasing trend. The mean contribution of customs over the 13 years period is 19.53%. It shows that customs is also highest revenue source in the total revenue of Nepal. In 2009/10 it is below the average because of government gives subsidy.

Non-tax revenue occupies the third place of its contribution to total revenue of Nepal. Its contribution has 6998.1 millions in fiscal year 1997/98 and Rs 23650.90 millions in fiscal year 2009/10. It has been increasing trend per year but in 2005/06, it has decreased with compare to previous year and it again increases in 2006/07 and then after again decreased in 2009/10. The mean contribution of non-tax revenue over the thirteen years period is 20.85%. It shows that the contribution of tax revenue is increasing trend and non-tax is decreasing.

Tax on property, profit and income occupied the fourth placed regarding its contribution to the total revenue of Nepal. Tax on property, profit and income consists of income tax. From public enterprises, income tax from semi-public enterprises, income tax from private corporate bodies, income tax from individuals, income tax from employment, urban house and land tax, vehicle tax on interest and other taxes. It has share of Rs 5183.70millions and Rs 36238.90 millions in fiscal year 1997/98 and 2009/10 respectively i.e. 15.74% contribution in fiscal year 1997/98 and 20.14% contribution in fiscal year 2009/10. It has been increasing per year except in year 2002/03. The mean contribution of tax on property, profit and income in total revenue of Nepal is 17.92%.

Land revenue and registration has the lowest average contribution of 2.65% in total revenue of Nepal. Its contribution in fiscal year 1997/98 was Rs 1004.2 millions i.e. 3.05% in total revenue of Nepal. The percent contribution has been fluctuation but amount contribution in total revenue has been increasing per year except certain years.

4.1.2 Tax and Non-tax Revenue of Nepal

Table 4.3: Composition of Tax and Non-tax Revenue in Nepal

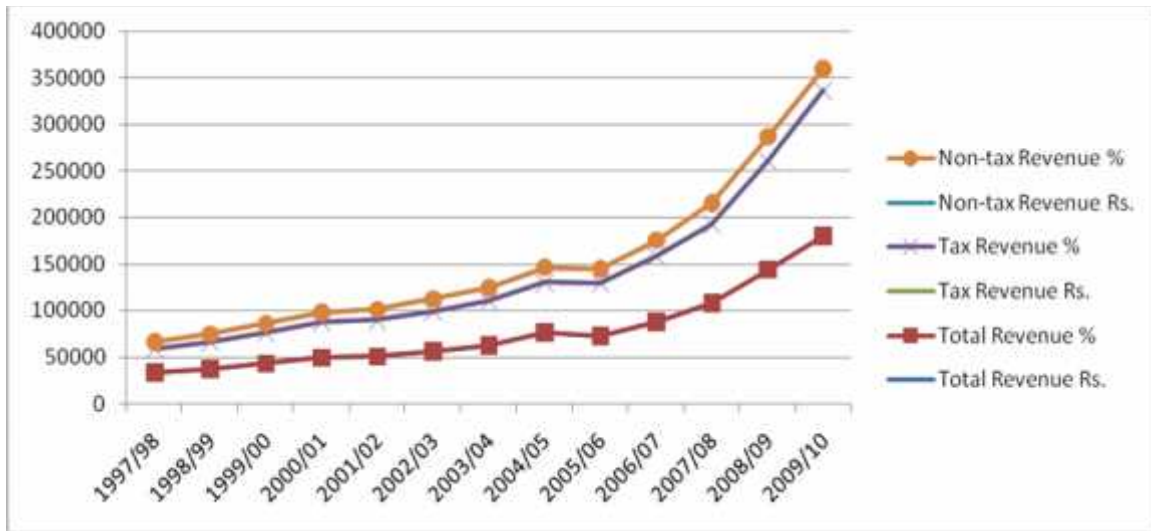
(Rs. in Millions)

Fiscal Year	Total Revenue		Tax Revenue		Non-tax Revenue	
	Rs.	%	Rs.	%	Rs.	%
1997/98	32937.9	100	25939.80	78.75	6998.10	21.25
1998/99	37251.3	100	28752.90	77.19	8498.40	22.81
1999/00	42893.7	100	33152.20	77.29	9741.60	22.71
2000/01	48893.6	100	38865.00	79.49	10028.60	20.51
2001/02	50445.6	100	39332.00	77.97	11114.90	22.03
2002/03	56229.8	100	42587.00	75.74	13642.90	24.26
2003/04	62331	100	48175.70	77.3	14158.00	22.72
2004/05	76122.7	100	54104.70	77.16	16018.00	22.84
2005/06	72282.1	100	57430.50	79.45	14851.70	20.55
2006/07	87712.2	100	71126.70	81.09	16585.50	18.91
2007/08	107622.4	100	85155.40	79.12	22467.00	20.88
2008/09	143474.5	100	117051.90	81.58	26422.60	18.42
2009/10	179945.8	100	156294.90	86.86	23650.90	13.14
Average	76780.2	100	61382.21	79.15	14936.78	20.85

Source: Economic Survey, 2067/68

Total revenue of Nepal consists of tax revenue and non-tax revenue. Tax revenue comprise of customs, excise, sales tax (VAT), income tax, vehicle tax, land and house registration, Non-tax revenue includes duties, fees sale of government properties commodities and services, dividends on share, interest on loans, donation and gifts. In Nepalese revenue structure from fiscal year 1997/98 to 2009/10 tax revenue has always been greater than three times of non-tax revenue. This means heavy contribution of tax revenue always been increasing per year.

Figure 4.2: Composition of Tax and Non-tax Revenue in Nepal



From above table and figure it is addressed that percent contribution has always been fluctuating within the lower limit of about 75.74% to the upper limit of about 86.86%. In 1997/98, out of total revenue of Rs 32937.9 millions 78.75% i.e. 25939.8 millions was contributed by tax revenue. In 2002/03, 75.74% that is 42587.0 millions out of total revenue of Rs 56229.7 millions has collected as tax revenue. It increased in 2002/03 by Rs 3256.2 i.e. 11.47% in total revenue. Similarly, in 2009/10, 86.86% i.e. Rs 15294.90 millions of total was collected as tax revenue. It was increased by Rs 39243 millions i.e. 25.11%

Non-tax revenue has the lowest contribution as compared to tax revenue. Its contribution to total revenue has remained below 25%. In 1997/98, Rs 6998.1 million was collected as non-tax revenue which was about 21.25% of total revenue. Its contribution over the thirteen year's period has been fluctuating within 19% to 25%. In 2009/10 out of total revenue of Rs 179945.8 millions, Rs 23650.9 millions was contributed from non-tax revenue. It was about 13.14% of total revenue. It was decrease by in Rupees and in percentage compared to 2008/09.

From the above table and figure clearly shows that tax revenue has been significantly contributed in total revenue and non-tax revenue has been poor contributed. In conclusion, we can say that tax is the most important source of government revenue. It is suitable source of collecting revenue internally.

4.1.3 Structure of Income Tax in Nepal

Nepalese income tax structure is formed by contribution of income tax from public enterprise, semi-public enterprises, private corporate bodies, individuals, and employment tax on interest. This has been presented in table 4.4. (a) and 4.4.(b). Here, public enterprise consists of 100% government ownership and semi-public enterprise includes 51% government ownership. Private corporate bodies mean individuals denote Sole traders, partnership and private limited companies. Remuneration/employment refers to salaries earned from the services provided to the government and non-government sectors.

Table 4.4 (a): Composition of Income Tax in Nepal

FY	Public Enterprises	Semi-Public Enterprises	Private Corporate Bodies	Individuals	Remuneration	Tax on Interest	Total Income Tax
1997/98	1317.80	-	925.10	2120.80	322.20	212.20	4898.10
1998/99	1526.50	-	1155.00	2772.70	396.50	315.50	6166.20
1999/00	2198.80	-	1339.50	3016.40	451.50	414.40	7420.60
2000/01	2928.00	-	1924.30	3200.50	597.30	463.90	9114.00
2001/02	1769.30	-	1412.00	4419.10	835.60	467.70	8903.70
2002/03	1251.00	-	1236.30	3362.30	1252.60	864.00	7966.20
2003/04	2056.60	-	1531.30	3533.40	1391.20	733.40	9245.90
2004/05	1332.40	-	2467.80	3926.30	1675.90	757.00	10159.40
2005/06	195.70	-	3404.30	4234.70	1764.10	774.90	10373.70
2006/07	1019.70	-	5717.10	5234.40	2007.90	1054.90	15034.00
2007/08	204.60		7186.50	6381.20	2451.00	1087.90	17311.20
2008/09	959.10		9425.10	9877.50	3195.60	1850.00	25307.30
2009/10	1131.80		12234.40	11039.90	4413.10	2417.90	31237.10
Average	1376.25		3842.98	4855.32	1596.50	877.98	12549.03

Source: Economic Survey, 2067/68

Table 4.4(b): Structure of Income Tax in Nepal from 1997/98 to 2009/10 in Percent

FY	Public Enterprises	Semi-Public Enterprises	Private Corporate Bodies	Individuals	Remuneration	Tax on Interest	Total Income Tax
1997/98	26.9	-	18.89	43.3	6.58	4.33	100
1998/99	24.74	-	18.72	44.94	6.43	5.17	100
1999/00	29.63	-	18.05	40.65	6.08	5.59	100
2000/01	32.13	-	21.11	35.12	6.55	5.09	100
2001/02	19.87	-	15.96	49.5	9.38	5.26	100
2002/03	15.7	-	15.52	42.21	15.72	10.85	100
2003/04	22.24	-	16.56	38.22	15.05	7.93	100
2004/05	13.11	-	24.29	38.65	16.49	7.45	100
2005/06	1.89	-	32.82	40.82	17	7.47	100
2006/07	6.78	-	38.02	34.82	13.39	7.02	100
2007/08	1.18		41.51	36.86	14.16	6.28	100
2008/09	3.79		37.24	39.03	12.62	7.31	100
2009/10	3.62		39.17	35.24	14.13	7.74	100
Average	19.3		22	40.82	11.26	6.62	100

Source: Table 4.4 (a)

Figure 4.3: Structure of Income Tax in Nepal from 1997/98 to 2006/07 in Percent

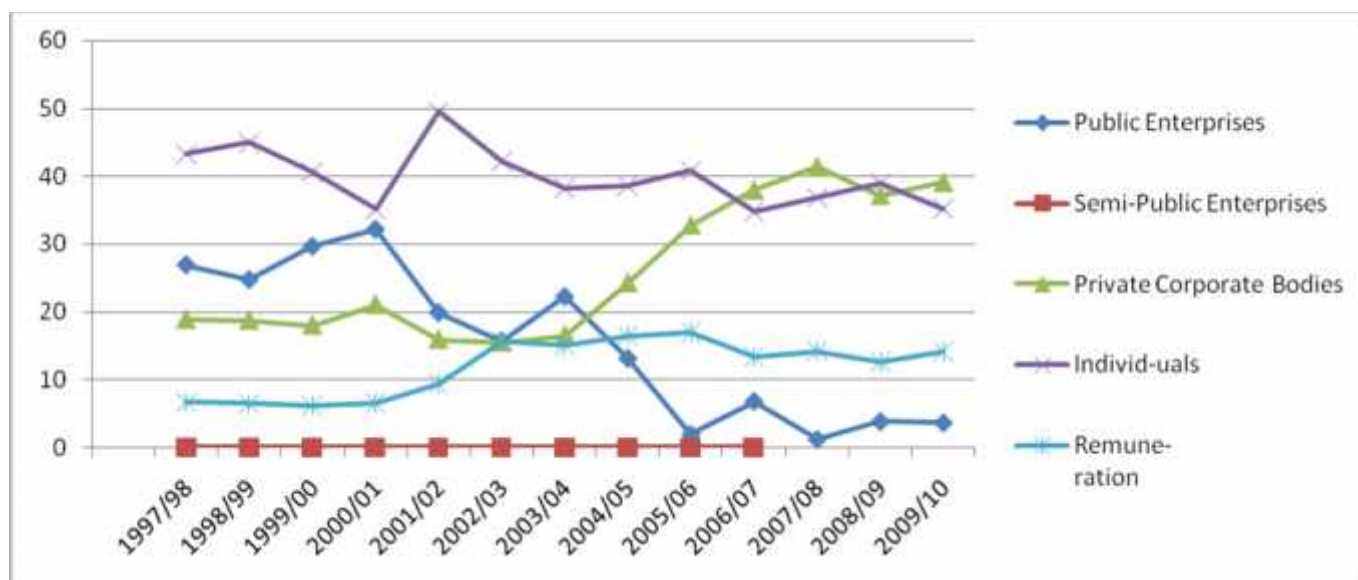


Table 4.4 presents the structure of income tax in Nepal which shows that the total income tax has increased in every fiscal year except in the year 2001/02 and 2002/03. It has increased from Rs 4898.1 millions to Rs 31237.1 millions in fiscal year 2009/10.

The income tax contribution of individuals has occupied first position in total income tax revenue of Nepal up to 2005/06. In fiscal year 1997/98, 2120.8 millions was raised from individuals as income tax, from then it has been increasing trend up to 2001/02 then it is significantly decreasing in fiscal year 2002/03 amount Rs 1056.90 millions i.e. 23.91%. In 2002/03, out of total income tax revenue of Rs 7966.2 millions, Rs 3362.3 millions has been raised from individuals. It is about 42.21% contribution by individuals. In 2003/04, it is slightly increased from the year 2002/03 to Rs 3533.4 million. Similarly 2009/10, contribution from individuals in total revenue has increase to Rs 11039.9; this is 35.24% of total tax revenue. Its contribution was highest Rupees in the fiscal year 2009/10 and highest in percentage in fiscal year 2001/02.

Income tax from public enterprise has occupied second position regarding its contribution in total income tax revenue of Nepal. In fiscal year 1997/98 out of total income tax revenue of Rs 4898.1 millions, Rs 1317.8 millions has been contributed by public enterprises. Its contribution has been increasing trends up to 2000/01. Then it is in decreasing trends in 2001/02, 2002/03, 2004/05, 2005/06, 2007/08 in 2006/07 it is increase from 195.7 to 1019.7 and 2008/09 increase from 204.6 to 959.1 millions. In fiscal year 2009/10 out of total income tax revenue of Rs 31237.1 millions, Rs 1131.8 millions has been contributed by public enterprises.

Private corporate bodies occupied third position out of total income tax revenue of Nepal. In 1997/98, private corporate bodies paid Rs 925.1 millions out of Rs 4898.1 millions total income tax revenue, i.e. private corporate bodies contributed 18.89% of total income tax revenue. This was very much insignificant contribution. Its contribution has been increasing trend up to 2000/01 and then it decreased by Rs

175.5 million i.e. 12.44% while in 2001/02, it was decreased by Rs 512.3 million i.e. 26.62% and in 2003/04, its contribution has increased to Rs 1531.3 millions i.e. 16.09% of total tax revenue. Similarly, in 2004/05, it has also increasing trend. In 2009/10, it was Rs 12234.4 millions which was 39.17% of total tax revenue. It is highest contribution among the other sources.

Income tax from remuneration has occupied fourth position in total income tax revenue of Nepal. In 1997/98, total income tax revenue was Rs 4898.1 millions and Rs 322.2 millions was contributed by employment income tax i.e. 6.58% of total income tax revenue. Income tax from remuneration has been increasing in all the years. In 2004/05, total income tax revenue was Rs 10159.4 millions included Rs 1675.9 millions as income tax from remuneration. Similarly, in 2009/10 out of total income tax revenue of Rs 31237.1 million, 4413.1 million was contributed by remuneration. It was about 14.13% of total tax revenue. It shows that the remuneration tax has been contributed significantly in total tax revenue from this analysis, we can include that remuneration tax is suitable means of collecting income tax revenue.

Tax on interest has occupied fifth position in total income tax revenue. In fiscal year 1997/98, Rs 212.2 millions was collected as tax on interest out of Rs 1898.1 millions of total income tax revenue. Interest tax was in increasing trend in all the fiscal year except 2003/04. In fiscal year 2009/10 out of total income tax revenue of Rs 31237.1 millions Rs 2417.9 millions has been collected as interest tax. It was 6.62% of total tax revenue. It was highest in fiscal year 2002/03 and lowest in fiscal year 1997/98.

The share of semi-public enterprises was nil in each year from 1997/98 to till because the source of revenue was restricted and share of semi-public enterprises was not calculated separately also.

4.1.4 Tax/GDP Ratio

Here, this analysis has been made to know about analysis of the share of taxation in total Gross Domestic Product (GDP) of Nepal. It is to be noted here that the Tenth plan has targeted to increase the share of tax revenue in GDP.

Nepal is one of the least developed countries in the world. Nepalese economic activity is very slow and does not show any drastic positive change. The moderate Tax/GDP ratio ranged from 15%-18% is other developing countries (WB1991) but in Nepal, it is obvious from the fact that Tax/GDP ratio never exceeded 15% and it was never around 15 % throughout the fiscal year.

Table 4.5: Contribution of Tax Revenue and Income Tax Revenue in GDP of Nepal

(Rs. in million)

FY	GDP	Tax Revenue	Tax Revenue as %of GDP	Income Tax Revenue	Income Tax Revenue as % of GDP
1997/98	289798.00	25939.80	8.95	4898.10	1.69
1998/99	330018.00	28752.90	8.71	6166.20	1.87
1999/00	366251.00	33152.10	9.05	7420.60	2.03
2000/01	413429.00	38865.10	9.40	9114.00	2.20
2001/02	430396.00	39332.60	9.14	8903.70	2.07
2002/03	460325.00	42587.00	9.25	7966.20	1.73
2003/04	500699.00	48173.00	9.62	9245.90	1.85
2004/05	548485.00	54104.70	9.86	10159.40	1.85
2005/06	611118.00	57430.40	9.39	10373.70	1.70
2006/07	675484.00	71126.70	10.53	15034.00	2.23
2007/08	755257.00	85155.40	11.28	17311.20	2.29
2008/09	909309.00	117051.90	12.87	25307.30	2.78
2009/10	1060881.00	156294.90	14.73	31237.10	2.94
Mean/ average	565496.15	61382.04	10.21	12549.03	2.09

Source: Economic Survey, 2067/68.

Note: GDP is taken in current price.

From above table it is addressed that Tax/GDP ratio is not satisfactory. It is fluctuate time to time. From 1997/98 to 1998/99, it is below 9% then after it is above 9%. A maximum of 14.73% Tax/GDP ratio was achieved in 2009/10. The mean Tax/GDP ratio for the ten years has been computed to be 9.39%. Income tax revenue is also fluctuating time to time. Its contribution is high in the fiscal year 2009/10 i.e. 2.94%. It is not satisfactory level.

4.1.5 Composition of Direct Tax and Indirect Tax Revenue in Total Revenue of Nepal

Total revenue consists of tax revenue and non-tax revenue. Total tax revenue consists of direct tax revenue and indirect tax revenue. Direct tax includes income tax, land revenue and registration, urban house and land tax property tax, vehicle tax etc. Indirect tax includes customs, excise, VAT, entertainment tax, hotel tax, air flight tax, contract tax and road & bridge maintenance tax. Table 4.6 shows the composition of direct tax and indirect tax revenue in total tax revenue of the country from fiscal year 1997/98 to 2009/10.

Table 4.6: Composition of Direct Tax and Indirect Tax in Total Tax Revenue of Nepal

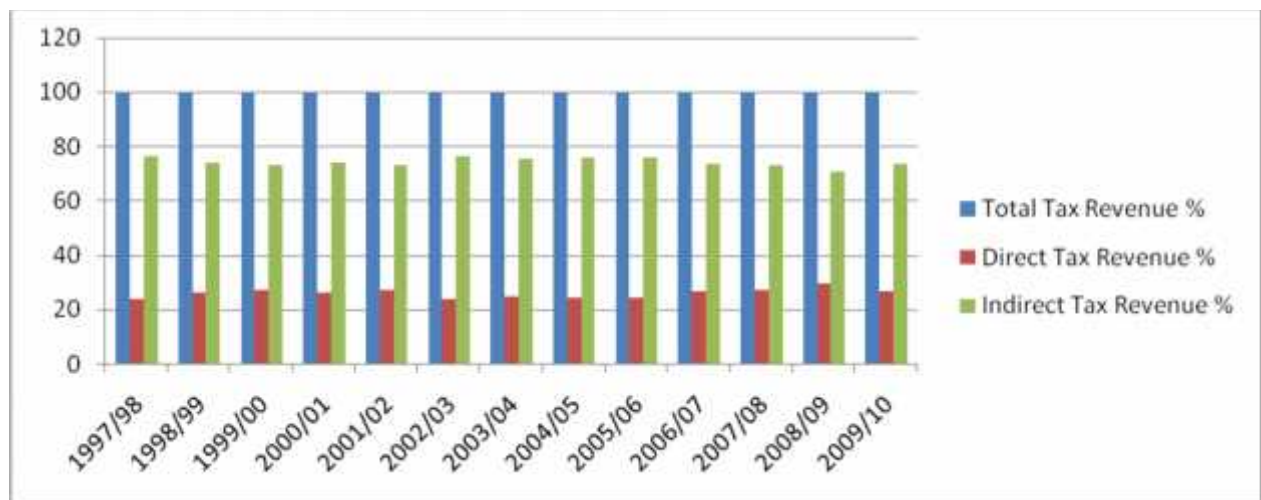
(Rs in millions)

FY	Total Tax Revenue		Direct Tax Revenue		Indirect Tax Revenue	
	Rs.	%	Rs.	%	Rs.	%
1997/98	25939.80	100	6187.90	23.85	19751.90	76.15
1998/99	28752.90	100	7516.10	26.14	21236.80	73.86
1999/00	33152.20	100	8951.50	27.00	24200.60	73.00
2000/01	38865.00	100	10159.40	26.14	28705.70	73.86
2001/02	39330.60	100	10597.50	26.94	28733.10	73.06
2002/03	42586.90	100	10105.80	23.73	32481.20	76.27
2003/04	48173.00	100	11912.60	24.73	36260.50	75.27
2004/05	54101.70	100	13071.80	24.16	41032.80	75.84
2005/06	57430.40	100	13968.10	24.32	43462.30	75.68
2006/07	71126.70	100	18980.30	26.69	52146.40	73.31

FY	Total Tax Revenue		Direct Tax Revenue		Indirect Tax Revenue	
	Rs.	%	Rs.	%	Rs.	%
2007/08	85155.40	100	23070.70	27.09	62067.70	72.89
2008/09	117051.90	100	34320.70	29.32	82731.20	70.68
2009/10	156294.90	100	41750.00	26.71	114544.90	73.29
Average	61381.65	100	16199.42	25.91	45181.16	74.09

Source: Economic Survey, 2067/68

Figure 4.4: Composition of Direct Tax and Indirect Tax in Total Tax Revenue of Nepal



The above table and figure shows that the total Tax revenue was dominated by indirect tax revenue. The share of direct tax revenue in total tax revenue for the period 1997/98 period was 23.73% of total revenue. The amount of direct tax is increasing every year except 2002/03. It increased by 6187.9 millions in 1997/98 to Rs 41750 millions in 2009/10. The percent of direct tax revenue to total tax revenue is fluctuating trend. The contribution of direct tax to total tax revenue was minimum in 2002/03 i.e. 23.73% and maximum in 2008/09 i.e. 29.32%. It was 26.71% in fiscal year 2009/10. It is noted that the contribution of direct tax in total tax revenue was increased in first 3 years in percentage but after it was in fluctuating trend in percentage, even if increasing trend in total amount.

Revenue from indirect tax was in increasing trend every. It increased from Rs 19751.9 million in 1997/98 to Rs 114544.9 million in 2009/10. The percentage contribution of indirect tax revenue to total tax revenue was fluctuating trend. Its contribution to total tax revenue was minimum level of 73% in 1999/00 and maximum level of 76.27% in 2002/03. It was 73.29% in 2009/10.

4.1.6 Composition of Direct tax/ Structure of Direct tax in Nepal

The structure of direct tax is the composition of income tax, land revenue and registration, vehicle tax, interest tax and other tax. Direct tax has been divided into three sub-heads for the analysis i.e. income tax, land and house registration, and miscellaneous tax, among various direct tax revenue income tax has occupied the supreme position. It has been presented in table 4.7.

Table 4.7: Contribution of Various Taxes in Direct Tax Revenue in Nepal

(Rs in millions)

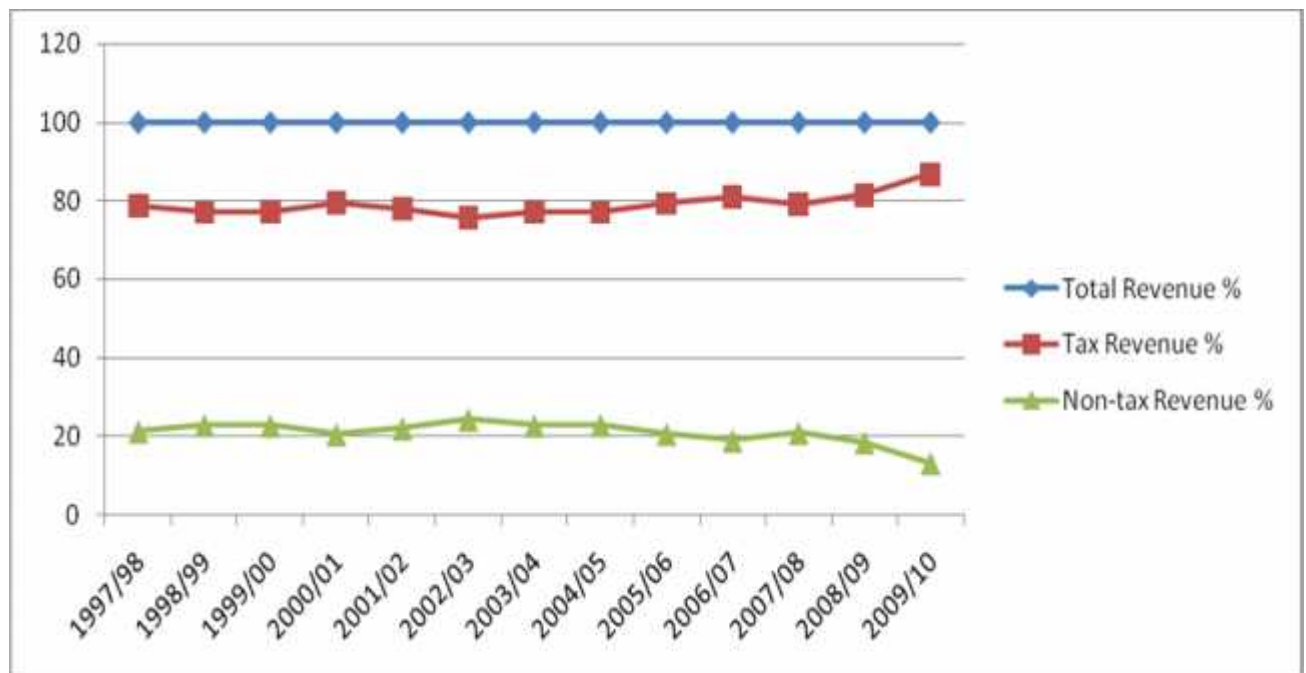
FY	Direct Tax Revenue		Income Tax Revenue		Land Revenue		Miscellaneous Taxes	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%
1997/98	6187.90	100	4898.10	79.16	1004.20	16.23	285.60	4.61
1998/99	7516.10	100	6170.20	82.09	1003.20	13.35	342.70	4.56
1999/00	8951.50	100	7420.60	82.90	1015.90	11.35	515.00	5.75
2000/01	10159.40	100	9114.00	89.71	612.90	6.03	432.50	4.26
2001/02	10597.50	100	8903.70	84.02	1131.80	10.68	562.00	5.30
2002/03	10105.70	100	7966.20	78.83	1414.30	14	725.30	7.18
2003/04	11912.50	100	9245.90	77.62	1697.50	14.25	969.20	8.13
2004/05	13071.90	100	10159.40	77.72	1799.20	13.76	1113.20	8.51
2005/06	13968.10	100	10373.70	74.27	2181.10	15.61	1413.30	10.12
2006/07	18980.30	100	15034.00	79.21	2253.50	11.85	1692.30	8.92
2007/08	23070.70	100	17311.20	75.03	2970.70	12.88	2836.60	12.88
2008/09	34320.70	100	25307.30	73.74	5223.30	15.22	3955.00	15.22
2009/10	41750.00	100	31237.10	84.82	5511.10	13.20	4953.30	13.20
Average	16199.41	100	12549.34	79.93	2139.90	12.17	1522.77	8.36

Source: Economic Survey, 2067/68

Note: 1. Income tax includes tax from public enterprises, semi-PES, private corporate bodies, individuals, remuneration and interests.

Note: 2. miscellaneous taxes include urban house and land tax, vehicle tax and other tax.

Figure 4.5: Contribution of Various Taxes in Direct Tax Revenue in Nepal



The above table and figure shows that income tax occupied the first place among various direct tax revenues. The amount of income tax has been showing an increasing trend except in the fiscal year 2001/02 and 2002/03. Out of total direct tax revenue Rs 4898.1 millions has been contributed by income tax. This is about 79.16% of the total direct tax revenue. In fiscal year 2009/10, out of total direct tax revenue Rs 41750 millions Rs 31237.1 millions has been contributed by income tax revenue. It is about 84.82% of total direct tax revenue which was maximum amount during the thirteen years period and 89.71% was the highest percentage income tax in 2000/01.

Land and house registration income occupied second position among various direct taxes. The amount of land and house registration increased from Rs 1004.2 million to 2253.5 million from the fiscal year 1997 to 2009/10. Trend of that was fluctuating over the period. The contribution of land and house registration had so much decreased in the fiscal year 2000/01. It was only 6.03% of total direct tax revenue. Out of total direct tax revenue of Rs 6187.9 millions Rs 1004.2 million was contributed by land and house registration in fiscal year 1997/98. Out of total direct tax revenue of Rs 41750, Rs 5511.10 million was contributed by this revenue i.e. 13.20% of total tax revenue in fiscal year 2009/10. In this year its percentage is in fluctuating trend.

Miscellaneous taxes occupied third position among the various direct taxes. The trend of that revenue has been also fluctuating. In fiscal year 1997/98, its contribution on the total direct tax was Rs 285.6 million i.e. 4.61%. In 2009/10, its contribution out of total direct tax of Rs 41750 million was Rs 4953.3 million i.e. 13.2% on direct tax revenue.

It is conclude that in the position of direct tax income tax plays vital role from the beginning, its contribution around 75% to 85% in various years.

4.1.7 Contribution of Income Tax in Total Revenue, Tax Revenue and Direct Tax Revenue of Nepal

Nepal is facing serious and growing fiscal resources gap and her need for mobilizing additional financial resources from domestic resources through taxation has been urgent. The base for living taxes may be consumption, income and capital. Taxes on incomes, capital are known as indirect taxes. Tax structure of Nepal is composed of both direct and indirect taxes. Income tax has been an important element of direct tax and it is playing vital role to generate government revenue for the development of National economy.

Table 4.7: Contribution of Various Taxes in Direct Tax Revenue in Nepal

(Rs in millions)

FY	Direct Tax Revenue		Income Tax Revenue		Land Revenue		Miscellaneous Taxes	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%
1997/98	6187.90	100	4898.10	79.16	1004.20	16.23	285.60	4.61
1998/99	7516.10	100	6170.20	82.09	1003.20	13.35	342.70	4.56
1999/00	8951.50	100	7420.60	82.90	1015.90	11.35	515.00	5.75
2000/01	10159.40	100	9114.00	89.71	612.90	6.03	432.50	4.26
2001/02	10597.50	100	8903.70	84.02	1131.80	10.68	562.00	5.30
2002/03	10105.70	100	7966.20	78.83	1414.30	14	725.30	7.18
2003/04	11912.50	100	9245.90	77.62	1697.50	14.25	969.20	8.13
2004/05	13071.90	100	10159.40	77.72	1799.20	13.76	1113.20	8.51
2005/06	13968.10	100	10373.70	74.27	2181.10	15.61	1413.30	10.12
2006/07	18980.30	100	15034.00	79.21	2253.50	11.85	1692.30	8.92
2007/08	23070.70	100	17311.20	75.03	2970.70	12.88	2836.60	12.88
2008/09	34320.70	100	25307.30	73.74	5223.30	15.22	3955.00	15.22
2009/10	41750.00	100	31237.10	84.82	5511.10	13.20	4953.30	13.20
Average	16199.41	100	12549.34	79.93	2139.90	12.17	1522.77	8.36

Source: Economic Survey, 2067/68

Table no 4.8 shows the percentage contribution of income tax to total revenue. It was increased 14.87% to 18.64% from fiscal year 1997/97 to 2000/01. It was fluctuating till the fiscal years 2001/02 to 2005/06 and fiscals 2007/08 to 2009/10. Then after in 2006/07 it was increased 14.35% to 17.14% in 2005/06 to 2006/07. We see that in the recent years there was decreasing trend of percentage of income tax to total revenue in 2009/10.

Above table shows that the contribution of income tax in Nepalese tax revenue from 1997/98 to 2009/10. It was increased 18.88% to 23.45% from 1997/98 to 2001/02, then after it was in fluctuating trend. In year 2005/06 it was minimum i.e. 18.06% .

Similarly above table shows that there is substantial contribution of income tax in the composition of direct tax revenue in Nepal for the 13 years period i.e. 1997/98 to 2009/10. The contribution of income tax has never been less than 70% and it was in fluctuating trend. It was 73.74% in 2008/09 but in 2009/10 it was increased and reached 74.82%.

So it is clear that there is significant contribution of income tax in Nepal to increase total revenue, total tax revenue and direct tax revenue. There seems to be highly positive correlation of income tax revenue with total revenue, tax revenue and direct tax revenue. It means if the income tax revenue is increase total revenue, tax revenue and direct tax revenue also increase.

4.1.8 Resources Gap in Nepal

A resources gap is the serious problems of Nepal in the beginning of the economic development. Like other developing countries in the world, Nepal has been suffering from resource constraint, mass poverty, rapid growth of population, aggressive dependence on agriculture income, subsistence living standard etc.

Source mobilization of Nepal is still poor and that doesn't cover the growing expenditure. Fiscal deficit is due to continuously growing expenditure of the government instead of the low revenue performance in Nepal. So, the country is facing the increasing burden of foreign loan.

Table 4.9: Resource Gap of Nepal

FY	Total Expenditure (A)	Total Revenue (B)	Resources Gap
1997/98	56118.3	32937.9	23180.4
1998/99	59579	37251.3	22328.3
1999/00	66272.5	42893.7	23378.8
2000/01	79835.1	48893.6	30941.5
2001/02	80072.2	50445.5	29626.7
2002/03	84006.1	56229.8	27776.3
2003/04	89442.6	62331	27111.6
2004/05	102560.4	70122.7	32437.7
2005/06	110889.2	72282.1	38607.1
2006/07	133604.6	87712.1	45892.5
2007/08	161349.9	107622.5	53727.4
2008/09	219662	143474.5	76187.5
2009/10	259689.1	179945.8	79743.3
Average	115621.6	76318.65	39303.1

Source: Economic Survey, 2067/68.

From the above table it is observed that the value of resource gap is increasing trend except year 2001/02, 2002/03 and 2003/04. Average resource gaps in the 13 year period was 39303.1 million, after 2003/04 it was more than average and 2005/06, it is maximum of 13 year period i.e. 79743.3 million. Political problem, development activities, inflation etc are the cause of increasing resource gap. Increasing trend of resource gap is not well for the country. To fulfill the resource gap country can increase internal revenue like taxes.

4.2 Empirical Investigation

4.2.1 Introduction

An empirical investigation has been conducted in order to find out various aspects of contribution of income tax to government revenue, for this questionnaire was developed and responses were collected from the respondents. A set of 54 questionnaires were received from the respondents out of 60 questionnaires distributed to them. Respondents were classified into two group i.e. tax experts/ tax administrators and tax payers. The responses have been analyzed in order to facilitate the descriptive analysis of the study.

The questionnaire was asked for either Yes/No responses or asked for ranking of the choices. According to the number of alternatives where the first choice was the most important. For the purpose of analysis, most important choices were assigned according to the number of alternatives. If the number of alternatives were four, the first preferred choice would get four points and last preferred choice would get one point. Any alternatives which were not ranked didn't get any point. The total points available to each choice were converted into percent with reference to the total points available for all choices. The choice with the highest percent score was ranked as the most important choice and then on with the percent score was ranked as the last choice. The following table shows the group of respondents.

Table 4.10: Groups of the Respondents

S.N	Groups of Respondents	Sample Size
1.	Tax expert/ tax administrators	30
2.	Employee/ tax payers	30
	Total	60

Source: Opinion Survey, 2012.

4.2.2 People are well informed about the Tax System

To know the respondents opinion about the people are well informed about the tax system. The question “Do you think that people of Nepal are well informed about the tax system? Was asked the responses received from the respondents are tabulated as follows.

Table 4.11: People are well informed About the Tax System

Responses Respondents	Yes		No		Total	
	Nos.	%	Nos.	%	Nos.	%
1. Tax experts and tax administration	11	20	16	30	27	50
2. Tax payers	13	24	14	26	27	50
Total	24	44	30	56	54	100

Source: Opinion Survey, 2012.

From the table it is observed that about 56% of the respondents responded that people are not well informed about tax system and only 44% of the respondents accepted that people are well informed about tax system.

In conclusion, it can be said that the most of the respondents opined that people are not well informed about tax system.

Test of Hypothesis:

Respondents	Yes	No	Row Total
Tax experts/tax administrators	11	16	27
Tax payers	13	14	27
Column Total	24	30	54

Null hypothesis H_0 : There is no significant difference in the view of Tax experts/ administrators and tax payers regarding people are well informed about the tax system of Nepal.

Alternative hypothesis H_1 : There is significant difference in the views of tax experts and tax administrators and tax payers regarding people are well informed about tax System of Nepal.

Test statistic: Under H_0 , the test statistic is

$$\chi^2 = \frac{(f_o - f_e)^2}{f_e}$$

Where, f_o = Observed frequency

$$f_e = \text{Expected frequency} = \frac{\text{Row total} \times \text{column total}}{\text{Grand Total}}$$

Calculation of χ^2

Row, column	f_o	f_e	$f_o - f_e$	$(f_o - f_e)^2$	$\frac{(f_o - f_e)^2}{f_e}$
1,1	11	$(27 \times 24) / 54 = 12$	-1	1	0.083
1,2	16	$(27 \times 30) / 54 = 15$	1	1	0.067
2,1	13	$(27 \times 24) / 54 = 12$	1	1	0.083
2,2	14	$(27 \times 30) / 54 = 15$	-1	1	0.067
					$\frac{(f_o - f_e)^2}{F_e} = 0.3$

Calculated $\chi^2 = 0.3$

Degree of freedom = $(r-1)(c-1) = (2-1)(2-1) = 1 \times 1 = 1$

Level of significance = 5% = 0.05

Tabulated $\chi^2_{0.05} = 3.841$

Conclusion: Since calculated χ^2 < tabulated χ^2 , it is not significant and H_0 is accepted which means that there is no significant difference in tax experts/ tax administrators

and tax payers views regarding the people are well informed about tax system of Nepal.

Table 4.12: Opinion Towards More Appropriate Method for Assessing of Income Tax

S. N.	Alternatives	Tax expert and Tax Administrators	Tax Payers	Overall Points	%	Rank
1	Self-assessment	93	72	165	31.55	1
2	Assessment on the best judgment	75	56	131	25.05	2
3	Assessment on the basis of account submitted by the tax payers	55	49	101	19.88	4
4	Tax settlement commission	56	67	123	23.52	3
				523	100	

Source: Opinion Survey, 2012.

While ranking together the opinion of both groups the corresponding prioritized reasons for more appropriate methods for tax assessment are as follows:

1. Self- assessment
2. Assessment on the best judgment
3. Tax settlement commission
4. Assessment on the basis of accounts submitted by the tax payers.

From the above table it is concluded that the self- assessment is the more appropriate method for tax assessing of income tax.

Calculation of Rank correlation coefficient

S.N	Alternatives	Total Points (X)	Total Points (Y)	Ran for X(R ₁)	Rank for Y (R ₂)	d=R ₁ -R ₂	d ²
1	Self-assessment	93	72	1	1	0	0
2	Assessment on the basis of best judgment	75	56	2	3	-1	1
3	Assessment on the basis of account submitted by the tax payers	55	49	4	4	0	0
4	Tax settlement commission	56	67	3	2	1	1
							d ² = 2

Source: *Opinion Survey, 2012.*

Where, X = tax experts and tax administrators

Y = tax payers

We have,

$$r = \frac{1 - 6 \frac{d^2}{n(n^2-1)}}{4(4^2-1)} = \frac{1 - 6 \times 2}{4(4^2-1)} = 0.8$$

The correlation indicates that there is high degree of positive correlation between tax experts and tax administrators and tax payers ranking regarding the more appropriate method for assessing of income tax.

4.2.3 Specific Objectives of Income Tax in Nepal

In order to know the specific objective of income tax respondents were requested to rank the responses on given choices. The question was “in your opinion what should

be the specific objective of income tax in Nepal?” The following table shows the rank wise responses received from the respondents.

Table 4.13: Specific Objective of Income Tax in Nepal

S.N	Objectives	Tax expert (Total Point)	Tax Payers	Overall Point	%	Rank
1	To enhance the government revenue	81	84	165	30.56	1
2	To meet the government expenditure	76	80	156	28.89	2
3	To achieve national economic development	61	60	121	22.41	3
4	To check inflation	52	46	98	18.14	4
				540	100	

Source: Opinion Survey, 2012.

From the above table it is addressed that the specific objective of income tax in Nepal should be enhance the government revenue and other objectives are ranked follows.

1. To enhance the government revenue
2. To meet the government expenditure
3. To achieve National economic development
4. To check inflation

4.2.4 Opinion towards Problems Facing by the Tax Administration of Nepal

To know the respondent’s opinion regarding the problems faced by the tax administration of Nepal, a question was asked “In Nepal what are the major problems facing by the tax administration?” The responses received from the respondents are tabulated below;

Table 4.14: Opinion towards Problems Facing by the Tax Administration of Nepal

S.N	Problems	Tax Expert and Tax Administrators	Tax Payers	Overall Point	%	Rank
1	Lack of trained & competent tax personnel	85	90	175	15.38	5
2	Lack of proper direction	84	93	177	15.55	4
3	Complicated tax laws	102	99	201	17.66	2
4	Undue delay in making assessment	120	112	232	20.38	1
5	Unnecessary outside pressure	94	80	174	15.29	6
6	Lack of co-ordination	88	91	179	15.74	3
	Total			1138	100	

Source: Opinion Survey, 2012.

From the above table in making assessment problems faced by tax administration is undue delay in making assessment and other important factors are ranked, while ranking together the options of both the groups. The corresponding prioritized problems are as follows:

1. Undue delay in making assessment
2. Complicated tax laws
3. Lack of co-ordination
4. Lack of proper direction

5. Lack of trained and competent tax personnel
6. Unnecessary outside pressure

Calculation of Rank Correlation Coefficient

S. N	Alternatives	Total Points (X)	Total Points (Y)	Rank for X (R ₁)	Rank for Y (R ₂)	d= R ₁ -R ₂	d ²
1	Lack of trained and competent tax personnel	86	90	5	5	0	0
2	Lack of proper direction	84	93	6	3	3	9
3	Complicated tax laws	102	99	2	2	0	0
4	Undue delay in making assessment	100	112	1	1	0	0
5	Unnecessary outside pressure	94	80	3	6	-3	9
6	Lack of co-ordination	88	91	4	4	0	0
	Total						d ² =18

Where, X= Tax expert and tax administrators

Y= Tax payers

We have,

$$r = \frac{1 - 6 \frac{d^2}{n(n^2-1)}}{6(6^2-1)} = \frac{1 - 6 \times 18}{6(6^2-1)} = 0.49$$

The correlation indicate that there is positive correlation between tax experts and tax administration and tax payers ranking regarding the problem facing by the tax administration in Nepal.

From the analysis, it can be concluded that there are so many problems facing by administration out of them undue delay in making assessment is the main problem. So this problem should be minimized as soon as possible.

4.2.5 Opinion Regarding the Tax Evasion is Most Often Practice in Tax System

To know the views of respondent about the opinion towards the practice of income tax evasion in tax system, a question was asked, it is said that the tax evasion is most often practice, do you agree this statement? The responses received from respondents are tabulated as follows.

Table 4.15: Practice of Tax Evasion in Tax System

Responses	Yes		No		Total	
	Nos.	%	Nos.	%	Nos.	%
1. Tax experts and tax administrators	16	29.63	11	20.37	27	50
2. Tax payers	14	29.93	13	24.07	27	50
Total	30	55.56	24	44.44	54	100

Source: Opinion Survey, 2012.

From the above table it is clear that about only 44% of the respondent responded that tax evasion is not practical in tax system and about 56% of the respondents responded that, tax evasion practice is most often in tax system.

In conclusion it can conclude that most of the respondents agree with the tax evasion is most often practice in tax system. And tax evasion should be discouraged by the tax payers tax officers, tax administrators and other related person.

Test of Hypothesis:

Respondents	Yes	No	Row Total
Tax experts/ administrators	11	16	27
Tax payers	13	14	27
Column total	24	30	59

Null hypothesis, H_0 : There is no significant difference in the views of the tax experts and tax administrators and tax payers regarding the tax evasion practice in the tax system.

Alternative hypothesis, H_1 : There is significant difference in the views of tax experts and tax administrators and tax payers regarding tax evasion practice in the tax system.

Calculation of χ^2

Row, column	f_o	f_e	$f_o - f_e$	$(f_o - f_e)^2$	$(f_o - f_e)^2 / f_e$	$(f_o - f_e)^2 / f_e$
1,1	16	$(27 \times 30) / 54 = 15$	1	1	0.067	0.067
1,2	11	$(27 \times 24) / 54 = 12$	- 1	1		0.083
2,1	14	$(27 \times 30) / 54 = 15$	-1	1		0.067
2,2	13	$(27 \times 24) / 54 = 12$	1	1		0.083
					$(f_o - f_e)^2 / f_e = 0.3$	

Test statistics under H_0 , the test statistics is

$$\chi^2 = \frac{(f_o - f_e)^2}{f_e}$$

Where, f_o = Observed frequency

$$f_e = \text{Expected frequency} = \frac{\text{Row total} \times \text{column total}}{\text{Grand total}}$$

Now,

$$\text{Calculated } \chi^2 = 0.3$$

$$\text{Degree of freedom} = (r-1)(c-1) = (2-1)(2-1) = 1 \times 1 = 1$$

$$\text{Level of significance} = 5\% = 0.05$$

$$\text{Tabulated } \chi^2_{0.05} = 3.841$$

Conclusion, since calculated χ^2 is less than tabulated χ^2 . It is not significant and H_0 is accepted which means that there is no significant difference in tax expert and tax

administrators views and tax payers views regarding the tax evasion is the most often practice in tax system.

4.2.6 Opinion Towards Factors Responsible for Income Tax Evasion

In order to know the opinion towards the factors responsible for income tax evasion, the question was asked to the respondents, “In your opinion, what are the factors responsible for income tax evasion?” the response received from the respondents are listed below:

Table 4.16: Opinion towards Factors Responsible for Income Tax Evasion

S. N.	Alternatives	Tax Experts	Tax Payers	Overall Points	%	Rank
1	Defective tax administration	109	112	221	18.95	1
2	Inappropriate income tax	974	109	206	17.67	3
3	Loopholes in income tax act	115	86	201	17.24	4
4	Lack of consciousness in tax payers	96	67	163	13.98	6
5	Corruption in tax authority	71	96	167	14.32	5
6	Lack of political commitment	107	101	208	17.84	2
	Total			1166	100	

Source: Opinion Survey, 2012.

From the table it is clear that the main factors responsible for income tax evasion is defective tax administration and other factors are ranked below in order of preference:

1. Defective tax administration
2. Lack of political commitment
3. Inappropriate income tax policy
4. Loopholes in income tax act

5. Corruption in tax authority
6. Lack of consciousness is tax payers

From the above analysis we can conclude that tax administration should make more effective and provide political commitment to reduce tax evasion.

Table 4.17: Opinion towards Ways of Controlling Tax Evasion

S.N.	Alternatives	Tax Experts & Tax Adms.	Tax Payers	Overall Points	%	Rank
1	Educating tax payers	49	40	89	8.83	8
2	Simplifying tax laws	65	56	121	12	4
3	Timely assessment of tax	59	38	97	9.62	7
4	Incentives of regular tax payers	94	49	143	14.1 9	3
5	Fines and penalties to tax evasion	75	41	116	11.5 1	5
6	Compulsory maintenance of accounts	107	59	166	16.4 7	1
7	Heavy punishment for the corrupter personnel	92	64	156	15.4 8	2
8	Rewards to the information giver about tax evasion	63	57	120	11.9	6
				1008	100	

Source: Opinion Survey, 2012.

From the table it is clear that the main factor is control income tax evasion in Nepal is compulsory maintenance of accounts. The other different factors suggested by the respondents are ranked below in order of preference:

1. Compulsory maintenance of accounts
2. Heavy punishment to corrupt personnel

3. Incentives of regular tax payers
4. Simplifying tax laws
5. Rewards to the tax evasion finders
6. Fines and penalties to tax evaders
7. Timely assessment of tax
8. Educating tax payers

So it can be concluded that there are so many ways to control income tax evasion out of them, compulsory maintenance of account is first order. It should be think by all tax expert, tax administrator and tax payers and related person.

4.2.7 Opinions towards Problem Faced by Employee while Income Tax

To know the respondents opinion regarding the problems faced by employees while paying income tax the question was asked, the question was “What types of problem that employee faced while paying income tax?” The responses received from the respondents are tabulated below:

Table 4.18: Opinion towards Problem Faced by Employee while Paying Income Tax

S.N	Problems	Tax expert (Total Point)	Tax Payers	Overall Point	%	Rank
1	Lack of knowledge about taxation (how to return file)	75	60	135	25.71	2
2	Procedural complication	86	94	180	34.29	1
3	Weak and immature treatment by tax administration	52	45	97	18.48	4
4	Hesitation to pay income due to low income	67	46	113	21.52	3
				525	100	

Source: Opinion Survey, 2012.

From the above table, it is know that most important problem faced by employees while paying income tax is procedural complications. While ranking together the opinions of both the groups, the corresponding prioritized problems are as follows:

1. Procedural complications
2. Lack of knowledge of taxation
3. Hesitation to pay income tax due to low income
4. Weak and immature treatment by tax administrators

4.2.8 Opinion towards the Provision of Fines and Penalties Under Income Tax System

To know the respondents opinion regarding the provision of fines/ fees and penalties under income tax system, a question was asked, “The provision of fines, fees and penalties under income tax system is reasonable?” The responses received from the respondents are tabulated below:

Table 4.19: Provision of Fines, Fees and Penalties Under Income Tax System

Responses	Yes		No		Total	
	No.	%	No.	%	No.	%
<i>Respondents</i>						
Tax experts/tax administrators	17	31.48	10	18.52	27	50
Tax payers	13	24.07	14	25.93	27	50
Total	30	55.55	24	44.45	54	100

Source: Opinion Survey, 2012.

From the above table, it has been clear that about 56% age of the respondents responded that the fines, fees and penalties under income tax is reasonable and about 44% respondents responded fines fees and penalties is not reasonable.

In conclusion it can be said that provision of fines, fees and penalties under income tax system is reasonable.

Test of Hypothesis:

Respondents	Yes	No	Row Total
Tax experts/ administrators	17	10	27
Tax payers	13	14	27
Column total	30	24	54

Null hypothesis, H_0 : There is no significant difference in the views of the tax experts and tax administrators and taxpayers regarding the provision of fees, fines and penalties

Alternative hypothesis, H_1 : There is significant difference in the views of tax experts and tax administrators and taxpayers regarding the provision of fees, fines and penalties

Test statistics under H_0 , the test statistics is

$$\chi^2 = \frac{(f_o - f_e)^2}{f_e}$$

Where, f_o = Observed frequency

$$f_e = \text{Expected frequency} = \frac{\text{Row total} \times \text{column total}}{\text{Grand total}}$$

Calculation of χ^2

Row, Column	f_o	f_e	$f_o - f_e$	$(f_o - f_e)^2$	$(f_o - f_e)^2 / f_e$
1,1	17	$(27 \times 30) / 54 = 15$	15	4	0.27
1,2	10	$(27 \times 24) / 54 = 12$	- 2	4	0.33
2,1	13	$(27 \times 30) / 54 = 15$	-2	4	0.27
2,2	14	$(27 \times 24) / 54 = 12$	2	4	0.33

$$\chi^2 = \sum \frac{(f_o - f_e)^2}{f_e} = 1.2$$

Now,

$$\text{Calculated } \chi^2 = 1.2$$

$$\text{Degree of freedom} = (r-1)(c-1) = (2-1)(2-1) = 1 \times 1 = 1$$

$$\text{Level of significance} = 5\% = 0.05$$

$$\text{Tabulated } F_{0.05, 1, 38} = 3.841$$

Conclusion, since tabulated $F_{0.05, 1, 38}$ is calculated $F_{0.05, 1, 38}$ i.e. 1.2 so it is not significant and H_0 is accepted. This means there is no significant difference in the view of tax experts and tax administrator and taxpayers regarding the provision of fines, fees and penalties under income tax system.

4.2.9 Opinion towards Most Important Factors for Effectiveness of Income Tax in Nepal

In order to know the most important factors for effectiveness of income tax, respondents were requested to rank the responses on given choice. The question was “what are the most important factors for effectiveness of income tax in Nepal?” The following table shows the rank wise responses received from the respondents.

Table 4.20: Opinion towards Most Important Factors for Effectiveness of Income Tax

S. N.	Factors	Tax Experts & Tax Adms.	Tax Payers	Overall Points	%	Rank
1	Honest tax payers	73	84	157	19.55	3
2	Honest tax officer	90	53	143	17.81	4
3	Clear and simple act, rules and regulation	109	95	204	25.40	2
4	Effective income tax administration	103	108	211	26.28	1
5	Other	41	47	88	10.96	5
	Total			803	100	

Source: Opinion Survey, 2012.

From the above ranking on the basis of prioritized given by respondents, it can be concluded that the effective income tax administration is the most important factor for effective of income tax revenue in Nepal and other factor are ranked below:

1. Effective income tax administration
2. Clear and simple act rules and regulation
3. Honest tax payers
4. Honest tax officers
5. Others

Table 4.21: Calculation of Rank Correlation Coefficient

S. N.	Alternatives	Total Points (X)	Total Points (Y)	Rank for X (R ₁)	Rank for Y (R ₂)	d= R ₁ -R ₂	d ²
1	Honest tax payers	73	84	4	3	1	1
2	Honest tax officer	90	53	3	4	-1	1
3	Clear act rules and regulation	109	95	1	2	-1	1
4	Effective income tax administration	103	108	2	1	1	1
5	Other	41	47	5	5	0	0
	Total						d ² =18

Source: Opinion Survey, 2012.

Where, X= Total expert and tax administrators

Y= tax payers

We have,

$$r = \frac{1 - 6 \frac{d^2}{n(n^2-1)}}{5(5^2-1)} = \frac{1 - 6*4}{5(5^2-1)} = 0.8$$

The correlation indicate that there is high degree of positive correlation between tax experts and tax administration and tax payers ranking regarding the most important factor for effectiveness of income tax in Nepal.

4.2.10 Opinion towards Increase the Income Tax Revenue

In order to know the opinion towards increase the income tax revenue a question was asked to the respondents,; How can we increase the income tax revenue in Nepal?"

The responses received from the respondents are listed below:

Table 4.22: Opinion towards the Reasons to Increase Tax Revenue in Nepal

S. N.	Alternatives	Tax Experts & Tax Adms.	Tax Payers	Overall Points	%	Rank
1	Educating tax payers	115	100	215	26.71	1
2	Simplifying tax laws	37	85	182	22.61	2
3	Incentives of regular tax payers	78	69	147	18.26	4
4	Timely assessment to tax	73	82	155	19.25	3
5	Imposing fines and penalties	50	56	106	13.17	5
	Total			805	100	

Source: *Opinion Survey, 2012.*

From the table it is clear that the main factor to increase the tax revenue from corporation is education and other preferences are ranked below in order.

1. Educating tax payers
2. Simplifying tax laws
3. Timely assessment of tax

4. Incentives to regular tax payers
5. Fines and penalties

From the above analysis we can conclude that each tax payers have to be given knowledge about tax. Tax payers should have conclusion regarding about tax system. Simplifying tax laws is also important factors for increasing income tax revenue of Nepal.

4.2.11 Opinion towards Major Problems in Income Tax System

In order to know the major problems in income tax system of Nepal, respondents were requested to rank the responses on given choices. The question was” Which are the major problems in income tax system of Nepal?” The responses received from respondents are tabulated below:

Table 4.23: Opinion towards Major Problems in Income Tax System

S. N.	Alternatives	Tax Experts	Tax Payers	Overall Points	%	Rank
1	Inadequate economic policy	105	109	214	13.72	2
2	Inefficient income tax administration	112	125	237	15.19	1
3	Complicated income tax act	99	102	201	12.89	3
4	Lack of education to tax payers	75	67	142	9.10	8
5	Lack of training & incentives to employee	87	95	182	11.67	4
6	Difficulties in maintaining account for tax purpose	73	89	162	10.38	5
7	Lack of expert in tax management	55	94	149	9.55	6
8	Practice of tax evasion	82	64	146	9.36	7
9	Inappropriate rate and exemption limit	43	84	127	8.14	9
	Total			1560	100	

Source: *Opinion Survey, 2012.*

From the above table it is clear that the major problem of income tax system is inefficient income tax administration and other problems are ranked below in order of preference.

1. Inefficient income tax administration
2. Inadequate economic policy
3. Complicated income tax act
4. lack of training to incentives to employee
5. lack of tax expert in tax management
6. Difficulties in maintaining account for tax purpose
7. Practice of tax evasion
8. Lack of education to tax payers
9. Inappropriate rate and exemption limit

Table 4.24: Calculation of Rank Correlation Co-efficient

S. N.	Alternatives	Total Points (X)	Total Points (Y)	Rank for X (R ₁)	Rank for Y (R ₂)	d= R ₁ -R ₂	d ²
1	Inadequate economic policy	105	109	2	2	0	0
2	Inefficient income tax administration	112	125	1	1	0	0
3	Complicated income tax act	99	102	3	3	0	0
4	Lack of education to tax payers	75	67	6	8	-2	4
5	Lack of training & incentive to employee	87	95	4	4	0	0
6	Difficulties in maintaining accounts for tax purpose	73	89	7	6	1	1
7	Lack of expert in tax management	55	94	8	5	3	9
8	Practice of tax evasion	82	64	5	9	-4	16
9	Inappropriate rate and exemption limit	43	84	9	7	2	4
							d ² =34

Source: Opinion Survey, 2012.

Where, X= Total expert and tax administrators

Y= tax payers

We have,

$$r = \frac{1 - \frac{6}{n} \frac{d^2}{(n^2-1)}}{1 - \frac{6 \times 34}{9(9^2-1)}} = 0.72$$

The correlation indicates that there is high degree of positive correlation between tax experts and tax administrators' views and taxpayers' views ranking regarding the major problems in income tax system in Nepal. So, for effectiveness income tax system we should make efficient income tax administration.

4.2.12 Comments and Suggestions Regarding to Achieving Effectiveness of Income Tax

An open question was asked to the respondents to know there comments and suggestions regarding achieving effectiveness of income tax. The responses received from the respondents are given below:

1. To carry all taxpayers in mainstream, the government must conduct public awareness programs and should be done transparent tax collection procedure.
2. Tax personnel should be trained and motivated
3. Proper monitoring by tax authorities is needed
4. Revenue administration should be made flexible
5. Simplified tax system and lower rate of tax is effective tool to recover more tax revenue.
6. Taxpayers should make aware of the provision of taxation.
7. Need of changing the behavior of them.
8. Government should provided sufficient remuneration to collect more tax revenue.
9. Simplification in the procedure.

10. Tight tax policy should be applied on equitable basis.
11. Discourage tax evasion through fine and penalties
12. Government should reward to regular taxpayers.

4.3 Major Findings of the Study

Following findings have been drawn out from the secondary data analysis and primary data conducted with tax expert and tax administrator and tax payers, are as under:

4.3.1 Findings from Secondary Data

The major findings of the study are pointed out as follows.

- a. Nepalese revenue structure consists of tax and non-tax revenues. Tax on consumption and product of goods and service has occupied first place regarding its contribution to total revenue of Nepal. The average contribution of tax on consumption and product of goods and services over the thirteen years period is 35.69% of the total revenue of Nepal. The average contribution of custom, tax on property, profit and income and non-tax revenue has 22.93%, 2.65%, 17.92%, and 20.85% respectively. Land and revenue registration has the lowest average contribution percent in total revenue of Nepal.
- b. Total revenue of Nepal consisted of tax revenue and non-tax revenue. Tax revenue comprises of customs, excise, sales tax (VAT) income tax, land revenue and registration and miscellaneous tax. In Nepalese revenue structure, tax revenue has always been greater than three times of non-tax revenue. In 1997/98 out of total revenue of Rs 32937.9 millions, 78.75 % i.e. 25939.8 millions has been contributed by tax revenue and rest has contributed by non-tax revenue. Similarly in 2009/10, 86.86% i.e. 156294.9 millions out of total revenue of Rs 179945.8 millions has been collected as tax revenue. The

- average contribution of tax and non-tax revenue during thirteen years period was 79.15 and 20.85% respectively.
- c. Nepalese income tax structure is formed by contribution of income tax from public enterprises, semi-public enterprises, private corporate bodies, individuals, tax on employment, tax on interest and other taxes. Contribution of individuals has occupied first position in total income tax revenue. The mean contribution of income tax revenue from F.Y. 1997/98 to F. Y. 2009/10 has been computed to be 40.82 %, private corporate bodies public enterprises, , employment, interest and other taxes have occupied second, third, fourth, fifth and sixth position in the total income tax revenue of Nepal and it is in fluctuating trend.
 - d. Nepalese tax revenue is composition of direct and indirect tax revenue. Average contribution of direct and indirect tax revenue to total tax revenue is 25.91 % and 74.09 % respectively during the thirteen years period. The structure of direct tax revenue is the composition of income tax revenue, land and registration and miscellaneous taxes. Among direct tax revenues income tax revenue has occupied the largest share. The mean contribution of income tax during thirteen years period was 79.93 % of direct tax revenue of Nepal. Average contribution of land and registration is second position of direct tax revenue.
 - e. Contribution of income tax has been in increasing trend. The mean contribution of income tax during the thirteen years period was 79.93%, 16.44%, 20.44% in direct tax revenue, total revenue and total tax revenue respectively. From this it is clear that the income tax revenue is one of the important sources of government revenue.
 - f. Tax revenue /GDP ratio in F.Y.1997/98 was 8.95 % and it was 14.73 % in 2009/10. It shows that the Tax/GDP ratio of Nepal is not satisfactory and Income tax/GDP ratio was 1.69 % in 1997/ 98 and 2.94% in 2009/10. It is slowly in increasing trend except 2001/02, 2002/03 and 2005/06. Resources

gap of Nepal is in increasing trend except in 2002/03 and 2003/04 during the study period. Resources gap was highest in 2009/10 and average gap was 39330.1 million during the period.

4.3.2 Findings from Primary Data

The major findings of the opinion survey are pointed out as below:

- a. People of Nepal are not well informed about tax system and the more appropriate method for assessing income tax is self assessment
- b. Defective tax administration is more responsible factors for being income tax evasion in Nepal and compulsory maintenance of account is the effective ways of controlling income tax evasion.
- c. A specific objective of income tax in Nepal is still enhancing the government revenue.
- d. Major problem faced by the tax administration is undue delay in making assessment. So it should be reduced as soon as possible and a complicated tax law is also the problem.
- e. Majority of the respondents opined that tax evasion is practiced while paying income tax.
- f. In Nepal major problem that employees faced while paying income tax is procedural complication.
- g. It is clear that provision of fines and penalties under income tax system is reasonable way of collect more income tax.
- h. Effective income tax administration is important factor for effectiveness of income tax etc.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Nepal is an agriculture based under developed country. In Nepal has deficit budget and it has been making economic condition of the country very bad. Resources gap of the country has been winding from the beginning to recent years. To solve the resource gap of the country it can be obtained income from external and internal sources. External sources are uncertain and guided by socio-political motives of the donor country, so it is not good for the country. Internal source of fund is own sources derived with in the country. Internal source of fund includes both tax and non-tax revenue.

Among internal source taxation is a prime factor. It is the pallor of the fiscal policy. Regarding the fact the present study entitled to “Contribution of Income Tax to National Revenue of Nepal” had been done. In this study contribution of income tax to national revenue has been analyzed, examination. Contribution of income tax to direct tax, tax /GDP ratio, composition of direct tax etc has been analyzed.

Various books, articles, discretions and other relevant materials are studied during the course of study. Almost dissertations have been found written on various aspects of income tax. Books are mainly based on the syllabus of universities, so they are descriptive than analytical. Various concepts of taxation have been discussed in the conceptual framework of study. Sources of government revenue, meaning of tax, classification of tax, historical background of income tax, heads of incomes etc has been taken in the consideration.

The researcher has discussed about various aspects of research methodology, such as research design, data collection procedure, size of population and samples, nature and

sources of data, selection of the respondents, procedure of selection and analysis of data etc, in the third chapter.

Secondary data as well as primary data have been used in this study. Economic survey has been used as the major sources of the secondary data. An opinion survey technique has been used in this study to collect the reliable primary data for the study. Primary data have been collected from two respondents groups i.e. tax experts/tax administrators and tax payers. Tax experts consist of chartered accountants, lawyers and government officers for tax administrators. Taxpayers consist of employees working in government offices, banks and private organization. A set of questionnaire was developed and 60 questionnaires have been distributed to the respondents 30 each for both groups, 27 each from both groups responses have been received. Statistical tools like

Simple, average, rank correlation coefficient and X² test for hypothesis have been used to analyze and interpret the data so as to obtain designed result. For the analysis of secondary data, data has been tabulated and present in figures. Percentage and average have been computed from 1997/98 to 2006/07. Major findings of the secondary data analysis have been put in the end of the chapter.

Data obtained from opinion survey with the respondents have been tabulated and analyzed to achieve design result. Hypothesis have been set out and tested in order to see the similarity or dis-similarity in the opinions of tax experts and taxpayers. Rank correlations co-efficient have been also calculated to find out correlation between tax experts/tax administrators view and taxpayers views. Major findings of the primary data have been put in the end of the chapter. Conclusions of the study are in the last chapter. Some recommendations are also giving in the end of the study to increase the contribution of income tax to national revenue of Nepal. In this way, this study has been completed with the achievement of the started objectives.

5.2 Conclusion

The conclusions of this study are mentioned below.

- a. Revenue structure of Nepal is composed of tax and non-tax revenues. Tax revenue has the largest share of contribution in total revenue i.e. in average, 79.15 percentage of total revenue. In F.Y 2009/10 its contribution has 86.86%, which has been highest during the study period. Similarly, From the F.Y. 1997/98 to 2009/10 taxes on consumption and product of goods and services has occupied first position regarding its contribution in total revenue.
- b. Tax revenue consists direct and indirect tax revenue has been heavily dominated by indirect tax from FY 1997/98 to 2009/10 average contribution of indirect tax revenue has been found contribution of indirect tax revenue has been found 73.29% in tax revenue. Among direct taxes, contribution of income tax has the highest contribution.
- c. Income tax has average contribution of 16.44% of total revenue 20.44% in Tax revenue and 79.93% in direct tax revenue from the F.Y. 1997/98 to 2009/10. Contribution of individual sectors in income tax revenue has been highest in the study period and income tax from employment has very much insignificant contribution in total income. It was about 11.26% of total income tax revenue
- d. Total income tax revenue consists of various sources i.e. public enterprises semi-public enterprises, private corporate bodies, individuals, remuneration, tax on interest etc. Income tax from individuals has occupied first position i.e. 40.82% in average, private corporate bodies has occupied 2nd position i.e. 22.00% in total income tax revenue of Nepal. Similarly, Public enterprises, remuneration and tax on Interest have occupied 3rd, 4th and 5th position respectively.
- e. Direct tax revenue consists of income tax revenue, land and registration and miscellaneous taxes. Among direct tax revenue, income tax has occupied

highest share during the study period, which was 79.16%, in 1997/98 and 84.82% in 2009/10. The contribution of income tax revenue was in increasing trend in 2009/10.

- f. Tax/GDP ratio of Nepal is not good. The study showed the lower contribution of tax/GDP ratio. So, tax revenue of Nepal is to be increased.
- g. People are not well informed about tax system of Nepal.
- h. The most appropriate method of tax assessment is self-assessment then after assessment as the best judgment tax settlement commission and account submitted by the taxpayers. Sill specific objective of income tax in Nepal is to enhance the government revenue. So the specific objectives of income tax need to be changed.
- i. Tax administration is also facing various problems such problems are under delay in making assessment, complicated tax laws, lack of coordination, lack of practice direction etc.
- j. Tax evasion is a serious problem in the tax system, but there is less chance of tax evasion in employment income in which tax is already deducted as source, while receiving salaries.
- k. In the viewpoint of respondents the factor responsible for tax evasion is defective tax administration and other factors are lack of political commitment, inappropriate income tax policy, loopholes in income tax act, corruption in tax authority and lack of consciousness in the taxpayers.
- l. To control tax evasion, the respondents suggested different factors, such as maintenance of compulsory account, neryy punishment to corrupt personnel, incentives of regular taxpayers. Simplifying tax laws, towards to the tax evasion finders etc.
- m. Major problem that employees faced while paying income tax is procedural completion and provision of fines and penalties under income tax system is reasonable.

- n. For effectiveness income tax system, effective income tax administration is the most important factor and to increase income tax revenue we should educate the taxpayers using different tools.
- o. In order to know the opinion of respondents inefficient income tax administration is the major problems of income tax system. The rules and regulations of the income tax are also complicated and hence need to be simplified.

5.3 Recommendations

On the basis of above analysis, the following recommendations are offered regarding income tax.

- a. Nepalese tax revenue is heavily dominated by indirect tax revenue. Only one-fifth of tax revenue has been contributed by direct tax revenue. It is necessary to increase the share of direct tax revenue. So, as to direct the economy towards the channel of development. Resources mobilization through direct taxation should be focused.
- b. The contribution of income tax to total revenue, direct tax revenue and total tax revenue should be increased by making effective changes in income tax policy, rules and regulations bringing new tax payers into tax net, providing incentive programs with sound tax planning.
- c. Income tax act 2058 is very vague in nature so, income tax act should be made effective for its implementation and employees should be provided with sufficient knowledge of taxation for to aware the existing income tax policy.
- d. The standard tax GDP ratio is 15% to 18% but the tax/GDP ratio of Nepal did not exceed 14.73% during the study period. So, the government should make appropriate measures to meet the standard.
- e. There are various types of problems that the taxpayers face while paying income tax. So, the problems and troubles should be minimized as far as

- possible. Tax administrator should be made more responsible, tax clearance certificates should be provide to the tax payers while paying income tax, taxation knowledge to the employee should be provided, refund of tax should be made without delay. Procedural complications in paying income tax should be made simplification etc.
- f. There are some problems and troubles that the tax administration faced. So, they should be minimized as soon as possible tax offices should be recruit trained and competent tax personal, complicated tax laws should be simplified. It should not delay in making tax assessment etc.
 - g. There should be established coordination between tax policy transparent and careful enforcement of existing provision. So, efforts must be made in this regard.
 - h. The rate of fines and penalties should be increased for those taxpayers who submit false income statement and who do not submit income statement for tax purpose.
 - i. The provision of fines, penalties and punishment should be implemented effectively for income tax evaders.
 - j. Effective public participation is necessary to minimize the income tax evasion. Continuous effort should be done tax authority to build the taxpayer's positive attitude towards taxation.
 - k. Tax personal should be encouraged, punished and transferred based on work and experience. Regular and effective training system, reward, prize, and punishment system should be established for effective personnel management.
 - l. Government should provide sufficient remuneration to collect more tax revenue; it should be transparent to collect more tax revenue and every sector.
 - m. The staffs of tax office should develop working culture. When the taxpayer visits the office, they should be provided with respect and co-operation. Due respect should be given to the taxpayers when they visit the office.

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APPENDIX

"Questionnaire to Tax Experts/Tax Administrators and Tax Payers"

Dear Sir/ Madam

First of all, I would like to introduce myself as a student of Nepal Commerce Campus, Tribhuvan University, MBS final year. In order to fulfill the partial requirement of master degree in business studies of Tribhuvan University of Nepal, I am conducting the research work entitled "An analysis of income tax structure and its contribution to government revenue."

I have sent this questionnaire to spare some of yours valuable time to provide your valuable experience, suggestion and opinions concerning with income tax system of Nepal. This will be very much appreciated if you could provide your important time for filling this questionnaire.

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

Yours sincerely
Sita Bartaula
Nepal Commerce Campus

Date:

Name:
Office/ organization

Designation:
Occupation:

Please tick () the answer of your choice or wherever appropriate put in order of preference from 1 to last number on the basis of alternatives. Number 1 stand for the most important and vice versa.

1. Do you think that people are well informed about tax system of Nepal?
 - a. Yes []
 - b. No []

2. Which method is more appropriate in Nepal while assessing income tax (please rank)
 - a. Self assessment []
 - b. Assessment on the basis of best judgment []
 - c. Assessment on the basis of account submitted by the tax payers []
 - d. Assessment by the tax settlement committee []
 - e. Others (please specify).....

3. In your opinion, what should be the specific objective of income tax in Nepal (please rank)
 - a. To enhance the government revenue []
 - b. To meet government expenditure []
 - c. To achieve national economic development []
 - d. To check inflation []
 - e. Others (please specify).....

4. In your opinion, what are the major problems facing by the tax administration in Nepal? (Please rank)
 - a. Lack of trained and competent tax personnel []
 - b. Lack of proper direction []
 - c. Complicated tax laws []
 - d. Undue delay in making assessment []
 - e. Unnecessary out side pressure []
 - f. Lack of co-ordination []

5. It is said that tax evasion is most often practice in tax system, do you agree this statement?
 - a. Yes []
 - b. No []

6. In your opinion, what are the factors responsible for income tax evasion (please rank)
 - a. Defective tax administration []
 - b. Inappropriate income tax policy []
 - c. Loopholes in income tax policy []
 - d. Lack of conciseness in tax payers []

- e. Corruption in tax authority []
 - f. Lack of political commitment []
 - g. Others (please specify).....
7. In your opinion, what are the ways of controlling income tax evasion in Nepal (please rank)
- a. Educating tax payers []
 - b. Simplifying tax laws []
 - c. Timely assessment of tax []
 - d. Incentives of regular tax payers []
 - e. Fines and penalties to tax evaders []
 - f. Compulsory maintenance of accounts []
 - g. Heavy punishment for the corrupter personnel []
 - h. Rewards to the information giver about tax evasion []
8. What types of problem faced by employee while paying income tax? (Please rank)
- a. Lack of knowledge about taxation []
 - b. Procedural complication []
 - c. Weak and immature treatment by tax administrators []
 - d. Hesitation to pay tax due to low income []
 - e. Others (please specify).....
9. In your opinion, the provision of fines fees and penalties under income tax system is reasonable?
- a. Yes []
 - b. No []
10. What are the most important factors for effectiveness of income tax in Nepal? (Please rank)
- a. Honest tax payers []
 - b. Honest tax officers []
 - c. Clear and simple act, rules and regulation []
 - d. Effective income tax administration []
 - e. Others (please specify).....
11. In your opinion, how can we increase the income tax revenue of Nepal? (Please rank)
- a. Educating tax payers []
 - b. Simplifying tax laws []
 - c. Incentives to regular tax payers []
 - d. Timely assessment of tax []
 - e. Imposing fines and penalties []
12. What are the major problems in income tax system of Nepal (please rank)
- a. Inadequate economic policy []
 - b. Complicated income tax act, rules and regulation []
 - c. Inefficient income tax administration []
 - d. Lack of education to tax payers []

- e. Lack of training and incentives to employee []
- f. Difficulties to maintaining account for tax purpose []
- g. Lack of experts in tax management []
- h. Practice of tax evasion []
- i. Inappropriate rate and exemption limit []

13. Do you have any comment and suggestion for achieving effectiveness of income tax in Nepal? Please specify.....
Thank You for Your Kind Co-operation"