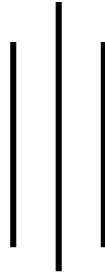


**STUDY ON EFFECTIVENESS OF INCOME TAX WITH
REFERENCE OF EMPLOYMENT INCOME TAX IN
NEPAL**



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**In partial fulfillment of the requirements for the degree of
Master of Business Studies (MBS)**

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June, 2010

RECOMMENDATION

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**“Study on Effectiveness of Income Tax With Reference of
Employment Income Tax in Nepal”**

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DECLARATION

I hereby declare that the work reported in this thesis entitled "**Study on Effectiveness of Income Tax With Reference of Employment Income Tax in Nepal**" submitted to Patan Multiple Campus, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the Master's degree in Business Studies under the supervision of Mr. Dinesh Man Malego.

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Abbreviations

DDC	District Development Committee
Df	Degree of freedom
GDP	Gross Domestic Product
GNP	Gross National Product
GON	Government of Nepal
HMG	His Majesty Government
IRD	Inland Revenue Department
KTM	Kathmandu
M.A.	Management Assessment
MOF	Ministry of Finance
NRB	Nepal Rastra Bank
OECD	Organization for Economic Cooperation and Development
P.E.	Probable error
TDS	Tax Deduction at Source
UDCs	Underdeveloped Countries
VAT	Value Added Tax
VDC	Village Development Committee
WDR	World Development Reports

CHAPTER – ONE

INTRODUCTION

1.1 General Background of Study

The public revenue of the country comes from taxes as well as non-taxes sources of revenue.(NRB, Bulletin 2005). The revenue of government comes from basically two sources - non tax and tax. Non-tax revenue includes different sources like grants, gifts. Administration income business income and taxation, grants and gifts mean the amount given by the people of country itself voluntarily or one country to another country. If a country does not have to repay the amount of assistance to the donor, it is called grants refers to gift of money or technical assistance does not have to be repaid. (**Prasashan, 2061**)

The examples of such types of revenues are grants of foreign government or agencies. The administration income denotes the amount charged by the government for providing administration service. The examples of such revenues are registration fee, fines and penalties. Business income means the return received by the government for providing various goods and services to the people. The examples of the business income are charges for postage, electricity, water telephone and so on. Such type of revenue comes automatically while performing many other work in Nepal. Other source of government revenue is taxation, customs, excise, value added tax, corporate and personal income taxes are the examples of these sources of the tax revenue. The main objective of taxation is to collect revenue. The government passes the acts for getting tax revenue and collects the taxes as per the act. The tax cannot be imposed without tax act of parliament in Nepal too; **section 73 of the constitution of Nepal 2047** prohibits or imposes tax without law.

As already stated, the government collects the revenue from different sources such as tax, remittance from public enterprises, fees, fines interest, grants deficit financing. However, across all these sources of collecting the revenues, taxation is the main sources since it occupies the most important place in the government treasury. Because of the importance of the source is revenue mobilization of a country, some persons like to say tax as the sinews of the state.

Tax revenue includes the amounts, which are compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred. The taxpayer does not have any right to receive direct benefit from the tax paid. Due to this compulsory nature, people have expressed different views in satirical ways about the taxation. Some says, nothing is certain in this world without Death and taxes, some says, death and tax both are certain, but death is not annual where as tax is annual. Other says, Death is stopping to pay tax. Here it should be noted that not all compulsory payments are taxes. For example, fines and fees are also compulsory payments without having direct benefit to the taxpayer but they are not tax, because their objectives are not to collect revenue but to curb certain type of offence. Secondly, tax payee cannot receive any quid-pro-quo for the payment of tax. The tax payer can not receive any quid-pro, quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. A tax is not a price paid by one, for which he can claim goods and services. The charge of price for goods and service by public authority is not a tax. Thirdly, the tax is paid to the government for carrying out its function smoothly. Fourthly, in case of tax, the amount is spent for common interest of people. The tax is collected from haves and spent for the interest of haves not in the society. Fifthly, a natural or an artificial person pays the tax. **(Source: Kandell, 2004:1-2)**

In conclusion, it can be said a tax is liability to pay an amount to the state tax revenue not only contributes in national capital formation but only in

equal distribution of national income of the country. It helps to **reduce the unequal distribution of wealth and national income**. Therefore, taxes are better source of public revenue and it has been taken as the best effective tools for raising the public fund. Taxes are usually classified into two parts namely: direct and indirect taxes. A direct tax is one whose burden can not be shifted to others. Income tax, property tax, interest tax, vehicles tax, gift tax, death tax, expenditure tax etc are the examples of direct tax. Similarly, indirect tax is that tax which is shift able whole or partially to others. Custom duties, excise duties, VAT, entertainment tax, hotel tax, import and export tax duty are the examples of indirect tax.

The employment income taxation in Nepal is introduced in the fiscal year 2016/17 when the business profit and remuneration tax act, 2017 was enacted. Employment income is the income earned by a person in an income year from the employment or service. **Remuneration means amount given for providing service, in case of remuneration, there was to be one getting services and other providing services.** The person getting service is called employer and the person providing service is called employee. According to sec. 8 an individuals income from an employment for an income year. In the individual's remuneration from the employment includes a post present. A prospective employment for the year. Sec 2 (a,i) as the act has given a definition that employment includes a post, prospective employment. It can be said that remuneration means the income or service rendered by the person from the employer in any income year.

In the global prospective, income from employment is also known as salary. Certain conditions that are required to come under income from employment are:

-) There should be employer employee relationship between two person and
-) The amount paid should be of regular nature.

Among the various source of income tax, the employment income tax is most important one. As a student of taxation, it is better to understand the employment income taxation at the country. That present study has been designed to study the contribution of taxation on income from employment in the total tax structure in Nepal. Taxation on income from employment plays the role in social and economic development process at the nation. The income from an employment can be generated only when a relation of employer and employee or master and servant has been established between a payer and payee. Whatever the employee derives from the employment in the shape of regular salary, allowances, overtime payment, bonus etc are included in the income from employment.

Generally, An employment is known as long term employment but in legal terms, an employment can be of a short period or may be a part time. One an individual may have more than one employment on a day. The employee must be present physically at the work to perform his or her duty. The employment is awarded based on his or her ability, education, experience, honesty, behaviors etc and so a proxy is nowhere allowed to work on a behalf of the employee. A written appointment letter does not always qualified on included the following incomes for remuneration (employment) income purpose i.e. salary, wages, allowances for specific works, other allowances, reimbursing of expenses, fees, commission, overtime payments, awards, prizes, gifts, bonus or incentives amount received in compensation payment for the termination of the employments, retirement from government any other payment by the employer, interest, less than market rate payments made by on employer for medical allowances etc.

1.2 Statement of the Problem

In a developing country like Nepal, the objectives of income tax could be generating revenue in order to help or financial development activities and

to help to establish social justices through income distribution. Considering these objectives, since income tax introduced in Nepal, several changes have been making in tax laws, tax acts, tax policies, tax systems and tax procedures so on.

The idea of introducing income tax in Nepal originated in the early 1950. But the first elected government of multi parties democratic system in 1959, introduced income tax in Nepal. At that time income tax was levied only on business profit and salaries. After three years of experience of income tax in 1962 income tax was appealed to income derived from different sources. Since 1974, income tax sources have been re innumerate into five sources. However, agriculture income had been kept outside the tax except few year through the financial act.

Income tax act 2002 also brought all source of income including capital gains into tax act. This act 2002, also brought all source of income in three groups viz; Business, Remuneration, and investments. Such type of changes in income tax act and taxation procedure could create confusion in taxation to tax payer and even to tax administrator. The concerned of every nation of the world in economic development; least developed countries are facing numerous problem in the process of economic development. Nepal is not an exception to these process of economic development. **About 42% of total population is below poverty line.** Due to various internal and external reason fiscal year 2002/2003 could not appear as successful year from the perspective of peace, security and development (Economic survey, 2003).

Lack of managerial efficiency is one of the major problem of income tax in Nepal. Similarly, lack of effective personnel management, reward and punishment system, poor income tax assessment procedure, not effective implementation of self assessment of tax, poor tax information system, lack of tax payers, very narrow coverage of income tax, tax evasion, lack of education of tax payers, tax avoidance, not proper utilization of tax

planning, corruption, quality of paying tax, ability to pay tax are the major problems of income tax in Nepal.

Similarly, most of the tax payers are the ordinary people or without having sufficient tax related knowledge nor have the capacity to hire the tax experts, complexity of income tax law and tax assessment are the major problem of these days that the tax payers of Nepal are facing. Tax paying habit of Nepalese people is very poor but tax evasion habit of such people is increasing day by day. It is due to lack of knowledge, zero incentives to regular tax payers, administrative harassment and poor enforcement of fines and penalties, likewise, evasion of income tax is a major constraints of resource mobilization through income tax, reason for wide spread evasion of income tax could be inefficient tax administration, wide spread practice of illegal business reluctance to maintain accounts, poor tax morality, tax payers compliance in Nepal and supersede of law by the persons who are in the power and authority.

Since income tax is very important tools for generating public revenue; out of this tax from income from employment is also the important source of income tax. Taxation on income from employment could be the better sources of income tax for generating government revenue. However, it has also some problems and weaknesses, thus the study has been focused towards the finding some solution of the following question:

1. How has the taxation on income from employment contributed in the income tax revenue and total tax revenue?
2. What is the present position of tax collection from income from employment in Nepal?
3. What is the effectiveness of tax collection from employment income tax in Nepal?
4. What are the major problems and weaknesses of taxation on income from employment in Nepal?

1.3 Objectives of the study

The major objectives of the study are to examine the effectiveness of income tax collection with reference to employment income tax in the income tax in Nepal. The specific objectives of the study are as follows:

1. To examine the contribution of tax collection from employment income on total income tax revenue and total tax revenue of Nepal.
2. To analyze the existing position of tax collection from income from employment in Nepal.
3. To analyze the effectiveness of income tax collection from income from employment.
4. To indicate the major problems and weaknesses in different aspect of taxation on income from employment in Nepal.

1.4 Significance of the Study

In developing countries like Nepal, the importance of income tax cannot be minimized, because it covers huge amount of public revenue. It requires higher amount of financial resources of development program. The resources collected internally are sufficient to run day to day administration of the country but the revenue surplus is not adequate to undertake the development activities. So the country is heavily dependent of the foreign aids and grants to undertake its developmental activities. Remuneration tax is one of the most important sources of income tax. Therefore, the remuneration tax plays vital role in the public revenue of the country. It is a regular source of income tax too. This study focuses to words the efficiency of income tax with special reference to taxation on income from employment in Nepal.

Thus, the study tries to find out the problems and difficulties associates in the collection of tax on employment income tax as well. As facilities and

benefits provided by the income tax act 2058, contribution of tax from employment income on income tax, total tax and direct tax revenue of Nepal, effectiveness of tax from employment income tax in Nepal. It has been also tried to suggest and recommends in some possible areas of reform in income tax with reference to employment income tax. There are many thesis on various topics of income tax but very few have studied in detail on effectiveness of tax from employment income in Nepal. So this thesis is directed toward acquiring information about income tax collection from taxation on employment income, which has not been studied in detail in this topic. Thus, this study is beneficial to all the concerned parties such as researcher, tax payer, tax administrator and also the important material for library, teachers, students and other practitioners etc. In this study with the reference of the tax payers and tax experts opinion in “**empirical analysis**” had been composed which could be useful for policy maker also.

1.5 Organization of the Study

The research outlook has been divided into the following five chapters each devoted to some aspects of the study on effectiveness of income tax with reference of employment income tax in Nepal. The categorizations are as follows:

Chapter 1 – Introduction to Income tax, Statement of the Problem, Objectives of the study, significance of the study and organization of the study.

Chapter 2 – is concerned with literature review. The reading materials of this chapter are conceptual review and review of related literature like, published books, thesis, journals, reports etc.

Chapter 3 – is related to different suitable research methodology, demanded by the objective of this study. Such as data collection,

presentation and different analytical tools like statistical tools used for analysis for specific output.

Chapter 4 – has covered the “Presentation and analysis of data”. The chapter is divided in two parts i.e. presentation and analysis of secondary data and analysis of opinion survey conducted with tax experts and employees.

Chapter 5 – is concerned with output of research as summary, conclusion of this study and recommendation for future improvements.

CHAPTER – TWO

REVIEW OF LITERATURE

Literature review is basically a stock taking of available literature in one's field of research. The literature survey thus provides the knowledge of the status of the field for research. So, the literature review is important to find out the purpose of research like what related research studies have been conducted and what remains to be done in particular field of study. Here, the related studies like history of taxation, different acts and rules in different period with its amendment, thesis and related articles reviewed to find out the strength and weaknesses of this taxation for concluding the idea of taxation on employment income regarding its contribution in taxation as a whole.

2.1 Conceptual Review

For the concept of taxation from ancient period to current days with respect to time period, acts and rules, inclusions and exclusions in employment income, specimen of tax calculation, objective etc are reviewed.

2.1.1 Historical Background of Tax law in Nepal.

) Taxation in Pauranic Kal

Nepal is one of the part of stone civilization within civilization, tax used to be imposed as per the Sitars in ancient time. Kautilya Niti, Yagnablaka Smriti etc were sutras, which governed the taxation system of that time. The main principle of taxation at that time was imposed tax without hampering the taxpayer. According to the sutras, the taxes were to be

imposed like honey collection of honeybee or getting milk from the udder of the cow. In this respect Kautilya says that the **state should collect tax just like the honeybee collects the honey from the flower**. It collects honey without hampering the flower. This model of tax collection can be called honeybee collection model. Nepal's tax system was also based on this model at that time **(Kandel: 2004:10)**

) Taxation from Ancient Time to Present Days:

In Lichchhavi period, the main sources of revenue of the government were tax. There were tri-koras, Bhaga (tax on agriculture), Bhoga (tax on livestock) and Kara (tax on trade), matsya kara (imposed on fishing), palabdu kara (imposed on onion & garlic), Malla kara (imposed on wrestling), Goyuddha kara (imposed on bull fighting), Sim kara (imposed on firewood) etc were different form of tax . Ansubarma, one of the kings of Lichchhavi period imposed tax on water and religious monument repair tax. At that time, a tax on income of the farmers from agriculture was imposed at the rate 1/6, 1/8 and 1/12 share of crop production depending on the land quality.

In Malla period, there were taxes related to land, trading etc. Jayasthity Malla imposed taxes on cremation (Dahasanskar), and caste purity. In Shah period also there was continuation of the tax system of malla period, i.e. based on land and trade. Prithivinarayan Shah introduced pota tax in 1772. This system of tax was based on flat rate and limited on small birth owners. In this period of Surendra Bikram Shah, excise was introduced in Nepal. In Rana period, the main sources of government revenue were land tax, custom duties, and excise. The tax system was based on contract and amanat. Jimmal, Mukhiya, Dittha etc were the persons who used to collect the tax. **Sandas and Sawals were the laws guiding tax system (Kandel: 2004:11).**

2.1.2 Historical Background of Evolution of Income tax in Nepal

Great Britain is the first country to introduce income tax in the world. The British Government introduced income tax in 1799 in order to generate revenues to finance the war against France. The United Kingdom imposed the income tax regularly from 1869. Income tax was introduced in Switzerland in 1840, Austria in 1849, India in 1860, USA in 1862 and Nepal in 1959 (Amatya Pokharel, and Dahal 2004: 13)

After the dawn of Democracy, the idea of introducing income tax in Nepal originated along with the **first budget on 21st Magh 2008 (1952)**. Then finance minister in the first budget speech said “a proposal to levy an income tax including tax on Agriculture income is under consideration”. After that, so many reforms in tax of laws in Nepal and several attempts were made to introduce income tax in subsequent years. Different types of tax laws were introduced and abolished. However, it could not be introduced successfully until 2061 due to political instability and some other factors. For the first time, the finance act 1959 had imposed tax on business profit and remuneration in Nepal. (Amatya, Pokharel, Dahal, 2004: 13)

However it was actually introduced only in 2017 (1960) when the finance acts, 2016, business profit, and remuneration tax act, 2017 was enacted. At the beginning, equivalent tax rates with progression and exemption limit were prescribed by the finance act of 2017 and afterwards to all companies, private firms, individuals, and families. The marginal rate of taxation prescribed by these acts was 25 percent. Since income tax was imposed only on income from business profit and remuneration, the tax could not cover all the sources of income and so was replaced by the income tax act 2019 in 2019. Income tax act, 2019 with 29 sections divided the heads of incomes into 9 parts covering business, professions

and occupations, remuneration, house and land, cash or kind investment, Agriculture, insurance business, Agency business and other sources, the act was amended in 2029 extensively. However, considering this act in capable of fulfilling the needs of the times, it was replaced in 2031 by another act (Kandel, 2004:16-17).

As already stated, income tax act, 2031 replaced income tax act, 2019. This act having 66 sections, and classified the sources of income into 5 heading namely: i) Agriculture, ii) Industry business, professions or vocation, iii) Remuneration, iv) House and land rent and v) other sources. The act had identified the chargeable incomes and admissible expenses of each head of income. The other feature of this act was provision of registration, provision of carry forward or loss, provision of common expenses, provision of self-assessment tax, provision of small tax payers, tax assessments, provision of fine, penalties and appeals, provision of tax deduction at sources, provision of tax refund, provision of exemptions by different other act and rules, provision of avoidance of double taxation, provision of advance payment of tax, provisions relating to re-assessment or additional tax assessment, provision relating to computing of net income by agreement in special cases, etc.

Although, income tax, 2031 has made advanced than the former income tax acts, it had several weaknesses and used many vague unclear words like reasonable appropriateness etc. Income tax Act, 2031 was revised for 8 times in 1977, 1979, 1980, 1984, 1985, 1986, 1989 and 1992. It had also provided high discretionary power to the tax officer in the matter of tax assessment. Similarly, it did not success to cover large portion of income under different areas.

In the course of development and modernization of income tax system the new "**Income tax act 2058**" has been enacted. Similarly, the new "Income tax rules 2059" have also been enacted for effective implementation of the objectives of this act. The new act has introduced and classified the

effective from 2059-02-27(June 10th, 2001). This act has classified the heads of incomes into three categories viz, employment, business and investment. The new income tax has 143 sections. This act was brought in Nepal to avoid the following defects of Income Tax Act, 2031.

- Narrow base of tax.
- Taxing only the income originated in Nepal.
- Dispersion of tax related acts i.e. income tax related provisions were given different acts.
- Low penalty rate to tax evader.
- Incompatible to self-assessment system and
- Unsuitable to modern economy.

The different income tax law in Nepal are enacted and amended time and again . The following table shows the major tax laws implemented affectively from time to till now.

Table 2.1

S.No.	Income Tax Laws	Effective from and to
1.	Finance Act, 2016 (1959)	FY 2016/17 to 2017/18
2.	Business Profit and remuneration	Ordinance FY 2016/04/25 to 2017/02/1
3.	Business profit and remuneration tax act, 2017 (1960)	2017/02/02 to 2019/04/09
4.	Nepal Income tax Act, 2019 (1962)	2019/04/09 to 2031/07/04
5.	Income tax act, 2031 (1974)	2031/07/05 to 2058/12/18
6.	Income tax act, 2058 (2002)	2058/12/19 to date

(Source : Amatya, Pokharel, Dahal, 2004:14)

2.1.3 Review of Nepalese Income tax act on Modern Nepal

In the history of income taxation, the modern Nepal is known after the introduction of multi-party system in the country. When the multi-party

democratic political system was introduced in the country, the idea of introducing income tax in Nepal was originated. Since 1951, government was enforced to implement development activities besides performing the regular functions. To fulfill the requirements of additional funds for development activities, internal source of revenue must be mobilize. So, the systematic rules and regulations is necessity. It leads the development of income tax in Nepal. Several income tax laws were exerted in the development process of income taxation. Now, the income tax act 2002 (2058) has been effective in our country.

The constitution of kingdom of Nepal, 2047 prescribes that **“No tax shall be levied and collected except in accordance with law” (Constitution of kingdom of Nepal:2047, 72,(1))**. Now the new income tax act 2058 has been implemented, and income tax rules, 2059 made there under, finance act is passed every year to translate the economic policy contained in the budget speech in order to form law. It generally prescribes the rates and exemption limit for tax purposes and may delete, add or modify the provisions contained in the income tax act. Decisions of Supreme Court in Nepal also act as precedents for income tax law purpose.

The notifications in Nepal Gazette or circular by department of tax clarify and complement the legal provisions. The legal aspect of income tax, therefore, includes the provisions in the constitutions, income tax act, finance act, income tax rules, and decisions of the Supreme Court. Several income tax acts have been enacted in the development of legal aspect of income tax in Nepal. The following income tax acts are reviewed in general descriptions.

) Business profit and Remuneration Tax Act, 1960 (2017)

It was the first income tax act of Nepal. It was known as business profit and remuneration tax Act, 1960. This act consisted 22 sections. The salient features of this act were as follows:

- a) The sources of income for tax purpose were limited only to business profit and remuneration.
- b) Tax on remuneration was deducted at source.
- c) The basic for calculating the tax liability for remuneration was the income of the current years where as for business profit was the profit of the preceding fiscal year.
- d) There was a provision of an official assessment in case of false statement or in absence of income tax return.
- e) Salary of any diplomatic representative foreign citizen dividend of shareholders, profit to spend on religious or public welfare activity, profit of local autonomous organization, allowances granted by HMG to ministers, Assistant Ministers, Speakers, Deputy Speakers, Chairman, Government chief whip, and leaders of opposition. Crop of own land money drawn from provident or saving fund were subject to tax exempt.
- f) In case of default the fines ranged from Rs 500 to Rs 5000 and for information, there was a provision of 20% of total tax realized if the information had been proven.
- g) The first court of appeal was local "Bada Hakim" or magistrate if he had not satisfied with the decision, he could appeal to the "Revenue and tax court" after depositing fixed amount.
- h) Profits from industries were granted a rebate of 25% and profit from small industries were granted a rebate of 50% etc (Act, 1960).

The main features of this income tax act were limited to the income from business and remuneration grades. Large portion of probable tax payers were out of the tax boundaries. There were many loopholes and inadequate provisions. Those were the basic reason for replacement of this tax act. It was replaced by Nepal income tax act 1962 (2019).

) Income Tax Act 1962 (2019)

Since the Act 1960 has limited coverage in income, the act was replaced by the act 1962. As per the article 93 of the constitution of Nepal 2072, the

act was introduced. The act has all about 29 sections. The income tax act had defined more clearly than former income tax act. This act had enhanced the area of tax base. Again, it was amended in 1972. The following were the main features of this act:

- a. Income was clearly defined as all kind of income including income from business, salaries, any professions, rents from houses or land, investment in cash or kind, agriculture, insurance, agencies and any other sources.
- b. The procedures for assessment and collection of income tax were clarified. Specific provisions were made for allowable deductions. Methods were also specified for collection of net income.
- c. The status of taxpayers was defined personally as well as residentially.
- d. The basis was specified for assessing tax on the best judgment estimate or the tax officers.
- e. There was additional provision of exemption for income of Nagar Panchayat, Village Panchayat, Public Organization, Income of Nepal Rastra Bank (NRB), deposits of employees in the employees sharing from salaries any income notified in the Nepal Gazette.
- f. Provisions were made for payment of tax in installment as well as advance payment of tax.
- g. There was special provision for newly opened industry in which the government
- h. Agricultural income was brought under the scope of income tax for the first time.
- i. Provision was made for reassessment of tax as well as rectification of arithmetical errors.
- j. Provision was made for carry forward of losses and it was allowed for a period of two years.
- k. The act granted power to constitute a net income assessment committee etc. (Act, 1962)

The finance act 1966 (2023 B.S.) exempted the agriculture income fully from income tax. The finance Act 1973 (2030 B. S.) restored agriculture income under the scope of income in order to suite the changing environment of business. Another income tax act 1974 (2031 B.S.) was introduced and replaced the income tax act 1962.

) **Income Tax Act 1974 (2031)**

To meet the changing environment of Nepal as well as the entire world the act 1974 was introduced. The act has 66 sections. In this act the source of income were wider than the former law. Its basic framework has been derived from the income tax act 1962. It had retained or amended certain provision of the old act and has added certain new provisions. This act was practiced for 28 years, almost three decades in Nepal. **The act was amended for eight times.** Following were the some salient features of this act.

- a. This act had clearly defined the terms relating to income tax specially tax payers, income assessment year, tax assessment, tax officers, firms, company, net income, person, family, philanthropic work, non resident, resident etc.
- b. Source of income was classified into five categories i) Agriculture, ii) Industry, Trade, Business, Profession or Occupations, iii) Remunerations, iv) House and compound taxes and v) Income from other sources.
- c. The taxpayers had to register their industry, business, professions, or vocation in tax office before the commencement of the work.
- d. It had made the provisions for deduction of expenses relating to expenses incurred when the taxable income is generated.
- e. Provision relating to computation of net income by agreement in special cases is another main feature of this act.
- f. This act had made provision for self-assessment of tax for the first time and if any mistake arises or lower tax was assessed, tax officer might make final assessment.

- g. Income of Guthi, income of VDC/DDC/Municipalities, compensation for life insurance or after the expiry of the life insurance policy, income from provident fund etc. were the subjects to tax exemption.
- h. Carry forward of the losses was allowed for subsequent three years.
- i. The punishment provision was specified in different heading, viz. failure of submission of particulars of income, false particulars, not maintaining the accounts, obstructions and others.
- j. Provisions had made for re-assessment or additional tax assessment.
- k. The process of advance payment of tax, deduction of tax at source, and refund of tax had been specified.
- l. It had the provision relating to make agreement for avoidance of double taxation.
- m. The government of Nepal might form an income assessment committee consisting five members by publishing notice in the Nepal Rajpatra. Etc. (ACT, 1974).

Although, income tax act 2031, had made advanced than the former income tax acts, it had several weaknesses and used many vague or unclear words. It had also provided high discretionary power to the tax officers in the matter of tax assessment. Similarly, it did not success to cover the large portion of income under different areas. Therefore, due to these reasons, the new income tax act 2058 (2001) has been enforced in the country to improve the tax vase and consolidate the other laws relating to income tax under the income tax act.

) **Income Tax Act 2002(2058)**

Tax system is the sub-system of the total of a country. Country in world economic policy and advancement in information technology has a vast impact on Nepalese economy too. Small economic like Nepal have to adopt the economic policy followed by world bank, international monitory fund, Asian Development Bank and others international agencies. Specially, often 1990's there is re-emergence of the liberalization, globalization, privatization system

that focus on the minimum international of the state on private economic matters. The 1990's concept of high incentives, high tax rate is changed to the concept of low rate, wide net. This trend in tax system is followed by most of the countries of the world. Nepal also is not an exception this respect and Nepalese administrators and policy makers too have tried to changed the policy of the country. Income tax act, 2058 is the result of the change in all these matters. As given by the policy maker, the new act is:

- a. To bring all income generating activities with in tax net.
- b. To increase the base of taxation.
- c. To bring all the income tax related provisions clear and transparent.
- d. To make income tax related provisions clear and transparent.
- e. To inter link Nepalese tax system with tax system of other countries.
- f. To make tax system based on account.
- g. To minimize tax avoidance and tax evasion.
- h. To make tax system compatible to modern economy.
- i. Reducing the scope of discretionary interpretation of the tax administration thereby ensuring simplicity, uniformity and the transparency.
- j. Separating administrative and judicial responsibilities.
- k. Defining the power as well as authority of the tax administration, distinguishing tax payers violation of civil duties and criminal offences, and
- l. Further streaming the appeal system by making it mandatory for the taxpayer to file on objections with IRD of taxation before appealing to the revenue tribunal.

The act is quite advanced tax that has introduced in Nepal. In 2058, "Income Tax Act, 2058" was enacted by the parliament by replacing the existing act. This act is broad as compared to the previous act. This act has been made in accordance with global standard. Income tax rules, 2059 was framed by GON to clarify some provisions of the acts. Finance ordinance have been making

slight amendment in the act every year. The main salient features of this act are as follows:

- a. It has clarified certain definitions especially related to tax, income assessment year, year of income status of the person, resident and non-resident person, company dividend, investment, royalty, interest partnership, business stock, property, general insurance, shareholders, depreciation etc.
- b. Income Tax Act, 2058 has classified income tax into three different heading.
- c. When income tax act 2031 was practiced, there were several exemptions and deductions provided by the act and other related acts. Now, there is no more exemption and deductions except the ones provided for by the act.
- d. All income tax related matters are confined within the act abolishing all tax related concessions, rebates and exemptions provided by different acts.
- e. The act has broadened the base unlike the previous act, tax rates are spelled out in the act. The tax rates and concession are harmonized on equality grounds.
- f. The act has given the option for husband and wife as a separate mature individual until they do not accept as couple.
- g. The act has first introduced taxation of capital gains.
- h. The act ahs provided a liberal loss set-off and carry forward backward provision. Inter-head adjustments of losses are clearly specified.
- i. There is a provision of the function division of worker among tax officers. The division is to be made under the direction of GON and other tax officers are under the direction of GON and director.
- j. Subject to this new act, income is defined as “a person income from any employment, business or profession in accordance with in act.” It includes all kind of income received for the provision of labor or capital or both in whatever form or nature in the taxable income.

- k. A resident person may claim a foreign tax credit for any income year for any foreign income tax paid by the person to the extent to which it is paid with respect to the person's assessable income for that year.
- l. According to this act, a company is liable to tax separately from its shareholders. The bonus share, loans, and advances to direct and shareholders, distribution made on liquidation etc are also brought under the tax net in order to plug loopholes for avoidance.
- m. A person has defined as a resident whose place of birth is in Nepal and who present in Nepal at any time or who present Nepal for 183 days or more with in the income year, or who is an employee of GON posted abroad during the income year.
- n. This act has determined the rate of income tax itself for the first time, which used to be determined by the finance acts in the previous act.
- o. The income for approved retirement fund is free from tax. But retirement payments in the hands of employee are taxable.
- p. For calculating a person's income from any business, investments, there are provisions of deduction related overhead costs.
- q. The act has provided a stringent fine and penalty for the defaulters.
- r. Global incomes of a resident are made taxable. Non-residents are also taxed on their incomes having sources in Nepal.
- s. All expenses relating to income tax have made admissible.
- t. The act has made provision of international taxation. Foreign tax credit has been introduced for the first time.
- u. Presumptive tax is limited to the small taxpayers whose annual net income is up to Rs 150000 or annual run over is up to Rs 1500000 and are subject to flat annual taxes.
- v. The tax has introduced the concept of medical tax credit tax of 15% of the amount of approved medical cost.
- w. This act has adopted a pooled system of charging depreciation in which assets are broadly classified into five categories. The depreciation rates are 5%, 25% 20% and 15% for class A, B, C and

D respectively which are based on diminishing balance method of depreciation and intangible assets are depreciated, which categories in pool 'E', the rate is based on straight line method of depreciation.

- x. According to the act the **Inland Revenue Department** is responsible for the implementation and administration of this act.
- y. This act focuses on the self-assessment system and every assessment is treated as a self-assessment. The tax officers can determine only the amended tax assessment within four years. The jeopardy assessment is essential when a person becomes bankrupt, is wound up or goes into liquidation; a person is about to leave Nepal forever or to close down activity in any department in Nepal. There is no time limit in the case of jeopardy assessment.
- z. The act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities etc.

2.1.4 Income Heads

The act imposed tax on those activities contributing towards the creation of wealth. Wealth is created with the help of labor, capital and capital labor activities that generated income from employment, investment and business respectively. They have made broad classification of income encompassing all income earning activities. They are

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

Income from employment

An individual remuneration income from an employment is termed as income from employment and is included in employment income. All payment or benefits received in respect of employment, including past, future employment

are made taxable. For examples, payments relating to terms of employment, fringe benefits, various types of allowances, salaries, wages payments received through third parties etc are included in employment income.

Income from business

Profits and gains from arising from business are considered as business income for the purpose of income tax. These types of income may include service fees, amount of derived from the disposal of trading stocks, net gains from disposal of business assets (liabilities), gifts, relating to business and other related amount.

Income from investment

Profits and gains from conducting an investment are considered as investment income. All types of investment incomes including dividend, interest, natural resources payment, rent, royalties, gain from investment insurance, gain from an unapproved retirement fund, retirement payment made by an approved retirement fund are included in investment. (Bhattarai & Koirala, 2004:1.14)

2.1.5. Meaning and Concept of Taxes

Government is very powerful institution which is center point of the county. The primary purpose of modern government of any underdeveloped and developing country is to increase the living standard of its people through the development process. In order to achieve this goal, every government lunches different economic, social, cultural and other development activities or programs. To carry out these activities, government requires various kinds of resources i.e. man, money, machines, materials etc; among this one of the very essential thing is huge amount of financial resources. Both internal and external financial resources are utilized to fulfill the government requirements. However the internal resources are more preferable than external ones for sustainable economic development.

Sources of the government revenue can be classified broadly into two heads i.e. tax revenue and non-tax revenue. The government received the tax revenue as a compulsory payment whereas non tax sources are not created for tax collection purpose whereas the tax revenue sources are created to collect the government revenue.

“A tax is a compulsory contribution made to government without reference to particular benefits received by the tax payer” (Goode: 1984). It is a personal obligation to pay tax and there is no direct relationship among tax, benefits and individual taxpayers.

According to Adam Smith the father of political economy, **“A tax is a contribution from citizens for the support of the state”**, the primary purpose of the taxation is to divert control of economic resources from taxpayers to the state for its own use or transfer to other.

Raising more revenue, prevention of wealth for the common goods, maintenance of welfare state, handle the daily administration keep peace and security, lunch other public welfare programs.

Encountering essential products; production, rapid economic growth, enforcing policy, increasing saving and investment, reducing unemployment, removal of regional disparities etc are the objectives of tax policy. For under developed countries, to achieve economic growth and equalities at the same time is more difficult task. The imperative of economic growth still overshadows other objectives in these countries.

Tax is a compulsory contribution to the state from a person without getting corresponding benefit of services or goods from the government. Prof. Seligman has defined tax as a **compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without references to special benefit conferred** (Dhakal, 2057:1-2).

According to Plehn, **“Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefits upon the resident of the state”** (Dhakal:2).

According to Taylor **“A tax is a compulsory payment to the government without expectation of direct benefit in return to tax payer.”**

Similarly, in the opinion of Bastable, **“A tax is a compulsory contribution wealth of a person or body of persons for the services of public powers.**

From the above definition, it is clear that:

-) Tax is imposed in the person by the government according to the laws of the country.
-) The person on whom tax is imposed must pay taxes otherwise, the laws punish him.
-) The government does not provide any corresponding benefit to the taxpayer for tax.
-) The natural person and artificial person (entity or corporate body) having tax liabilities pay the taxes to the government.
-) There is no discrimination among the taxpayer other than specified by the law.
-) The amount of tax is spent for common benefits, goods, and interest of the country. This means the government for tax by taxpayer provides no special benefit.

2.1.6 Classification of Taxes

A tax can be classified into different division on different basis. Our government classifies taxes in following heads: taxes from international trade, taxes from internally produced and consumed goods; land revenue and taxes from income, profit, and property. OECD classifies the taxes into taxes on income, profits and capital gains, social security contributions, taxes on

payroll and workforce; taxes on property; taxes on goods on services and other taxes. (Kandel, 2004:6)

The taxes can be classified in two parts:

Direct tax

If the person paying bearing the tax is same, it is called direct tax. According to Dalton **“A direct tax is really paid by the same person on whom it is legally imposed.”** Direct tax is a tax on income and property. The characteristics of a direct tax are equitable as per the property or income; certain as per the process of a payment, amount to be paid, time of payment, elastic in nature etc. The examples of direct tax are income tax, property tax, vehicle tax, inheritance tax, and so forth.

Indirect Tax

In contrast to direct tax, indirect tax is that tax where person paying the tax and the person bearing the tax are different.

According to Dalton, **“An indirect tax is imposed on one person but paid partially or wholly by another.”**

An indirect tax is a tax on goods and services. The main feature of indirect tax are convenient to pay, mass participation, limited evasion, shifting of incidence, the consumer pays the tax to the business person not the government etc. The examples of indirect tax are costume, excise, value added tax, contract tax and so on (Kandel, 2004:9).

2.1.7Income Tax

Income tax plays a very important role in the national economy. It is one of the important sources of revenue to the government. In addition, it is also looked up as a tool for achieving the social and economic objectives as laid down in the constitution. It has been recognized as a good financial level to narrow the disparities in income, regional economic imbalances are also being reduced by providing incentives and concessions in income tax for starting new industries in backward areas. Thus besides being a

source of revenue, income tax has become an effective instrument to ensure balanced socio-economic growth (B B Lal: 1997).

The term income is the focal point in the study of income tax anywhere in the world unless the amount belongs to the category of 'income' it cannot be taxed under income tax act.

Income in a broad sense is the income of any economic gain a person has experienced during the period. In general, individual income is defined as the functions of the consumption of individual plus net increased in wealth.

An optional income tax should have the following characteristics:

All the income should be treated informally regardless of sources, in view of the equal treatment of equal or horizontal – equality rules.

Just as equals should be treated equally, unequal should be treated unequally in a pattern consistent with accepted goals equity.

The tax structure should be consistent with society's views towards income equality and redistribution.

The structure of the tax must be to design for efficiency reason in such a fashion as to facilitate compliance and enforcement, consistent with other objectives.

Income tax is a state share out of the taxable earnings of an assessed. It is charged on the total income of the previous year at the rate applicable during the relevant assessment year. Total income is computed with reference to residential status of assesses. Some earnings are not included in the total income (Indian income tax act, 1962, sec 10). Income tax can be broadly classified into two types.

(a) Individual Income Tax (b) Corporate Income tax

Individual Income Tax

The income tax is levied on every person who has taxable income in fiscal year. It is levied in both residents and non-residents. A person whose total length of stay in the country is more than 183 days during a fiscal year is considered a resident for that year, the stay in Nepal does not have to be continuous. In the case of resident, the tax is levied on income arising or derived from Nepal and on income obtained abroad from activities carried out in Nepal. In case of non-resident tax is levied only on income arising in or derived from Nepal. (Khadka: 1994).

Corporate Income Tax

Government corporation and public and private limited companies are subjected to flat rate corporate income tax. Domestic company levy corporate income tax on both domestic and foreign companies when the effective management of a company is exercised. Similarly, when the effective management and investment of a company is through the foreigner or out of the Nepal is called foreign company. Corporate income tax is also levied on the income of a company which may be income derived from sources in Nepal plus income received abroad from activities carried out in Nepal. For foreign company tax is only levied on income earned from source in Nepal (Khadka: 1994).

2.1.8 Objectives of Taxation

Taxation has been a very essential element of a government from the very beginning of the state system. However, the main objectives of the taxation have been different etches. In ancient times the major objectives of the taxation were strengthening the muscle of the state by providing the resources. Until to the time of Adam Smith, the chief motive of state collection was to provide resources to the government for providing security to an individual and society against violence, invasion and injustices and maintaining public institution.

In modern days, the main objectives of taxation have been shifting from security perception to the economic development. The modern objectives of taxation are not only to maintain peace and security.

Some major objectives of taxation are explained below:

1. **Raising more revenue** – A state needs adequate funds to provide its people with peace and security and development activities. Therefore, prime objectives of taxation are to collect sufficient revenue to meet the government's expenditure.
2. **Prevention of concentration of wealth in a few hands** – Through progressive tax policy, a democratic government prevents the concentration of wealth in a few hands.
3. **Redistribution of wealth for the common goods** – It is not justifiable to levy taxes to all the people without considering their ability to pay. A welfare state collects revenue from the have and distributes it to the have-nots in the society. As a result, wealth is distributed for the common goods of the general public.
4. **Maintenance of welfare state** – A welfare state needs huge investment in development activities, it has to make its expenditures on education, health, industrial development, etc. Which fall under the primary functions of welfare state. Maintenance of economic stability is an important function of the state. The government maintains economic stability.
5. **Others** –
 -) Encouraging essential products production
 -) Rapid economic growth
 -) Enforcing saving and investment
 -) Reduction in unemployment

In conclusion, it can be summarized the objectives of taxation as raising revenue for resource mobilization, equal distribution of wealth and income in the society, encouragement in employment, saving and investment, removal of regional imbalances and enforcement of policy.

2.1.9 Taxation on Employment Income

There are three ways of earning income i.e. by labor, by capital and by mix of capital and labor. Among these three, the first one is employment income. Employment income means amount given for providing services, in case of employment income, there used to be one person getting service and other person providing service, the person getting service is called employer and the person providing services is employee.

(Kandel, 2004: 37).

Income tax act, 2058 has defined “employment” as past, present or prospective employment. All payments or benefits received from the employer or has associated in exchange of labor are termed as employment income (or remuneration). An employer is a person who gets the services (i.e. labor) from the employee against consideration payments. An employee is a person who provides the service to the employee to get certain amount of benefits. In order to include the amount in the employment income, certain conditions that are required to come under remuneration are

-) There should be employer – employee relationship between two person i.e. payer and payee.
-) The amount paid should be of regular nature. Section 22(2) of the act has specified that employment income should be assessed on cash basis.
-) The person getting remuneration should work as per the direction of the employer.

(Kandel: 38)

2.1.10 Essential Features of Employment Income

The essential features of income from employment may make clear idea in order to understand the meaning of employment income. They are as follows:

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

- b) **Mode of Payment** – It should identify whether the mode of payment is according to the passage of time or it depends on some job being performed or completed by the assessee. In a contract services, there exist employer and employee relationships and the remuneration of the contractor (employee) is chargeable under income from employment. As against this, in a contract for service, the contractor (employee) can best specify what is to be done and the contractor independently achieves the details of work and executes the same. In this case, income earned by the contractor for this service is chargeable under income from business and not as salary income since there does not exist any employer and employee relationship.

- c) **Remuneration Income and Professional Income** – Remuneration income is derived with the passage of time but not depends on some job being performance or completed. A radio singer and an actor are not ordinary employees and therefore, the remuneration they receive for job performed or completed will be taxed under income from profession. Nevertheless, incase respective employee works on the time basis, the amount is taxed as salary.

- d) **Income Received from Third Party** – Sometimes a third party pays remuneration under an arrangement with an employer. Remuneration derived from the third party on behalf of the employer is also chargeable remuneration income to an employee.

- e) **The amount Paid should be of Regular nature** – As discussed earlier, the remuneration received on the basis of passage of time is chargeable under income from employment. It is accruing periodically for service rendered by an employee as result of expressed or implied (indirect) contact. Moreover, if the employee receives such periodic accrued remuneration, then it becomes chargeable income from employment.

- f) **Income received from an associate of the employment** – Sometimes, an associate of the employer pays remuneration; such remuneration derived from the associate of the employer is included in the employee's remuneration from employment. For example, remuneration paid to the employee by the managing director of a company. (Amatya, Pokharel & Dahal: 2004: 69).

2.1.11 Some Basic Points for Consideration

There are some basic considerations while computing assessable income from employment. These considerations may be as follows:

-) Remuneration, salary and wages are not conceptually different. But the remuneration income and profession income are conceptually different.
-) Salary may be received from more than one employer.
-) Salary from a former employer, present employer and respective employer is included in the income from employer.
-) Salary income must be real but not fictitious.
-) Remuneration income is taxed on receipt basis: tax accounting of remuneration is cash basis. Hence it is obvious that advance salary and arrears of salary may be taxed in his year of receipt apart from the current year's salary.

(Amatya, Pokharel & Dahal: 71).

2.1.12 Administrative Income (Amount Included in Remuneration)

Income tax Act, 2058 has specified the income from employment. All the amount or benefits received in connection with employment are made taxable. The chargeable income under income from remuneration is specified in Section 8 of the Act. As per the Act, the following payments made to a natural person from employer are included in calculating the person's remuneration from employment.

1. Payment of wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts (as per market valuation in case of prize and gift is not on cash), bonus and other facility, i.e. Dashain expenses, Tihar expenses, telephone facility, transportation facility etc.
2. Payments of any personal allowances including a cost of living substance, rent, entertainment and transportation allowance.

However according to section 28 of the Income tax rules 2059, remote exemption up to Rs 30000. They are 30000 for "A" class area, Rs 24000 for "B" class, Rs 18000 for "C" class, Rs 12000 for "D" class area and Rs 6000 for "E" class area.

3. Payments providing any discharge or reimbursement of costs incurred by the individual or on associate of the individual. For example, reimbursement of medical expenses, payment of life insurance premium and private trip expenses.
4. Payments for termination for the individual agreement to any conditions of the employment.
5. Payment for termination or loss of service or compulsory retirement, for examples, amount derived as golden handshake scheme.
6. Retirement conditions including those paid by the employer to a recognized retirement fund in respect of the employee, and retirement payment.
7. Other payment made in respect of the employment.
8. Other quantified perquisites.

In addition to above stated items of remuneration the following types of perquisites are included in remuneration from employment of a person.

-) Transfer of the assets (27(a)): in case of transfer of the assets from employee, the market value of such assets is included in the employee's income.
-) Vehicle of personal and official purpose and rent free accommodation for personal purpose (27(b)).

a) Vehicle facility: Availability of motor vehicle wholly or partly for private purpose

- i. 0.5% of the salary in case of employee (Sec B of Income Tax Rules, 2059)

- ii. Motor vehicle includes motor, car, jeep or similar other motor vehicle. This means motor cycle, joint bus facilities does not fall under the definition of motor vehicle facilities.
- iii. When a characterized amount for motor vehicles facilities is included in the employee's income any cost of fuel and driver's salary borne by employee will not be taken in to consideration as per circular issued by IRD on 28 Shrawan 2059.

b) Provision of house to Employee (Including rent – free accommodation):

- i. 2% of salary in case of employee.
- ii. In case employer is providing an amount for house rent, the amount is included in income from employment rather the quantified amount.

c) Payment consisting of the provision of the following facilities, the amount of expenses incurred by the employer in making provision as reduced by any contribution made by the employer towards the provision (20 (c)).

- i. The service of a housekeeper, chauffeur (driver), Gardener or other domestic assistant.
- ii. Any meal, refreshment or entertainment.
- iii. Drinking water, electricity, telephone, and the like utilities in respect of the employee's place of residence.

d) In case where the interest paid by the employee during the year under the loan is lower than the interest to be paid as per the prevailing interest rate, the amount to the extent it is lower (28(d)).

e) Compensation (31(a), 62 & 92): In case a person or associates of a person derives a compensating amount including a payment

under insurance that compensates for income from employment at the time, the compensation amount is derived.

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

2.1.13 Amount Excluded from Remuneration

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

- a) Exempt amount (sec 8.3(a) and 10): The following payments are not included while calculating the income from employment as per sec. 10 of the act:**

-) Amount derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between Nepal Government and a foreign country or an international organization.**
-) Amount derived by an individual from payment in the public service of the government of a foreign country provided that
 - I. Amount derived from the public fund of the foreign country by an individual who is not a citizen of Nepal or by a member of immediate family of the individual.**
 - II. Amount derived by an individual who is not a citizen of Nepal from employment by Nepal Government in terms of a tax exemption.****

- III. Allowances paid by Nepal Government to widows, elder citizen or disabled individuals.
- IV. Amount derived by way of gift, bequest, and inheritance of scholarship except as required to be included in calculating income from business, employment, or investment.
 - a. Gifts
 - b. Other contributions that directly relate to the exempt organizations function, whether or not the contribution is made on return for consideration provided by the organization.
 - c. Amounts derived by Nepal Rastra Bank as per its objectives. Pension received by Nepali citizen retired from the army or police service of a foreign country provided the amount are payable from the public fund of that country.

b) Final Withholding Payments under Section 92:-

If a person receives final withholding payment after tax deduction at source, they are not included in the person's income. The following income received after deduction tax at source, as final withholding payments are not included while calculating income.

-) Dividend paid by a resident company.
-) Rent for the lease of land or a building and associate fitting and fixture having source in Nepal and an individual other than the business receives that.
-) Payment made by a resident to unrecognized retirement fund to the beneficiary from interest on unrecognized retirement fund.
-) Interest paid by financial institution and bank to natural person.
-) Payment made to non-resident person that are subject to tax withholding by employers, withholding from investment returns

and service fees, withholding from contract payment under 87,88, and 89 respectively.

-) Retirement payment made by GON or recognized retirement fund.
-) Meeting allowance (payment for part-time teaching, payment for setting question papers and payment for examining answer book from F/Y 2060/61 and onwards) etc.

c) Meals or refreshment provided in premises operated by or a behalf of an employer to the employees that are available to all the employees on similar terms (Sec. 8.3(d)). Any discharge or reimbursement of costs incurred by the individual (Sec. 8.3(c.1, c.2).

-) That serves the proper business of the employer.
-) That would otherwise be deductible in calculating the individual's income any business or investment.

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

e) Other Amounts:- As per notification published by the inland revenue department in July 2002 and also as per rule 20 (6), all amounts exempt from tax under the income tax act, 2031, which accrued prior to the act coming into force, will remain exempt from tax even if the payment is made after Chaitra 18, 2058. Therefore, the following amounts seem to be exempted from tax:-

-) Encashment of accumulated leave accrued before Chaitra 19, 2058.
-) Payment up to Rs. 180000 as medical expenses at the time of retirement of employee who were in employment when the act came force.
-) Provided fund including interest accrued before Chaitra 19, 2058.
-) Amount deposited with citizen investment trust including interest accrued before Chaitra 19, 2058.
-) Gratuity accrued before Chaitra 19, 2058.

2.1.14 Reduction in Employment Income

Following payments are allowed for reduction from the total assessable income of an individual:-

i. Retirement contribution to an approved Fund (Sec63):-

Under Sec.63, contribution to an approved retirement fund, subjective to capping thresholds, set out in the income tax rules 2059, will be deduction for the income tax purpose. The limit prescribed by rule 2% in an income year is Rs 300000 or one third of assessable income, which ever is less. Approved retirement fund means, provident fund (recognized) and citizens investments trust.

ii. Donation:-

Donation to on approved exempt organization is deductible up to a maximum of Rs 100000 or 5% of taxable income after retirement benefit or actual donation, which ever is lower. But special donation given to the exempt organization specified in Nepal Gazette is allowed for reduction partly or wholly.

iii. **Medical Tax Credit:-**

As per Sec.51(1), medical expenses incurred for a resident individual can be claimed for tax offset. Claim to be adjusted a year will be 15% of the eligible medical expenses plus any amount carried forward in respect there of from the previous year. Maximum amount that can be claimed in an income year will not exceed Rs. 750 as per rule 17.

2.1.15 Exemptions (1.1, 1.5 % 1.9 of schedule 1 of Income Tax Act, 2058)

- a) **Statutory exemption limit:** Income tax act 2058 has provided statutory exemption limit for the resident individual and couple: For individual (single) and couple are Rs 100000 and Rs 125000 respectively, is allowed to deduct while computing taxable income from the income year 2062/063.
- b) **Remote area allowance as an additional exemption limit:** Remote area allowance is applicable to all natural person as an exemption in additional to the statutory. Exemption limit for income from employment, business, or investment (i.e. Rs. 30000, 24000, 18000, 12000, 6000 for A, B, C, D and E class areas respectively.
- c) **Additional exemption for pension income:** In case of pension income, an additional amount of 25% of statutory exemption limit (i.e. Rs 100000 or 125000) is allowed to deduct while computing taxable income of an individual or a couple from the income year 2062/063.
- d) **Life insurance premiums admissible deduction from the income year 2061/062:** Finance ordinance, 2060 had provided the facility of exemption for the premium @ 7% of insured policy amount or Rs

10000 or actual amount, which ever is less from the assessable income to the natural person.

- e) **Foreign tax credit (17):** Amount of income tax paid in a foreign country is deductible as tax credit from the tax liability of foreign source income. However such amount does not exceed the average rate of Nepal income tax.

2.1.16 Specimen for Computation of Income from Employment, Taxable income, Tax Liability and Tax Payable.

The following format as designed by IRD shows the way in which the taxable income from employment income is derived.

A. Computation of Assessable Income from Employment Income as Per Income Tax Act, 2058.

Table 2.2

Particular	Rs	Rs
Salary and Wages (Sec 8.2)	XXX	XXX
Leave Pay (Sec 8.2)	XXX	XXX
Pay for overtime (Sec 8.2)	XXX	XXX
Prizes and gift related employment (Sec 8.2)	XXX	XXX
Other Facilities (Sec 8.2)	XXX	XXX
Bonus (Sec 8.2)	XXX	XXX
Dearness Allowances (Sec 8.2)	XXX	XXX
Living Allowances (Sec 8.2)	XXX	XXX
Rent (Sec 8.2)	XXX	XXX
Subsistence (Sec 8.2)	XXX	XXX
Entertainment and transportation allowances (Sec 8.2)	XXX	XXX
Other personal allowances (Sec 8.2)	XXX	XXX

Reimbursement and Transportation allowances (Sec 8.2)	XXX	XXX
Payment accepting and condition regarding employment (Sec 8.2)	XXX	XXX
Redundancy or loss related payments (Sec 8.2)	XXX	XXX
Other payments made in respect of employment (Sec 8.2)	XXX	XXX
Retirement payment and retirement contribution (Sec 8.2)	XXX	XXX
Amount related to vehicle facility (Sec 8.2)	XXX	XXX
Amount related to the payment for services of housekeeper, chauffeur, gardener, domestic assistant (Sec 8.2)	XXX	XXX
Amount related to services resulting during water, electricity, telephone and other utilities in respect of the Payees (Sec 8.2)	XXX	XXX
Any meal refreshment or entertainment provide by employer (Sec 8.2)	XXX	XXX
Under payment of interest by employee to employer for loan taken from employer (Sec 8.2)	XXX	XXX
Assessable Income From Employment Income	XXX	XXX

B. Statement of Total Taxable Income

Table 2.3

Assessable Income from Employment Income		
Assessable Income from Business (if any)		
Assessable Income from Investment (if any)		
Total Assessable Income		
Less: Contribution to recognized retirement funds (Employees provided fund and citizen investment trust @ 1/3 of assessable income or 300000 or actual which ever is less (Sec 63)		

Taxable Income Before Donation		
Less: Donation (5% of adjusted taxable income or actual donation or Rs 100000 which ever is less or prescribed by NOG)		
Total Taxable Income		

C. Computation of Income Tax Liability

Table 2.4

First Rs 100000 for individual or Rs. 125000 for couple		
Next Rs 6000 to 300000 as per category of remoteness for remote area allowance (if any)		
Next amount equal to Rs 10000 or 7% of insured amount or actual premium (which ever is less)		
Next amount is equal to 25% of 100000 or 125000 for pension income (if any)		
Next Rs 75000 @ 15%		
Balance Rs ----- @ 25%		
Special additional tax @ 1.5% on slab of 25%		
Total Tax Liability		

Computation of Total Tax Payable

Table 2.5

Total Tax Liability		XXX
Less: Last year's excess payment (if any)	XXX	
Less: Tax paid in Advance including tax deduction at source	XXX	
Less: Medical tax Credit (15% of Approved medical expenses or Rs 750 which ever is less)	XXX	
Actual Amount to be paid		XXX

Notes:

- a) Contribution to an unapproved retirement funds are not eligible for deduction for income tax purpose.
- b) For a non resident, no exemption will be provided and income is taxed at the flat rate of 25%.
- c) Salary means total salary including grade also.
- d) An individual having pension income is entitled to 25% additional basic exemption.
- e) Additional exemption up to Rs 30000 is available for individuals working remote parts of Nepal. In case an individual works in remote areas, A, B, C, D and E, additional exemption of Rs 30000, Rs 24000, Rs 18000, Rs 12000 and Rs 6000 respectively will be granted to the individuals

2.2 Review of Books

Various books and dissertation have been reviewed for performing this research study; while reviewing the books it is found that most of the books are syllabus oriented. Some of them are extremely based on campus

syllabus. Since the period of 1959/60, many individuals and institutions have made there appreciable efforts on study of various aspect of income tax system of Nepal. In the course of the study various books, articles, dissertations, journals and other reference material were reviewed. Some useful and important are mentioned below.

Narayan Raj Tiwari (2056), has presented the books “Income tax system in Nepal”. He stated the detail information about tax act and regulations. He has defined the definition of tax, historical aspect of the income tax, tax assessment procedure under different heading etc.

Kamal Deep Dhakal (2058), has described the provisions under income tax act in detail and definition of tax, income tax assessment under different headings taxpayers and other provisions relating to the income tax assessment in his book named, “Income tax, house, compound tax law, and practice” this book was based on income tax act, 2031. This book is very much useful for getting knowledge about history of taxation and practices under the previous act.

Dr. Rup Bahadur Khadka (1994) had written a book entitled “Nepalese taxation, a path for reform”. The book dealt with the both national and international taxes, the writer detailed the scenario of Nepalese tax system from origin of income tax, adoptions 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, more from joint taxation to individual expenses, experiment with an advanced tax on impacts and the existing structure, commodity taxes and property tax. He had evaluated the Nepalese tax system based on conventional, theoretical concepts and suggested various measures for its improvement. The book had not been directly focuses on corporate tax only but explains the whole Nepalese taxation system and structure for its reform.

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

K.P Aryal and S.P. Paudel (2060) had written a book entitled, “Taxation in Nepal”. They had explained about the income tax system in Nepal along with house and land tax and value added tax. The book has been designed based on the curriculum of B.B.S. It has been divided into three parts. In the first part of the book introduction and development of income tax, capital and revenue nature expense and income from business, remuneration and investment have been explained with numerical and theoretical examples. House and land tax and value added tax have been explained in the second and third part respectively. The book also included proper bibliography and adequate appendix where various income tax, house and land rent and VAT related forms, schedules and format had been described.

Mr. Santosh Raj Poudel and Prem Prasad Timsina (1990) wrote a book “Income tax in Nepal”. This book has been written on the income tax act 2031. They have given a detailed computation of income from various sources. They have also described other theoretical aspect of income taxation. This book was mainly written for the course requirement of Bachelor’s level in management. This book is not relevant today, as the act has been changed.

But some description, theoretical and historical aspect can be drawn for the study.

Mr. Ishwor Bhattarai and Mr. Girija Prasad Koirala (2004), published two books named "Taxation in Nepal" and "Tax laws and tax planning". First book has been designed in conformity with the syllabus of B.B.S. 3rd year and the second book has been designed on the syllabus of M.B.S. 2nd year. Relevant theoretical and practical aspects have been discussed in the books. Both books have shown taxable income are computed under employment, business and investment sources and described about tax planning.

Prof. Dr. Chandramani Adhikari (2003) wrote a book entitled "Modern taxation in Nepal: Theory and Practice". This book also has been written according to syllabus 2060 has also been included Theoretical as well as practical aspects.

Mr. Ishwor Man Raj and Narayan Prasad Bastola (2003) published book entitled "Taxation in Nepal". It is also book designed according to the syllabus of BBS 3rd year, computation regarding different sources of incomes have been included in this book.

Mr. Surendra Deshar Amatya, Dr Bigari Binod Pokharel and Rewant Kumar Dahal (2003) wrote a book entitled "Taxation in Nepal". This book is also designed to meet the requirement of BBS III year syllabus. Theoretical as well as practical aspects of taxation have been included in the book. This book is a descriptive one not analytical.

Dr. Puspa Raj Kandel (2003) wrote two books on taxation. One book entitled "Tax laws and Tax planning" and "Nepalko Bartaman Kar Byabastha" for BBS III year. He has presented practical as well as theoretical aspects on taxation in these books.

Mr. Jagadish Agrawal (2004) published a book named "Income tax theory & Practices". This book is useful to anyone who is interested in the subject of

taxation. In this book, Mr. Agrawal has explained income tax act, 2058. He wanted to serve all the concerned people like tax practitioners, chartered accountants, registered auditors, accountants and other managerial person in big organization. The book is also source of information on the subject of income tax. He brief explained about fixed assets and depreciation treatment on income tax purpose. Mr. Agrawal provides a schedule for depreciation. This book is useful to know about theoretical as well as practical aspects in the field of taxation.

2.3 Review of Articles

Mr. Narendra Lal Kayastha (1993) wrote an article in “Rajaswa” entitled “Problems and prospects of Resource mobilization through direct taxation in Nepal.” In this article, he has shown that Nepalese tax structure has heavily relied upon indirect taxes and non-tax revenues with the growth in comparison to other taxes, but the trends in Nepal is still not encouraging. He has stated that there is almost need for certain tax measures and widening of tax base. He has mentioned that revenue administration is very urgent it widen the tax base. He has pointed out the following factors responsible for weak revenue administration in Nepal.

-) Lack of policies with a clear directions and consistency in a long run prospective.
-) Lack of information and records.
-) Lack of trained staff and heavy dependency on non-technical staff.
-) Lack of proper accounting and auditing system in general for business firms.
-) Lack of monitoring and prevalence of large informal sector both in industry and in trade.

The tax collection process suffer from leakages and loopholes also, because of discretionary power with authorities on the one hand and low salary structure of government as against high social obligation and a high

cost of livings. In order to make the revenue administration more effective, the formation of separate revenue groups were a commendable beginning. As per him, drastic reforms in tax rates, rules and the regulations in the annual budget along with the above suggestions may help to increase the domestic resources mobilization through taxation in Nepal.

Govinda Ram Agrawal, Netral Lal Kayastha, Bal Prasad Rai and Arun Kumar Lal Das (1978) presented the research report entitled “**Resources Mobilization for Development, The reform of income tax in Nepal**” which was published by CEDA Kathmandu in 1978. In the research work, they analyzed various aspects of income tax system in Nepal such as role of income tax, legal aspect of income tax and administrative aspect of taxation in Nepal. As per their study, the main cause of administrative problems were under delay in tax assessment, failure to locate new taxpayers, failure to maintain proper records by a tax officers etc. He also showed the main reasons of assessment delays in Nepal, as delay in settlement of appeal, defective assessment procedure, failure to maintain the proper accounts and records by taxpayer/ tax officers.

Govinda Ram Agrawal (1984) presented the research report entitled “**Direction of tax reforms in Nepal**” in June 1984. This was presented to ministry of finance. In the research work, he analyzed some aspect of direct tax, such as structure of a direct tax, growth performance of direct tax, elasticity of direct tax etc. He found that the major problems of income tax in Nepal were that tax officers did not like to make assessment based on income tax purpose. Capital gains should be included in income for the purpose of income tax. This will not only generate additional revenue but will also discourage speculative and unproductive investment. He suggested that political and undesirable pressure in tax administration should be minimized; effective taxpayer information system should be developed, allowed to deduction expenses for two children etc.

Damber Bahadur Pant (2004) has written an article entitled “**Problems in tax administration and their remedies**” published in journal of finance and development “Rajaswa” 2004, April Vol.

1. He has comprehensively explained about the problems and their remedies related with tax revenue and the major types of practical problems and challenges, in tax administration. He had maintained in his article where showing limited amount of transaction, showing how selling price, lack of issuing and taking bills, lack of showing the real factory cost, legal ambiguity and complexity in implementation and lack of coordination between inland revenue department and revenue investigation unit. Meanwhile, he had recommended some valuable suggestions to solve the problems and to overcome the challenges. They were statistical and information system should be properly managed, fixed norms and standards should be made compulsory, coordination between Inland Revenue Office with various entitles of NOG, revenue investment department and its related units should pay the important role and auditing of tax should be widened etc.

Mr. M.K. Dahal ET. Al. (1995) presented and submitted a report entitled “**Review of tax system**” to MOF; NG/N covered the various aspects of tax system at time. Narrow tax base, low tax elasticity, higher burden of indirect tax to direct tax, lack of voluntary compliances, leakage etc were the major defect of taxation identified by this report. This study stressed on the narrow tax base. The exemption of income from agriculture sector, which contributed 43% of total GDP, was marked as a main reason of narrow base. Including agriculture sector, income from domestic industries, social sector, and electricity sector that contribute 52% was exempted from income tax and only large industries, mines, construction, trade, hotel, and restaurant that contributed 48% income to GDP were under income tax. All these provisions made the tax base very low. The tax rates were unnecessarily high. Only 73000 tax payers income was demanded which was less than 1% of the economically active population. Real i.e. capital income growth rate at that time was only 0.3% which

showed the low taxable capacity of people. This report suggested increasing the tax to GDP, to increase the total number of taxpayers and to increase the total number of taxpayers and to increase the per capital income. This study further suggested about 40% extra resource mobilization, it proposed tax policy and program were in pace. This study recommended various practical ideas to widen income tax base like 20% exemption from total tax assessment effective. It also suggested the exemption limit should be raised based on inflation rate.

Review of Revenue Consultation Committee (2001), MOF, NG/N 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 tax payers of new sector. For this, the report suggested to make the act more transparent and clear in order to attract foreign and domestic investment. This report recommended for written communication between taxpayers and tax administration rather than the informal relation. It also suggested to implement account based BAT more effectively. Self-assessment of income tax was fully recommended. It suggested bringing all potential taxpayers into 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 report gave suggestion for NG to expand the permanent Account Number (PAN) out side the valley and reduce the land and house registration rate and to rationalize the tax deduction at source (TDS).

2.4 REVIEW OF THESIS

Miss Roshani Shrestha (1984) wrote a dissertation entitled, “**Income Tax in Nepal**”. She has described the historical background of income tax in Nepal and the role of income tax in Nepalese taxes structure. She has studied the problems of income tax in Nepal. She has found that revenue from the income tax is small due to tax evasion, which shows that income tax policy is not well

operated and the collective revenue is low. To increase the revenue from taxation, per capita income should be increased. Growing per capita real income provides a means to collect larger tax revenue. To increase income tax revenue, there must be efficient administration; she has suggested that the practice of taxation must be checked, if the taxes are contributed to the economic growth of Nepal.

Mr. Shambhu Nath Regmi (1986) wrote a dissertation entitled "**The role of Income tax in Nepal**". He has discussed the trend and contribution of income tax in the developmental efforts of Nepalese government. He has suggested checking income tax evasion because it has been a great problem in income tax collection of Nepal. According to him, if the income tax evasion is checked properly, income tax can contribute significantly to the economic growth of Nepal.

Mr. Prem Prasad Timsina (1987) wrote a thesis entitled "**Income Tax Evasion in Nepal**," the objectives of his study were to analyze the structure of income tax in Nepal, to study the role of income tax in mobilizing resources in Nepal, to examine income tax evasion tendency in Nepal, to observe the general opinion about income tax evasion in Nepal. He has shown serious problems of finance resource gap in Nepalese economy. He has stated that income tax evasion tendency by remuneration tax payers are increasing in Nepal. He has pointed out different causes of income tax evasion in Nepal; widespread illegal business, high corruption, poor tax paying habits, inefficient tax administration, poor tax paying habits, inefficient tax administration, open border with India and political indiscipline in Nepal. He has also mentioned different methods of income tax evasion in Nepal viz. non-reporting of income from illegal business, non-mentioning of accounts, failure to submit income from different sources, re-registration of business and failure to make deduction at source (TDS). He has concluded that income tax evasion is in decreasing trend in Nepal. But due to lack of complete and authentic data, he was unable to prove it statistically.

Mr. Hari Bhandari (1994) wrote a dissertation entitled “**Contribution of Income tax to Economic Development of Nepal**”. In this dissertation he has examined the collection of income tax and its contribution the actual revenue collection in Nepal is lower than the targets set out. For this, he has pointed out some responsible factors like poor tax paying habit of Nepalese tax payer, poor tax administrative system, widespread income tax evasion etc. He has also studied the income tax structure, trend of income tax collection, and the share of contribution of income tax to the development of Nepalese economy. He has put forward some suggestions to overcome those problems such as improving tax administration system, checking income tax evasion etc.

Mr. Shree Krishna Kharel (1996), present a dissertation entitled “**Self Assessment under Income Tax Act in Nepal**”. In his work, he has made a review of tax laws about self-assessment, analyzed the problems faced by the assessment while doing the self-assessment of their own income and made recent recommendation to reform in income tax laws as administration in future. He has concluded that self-assessment of tax is a suitable means of raising domestic resources and it would be effective if taken seriously. He has further experienced that the effectiveness of self-assessment of tax depends upon its appropriate reformation.

Mr. Krishna Kumar Shakya (1995) presented a dissertation entitled “**Income tax in tax structure of Nepal**”. In his study, he has endeavored to examine the pattern of existing income tax structure of Nepal with view on its collection, mobilization in development perspective. He has pointed out some factors responsible for limiting Nepal’s taxable capacity. They are low per capita income, extensive subsistence economy relatively closed economy, political and social factors; weak expert position administrative and enforcement problems of tax etc. He has suggested for honest and efficient administration, punishment to tax evaders, scientific method of taxation and assessment of small tax payers on door-to-door basis and encouragement of self-assessment tax system.

Miss Bibha Pradhan (2001), wrote a thesis entitled “**Contribution of Income Tax from Public Enterprises to Public Revenue of Nepal With reference to Nepal Telecommunication Corporation**”. She has analyzed the contribution of income tax from public enterprises, to public revenue of Nepal, examined the revenue collection from public enterprises, shown the contribution of income tax in total tax and total income tax revenue of Nepal, analyzed the effectiveness of income tax revenue of Nepal, and analyzed the effectiveness of income revenue collection from NTC. She has also recommended possible measures to increase the present status. She has found that the contribution of income tax from PEP in Nepal is not satisfactory due to poor achievement, weakness in government’s economic policy and deficiency in legislation existing corporate tax rate has been found. Suitable self-assessment of tax is more appropriate. Public enterprises have remained in the second place on total income tax revenue. Out of PES, NTC has contributing effectively to total income tax revenue of Nepal. NTC’s contribution total corporate income is high. She has found that the average share of NTC on corporate income tax was 35-76 during ten years period i.e. from fiscal year 1989/90 to 1998/99. She has recommended possible measures to overcome the existing problems. Staff should be taught discipline and be motivated. Management should have the feeling to contribution to the state etc.

Mr. Satyendra Timilsina (2001) wrote a thesis entitled “**personal Income Taxation in Nepal: A study of exemption and deduction**”. He has analyzed the existing system of tax exemption and deductions and given suggestions to improve the tax system so that the government can collect more revenue and use it in the process of national development. He has measured the extent of exemption limit provided to the individual and the family and exempted its appropriateness to its subsistence requirement and analyzed the existing nature of standard deduction should be reintroduced; exemption should be provided to the couple/family considering the dependents; income tax revenue and personal income tax revenue is increasing every year; A minimum of Rs 90000 exemption should be provided

in the assumption that the employment income of a section officers in a government institution should not be taxed, morale of the tax officials should be increased. He has stated that exemption limit should be provided by considering the general expenses of two dependent children and the dependent parents for the year. Income form agriculture above some exemption limit must be taxed. The exemption limit must be adjusted with the inflationary condition of the country every year.

Miss Jayanti Poudel (2002) presented a dissertation entitled “**Income in Nepal: A study of its structure and productivity**”. The objectives of her study were to analyze the structure of income tax in Nepal, to estimate the elasticity and buoyancy of income tax in Nepal, to evaluate the success of voluntary disclosure of income scheme (VDIS) program in brief and to provide the suitable recommendation for improving the scenario of income tax. She has found that overall revenue of Nepal showed on annual growth of 16% indirect taxation has more significant contribution in total tax revenue, income tax occupied the first rank among the direct taxes, personal income tax slabs has been changed radically form seven slabs in 1975/76 to two slabs in 1999/2000, VDIS could not attract more potential taxpayers into tax net due to lack of good planning and adequate home work of the government working procedures of the tax administrators are still traditional and cost of administration has not been bought to the satisfactory level.

Mr. Thuman Sherchan (2003) has studied about fines and income penalties under income tax act, 2058 in this thesis entitled “**An analysis of Fines and penalties regarding to income tax system of Nepal**”. He has analyzed tax structure of Nepal, found out the share of income tax to government revenue, analyzed the provisions of fines and penalties under income tax law, tried to know the taxpayer’s knowledge and tax officers’ views about fines and penalties shown the role of fines and penalties to increase the tax paying habit of Nepalese people and suggested regarding fines and penalties are not the only effective methods of reducing tax evasion. He has suggested making

provision of fines and penalties effective. Education to the tax payers to increase tax consciousness should also be provided.

Mr. Dhan Bahadur Palli Magar (2003) wrote a thesis entitled “**Income tax in Nepal: A study of Exemption and Deductions**”. He has studied the exemption and deduction provided by the income tax act 2058. Problems and weaknesses in income tax system, contribution of reform. He has stated the need for clarity in provisions and language of the act. He has recommended ten slabs for taxing the income of a tax payer, first rate being 5% and the last one being 55%, he has suggested following expenses for deduction from employment income:

-) Expenses for the better education of their children.
-) Medical expenses made by the taxpayer.
-) Expenses made for house rent.
-) Education expenses for the taxpayer himself if he is studying in an educational institution.
-) Life insurance premium of the taxpayers.

Mr. Girija Prasad Koirala (2004) presented a dissertation named “**Contribution of Remuneration tax on Income tax**”. He tried to identify the contribution of income tax from employment income to public revenue of Nepal. He also tried to analyze the effectiveness of income tax revenue collection from employment income. His major findings are as follows:

-) Income tax an important source of collection government revenue.
-) The contribution is employment income to total tax revenue of Nepal has not been found satisfactory due to various like low pay scale of the employers, ineffectiveness in the implementation for the act, tax evasion etc.
-) The contribution of income tax from employment income to income tax revenue can be increased mainly by bringing new tax payer into tax net and making TDS more effective. Majority of the respondents opined

that tax evasion is not often practical in employment income as tax is already deduction at source while receiving salaries.

-) Exemption limit should be adjusted by considering factor like average cost of living, education expenses, inflationary condition of the country, and number of dependents of the income earner.
-) Current exemption limit is not satisfactory. Exemption limit provided to couple should be quite higher than the exemption limit provided to the individual.
-) Medical expenses paid by employer, Dashain allowances and pension income should be made tax-exempted income.
-) Unlike the income tax act 2031, standard deduction as expenses should be provided from employment income.
-) Imposition of income tax on pension income is not justified. Those who accepted imposition income tax on pension income they responded that additional 25% exemption limit compensates the taxpayers who were not taxed earlier. The respondents who responded that pension income should be taxed were on the ground that the adequate exemption limit does not bring the pension income in income tax bracket.
-) Majority of the respondents responded that employees have not faced any problems while paying income tax etc.

Mr. Alok Jyoti Shakya (2004) wrote a thesis entitled “**Structure and Responsiveness of Nepalese tax system**”. He attempted to analyze the structure and responsiveness of Nepalese tax system. Further, the study also attempted to compare the structure and responsiveness of Nepalese tax system between two different periods i.e. before (1976/77 to 1990/91) and after (1991/92 to 2002/03). Finally he has attempted to review the process of Nepalese tax reform and policy. He has found that very little base expansion and greater discretionary changes in the Nepalese tax system, which is further compensated by evasion, exemptions the specific nature of a number of taxes, and probably weak administrative effort in collection taxes at existing rate. He also found that Nepalese tax system has been erratic and unstable in

its policies, bases and rates however, this approach is not a self-sustaining process of revenue mobilization. Further he also described that the low elasticity of majority of the individual taxes must be explained in terms of their low tax to base elasticity, which indicates lack of efficient administration and progressive taxation.

Mr. Jhalak Mani Lamsal (2004) presented a dissertation entitled **“Effectiveness of Remuneration tax in Nepal”**. He has analyzed the effectiveness of remuneration tax. He also analyzed the contribution of income tax in tax revenue, contribution of employment tax in income tax etc. Major findings of his study are as follows:

-) Income tax from remuneration has very insignificant contribution in total tax revenue of Nepal.
-) Out of the total tax revenue, 19.71% has been contributed by income tax revenue.
-) Government revenue of Nepal is comprised of different taxes such as customs, excise, sales tax/VAT, income tax, land revenue, registration miscellaneous taxes, and non-tax revenues. By the various tax and non-tax revenues, tax on consumption and product of goods and services has the highest percentage of contribution in million of rupees has been increasing per year.
-) According to the respondents, income tax as an important source of collecting government revenue.
-) From the opinion survey conducted towards the tax experts and employees, the conclusion can be drawn out that remuneration tax as a suitable means of collecting government revenue.
-) The contribution tax in total income tax revenue of Nepal has not been found satisfactory due to unfair and weak administration complexity in income tax policy, rules and regulation, no provision of education; it is burden of tax in low level income group.
-) The main factor that should be initiated to increase the contribution of remuneration tax in Nepal is making tax deduction at source (TDS).

The other factors should be initiated to increase the contribution of remuneration tax in Nepal are reform in the income tax policy, rules and regulation, reduction in exemption limit and increase in tax rates.

-) The contribution of income tax from remuneration tax to the public revenue is not effective and satisfactory.
-) Medical expense paid by employer, Dashain allowances etc should be tax exempted.
-) Pension income should not be taxed as pension income is lower than regular income while in the job and it is inadequate to run the retired life.
-) Rules and regulation of income tax have been found very complicated. They need to simplify. Taxpayers should be provided with taxation knowledge. Behaviour of tax administrative should be improved and they should have the feeling of contribution toward the state.
-) In this study, majority of respondents are suggested that the exemption limit for senior and disables citizens should not be necessarily more than that of other citizen. Rest of the total respondent suggested that the current exemption limit of senior and disabled citizens should be more than that of other citizen. He found that from the above result, current exemption limit for the senior and disabled citizen should not be necessarily more than that of other citizen.

Mr. Keshav Raj Gautam (2004) has described about contribution of income tax to national revenue of Nepal. He has mainly focused about conceptual framework, legal provision, and structure of income tax. He has an empirical investigation about various aspects of income tax in Nepal.

He has found that the contribution of direct and indirect tax revenue were 20.63% and 79.40% respectively in 2002/03. Income tax revenue has occupied third position based on mean contribution other sources of revenue; the contribution of income tax to total revenue was 80.84%. It may enhance the revenue of government, promote to distribute justice and encourage private sector investment. Nepalese government expenditure is

increasing at the faster rate than the increase in revenue the resource gap has existed in Nepalese economy and it is increasing trend, Tax/GDP ratio of Nepal is found satisfactory, the exemption limit is not satisfactory. He has made the specific suggestion for a sound and effective income tax system. They were established; promotion and reward system to efficient and honest tax personnel, increasing public participation to minimize the tax evasion, strict action against corruption, income tax rules and regulation should be clear and simple. The provision of fines, penalties and punishment should be made at higher rate for income tax evaders; more deduction should be provided for exports promote and separate income tax department should be established.

Miss Shikha Sharma (2005) wrote a thesis entitled “**Income Taxation in Nepal, with special reference to Taxation on Capital Gain**”. She attempts to analyze the capital gain tax in Nepal. This study is mainly dealt with taxation on capital gains. In this study, contribution of income tax revenue have been analyzed and examined. Moreover, composition and trend of income tax in Nepal is also presented and analyzed. This study incorporates the rationales behind levying tax on capital gains, incidents of capital gains and provisions of taxation on capital gains and these problems and weaknesses. In this study, various concept of tax system have been discussed. This study has tried to present crystal clear picture of taxation on capital gains with respective analysis and assessment. She has found that 78.22% of total revenue has been contributed by tax revenue from F/Y 1993/94 to 2002/03. He also found the tax on capital gains is in inception stage in context of Nepalese income tax system. It has provided a large tax base in her study; she has analyzed and found in different aspect of capital gain taxation.

2.5 Concluding Remarks

All the research studies mentioned above are concerned with study of laws, provisions, administrative aspect, structure, management and contribution of tax. Most of them have indicated the inefficiency of tax administration wide spread tax evasion. No attention is paid on a particular problem. Many of them have taken various problems and their research objectives and no thoroughly study on a particular subject problems is done except few of the research work.

In this topic very few research works have been done. Employment income tax is a suitable means of public revenue. Contribution of income tax on income from employment plays vital role in Nepalese tax structure. I found no more study has been done in income taxation and its effectiveness; with special reference to income tax on employment income. So this study is original one. This research work about employment income tax, policy maker to make effective to tax on employment income, and it also helps to further researcher who will be interested to study more about tax on employment income.

CHAPTER – THREE

RESEARCH METHODOLOGY

Research means to research the problems by segregating the word into two parts that is re means again and search means to find out something more about the problem. Methodology refers the various steps that are generally adopted by a researcher in studying his research problem along with the logic behind it. Thus, research methodology is a way to systematically analyze the logic behind problems so as to find out something about the problems. (Mahat, Kiran, 2008).

3.1 Introduction

Research methodology refers to the various sequential step (along with rationale of each step) to be adopted by a researcher in studying a problem with certain object in a view. It would be appropriate to mention that research projects are not susceptible to determine the particular steps to be taken in order too.

The basic objective of this study is to evaluate the effectiveness of collection of income tax from taxation on income from employment in Nepal; so suitable research methodology as demanded by the study has been followed. In order to accomplish the objective, the basis of primary and secondary data is using the financial and statistical tools. This study has mainly two aspects. They are descriptive and analytical. This chapter explains about the research design, sources of data, data collection procedure, methods of analysis of data and tools of analysis of data.

Both **primary and secondary data** has been used in this study. Opinion survey techniques has adopted while collecting primary data. Questionnaires were distributed to income tax experts and employers so as to know their opinions towards various aspect of employment income. Economic survey and economic bulletin was used as the major source of secondary data. Different statistical tools were used to analyze the data. In this study, correlation, simple average, percentage and t- test for hypothesis have been used to analyze the collected data.

3.2 Research Design

The analysis of this 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. The research study mainly focused towards effectiveness

of income tax (with special reference to employment income tax). For this purpose, the research design of the study has been used for analytical as well as descriptive methods of collected data most of the materials of this study are concerned with past and present phenomenon of the preference in numerical or theoretical terms. The study is oriented to :

3.2.1 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 will be carried in terms of role of total tax revenue, income tax revenue and employment tax in the public revenue of Nepal.

3.2.2 Descriptive Research

Descriptive research includes surveys and facts finds enquiry of different kinds. It is concerned with finding of facts relating to the subject matter, about important data and getting new areas of knowledge by describing them descriptive research will be carried out in the study of income tax (with reference to employment income tax)

3.2.3 Empirical Investigation

Empirical investigation has been conducted in respect of income tax collection, employment income contribution to income tax revenue and effectiveness of income tax collection from employment income and other practical aspect of income tax with reference to employment income tax.

To achieve the stated objectives of the study, opinion survey of respondents will be collected. Respondents are classified into tax experts and employee (tax payers). Questionnaires were sent to the respondents.

The study has attempted to collect information 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, and reliable information for analyzing the personal views from tax experts and tax payers. Where as data related to income tax collection and contribution all are collected from different sources like Economic Survey and Annual Reports published by Inland Revenue Department and latest one from website. Additional valuable information was also collected from interview with the respondents, field visit and observation (i.e. tax office, IRD and other related institution), as well as group discussion with taxpayers etc.

3.4 Population and Sampling

All the tax experts, tax administrators, tax payers and other related person in Nepal are concerned as total population. Out of them tax experts and employee (tax payers) in Kathmandu valley are concerned as target populations. Out of the target population, 50-60 respondents have been taken as sample size.

3.5 Nature and Sources of Data

Both primary as well as secondary data have been used in this study. The primary data needed were collected from opinions of tax experts and taxpayers regarding employment income tax, needed primary data were obtained through questionnaire method. In most case face to face interviews/ discussions with the selected persons included in the purposive sample.

The secondary sources of data has been obtained through tax office, IRD, statistics relating to tax published by GON, economic survey, Budget speech, Annual Reports published by Inland Revenue Department, bulletins and other related journals and newspaper etc.

3.6 Classification, Editing and coding of Data

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

3.7 Procedure of Processing and Analysis of Data

After the classification, editing of data, it was presented into tabulate form with separate format systematically in order to achieve the desire objectives. It has been presented into various tables, figures, graphs according to the subject in order. Available and collected data has been presented and analyzed. In descriptive way with the help of simple statistical tools, such as percentage, average, correlation, t- test for hypothesis etc. are used.

3.7.1 Statistical tools:-

i) Correlation coefficient

$$r = \frac{(X - \bar{X})(Y - \bar{Y})}{(X - \bar{X})^2 + (Y - \bar{Y})^2}$$

$$r_1 = \frac{(Z - \bar{Z})(Y - \bar{Y})}{(Z - \bar{Z})^2 + (Y - \bar{Y})^2}$$

where, X = Total income tax

Y = tax on income from employment

Z = Total tax

ii) Probable Error (P.E.)

$$= 0.6745 \times \frac{1 - r^2}{n}$$

iii) The relation between r and P.E. in terms of significant test is, if $r > 6 \text{ P.E.}(r)$, it means if observed value of r is greater than 6 times its P.E. then r is definitely significant. If $r < 6 \text{ P.E.}(r)$ means if observed value of r is less than its P.E. then correlation is not at all significant.

iv) For the selected hypothesis model,

Test Statistics, under H_0

$$t = r \times \frac{\sqrt{n - 2}}{\sqrt{1 - r^2}}$$

3.8 Period Covered

The research study has included secondary data also that secondary data is based on historical data. The study covers the data of past 8 year's period i.e. from fiscal year 2057/58 to 2064/65

3.9 Selection of the Respondents

After careful study of the subject matter, a set of questionnaire had been developed and distributed to two respondents' group viz. tax experts comprises of employees working in various organizations like banks, government offices, manufacturing organizations and other private organizations were contacted for their opinion regarding various aspects of taxation on employment income .

3.10 Hypothesis and Model

Hypothesis 1 :

$H_0: \partial = 0$, There is no significance contribution of employment income tax on total income tax revenue.

$H_1: \partial \neq 0$, There is significance contribution of employment income tax on total income tax revenue.

Hypothesis 2:

$H_0: \partial = 0$, There is no significance contribution of employment income tax on total tax revenue.

$H_1: \partial \neq 0$, There is significance contribution of employment income tax on total tax revenue

3.11 Limitation of the study

All research study is to be done to solve particular research problems. It requires various kind of data materials and other relevant information. The study can not escape from the frame of limitation, which is based on primary data as well as secondary data provided by inland revenue department and other published as well as unpublished reports. Primary data as well as necessary information has been collected through opinion survey. The following are the some limitation of the study-

-) This study is based on primary as well as secondary data.
-) This study has been concerned in the provision of income tax act 2058.
-) Primary data has been collected through opinion survey of employees, and tax experts available in Kathmandu only.
-) The study covers the period of 8 years from fiscal year 2057/58 to 2064/65.

CHAPTER – FOUR

PRESENTATION AND ANALYSIS OF DATA

4.1 Analysis of Secondary Data

This part is devoted to the analysis and presentation of secondary data. The secondary data have been obtained from economic survey, economic bulletin, budget speech and other related newspaper. The available data have been

tabulated and presented into graphs, charts and analysis to reach at some findings.

The data collected from economic survey and other related newspapers have been analyzed but dividing into sub headings they are structure of income tax revenue of Nepal, structure of tax and non tax revenue of Nepal, composition of direct tax and indirect tax revenue in total tax revenue of Nepal, contribution of employment income tax to total tax revenue, direct tax revenue and income tax revenue of Nepal. Exemption limit allowed by income tax act and budget speech for 8 years period i.e. from fiscal year 2057/58 to 2064/65

4.1.1 Structure of Income tax in Nepal

Nepalese income tax structure is formed by combination of income tax from public enterprises, private-corporate bodies, individual, remuneration and tax on interest. This has been presented in table no. 4.1(a) below. Here public enterprises consist of 100% government ownership and private corporate bodies mean public limited companies individual denote sole trader, partnership and private companies. Employment income refers to salaries earned by government and non-government sectors' employees.

Table 4.1

**Structure of Income tax in Nepal from fiscal year 2057/58 to 2064/65.
(Amounts are in Crore)**

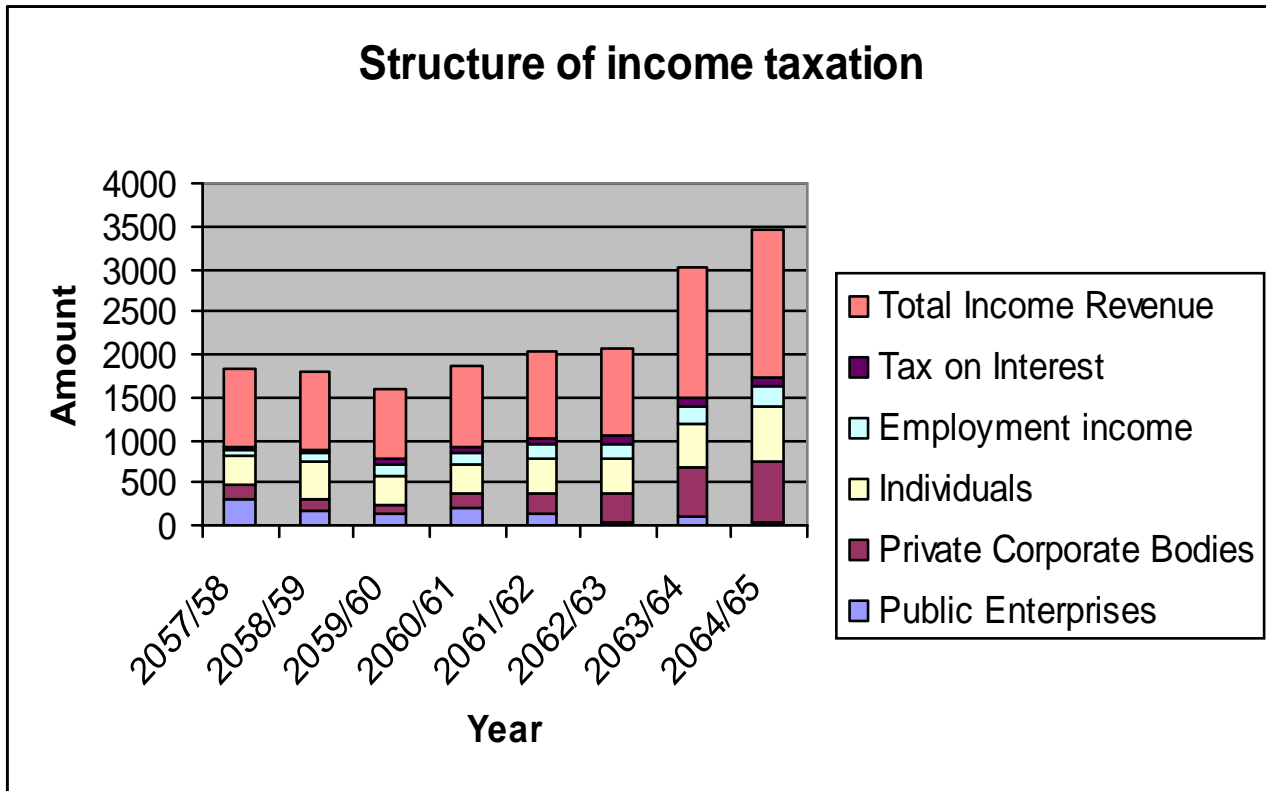
Fiscal Year	Public Enterprises Tax	Private Corporate Bodies Tax	Individuals Tax	Employment income Tax	Tax on Interest	Total Income Tax Revenue	Total Tax revenue
2057/58	292.8	192.43	320.05	59.73	46.39	911.4	3886.5
2058/59	176.93	141.2	441.91	83.56	46.77	890.37	3933.06
2059/60	125.1	123.63	336.22	125.26	86.4	796.61	4258.69
2060/61	205.66	153.13	353.34	139.12	73.34	924.59	4817.3
2061/62	133.24	246.78	392.63	167.59	75.7	1015.9	5410.47
2062/63	19.57	340.43	423.47	176.41	77.49	1037.4	5743.04

2063/64	101.97	571.71	523.44	200.79	105.49	1503.4	7112.7
2064/65	20.46	718.65	638.12	245.1	108.79	1731.1	8515.55

Table no. 4.1 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 2058/59 and 2059/60. It has increased from Rs. 911.4 crore in 2057/58 to Rs. 1731.1 crore in fiscal year 2064/65. Similarly Total tax revenue is in increasing trend from the beginning to end in our data. That has gradually been increasing from Rs.3886.5 crore in the year 2057/58 to Rs. 8515.55 crore in the year 2064/65.

It can be shown in the following graph.

Fig. 4.1



From the above chart also it is clearly seen that the contribution of tax on income from employment is increasing year by year. From the chart the contribution in year 2057/58 is the least one where as in year 2064/65 it is the highest. In between the years, however it is increasing from beginning to end, only in the year 2060/61 the contribution is decreased than the previous year.

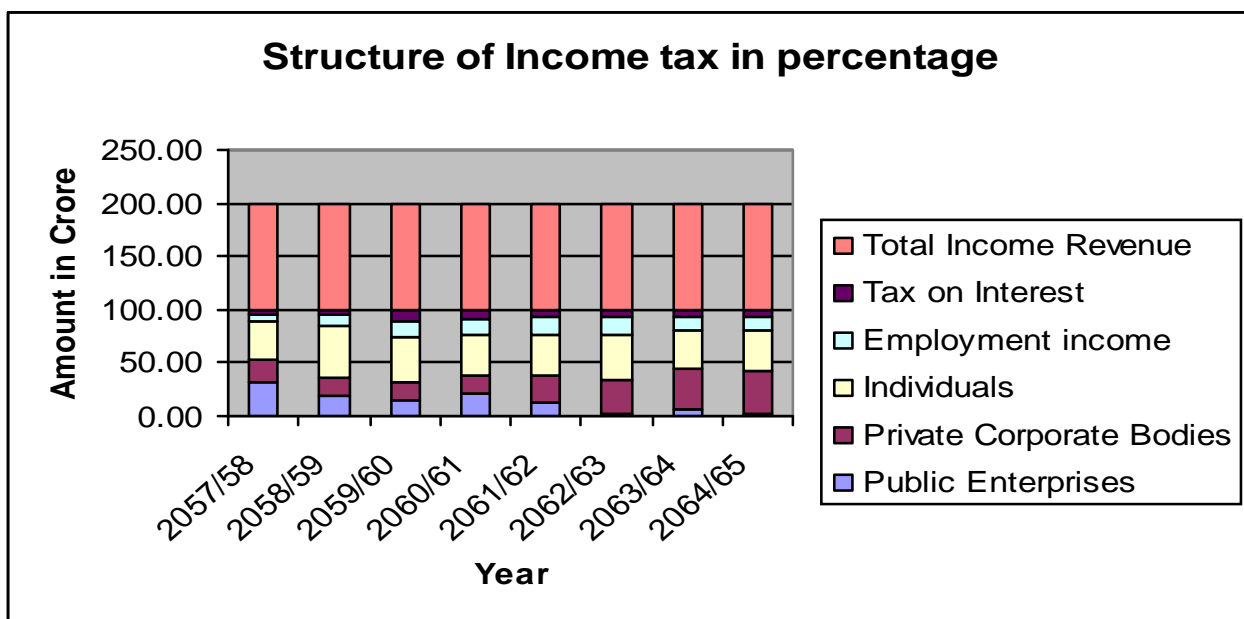
Table 4.2

(Structure of Income tax as percentage in Nepal from fiscal year 2057/58 to 2064/65).

Fiscal Year	Public Enterprises	Private Corporate Bodies	Individuals	Employment income	Tax on Interest	Total Income Revenue
2057/58	32.13	21.11	35.12	6.55	5.09	100
2058/59	19.87	15.86	49.63	9.38	5.25	100
2059/60	15.70	15.52	42.21	15.72	10.85	100
2060/61	22.24	16.56	38.22	15.05	7.93	100
2061/62	13.11	24.29	38.65	16.50	7.45	100
2062/63	1.89	32.82	40.82	17.01	7.47	100
2063/64	6.78	38.03	34.82	13.36	7.02	100
2064/65	1.18	41.51	36.86	14.16	6.28	100

From the above table 4.2 we can see in first two years, 2057/58 and 2058/59 the contribution of employment income tax is in fourth position. However, in the year 2059/60 the contribution is second highest. But after this for the first year it is again in fourth position where as in the following years the contribution has stood in the third position.

Fig 4.2



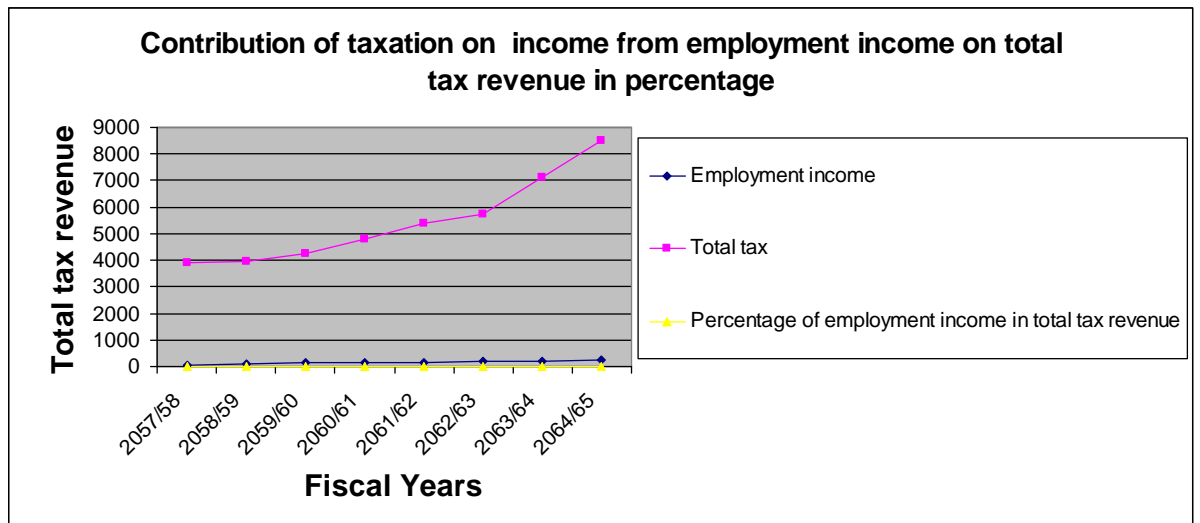
In the graph above the contribution of Taxation on income from employment is gradually increasing up to year 2062/63, then after it is in decreasing trend.

Table 4.3

Fiscal Year	Employment income	Total tax	Percentage of employment income in total tax revenue
2057/58	59.73	3886.5	1.54
2058/59	83.56	3933.06	2.12
2059/60	125.26	4258.69	2.94
2060/61	139.12	4817.3	2.89
2061/62	167.59	5410.47	3.10
2062/63	176.41	5743.04	3.07
2063/64	200.79	7112.7	2.82
2064/65	245.1	8515.55	2.88

Similarly table no. 4.3 shows the contribution in percentage, as per our specific objective to study contribution of employment income tax on total tax revenue. It is clearly seen that till the year 2059/60 the contribution is in increasing trend which has increased from 1.54% to 2.94%. But in year 2060/61, it has decreased to 2.89%. Again it has increased to 3.1% and decreased to 3.07% in year 2061/62 and 2062/63 respectively. Further it decreased to 2.82% in the year 2063/64 and increased to 2.88% in year

2064/65. Though it is fluctuating it is clearly seen that its contribution is increasing and significant than the initial year of our data.



Actually the contribution of taxation on income from employment on total tax revenue is negligible in percentage. So it can not be read in the graph however its trend is seen to be increasing in the following years.

The information what we have derived from the fore mentioned tables and graphs can also be analyzed by using statistical tools like correlation, coefficient of variation and hypothesis testing (t- test).

1) The correlation between Total income tax (X) and tax on income from employment (Y) is calculated as,

$$r = 0.83$$

This shows the total income tax (X) and tax on income from employment (Y) are highly correlated. This is so, because if the value of r is nearer to 1 then the data is considered to be highly correlated.

2) The correlation between Total tax (z) and tax on income from employment (Y) is calculated as,

$$r_1 = 0.95$$

This too, shows the total tax (Z) and tax on income from employment (Y) are highly correlated. This is so, because if the value of r is nearer to 1 then the data is considered to be highly correlated.

- 3) Probable error for r is
P.E. = 0.074 and
6 x P.E. = 0.445

which is less than calculated r. This also shows the contribution of taxation on income from employment on total income tax is significant.

Again to test the hypothesis 1, the calculated t = 3.64 and table value of t at 5% d.f. = 2.31. Since calculated $t > t_{0.05}$, it is significant and null hypothesis is rejected at 5% level of significance.

- 4) Probable error for r_1 is
P.E. = 0.023 and
6 x P.E. = 0.139

which is less than calculated r_1 . This also shows the contribution of taxation on income from employment on total tax is significant.

Again to test the hypothesis 2, the calculated t = 3.64 and table value of t at 5% d.f. = 2.31. Since calculated $t > t_{0.05}$, it is significant and null hypothesis is rejected at 5% level of significance.

Not just the income of the people is the factor for determining collection of tax but also the different exemption limit varied in different time period also plays significant role in contribution of taxation on income from employment. Here is the table below to present the exemption limit of Individual and Couple or family in year 2057/ 58 to 2064/65.

Table 4.4

Fiscal Year	Individuals Rs.	Couple or family Rs.
2057/58	55000	75000
2058/59	65000	85000
2059/60	65000	85000
2060/61	80000	100000
2061/62	80000	100000

2062/63	100000	125000
2063/64	100000	125000
2064/65	115000	140000
2065/66	115000	140000

From the above table we can see that the exemption limit in year 2057/58 was 55000 for individual which is continuously increasing year by year. For each two year 2058/59 and 2059/60, similarly 2060/61 and 2061/62 and so on upto year 2064/65 and 2065/66 remained same exemption limit of Rs 65000, 80000, 100000 and 115000 respectively for individual where as for couple increasing from Rs 75000 in year 2057/58, remaining same for each couple of year in later years likewise in the case of individual crossing the limit of Rs 85000, 100000, 125000 has reached upto Rs 140000 in year 2064/65 and 2065/66. These increments in exemption limit also make people out of tax bracket if their income didn't increase simultaneously who were in tax bracket in the initial years. These increments in tax exemption limit are also necessary for the people because everything is being expensive day by day. If it is not increased then people will be poorer and poorer where government may not success in duly respect their needs and fulfill their necessity for development. But it is one of the reasons for being unable to show huge increment in collection of taxation on employment income. But still we can see it as the continuous and static (slightly increasing not vast change seen) source of income tax collection for the government's revenue and we can be very assured that taxation on income from employment is the one source of fund for government revenue

4.2 Empirical Investigation

4.2.1 Introduction

An empirical investigation has been conducted in order to find out various aspects of employment income. For this questionnaire was developed and responses were collected from the respondents a set of 54 questionnaire was developed and responses were collected from the respondents out of the 60 questionnaire distributed to them. Respondents were classified into two

groups i.e. tax experts and employees. The responses received from various respondents have been arranged tabulated and analyzed in order to facilitate the descriptive analysis of the study.

4.2.2 Respondents' Profile

Questionnaire was distributed to sixty respondents. They are tax experts and employees. Out of them, fifty-four questionnaires were received, twenty-seven each from both groups. The following table reveals the different denominations, number, and percentages of the respondents.

Table 4.5

Respondent's Profile.

Serial No.	Respondents	Total samples		Responses Received	
		Number	%	Number	%
1	Tax Experts	30	50	27	45
2	Employees	30	50	27	45
Total		60	100	54	90

Source: Opinion Survey, 2006

4.2.3 Remuneration Tax as a suitable means of collecting public Revenue.

To know the respondents opinions about the remuneration tax as a suitable means of collecting revenue. The first question "in your opinion is the remuneration tax is a suitable means of collecting public revenue" was asked. The responses received from the respondents are tabulated as follows:

Table No. 4.6

Remuneration Tax as a suitable means of collecting public revenue.

Responses Respondents	Yes		NO		Total	
	Number	%	Number	%	Number	%
Tax Experts	19	35.19	8	14.81	27	50
Employees	20	37.04	7	12.96	27	50
Total	39	72.22	15	27.78	54	100

Source: Opinion Survey, 2006

From the above table, it is clear that 72.18% of the respondents approved remuneration tax as an important source of collecting public revenue and only 27.78% out of 100% of the respondents did not recognize remuneration as a suitable means of collecting public revenue.

Thus from the above, conclusion can be drawn out that the remuneration tax is a suitable means of public revenue (government revenue) because it is transparent, less chance of tax evasion and it is based on progressive tax from the view point of respondents. It can be also said that, remuneration tax should be made effective to collect more revenue.

4.2.4 Opinions Towards contribution of Employment Income to Income Tax Revenue of Nepal.

In order to know, whether the remuneration tax contributing significantly to the income tax revenue or not; a second question was asked, “In your opinion, is remuneration income contributing significantly to the income tax revenue of Nepal?” The question was intended to know respondents’ opinion towards the contribution of remuneration tax in the income tax revenue. The responses received from respondents are tabulated below.

Table no. 4.7

Significant contribution of Employment Income to Income tax Revenue of Nepal

Responses	Yes		NO		Total	
	Number	%	Number	%	Number	%
Tax Experts	5	9.25	22	40.75	27	50
Employees	10	18.52	17	31.48	27	50
Total	15	27.77	39	72.23	54	100

Source: opinion survey 2006

From the above table, it is clear that, 72.23% of the total respondents showed their dissatisfaction regarding the contribution of employment income to income tax revenue of Nepal and about 27.77 percent of the respondents

replied that employment income contribution in the income tax revenue was significant.

4.2.5 Comments and suggestions regarding taxation of Employment Income

An open question was asked to the respondents to know their comments and suggestions regarding taxation of employment income. The responses received from the respondents are given below:

-) Job related expenses should be allowed for deduction to arrive at taxable income.
-) Working culture should be developed by staff of tax office, when the tax payers visit tax office the employees should respect them because they have come to pay tax.
-) Mutual understanding between taxpayer and staffs are essential. One should not look on doubt to other, as if employees are corrupt and payers to evade tax.
-) Tax payer should be made aware of the taxation provision and tax planning.
-) Revenue administration should be made flexible.
-) Simplified tax system and lower rate of tax is effective tool to recover more tax revenue.
-) Focus should be given on payroll auditing and tax payer's education.
-) Simplify the tax rules and laws, so that employees will understand clearly the provisions regarding tax on income from employment
-) When an employee pays income tax they should be immediately provided proof of that.
-) Penalize the employer who do not deduct tax at source and make compulsory filing of returns by the employees whose incomes are taxable.
-) Dashain allowances, transportation allowance, dearness allowances, medical expenses paid by employer should be tax- exempted.
-) Proper monitoring by tax authorities is needed.

-) Tax personal should be trained and motivated.
-) There is an urgent need of changing the behavior of them.
-) Exemption limit provided for couple or family is not adequate, it should be increased.
-) Government should provide sufficient remuneration to collect more tax revenue and it should be transparent in every place.
-) To carry all tax payers in mainstream, the government must conduct public awareness programs and should be done transparent tax collection procure.
-) Government should reward to the taxpayer by giving different kinds of incentives.
-) Simplification in the procedure and incentives should be created by the concerned department.
-) Tight tax policy should be applied on equitable basis.
-) Discourage tax evasion through fine and penalties should be applied immediately.

CHAPTER – FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Nepal is one of the least developed countries with per capita income of about US\$300. Being a poor country, Nepalese people mostly depend on agriculture for their livelihood. The Nepalese economy has not become successful in creating investment friendly environments the private sector doesn't seem to be confident with the current economic and political environment. In such a situation there remains less possibility to materialize the slogan of public private partnership. Nepalese economic is tiling serious resources and fiscal

gap problems, revenues collected internally is sufficient to meet the cost of day to day administration of the country but the revenue surplus is not adequate to undertake development as activities sufficiently in the country. Therefore, Nepal has been dependent on foreign aids and loans to fulfill the need for developmental activities, which is not beneficial in the long run interest of the country. Lack of sufficient financial resources is the main constraints for national economic development of Nepal. Lot of fund is required to meet the additional financial requirements for the developmental activities of the country.

To solve this problem, income tax is the most important source for internal revenue generation in which taxation from tax income from employment occupies the major portion. Regarding the tax the present study entitled “Effectiveness of Income tax with special reference to tax on Employment Income” is related to the remuneration aspect of income taxation. In this study contribution of employment income tax to public revenue has been analyzed, examination and analysis of effectiveness of income tax revenue has been done and contribution of employment income to total tax revenue. Income tax revenue and direct tax revenue of Nepal has been shown. This study has covered the role of income tax in Nepal, with reference to income tax from employment income in public revenue of Nepal comparative study on the role of income tax from remuneration income to total tax revenue income tax revenue and direct tax revenue of Nepal. Various books, articles, dissertations and other related materials are studied during the course of this study. Almost dissertation have been found written on various aspects of income taxation books are found based mainly in the syllabus of universities so they are descriptive than analytical. Various concept of taxation have been discussed in this study, sources of public revenue meaning of taxation, classification of taxes merits and demerits of direct tax and indirect taxes objective of taxation historical background of income tax heads of income and concept of remuneration tax. Method of computing remuneration tax has been discussed in conceptual framework of this study. Very few persons have studied an employment aspect of income taxation. So this study is unique and original.

Researcher has discussed about various aspect of research methodology. Such as research design used for this study, data collection procedure, population and samples nature and resources of data, selection of the respondents, procedure of processing and analysis of data.

Secondary as well as primary data have been used and analyzed them to get the meaning, the result and finding. Economic survey has been used as the major secondary data and other economic bulletin and statistical abstracts has been used to get the relevant an reliable data for the study also opinion survey techniques has been used in this study to collect reliable primary data on employment aspect of income taxation. Primary data have been collected from two respondents group i.e. tax experts and employees. Tax experts consist of chartered accountants, law or policy maker at ministry of finance and professionals. Employees consist of employees working in banks, manufacturing organizations, government office and other private organization. A set of questionnaire was developed and 60 questionnaires have been distributed to respondents. 30 each for both groups, out of them 54 responses have been received, 27 each from both groups. Statistical tools like simple average, rank correlation coefficient and chi-squared test for hypothesis have been used to analyze and interpret the data so as to obtain desire results.

Secondary analysis has been done by presenting the relevant data into tables, figures and chart. Percentage and averages have been computed for the eight year period i.e. from fiscal year 2057/58 to 2064/65. Comparative analysis for different years has been done in the analysis part of the study. Major finding of the secondary data analysis have been put at the end of the chapter, data obtained from opinion survey with the respondents have been tabulated and analyzed to achieve desired results. Hypothesis has been set out and tested the opinion of tax experts and employees on various aspect of employment income taxation.

In this way, this study has tried to present crystal clear picture of taxation on employment income with respective analysis and assessment. An effort has made to maintain balance between the theories and actual practice. The study has been completed with the successful achievement of the stated objective.

5.2 Conclusion

The conclusions of this study are mentioned below:

1. Nepalese income tax revenue is the composition of income tax from the public enterprises, private corporate bodies, individuals, remuneration and tax on interest. Income tax of Rs. 1731.10 crore was collected in 2064/65, share of private corporate bodies' tax to income tax revenue is the highest.
2. Income tax from remuneration has very much insignificant contribution in total revenue of Nepal. In average there is only 14% contribution in total Income Tax revenue and 3% contribution in total tax revenue from remuneration taxation.
3. Income tax exemption limit in Nepal was Rs. 55000 for individuals and Rs. 75, 000 for couple and family in 2057/58 but income tax exemption limit is Rs. 115,000 for individuals and Rs. 140, 000 for couple and family in 2065/66. The exemption limit is not provided for partnership firms, corporation and non residents. It is found that exemption limit has been changed as per need of time and income.
4. Tax experts as well as employees have recognized tax as an important source of collecting public revenue.

5. From the opinion survey conducted towards the tax experts and employees, the conclusion can be drawn out that remuneration tax as a suitable means of collecting public revenue.
6. The contribution of income tax from remuneration in total income tax revenue of Nepal has been told satisfactory due to low pay scale of the employees, less number of employees having tax liabilities. Unfair and weak administration complexity of income tax policy, rules and regulation and ineffectiveness in the implementation of the tax etc.
7. The main factor that should be initiated to increase the contribution of remuneration tax in Nepal is making new taxpayer should be brought into tax net, tax deduction at source should be made more effective reform in income tax policy rules and regulations, reduction in exemption limit and increase in tax rates etc.
8. Remuneration tax system of Nepal is not sound and efficient due to some problems of remuneration tax system i.e. due to defective tax range complexity in income tax policy rules and regulation, unfair and weak administration, high burden of tax on low level income earners, no provision of deducting any expenditure while computing remuneration income etc.
9. Current exemption limit provided to individuals and couple/family are found unsatisfactory and unsuitable on the basis of responses received by respondents. It should adjust some factors that are unsatisfactory and unsuitable due to inflationary condition of the country, average cost of living educating at least two children, number of dependents etc. the current exemption limit should be increased and couple should be given bigger tax exemption limit than individuals.
10. There is less chance of tax evasion in employment income as tax is already deducted at source while receiving salaries. Most of the respondents do not agree with tax evasion. Thus, conclusion can be

drawn as tax evasion is not most often practiced in employment income tax.

11. There is no provision made for deduction of expenses from remuneration income. It is found that this provision is not suitable. Some expenses for deduction to be provided while collecting the remuneration income is medical expenses incurred in treatment of the employee, educating expenses, transportation expenses to go to the office and return back, books and reading materials purchased for the job, leave salary.
12. Educate taxpayer, simplifying tax laws, timely assessment, tax incentives to regular taxpayer, fine and penalties are the sectors suggested by respondents to increase the tax paying habit of Nepalese people.
13. Pension income should not be taxed, as pension income is lower than regular income while in the job and it is inadequate to run the retired life. However the additional 25% exemption limit hardly brings pension holder into tax bracket.
14. Medical expenses paid by employee, Dashain allowance contribution to provident fund paid by employees etc should be tax exempted from the view point of respondents.
15. Tax payers are facing problems while paying income tax such as poor responses from tax administrations mental pinch, hesitation to pay income tax due to low income, procure complications, due to taxation knowledge, unnecessary delays hassles from the tax office in getting tax clearance certificate etc.
16. Tax administration is also facing some problems such as undue delay in making assessment, lack of co-ordination, lack of proper direction,

complicated tax laws, lack of trained and competent tax personnel, unnecessary outside pressure etc.

17. Rules and regulation of the income tax have been found complicated, they need to be simplified, behavior of tax administrators should be improved and they should have the feeling of contribution towards the state.

5.3 Recommendations

On the basis of above analysis, it is necessary to give various recommendations to the concerned department. It may be essential to improve different aspect of income taxation. The following recommendations are offered regarding taxation of employment income.

1. Out of total revenue, the contribution of income tax revenue is very low. So the contribution of income tax revenue to tax revenue should be increased by checking income tax evasion, bringing new tax payers into tax brackets tax incentive programs with the help of sound tax planning, making TDS also effective to increase income tax's share in tax revenue.
2. Income tax on employment income has very much insignificant contribution in total revenue of Nepal. So it should be increased. Contribution of employment income in income tax revenue has been increased in the recent years as compared to previous years. It is a good sign for national economy. The slabs should be made to pay higher income taxes. Filing of income returns by employees should be enhanced for collecting more income tax revenue.
3. Income tax act 2058 is very vague in nature in various aspects of provision of income tax. So income tax act should be made effective in the implementation aspect. And it should be modified by clarifying the

current provisions. Employees should be provided with taxation knowledge so that they will be aware of the existing provisions in force of the income tax act regarding taxation of employment income. They should also be encouraged for tax planning.

4. The income tax act 2002(2058) has no provision of deduction of any expenses while calculating remuneration income. So the provision for deduction of expenses should be provided from employment income as of previous income tax act 2031. Medical expenses, expenses incurred to newspaper, magazine and books, transportation expenses to go and return from office, house rent paid by employees, education expenses etc should be allowed for deduction at a standard amount.
5. Medical expenses paid by employer, Dashain allowance, remote area allowance, life insurance premium paid by employer, contribution to provident fund by the employer, leave encashment etc should be made tax exempted. So that employees will be relieved from heavy income tax burden imposed on them.
6. Pension income should be taxed by giving enough exemption limits as the pension holder becomes of old age and lack of other sources of income. Additional 50% of the prevailing exemption limit should be provided to them, so that the high-income pension holder should only be taxed.
7. Couple should be provided more tax exemption limit as compared to individuals because of their cost of living. The exemption limit should be around Rs 50000 higher than the individuals.
8. Average cost of living of the tax payers, education expenses of at least two children and inflationary condition of the country should be considered to adjust the exemption limit of the individuals and couples and be provided at a standard amount.

9. There are various types of problems that the employees faced while paying remuneration tax. So, the problems and troubles faced by employees should be minimized. Tax administrations should be made more responsible, tax clearance certificate should be provided immediately to the employees after paying income taxes. Taxation knowledge to the employees should be provided, refund of tax should be simplified and minimized. Some provisions of the tax act and rules should be simplified and made understandable and employees should be made such that they do not feel mentally pinched by paying income tax by giving them a sense of contribution to the nation.

10. There are some problems and troubles that the tax administration faced. So the problems and troubles faced by tax administration should minimize. Tax office should recruit trained and competent tax personnel; complicated tax laws should be simplified and made clear. It should not delay in making tax assessment. Co-ordination between top level officer, lower level officer, policy maker and other department personnel should be developed, tax personnel should be trained and motivated, there should be changed the behavior of them, proper monitoring should be made by tax authorities, revenue administration should be made flexible etc.

11. It is very essential to have proper co-ordination and effective working relationship among various concerned authorities for transparent and careful enforcement of existing provision. So efforts must be made in this regard. Moreover, the existing controlling mechanism of the concerned authorities is satisfactory; improvements are needed in these aspects also.

12. Income tax act rules and regulation should be clear and simple for all the taxpayers as well as tax experts and administrators. The language of the act should be simple and clear, the income tax assessment

procedure and tax collection provision should be made clear and simple, so that tax payer would be encourage to pay income tax.

13. The rate of fine and penalties should be increased for those tax payers who submit false income statement and who do not submit income statement for tax purpose.
14. The provision of fine and penalties and punishment should be implemented effectively for income tax evaders.
15. Tax personnel 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.
16. Effective public participation is necessary to minimize the income tax evasion. The continuous effort should be done by tax authority to build the tax payer's positive attitude towards taxation.
17. Government should provide sufficient remuneration to collect more tax revenue, it should be transparent to collect more tax revenue, and it should be transparent in every place.
18. Staff of tax office should develop working culture when the tax payer was in the office, the employees should respect them because they have come to pay tax.
19. Mutual understanding between taxpayers and staff are essential. One should not look on doubt to others as if employees are corrupt and taxpayers try to evade tax.

20. Tax payers should be given details of their tax, implemented sectors. The accountability of their paid tax should be sent on time to their related offices from concerned authorities.

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Questionnaire Asked to Tax Experts

1. Is there any problem in collecting tax?
2. Is employment tax a suitable means of collecting public revenue?
3. Does employment income tax significantly contribute to the income tax revenue of Nepal?
4. What kinds of response do you face while collecting tax?
5. What is the reason do you think of facing such conditions?
6. In your point of view what do you suggest and comment regarding taxation on employment income?

Questionnaire Asked to Tax Payers

1. What is Tax ?
2. Do you know about tax you pay?
3. What kind of importance do you feel to contribute in the form of employment income tax?
4. Are you satisfied to know about your contribution for national development? (Here we suppose all collected public revenue is spent on national development).
5. Is there any problem in paying tax?
6. Is employment tax a suitable means of collecting public revenue?
7. Does employment income tax significantly contribute to the income tax revenue of Nepal?
8. What kinds of response do you face while paying tax?
9. What is the reason do you think of facing such conditions?
10. In your point of view what do you suggest and comment regarding taxation on employment income?