BUSINESS TAX IN NEPAL SPECIAL FOCUS ON EXEMPTIONS AND DEDUCTIONS

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RECOMMENDATION

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Date: September 2013 **Jageshwar Mandal**

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ABBREVIATIONS/ACRONYMS

A.D.	: Anno Domini
B.S.	: Bikram Sambat
CEDA	: Center for Economic Development and Administration
DDC	: Dairy Development Corporation
Dr.	: Doctor
DT	: Direct Tax
e.g.	: For Example
ed.	: edition
eds.	: Editors
et al.	: and others
etc.	: and the other
FDB	: Forest Development Board
FNCCI	: Federation of Nepalese Chamber of Commerce and Industry
Fy	: Fiscal year
GON	: Government of Nepal
GDP	: Gross Domestic Product
i.d.	: the same
i.e.	: that is
I.T.	: Income Tax
Ibid	: in the same place: from the same work given immediately
IRD	: Inland Revenue Department
Ktm.	: Kathmandu
Ltd.	: Limited
MBA	: Master in Business Administration
MBS	: Master in Business Studies
MOF	: Ministry of Finance
Mr.	: Mister
Mrs.	: Mistress
No.	: Number
PP	: Page(s)
Pvt.	: Private
Rs.	: Rupees
S.N.	: Serial Number
T.U.	: Tribhuvan University
VAT	: Value Added Tax
viz.	: Namely
Vol./Vols.	: Volume(s)
vs.	: Versus, against
$	: US Dollar

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

The government of a country has to carry out development plans, handle day-to-day administration, maintain peace and security and launch other public welfare activities. In each country, a lot of fund is spend by the public authority for the protection a common people and for the creation various socio-economic infrastructures. The other type public expenditure is development expenditure. This is the expenditure incurred for providing education, health and public unify facilities to the community. So, the government expenditures are increasing day- by day because of demand of time, increase in price and national income, increase in population, social progress, and so on. The government needs more money to run it successfully. The money that is so much important to the government is called public revenue or receipt. It is received from different sources. These are external and internal sources.

External sources of fund are foreign grants and loans. This kind of fund is received from foreign countries, international agencies and organizations. External sources of fund are more important for undeveloped and underdeveloped countries. It is used for economic development, reconstruction, and foreign exchange, to recover from crisis condition for productive uses (Sharma & Luitel, 2002). But external sources are not good for healthy development of nation because they have to pay after a certain period. So, it is better to mobilize internal sources rather than looking with beggars eyes the donors (Pant, 1996). It reduces the liquidity position of the government, increase over-dependence upon other countries and increase the inflation too. Like developed countries, developing countries try to mobilize their internal sources for regular and developmental activities. Nepal is not exception for it. But Nepal's experience is that it has mobilized internal resources fewer than expected.

Internal sources of the fund is own source within nation. Internal source of fund include both tax and non tax revenue. Continuous use of external sources of fund to raise necessary public fund is not good because it reduces the liquidity of the government, increases over- dependence upon other countries and increase the inflation. So internal sources are more important not only for financing necessary fund but also for proper mobilization of external sources. Internal source has no obligation towards the third party and is less risky compared to the external fund. It is the best source to fund the development activities and can play a vital role in the development process of an economy. Nepal should try to mobilize its internal sources of fund for running the development activities. On the other hand, internal source of fund includes both tax revenue and non-tax revenue.

Public revenue can be classified into two types:

i. Tax revenue and
ii. Non-tax revenue

Tax revenue includes the amounts which are compulsory contributed by tax payers to the government. Tax revenue includes the amounts which are compulsory contributed by tax payers to the government. They are customs, excise duty, value added tax, corporate and personal income taxes. Nepal gets around 80 percent of the revenue from this source. Non-tax revenue includes different revenues like gifts, grants, special assessment and revenue from public enterprises, administrative revenue such as registration fees, fines and penalties. In Nepal, 20 percent of the revenue comes from these sources. Non-tax sources are uncertain and inconvenient because they are imposed according to the necessary to the government. So, taxes are the better sources of public revenue. The use of taxes is safer for financing public revenue in developing countries. So, taxation has been taken as the best and effective tool for raising the government revenue.

A compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred (As referred by I & Koirala, 2008, Prof. Seligman).

Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefits upon the residents of the states (As referred by I & Koirala, 2008, Plehn).

So, a tax is a compulsory levy imposed by the government. It is levied on persons as per the prevailing laws. The person, who pays tax, does not get any direct benefit from the government. It is a compulsory liability of the person who has to pay tax. The collected tax is spent for common interest of the people or it is collected from haves and spent for the interest of have-nots in the society.

Generally, taxes are categorized into two types. They are:

- Direct Tax
- Indirect Tax

These taxes are collected according to income level of people or Organization. If one pays or to be paid tax to the government from his/her own income it is termed as direct tax. Or, direct tax is a tax paid by a person on whom it is legally imposed. And it is a tax on income and property. Examples of direct taxes are: Income tax, property tax, vehicle tax, interest tax, expenditure tax, death tax, gift tax etc.

An indirect Tax is a tax imposed on one person but partly or wholly paid by another. In indirect tax, the person paying and bearing the tax is different. It is the tax on consumption or expenditures. Examples of indirect taxes are: Excise duty, custom duty, VAT, sales tax, import and export tax etc. It is considered as one of the major elements of tax revenue.

Income tax is most popular direct tax. It is considered as one of the major element of tax revenue. Income tax is charge on person’s income according to the law of nation. It covers all the fees, additional fees, fines etc. Income includes all the income, which are received from employment, business and investment. Income tax is superior to other taxes because it is imposed on the basis of paying capacity of tax payers. People, whose income is under the taxable income is free from the incidence of income tax. According to income tax Act, 2058, there are two forms of incentives. They are: exemptions of income and deductions of expenses.

An exemption may be in the form of non-taxation of an income or in the form of relief on a payment or expense which is otherwise not allowed or deducted in computing taxable income, profits or gains (GON, 1960).

Within the income tax system, deductions and exemptions are more important for knowing about income tax because they used continuously and treated differently year to year. To make up-to-date knowledge about income tax system, it should be known. By knowing it, we can compute net income and tax liability. Income tax law of every nation must clearly mention about the exemption of income and deduction of expenses.

Income tax reduces concentration of wealth in a few hands by imposing high rate to those persons and organizations have high level of income and low rate to those whose income level is less. It also helps to increase the government revenue, which can use for public welfare to development infrastructure, provide general service etc. People who are paying tax to the government expend the revenue in good manner. Income tax is not only essential for collecting government revenue but also to control consumption to promote saving and generate more employment.

First of all, income tax system was introduced in England to manage the war. Similarly, to manage the civil war, USA introduced corporate income tax in 1862. In 1909 Federal Corporation income tax was originated. Now a day it is expanded all over the world. Every nation is introducing income tax according to their needs.

In Nepal, the first elected government in 1959 introduced “Business Profit and Salaries Tax Act 1960.” At that time, income tax was levied only one business profit and salaries. In earlier days both individual and corporate tax was taxed on progressive rate. The government replaced the prevailing tax act by “Income Tax Act 2058” is in implementation.

Income tax plays a very important role in the economic development of Nepal. It is a tool of achieving maximum social and economic objective as laid down by the constitution of Nepal. Taxation in the modern world has been taken as the best effective tool for raising the ratio of saving of the national income (Pant, 1996). It is also recognized as a good financial tool to make narrow the inequality in income. It reduces the regional economic unbalance by providing tax concession and holidays to the business or industry, which is established in remote and backwards area. Income tax is essential not only for collecting government revenue but also to control over consumption, to reduces inequality of income and wealth to promote saving and investment and to accelerate economic development (Joshi, 1998).

It is no doubt that income tax is the main source of government revenue. It is also usable in the balance economic development. Nobody can doubt that, the distribution of income of income is also possible through progressive income tax rate. The percentage of income tax in government revenue is increasing trend, but government is unable to maximize the share of income tax to the public fund as per expectations. Income tax is assessed on yearly basis.

Although the legal provision has been made and updated timely, there are many problems about income tax and exemptions and deductions. There are many problems in income tax practice in Nepal such as: leakage in tax, feeling of people about tax as a penalty, lack of consciousness of people, inability of tax administration to cover new tax payer, delays in computation and collection, lack of accuracy and unity in accounting system etc. (Khadka, 1994). The main objectives of taxation are more revenue collection. Exemptions and deductions play important role to collect the tax. Because of all these reasons exemptions and deductions of income tax system must be reviewed and immediate correction can be made.

1.2 Statement of the Problems

As other developing countries, Nepal is in need of huge capital investments for invest in existing as well as new development purposes. The government has to make heavy spending on the several overheads. The funds required to make expenditure for development activities can be obtained by two sources: External sources and internal sources. The external financing depends upon the interest and the conditions of the funding countries and agencies and internal sources has no obligation towards the third party and less risky compared to the external funds.

Under developed countries are facing various problems in process of economic development. Nepal is not an exception to this condition. Nepal has facing very serious problem of resource gap highly dependency of foreign loan and grants. Taxes are important sources of public revenue. It is the major instruments to increase the rate of capital formulation to achieve high rate of economic development. Higher resource mobilization is the best option of healthy economic development for the nation.

People in developing nations tend to have greater propensity to evade taxes. This is because, they have lesser knowledge about income tax and they have to maintain their livelihood from their limited income. Rich people are avoiding taxes by using legal loopholes and taking advantages of an inefficient tax administration. The coverage of income is very narrow in Nepal. For example, agricultural income is exempt from income tax widespread income tax evasion, complicated and frequent change in the tax rate and policies etc. are major factor for low contribution income tax revenue at present.

Nepal’s low revenue collection is due to poorly design and defective tax system where the taxes are less productive, less responsible and distortion. In Nepal, the coverage of income tax is very low. Only 0.5 percent of the total population pays the income tax. There is poor taxpaying habit of Nepalese people. Tax authorities are inefficient and ineffective in enforcement. Tax offices are looked upon as heaven for corruption, harassment and incompetent personnel are other major problems. The assessment produce of income tax is ineffective. There are no integrated programs for taxpayer’s education, assistance, guidance and counseling.

Income tax act has provided some exemptions granted to the special industries and the industries established in the backward areas of Nepal are not effective and scientific. Although tax incentive or concessions encourage or support to establish industries in certain area but they vanish or change name, ownership or place of the business when the tax exemptions and concession period expires.

Income tax act has also provided exemption limit to an individual into two distinct categories in Nepal. They are individual and the family according to the personal status. This classification does not discriminate between a taxpayer having only a spouse and a taxpayer with a spouse, parents and children. Therefore this limit is the Nepalese context neither shows any specific or definite relationship with per capita income nor with the rate of inflation nor with poverty norm.

In Nepal the present deductions allowed are the provident fund contribution of the taxpayers, the life insurance premium, the contribution and the investment on the Citizen Investment Fund, Medical expenses, Research and Development, Pollution control cost. Besides these provisions, the tax deductible expenses are the donations made for non-profit earning institutions and other expenses as mentioned above. At present, there is no any provision for deduction on the necessary expenses like the higher education expenses, pregnancy delivery expenses, incurred by the taxpayers or his/her dependents. However, various problems of exemption and deductions can be stated in terms of the following research questions.

- Is the tax administration system of Nepal Sound?
- Are the exemption items of income and exemption limit being provided by Income Tax Act are sufficient?
- What types of income is prioritized for exemption?
- What types of expenses is prioritized for deduction?
- Is the contribution of income tax to national revenue of Nepal satisfactory?
- Are the provisions made under the Nepalese Income tax Act sufficient in all aspects?

1.3 Objective of the Study

General objective of this study is to gain and insight into the exemptions of income and deductions of expenses and give appropriate suggestions to improve the tax system so that the government can collect more revenues and use them in the process of national development. The study does not only help the government to collect more revenue but also make the concerned people aware about the exemption of income tax and deduction of expenses. However, the specific objectives of the study are as follows:

- To know the tax administration system of Nepal.
- To analyze the exemption of income under prepailng Income Tax Act.
- To measure the extent of exemption limit provided to individual, couple and the family.
- To analyze the deductions of expenses which are allowed by the income tax Act.
- To analyze the contribution of income tax to national revenue of Nepal.

- To provide suggestions and recommendations regarding income tax administration and income tax law of Nepal.

1.4 Scope of the Study

The purpose of the study is to analyze the exemption of incomes and deduction of expenses provided by the income tax act, contribution of income tax to the government revenue and the extend of exemption limit provided to individual and the family. It also aims to suggest and recommend regarding income tax of Nepal. The sample space for the opinion will be taken from tax administrator, tax experts/auditor and taxpayer.

The scope of the study covers the following aspects of Income tax system of Nepal.

- Exemption and deductions of income tax.
- Structure of government revenue in tax.
- Contribution of income tax to the government revenue and GDP.
- Administrative aspects of income tax in Nepal.

1.5 Importance of the Study

Developing country like Nepal requires higher magnitude of financial resources for the development program. Internal resources have more significant role than the external resources for developmental program. The income tax is one of the most important internal sources of government revenue. Among the internal resources income tax plays significant role in the economic. But it is a matter of great unpleasures to quote that the contribution of income tax to the national revenue is very low in Nepal. To increase the contribution of income tax to the national revenue, problem faced by the income tax system should be researched and analyzed objectively and then the corrective actions should be started few studies and research works have been conducting in the area of income tax in Nepal. Within income tax, the intensive study on tax exemption and deduction hasn’t been done in Nepal. Most of the researchers are based on contribution on income tax or national revenue. They are not giving main emphasis to research on exemption and deduction topic which is maintained in Income Tax Act. Due to this context need and significance of this study can be known easily.

1.6 Limitation of the Study

The present study aims to analyze on exemption of incomes and deductions of expenses in Nepalese Income Tax. It is not a complete study of income tax system in Nepal. The limitation of the study can be stated as follows.

- It is based on exemption of incomes and deduction of expenses but not as a complete study of income tax system.
- In the context of Nepal related sectors still are unable to provide relevant data properly. There is no systematic data base that makes it difficult to carry out on any research in Nepal. Sometimes authority person do not want to provide relevant information, this problem is also incorporate with this study.
- Opinions of the respondents have been taken as a sense of truth which may not be correct at all time.
- Both primary as well as secondary data are being used, but the reliability of secondary data has not been examined.
- It will prepare on short time base on limited sources. The outcomes of this study may not represent the extent of the problem for the country as a whole.

1.7 Organization of the Study

The structure of the study has been organized into five chapters, they are as follows:

I. Introduction
II. Review of literature
III. Research methodology
IV. Data presentation and analysis
V. Summary, conclusion and recommendations

Introduction: The first chapter is introduction of the research study which comprises background information, statement of the problems, objectives of the study, scope of the study, need of the study, limitations of the study and organization of the study.

Review of Literature: The second chapter is the review of literature. Some books, annual reports of Nepal Rastra Bank, Inland Revenue Department, Ministry of Finance, Statistics Bureau, dissertations, articles, news, magazines and necessarily materials have been reviewed for the study.

Research Methodology: The third chapter is research methodology. This chapter comprises research design, population and sample, nature and sample of data, data gathering procedure, data processing procedure and analysis of data, weight of choice and weight of respondents have been described.

Data Presentation and Analysis: The fourth chapter is the main body of the study includes with presentation, analysis and interpretation of data. Different tables and diagrams are also presented in this chapter. It also includes the result of opinion survey about the efficiency and effectiveness of new act and major findings also presented in this chapter. On the basis of analysis, it will try to find out whether the income tax system in Nepal is satisfactory or not. It describes the problems and weakness of tax administration too.

Summary, Conclusions and Recommendation: The fifth chapter is mainly concerned with summary, conclusion and recommendations. In the beginning of the chapter, the major findings have been presented about the exemption and deductions of income tax system, tax structure and administration aspects of revenue administration. Some possible areas for reform the defects in income tax system have been recommended.

Bibliography and Appendix have been presented in the last part of the study.

CHAPTER- II

REVIEW OF LITERATURE

This chapter deals with the literature relevant to the study. Review of literature is basically of stock taking of available literature in the field of research. It supports the researcher to explore the relevant and true facts for the reporting purpose in the field of study. It develops expertism and help to find out contributions done. Literature review also help to know that what is uncovered and it will be clear that how the present studying relates with past. Literature review guides not to conduct the study on already conducted area. Thus Literature review established starting point for further research avoids duplication and reveals the research needed area.

To deepen knowledge and understanding about the subject matter. Some literatures related with the study were reviewed. It includes the conceptual review and Review of some previous studies.

2.1 Conceptual Review

Great Britain is the first country in the world to introduce the modern income tax system. She introduced income tax in 1799 in order to generate revenue of finance the war fought with France.

While the history of income tax was not bright, the situation is different now, Income tax has been an important element of the modern tax system. All sorts of countries have been adopted this tax as an important instrument to generate revenue required to finance state activities. This tax is also considered as fairest tax since it can be tied with the taxable capacity of the taxpayers.

The finance act annually prescribes tax rates classifies some of the procedures mentioned in the income tax act, where as income tax act governs procedure, penalty and administration of taxes. Hence the provisions and procedures of income tax can be analyzed only by the study of both the income tax exemption and deduction was started since the enactment of the first finance act in 1959 A.D. Since then the tax exemption limit and deduction have been revised several times.

Income tax act 2058 is in practice since 19/12/2058 BS replacing the existing income tax act 1974. There are various up to date provisions in this act. They are:

- Classification of sources of income into 3 classes (1) Business (II) Employment (III) Investment.
- Definition of income as "A person's income from any employment, business, investment or in accordance with this act. It includes all kind of income received for the provision of labor or capital or both in whatever from or nature in the taxable income.
- Provision of natural person or couple for husband and wife.
- The act has granted the rights and secrecy for taxpayers.
- Offence is divided into two parts (I) civil offence and (II) criminal offence. So in the penalty. The tax officer can levy only charges and interest while the court levies penalties and imprisonments.
- The rate of income tax is determined in the act itself for the first time, which used to be determined, by the finance act in the past.
- A person in defined as a resident whose place of ad\bode is in Nepal and who is present in Nepal at any time or who stays in Nepal for 183 days or more within the income assessment year or who is an employee of G/N Nepal posted abroad during the income year.
- There is provision of deduction related to overhead cost while calculating assessable income from business and investment.

- Government allowances to under privileged person (such as widows, elderly citizens or disabled citizens) and gift, bequest, inheritance, scholarship, income of foreign officials, government bodies and non-profit making organizations have been exempted from the income tax. Income of a person privileged under unilateral or multilateral treaty, an agriculture income, and income of co-operative societies based on agriculture products and dividends of such society etc. are also exempted from income tax.

- There are limited exemptions as compared to previous acts.

- A resident person may claim a foreign tax credit to the extent of average Nepalese income tax rate with respect to person's taxable income for the year.

- The IRD is responsible for the administration of the act.

- Resident individuals and domestic companies are taxed on worldwide income basis whereas non-resident individuals and foreign companies are taxed on source income basis only

- Company is separated from its shareholders. The bonus share, loans and advances to director and shareholders, distribution made on liquidation etc. are also taxed.

- Approved retirement fund is free from income tax.

- Tax on capital gain: Business capital gains are taxed as an ordinary income whereas gains from non-business assets such as land and building, securities etc. are taxed at a flat rate of 10 percent.

- The act has adopted global income tax principle and has brought all sources of income to the tax net and has treated in the equal manner.

- The act has adopted global income tax principle and has brought all sources of income to the tax net and has treated in the equal manner.

- The act has adopted a pooled system of depreciation in which assets are broadly classified into five categories. The depreciation rates are 5%, 25%, 20%, 15% for A, B, C and D respectively which are based on diminishing balance method and that class E, the rate is based on straight-line method.

- There is provision of medical tax credit under which resident individual may claim up to 15% of approved medical costs.

- The main feature of this act is self-assessment and every assessment is treated as self-assessment. The tax officer can determine only the amended tax assessment within four years of self-assessment. 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 business activity in any department or in Nepal. There is no time limit in this case.

- Presumptive tax is limited to the small tax payers whose annual turnover is up to Rs. 1.2 million and net income is up to Rs. 120000 and the lump sum tax is 2000, 1500 and 1000 for sub-metropolitan city, Municipality and village development committee area respectively.

- The act has made the provision of administrative review to correct the administrative mistakes effectively by taking appropriate decision within 90 days or the submission of objection to the director general of the IRD. If the department does not give its demission within the given time limit, tax payers can appeal to the revenue tribunal.

- There is a provision of functional division of was in IROS. The division is to be made under the direction of G/N and tax officers are under the direction of G/N and director general.

2.1.1 Review of Books

Brief review of different studies has been performed in this research study. The researcher has consultant many books, dissertations, articles, annual reports of different institutes, news, magazines, published and unpublished materials concerning with income taxation during the thesis writing.

While reviewing the books, it was found that most of the books were syllabus wise oriented but some of them have described the problems and prospects of income tax system and a path for reform of income tax. Similarly, most of the dissertations have described the income tax laws, provision, structure, problems and prospects, contribution of income tax etc. there were no any detailed studies made on the topic of income tax exemptions and deductions. Although, some books of taxation are useful and helpful for this research work which are briefly described below:

Poudel & Timilsina (1990) had described the provisions and laws related to income taxation of Nepal in a book named "Income tax in Nepal". This book is extremely based on the syllabus of B.Com. They were described the theoretical as well as practical aspects of income tax. He has not analyzed the role of income tax, income tax structure and defects of income tax in Nepal. The book was descriptive rather than analytical.

Tiwari (1993) published a book named "Income Tax System in Nepal." He described the legal provisions relating to income. He described the process, provisions and methods to assess the income with numerical examples. The book was based on T.U. syllabus. Tiwari did not describe the role of income tax in economic development of Nepal and problems of income tax system. His book was descriptive of legal provisions rather than analytical.

Dhakal (2000 A.D) published a book named "Income tax and House and Compound Tax and Practice with VAT." Dhakal described the legal provisions relating to income tax with numerical examples. This book is very useful to know about legal provisions of income tax act 2031 B.S. Dhakal was fully based on T.U. syllabus. His book was informative/descriptive rather than analytical. He did not mention the role of income tax and the structure of income tax.

Adhikari (2003) published a book named "Income Tax Law: Then and Now." Adhikari described the legal provisions of new income tax act 2058. Adhikari also described the decisions made by Supreme Court about the income tax. Adhikari described the legal provisions with critical analysis. His book was very useful to know the new income tax act 2058 but not analyzed the role of income tax and income tax structure.

Bhattrai & Koirala (2004) published a book named "Income Taxation in Nepal with Tax Planning and VAT." This book was published second, third and fourth time in

2004,2007 and 2008 respectively. This book has described the legal provisions with critical analysis. This book has theory and enough practical problems. Critical and comprehensive problems are given. This book also has added income tax act, 2058 (as amended by Finance ordinance, 2061) and value added tax act 2052 (as amended by Finance Ordinance, 2061). This book has also described the tax planning and VAT but not described the role of income tax and income tax structure.

2.1.2 Review of Some Articles, Reports

Some articles, reports. Were reviewed for this study, which are described briefly below

Agrawal (1978) in his study of "Resource Mobilization for Development: The Reform of Income Tax in Nepal." Presented to CEDA, T.U. described the different concepts of income tax. Agrawal described the resource mobilization through income tax, fiscal policy, role of income tax, legal provisions relating to income tax, legal aspect of income tax, administrative aspect of income tax etc. Agrawal identified the major problems in income tax system as inefficiency of tax administration and tax evasion. Agrawal observed that the tax authorities were insufficient in enforcement of law. There were no integrated programs for taxpayers' education, assistance, guidance and counseling. Tax office was taken as heaven for corruption. Delays, unfair dealing, insufficiency, harassment and incompetent personnel were the major problems of tax administration.

About the exemption and deductions, Agrawal suggested to increase the exemption limit from the range of Rs. 8000 to Rs. 12000. On his study, the income tax exemption limit was Rs. 6500 for an individual, Rs. 7500 for a couple. Agrawal also suggested providing additional deductions to the salaried taxpayers for educational expenses, medical expenses and house rent and he was favoured for more progressive rates of income tax.

This study is very useful to find out the reality about the income tax in Nepal. This study was a comprehensive and included. Various aspects of tax system of that period, all things mentioned in it are not fully relevant today. But some of the problems identified in it are still inexistence. Agrawal described various aspects of income tax but he did not describe business expense. Agrawal did not conduct any research on business expenses as exempted income too.

Ghimire (1993) analyzed the principle of direct tax and provision of direct tax. Ghimire described the classification of tax, relation of capital and income, base of income or expenditure tax, procedure of computing income, weakness of traditional accounting system classification of tax rates index, index of income tax in Nepal, contribution of income tax to national revenue, errors of past provisions, briefication of tax improvements, etc. Ghimire found that the income tax was only 7% of total revenue that was very low as compared to neighboring countries. For this, he has identified the following causes: No taxation on agricultural income, narrow base of income of retail business, high exemption limit on remuneration income etc. Ghimire accounted the improvement made on income tax like provision of tax collection of source, provision of self assessment of tax, increase in additional fee to remove tax evasion etc. It also described some steps of administrative improvement. They were provision of income assessment committee, flat rate of tax to small taxpayers, establishment of tax offices etc.

Bhattarai (2000) critically analyzed the income tax facilities provided by Industrial Enterprise Act 2049 in his draft, Income Tax Facilities provided by Industrial Enterprise Act 2049, an analysis of Rajaswa."Bhattarai described the facilities given to the industries. Bhattarai also critically analyzed these facilities as continuous 7-8 years exemption of income tax would develop the tradition of taking exemption by incorporating legal ways. The deduction allowed on modernization industries, pollution control device, product and technology development, sales promotion expenses etc. would protect only the big industries but not effect to the small industries. Provisions made on advertisement and entertainment or hospitality expenses would create rude on income tax because if it was given to the all industries in the same manner. There was a provision of exemption of income tax of an industry which did not get exemption but reinvested on non-exempted industry. This provision exempts the tax to the industry of alcohol, tobacco etc., if an industry reinvest on non-exempted industry. Periodic exemption of tax would create bad effects such as change in signboard, change in name and change in ownership to own family members.

Kandel (2003) published a draft of Income Tax Act 2058 as a critical analysis. Kandel criticized the ITA 2058 on several grounds such as exemption of agricultural income from income tax; export duties levied on export inequality between different capitals earned income, withdrawal of exemption and adjustment for inflation. Kandel futher criticized the act for the provision of income tax from export as 0.5 percent of total export because it is not good choice of income tax base.

Pant (2004) presented an article entitled, "Problems in Tax Administration and their Remedies" published in journal of Finance and Development. Pant comprehensively explained about the problems and their remedies related with tax revenue. The major types of practical problems and challenges, in tax administration he has mentioned in his article are, showing limited amount of transaction, showing low selling price, lack of issuing and taking bills, lack of showing the real factory cost, commercial fraud, lack of cooperation in tax auditing legal ambiguity and complexity is implementation and lack of coordination between Inland Revenue Department and revenue investment unit. Meanwhile Pant has recommended some valuable suggestions to solve the problems and to overcome the challenges. They are, statistical and information system should be properly managed fixed norms and standards should be made compulsory, coordination between Inland Revenue Office with various entities, revenue investigation department and its related units should play the important role and auditing of tax should be widened etc.

Thapa (2004) published a draft of tax system and its reform in Nepal as a descriptive way. Thapa described the tax system features of tax, causes of reform the tax and areas of reform. Thapa characterized the tax system as high rates, and tax holiday multiple objectives of taxes, too many income brackets and high progressively complicated and ambiguous tax laws.

Thapa identified the areas for reform the tax system in Nepal. They were:

- Simplicity and neutrality,
- Low tax rates on broad base,
- Gradual abolition of exemptions, deductions and to broad tax base,
- Few rates for single rate,
- Few taxes with high revenue productivity,
- Emphasis on tax compliance rather than coercive enforcement,

- Incentives to saving and investment,
- Excise duty only on cigarette, tobacco, alcohol, automobiles, petroleum and automobile spare parts, etc.

Kandel (2004) presented an article entitled, "Are Tax Incentives Useful?" If so, which one?" published in Journal of Finance and Development. In this article Kandel tried to seek the answer form the survey of various empirical studies earlier done in Nepal, India, Pakistan and other investment countries. Kandel found that the tax incentives are still the controversial matter whether they promote the investment or not. But Kandel argued that most of the developed countries used tax incentives.

As per the studies done in various countries the conclusion in that among different types of tax incentives, investment allowance or investment tax credit and accelerated depreciation are superior to other types of tax incentives. Tax holiday is the most inferior type of tax incentive which causes revenue loss without enhancing the investment environment. Meanwhile, most of the researchers have opposed the tax holiday system both within Nepal and outside Nepal.

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

In 2010, June, Nagrik daily presented news entitled, "Focuses on Efficiency of Budget Rather Then Size" in this news it tries to present the size of budget for coming FY and revenue collection of last year. In this news it presents the view of representative of industrialist and businessman. One of the representative said that the government should remove the export fees and also demand that the government should give incentives to the export business.

He also added that the exemption limit should be extended to Rs. 200000 and Rs. 300000 respectively to individual and family or couple. The corporate tax rate should be decreased to 20% from 25% and also the provision of house rent should be changed. The government should collect tax from owner of the house not from the rent payer.

The representative also demands that the VAT should be brought under the multi-rate system. The government should give VAT rebate on agriculture industry, tourism industry, bricks industry and cold storage industry etc.

In 2010 June, Kantipur daily presented news entitled, “Demand to Reduce Corporate Tax Rate” in this news Kantipur reporter tries to present the view of the representative of Nepal Pari Sangh on Nepalese corporate income tax rate. He present that the representative demanded to reduce the corporate income tax rate from 25% to 20%.

He also presents the view of representative on exempt limit. According to this news the present tax exemption limit is not sufficient and the limit should be extended to Rs. 250000 and Rs. 300000 respectively to individual and family.

He also present that the government should remove tax on foreign investment

Gain, VAT should bring under multi-rat system; the government should remove export service fees and also reduce penalties from 25% to 10% on provision of unable to export.

2.2 Review of Related Studies

Some dissertation and thesis were reviewed for this study. They are as follows:

Tuladhar (1979) presented a dissertation named “Role of Income Tax in the Mobilization of Domentic Resource in Nepal.” Tuladhar described the trends of revenue from income tax, structure of income tax, taxes as percent of GDP, per capita burden of income tax, agricultural income tax, elasticity and buoyancy of income tax. Tuladhar described the role of income tax in the mobilization of domestic resource for the economic development had been increasing significantly. The growing share of income tax to the total revenue indicated that the tax would be the major source of revenue in further. According to him, tax efforts in Nepal seemed quite insufficient. Tuladhar further added that consistent efforts should be made to mobilize resources for development through taxes.

Tuladhar suggested widening the income tax base, income tax holiday to new industries, simple and easy tax law, reformation of income tax administration, research in income tax, but Tuladhar did not mention the legal provision relating to income tax. Tuladhar accounted the exemptions and deductions too.

Suwal (1981) presented a dissertation named “Income Tax System in Nepal.” In her study, Suwal studied the problem of financial resource gap in Nepal. Suwal also analyzed the resource mobilization and income taxation in Nepal, direct and indirect tax along with their relative importance, origin, definition and concept of income tax, importance of income tax on overall tax structure and the role of income tax system in the process of economic development.

Her finding about the main reasons of tax evasion were absence of a clear and comprehensive definition of income, lack of tax consciousness of Nepalese people, loopholes, widespread illegal business activities open borders, high tax rates, corruption etc. Similarly her finding about the problems of income tax in Nepal were lack of accounts and records of taxpayers, delays in tax administration, lack of responsibility and honesty among the tax officers, tax evasion etc. Which are more relevant now a day also?

Suwal concluded that the tax structure of Nepal is failed to make account of the prevailing economic structure and pattern of income distribution. More effective use of income tax is needed for structural change and has to be implemented and designed deliberately.

Nepal (1983) presented a dissertation named “A Study on the Problems and Prospects of Income Tax in Nepal.” Nepal described the fiscal system of Nepal, tax structure of Nepal and an opinion survey of the problems and prospects of income tax in Nepal. Her findings about the problems of income tax were lack of account keeping by the taxpayers, narrow tax coverage, lack of cooperation between the taxpayers and departments, lack of tax education, assessment deficiency etc. which are considerable at now. Nepal mentioned that the future income tax is good because it is growing year to year. Nepal has taken an opinion survey of 10 tax officers and 25 taxpayers about the different aspects of income tax. About the exemptions and deductions, she has taken opinion survey of exemption limit. Nepal conducted an opinion survey of the appropriateness of exemption limit. Out of 10 tax officers, 9 were in positive response and 1 was in negative response about the appropriateness of exemption limit.

Similarly, out of 25 taxpayers, 9 were in positive response and 16 were in negative response. Nepal has also taken an opinion survey of adjustment of exemption limit according to the inflation, out of 10 tax offices, 8 were agreed to adjust and 2 were disagreed. About taxpayers, 23 taxpayers were agreed to adjust and 2 were disagreed. On the widening the percent income tax coverage, all total (10) tax officers were agreed and all total 25 taxpayers were agreed.

Her suggestions about the tax rate and exemption limit were that it should be elastic, scientific and progressive. The exemption limit should be separated to the couple and family. But only the increase in exemption limit would not create benefit. If exempted income is spent in luxurious consumption, it would hamper saving and investment. Nepal did not mention the legal provisions relating to income tax, exemption incomes and deductions of expenses.

Regmi (1986) presented a dissertation entitled “The Role of Income Tax in Nepal.” Regmi described the conceptual framework of income tax, structure of income tax, income tax and resource mobilization, problems and income tax. Regmi has also described the objectives of income tax. Regmi has given more concentration on the study of tax structure of Nepal. In his study, Regmi found the share of indirect tax was more than 70 percent of total tax revenue in 1981/82. The share of direct tax was about 30 percent of total tax revenue. Within direct tax, the share of income tax was 17.29 percent in 1972/73 which was increased 35.68 percent in 1981/82.

Regmi found the problems of income tax, they were lack of maintaining the record of taxpayer's assessment delays, lack of responsibility and honesty among the tax officers, tax evasion, corruption, lack of coordination between the various revenue and other non-revenue departments, leakage in personal income tax collection.

Regmi has given suggestions about the income tax were, income tax law should be clear and precise widening the tax coverage, application of scientific assessment method, simple and easy procedure of tax payment. Honest and efficient staffs, coordination between staff and departments, establishment of research unit, tax holidays to new industries. Although, Regmi did not mention the legal provisions relating to income tax. His topic was about the role of income tax but he did not describe any role of income tax, any numerical examples and mention the exemption and deduction.

Shivakoti (1987) accomplished a research entitled “Analytical Study of Income Tax in Nepal.” Shivakoti presented the concept of income tax along with its historical perspective, role of income tax in Nepal, income tax structure of Nepal, problems of income tax administration in Nepal. Shivakoti also explained that the taxation plays an effective way of mobilizing internal and external sources adequately.

Shivakoti further added that taxation policy in a developing country should include three objectives: First, it should promote saving in the private sector. Secondly, it should reduce wide gap between income of few rich and poorer. Thirdly, it should not have undesirable inhibiting effects in terms of inflationary pressures and it should be or counter inflationary in its action. According to him, income tax plays a vital role for the development of the country. It reduces the unequal distribution of wealth among people and is a suitable method to collect funds. In case bridge the increasing gap of disparity of income. For this purpose, higher income group has to pay more tax and lower income group has to pay less tax.

Shivakoti concluded that income tax has been a pivotal element in direct tax and equally significant for the government revenue in Nepal. But its significance does not seem to have achieved equal attention on the part of the government.

Shivakoti also recommended for a deliberate program of tax information to awareness to the public so that they can feel that to pay tax is to contribute to the economic development of the country. Likewise, tax administration should be honest, efficient, trained and effective-research unit should be established. Shivakoti further stressed to keep up to date information in tax offices to reduce the delay in the assessment. The personnel working should be encouraged through awarded on the basis of performance and also computer and other scientific equipment should be used.

Acharya (1994) did a research on “Income Tax in Nepal” A study of its structure, productivity and problem” T.U. Acharya described the structure of income tax, productivity of income tax and problems of income tax system. He presented some numerical and diagrams of structure and productivity of income tax. His study about income tax was not so detailed because he did not explain the provisions relating to income tax and his study was more concentrated on the problems of income tax system. Although, his findings about the problems of exemption limit and allowances were considerable and accountable. Acharya showed the problems of exemption limit as follows:

- Exemption limit being equal to remuneration taxation taxpayers and business individual does not seem reasonable. The exemption limit for remuneration taxpayers should be comparatively higher than the business individual.

- The exemption limit in the Nepalese context neither shown any definite relationship with per capita GDP nor with the rate of inflation nor with poverty line so it seems to be unscientific. His findings about the problems with allowances were as follows:

➢ Fifteen percent depreciation allowances for corporate taxpayers seem to be inadequate.

➢ Private boarding schools running now a day are basically inclined with profit. They are excluded from income tax, which is not reasonable.

➢ One and two percent deduction of the total income from trade, industry, profession and vocational for advertisement and guest hospitality, respectively seem to be low.

➢ Allowances for remuneration taxpayers are not scientific in specifying the figure in obsolete term also. Only the proportional figure is recommended, otherwise these should be frequent adjustment in income tax act, which is not so practical.

➢ Additional allowances are lacking for specific industries provided that they are feasible in the Nepalese economy. Tourism industries, cooperative organizations in rural sectors etc. are in this category and should been encouraged. On the other hand, the special allowance for export income of industry does not seem essential such as for carpet of garment industry. It is because those small business investors are unable to export their products.

Tripathee (1995) presented a dissertation entitled “Income Tax System in Nepal and some potential Areas for reforms,” T.U. In this study, Tripathee tried to show the tax structure in Nepal, role of income tax in Nepalese economy, income tax administration and tax evasion in Nepal along with reforms.

Tripathee has more emphasized on the income tax administration and tax evasion. Tripathee conducted an opinion survey about the sufficiency of tax incentives and tax holidays to the industries. Tripathee took a sample of 26 respondents, out of them 16 respondents were in positive response and 10 respondents were in negative response about the sufficiency of tax incentives and holidays. According to the respondents following reformatory activities should be performed.

- The industries, who invest Rs. 500,000 or more, should be defined as employment oriented industries.
- There should be prize system, which may be as the form of tax incentives or tax holidays to the taxpayers.
- The period of tax holiday should be extended for industry, which utilized Nepalese raw materials and produces handicrafts. The period of tax holidays should be extended 10, 8 and 5 years instead of existing period of 7, 5 and 2 years respectively.
- For the expansion of industry, additional incentives should be provided.
- The items of deduction should be added.

Tripathee suggested should to increase the exemption limit of Rs. 25,000 to Rs. 30,000 for an individual, Rs. 35,000 to Rs. 40,000 for a couple and Rs. 35,000 to Rs. 50,000 for a family.

Tripathee’s suggestions about deduction of expenses of remigration taxpayers were as follows:

- Expenses for better education of their children not exceeding the amount of Rs. 10,000 p.a.

- House rent allowances not exceeding Rs. 12,000 p.a.
- Educational expenses for taxpayers himself. If he is studying in an educational institution. His dissertation is very useful to further study about income tax purpose. But he did not include the exempted items of income and business expenses and also not mention about the legal provision relating to income tax system.

Kandel (2000) presented the Ph.D. thesis entitled, “Corporate Tax System and Investment Behaviour in Nepal.” He undertook the research work to find out the problems relating to corporate tax, which blocks the development of the private investments. The main objectives of his study were to evaluate the corporate tax system in general to examine the sensitivity of certain policy like inflation, capital gain tax, dividend tax and interest tax etc. based on their impact on tax burden. Kandel showed the relationship of private investments with average effective tax rate (AETR), Marginal effective tax rate (METR) and tax incentives in Nepal. Kandel found that the METR for debt-financed project are almost negative i.e. (-17%) and positive for equity financed project and debt equity ratio project by 27% and 19% respectively. Kandel has also found the impact of inflation to the METR. According to him, the statutory tax rate deduction had impact on private investments by 60% to 20%. In his regard, he showed the adjusted R value 0.87 at 5% level of significance. Kandel concluded that the statutory tax rate was in moderate level under the financing options: debt mix and equity i.e. it was not much distortive. The relationship between inflation rate and effective tax burden in Nepal was negative.

Shakya (2003) submitted a thesis entitled, “A Study on Income Tax Collection form Commercial Banks.” The thesis report was aimed to evaluate the contribution of income taxed paid by commercial banks in the government revenue, point out main income tax related problems faced by commercial banks, analyze relevant options and views of bankers regarding income tax, put forward necessary suggestions and recommendation for income taxation with reference to commercial banks.

Shakya found that during the five years direct tax revenue has contributed 20.01 percent in an average on total tax revenue and it was 79.99 percent of indirect tax revenue. Shakya also pointed out some problems pertaining corporate tax has been found in the course of investigation. Thesis problems are: assessment delay, undue delay in settlement of fixed appeals with revenue tribunal, negative attitudes and have been affecting in the profitability of banks. Increasing compliance cost and decreasing corporate tax collection. Shakya has recommended that the private investment from domestic as well as from foreign countries should be encouraged so that economic transaction in the national economy would be increased and boosted up when private institutions invest in different sectors, the banking transactions would also be increased and they make higher profits. As a result, corporate tax collections from those sections as well as from other new corporate sectors would be increased. From this, the government has to show the flexibility in making various laws relating to trade, industries and banking to make incentives in order to form new corporate.

Kafle (2004) presented a dissertation named, “Income Tax Contribution from Nepalese Public Enterprises with Reference to Nepal Electricity Authority.” Kafle tried to determine to effectiveness of income tax revenue collection from public enterprises and major problems of income tax system and Kafle also tried to find out the contribution of income tax from Nepalese electricity authority to total revenue and total income tax revenue as national revenue of Nepal. Kafle found that income tax on total tax revenue was 8.36 percent in the fiscal year 1993/94 and it increased up to 22.64% in fiscal year 2003/04. Income tax revenue/GDP ratio, income tax revenue/total tax revenue and income tax revenue/direct tax revenue ratios are 2.2%, 22.64% and 84.02% respectively in the fiscal year 2003/04. The contribution of income tax from Nepal Electricity Authority to total income tax revenue has also been flotation the average contribution is 2.57%. In the composition of income tax from Nepal Electricity Authority on the income tax from public enterprise has shared 8.5 % in an average. Lack of clear transparent and progressive economic policy the main reason for unsatisfactory tax collection was due to the lack of effective income tax system of Nepal.

Khatiwada (2004) conducted a research entitled, “Structure of Income Tax System in Nepal, A Managerial Study.” T.U. Khatiwada aimed to evaluate the structure of income tax system and managerial study. Khatiwada accepted that ITA, 2058 and Provisions are difficult to understand, language is vague and unclear, narrow base i.e.

agricultural income has not been included in tax net, provision of double taxation in dividend, insufficient provisions related to capital gains.

Khatiwada also analyzed that income tax management system in Nepal is not effective and efficient due to ineffective management system, inadequate government policy and defective income tax laws. Khatiwada also mentioned the major constraints of effective and efficient income tax management system are:

- Misuse of power by tax administrations.
- Less consciousness of tax payers.
- Lack of motivated and trained human resources.
- Inadequate experts in tax management, non-maintenance of books and accounts, time consuming process of income assessment i.e. scientific assessment.

Khatiwada also added income tax assessment procedure is not sound and efficient, high level of evasion found in income tax, income tax administration as a high degree of corruption has been found. But he did not mention any provision about exemption of incomes and deduction of expenses in Nepal.

Niroula (2005) did a research study named, "Study of Incentives and Facilities to Industries under Income Tax Act, 2058" T.U. This study was aimed to examine and analyze the effectiveness of tax incentives and facilities to industries. Niroula concluded that;

- Income tax incentives and facilities do not play the major role in the establishment of industries but other factors such as political stability, industrial environment, administrative efficiency and availability of market, raw material, Labour, infrastructure etc. play key role in the establishment of industries. If these facilities are available the incentives and facilities provided by the ITA might play major role in the establishment of industries.

- Investment tax credit and investment allowance play vital role in the establishment of new industries.

- A flat rate of 20% income tax to all industries seems to be little bit higher to the small industries.

- The deduction facility of PCC and R & D has been tremendous effect to achieve its objectives and industries are exploiting these facilities.

- Tax rebate of 25% and 30% to the undeveloped and underdeveloped areas are not sufficient.

Niroula has recommended that investment tax credit and investment allowance should be provided to new industries. The rate of 20% to the export industry is higher and it should be minimized. Niroula further recommended that the contradiction between the Income Tax Act and Industrial Enterprises Act should be eliminated. Niroula further conducted from time to time to make aware about the tax incentives and facilities to current taxpayers and potential investors.

Dhungel (2006) had presented a dissertation entitled “Special Provision to Individual under Income Tax Act 2058.” She had examined and analyzed the effectiveness of special provision provided by ITA 2058 to individual and identified the other provisions to be included in the special category. She also wanted to make aware about special provisions to individual (Taxpayers) and tax experts. She has found special provision to an individual provided by Income Taxes Act 2058 is not sufficient and more provisions should be provided and the retirement contribution should be wholly exempted, the tax concession to individuals working at different area is contradictory. Tax experts are satisfied and tax payers are not satisfied.

Dotel (2007) presented a dissertation named “Income Tax Act 2058; Expectations and Realities” in 2007. The objectives of the study were to measure the effectiveness of Income Tax Act 2058 both in theory and practice, to rcview the views of taxpayers, tax experts and tax administrations to ITA 2058. He found that Income Tax Act 2058 seems effectives because it has the features of provisions of international taxation, taxing capital gains and dividends income, abolition of various tax related concession, rebate and exemption etc. He also found that the most of taxpayers, tax administrators and tax experts are acquaintance to present Income Tax Act. However they suggest that some of the words in the act needed to be further simplified.

Baral (2008) Presented a dissertation named “Income tax in tax structure in Nepal.” She has mentioned the contribution of income tax in tax revenue of Nepal. She has also shown that contribution of direct tax has been decreasing and indirect tax has been increasing. She has stated the problems of clear and comprehensive definitions of income, lack of punishment to tax evaders, lacks of tax consciousness, lack of efficient tax administration, lack of public information, lack of scientific method of tax collection and trained tax collectors.

Khatri (2009) in his dissertation “Effectiveness of self assessment tax system in Nepal” explain that the audit and investigation function towards limited issue focused examination (LIFE) of the taxpayer’s business. It will help to develop professionalism in tax administration.

Bhandari (2010) presented a dissertation named, “Tax Administration and its Effectiveness in Nepal.” In his work he had made a review of tax laws about self assessment, analyzed the problem faced by the assesses while doing the self assessment of their own income and made relevant recommendation to reform income tax laws as well as administration in future. He had concluded that self assessment of tax is suitable means of raising domestic resources and it would be effective if taken seriously. He had further expressed that the effectiveness of self assessment of tax depends on appropriate reformation.

Magar (2011) wrote a thesis entitled “Income Tax in Nepal; A Study and Exemptions and Deductions.” He had covered tax structure, role of income tax and exemptions & deductions provided in the law. He had found that there was dominated share of tax structure in Nepalese government revenue. Income tax had occupied third position in his study period and it was increasing trend. The TAX/GDP ratio was not found satisfactory. With the income tax, there was the dominated role of corporate income tax but it was in decreasing trend and contribution of individual income tax shortage of income tax experts/professional in tax administration, lack of public participation, faculty organizational structure of tax administration, weakness in administration, observed by him. His suggestions about exemption were; revision the exemption limit, elimination double taxation on dividend, tax rebate for submitting true income statement in theme, increase income tax rate slab up to 10, increases the exemption limit to individual as well as family etc. Besides above suggestions, his suggestions about deduction were: clear provisions for deduction: fully allowed interest expense, pollution control expenses, repair and improvement expenses, research and development expenses. He is totally concentrated on the exemption and deduction in his study. He has not stud about various aspect of income tax.

2.3 Research Gap

During the research study, the researcher viewed various books, reports, articles and dissertations and thesis. Most of the researchers are concerned on the legal and assessment procedure of income tax, administrative and historical aspect of income tax. The thesis presented by the researcher have focused about the trend of income tax collection and buoyancy of income tax, inefficiency of tax administration, widespread of tax evasion, value added tax, role of income tax income tax system in Nepal, problems and prospects of income tax in Nepal, corporate tax planning of Nepal, income tax collection from commercial banks etc. There is a limited number of research studies carried out specifying taxpayer groups and concentrated on exemption and deductions of income tax. No attention is paid on a particular problem like exemption of incomes and deduction of expenses. Most of them have been taken various problems as their research objectives and no thoroughly study on a particular subject problem. The researcher has found that no more study done in exemption of incomes and deduction of expenses. This study will help to know the provisions of exemptions and deductions provided by ITA, 2058 and getting optimum benefits within the frame of ITA by exempting of incomes and deducting of expenses to the taxpayers.

CHAPTER – III

RESEARCH METHODOLOGY

This chapter describes the research methodology used in this study for the achievement of desired objectives. Primary as well as secondary data were used for the study. Opinion survey technique is adopted to collect the primary about the different aspects of income tax. While conducting opinion survey, questionnaires were distributed to different groups who were related to income tax. They were income tax payers, specialist income tax administrators, income tax experts' accountant, auditors and officers etc.

The collected data were tabulated into the separate format and tables. Some statistical tools such as simple average and percentage were used where necessary. The results were expressed in the form of descriptive and analytical.

3.1 Research Design

Research design is the plan structure and strategy of investigation conceived so as to obtain answers to research questions and variances (Kerlinger, 1986). This research study attempts to analyze the present exemptions and deductions of income tax. Opinion of 60 respondents associated with the income tax. Income tax experts, income tax administrators and income tax payers are collected through the questionnaire. Different types of questions regarding income tax are used in questionnaire. Similarly various publications regarding income tax are used for this study. In this way, the research design of this research is descriptive, analytical and empirical.

3.2 Population and Sample

The population for this study comprised all the persons belonging to income tax of Nepal. 60 samples from Inland Revenue Office staffs and government or Non-governmental officer of Pokhara. Samples are carefully selected by consultation with the supervisors and best judgments of the researcher. The respondents have been divided into three groups. The following table presents the groups of respondents and size of sample.

Table: 3.1

Group of Respondents and Size of Samples

S.N	Group of respondents	Sample Size
1	Income Tax Experts	10
2	Income Tax Administrators	25
3	Income Tax Payers	25
Total		60

3.3 Nature and Sources of Data

The significance of research basically depends upon the nature availability and accuracy of information. On the side method of data collection constitute important activity of research work and on the other it is very tough task. So far as this research is concerned, I have used two method of data collection procedure;

I. Primary data collection.

II. Secondary data collection

Primary Data

Primary data and information are collected through the questionnaire from the sample population. The questionnaires were distributed to different respondents. Tax administrators are selected from department and various sector of tax offices. Tax experts are the faculties have experience of tax management, auditors, chartered accountants etc. tax payers are selected from various sector i.e. finance company, bank, insurance company, private company, departmental store etc.

Secondary Data

The secondary data were collected from secondary sources. The major sources of secondary data are as follows:

- Budget speech and economic survey of various years, ministry of finance,
- Report and record of department of taxation, ministry of finance of Nepal.
- Book and bulletins related to income and public finance.
- National and international newspapers, journals and news magazines.
- Different dissertation related to income tax.
- Other relevant records and data.

3.4 Data Collection Procedure

Data and information used in this study was collected from primary as well as secondary sources. To get the accurate and actual information in time, all questionnaires were distributed and collected personally through field visits.

3.5 Data Analysis

For the analysis, all collected data and information of various aspects of income tax were arranged in order and processed. Then, the financial tools and statistical tools such as simple percentage, simple average, graphs, charts, diagrams etc. have been applied in the way of analysis so that the findings could be presented and interpreted properly and clearly.

Simple Percentage

It measures the proportion of one unit among the whole units. It helps to find out the actual contribution of each unit among total contribution. Thus percentage is expressed as

$$\text{Percentage (\%)} = \frac{Obtained\,Value}{Total\,Value} \times 100$$

Average

Average is the sum of all the observations divided by the total number of observations

Average is expressed as:

$$\text{Average} = \frac{Sum\, of\ Observations}{No\, of\ Observations}$$

3.6 Weight of Choice

The respondents are requested either to rank their answer or to give yes/no response or to write their opinion. In the case of ranking the answer the scale varies from question to question. The scale was given according to the number of probable answer. For e.g. if the probable answer is 6, the scale is giving 1 to 6 where 1 standards.

CHAPTER-IV

PRESENTATION AND ANALYSIS OF DATA

This chapter is the main body of the study, which answers the research problems for obtaining the specific goals of the research. Presentation is the act of introducing and appearing or giving a particular impression for any causes of problems. It means the researcher shows the found impression formally at related area or ceremony where as analysis is a method of studying specific content and analyzing communications materials in systematic, objective and quantitative manner to measure variables. The presentation and analysis of data can be described as in the following topics.

4.1 Presentation and Analysis of Data

Modern economic development of Nepal was started with the initiation of first economic planning in 2013 B.S. Since then, taxes have been used for the achievement of national economic goals. So, taxes play vital role for the economic development of Nepal. Tax structure should be known to study about the taxes. Tax structure reform to the level as well as relative importance of various taxes in the composition of total tax revenue of a country. Tax structure of any country is composed of both direct and indirect taxes. Total tax structures of Nepal from the fiscal year 2002/03 to 2011/12 are presented below.

An Empirical Analysis

4.1.1 Introduction

An empirical investigation has been conducted in order to find out various aspects of income tax from the experience of the real world. The major tools used for this purpose is an opinion questionnaire, which was dispatched to 80 persons representing tax administration, tax experts and tax payers, but only 60 responses were received. The questionnaire included the various aspects of income tax concerning with provisions of exemptions and deductions and contribution of income tax to the government revenue. The questionnaire either asked for a yes/no response or asked for ranking of choice according to number of alternatives where a first choice was most important and last choice was least important. Information received from respondents was tabulated into the separate format and they were express in percent of total numbers or points then analyzed into descriptive way.

The following table shows the groups of respondents and code used to represent them.

Table: 4.1

Group of Respondents and Code Used

S.N.	Groups of Respondents	Sample Size	Code Used
1	Tax experts	10	A
2	Tax administrators	25	B
3	Taxpayers	25	C
Total		60	

Source: Opinion Survey, 2013

4.1.2 Soundness of Income Tax Administration of Nepal

In order to know the respondent's opinion about the soundness of income tax administration of Nepal, a question was asked. "Do you consider that the income tax administration in Nepal is sound?" The responses received from the respondents are tabulated as follows:

Table: 4.2
Soundness Income tax Administration of Nepal

	Yes		No		Total	
	No	%	No	%	No	%
A	12	48	13	52	25	100
B	4	16	21	84	25	100
Total	16	32	34	68	50	100

Source: Opinion Survey, 2013

The question received 100 percent response as 32 percent of total respondents agree that the income tax administration of Nepal is sound and 68 percent of total respondents do not agree about the soundness of income tax administration of Nepal. Most of the respondents of code B were disagreed about soundness of income tax administration of Nepal. Almost half of the administrators and tax experts were against the soundness of tax administration. From this, it can be concluded that the income tax administration of Nepal is unsound.

In order to know the causes of unsound income tax administration, the next question was asked, “If no, what are the causes, which are responsible for the creation of unsound tax administration? The respondents were requested to rank their answer from 1 to 6. But most of the responses were received as a tick mark. For ranking purpose, the alternative, which got many more tick mark, was arranged as the most important.

Table: 4.3

Causes for the Creation of Unsound Income Tax Administration

S.N.	Causes	Group		Total Frequency	Percentage age	Rank
		A	B			
1	Defective income tax Act	3	5	8	8	6
2	Lack of public participation	10	12	22	21	3
3	Lack of Trained Employee	12	12	24	23	1
4	Faculty organizational structure of tax administration	9	8	17	16	4
5	Shortage of income tax experts/professionals in tax administration	10	13	23	22	2
6	Weakness in Government’s Economy policy	5	6	11	10	5
	Total					

Source: Opinion Survey, 2013

In the above table, percentage was calculated according to the total frequency obtained by each causes. For ranking purpose percentage of each cause was matched with each other and assigned first rank to the highest percentage. According to the respondents’ point of view, the main cause for the creation of unsound income tax administration of Nepal was ranked as follows:

I. Lack of trained employees

II. Shortage of income tax experts/professionals in tax administration.

III. Lack of public participation.

IV. Faculty organization structure tax administration.

V. Weakness in government economic policy.

VI. Defective of Income Tax Act.

Lack of public awareness, public tendency not to pay tax but get something from the state and difficulties in payment system of tax were some of the cause stated by the respondents.

From the above in overall, it can be concluded that the main cause for the creation of unsound tax administration of Nepal is lack of trained employees in tax administration.

In separate view of each group of respondent. Group A (Tax experts and tax administrator) were prioritized the lack of trained employees as the main cause of unsound income tax administration. Group B (tax payers) were prioritized the shortage of income tax experts/professional in tax administration also. In overall, most of the respondents of each class were agreed that the main causes of unsound tax administration are lack of trained employees, shortage of income tax expert/professionals in tax administration and lack of public participation.

4.1.3 Income Tax Rate In Nepal

Tax rate and its structure have been changing frequently since its introduction in 1959/60. Since 1959/60 to date, there are various records of highest and lowest income tax rate. In 1963/64, the lowest income tax rate was 4 percent and in 1975/76, the highest income tax rate was 60 percent. After introducing of income tax, tax rate is charged on different slabs. In 1975/76, the income tax rate for personal income was 10 percent to 60 percent for 7 different slabs. From 1998/99 to till date, the income tax rate for personal income is 15 percent and 25 percent for two different slabs.

Under new Income Tax Act 2001; individual income tax is levied with two rates of 15 percent and 25 percent. For individuals; who have Rs. 120000 income or Rs.

1200,000 turnover from any kind of business in metropolitan or sub-metropolitan cities, municipalities and other areas in Nepal are subject to pay tax as follows:

Metropolitan or sub-metropolitan cities	Rs. 2000
Municipalities	Rs. 1500
Anywhere else in Nepal	Rs. 1000

The income tax rate for partnership firms, corporations and non-resident was 15 to 60 percent for different slabs in 1975/76 which decreased to 30 and 25 percent for total taxable income. Income tax act has provided rebates or facilities so only 20 percent is taxed on their income for a special industry.

For every year, finance acts prescribe the exemption limit for individual, family and couple. Above the exemption limit, different income tax rate have been levied. The exemption limits in different years are shown in the following table:

Table: 4.4

Exemption Limit

Fiscal year	Individual	Couple	Family	All tax payers
1967/68-1973/74	3000	4500	6000	-
1974/75	4500	6000	6000	-
1975/76	5500	6500	7500	-
1976/77-1978/79	6500	7500	8500	-
1979/80-1980/81	7500	10000	10000	-
1981/82-1982/83	10000	15000	15000	-
1983/84-1989/90	15000	20000	20000	-
1990/91-1991/92	20000	30000	30000	-
1992/93-1996/97	25000	35000	35000	-
1997/98	30000	40000	40000	-
1998/99	40000	50000	50000	-
1999/2000	50000	60000	60000	-
2000/03-2003/04	55000	75000	75000	-
2004/05	65000	85000	85000	-
2005/06	80000	100000	100000	-
2006/07	85000	115000	115000	-
2007/08	100000	125000	125000	-
2008/09	115000	140000	140000	-
2009/10	115000	140000	140000	-
2010/11-2011/12	160000	200000	200000	-

Source: MOF, GON.

The above table 4.4 shows that there was only one exemption limit for all individual, taxpayers from 1959/60 to 1966/67. After 1967/68, individual taxpayers were categorized into 3 heads i.e. individual couple and family. From the FY 1967/68 to 1978/79, exemption limit was distinct for each 3 categories. But after 1981/82 to till date, the exemption limit of couple and family is treated equal. This indicates that the exemption limit is given only for 2 categories i.e. individual and family or couple. Above the exemption limit of individual income, different sets of tax rates are levied for different slabs. The following table shows the rates for personal income tax in Nepal.

Table: 4.5

Rates of Personal Income Tax in Nepal

	Slabs over exemption limit							
Fiscal year	1	2	3	4	5	6	7	8
1975/76	5000 7%	5000 10%	10000 20%	10000 30%	10000 45%	500000 55%	Bal 60%	
1980/81	5000 5%	5000 10%	10000 15%	20000 20%	20000 30%	30000 40%	Bal 50%	
1985/86	5000 10%	5000 15%	10000 20%	15000 25%	15000 40%	30000 40%	200000 50%	Bal 55%
1990/91	10000 15%	15000 20%	20000 35%	25000 40%	30000 45%	Balance 50%		
1995/96	40000 10%	25000 20%	Balance 30% (a) 33% (b)					
2002/03	75000 15%	Balance 25%						
2003/04-2008/09	75000 15%	Balance 25%	Addition al 1.5%					
2009/10	85000 15%	Balance 25%						
2010/11-2012/13	85000 15%	Balance 25%	More than 250000 @35%					

Source: Fiscal Acts of Various Years, MOF, G/N.

Where, (a) Remuneration (b) Others.

From the above table 4.5, the rates for personal income tax in Nepal are different for different slabs. In 1975/76, the rate for personal income was 7 to 60 percent for 7 different slabs. After 1975/76, the slabs were increased to 8 in 1985/86. But after 1985/86 the numbers of slabs and rates of personnel income tax decreasing till date.

From 2003/04 to 2008/09 there was 15% rate for first Rs. 75000 and 25% for balance and additional 1.5% for balance too. From fiscal year 2009/10, the additional tax for balance has been eliminated. There was 15% tax rate for first 85000 and 25% for balance.

Similarly, income tax is charged for partnership firms, corporation and non-residents. The exemption limit for them is not provided by the income tax act. Tax is charged on the income after deducting all expenses. The rates and slabs approved for different years are given below:

Table: 4.6

Income Tax Rates for Partnerships Firms, Corporation and Non-Residents

	Slabs over exemption limit							
Fiscal Year	1	2	3	4	5	6	7	8
1975/76	10000 15%	10000 25%	10000 40%	500000 55%	Balance 60%	-	-	
1980/81	5000 5%	5000 10%	10000 15%	20000 20%	20000 30%	30000 40%	Balance 50%	
1985/86	5000 10%	5000 15%	10000 20%	15000 25%	15000 30%	30000 40%	200000 50%	Balance 55%
1990/91	10000 15%	15000 20%	20000 35%	25000 40%	30000 45%	Balance 50%		
1995/96	33% in total							
2002/03-2007/08	30% (a) 25% (b)							
2008/09-2011/12	30% (a) 25% (b) 20% (c)							

Source: Finance Act of various years, MOF, G/N

Where, (a) For banks and financial companies and alcohol/tobacco industry.

(b)Others (including partnership firms)

(c)For special industry and income generated from export business.

The above table 4.6 shows that the income tax rates for partnership firms, corporation and non-resident were different for different slabs in the earlier years. But after 1995/96, the rate and slabs is only one. This shows the progressive tax in earlier year and flat tax rate in the recent years. The income tax rates for 1975/76 were 15 to 60 percent for 5 slabs. But in 1995/96, tax rate was in total 33 percent. And from 2004/05, to till date, the tax rates are 30 percent for banking and financial institutions and tobacco and alcohol industries, 25 percent for other (including partnership firms) and 20 percent for the special industry at a flat rate on taxable income.

4.1.4 Personal Exemption

Income Tax Act 2031 was replaced by Income Tax Act 2058 has classified the income heads into the following 3 heads:

a. Business,
b. Employment, and
c. Investment.

The act has defined the income heads as follows:

a. Business means any industry, a trade, a profession, or the like isolated transaction with a business character and includes a past, present or prospective business. By contrast to employment, business is an earning activity typically consisting of not only the provision of labor but of the combined provision of Labour and capital.

b. Employment: The income earned with the help of Labour is defined as an employment income. In other words, the payment or benefit received either in cash or kind from the employment or his/her associate in exchange of Labour is defined as employment income.

c. Investment: The income earned with the help of using capital is defined as an investment income. Income Tax Act, 2058 has defined investment as an act of holding or investing one or more assets.

For the calculation of net income of these three income heads, the act has defined the incomes or amounts, which are taxable and non-taxable and expenses, which are allowed for deduction and not allowed for deduction. For the computation of income, act has made the following provisions:

4.1.5 Income from a Business

Income Tax Act 2058, section 7, has clearly mentioned the incomes or amounts which are includable in computing the income from business. They are:

a. Service charge (Sec. 7.2)
b. Disposal of business/trading stock (Sec. 7.2)
c. Net gain from the disposal of the person's business assets or liabilities of the business (Sec. 7.2
d. Gain from disposal of pool of depreciable assets (Sec. 7.2)
e. Prizes of gifts received by the person in respect of business (Sec. 7.2)
f. Amount received in lieu of accepting any restrictions regarding business (Sec. 7.2)
g. Amount received from any investment directly related to business (Sec. 7.2)
h. Income to be included due to change in accounting methods (Sec. 22.6)
i. Excess amounts received due to exchange rate variation (Sec. 24.4)
j. Bad debts received (Sec. 25.1)
k. Proportionate amounts received under long-term contract (Sec. 26.1)
l. Under payment of interest according to market rate (Sec. 27.1)
m. Receivable amounts paid to others (Sec. 29)
n. Amount received from compensation (Sec.31)
o. Other amounts received under the head of business income (Sec. 7.2).

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

a. Exempt amount under section 10.
b. Taxation of dividends under section 54.
c. Final withholding payments (Sec. 92) and
d. Dividends distributed by a controlled foreign entity at the end of the year under section 69.

4.1.6 Income from an Employment

Income Tax Act 2058, section 8, has clearly defined the incomes, which are includable in computing income from employment. An individual's income from an employment for an income year is the individual's remuneration from the employment of the individual for the year. For the purpose of computing income from an employment, the following amounts or incomes received by him in respect of any employment of services rendered by him in any of income shall be included.

a. Any wages, salary, leave pay, overtime pay, fees, commission, prizes, gift, bonuses and other facilities belongs to employment.

b. Any personal allowances, including any cost of living, dearness, subsistence, rent entertainment, and transportation allowances.

c. Any payment for reimbursement of costs incurred by the individual or an associate of the individual.

d. Any payments of the individual's agreement to any conditions of the employment.

e. Any payments for redundancy or loss or termination of the employment.

f. Retirement contributions, including those paid by the employer to a retirement fund in respect of the employee, and retirement payments.

g. Other payments made in respect of the employment.

h. Other amounts includable on tax accounting or quantification, allocation and characterization of amounts.

In the above provisions, there is a provision of loss of employment. But the provision has not classified the meaning of loss of employment. In the other hand, retirement contributions are nothing else than the product of sacrifice of oldness of employments. These are the bases for living standard of oldness of employees. So it does not give good information to the taxpayers/employees. Dearness allowance is given to meet the living standard of employees. It is not lawful in taxable income.

Non-includable amounts on employment income:

The following amounts are not includable in computing the net income from employment.

a. Amount exempt under section 10 and final withholding payments.

b. Meals or refreshments provided in premises operated by or on behalf of an employer’s employee that the available to all the employees or similar terms.

c. Any discharges or reimbursement costs incurred by the individual:

    I. That serve the proper business purpose of employer or

    II. That would otherwise be deductible in calculating the individual’s income from any business or investment.

d. Payments of prescribed small amounts, which are so small and thus unreasonable or administratively impractical to make accounting for them. (Only up to Rs. 500 at once-expenses may be stationery, box is gift, tea/ coffee expenses, emergency medical expenses and pointed by department).

4.1.7 Income from an Investment

Section 9 of Income Tax Act 2058, has defined the income received from an investment for income tax purpose. For the purpose of computing income of any person from an investment for an income year is the person’s profits and gains from conducting the investment for the year and there shall be included:

a. Any dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from an unapproved retirement fund interest or retirement payment, made by an approved retirement fund, gain received from non-approved retirement fund or retirement payment from approved retirement fund.

b. Net gains from the disposal of the person's non-business chargeable assets of investment.
c. Excess amount of incomings over the depreciation basis including outgoing on the disposal of depreciation assets of the investment of the person.
d. Gifts received by the person in respect of investment.
e. Bad debt recovered related to investment.
f. Under payment of interest related to investment.
g. Compensation received.
h. Exchange gain.
i. Amount required being included due to change in accounting system.
j. Income from natural resources.
k. Royalty received.
l. Rent received except from house and land.
m. Interest except received by a natural person/bank.
n. Retirement contributions, including those paid to a retirement payments in respect of investments.
o. Amounts derived as consideration for accepting restriction on the capacity to conduct the investment.

Other amounts required to be included on tax accounting or qualification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business.

In the above provision, act has included the amounts derived as consideration for accepting or restriction or the capacity to conduct the investment, it is fruitful to the investors who receive the compensation against the restriction. But it will not be possible to implement, if the act does not clarify the nature of restriction, cause of imposing restriction, process of compensation-computing and entity which give compensation non-includable amount on investment income.

The act has defined the amounts, which are excluded in computing income from an investment under section 9(3). They are:

a. Exempt amount under section 10,
b. Taxation of dividend under section 54,
c. Dividend distributed by a controlled foreign entity at the end of the year under section 69 and final withholding payments, and
d. Amounts those are included in calculating the person's income from any employment or business.

4.1.8 Exemption from Income Tax

Income Tax Act 2058, has clearly defined the amounts, which are exempt and other concessions. They are described in the following section.

1. Exempt Amounts

The following amounts are exempted from tax under section 10, Income Tax Act 2058:

a. Amount derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between government of Nepal and foreign country or an international organizations.
b. Amounts derived by an individual from employment in the public service of the government of foreign country provided that.
    I. The individual is a resident person solely by reason of performing the employment or is a non-resident person and
    II. The amounts are payable from the public funds of the country.
c. Amount derived from public fund of the foreign country by an individual who is not a citizen of Nepal as referred to paragraph (b) or by member of the immediate family of the individual.

d. Amounts derived by an individual who is not a citizen of Nepal from employment by government of Nepal on terms of tax exemption.

e. Allowances paid by government of Nepal to widows, elder citizens, or disabled individuals.

f. Amounts derived by way of gift, bequest, inheritance or scholarship (which are including exception of business employment or investment income)

g. Amounts derived by an exempt organization by way of

h. Gift, donation.

   I. Other contributions that directly relate to the organization's function of the definition of exempt organization in section 2.

   II. Amounts earned by Nepal Rastra Bank as its objectives.

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

In the above section, pension's amount received by Nepalese people being retired from the service by army or police of foreign country is exempted from income tax. It restricts the objective of raising more revenue of government because some of receive more amount than the exemption limit approved by the government.

2. Exempt Organization

Exempt Organization means:

i. A social, religious educational or charitable organization of public character registers without having profit motive.

ii. An amateur sporting association formed for the purpose of promoting social or sporting amenities not involving the acquisition of gain.

iii. A political party registered with the Election Commission.

iv. A village Development Committee (VDC), Municipality or District Development Committee.

v. Nepal Rastra Bank.

vi. Government of Nepal.

vii. The prescribed entity that has been issued with a personal ruling under section76 stating that too is an exempt organization.

Income Tax Act has mentioned the organizations, which are tax-free (Exempt Organization) as social, religious, educational or charitable organization of a public character registered without having profit motive, in the case of non-transparent private business like boarding schools, NGO’s or other like entities, where profits are earned but they are tax free. Budget speech 2065/66 has announced that the private boarding schools have to pay 5 percent tax through the every student's fees to the government.

3. Personal Exemption Tax- Concession

The following business exemptions and concessions are mentioned in section 11 of Income Tax Act 2058.

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

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

c. Income derived from sources in Nepal during an income year by a person from a special industry is taxed as follows:

   a. The industry provides direct employment to 600 or more Nepalese citizens throughout the year, 10 percent rebate is provided to the special industries or 90 percent of rate is applicable to that income for the period of forever.

   b. The special industry operated in a underdeveloped, undeveloped, highly undeveloped and remote zone, at 90, 80, 75 and 70 percent respectively, of the rate is applicable for the period of 10 years from commencing and including the year in which the operation commences.

   c. The special industries based on information technology established in a information technology (IT) park like Banepa, 25% reate is provided on existing rate for forever.

   d. A person who is entitled to concession under subsections a, b or c shall calculate the income referred to in those subsections as through the income was the only driven by a separable.

   e. When a person qualifies for more than one concession under subsection (b) I or II with respect to the some income, the person shall only be entitled to one concession with respect to that income but shall be entitled to select which concession applies.

4. Donation gifts to exempt organizations:

Section 12 of Income Tax Act 2058 has mentioned the provisions of donation gifts to exempt organization. The provisions are:

a) A person may claim to have his taxable income for an income year reduced by donation gifts made by the person during the year to an exempt organization, that are approved for the purposes of this section by the department.

b) Donation made to an exempt organization, approved by Inland Revenue Department (IRD) is allowed for reductions from taxable income. Reductions allowed to an individual or an entity will not exceed Rs. 100,000 or 5% of adjusted taxable income. However, the government of Nepal may prescribe by a notification in the Nepal Gazette, as to allow full or partial deduction at the time of assessing income of the expenses incurred for special purpose or donation given by the person.

c) Donation given to national political parities up to Rs. 10,00,000 before three months of election is deductible expenses from taxable income. Likewise donation given to Lumbini Development fund and Pashupati Development Fund up to Rs. 10,00,000 is tax exempt amount.

From the above provision, it is clear that the donation given to political parties is allowed for deduction but it has not been able to solve the voice of people of transparency of donation amount given by businessmen to political parties.

4.1.9 Deduction Allowed

Income Tax Act 2058 has provided the provisions relating to expenses, which are allowed for deduction and not allowed for deduction. They are discussed or analyzed in the following section:

1. General Deductions (Sec.13)

For the purpose of calculating a person's income from an income year from any business or investment, there shall be deducted, all actual costs to the extent incurred during the year, by the person and in the production of income from the business or investment.

2. Interest Expenses (Sec.14)

For the purpose of calculating the income of a person from an income year from a business or investment, there shall be deducted all interest incurred during the year by the person under a debt obligation of the person that the debt obligation was incurred in borrowing money, used during the year or was used to purchase an asset that is used during the year or in any other case the debt obligation was incurred.

But the total amount of interest that an exempt controlled resident entity may deduct under the above case for an income year shall not exceed the sum of all the interest derived by the entity during the year that is to be included in calculating the entity's taxable income for the years and 50% of the entity's taxable income for the year calculated without including any interest derived by the entity or deducting any interest by the entity.

Any interest for which the deduction is denied as a result of above cause may be carried forward and treated as incurred during the next income year.

It is an unlawful step to businessmen not to get the deduction of full amount of interest. It does not fulfill the objectives of industrial or economic development. There is a controversial condition between the law of banking and law of income tax because according to the law of banking interest must be paid to bank but according to the law of income tax there is a provision of not to get the deduction of full amount of interest for an income year.

3. Cost of Trading Stock (Sec. 15)

For the purpose of calculating a person's income for an income year from any business, no deduction in otherwise allowed for the cost of trading stock except the allowance determined by subtracting the amount of closing value of trading stock of business from the opening value of trading stock plus the cost of trading stock of the business acquired by the person during the year.

The opening value of trading stock of business for an income year is the closing value of trading stock of business at the end of the previous year. The closing value of trading stock of business is the lower value of the cost trading stock of the business at the end of the year or the market value of trading stock of the business at the end of the year.

The cost of trading stock of a business at the end of a person is determined by using the prime cost or absorption cost method in the case of a person accounting for tax purpose on a cash basis in calculating income to the business and using the absorption cost method in the case of person accounting for tax purpose on an accrual basis in calculating income of the business.

In the case where absorption cost method is followed the cost of trading stock is determined as per the generally accepted accounting principle under which the cost of trading stock is equal the sum of direct material costs, direct labour costs and variable factory overhead costs. In the case where the prime cost method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which the cost of trading stock is equal to the sum of direct material costs, and variable factory overhead costs.

Where trading stock of a person's business is not readily identifiable, the person may elect that the cost of trading stock be determined according to the first in first out (FIFO) method and average cost method. Once chosen the method may only be changed with the written permission of the department. In the case where average cost method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which the cost of particular type of trading stock is determined as the weighted average cost of all trading stock of that type and held by the business.

For the purpose of this section "Direct Labour Cost" means labour costs directly related to the production of trading stock, "Direct Material Costs" means the cost of materials that are or become an integral park of the trading stock, "Factory overhead costs" means the total costs incurred by the person in manufacturing trading stock except direct material costs and "variable manufacturing overhead costs" means those factory overhead costs that vary directly with changes in volume of trading stock manufactured.

4**. Repair and Improvement Cost (Sec. 16)**

For the purpose of calculating a person's income for an income year from any business or investment, there shall be deducted all costs to the extent incurred during the year in respect of the repair or improvement of depreciable assets owned and used by the person during the year in the production of the person's income from the investment or business.

But the deduction allowed under the above case with respect to all repair and improvement costs should not be excess amount of 7% of depreciation base or actual repair and improvement expenses whichever is less is deductible and the excess repair expenses (Inadmissible portion) is capitalized in respective groups at the beginning of the next income year.

5. Pollution Control Costs (Sec. 17)

For the purpose of calculating a person's income for an income year from any business, there shall be deducted pollution control cost to the extent incurred by the person during the year in conducting the business. But the deduction allowed to a person for an income year with respect to all business conducted by the person shall not exceed 50% of the taxable income. Any excess costs or part thereof, for which deduction is not allowed shall be capitalized and may be depreciated in accordance.

For the purpose of this section, "Pollution control costs" means costs incurred by a person with respect to a process or an asset that seeks to control pollution or otherwise protect or sustain the environment.

Government has a will of controlling pollution and then protection of environment but has not spent a little bit money on it. In the other hand all the expenses made by the businessmen to control pollution are not allowed for deduction and made a standard limit for it. So, it is not a good symptom of controlling pollution.

6. Research and Development Costs (Sec.18)

For the purpose of calculating a person's income for an income year from any business, there shall be deducted research and development costs to the extent incurred by the person during the year in conduction the business. But the deduction allowed to a person for an income year with respect to all business conducted by the person shall not exceed 50% of the taxable income calculated without a deduction of research and development cost. Any excess, or part of thereof, for which deduction is not allowed shall be capitalized.

Research is an infrastructure of development. For successful industrial development, research and development is more important and must be expended on it. Expenses made on it must be approved and should be allowed for deduction for tax purpose. But the provision of income tax has not given full deduction on it. It is a myopic vision of government.

7. Depreciation Expenses (Sec. 19)

For the purpose of calculating a person's income for an income year from any business or investment, there shall be deducted in respect of depreciation of depreciable assets owned and used by the person during the year in the production of the person's income from the business or investment. But the following provisions shall be applied in respect of depreciation of machines, equipment and other machinery installed in the electricity projects that are involving in building power station, generating and transmitting electricity and in the projects conducted by any entity so as to build public infrastructure, own operate and transfer to the government of Nepal.

In case where the old machines, equipment and other machinery that are already installed require replacement in any income year as they are out of order due to being too old, the balancing value of the old machines, equipment and other machinery remained after cost shall be allowed as expenses for the year.

At the time of transfer of other assets to the Nepalese government except of old assets replace in accordance with above paragraph, the balancing value of remained, after subtracting the depreciation up the year of the transfer from their cost shall be allowed as expenses.

For the purpose of depreciation calculation, depreciable assets are categorized into five groups on their size, nature, and cost, durability, similarly, utility and so on as A, B, C, D and E block, pool or group. Depreciation are charged at the rate of 5, 25, 20 and 15 percent for A, B, C and D respectively and for pool E depreciation is charged on the basis of cost dividend by useful life.

Rates of depreciation are far from reality because there is no specific estimation provision of real age of assets and depreciation rate in Nepal. In the other hand, there is no any specific provision of depreciation of assets, which are taken in lease and installment payment basis. It shows a weak point of new income tax act.

8. Loss Recovery (Sec. 20)

For the purpose of calculating a person's income from an income year from any business or investment there can take place different losses in business or investment.

When losses incurred in business of domestic source, those losses can be set off and carry forward up to 7 years from any business income situated within the country or outside the country. In the case of electricity projects involving in business power station, generating and transmitting electricity projects involving in business power station, generating and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own operate and transfer (BOOT) to the government, entity conducting petroleum business under Nepal Petroleum Act. 2040, losses can be deducted up to next 12 years.

When losses incurred in investment of domestic source, those losses can be set off and carry forwarded up to 7 years from any incomes of investment within the country or outside the country only.

Where a person may deduct an unrelieved loss in calculating the person's income for an income year from more than one business or investment, the person may prioritize in which calculation the loss or part of the loss is deducted.

Carry forward the losses for 7 years are not sufficient as compared to other countries. It is not enough to encourage the business for taking risk. The provision of carry backward is also thoughtful because of accounting system of Nepal is not so standard to apply this provision.

4.1.10 Expenses not Allowed for Deduction

To calculate the income of a persons' for an income year from any business, employment, or investment, the following expenses are not allowed for deduction under section 21 of Income Tax Act 2058.

a. Personal nature or domestic expenses.
b. Income tax paid fines and penalties.
c. Expenses incurred for acquiring tax free income and final withholding payments.
d. Cash payment in excess of Rs. 50,000 at a time by a person having annual transaction more than Rs. 20,00,000 (2 million) except in certain circumstances.

e. Distribution of profits by an entity for example dividend distribution to the shareholders.
f. Expenses not related to earning of income.
g. Any reserve, provision or fund.
h. Expenses of capital nature.
i. Foreign income tax.
j. Other expenditures not exempted as admissible.

A person whose annual turnover for an income year exceeds Rs. 20,00,000 is not allowed a deduction for a cash payment in excess of Rs. 50,000 incurred at once other than in the following conditions by the person during the year, if:

a. Payment made to government of Nepal, a constitution body, a corporation owned by the government of Nepal, or a bank or financial institution,
b. Payment is made to a farmer or producer producing primary agriculture products even in the case where the product is primary processed by the farmer himself,
c. Payment is a retirement contribution or retirement, payment,
d. Payment is made in an area where banking services are not available. An area having banking services means the area where there are no banking facilities within the surrounding of ten kilometers.
e. Payment is made must necessarily be made in cash or on a day when banking services are closed.
f. Payment is made into a bank account of the payee.

Any other amounts, to the except to which a deduction is not defined by section 21: (1) (f), has not defined the amounts. This kind of provision will provide a loophole for both tax administration and taxpayers.

4.1.11 Composition of Total Revenue

Total revenue is composed of tax revenue and non-tax revenue. The trend and composition of tax revenue and non-tax revenue in different fiscal years are presented below.

Table: 4.7

Composition of Total Revenue

(Rs. in Millions)

Fiscal year	Total revenue	Tax revenue	Tax revenue as % of total revenue	Non-tax revenue	Non tax revenue % of total revenue
2002/03	42894	33152.2	77.29	9741.6	22.71
2003/04	48893.9	38865.1	79.49	10028.8	20.51
2004/05	50445.5	39330.5	77.79	11114.9	22.03
2005/06	56229.7	42586	75.74	13642.86	24.26
2006/07	62331	48173	77.28	14158	22.71
2007/08	70123.1	54104.7	77.16	16018	22.84
2008/09	72282.1	57430.4	79.45	14851.6	20.54
2009/10	87712.2	71126.7	81.09	16585.5	18.9
2010/11	107622.5	85155.54	79.12	22467.04	20.87
2011/12	126304.8	102120.3	80.85	24184.5	19.14
Total	724838.8	572044.44	78.92	152792.8	21.079556
Average	72483.88	57204.444	78.92	15279.28	21.079556

Source: Economic Survey, 2011/12

Table 4.7 shows that the share of tax revenue of the fiscal year 2002/03 was 77.29% of the total revenue and was increased to 80.85% in fiscal year 2011/12. The total tax revenue, non-tax revenue and total revenue were Rs. 572044.44 million, Rs. 152792.8 million and Rs. 724838.8 million respectively whereas average percentage collected tax revenue and non-tax revenue were 66.24% and 33.76% respectively during the study periods. In 2011/12, the share of non-tax revenue was 19.14% of total revenue as compared to 22.71% in 2002/03. So, the tax revenue contributes about three fourth of the total revenue. This also indicates that the tax revenue plays the significance role in total revenue.

Figure: 4.1

Composition of Total Revenue

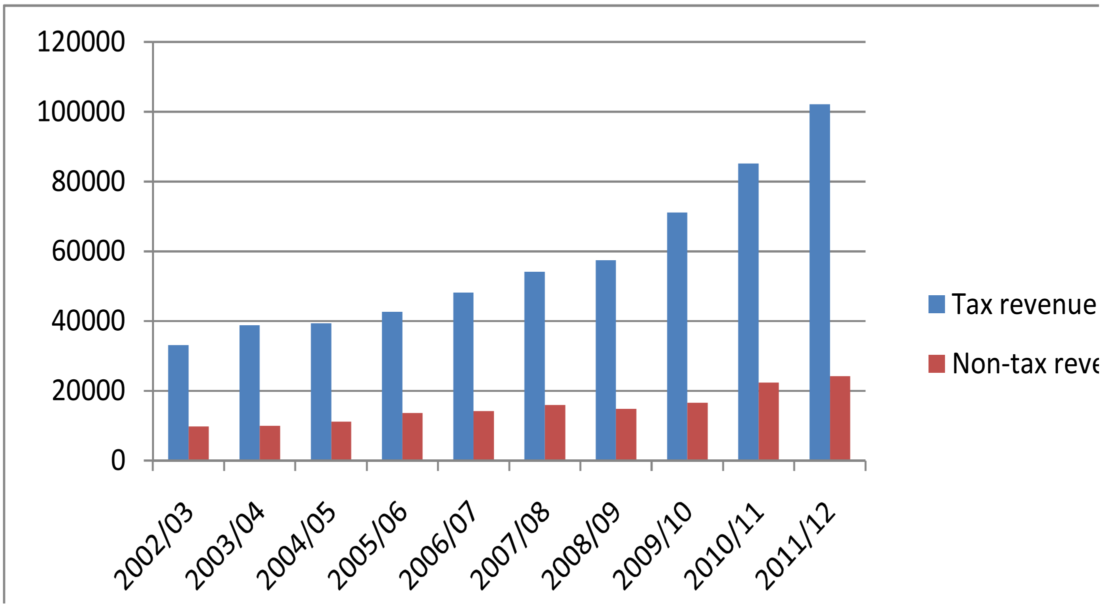


Figure 4.7 shows that the trend line of tax revenue is increasing every year with the amount of Rs.33152.2 million in fiscal year 2002/03 to Rs. 102120.3 million in year 2011/12. From the fiscal 2002/03 to 2011/12 the percentage contribution of tax revenue of total revenue of total revenue was increased up to 81.09% from 77.29%. Likewise the trend line of non-tax revenue collection was also increased during the period of 2002/03 to 2011/12 as it increased from Rs.9741.6 million to Rs. 24184.5 million respectively. But comparison to the total revenue, the percentage contribution is fluctuating in different years.

4.1.12 Contribution of Various Taxes as GDP

The trend and composition of tax revenue for the fiscal year 2002/03 to 2011/12 are given in the table below.

Table: 4.8

Contribution of Various Taxes as GDP (In Percentage)

Year	Total revenue as % GDP	Tax Revenue	Direct tax	Indirect tax	Income Tax	Custom duties	Excise duties	VAT	House and Land Tax
2002/03	11.71	9.05	2.44	6.61	2.02	2.95	0.85	2.80	0.28
2003/04	12.41	9.86	2.58	7.28	2.31	3.18	0.95	3.14	0.25
2004/05	11	8.6	2.61	6.28	1.94	2.76	0.83	2.68	0.24
2005/06	11.4	8.7	2.31	6.63	1.62	2.90	0.97	2.74	0.28
2006/07	11.6	9	2.51	6.77	1.72	2.90	0.89	3.70	0.32
2007/08	11.9	9.2	2.38	6.97	1.73	2.66	1.09	3.21	0.30
2008/09	11.1	8.8	2.31	6..65	1.58	2.35	0.98	3.31	0.33
2009/10	12.1	9.8	2.61	7.18	2.07	2.21	1.28	3.59	0.32
2010/11	13.2	10.4	2.82	7.58	2.11	2.57	1.36	3.64	0.35
2011/12	14.8	12.2	3.53	8.67	2.55	2.76	1.65	4.25	0.48

Source: Economy Survey, 2011/12

The contribution of total revenue on GDP has increased from 11.71 percent to 14.8 percent as compared 2002/03 and 2011/12. The contribution of tax revenue on GDP is increasing satisfactorily. In 2002/03, the share of tax revenue was only 9.05 percent, which was increased to 12.2 percent in 2011/12 within tax revenue, there is significant role of the contribution of indirect tax and direct tax was 6.61 percent and 2.44 percent respectively which were increased to 8.67 percent and 3.53 percent in 2011/12.

The contribution of income tax on GDP is increasing gradually. It contributed 2.02 percent in 2002/03, which was increased to 2.55 percent in 2011/12. Within direct tax, income tax is in the leading role at now. The contribution of house and land tax was 0.28 percent and 0.48 percent in year 2002/03 and 2011/12 respectively, which is in fluctuating trend. Which is decreased to 0.15 in year 2003/04 and started to increased and reached to 0.31 percent in year 2006/07. Again decreased to 0.32 percent in year 2007/08, which is 0.48 percent in year 2011/12.

Within the indirect tax, the contribution of custom duty on GDP is higher than other individual tax. The custom duty is composed of import and export duties which had contributed 2.95 percent 2002/03 and 2.76 percent in 2011/12. The contribution of VAT is also in increasing trend. It contributed 2.80 percent in 2002/03, which is increased to 34.25 percent in 2011/12. VAT as a substitute of sales tax, contract tax, entertainment tax, hotel tax is increasing in recent years. The contribution of excise duty was 0.85 percent in 2002/03. But in 2004/05, it was decreased to 0.83 percent and then it is fluctuating trends till 2008/09 and then started to increased and reached to 1.65 percent in 2011/12.

Figure: 4.2

Contribution of Various Taxes

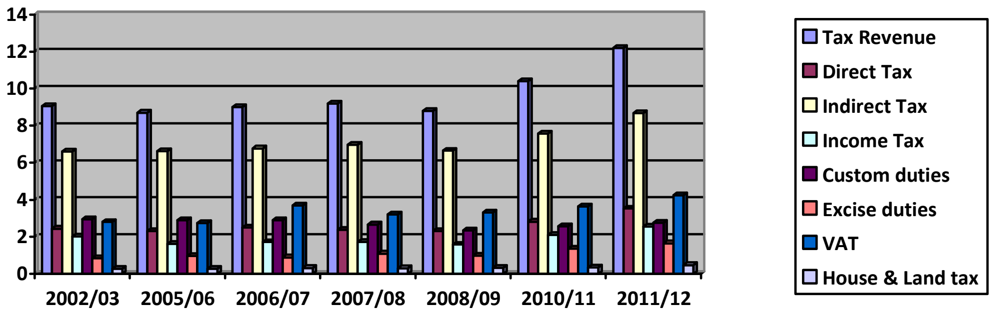


Figure 4.8, Shows the contribution of tax revenue on GDP is increasing satisfactorily. The share of tax revenue was 9.09% in year 2002/03 and it was increased to 12.2% in 2011/12. Indirect tax and direct tax were also in increases to 8.67% and 3.53% in 2011/12. The contribution of income tax on GDP is increasing gradually. The contribution of VAT and Land tax were also in increasing trend and become 4.25% and 0.48% in fiscal year 2011/12.

4.1.13 Composition of Direct Tax

In Nepalese tax structure, the major component of direct taxes are income tax, land and house tax and land tax. Until the fiscal year 1993/94 vehicle tax was considered as a direct tax and since 1994/95 budget speech, it has been classified under the indirect tax. On the other hand, interest tax and urban house and land rent tax were including under the income tax since 1994/95. Thus the contribution of income tax has become larger than the other direct taxes. The share of the major components of the direct tax is given the following table (Annual report, 1994/95, MOF, Inland Revenue Department, Kathmandu).

Table: 4.9

Components of Direct Tax and Percentage Share

(Rs. in Millions)

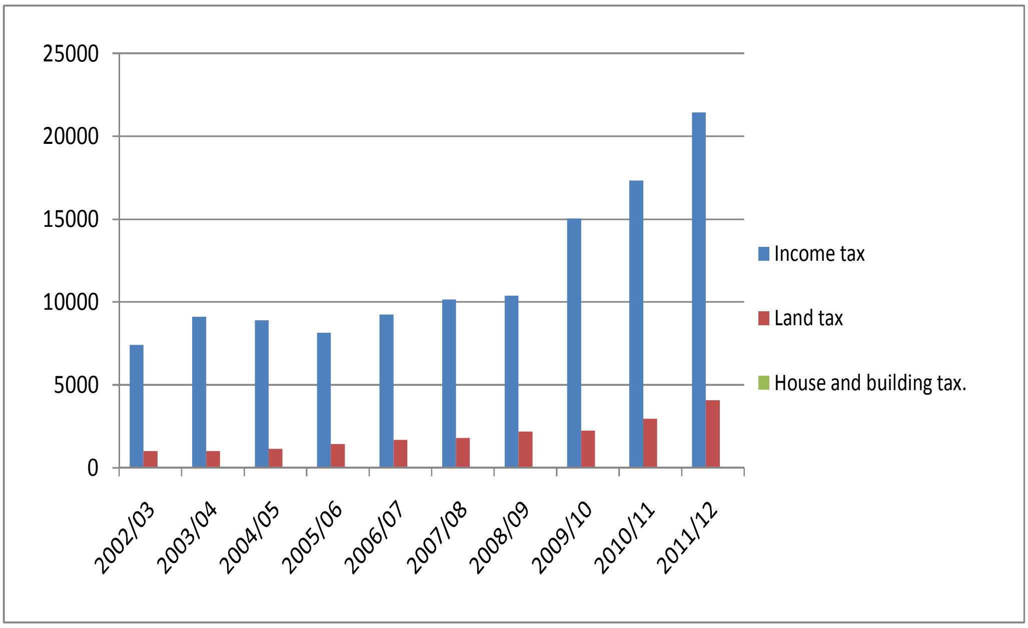
Fiscal year	Direct tax	Income tax	% share of IT	Land Tax	% share of LT	House and building Tax.	% share of HBT
2002/03	8555.0	7420.6	86.74	4.6	0.05	1001.8	13.73
2003/04	10159.4	9110.0	89.67	5.1	0.05	1011.3	11.82
2004/05	10597.55	8903.6	84.01	0.82	0.01	1131.82	10.68
2005/06	10105.66	8132.2	80.47	-	-	1414.30	14
2006/07	11912.6	9245.9	77.61	-	-	1697.50	14.25
2007/08	13071.8	10159.4	77.72	-	-	1799.20	13.76
2008/09	13968.1	10373.7	74.27	-	-	2181.10	15.61
2009/10	18980.3	15034	79.20	-	-	2253.50	11.87
2010/11	23087.76	17311.22	74.98	-	-	2940.74	12.73
2011/12	29571.3	21418.05	72.92	-	-	4084.05	13.81
Total	150009.47	117108.67	78.07	10.52	0.11	19515.31	13
Average	15000.95	11710.87	78.07	1.05	0.11	1951.53	13

Source: Economy Survey 2011/12.

Income tax occupies largest share in the direct tax and that the percentage share of this component in the fiscal year 2002/03 was 86.74 percent amounting to Rs. 7420.6 million. Land tax, which comprised 0.05 percent of direct tax in 2002/03, contributed only 0.05 percent in 2003/04 and zero in 2011/12. The share of land tax was decreased sharply in the mid 1970's due to the rise in the relative importance of indirect taxes and income tax and large exemptions granted under the land revenue system. Since 1996/97, land revenue collection authority has been transferred to total government revenue and has ceased to because revenue sources of control government. Thus land tax has been a negligible contribution to the revenue structure of Nepal. The total collection of income tax, land tax, house and land tax during the study period were Rs. 117108.67 million, Rs. 10.52 million, Rs. 19519.31 million and Rs. 6316.56 million respectively, in which average collection on direct tax were 78.07, 0.01, 13, 4.2 percent respectively.

Figure: 4.3

Composition of Direct Tax



4.1.14 Contribution of Direct Tax

The contribution of direct tax in tax revenue and total revenue were 28.35 percent and 23.41 percent respectively in 2011/12 as against 25.38 percent and 19.59 percent in 2002/03, which is given in the following table 4.10.

Table: 4.10
Contribution of Direct Tax

(Rs. in millions)

Year	Direct tax (DT)	DT as % of tax revenue	DT as % of GDP	DT as % of total revenue
2002/03	8555.0	25.80	2.44	19.94
2003/04	10159.4	26.14	2.58	20.78
2004/05	10597.55	26.94	2.61	21
2005/06	10105.66	23.73	2.31	17.97
2006/07	11912.6	24.73	2.51	19.11
2007/08	13071.8	24.16	2.38	18.64
2008/09	13968.1	24.32	2.31	19.32
2009/10	18980.3	26.68	2.61	21.63
2010/11	23087.76	27.12	2.82	21.45
2011/12	29571.3	28.95	3.53	23.41
Total	150009.47	26.22	2.61	20.33
Average	15000.95	26.22	2.61	20.33

Source: Economy Survey 2011/12

From the table 4.10, the share of direct tax on total tax revenue was 25.80 percent in 2002/03, after that it is increasing slowly up to 28.95 percent in 2011/12. The main reason of this loss contribution of direct tax in Nepal is the exemption of income from agriculture sector.

The share of direct tax on GDP is very low. Its share in 2002/03 was only 2.44 percent and it increased to 2.61 percent in year 2004/05. After that it decreased to 2.31 percent in year 2005/06 and started to increase and reached to 3.53 percent in year 2011/12. On the other hand, the share of direct tax on total revenue remained from 19.94 percent in 2002/03 to 23.41 percent in 2011/12. The average percent of direct tax on tax revenue, GDP and total revenue were 26.22, 2.61, and 20.33 percent respectively during the study period.

Figure: 4.4

Trend of Direct Tax Revenue

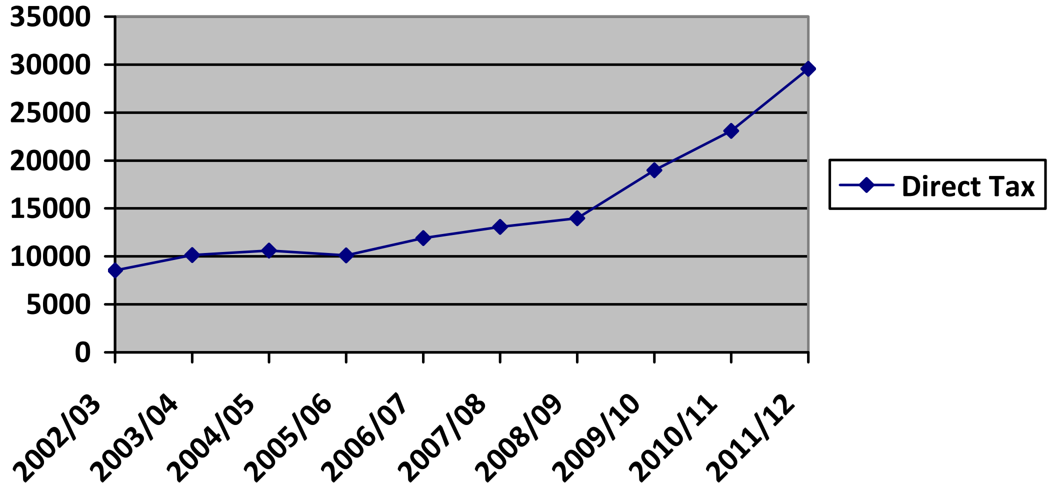


Figure 4.10 Shows direct tax on total revenue is increasing in 2004/05 and then it decreased to 23.73% in year 2005/06 and then increasing slowly up to 28.95% in year 2011/12.

4.1.15 Contribution of Income Tax in Nepal

The contribution of salary tax and business tax to total income tax during the first four years after the introduction of income tax is given in the following table 4.11.

Table: 4.11

Income Tax Revenue Collection from 1959/60 to 1962/63

(Rs. In Millions)

Heading	1959/60	1960/61	1961/62	1962/63
Business	162	339	1031	1767
Salary tax	41	67	135	169
Total	203	406	1166	1936
Foreign investment tax	-	-	1	140
Grand Total	203	406	1167	2076

Source: Budget speeches, MOF

Above table 4.11, shows that trend of revenue collection from Business, Salary and Foreign investment tax from different years. Business tax in1959/60 was 162 and increasing slowly up to 339 million in year 1960/61 then it is increasing in higher rate and become 1767 million in year 1962/63. Similarly, Business tax and foreign investment tax is also increasing trend and becomes 169 million and 140 million respectively in year 1962/63.

Table: 4.12

Contribution of Income Tax on Different Revenue Heads

(Rs. in Millions)

Year	Income tax (IT)	IT as % of direct tax	IT as % of tax revenue	IT as % of total revenue	IT as % of total GDP
2002/03	7420.6	86.74	22.38	17.30	2.03
2003/04	9110.0	89.67	23.44	18.63	2.31
2004/05	8903.7	84.01	22.63	17.65	1.94
2005/06	8132.2	80.47	18.70	14.16	1.62
2006/07	9245.9	77.61	19.19	14.83	1.73
2007/08	10159.4	77.72	18.77	14.48	1.73
2008/09	10373.7	74.27	18	15.35	1.58
2009/10	15034	79.20	21.13	17.14	2.07
2010/11	17311.22	74.98	20.32	16.08	2.11
2011/12	21418.05	72.92	20.97	16.95	2.55
Total	1171108.77	79.76	20.55	16.16	1.97
Average	11710.88	79.76	20.55	16.16	1.97

Source: Economy Survey 2011/12.

Income tax was increased about 3 folds in 2011/12 as against in 2002/03. Total income tax in 2002/03 was Rs. 7420.6 million and it increased to Rs. 21418.05 millions in 2011/12. The share of income tax to total direct tax was decreased to 72.92 percent in 2011/12. The share of income tax total tax revenue was 22.38 percent in 2002/03, which decreased to 20.97 percent in 2011/12. Similarly, its share on total revenue and total GDP were 17.30 percent and 2.03 percent respectively in 2002/03 and 16.95 percent and 2.55 percent respectively in 2011/12. The average percentage collection of income tax on direct tax, tax revenue, total revenue and GDP were 79.60 percent, 20.55 percent, 16.16 percent and 1.97 percent respectively during the study period of 10 years.

From the above table, it can be said that the income tax is one of the prime source of direct tax in Nepal. But the contribution of income tax to the total tax revenue is still lower than the developed countries. Nevertheless, income tax is most likely to surpass the custom duties in future and will be the second largest source of revenue and the first largest source will be VAT.

4.1.16 Composition and Trend of Income Tax

Till 1993/94 income tax revenue was divided into corporate income tax, individual income tax and remuneration. From 1993/94, the income tax revenue was divided into four groups, they were: corporate income tax, individual income tax, house and land tax and interest tax. Corporate tax is collected from government corporations, public and private limited companies and partnership firms. Individual tax is collected from remuneration, and industry, business, profession or vocation. Interest tax is collected from banks and financial companies that pay interest on all type of deposits and the house rent tax is levied on income obtained from renting house and land in urban areas. The composition and trend of income tax revenue is given in the following table 4.13.

Table 4.13

Components of Income Tax

(Rs. in Millions)

Year / Sources of income tax	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	20
A. Corporate income tax	4440	5990	3668.4	3358.3	4575.8	4979.8	48
i. Government corporation	2200	2930	1769.3	1251	2056	1332.4	19
ii. Public ltd company	1340	1930	987	871	987.9	1179.6	12
iii. Private ltd company	900	1130	1412	1236.3	1531.3	2467.8	34
B. Individual income tax	2320	2400	4419.1	3528.2	3533.4	3926.3	42
i. Remuneration	450	600	835.6	1252.6	1391.2	1675.9	17
ii. Industry, business, profession, and others	1870	1800	3583.5	2109.6	2142.2	2250.4	24
C. House and land tax	250	260	348.5	381.7	403.3	496.3	50
D. Interest tax	410	460	467.7	864	733.4	757	77
Total	7420	9110	8903.7	8132.2	9245.9	10159.6	10
% increase of income tax collection	20.26	22.78	2.26	8.66	13.69	9.88	2.

Source: Annual Reports, 2011/12

From the table 4.13, the amount of corporate income tax was gradually increased up to 2003/04 but it decreased in 2004/05 to 2005/06. Again it started to increase from year 2006/07 which was Rs. 4575.8 million and reached to Rs. 10032.40 million in years 2011/12. In overall, it plays the vital role in income tax.

The contribution of individual income tax was in increasing trend till the year 2004/05 and it was decreased in 2005/06. But it started to increase from year 2006/07 and reached to Rs. 7608.65 million in year 2011/12. Industry business profession, and others contributed in income tax is relatively higher than the remuneration.

The contribution of house and land rent tax and interest taxes were in increasing trend. Their contribution were Rs. 250 million and Rs. 410 million respectively in 2002/03 and Rs. 993.7 million and Rs. 1783.4 million respectively in 2011/12.

The percentage increased in income tax collection were 20.26, 22.78, 2.26, 8.66, 13.69, 9.88, 2.10, 44.92, 15.15 and 23.72 in year 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10, 2010/11and 2011/12 respectively.

Table 4.14

Composition of Income Tax

(Rs. in Millions)

Year	Total income tax	Corporate tax	% of income tax	Individual tax	% of income tax	House and land, tax	% of income tax	Interest tax	% inte tax
2002/03	7420.6	4440.6	59.84	2320	31.26	250	4.72	410	5.53
2003/04	9110	5990	65.75	2400	26.34	260	2.85	460	5.05
2004/05	8903.7	3668.4	41.2	4419.1	49.63	348.5	3.91	467.7	5.25
2005/06	8132.2	3358.3	42.16	3528.2	42.21	381.7	4.79	864	10.8
2006/07	9245.9	4575.8	49.49	3533.4	38.22	403.3	4.36	733.4	7.93
2007/08	10159.4	4979.8	49.02	3926.3	38.86	496.3	4.89	757	7.45
2008/09	10373.7	4855	46.80	4234.7	40.82	509.1	4.91	774.9	7.47
2009/10	15034	8145.3	54.18	5234.4	34.82	599.4	3.10	1054.9	7.02
2010/11	17311.22	9121	52.68	6381.2	36.86	721.1	4.17	1087.9	6.28
2011/12	21418.05	10032.4	46.84	8608.7	40.19	993.67	4.64	1783.4	8.32
Total	117108.77	59166.59	50.52	4458.95	38.07	4963.07	4.24	8393.18	7.17
Average	11710.88	5916.66	50.52	4458.6	38.07	496.31	4.24	839.32	7.17

Source: Annual Report of IRD, 2011/12.

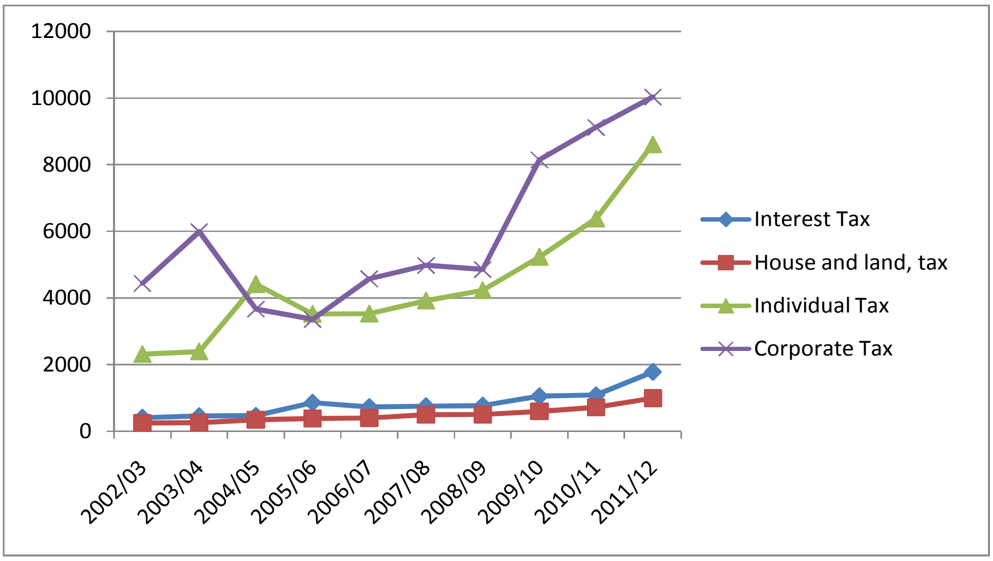
The share of corporate income tax on total income tax was 59.84 percent in 2002/03, which was increase to 65.75 percent in 2003/04. It was in fluctuating trend during the study period. In year 2011/12, the share of corporate income tax on total income tax was 46.84 percent.

Individual income tax contributed 31.26 percent of total revenue tax in 2002/03 which was decrease to 26.34 percent in year 2003/04. It was fluctuating trend and its share on total income tax in year 2011/12 was 40.19 percent. It contributed 49.63 percent in 2004/05 on total income tax which was maximum contribution during the study period. The contribution of house and land tax was in between 2 to 5 percent. Its share in 2002/03 was 4.72, which was decrease to 2.85 percent in 2003/04. The maximum share of house and land tax on total income tax was 4.91 percent in year 2008/09. Its share on total income tax was 4.64 percent in 2011/12.

Interest tax contributed 5.53 percent in 2002/03 which was increased up to 10.85 percent in 2005/06 and till 2010/11 it started to decrease. Interest tax was decreasing trend since 2005/06 to 2010/11. In 2011/12, the share of interest tax was 8.32 percent on total income tax. The composition of total income tax has been shown graphically as follows:

Figure: 4.5

Component of Income Tax



4.1.17 Contribution of Income Tax to National Revenue of Nepal

In order to know the respondent's opinion about the contribution of income tax to national revenue of Nepal a question was asked "Do you think that contribution of income tax to national revenue of Nepal is satisfactory? The responses were received from the respondents which are tabulated as follows:

Table: 4.15

Satisfaction towards contribution of Income Tax to National Revenue of Nepal

Response / Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	4	40	6	60	10	100
B	10	40	15	60	25	100
C	12	48	13	52	25	100
Total	26	43	34	57	60	100

Source: Opinion Survey, 2013

The questionnaire received as 26 respondents i.e. 43 percent of the total respondents were agreed that the contribution of income tax to national revenue of Nepal is satisfactory and 34 respondents i.e. 57 percent of the total respondents were not agreed about the contribution of income tax to national revenue. Most of the respondents of the all codes (A, B, C) were disagreed about the contribution of income tax to national revenue. Thus it can be concluded that the contribution of income tax to national revenue of Nepal is not satisfactory.

4.1.18 Opinion on Current Income Tax Rates

In order to know the opinion on current income tax rates, respondents were requested to tick only among the 3 alternatives (high, medium and low). The question was asked, "What is your opinion about the current income tax rates?" The respondents received are tabulated as follows:

Table: 4.16

Opinion on Current Income Tax Rates

S.N.	Tax rates	Group			Total Number	%	Ranking
		A	B	C			
1	High	3	6	12	21	35	2
2	Medium	6	16	13	35	58	1
3	Low	1	3	-	4	7	3
Total		10	25	25	60	100	-

Source: Opinion Survey, 2013

Out of the cent percent response, 58 percent of the respondents were agreed that the current income tax rate is medium where as 35 percent of the respondents agreed on high tax rate and 7 percent of the total respondents were agreed on low tax rate. From the above table, it can be concluded that the current income tax rate is medium. Some respondents feel that the rate is not higher in absolute terms but it is higher as compared to taxpaying capacity of Nepalese people.

4.1.19 Sufficiency of Exempted Items of Income Tax

Income tax act has provided exemption to the various incomes. The exemption provided to different items of income. Act has clearly pointed the exempt organizations, which are tax free organizations. To know the sufficiency of exempted items of income, a question was asked, “Do you think that the exempted items of income are sufficient?” The responses were as follows:

Table: 4.17

Sufficiency of Exempted Items of Income Tax

Respondents / Responses	Group			Total number	**%**	Ranking
	A	B	C			
Yes	4	18	10	32	53	1
No	6	7	15	28	47	2
Total	10	25	25	60	100	-

Source: Opinion Survey, 2013

There were 100 percent responses received from respondents out of 60 respondents, 32 respondents i.e. 53 percentages were agreed that the exempted items of income are sufficient whereas 28 respondents i.e. 47 percentages were disagreed about the sufficiency of exempted items.

Those respondents who gave [No] response about the sufficiency of exempted items of income were asked another question, “If no, what kind of incomes should be exempted?” It was requested to response in the blank orders. Most of the respondents did not response about it. Only few responses were received which are classified according to the code used in number-wise.

A. Tax experts

1. Provident fund
2. Life insurance premium
3. Export earning
4. Remote area allowance
5. Interest received from the government banks.
6. Awards and rewards.
7. Scholarship or
8. Rationale exemptions should be given to all kind of incomes.

B. Tax administrators

1. Life insurance premium.
2. Citizenship investment fund.

C. Taxpayers

1. Over time allowance.
2. Retirement benefits.
3. Income of foreign employee.
4. Life insurance premium.
5. House rent.

6. Educational allowances for the children.
7. Electricity and water.
8. Medical expenses on the basis of bills.
9. Tiffin allowance.

The majority of remuneration taxpayers, the responses of group C were related with employment income.

4.1.20 Adequateness of Current Income Tax Exemption Limit

Finance act of Nepal yearly prescribes the tax rate and exemption limit of income. When the income tax introduced, tax rates and exemption limit are changing yearly. To know the respondent's view about the current exemption limit, a question was asked in yes or no answer as, "Do you think that the current income tax exemption limit is adequate?" The responses are as follows:

Table: 4.18

Adequateness of Current Income Tax Exemption Limit

Respondents / Responses	Group			Total number	**%**	Ranking
	A	B	C			
Yes	4	10	3	17	28	2
No	6	15	22	43	72	1
Total	10	25	25	60	100	-

Source: Opinion Survey, 2013

From the above table 4.18 it can be seen that the current income tax exemption limit is inadequate 43 respondents out of 60 i.e. 72 percent were against the adequateness of current exemption limit whereas only 28 percent of the respondents i.e. only 17 out of 60 were for the adequateness of current exemption limit. The respondents who were against the adequateness of current exemption limit was asked a question, "If no, what exemption limit do you suggest for an individual and a couple or a family?" The responses were as follows:

Table: 4.19

Suggestion of Exemption Limit for an Individual

Respondents / Responses	Group			Total number	**%**	Ranking
	A	B	C			
Rs. 140,000	-	2	3	5	12	3
Rs. 150,000	2	4	4	10	23	2
Rs. 200,000	4	9	15	28	65	1
Total	6	15	22	43	100	-

Source: Opinion Survey, 2013

From the above responses about the exemption limit of an individual, it was found that 65 percent of the respondents in favor of Rs. 200,000 whereas 23 percent of the respondents suggested that the exemption limit should be Rs. 150,000 and 12 percent of the respondents suggested Rs. 140,000.

Table: 4.20

Suggestion of Exemption Limit for a Couple or a Family

Respondents / Responses	Group			Total number	**%**	Ranking
	A	B	C			
Rs. 175,000	1	3	2	6	14	4
Rs. 190,000	-	2	5	7	16	3
Rs. 200,000	2	5	5	12	28	2
Rs. 250.000	3	5	10	18	42	1
Total	6	15	22	43	100	-

Source: Opinion Survey, 2013

From the above table 4.20, it is clear that most of the respondents (i.e. 42%) suggested for Rs. 250,000 as exemption limit for a family. 28 percent of the respondents suggested for Rs. 200,000 also Rs. 190,000 and Rs.175,000 suggested by respondents of 16% and 14% respectively. It can be concluded that most of the

Respondents are in favor of Rs. 250,000 as an exemption limit for a family. On the personal discussion with the respondents, the researcher found that more people were in support to provide income tax exemption limit equivalent to annual remuneration income of a government employed section offices.

4.1.21 Family Exemption Limit According to the Number of Dependents

Income tax act has provided exemption limit to a family. But it has not defined the number of dependents within a family. So, to know the opinion about the exemption limit of a family according to the number of respondents, a question was asked, "Do you agree that family exemption limit must be provided according to the number of dependent?" The responses were as follows:

Table: 4.21

Family Exemption Limit on the Basis of the Number of Dependents

Respondents / Responses	Group			Total number	%	Ranking
	A	B	C			
Yes	2	8	15	25	42	2
No	8	17	10	35	58	1
Total	10	25	25	60	100	-

Source: Opinion Survey, 2013

The above table 4.21 shows the response of respondents about the family exemption limit that must be provided according to the number of dependents. Out of the 100 percent response, 58 percent of the respondents disagreed whereas 42 percent of the respondents agreed that the family exemption limit must be provided according to the number of dependents. The majority of respondent of group A and B were disagreed but Group C was agreed on providing the family exemption limit according to the number of dependents. On the personal discussion, either of any group of the respondents having micro family was against on providing the family exemption limit according to the number of dependents due to their lowest exemption limit. But as a whole, it can be concluded that most of the respondents disagreed on providing the family exemption limit according to the number of dependents. Researcher also found that respondents were in favor to provide exemption limit to a family according to the number of dependents but it is difficult to execute because it is impossible to apply in real field.

Similarly, one question was asked to know the opinion of respondents or exemption limit that should be adjusted according to the inflationary situation of the country. The question was, "Do you agree that exemption limit should be adjusted according to the inflationary situation of the country?" The responses were:

Table: 4.22

Exemption Limit According to the Inflationary Situation of the Country

Respondents / Responses	Group			Total number	%	Ranking
	A	B	C			
Yes	4	17	20	41	68	1
No	6	8	5	19	32	2
Total	10	25	25	60	100	-

Source: Opinion Survey, 2013

The above table 4.22 shows that 68 percent of the respondents were agreed to adjust the exemption limit according to the inflationary situation of the country whereas only 32 percent of the respondents were disagreed about it. So it can be concluded that the exemption limit of a family or an individual should be adjusted according to the inflationary situation of the country. But this situation makes the tax administration more complicated and vague, rather every year's fiscal policy may give tax relief to accommodate inflation.

4.1.22 Opinion on Providing Exemption Limit on Agriculture Income

After commencing of Income Tax Act, agricultural income has been treated as taxable income in something in a specific case and sometime as exempted income too. The new Income Tax Act has exempted agricultural income tax other than the income from company, or partnership, or corporate body, or through the land above the holding ceiling an prescribed in land act 2001. To know the opinion on it one question was asked as, "What is your opinion on exemption providing on agricultural income?" The following table gives the breakdown of responses:

Table: 4.23

Exemption on Agricultural Income

Responses \ Respondents	Group			Total number	%	Ranking
	A	B	C			
Yes, it should be exempted	6	15	20	41	68	1
No, it shouldn't be exempted	2	6	-	8	13	2
It should be treated as other income	2	2	3	7	12	3
Other, (if any, specify)	-	2	2	4	7	4
Total	10	25	25	60	100	-

Source: Opinion Survey, 2013

From the above table 4.23, it shows 68 percent of the total respondents were in support to exempt the agricultural income whereas 13 percent of the respondents were against the exemption of agricultural income. Only 12 percent of the respondents were in favor to treat it as other income. The respondents who specified their responses as other were given the following suggestions:

- Certain area and the income of marginal farmers should be exempted
- Based on subsistence farmer and commercial farming, for the first, it should be exempted.
- A practical arrangement for taxing agriculture should be formulated, for example, base on the size of landholding.
- Commercial agricultural income because there is a condition of not collecting land tax or revenue. On this condition, how can it collect the agricultural tax?

4.1.23 Sufficiency about the Itemized Deductions

Income Tax Act 2058 has provided different kinds of expenses as deductions. Some expenses are allowed for deduction as itemized deduction and some are standard deduction.

In order to know the attitude towards the item-wise deduction of expenses, a question was asked as, “Do you think that the itemized deduction are sufficient?” The responses were follows:

Table: 4.24

Sufficiency about Itemized Deductions

Respondents / Responses	Group			Total number	%	Ranking
	A	B	C			
Yes	4	15	10	29	48	2
No	6	10	15	31	52	1
Total	10	25	25	60	100	-

Source: Opinion Survey, 2013

There was cent percent response received from the respondents. Majority of the respondents were against sufficient of itemized deduction of expenses. Except tax administrators, majority of tax experts and taxpayers were in against of itemize deduction of expenses from the above table, it can be concluded that there are insufficiencies about itemized deductions.

The respondents who were against the sufficiency about itemized deductions was asked another question as, “If no, what kind of other expenses should be deducted while computing taxable income?” The respondents were requested to write in the blank orders. Few respondents replied responses which are classified according to the code used in number wise.

A. Tax experts

- Repair and maintenance should be fully allowed there is no meaning of allowing only 7% of the depreciation base according to the existing provision.
- Special Economic Zones (SEZ) should be created and alternative tax administration, exemption allowed for industries, processing units, infrastructure development projects in such regions.

B. Tax Administrators

- Daily T.A. expenses from residence to business.
- Educational expenses.

- Traveling expenses.
- Delivery expenses.

C. Taxpayers

- House rent
- Educational allowance
- Medical expenses on the basis of bills.
- Tiffin allowance.
- Traveling allowance.

4.1.24 Sufficiency of Provisions Relating to Exemption and Deductions

In order to know the sufficiency of provisions related to exemptions and deductions under the Nepalese Income Tax Act, respondents were requested to give their response in yes/no alternatives. The question was asked as, "In your opinion, are the provisions relating to exemptions and deductions under the Nepalese Income Tax Act sufficient in all aspects?" The responses received on it are tabulated as below:

Table: 4.25

Sufficiency of Provisions Relating to Exemptions and Deductions

Respondents / Responses	Group			Total number	%	Ranking
	A	B	C			
Yes	4	18	5	27	45	2
No	6	7	20	33	55	1
Total	10	25	25	60	100	-

Source: Opinion Survey, 2013

From the above table 4.25, it is seen that 45 percent of respondents were agreed whereas 55 percent of respondents were disagreed about sufficiency of provisions relating to exemptions and deductions under the Nepalese Income Tax Act. From the above table, it can be concluded that majority of the respondents were against the sufficiency.

The respondents who gave negative responses about the sufficiency of provisions relating to exemptions and deductions under the Nepalese Income Tax Act the question was requested to give their responses on the blank order. The question was, "If no, in which aspects the improvements are needed?" The responses received by the respondents for the improvement of different aspect of Nepalese Income Tax Act are as follows:

a) Tax rates.
b) Payment system.
c) Income statement.
d) Tax administration.
e) Monitoring unit.
f) Attitude of tax administration.
g) Tax base should be enlarged.
h) Tax laws.
i) Exemption limit.
j) First of all, business income should be brought into tax net, then tax should be imposed on the basis of level of income using multiple tax rates.
k) All rental incomes of the landlords or in urban areas should be brought into tax net by determining the minimum rent that could be collected from the tenant by the house owner, excess of the rent should be taxed using appropriate rate.
l) Depreciation allowance should be simplified.

Group 'B': Tax Administrators

a) Tax laws.
b) Accounting system.
c) Specification of job of the department.
d) Tax administration.
e) Computerized system in all tax offices.
f) Functional system.
g) Simplify the language.

h) Remove complicated provision.

Group 'C': Taxpayers

a) Language.

b) Depreciation.

c) Remuneration income.

d) Tax administration.

e) District wise tax offices.

f) Exemption limit on the basis of market price.

g) Property tax.

From the above aspects for improvement, most of the respondents were suggested to improve tax law and language to be simplified they also focused to improve the tax administration too.

4.1.25 Suggestions about Income Tax in Nepal

Income Tax Act 2058 is better than earlier Income Tax Act 2031, but this new act is not free from weaknesses and vague and complicated language used. Thus a question was asked to give suggestions about income tax in Nepal. The question was asked as, "Do you have any suggestions about income tax in Nepal?" Only few respondents of all kinds of group have given the suggestions which are given below.

- The tax laws needs to be simplified, easily interpreted and understood by even a layman.
- Tax administration and assessment procedures are also required to be simplified and should be made taxpayers as friendly.
- Accessibility of the tax administration should be improved.
- Utilization of revenue takes vital role to revenue generation and voluntarily self registration and assessment.
- Public awareness is needed and political commitment and credibility should be necessary.

- Income tax act should facilitate people to pay tax by making honestly and friendly organization and employees.
- It should give focus on the area of taxation rather than high tax rate.
- Lowering tax rate and increasing tax base.
- Increasing exemption limit.
- Motivation for self-compliance.
- Developing competence within tax personnel.
- Starting court case to evading people/entity.
- Compulsory declaration of assets of each individual.
- Different privilege and nation-wide recognition must be given to the regular and high taxpayers and also should give for abroad visiting.
- Punishment should be given for not paying tax to the government.

4.2 Major Findings

According to the preceding chapters, some important findings can be drawn. These summaries of this research study are summarized below:

- Income tax system of Nepal is suffering from various problems and weakness such as, lack of trained employee, 24%, lack of cooperation in tax administration, increased corruption, voluntary compliance, ambiguous provisions under the Nepalese Income Tax Laws, limited tax base, difficult to maintain the account for tax purpose, relatively high tax rate, 35%, lack of timely adjustment of tax laws etc.

- For the purpose of calculating the income of a person for an income year from any business, employment or investment, the following expense are not allowed for deduction, expenses of domestic or personal nature, income tax, expenses made on deriving amount exempt under section 10 or final withholding payments, distribution of profit by an entity, expenses of capital nature, foreign income tax and any other amount, any other amount to the extent to which a deduction is not denied by the above paragraph, has not defined and clarified the amounts.

This kind of provisions will provide loopholes for tax administration and tax payers. A person who annual turnover for an income year exceeds Rs.20,00,000 is not allowed a deduction for a cash payment is excess of Rs. 50,000 incurred at once other than in the following condition by person during the year:

- Payment made to G/N
- A constitution body
- A constitution owned by G/N
- A bank or financial institution,

❖ Government revenue is the composition of external revenue and internal revenue. Internal revenue includes both tax and non tax revenue. There is dominant share of total tax revenue in Nepalese government revenue. The main contribution of total tax revenue and it was 80.85 percent in 2011/12.

❖ Income tax has been considered as a major source for the collection of government revenue of government and mobilizing internal resources. It may enhance the revenue of government, promote distributive justice and encourage private sector investment.

❖ In Nepal, the coverage of income tax is very low. Agricultural income exempted from income tax. Exclusion of agricultural income from the tax net alone cuts out half of the GDP. In other hand, labour tax is taxed more heaving than the capital income. Retirement amount received by Nepalese people being retire from the service by army or police of foreign country is also exempted from income tax. Exemption of these sources provided loopholes for tax evasion.

❖ An opinion survey has been conducted in order to find out the various aspects of income tax. From the opinion survey of various respondents, the following conclusions have been drawn as:

    - Income tax administration of Nepal is considered as unsound main cause of unsound income tax administration are :

        i. Lack of trained employees, 24%

ii. Shortage of income tax expert/professional income tax administration 22% and
iii. Lack of public participation 21%

- Income tax rate of Nepal are considered a medium,
- Exempted items of incomes are sufficient,
- Current exemption limit of an individual and family are not sufficient and appropriate,
- Family exemption limits must be provided according to the inflationary situation of the country.
- Agricultural income should be exempted from income tax
- Half of the respondents were suggested for itemized deduction and were agreed on sufficiency of itemized deduction.
- All the expenses, which are related to earn income, must be prioritized for deduction.

CHAPTER-V

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

Developing countries like Nepal needs huge capital investments for development process, which can be fulfilled by tax sources, non-tax sources and foreign grants and loans. Due to poor performance on internal revenue collection and mobilization. The dependence is increasing which is not desirable for any economy. Thus, it is more essential to mobilize the internal fund to the optimum level.

To increase the government revenue, Nepalese is trying to extract money from people through taxation. Within tax, income tax is the most important sources of government revenue. It is considered as good remedy to cure growing resources gap problem in Nepal.

Within the income tax exemptions and deductions are more important. There are many problems in income tax practice in Nepal such as leakage in tax, feeling of people about tax as a penalty, lack of consciousness of people etc.

Modern economic development of Nepal was started with the initiation of first economic planning in 2013 B.S. Nepal has introduced its first tax act in 2031 B.S. and in 2058 B.S. named Income Tax Act (as amended by finance ordinance 2061). From the very beginning the concepts of exemption, deductions and other forms of tax relief in income tax have changed in Nepal. All income of an individual cannot be taxable because the minimum cost required for subsistence cannot be taxed. The exemptions, deductions and other forms of tax relief are essential to encourage an individual to work more. The tax relief works as an incentive to an incentive to an individual. So, the concept of exemption, deduction and tax relies were emerged in Nepal from the very beginning of income tax. Currently, income tax system of Nepal encompasses four taxes, i.e. corporate income tax, individual income tax, house rent tax and interest tax. Among them, contribution o corporate sector is highest. Exemptions limit and the rate of the income tax is determined according to the income level and sector wise but it is not adjusted according to the inflationary situation of the country and number of dependents.

This study has demonstrated the income tax administration of Nepal is not sufficient enough due to various causes with the help of primary data and secondary data of the study period. Such as income tax system of Nepal is suffering from various problems. So, to improve the tax system in Nepal for highly mobilization of resources.

5.2 Conclusions

- Lack of trained employees, lack of cooperation in tax administration, voluntary compliance and increase corruption are major problems and weaknesses of Nepalese income tax system.
- Some exemptions granted to achieve certain objectives are not effective. Tax incentive is one of the examples of this. Tax concessions encourage the establishment of industries in certain area but they vanish or change names, ownership or place the business when the tax concession facility expires.
- For the purpose of calculating the income of person for an income year from a business or investment all the interest are allowed for deduction. But in the case of an exempt-controlled resident entity, it may deduct the amount of interest but not exceeding the sum of all the interest derived by the entity during the year that is to be included in calculating the entity's taxable income for the years calculated without including any interest derived by the entity or deducting any interest by the entity. It is an unlawful step to business not to get the deduction of full amount of interest. Here a controversial condition exists between the law of banking and law of income tax does not give the deduction of full amount of interest for an income year.
- For the purpose of calculating person's income for an income year from any business no deduction is otherwise allowed for the cost of trading stock except the allowance determined by subtracting the amount of closing value of

trading stock plus the cost of trading of the business acquired by the person during the year.

- Provisions made under the Nepalese income tax are not sufficient in all respects. Improvement is needed in language, laws, tax administration, exemption limit etc.

5.3 Recommendations

- Income tax laws and administration in Nepal are to be deeply scrutinized and properly implemented. The provisions made on the act have to be mentioned clearly and language has to be made clear some reforms in tax administration are needed. All the tax personnel should be given comprehensive short as well as long time training on various aspects of taxation on regular basis.

- Exemption limit and the rate of the income tax is determined according to the income level and sector wise but has not been adjusted according to the inflationary situation of the country and number of dependents. It should be adjusted according to the inflationary situation of the country of yearly basis.

- To increase the government internal revenue, Nepalese government is trying to extract money from people through taxation. Within tax, income tax is the most important source of government revenue, which is considered as a good remedy to cure growing resource gap in Nepal.

- If the problems relating to income tax system in Nepal can be solved and resources are effectively utilized then only the prospects of revenue collection through income tax will be effective and bright and the economic development of Nepal will be achieved.

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APPENDIX

QUESTIONNAIRE

Name of the Respondent:………………………………………
Designation:………………………………..
Office/Organization:…………………………..
Address:………………………………………

(Please tick your answers in the following and put in order of preference from first to last number if there are more than four alternatives)

1. Do you think that contribution of income tax to national revenue of Nepal is satisfactory?

   a) High b) Medium c) Low

2. What is your opinion about the current income tax rate?

   a) High b) Medium c) Low

3. Do you think that the exempted items of income are sufficient?

   a) Yes b) No

- If no, what kind of income should be exempted?

  Please note in order:

a) ……………………………………………
b) …………………………………………..
c) …………………………………………..

4. Do you think that current income tax exemption limit is adequate?

a) Yes b) No

- If no, what exemption limit do you suggest for an individual unit?

a) Rs. 1,40,000 b) Rs. 1,50,000 c) Rs. 2,00,000 d) Other (if any specify)

- Similarly, how much exemption limit should be for a couple or family?

a) Rs. 1,75,000 b) Rs. 1,90,000 c) Rs. 2,00,000
d) Rs. 2,50,000

5. Do you agree that family exemption limit must be provided according to the number of dependent?

a) Yes b) No

6. Do you agree that exemption limit should be adjusted according to the inflationary situation of the country?

a) Yes b) No

7. What is your opinion on providing exemption limit on agricultural income?

a) Yes, it should be exempted.
b) No
c) It should be treated as other income
d) Other (if any, specify)

8. Do you think the itemized deductions are sufficient?

a) Yes b) No

- If no, what kind of other expenses should be deducted while computing taxable income?

a) ………………………….
b) ………………………….
c) ………………………….

9. In your opinion, are the provisions relating to exemptions and deductions under the Nepalese Income Tax Act sufficient in all aspects?

a) Yes b) No

- If no, in which aspects the improvements are needed?

a) …………………………..
b) …………………………..
c) …………………………..

10. Do you have any suggestions about in income tax in Nepal?

a) …………………………………..
b) …………………………………..
c) …………………………………..
d) ……………………………………