CONTRIBUTION OF INCOME TAXON GOVERNMENT REVENUE OF NEPAL

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by

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RECOMMENDATION LETTER

This thesis entitled **CONTRIBUTION OF INCOME TAXON GOVERNMENT REVENUE OF NEPAL** has been prepared by **Mr.BhismaBasnet**under my supervision. I hereby recommend this thesis for examination by the thesis committee as partial fulfillment of the requirements for the Degree of Master of arts in Economics.

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Prof. Dr. R.K. Shah

(Thesis Supervisor)

Date: 06/11/2073 B.S.

APPROVAL LETTER

This thesis entitled **CONTRIBUTION OF INCOME TAX ON GOVERNMENT REVENUE OF NEPAL** submitted by **Mr.BhismaBasnet**to the Central Department of Economics, Faculty of Humanities and Social Sciences in partial fulfillment for requirements of Master of Arts in Economics has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the said degree.

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BhismaBasnet

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ABBREVIATIONS/ACRONYMS

ADB	-	Asian Development Bank
BIMSTEC	-	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
CBS	-	Central Bureau of Statistics
CEDA	-	Center for Economic and Development Administration
CEDECON	-	Central Department of Economics
CPI	-	Consumer Price Index
DoF	-	Department of Finance
Etc.	-	et cetera
FY	-	Fiscal Year
GDP	-	Gross Domestic Product
GoN	-	Government of Nepal
IMF	-	International Monetary Fund
IRD	-	Inland Revenue Department
IT	-	Income Tax
ITA	-	Income Tax Act
Ltd	-	Limited
MoF	-	Ministry of Finance
NA	-	Not Available
No.	-	Number
NPC	-	National Planning Commission
NRB	-	Nepal Rastra Bank
NRs.	-	Nepalese Rupees
PFM	-	Public Finance Management
SAFTA	-	South Asian Free Trade Area

TU	-	Tribhuvan University
USA	-	United States of America
VAT	-	Value Added Tax
Vol	-	Volume
WB	-	World Bank
WTO	-	World Trade Organization

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Generally, tax is a compulsory payment made by the individuals or institutions and it is also defined as a levy or other type of financial charge of fee imposed by government on legal entities or individuals. It is a kind or money of which it is the legal duty of every citizen of the country to pay honestly. Tax is computed and paid as prescribed in the law. A tax payer is not entitled to compel the government, while paying taxes, to give something to him in return of the amount he has paid. Taxation can be considered as a convenient method of raising revenue which in turn is linked with the welfare of the people directly or indirectly (Kalauni, 2011).

In developing country like Nepal, government has to spend a lot of money to fulfill its responsibility towards its people. The responsibility may be either for security or for health or education or other developmental activities. In each country, a lot of fund is spent by the public authority for the protection of common people and for the creation of various socio-economic infrastructures. Protection expenditure includes the purchase of arms and ammunition, maintenance of army and police and administration of justice and jail. The expenditure of Nepalese government is increasing year by year because of time, income in population, social progress, war or preparation for war, increase in price, national income and so on.

Tax may be of various types. It may be direct and indirect tax. The rate and nature of tax may be different as economists have classified the tax from different angles. They have given a very long list of the types of tax. But on the basis of impact and incidence, the tax may be classified into two Categories:Direct tax and Indirect tax.

Direct taxes are those which are levied on permanent and recurring occasions, and indirect taxes changes on occasional and particular events. In modern times taxes are classified into direct and indirect taxes on the basis of assessment. Those taxes which are levied on the receipt of income are called direct taxes and those which are imposed on expenditure are regarded as indirect taxes. On this basis, income tax, profit tax, and capital gain tax would be examples of direct taxes. Excise duties, custom duties and sales tax are indirect taxes.

It will be possible to reduce the gap in income by imposing higher rate to those who are having higher income and from that collected amount providing necessary assistance to the people with very poor economic condition. Hence it will help to make equitable economic distribution in the society. Balanced regional economic development is also possible through the provision of income tax. The government should charge higher income tax on the income from urban area and less on the income from remote area. Income tax is the main source of revenue of the government, which is paid by people (i.e. tax payer) in developing countries as well as developed countries. Government conducts welfare projects for people by the help of tax collection. Hence the income tax is prerequisites for the development of the nation and daily operation of government activities (Devkota, 2011).

Great Britain is the first country in the world to introduce the modern income tax in 1799 to finance the war fought with France. USA introduced income tax in 1862 to generate revenue to finance civil war. In India income tax and its modern form was adopted in 1860, several experiments were made from 1860 to 1866 and finally the systematic income tax legislation was enacted in 1886. The history of taxation in Nepal dates back to antiquity. Nevertheless, the modern tax system gained its momentum with the establishment of democracy, and implementation of the first consolidated budget took place in 1951 (Dahal, 2013).

Until the late 1950s the two major source of revenue were land tax and tariff on foreign trade. After 1959, however, sales, and property taxes, as well as several other minor taxes, were introduced. An import-export tax and various business taxes, such as a sales tax, were the principal sources of revenue. The lad tax, which accounted for a considerable portion of revenue prior to 1960, no longer provided an important source of revenue. Income tax on individual incomes accounted for less than 7 percent of revenues. Most of the other taxes were progressive in nature (Kalauni, 2011).

1.2 Statement of the Problem

Income tax is the main source of government revenue. For the development of nation, every government needs high revenue. Performance of income tax is very constructive for all stakeholders closely attached with the government revenue as well as for a prosperous economic future of the country. Generation income by any individual and institution is the main source of income tax. If income is favorable then collection of income tax is also favorable. Lower contribution of income tax in government revenue negatively affects the country's development. The variation of income tax contribution brings the variation of government revenue and government development function. Country's economic development and government revenue are the closely related parts. For higher revenue economic development is necessary and for better economic development of a country, higher government revenue is necessary.

The trend of collection of income tax is not satisfactory. As mentioned above sustainable economic development and good political environment is necessary for the growth of the income. Income is source of income tax. Currently political situation of Nepal is not good from one and half decades it's being worse. Here is no good environment for income generating functions. Previously running organization also can't perform better. They are going downwards. Individual's income is also not a good increasing trend. It affects directly income tax and government revenue as well as government activities. The data of income tax may suffer a lot in lack of proper view and analysis practice of it, currently, contribution of income tax in government revenue of Nepal may not be sufficient for development of the nation. During the analysis period of the data of income tax collection remained below the expected level due to various national and international reasons. Therefore, this research study is concentrated on trend of income tax collection, to review and analysis the contribution in government revenue and to draw recommendation for coming period.

For the economic development of the country, contribution of direct tax is more essential rather than indirect tax, but the main tax structure of Nepal is dominated by indirect tax. Among the direct tax, income tax plays the significant role but it is not pleasurable to quote that the contribution of income tax to the national revenue is very low in Nepal. To increase its contribution to national revenue, many research and analysis should be conducted in the field of tax, but the studies and research work is lacking in the area of income tax. So to identify the problem and to overcome them and to improve income taxation, study in the field of income tax is essential. To raise government revenue there is necessary to raise its internal resources of revenue. An internal resource of revenue includes tax and non-tax revenue. Revenue mobilization, foreign grants and loan, domestic borrowings and change in cash reserve are used as fiscal instruments for financing government expenditure.

Following research questions are raised in this study:

1. What is the trend and composition of income tax in Nepal?
2. What is the contribution of income tax on national revenue of Nepal?

1.3 Objectives of the Study

The general objective of the study is to analyze the contribution of income tax on government revenue. However,following specific objectives are selected in this study:

1. To examinethe trend and composition of income tax in Nepal,
2. To analyze the contribution of income tax on national revenue of Nepal.

1.4 Significance of the Study

In developing countries like Nepal, only making act is not solution to maximize tax collection. Its implementation monitoring and its evaluation, to find out peoples view are also a part of solution for improving tax system. Income tax act is the key factor of government'srevenue generation. So, this study attempts to call government and policy makers to solve and frequent change in income tax act and aware people about income tax and encourage them to pay tax. This study can find out the difficulties of Income Tax Act, its implementation and its impact on revenue collection system as well as its benefit or contribution on national economy.

Sources of government of Nepal are very limited due to poor and least-developed condition. The government expenditure is increasing but the income of the government is not increasing side by side as compare to expenditure. So the government is facing deficit budget, every year. The deficit financing increases the share of internal as well as external debt. For the payment of internal as well as external debt tax revenue is the main source of government revenue. Income tax is a major component of tax revenue and it will also helpful to make equitable society by equitable distribution of wealth. Balance regional economic development is also possible through the provision of income tax. The government should charge higher rate of income tax on the income from urban area and less rate of income tax on the income from rural area. It has become an effective instrument to ensure balanced socio-economic growth (Dahal, 2013).

1.5 Limitations of the Study

This study has following limitations:

1. Since the study is based on Secondary data,the results depend uponthe reliability and validity of data.
2. The coverage of the period is from FY1999/2000 to FY2015/16.

1.6 Organization of the Study

This study is divided into five chapters.The first chapter is based on background of the study, statement of the problem, objectives of the study, significance of the study andlimitations of the study.The second chapterreviews different books, dissertations, related articles and journals.The third chapter deals with research methodology. This chapter analyzes the research design, nature and sources of data, tools and techniques of data collection, statistical tools and methods of data analysis.The chapter four isrelated with historical background of income tax in Nepal.The fifth chapter is related with presentation and analysis of data.The last chapter concludes the summary of findings and recommendations.

CHAPTER II

REVIEW OF LITERATURE

Review of literature is an essential part of scientific research it is the way to discover what other research in the area of our problem of our problem has uncovered. A critical review of literature helps the researcher to develop a thorough understanding and insight into previous research work that relates to the present study. It is also a way to avoid investigating problems that already been answered.

In theoretical framework, review of what has been written in academic books is carried out while review of related studies is further divided into review of journals, articles and review of master degree thesis.

This section also include conceptual framework, which includes concept of tax, direct and indirect tax, source of income, income tax in national and international context, historical background, income tax laws, etc.

2.1International Context

2.1.1 Theoretical Review

Okafor (2012)has explored that the impact of income tax revenue on the economic growth of Nigeria as proxies by the gross domestic product(GDP). Ordinary least square regression method was adopted by the researcher to explore the relationship between GDP as proxy for economic growth and a set of federal government income tax revenue heads from 1981 to 2007. However the researcher found that there is positive relationship between tax revenue and economic development in Nigeria and significant relationship between income tax revenue and money supply.

ADB (2009)has concluded that the strong revenue growth of Nepal has come mostly from increased income tax collection, which has now, for the first time exceeded custom revenue. The significant strides made in revenue collection are largely attributed to introduction of important tax reforms and improvement in tax administration, including implementation of a performance based incentive system for tax offices/officers, strengthening the large tax payers office with information technology based tax returns filing and payment systems and overall strengthening of the tax monetary and audit system. The new one-off voluntary declaration of income source (VDIS) campaign and reduction in the property rent tax rate has also helped to improve revenue mobilization.

McGee (2008)has studied about interested-adjusted income tax and interest adjusted profit tax. He further states that Croatia was the first country in the world to fully accept the consumption accepts in the field of direct taxes in the alternative form the interest-adjusted income tax and interest-adjusted profit tax. Advocates of consumption as the appropriate claim that income as a tax base discriminates saving, which is taxed twice first as being part of the income that is taxed by income tax and second as capital income that is the part of the comprehensive income of the next period. Saving and investment escape this double taxation in consumption based income and profit taxes, where the METR(marginal effective tax rate) is zero.

Sophia and Gamboa (2001)have focused on Ireland's corporation income tax and individual income tax responsiveness towards GDP and interest rate and found that there is a highly sensitive relation of income tax to interest rate and GDP by a 2.5% to 1percent ratio with GDP and 0.014percent to 1percent ratio with interest rate.

Kuo (2000)has used the following mathematical form for estimating the income tax revenue, the logarithm of real individual income tax was regressed with logarithm of real CPI as Ln(income tax)=a+bLn(CPI) and the study concluded with a positive relationship between real CPI value and the income tax collection in china. This model was further used to estimate tax revenue in china.

Zeitlhofer (1999)has analyzed about the macroeconomic relation between Australian income tax collection and interest rate in the Australian economy from 1982 to 2002 using Dicky-Fuller test and distributed lag model and tested for the causal relationship between income tax and interest rate using Granger-Causality test and concluded that interest rate Granger causes income tax in the long run.

Goode (1986)has studied about the importance of taxation and has explained that taxation diverts the economic resources from taxpayers to the state for its own use. Taxation not only restraints total spending by households and individuals but influences the allocation and affect the distribution of income and wealth. The level of taxation of a country is measured by the ratio of tax revenue to GDP, which is determined by the demand for government expenditure, the availability and willingness to use non tax source of finance, including borrowing and money creation and taxable capacity. The taxable capacity primarily depends on the percapita income in excess of the subsistence level and ability of government to collect taxes depend on administrative effectiveness. The actual tax ratio reflects both taxable capacity and tax efforts.

Goode (1984) has analyzed the objectives of fiscal policy are the promotion of income disparities between households and regions the promotion of economic stability and economic efficiency and the increase of host country returns from natural resource endowments. The primary purpose of taxation is to divert control of economic resources from tax payers to the state for its own use of transfer to others. Taxation not only restrains total spending by household and enterprise but influences the allocation of economic resources, recognizes social costs that are not reflected in the market prices and affects the distribution of income and wealth.

Khetan andPoddar (1976)have analyzed on measurement of income tax progression in a growing economy: the Canadian experience with respect to the Canadian personal income tax, it is found that over the period 1961-1971. The average amount of personal income tax collection was regressed with the changes in the price level and different income heads using indexing factor. The indexing factor was for income tax was calculated from the consumer price index data in accordance with income tax regulations. This model estimated income tax revenues with a very high degree of accuracy and examined how these effects are altered by indexing the tax for changes in the price level using CPI.

Schmidt (1959)has explained about the relationship between federal income tax collection with money supply and inflation separately by using ADF test for stationary and ARDL test for co-integration. He concluded that there is a complex and intricate significance relationship between the studied variables in the longrun.

2.1.2Empirical Review

Gale (2014) has examined how changes to the individual income tax affect long-term economic growth. The result revealed that the changes in the level of revenues and change in the structure of the tax system can influence economic activities, but not all tax changes have equivalent, or even positive, effective on long-term growth. The argument that income tax cuts raise growth is repeated so often that it is sometimes taken as gospel. However, theory, evidence and simulations studies tell a different and more complicated story. Tax cuts offer the potential to raise economic growth by improving incentives to work, save, and investment. But they also create income effect that reduces the need to engage in productive economic activity, and they may subsidize old capital, which provides windfall gain to asset holders that undermine incentives for new activity. In addition, tax cuts as a stand-alone policy (i.e. not accompanied by spending cut) will typically raise the federal budget deficit. The increases in the deficit will reduce national saving and with it, the capital stock owned by citizens and future national income and raise interest rates, which will negatively affect investment. The net effect of the tax cuts on growth is thus theoretically uncertain and depends on both the structure of the tax cut itself and the timing and structure of its financing.

Cremer, Gahvari and Ladous (2010) have studied the properties of two alternative tax structures to the current graduated tax system in France. The comparisons are based on a calibrated and simplified model of French economy containing four types of households with CES preferences. It has found that the switch to a flat tax leads at best to a small (and possible negative) welfare improvement unless the inequality aversion index for the society is extremely high. On the other hand, moving to an optimal general income tax improves welfare over the current system tremendously. To generate this, tem marginal income tax rates in France that are currently set to increase with income should be replaced with one that is U-shaped.

Sanchirico (2008) has established that – as a practical matter – inconsistency between motivation and measurement does indeed make a difference. Taxpayers at different levels of income do not, in fact, realize a similar proportion of their earning potential. Indeed, such differences may be substantial enough to be a decisive factor in assessing the effectiveness and adequacy of tax reform. Such was the case during 1990s, the period studied in this article, when the taxation of labor income became more progressive on paper, but less progressive in effect due to counteracting changes in the pattern of labor income realization.

Chaudhary and Hamid (2001) have focused to identify shortcomings in the tax revenue collection in Pakistan. For this purpose, elasticity of different taxes was estimated. Partial adjustment and regression model were estimated to qualify the values for these elasticity's. Short-run and long-run elasticity's for direct and indirect taxes were identified. The result indicated that long-run revenue elasticity' were significantly above unity, which is not very satisfactory for a developing country. It should be well above unitary value. Moreover, tax to base elasticity' of custom and excise duty was significantly less than unity. Besides, sales tax is also n0ot in full operation. Most of the revenue reliance is on indirect taxes, which is not a very healthy sign for the economic growth and its burden on the society. It means that main tax burden is on the poor. It is on the face that more than 30% people are living below the poverty line. These finding have important bearings for the policy makers. There is a need to broaden the tax base, improvement upon direct taxes, indirect taxes and rationalize sales tax.

Chaudhary and Altaf (1995) have identified in the drawbacks of the estimates provided by different studies regarding potential for agricultural income tax. Besides, the reliability of their result was to be judged by methodology used and quantity of the data utilized in the studies conducted so far. It was aimed to identify tax burden by different income classes and by regions, which have not been done by any study so far. The study reveals that there is a good potential for income tax revenue from agriculture. Besides it could be further improved. Since the government needs every paisa to fill in the deficit gap of budget and debt repayment, therefore, it will be an additional source of public revenue which needs to be explored.

Jantracher and Bire (1992) have suggested three some ingredients that are necessary for a successful tax administration reform in developing countries. First, the tax structure usually needs to be simplified for ease of compliance to the administration. Second, a reform strategy suitable to the specific circumstances of country must be developed. Finally and overall, there must be a strong political commitment to the improvement of tax administration and best-designed efforts.

Sicat and Virmani (1988) have produced a comparative view of the structure of personal income taxes in developing countries, based on a simple methodology which takes account of standard deduction and relative family incomes, on the basis of per capita GDP measurement. The marginal tax rates for the poorest developing countries were substantially lower than those for the upper-middle-income countries and were not found to be significantly different from that of the lower-middle-income countries.

The marginal rates for the upper-middle-income countries were, in turn, substantially lower than for the developed countries included as comparators.

Agrawal (1978) has found that buoyancy of income tax with respect to GDP for period FY 1967/68 to FY 1975/76 is 2.18 and elasticity is 2.01. he has further identifies that the main defects of the income tax administration as failure to locate new tax payers, to maintain the accounts, delay in assessment, poor tax payers compliance, evasion and avoidance of tax and defective management.

Mansfield (1972) has examined two major problems (a) what was the elasticity of the system and its components and how is the size of the elasticity coefficient explained? And (b) what was the buoyancy of the system relative to its elasticity? He found the elasticity coefficient of total tax system was 1.14 and elasticity of different tax heads such as import duties 7.21, income tax 1.08, wealth tax 1.52 and export taxes had a low elasticity of 0.06. Whereas the buoyancy coefficient had measured 1.69 which implies that 1 percent change in GDP will bring out 1.14 percent change in total tax and remaining 0.55 percent change in total revenue due to discretionary changes.

2.2 National Context

2.2.1 Theoretical Review

Khadka (2015)has shown that SAARC countries provide some allowances under their individual income tax regimes. These allowances are fixed amounts and are deducted from the total income before it is taxed. For example, basic allowance is most common under individual income tax of the SAARC countries. It is simply a slice of the income received free of tax by every taxpayer. The level of basic allowance is AFN 60,000 in Afghanistan, BDT 220,000 in Bangladesh, Nu 100,000 in Bhutan, INR 250,000 in India, MVR 500,000 in the Maldives, NPR 250,000 in Nepal, PKR 400,000 in Pakistan and LKR 400,000 in Sri Lanka. Afghanistan, Bhutan and Sri Lanka have one level of basic allowance for all. Nepal has a higher basic allowance for married couples (NRs 300,000), compared to individuals (NRs 250,000). Bangladesh and India provide higher basic allowance to senior citizens. In Bangladesh, basic allowance for senior citizens above 65 years is BDT 275,000, for disabled persons BDT 350,000, for war wounded freedom fighters BDT 400,000, and for others BDT 220, 000.

Dahal (2013) has conducted that unnecessary exemption and rebates announced by government annually through Finance Act have created difficulties for tax administration to implement the income tax law effectively. High earning groups are in one way or other using such provisions to reduce their tax liability. Weak tax administration and improper PFM are major causes of low tax compliance. Corruption has discouraged people to pay tax resulting in further corruption on the part of non-state agents through tax evasion. Forms to be filled up by taxpayers are not as simple they need. This has resulted in requirement of using middleman resulting in more transaction cost. Through IRD since its establishment in 2002has been undertaking different campaigns to increase tax compliance it has not been able to get good results out of its effort.

Sharma and Duwali (2013) have presented major compliance issues and incentives for compliance enhancement, which are law registration in income tax and vat. There is no supportive environment for compliance. There are no any new policy and tax rates for the last one year. Large no of case pending in Revenue Tribunal and huge amount of tax dues can be seen there. Similarly, there is problem of tax fraud, data mismatch, under invoicing and none invoicing. This study also includes some incentives for compliance enhancement, which are announcement of tax system reform year, implantation of 5 year strategic plan and 3 year reform plan, Human resource management plan prepared, celebration of National Tax Day along with that revenue research and forecasting unit established, Online taxpayer service system has been introduced.

Bharati (2012) has identified some problems of tax administration i.e. tax system in Nepal. His key objectives are to examine the income tax administration system in Nepal, to find out the course of corruption in Nepal and to know the difficulties in the process of assessing income tax under ITA2002. Similarly he focused on the ways and means of enhancing tax consciousness and on the contribution of income tax in government revenue. This study concluded that there are Complicated Act, rules and regulation, defective income tax administration, corruption and evasions as well as lack of consciousness among tax payers are the main problems of income Tax administration system in Nepal. Similarly corruption and lack of trained personnel is the other problems lying within tax administration. According to him no corruption, trained personnel and awareness to taxpayers are the key requirements for better tax administration.

Kadel and Lamsal (2012)have embraced sufficient numerical examples and questions, changed provision of the Act. A new chapter covering the problems related to resident and non-resident is added as per the demand of the teachers and students. It is updated as per the Finance Act, 2010. He has described about historical background, income tax act, rules and administrative aspects, house and land tax but has not shown problems related to income tax. Due to numerous changes and not availability of amended acts in English, the present edition of the book has not been able to update the act and so it is dropped out.

Shrestha (2012) has identified economic problems and causes of low tax collections. His main objectives are to review the tax collection system findings and to find out the contribution of tax to national revenue, to find out the problems in tax collection system. Following are the main findings made by the study are income tax is the suitable means of raising government revenue, Public awareness program is necessary to increase tax consciousness and raising the government revenue. Similarly this study show that mass poverty and low income level, increasing habit of tax evasion, inefficient income tax administrations etc are the major reasons for the low contribution of income tax to national revenue and lengthy process, vague provision in income tax laws, consuming unnecessary time etc are the major problems facing by the taxpayer while paying the tax.

Bhatta (2011) has analyzed that Nepal is one of the least-developed countries surrounded by two fastest growing Asian economies, India and Republic of China. Nepalese economy is suffering from ineffective, effortless and over ambitious plans, programs and policies. Moreover, Nepal is even today fighting against whatever bottleneck identified before the starting of planned period. With the change in time, challenges for Nepalese economy also increase. Apart from other economic problems, Nepal has to face the following problems: low responsiveness and productivity of tax yields, indirect tax dominated tax structure, low tax effort ratio, narrow tax bases, weak tax administration, rigid and complex tax laws and procedures, lack of strong commitment of policy maker and administrator to implement sound tax policy and most importantly lack of political instability.

Bhattrai and Koirala (2011) have presented the description of tax laws and tax planning. A simplified version of Income Tax Act 2001. He has presented theoretical as well as practical aspect on taxation in this book. This book is useful to anyone who is interested in the subject of taxation. This book is also helpful to research work. The aim of writing this book is to provide the readers with basic knowledge of general principles and practices of tax law in Nepal and to develop in them basic skills to handle the tax matter in the text has been presented in a very simple and clear manner for better understanding of the law.

Devkota (2011)has conducted that mass poverty and low income level, increasing habit of tax evasion, inefficient tax administrations are the major reasons for the low contribution of income tax to national revenue. Clear act, rules and regulation, ineffectiveness of tax administration are the most important instruments for effectiveness of income tax in Nepal. Progressive tax rate is considered as the suitable means of tax and lengthy process, vague provision in income tax laws, consuming unnecessary time are the major problems facing by the tax payer while paying the tax in Nepal.

Timilsina (2011)has tried to explain about the tax evasion behavior of taxpayers. People in developing countries like Nepal have greater propensity to evade taxes. Lack of proper measurement of tax assessment, Nepal is facing the problem tax evasion. Because of this, resources have not been mobilized efficiently and resource gap is increasing each year in Nepal Public Finance. His main objectives of the study are to analyze the structure of income tax in Nepal, examine the income tax evasion tendency in Nepal and draw suggestion for the elimination of income tax evasion in Nepal. There is a serious problem of financial resources gap in Nepalese economy. It was 41.69% during FY 1975/76 and increased to 53.35% during FY 1985/86. It needs to be controlled in time; otherwise it may create a greater problem in national economy. The composition of tax and non-tax revenue is still less satisfactory in Nepal. There were 79.14% tax and 20.86% non-tax contribution during FY 1985/86.More than 83% tax contribution is supposed to be appropriate here in Nepal. Income tax evasion has a decreasing trend in Nepal. There was 107.39%income tax evasion in FY 1975/76 and reduced to 58.47% in FY 1979/80. In an average there is 54.70% income tax evasion in Nepal. He has suggested to the government for timely correct the problems of resource gap through by increasing tax coverage through different programs and legal action should be taken towards tax evaders and corruption on the part of tax administration.

Bhattarai (2010) has highlighted some problems in implementation of Income Tax Act 2002. His study based on the objectives of finding problems of income tax law, need of reform in income tax system and contribution of income tax in national economy. He finds that there is problem in rules regarding income tax. According to his study complicated tax law, illegal business activities, support of auditors in tax evasion, weak record system of tax administration, social recognition of tax evaders, no belief of people in proper use of tax, unnecessary exemptions and deductions are major problems regarding income tax law. Similarly he suggested that income tax policy should be formulated based on the economic policy of the nation. Policy maker should pay attention on widen tax base to fill the resource gap but ability to pay principle should not be ignored. Along with that he suggested that right and duties should be defined for tax administrators and reward, punishment and promotion should be tied up with the performance of personnel and awareness raising campaign should be increased.

Jabara (2010) has discussed that the major constraints existing in the tax system is lack of simplicity and transparency. With an extremely limited tax base, low tax elasticity, relatively higher tax rates, poor voluntary compliance, inefficient tax administration, rigid and incomprehensive tax laws and regulations. The lack of strong political commitment, administrative capability and recording system are the major problems in the implementation of local tax. Furthermore lack of proper accounting and auditing, indifference attitude among tax official and weak appeal system have also been hindrances for the proper functioning of Nepalese tax system.

As a member of WTO, SAFTA and BIMSTEC, Nepal has a binding constraint to lower custom duties will decline in widening resource gap. Similarly, the major issues overpowering taxation are that the overall tax system of Nepal is inelastic in nature. Direct taxes have smaller elasticity in comparison to direct taxes, which indicates taxes are responsible for sluggishness of tax yields.

Lastly mentioned, that for the overall improvement in tax system is to constitute the Central Revenue Board for streamlining overall tax structure by examining its inbuilt structural problem in relation to its organizational structure, method of assessment and tax collection procedure and administrative, technical and judicial complexity of revenue administration.

Karki (2010) has found that tax education is most necessary in Nepal to increase the tax consciousness of tax payers. Self-assessment method is more appropriate for Nepal while assessing income tax. Similarly income tax evasion is the major problem of Nepal for income tax generation and income tax administration is not efficient for tax collection. He recommended there should be respected behavior for tax payer and quality service should be maintained to increase the contribution of income tax to Inland Revenue of Nepal. Training and career development should be provided to the tax personal time to time and also tax administration should be free from political pressure.

Rijal (2010)has pointed out some problems regarding tax law's implementation. His focus was on tax planning however findings and recommendations are useful in better implementation of income tax law in Nepal. Main objectives of his study are, to compare the past and present application of tax planning in Nepal so as to point out its degree of reform and to examine all the obstacles and challenges which are breaking the modernization path of tax planning. Similarly his study focused on the contribution of tax assess as well as government and tax authorities for enhancing the tax planning. This study concluded that there are problems of tax evasion and avoidance. There is lack of adequate incentives, facilities, rebates, grants etc. Training opportunities to tax officers as well as tax payers are very poor, record keeping system is also very weak and there is lack of motivation for tax personnel. He has concluded his study with the suggestions of maintain up to date taxpayer registration, increase income tax coverage by bringing affluent taxpayers into tax net by using the legal and promotional means and techniques and Strictly enforce the registration of non-resident and non-citizen tax payers. Similarly, fixing target to tax offices in terms of increasing the number of meaningful taxpayers and strengthen co-ordination with other agencies and offices within the tax system are major recommendations.

Shrestha (2010) has found that level of income tax collection has been rising. Income tax system of Nepal is suffering from various problems such as narrow tax coverage, mass poverty of Nepalese people, and lack of conscious taxpayers, inefficient tax administration, instability in government policy,etc.

Wasti (2010) has found that income tax system of Nepal is not sound and efficient, basically inefficient tax administration, practice of tax evasion and lack of awareness of tax payers. Tax education is most necessary to increase the tax consciousness of tax payers and honest tax officers. It is essential to make tax actmore clear so that tax payers and tax officers may not get confused.Similarly rules and regulations are the most important factor for the effectiveness of income tax in Nepal. Lack of trained and competent tax personnel, complicated tax laws and undue delay in making assessment are the most important causes of ineffectiveness of Nepalese tax administration.

Dahal (2009)has written that in developing economies, resource gap is critical and widening resulting to huge fiscal and budgetary deficits. The growing resource gap is frequently of by mobilizing internal and external borrowings consequently shifting the burden of debt to prosperity. In addition, legal base of taxation is compressed with limited tax shelters and tax administration lacks innovative mechanism to identify new tax payers and bring them in to tax net. The tax system suffers from structural constraints tremendous administrative and procedural complexity envisaged in the existing Income Tax Act which lacks simplicity and transparency. The author points out the major problems of taxation in Nepal as marginally high tax rates, limited tax base, low tax elasticity, poor voluntary compliance and inefficient, indifferent and corrupt tax administration.

The studies and reports on taxation exhibit that several reform have had been under taken by the government in the past to simplify and modernized the tax system. The reform in taxation in Nepal consists of three types which are; reformation in tax laws and regulations, reformation in environment and reformation in tax administration.

Shrestha (2009), has mentioned that income tax is the suitable means of raising government revenue, Public awareness program is necessary to increase tax consciousness and raising the government revenue. Similarly this study show that mass poverty and low income level, increasing habit of tax evasion, inefficient income tax administrations etc. are the major reasons for the low contribution of income tax to national revenue and lengthy process. Vague provision in income tax laws, consuming unnecessary time etc. are the major problems facing by the taxpayer while paying the tax.

Neupane (2007) has shownthat contribution of income tax to total tax revenue has decreased from 23.93 percent to 20.83 percent in the FY 1999/00 to FY2004/05. It may be due to the collection of the property tax by municipalities. But it is not only the cause; emphasis should be given to the income tax collection. To facilitate tax collection, Inland Revenue Department has implemented e-tads, e-pan and e-filing for the better tax compliance. There is provision of tax plate also. But the frequent change in the act decreases tax compliance which is a major drawback of instable political condition.

Khadka (2005) has focused on the human resource development of tax administrators. He also gives new ideas on tax administration to reform it such as computerization and autonomous revenue improvement of tax administration in Nepal.

Mallik (2003)has explained Income Tax Act, 2002 with explains wherever necessary. The author has presented the complex Act in simple and lucid manner so that it will be easy to understand the act. He has shared his expertise in his book. His book is descriptive and analytical. All the provisions in the act have been clarified in simple language. The author has also clarified why some of the tax exempted amounts have been brought into tax net by the new Act. In some cases he has also compared the provision of the old Act and the new Act.

2.2.2Empirical Review

Timilsina (2007) has concluded that the automatic response of tax to income is low. Compare to the period FY 1975/76 to 1994/95, the elasticity coefficients of tax during review period (FY 1975/75 to 2005/06) did not reveal significant differences. The buoyancy and elasticity of income tax during the study period was 1.37 and 0.41 respectively. This study has further concluded that only the discretionary measures cannot generate more revenue freeware. Improvement in tax administration to control the leakage and to broaden the tax bases in practice is important for enhancing the elasticity of the tax.

Neupane (2005) has concluded that tax/GDP ratio in Nepal is very nominal as compared to the same ratio in neighboring SAARC and other developing countries. He has also concluded that income tax is the main component of direct tax and its contribution direct tax and total tax revenue is 78.78 percent and 19.02 percent respectively. He has further said that for the economic betterment of the nation, additional internal financial resource mobilization should be strengthened and more should be generated from internal resources. Along with that planned development efforts, political stability, and liberal economy may be the means for such resource mobilization.

Amatya, Pokharel and Dahal (2004) have defined all the terms relating to income tax and value added tax. The examples that are presented in this book are very useful to readers to know more about provisions and procedures of the Income Tax Act 2002.

Dahal (2003) has addressed the narrow tax base, low tax elasticity, higher burden of indirect tax compared to direct tax lack of voluntary compliance, wide spread tax evasion, leakage's etc. as main constraints of Nepalese tax system. Including income from agriculture sector, income from domestic industries, social sector and electricity sector, which contributes 52 percent of total GDP, is exempted from income tax. This report has suggested that about 40 percent extra resource mobilization is possible if proposed tax policy and program took place.

Poudel (2002) has explained that within the direct tax, income tax is the largest source, which contributed more than 86 percent in FY 1999/00. The contribution of income tax to direct tax has increased significantly since its introduction. The elasticity and buoyancy coefficient of income tax has been found to be 0.16 and 1.36 respectively during the period FY 1975/75 to 1999/00. This shows that Nepalese income tax is very inelastic and there are minimum chances for further discretionary changes.

Dahal (2000) has explained has explained that the contribution of income tax to total revenue was 7.8 percent in FY 1975/76 and in 1999/00 it was 14.5 percent. This study has explained that the income tax rates and slabs have been changed radically in recent years. Under new Income Tax Act, 2002, individual income tax is levied with low rates of 15 percent and 25 percent and the corporate income tax is levied with single rate of 25 percent. For bank and financial institutions income the rate is 30 percent of taxable income.

Das (1995) has tried to compare the tax and non-tax revenue productivity of Nepal. The elasticity coefficient of tax and non-tax revenue for the study period were 0.98 and 1.02 respectively, while that of buoyancy coefficient were 1.77 and 1.53

respectively, indicates that the discretionary changes made over tax revenue was comparatively more effective than non-tax measures.

Nepal (1995) has mentioned that the overall elasticity of total revenue in Nepal's tax structure for the period FY 1968/69 to FY 1992/93was 0.64 and Nepalese revenue structure as a whole was regressive in nature. He reveals that the income tax elasticity was less than total revenue due to exemption of agriculture income from tax-net which leads narrow tax base and due to high evasion caused by loopholes on tax laws. But, the buoyancy coefficient of for the total tax revenue was 1.16 during the study period. However, elasticity of income tax was 0.48 in study period.

Gurugharana (1993) has found that the elasticity coefficient of total revenue as 0.49 for the period FY 1974/75 to FY 1983/84 and 0.58 for the period FY 1974/75 to FY 1988/89. For the same period, buoyancy coefficients were 1.36 and 1.28 respectively. Except for contract tax (1.89) and sales tax (1.05) the elasticity of remaining taxes i.e. custom, excise, income, hotel, entertainment, land revenue, etc. were extremely low (far below unity) of negative. But low elasticity had shown that the government engaged in imposing high rate on a taxed commodities and regressive nature of tax system.

Pant (1991) has measured tax elasticity as 0.495 for the period FY 1974/75 to FY 1983/84 and other hand tax buoyancy has declined to 1.28 in the period FY 1974/75 to FY 1983/84from 1.37. During the period elasticity of custom, excise, and import have improved but elasticity of income contract and hotel tax has declined indicating that efforts to raise revenue through discretionary measures were unproductive.

Dahal (1984) has studied various aspects of Nepalese tax structure for the period FY 1952/53 to FY 1981/82in general and FY 1964/65 to FY 1981/82 in particular. In this period the overall elasticity of the total revenue is equals almost unity (1.01), for indirect, it was marginally higher than unity (1.02) compared with elasticity of direct tax (0.68) and elasticity of tax revenue was 0.92 reflecting the tax system less responsive to change in income. But the buoyancy coefficient for the same time period were 1.54 for total revenue, 1.52 for tax revenue, 1.63 for indirect taxes and 1.23 for direct taxes.

Agrawal (1980) found that the elasticity and buoyancy coefficient different tax heads with respect to GDP. For the period FY 1967/68 and FY 1975/76, income tax has the highest elasticity of 2.18 followed by sales taxes 1.74, excise tax 1.28, land tax 0.12 and custom duties 0.08. Since both the elasticity and buoyancy coefficients of income tax were greater than unity, which implies that the income tax of Nepal was positively responsive to change in GDP. The coefficient of buoyancy was 2.18 and the difference between buoyancy and elasticity was 0.17, which implies that the one percent change in GDP will bring about 2.01 percent changes in total revenue due to discretionary measures.

IDS (1978) have reported that the elasticity of the Nepalese tax system was extremely low in comparison with the buoyancy for the period FY 1974/75 to FY 1984/85. The report has indicated that the government had concentrated only introducing the tax base. This study shows the elasticity of tax revenue 0.86 and buoyancy 1.35. Similarly the report found the elasticity of direct tax and indirect tax to be 0.66 and 0.93 respectively. Within these taxes, the elasticity of sales tax, excise duty, import duty, export duty and income tax were reported at 1.00, -0.33, 0.56, 0.66 and 1.06 respectively. Among them, elasticity of indirect tax was more than that of direct tax among all taxes: sales tax was highest (1.75) followed by income tax (1.49), excise tax (1.43), import duty (1.24), export duty (-0.030), whereas the buoyancy of all taxes except export duty was unitary.

Reejal (1976) has explained that Nepalese tax structure, as a whole was fairly elastic, with elasticity coefficient 1.82 and buoyancy coefficient 2.18 respectively for that study period by using Proportional Adjustment method of Shahota. This study has indicated that the Nepalese tax structure as a whole was elastic. This study found that the income tax to be highly elastic 4.39 which was highest among all the tax categories. The buoyancy of income tax for the study period was 3.13. The different between buoyancy and elasticity coefficient of income tax for the period was -1.26. The tax system as a whole had buoyancy of 2.18 compare to elasticity of 1.28 which indicates the positive impact of legislative change on the revenue productivity of the tax system.

2.3 Research Gap

There is gap between present research and previous research conducted. Context has been changed every year and new problems and issues were found every year.

The gap between government expenditure and internal resource is known as resource gap. In Nepal, internal resource mobilization is still poor due to resource constraints, mass poverty, rapid growth of population, aggressive dependence on agriculture, etc. and it is not sufficient to cover the growing expenditure. Mobilization of internal resource through income taxation is one of the vital solutions for more revenue collection.

Income Tax is the one part of entire tax structure of Nepal. In recent years, the government has taken several measures to reduce tax-induced distortions, strengthening tax administration, simplifying tax laws and procedures to make them more transparent to increase government revenue. Therefore, this study has been conducted analytically and intensively to analyze the role of income tax in government revenue.

Many individuals and institutions have studied different aspects of tax system in Nepal such as legal, administrative and historical. But all of them are found theoretical-oriented and there is no any practical significance. However, all of them help to understand the theoretical concept of income tax. So, this research fills the gap of practical relevance of resource mobilization through income tax in Nepal.

CHAPTER III

RESEARCH METHODOLOGY

This chapter includes the brief description about research methodology used to fulfill the objectives of this research study. It includes research design, sources of data collection, and statistical tools used in the study. This chapter is concerned with detailed discussion of the methodology used in this study by covering the procedures of getting research problems and solutions as per the objectives.

3.1 Research Design

This study is based on descriptive method using secondary data. To assess the structure of income tax, the data from FY 1999/00 to FY 2015/16 have taken into consideration. This study analyzes the structure of income tax in Nepal using descriptive method to describe the data, illustrating the data in tables, graphs and charts for clarity of the available data and information.

This research has been analytical and descriptive in design using historical data to assess the current role of income tax in resource mobilization internally and to explore some potential areas for additional domestic resource mobilization through income taxation to fill the gap of resource deficit in Nepalese economy.

3.2 Nature and Sources of Data

To fulfill the objective of the study, secondary data have been used. The nature of the study is descriptive as well as analytical.Analytical research has conducted to analyze the trend and contribution of income tax to government revenue in Nepal. Data and information used in this study have collected from secondary sources. The sources of data are:

- Economic survey of various years of Ministry of Finance(MoF),
- Official website of Inland Revenue Department, GoN: www.ird.gov.np,
- Related text booksand reference books of income tax and public finance available at national and international level,
- Related theses, available at the central library, library of Central Department of Economics, and others,
- National and international journals.

3.3 Tools and Techniques of Data Collection

In order to analyze the research study, different statistical and mathematical tools like ratio, percentage, mean, median, diagrams, graphs, correlation, etc.have been used.

3.4 Analysis and Presentation of Data

To analyze the trend of income tax in Nepal, trend line has explored. This will useful to highlight the income tax in different fiscal year under study period.

To show the relationship between income tax and total revenue, different diagrams have used. This diagram will helpful to show the relationship between two variables which is income tax and total revenue.

Similarly, different statistical tools such as diagrams, graphs, charts,pie charts, trend lines are used and mean, percentage, etc. also are used to validate of the study.

CHAPTER IV

Historical Background of Income Tax in Nepal

4.1 Concept of Tax

Every government needs huge fund to handle day to day administration, maintain peace and security carry out development plans and lunch other public welfare activities. The government collects the required fund from two sources. They are internal and external sources. Internal sources of fund can be divided into two types. They are tax source and non-tax source. Tax source is the one of the most important source of government revenue. Tax sources include vat, custom duty, excise duty, income tax. There is a high contribution of tax source than non-tax source in total GDP of Nepal. Therefore tax revenue is the major source of government revenue. Income tax is the major component of tax revenue for the government whether it is developed or developing country. Tax can be classified in two broad categories: direct and indirect tax. This is the most common and popular classification of tax.

4.2 Direct Tax

Direct tax is collected directly by the government from the person who bears the tax burden. The impact and the incident are on the one and the same person. In other words the same person pays and bears the tax burden. The examples of direct tax are:Income tax, Property tax, Interest tax, Capital gain tax, Vehicle tax, Death tax, Gift tax, Expenditure tax, Profit tax etc.

4.3 Indirect Tax

Indirect tax is imposed on one person but partly or wholly paid by another. In indirect tax the imposed and incident of tax are on different persons. In other words, the person paying and bearing the tax is different. The examples of indirect tax are: Value Added Tax (VAT), Excise duty, Sales tax, Import and export duties, Entertainment tax, Hotel tax etc.

4.4Objectives of Tax

Tax is a permanent instrument for revenue collection. It is a major source of revenue in the developed countries as well as developing countries. Tax has been an instrument of social and economic policy for the government. The main objectives of tax are: to raise more revenue, to redistribute wealth for the common good, to prevent concentration of wealth in a few hands, to remove regional disparities, to reduce unemployment, to boost up the economy etc.

4.5 Meaning of Income Tax

Generally the income means inflow of cash to person or firm. It includes income from employment, business and investment. Tax is contribution from citizen for the support of the nation. An income tax is a direct tax charged upon the incomes of an individual and corporation. Income tax refers to the tax levied on the income of a person and profits of corporation for the specific time period, particularly one year. Income tax is levied on the taxable income of a person or a company after deducting allowable expenses. Accounting profits may differ from taxable profits. For the computation of taxable income, generally incomes are added and expenses are subtracted and losses, which are allowed to deduct under the provision of income tax act are also subtracted. Then tax free incomes allowances and common expenses are also deducted to get taxable income. After giving the exemption limit as per law, the amount of tax to be levied on this computed income is the income tax.

4.6Types of Income Tax

- **The Individual or Personal Income Tax**

A personal or individual income tax is levied on the total income of the individual (with some deductions permitted). It is often collected on a pay-as-you-earn basis, with small corrections made soon after the end of the tax year. These corrections take one of two forms: payments to the government, for taxpayers who have not paid enough during the tax year; and tax refunds from the government from those who have overpaid. Income tax systems will often have deductions available that lessen the total tax liability by reducing total taxable income. They may allow losses from one type of income to be counted against another. For example, a loss on the stock market may be deducted against taxes paid on wages.

As a direct tax, individual income tax is highly elastic. It can be major source of revenue only if certain prerequisites are satisfied. A list of conditions are proposed: a) the existence of a predominantly money economy, b) a high standard of literacy, c) prevalence of honest and reliable accounting, d) a large degree of voluntary compliance on the part of taxpayers, e) a political system not dominated by comprador groups acting in their self-interest, and f) honest and reasonably efficient tax administration.

- **Corporate Income Tax**

Corporation income tax refers to a direct tax levied by various jurisdictions on the profits made by companies or associations and often includes capital gains of a company. It is the tax on capital income that occurs in the form of profit and originates in the corporate sector i.e. company. The history of tax was started from 1909 in USA when 1% excise was levied on corporation i.e. companies on the ground of the privilege they enjoy. Since then, corporate tax is contribution a substantial amount of revenue to the state treasury of most of the developed and developing countries.

4.7 Income Tax in International Context

During early days, taxes were considered as immediate source during scarcity and were calculated during the time of emergencies to finance wars and to provide communal services. Taxes were not compulsory but levied on the basis of welfare of the people.

The history of income tax is full of theory of wars, confrontation and resistance. Great Britain was the first country in the world to introduce successful income tax in 1799 to finance war with France. In USA, the first federal tax was imposed in 1862 with the same motives of financing civil war expenditures. After the sixteenth amendment of US contribution, income tax was permanently adopted in 1913 (ADB, 2009).

Several German states introduced income tax during 1840. After the Prussian reforms in 1891, the income tax was used as effective fiscal instrument in these states. Until 1920, German income taxes were exclusively state taxes, which became federal taxes from 1920 to 1945. At the end of the Second World War, they again became state taxes and now regulated by federal law (ADB, 2009).

Italy adopted the income tax in 1864 as one of its first product of its unification. It was until 1925 that a nationwide tax on total family income wasimposed with graduated ones. In France, the effort towards income tax began in 1870. The income tax bill was enacted as an emergency measure in 1914 and the permanent income tax system was adopted in 1917 (ADB 2009).

Norway introduced the income tax in 1892 and made its rates progressive in 1896. Sweden accepted modern income tax on the permanent basis in 1910. New Zealand adopted income tax in 1891. Australia and Canada had followed the income tax in 1915 and 1917 respectively.

After the First World War the income tax became an important source of tax revenue in many developed countries. By 1939, it has become the most important source of revenue in most developed countries and had made appearance in a number of developing nations.

In India, the income tax was introduced in 1860 by the British to relieve from economic burden created due to the first domestic revolution. It was discontinued for some years and then regularly collected after the participation of income tax 1886 (ADB2009).

With this, income tax has become the regular source of national income for all the countries of the world. In the beginning, income tax was generally levied at a flat rate. The principle of progressive tax was introduced in the United Kingdom and New Zealand in 1999. Norway's, a progressive rate of income tax is generally used all over the world.

4.8 Evolution of Income Tax in Nepal

- **Income Tax in Ancient Nepal**

Tax has been one of the major sources of national receipts since the ancient era in Nepal. In those days, tax was collected in the form of cash, kind and labor from the merchant, trader and farmers. However the nature tax levied by the government was temporary type in the old age. In the Lichavi regime taxes were known as “Trikar”, which meant three kinds of taxes viz, “Bhaga”, “Bhog” and “Kara”.

The Bhaga was levied on agriculture, Bhog was on animal and Kara was on business. These taxes were introduced as direct taxes for the first time in Nepal. Irrigation and religious monuments preservation taxes existed at the time of Ansubarma in Nepal. The farmers had to pay tax on income from agriculture to the government in 1/6, 1/8 and 1/12 share of production depending on the quantity of the land poses by them. All artists had to donate labor compulsory as the tax payment (Adhikari, 2007).

- **Income Tax in Unified Nepal (1768-1846)**

In that time, revenue maximization was the main objectives of tax policy. During that period different types of taxes like land tax, transit tax, market duties and forest product tax were levied. In that period tax was collected from three levels: Royal Palace, Central Government and Local Authorities. They collected goods or cash from taxpayer as taxes. Royal palace had levied taxes like Walak, Gaddimubarak and Goddhawa. Government had levied taxes like DarshanBhet and Salami. Local authorities had levied taxes on forest and water sources, commercial taxes like customs, transit and market duties, mines and mints, export of forest product like herbs, drug and wild life, birds, elephants and judicial fines. Taxes from land and business were type of direct tax among the all taxes during the period.

'Walak' was collected from each family in the period of national celebration or festivals. 'Gaddimubarak' was collected in the time of coronation ceremony of new king. 'Chumawan' and 'Goddhawa' were collected in the time of investiture and marriage ceremony of royal princes and princesses. 'DarshanBhet' was collected from civil and military. 'Salami' was collected by the local authorities in the terai region. After the unified period, land tenure system was divided into five main forms Raikar, Birta, Guthi, Seva and Kipat. The main sources of revenue from land were Birta and Kipat.

The founder of modern Nepal king Prithivi Narayan Shah had introduced "Pota" tax in 1772, which was regarded as revolutionary measure in fiscal system of Nepal. It was based on flat rate system rather than progressive rate principle. It was limited of small Birta owners. Through taxation was started, there was no income taxation in modern sense (Dahal, 2010).

- **Income Tax in Rana Regime (1846-1950)**

During the period of Rana Regime, there was no provision of effective revenue administration. The main source of revenue was land revenue, customs and export of wood, which was collected in the lump sum, contract basis and salami was collected from government employees as the revenue income tax. In those days taxes were collected as per the requirement because there were no formal Tax Act and Finance Act.

Taxes were charged as per the will of the Rana Prime Minister. Both income and expenditure of the government were confidential. In actual practice there was no difference exists between the private purses of the ruling prime minister and the government treasury therefore income and expenditure of the state were not transparent because there was no practice of presenting the budget in that period.

Rana Prime Minister levied taxes for meeting specific expenditure of the royal household of extraordinary expenditure necessitated by war or other crises rather than regular mobilizing in the nation. During Nepal-Tibbet war (1855/56) the first Rana Prime Minister JangaBahadurRana had impose a levy of 1% on the Jagir Assignment of government employees in 1891 to finance the transportation of water pipe supply in the capital. Another Prime Minister Ranodip Singh imposed a 50% tax on the income made by fisherman from the sale of fish in Deukhuri (Niraula, 2009).

- **Income Tax in Modern Nepal (Since 1950)**

After the political revolution in February 1951, the role of government had increased. The government of Nepal had presented its first budget in 1952. The First Five Year Plan started in 1956. Thus the changing role of the government demanded more revenue and Nepal also felt to levy tax on income as a permanent source.

Although Nepal has long history of taxation, corporate tax was introduced by the elected government in 1959. Introduced “Business Profit and Salaries Tax Act 1960” At that time, income tax was levied on business profit and salaries. In earlier day both corporate tax and individual tax was taxed at progressive rate. After about three years' experience of income tax, the government replaced the prevailing income tax act by “Income Tax Act 1962” In 1974 “Income Tax Act 1974” was enacted. This act classified income source into five types i)Agriculture ii) Industry, trade, profession iii) House and compound rents iv)Remuneration v) Other sources. But agriculture income is kept outside the tax net for the few years through the finance acts. The government of Nepal enacted “Income Tax Act, 2002” which is affected from 1 April 2002. This act has replaced the income tax act 1974, which was amended for eight times and lasted for a period of 28 years. Income Tax Act 2002” is in implementation. The government of Nepal has formulated Income Tax Rules 2004 to clarify the act (Bhattrai&Koirala, 2011).

- **Income Tax Act 2002**

The parliament of Nepal enacted Income Tax Act 2002 with effective from 1 April 2002. The government of Nepal framed Income Tax Rules 2004 to clarify the act. This act consists 143 sections along with 24 chapters. This is a forth income tax act of

Nepal. It has been made to minimize the weakness of previous acts and maximize government revenue by improving collection procedure of revenue.

Income Tax Act 1974 has classified income tax into five groups whereas this Act divides only in four groups as follows:

i. Individual income tax

ii. Corporate income tax

iii. Interest tax

iv. House and Land tax

This act was brought in Nepal to avoid the following defects of Income Tax Act, 1974 (Bhattrai&Koirala, 2011)

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

4.9Methods of Income Tax Assessment

Tax assessment means procedure of determining the taxable income, tax liability, interest and penalty of a tax payer. Income Tax Act 2002 has specified three types of assessment. Self-assessment is done by assessee himself whereas jeopardy and amended assessments are the assessment based on judgment of department. Tax assessment methods are as follows (Bhattrai&Koirala, 2011)

Self-tax assessment is done by the assessee himself. In self-assessment a taxpayer himself assess his tax liability. Income Tax Act 2002 focuses on the self-tax assessment system. It has made more responsible to the tax payer. Under this method taxpayer himself determines his tax liability with fine and penalty if any and submits it to the tax officer along with the tax due as per the return mentioned above within specific period of time. If tax officer doubts upon the income of tax payer tax authority can investigate. Otherwise, that becomes the final.

CHAPTER V

ANALYSIS AND INTERPRETATION OF DATA

This is the major part of the study. This chapter deals with the analysis and interpretation of trend and structure of income tax. The analysis of data is carried out by organizing, and assessing statistical results from different figures, tables and charts. In this chapter the data and information in connection with the taxation in Nepal are presented and analyzed which are already published and trying to find out the trend and contribution of income tax to government revenue.

5.1 Trend of Income Tax in Nepal

5.1.1 Income Tax Rate and Tax Exemption Limit in Nepal

The income tax is a fairly general tax. The system of income taxation in Nepal has forty-five years of history starting from the fiscal year 1959/60 as business profit and remuneration tax. During this period, exercises with four income tax Acts were formulated with numerous tax rates and exemption limit schedules. Income tax was initially levied on busyness income and salary income. The rate of income tax has been changing continuously since its introduction in FY 1959/60 to the present time. Finance Act prescribes the exemption limit for individualand couple which are as follows:

Table 5.1

Individual or A Couple having Taxable Income from Employment

For Individual	For Couple	Tax Rates (%)
Upto NRs. 350,000	Upto NRs. 400,000	1
Next NRs. 100,000	Next NRs. 100,000	15
Balance Exceeding 450,000	Balance Exceeding 500,000	25
Balance Exceeding 2,500,000	Balance Exceeding 2,500,000	35

Source:Internal Revenue Department Report, FY 2016/17, Ministry of Finance, Government of Nepal, 2017.

5.1.2 Trend Analysis of Income Tax in Nepal

Trend of income tax in different fiscal year under this study can be shown in following table:

Table: 5.2

Trend of Income Tax in Nepal

(NRs. in billion)

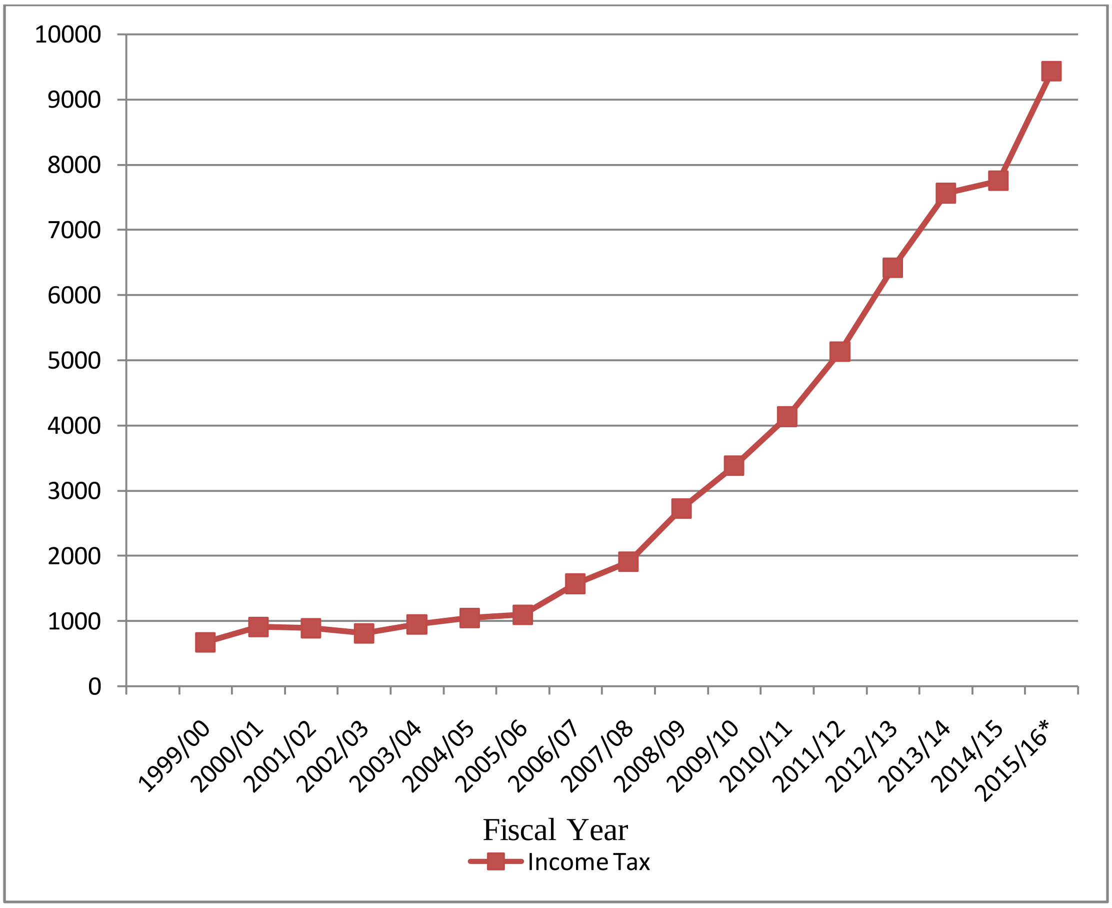
Fiscal Year	Total Revenue (TR)	Income Tax	Income Tax at % of TR
1999/00	4289.38	675.70	15.75
2000/01	4889.39	911.40	18.64
2001/02	5044.56	890.37	17.65
2002/03	5622.97	813.19	14.46
2003/04	6233.10	951.47	15.26
2004/05	7012.27	1046.61	14.92
2005/06	7228.19	1093.94	15.13
2006/07	8771.21	1573.18	17.93
2007/08	10762.25	1907.78	17.72
2008/09	14347.45	2724.74	18.99
2009/10	17799.09	3382.13	19.00
2010/11	19837.59	4135.03	20.84
2011/12	24437.29	5130.30	20.99
2012/13	29602.11	6418.67	21.68
2013/14	36292.36	7560.82	20.83
2014/15	39350.66	7751.60	19.69
2015/16*	46042.55	9428.99	20.47

Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Economic Survey and Budget Speech, various Issues from 1999/00 to 2015/16, Ministry of Finance, Government of Nepal, 2017.

Figure: 5.1

Trend of Income Tax in Nepal



Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.2

Table 5.2 and Figure5.1 show that the trend of income tax is increasing every year during last 13 year, but in initial 2 year income tax is in decreasing trend.The amount of income tax is NRs.911.40 billion in the FY 2000/01. Then after in FY 2001/02 and 2002/03 income tax is decreases and reached to NRs. 813.19 billion in FY 2002/03. From FY 2003/04 income tax is increasing each year and has reached to NRs.9428.99 billion in the FY 2015/16. It shows nowadays the trend of income tax in Nepal is in positive or growing situation from FY 2003/04, which is right trend for Nepal.

5.1.3 Government Revenue Structure of Nepal

The funds required by government are normally collected from two sources: debt and revenues. The revenue of government comes from two sources: tax and non-tax revenue. Non tax source includes different revenues like, interest, dividend, rent and royalty, administrative fee, penalties, fine and forfeiture. Tax source includes custom duty, excise duty, vat and income tax. The trend of tax and non-tax revenue of Nepal is shown in following table:

Table 5.3

Composition of Total Revenue

(NRs. in billion)

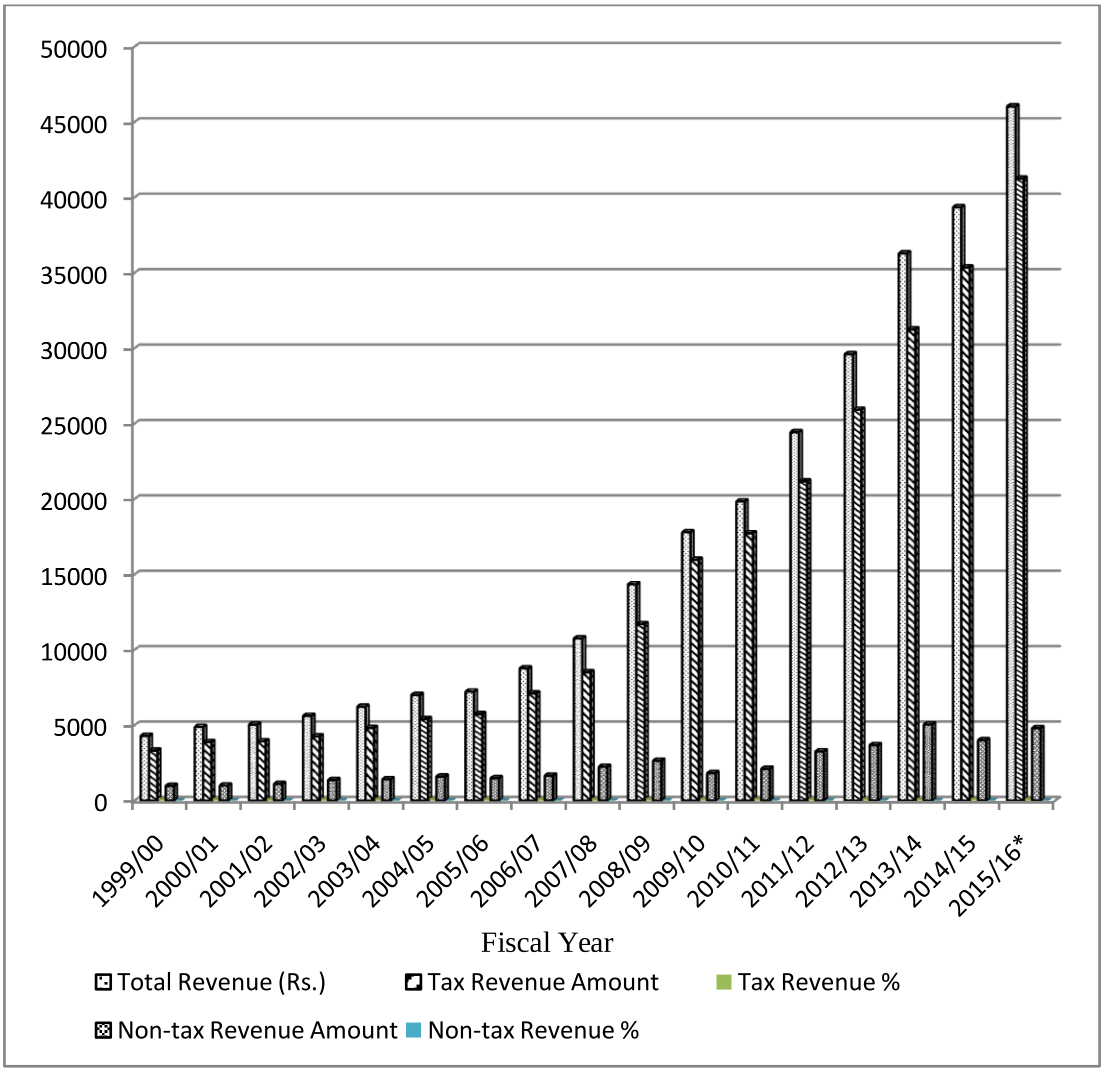
Fiscal year	Total Revenue	Tax Revenue		Non-tax Revenue	
		Amount	%	Amount	%
1999/00	4289.37	3315.21	77.29	974.16	22.71
2000/01	4889.39	3886.51	79.49	1002.88	20.51
2001/02	5044.56	3933.06	77.97	1111.50	22.03
2002/03	5622.97	4258.70	75.74	1364.27	24.26
2003/04	6233.10	4817.50	77.29	1415.80	22.71
2004/05	7012.27	5410.47	77.16	1601.80	22.84
2005/06	7228.19	5743.04	79.45	1485.15	20.55
2006/07	8771.21	7112.67	81.09	1658.54	18.91
2007/08	10762.25	8515.55	79.12	2246.70	20.88
2008/09	14347.45	11705.19	81.58	2642.26	18.42
2009/10	17799.09	15978.53	89.77	1820.56	10.23
2010/11	19837.59	17722.72	89.34	2114.87	10.66
2011/12	24437.29	21172.18	86.64	3265.12	13.36
2012/13	29602.11	25921.49	87.57	3680.62	12.43
2013/14	36292.36	31243.99	86.06	5048.37	13.94
2014/15	39350.66	35350.57	89.86	4000.08	10.14
2015/16*	46042.55	41242.44	89.58	4800.11	10.42

Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Economic Survey and Budget Speech, various Issues from 1999/00 to 2015/16, Ministry of Finance, Government of Nepal, 2017.

Figure: 5.2

Trends of Total Revenue, Tax revenue and Non Tax Revenue



Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.3.

Table 5.3 and Figure5.2 show that the role of tax revenue is very important in revenue mobilization of Nepal to meet the government expenditure. In FY1999/00 the government revenue mobilization has stands at NRs. 4289.37 billion out of which NRs. 3315.21 billion (77.29 percent) is mobilized from tax revenue source. The remaining NRs. 974.16 billion (22.71 percent) is collected from non-tax sources such as fees, fines, interest and dividends. In FY2015/16 government revenue increases to NRs.46042.55 billion with contribution of tax revenue being 89.58percent. The share of revenue from non-tax source decreases to 10.42 percent. The highest contribution of tax revenue to total revenue is 89.86 percent during the study period. It can be shown clearly that the tax revenue of the government is very high in comparison to non-tax revenue and total revenue is in increasing trend.

5.1.4 Composition of Tax Revenue in Nepal

Tax revenue is divided in to two classes one is direct and the other is indirect. A direct tax is such type of tax, which is imposed upon the person out of his income or property. A direct tax is really paid by the person on whom it is legally imposed. Income tax, property tax, gift tax, vehicle tax and others are the best examples of direct taxes. On the other hand, and indirect tax is such type of tax which is imposed upon any person without direct collecting from him. An indirect tax is imposed on person but paid partially or wholly by another. Sales tax, vat, entertainment tax, custom, excise duty are the good examples of this tax. The figure of direct tax and indirect tax revenue from FY1999/00 to FY2015/16 is presented in the following table:

Table: 5.4

Composition of Total Tax Revenue

(NRs. in billion)

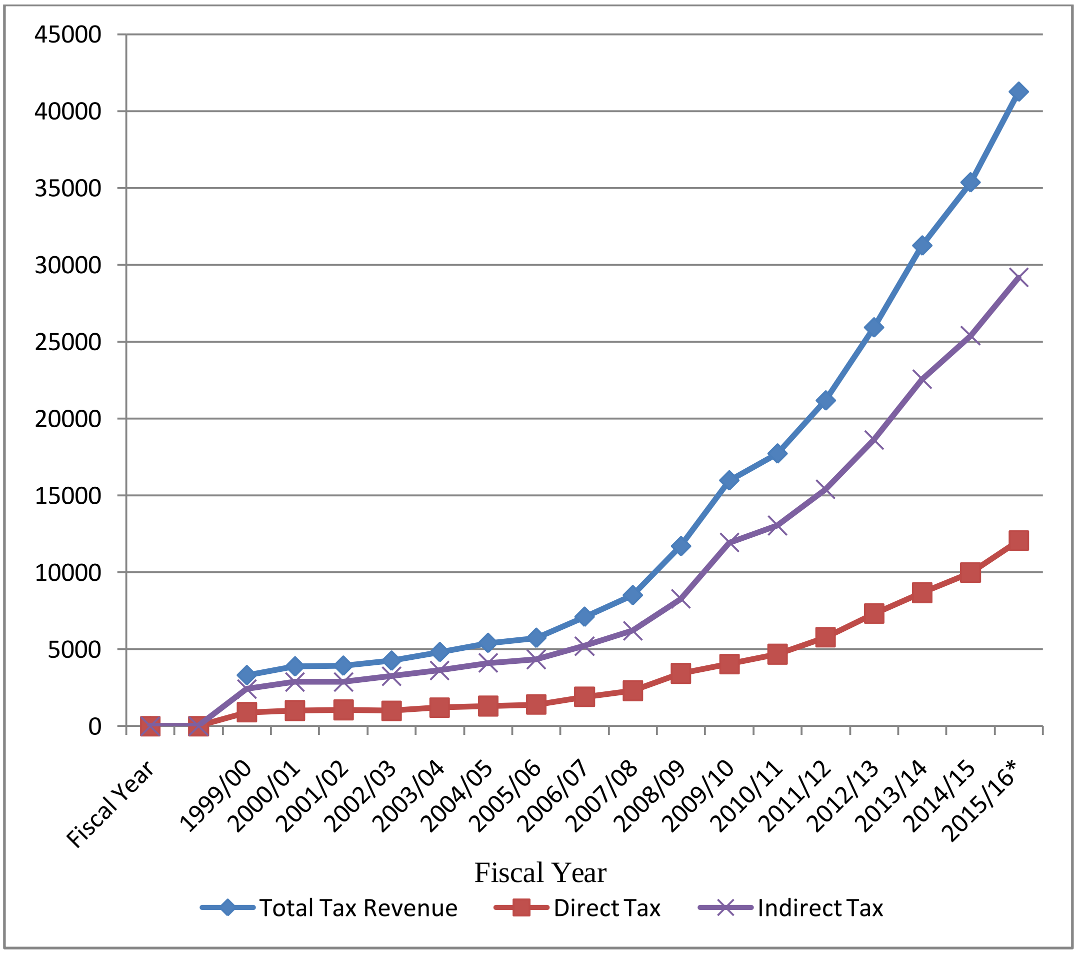
Fiscal Year	Total Tax Revenue	Direct Tax		Indirect Tax	
		Amount	%	Amount	%
1999/00	3315.21	895.15	27.00	2420.06	73.00
2000/01	3886.51	1015.94	26.34	2870.57	73.66
2001/02	3933.06	1059.75	26.94	2873.31	73.06
2002/03	4258.70	1010.58	23.73	3248.12	76.27
2003/04	4817.50	1191.26	24.73	3626.04	75.27
2004/05	5410.47	1307.18	24.16	4103.29	75.84
2005/06	5743.04	1396.81	24.32	4346.23	75.68
2006/07	7112.67	1898.03	26.69	5214.64	73.31
2007/08	8515.55	2308.77	27.11	6206.77	72.89
2008/09	11705.19	3432.07	29.32	8273.12	70.68
2009/10	15978.53	4039.60	25.28	11938.93	74.72
2010/11	17722.72	4672.03	26.36	13050.69	73.64
2011/12	21172.18	5777.02	27.29	15395.16	72.71
2012/13	25921.49	7301.26	28.17	18620.23	71.83
2013/14	31243.99	8673.65	27.78	22570.34	72.22
2014/15	35350.57	9966.99	28.19	25383.50	71.81
2015/16*	41242.44	12056.13	29.24	29186.31	70.76

Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Economic Survey and Budget Speech, various Issues from 1999/00 to 2015/16, Ministry of Finance, Government of Nepal, 2017.

Figure: 5.3

Total Tax Revenue, Direct Tax and Indirect Tax



Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.4

Table5.4 and Figure5.3 show that total tax revenue, direct tax and indirect tax are in increasing trend. The amount of direct tax is NRs. 895.15 billion in first FY1999/00. It is increasing each year and has reached to NRs.41242.44 billion in FY2015/16. Contribution of direct tax to total tax revenue is fluctuating over the study period from 27 percent to 29.24 percent. Similarly the amount of indirect tax is NRs. 2420.06 billion in FY1999/00. It is increasing each year and has reached to NRs. 29186.31 billion in FY 2015/16. Contribution of indirect tax to total tax revenue is fluctuating over the study period from 73 percent to 70.76 percent.

5.1.5 Composition of Direct Tax Revenue

The major components of direct tax are income tax, property tax, social security tax and other tax (including land revenue and registration). The share of major components of direct tax is given below in the following table:

Table 5.5

Composition of Direct Tax Revenue

(NRs. in billion)

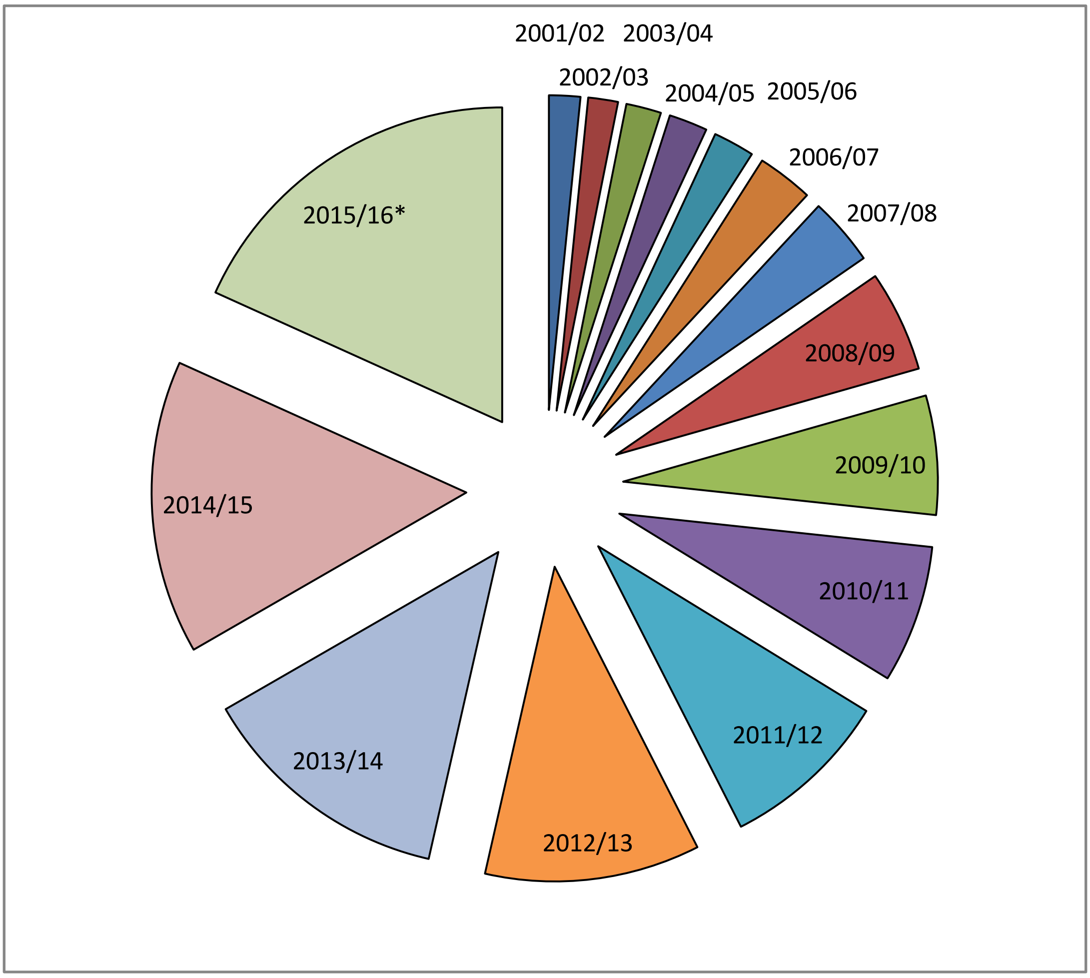
Fiscal Year	Total Direct Tax	Income Tax		Property Tax		Social Security Tax		Other Taxes (including Land Revenue and Registration)	
		Amount	%	Amount	%	Amount	%	Amount	%
1999/00	855.10	675.70	79.02	NA	NA	NA	NA	NA	NA
2000/01	1015.94	911.40	89.69	NA	NA	NA	NA	NA	NA
2001/02	1059.75	890.37	84.03	56.06	5.29	NA	NA	113.18	10.68
2002/03	1010.58	813.19	80.45	36.89	3.65	NA	NA	160.78	15.90
2003/04	1191.26	951.47	80.00	68.50	5.75	NA	NA	169.75	14.25
2004/05	1307.18	1046.61	80.07	80.65	6.17	NA	NA	179.92	13.76
2005/06	1396.81	1093.94	78.32	84.76	6.07	NA	NA	218.11	15.62
2006/07	1898.03	1573.18	82.89	99.50	5.24	NA	NA	225.35	11.87
2007/08	2308.77	1907.78	82.63	106.92	4.63	NA	NA	294.07	12.74
2008/09	3432.07	2724.74	79.39	185.00	5.39	NA	NA	522.33	15.22
2009/10	4039.60	3382.13	83.73	551.10	13.64	NA	NA	106.37	2.63
2010/11	4672.03	4135.03	88.51	357.25	7.65	70.98	1.52	108.77	2.33
2011/12	5777.02	5130.30	88.81	358.84	6.21	155.50	2.69	132.38	2.29
2012/13	7301.26	6418.67	87.91	534.02	7.31	188.06	2.58	160.52	2.20
2013/14	8673.65	7560.82	86.96	667.12	7.69	244.90	2.82	200.81	2.32
2014/15	9966.99	7751.60	77.80	869.91	8.72	1023.94	10.27	321.54	3.21
2015/16*	12056.13	9428.99	78.20	872.82	7.24	1391.16	11.54	362.71	3.02

Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Economic Survey and Budget Speech, various Issues from 1999/00 to 2015/16, Ministry of Finance, Government of Nepal, 2017.

Figure 5.4

Composition of Direct Tax Revenue



Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.5

Table 5.5 and Figure5.4 shows that collection trend of direct tax is increasing every year during last 13 year. The table also shows that the contribution of income tax to direct tax is higher than other tax and it has occupied the largest share in the direct tax. The percentage share of income tax to direct tax is 79.02 percent amounting NRs. 675.70 billion in FY 1999/00. It is 78.20 percent amounting NRs. 9428.99 billion in FY2015/16. On the other hand, the percentage of property tax, social security tax and other tax to direct tax is very lower in comparison to income tax. There percentages of contribution to direct tax revenue are fluctuating during the study period.

5.1.6 Composition of Indirect Tax Revenue

The composition of indirect tax in Nepal is presented below in table 4.10. An indirect tax is imposed on one person but paid partly or wholly by another. Indirect tax includes custom duty (export or import duty). Excise duty, sales tax (VAT) and others (entertainment tax, hotel tax, passenger tax, etc).

Table 5.6

Composition of Indirect Tax Revenue

(NRs. in billion)

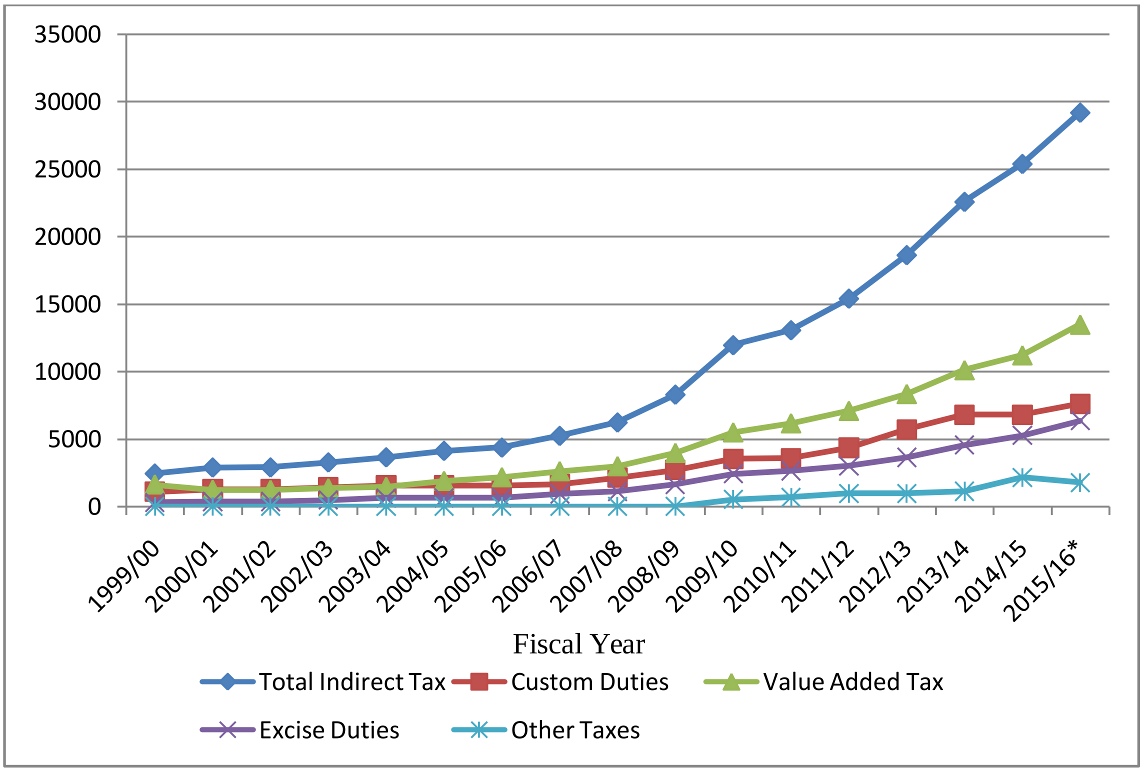
Fiscal Year	Total Indirect Tax	Custom Duties		Tax on Consumption and Product of Goods and Services					
				Value Added Tax		Excise Duties		Other Taxes	
		Amount	%	Amount	%	Amount	%	Amount	%
1999/00	2420.06	1081.33	44.68	1625.97	42.40	312.76	12.92	NA	NA
2000/01	2870.57	1255.21	43.73	1238.24	43.13	377.12	13.14	NA	NA
2001/02	2873.31	1265.88	44.06	1226.73	42.69	380.70	13.25	NA	NA
2002/03	3248.12	1423.64	43.83	1345.97	41.44	478.51	14.73	NA	NA
2003/04	3626.04	1555.48	42.90	1447.89	39.93	622.67	17.17	NA	NA
2004/05	4103.29	1570.16	38.27	1888.54	46.03	644.59	15.70	NA	NA
2005/06	4346.23	1534.40	35.31	2161.07	49.72	650.76	14.97	NA	NA
2006/07	5214.64	1670.76	32.04	2609.56	50.04	934.34	17.92	NA	NA
2007/08	6206.77	2106.24	33.93	2981.57	48.04	1118.96	18.03	NA	NA
2008/09	8273.12	2679.29	32.39	3970.09	47.99	1622.09	19.61	1.65	0.02
2009/10	11938.93	3521.89	29.50	5492.09	46.00	2414.76	20.23	510.19	4.27
2010/11	13050.69	3571.35	27.37	6166.36	47.25	2633.85	20.18	679.13	5.20
2011/12	15395.16	4339.06	28.19	7093.04	46.07	3001.61	19.50	961.45	6.24
2012/13	18620.23	5693.18	30.58	8341.84	44.80	3623.47	19.46	961.74	5.16
2013/14	22570.34	6798.06	30.12	10111.06	44.80	4541.10	20.12	1120.12	4.96
2014/15	25383.50	6770.49	26.70	11216.07	44.20	5253.00	20.70	2143.94	8.44
2015/16*	29186.31	7592.91	26.00	13492.00	45.90	6336.18	21.70	1756.22	6.40

Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Economic Survey and Budget Speech, various Issues from 1999/00 to 2015/16, Ministry of Finance, Government of Nepal, 2017.

Figure: 5.5

Composition of Indirect Tax Revenue



Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.6

Table 5.6 and Figure5.5 show that the custom duty and VAT have occupied major portion in indirect tax revenue. The contribution of custom duty to indirect tax is 44.68 percent amounting NRs. 1081.33 billion in FY1999/00. Then its ratio has decreased and reached to 26.00 percent amounting 7592.91 at the end of the study period i.e., FY2015/16. The VAT has become an important source of overall tax revenue. The contribution of VAT has 42.40 percent which is NRs. 1625.97 billion in the FY1999/00. The percentage contribution of VAT has increased and reached to 50.04 percent amounting NRs 2609.56 in the FY2006/07. Then its ratio is continuously decreases and reaches to 45.90 percent which is NRs. 13492.00 billion in the FY2015/16. The share of excise duty is 12.92 percent which is NRs 312.76 billion in the FY1999/00. The contribution of excise duty to indirect tax fluctuates during the study period and finally reaches to 21.70 percent which is NRs. 6336.18 billion. There is no seems the contribution of other taxes in the initial phase of study period. It starts from FY2008/09 in which the contribution of other taxes in FY 2008/09 is 0.02 percent amounting NRs.1.65 billion. The contribution of other taxes is increased and it reaches to 6.40 percent amounting NRs. 1756.22 billion at the last year of the study period which is FY2015/16.

5.2 Contribution of Income Tax

The contribution of income tax to gross domestic product (GDP), total revenue, total tax revenue and total direct tax in Nepal is shown in following table:

Table: 5.7

Contribution of Income Tax

(NRs. in billion)

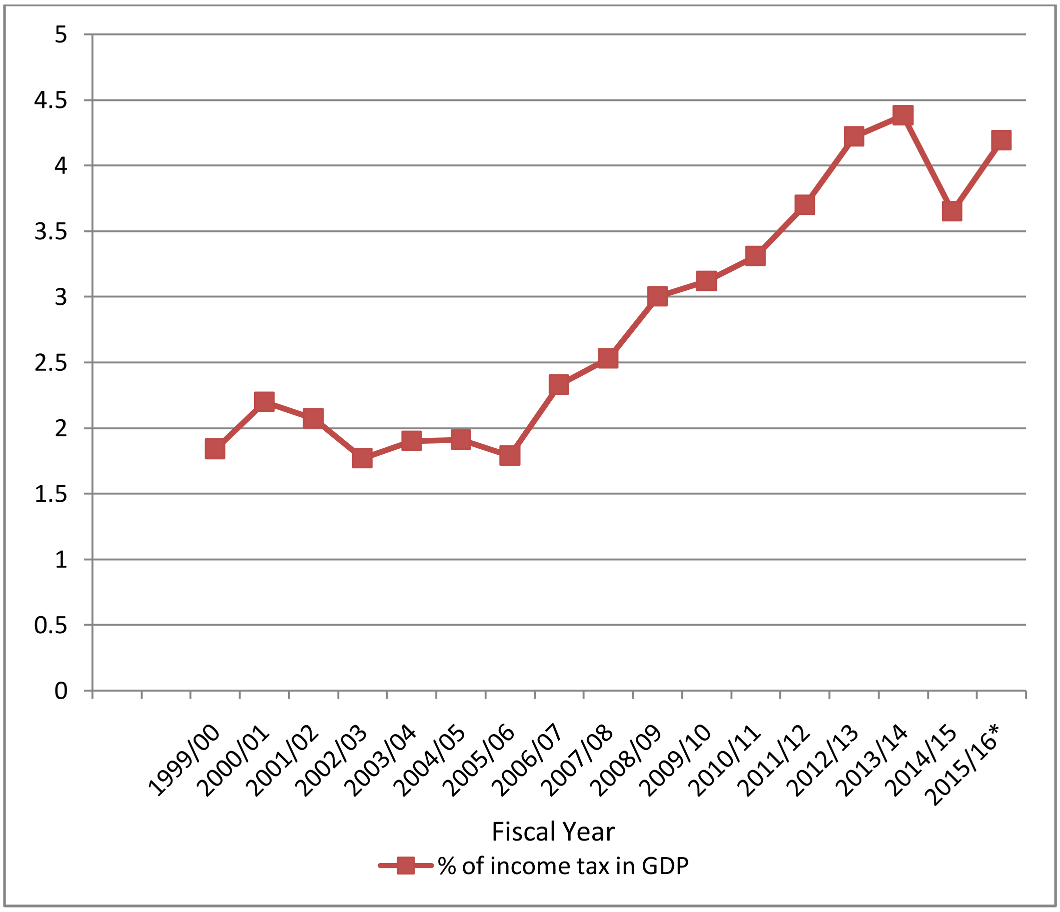
Fiscal Year	GDP Basic Price	Income Tax		Total Revenue (TR)		Total Tax Revenue		Total Direct Tax	
		Amount	Income Tax as % of GDP	Amount	TR as % of Income Tax	Amount	Total Tax Revenue as % of Income Tax	Amount	Total Direct Tax as % of Income Tax
1999/00	36625.1	675.70	1.84	4289.38	15.75	3314.83	20.38	855.10	79.02
2000/01	41342.9	911.40	2.2	4889.39	18.64	3886.51	23.45	1015.94	89.71
2001/02	43039.7	890.37	2.07	5044.56	17.65	3933.06	22.64	1059.75	84.02
2002/03	46032.5	813.19	1.77	5622.97	14.46	4258.70	19.09	1010.58	80.47
2003/04	50069.9	951.47	1.9	6233.10	15.26	4817.50	19.75	1191.26	79.87
2004/05	54848.5	1046.61	1.91	7012.27	14.93	5410.47	19.34	1307.18	80.07
2005/06	61111.8	1093.94	1.79	7228.19	15.13	5743.04	19.05	1396.81	78.32
2006/07	67585.9	1573.18	2.33	8771.21	17.94	7112.67	22.12	1898.03	82.89
2007/08	75525.7	1907.78	2.53	10762.25	17.73	8515.55	22.03	2308.77	82.63
2008/09	90952.8	2724.74	3.00	14347.45	18.99	11705.19	23.28	3432.07	79.39
2009/10	108341.5	3382.13	3.12	17799.09	19.00	15978.53	21.17	4039.60	83.72
2010/11	124848.2	4135.03	3.31	19837.59	20.84	17722.72	23.33	4672.03	88.51
2011/12	138748.2	5130.30	3.70	24437.29	20.99	21172.18	24.23	5777.02	88.81
2012/13	152285.3	6418.67	4.22	29602.11	21.68	25921.49	24.76	7301.26	87.91
2013/14	172459.6	7560.82	4.38	36292.36	20.83	31243.99	24.21	8673.65	86.96
2014/15	212000.0	7751.60	3.65	39350.66	18.56	35350.57	21.92	9966.99	77.77
2015/16*	224900.0	9428.99	4.19	46042.55	20.47	41242.44	22.86	12056.13	78.21

Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Economic Survey and Budget Speech, various Issues from 1999/00 to 2015/16, Ministry of Finance, Government of Nepal, 2017.

Figure: 5.6(A)

Contribution of Income Tax to GDP



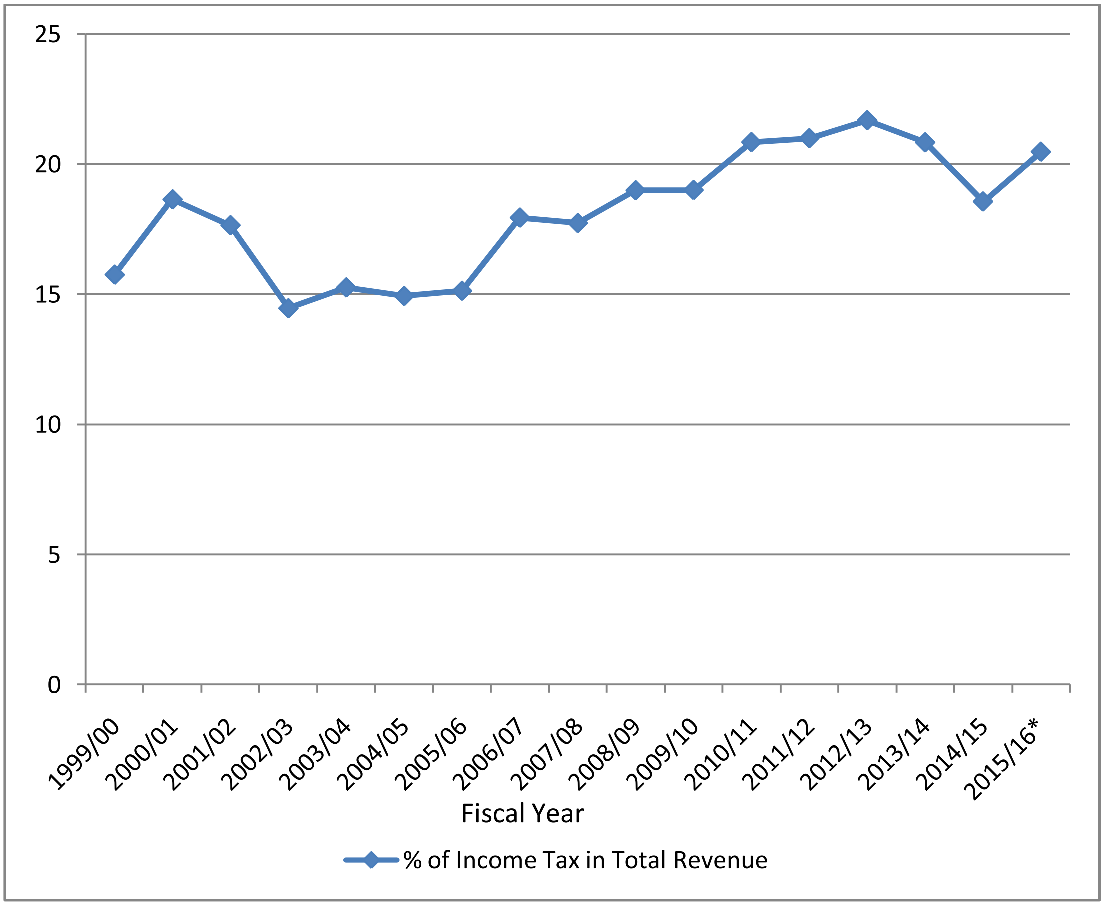
Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 4.7

Table 5.7 and Figure5.6 (A) show the contribution of income tax to GDP over the study period of 17 years. The maximum contribution of income tax to GDP is 4.38 percent in FY2013/14 while the minimum contribution stands at 1.77 percent in FY2002/03. Similarly the average contribution of income tax to GDP is 2.82 percent. In overall the contribution of income tax to GDP is in increasing trend after the FY2002/03 under this study.

Figure: 5.6 (B)

Contribution of Income Tax to Total Revenue



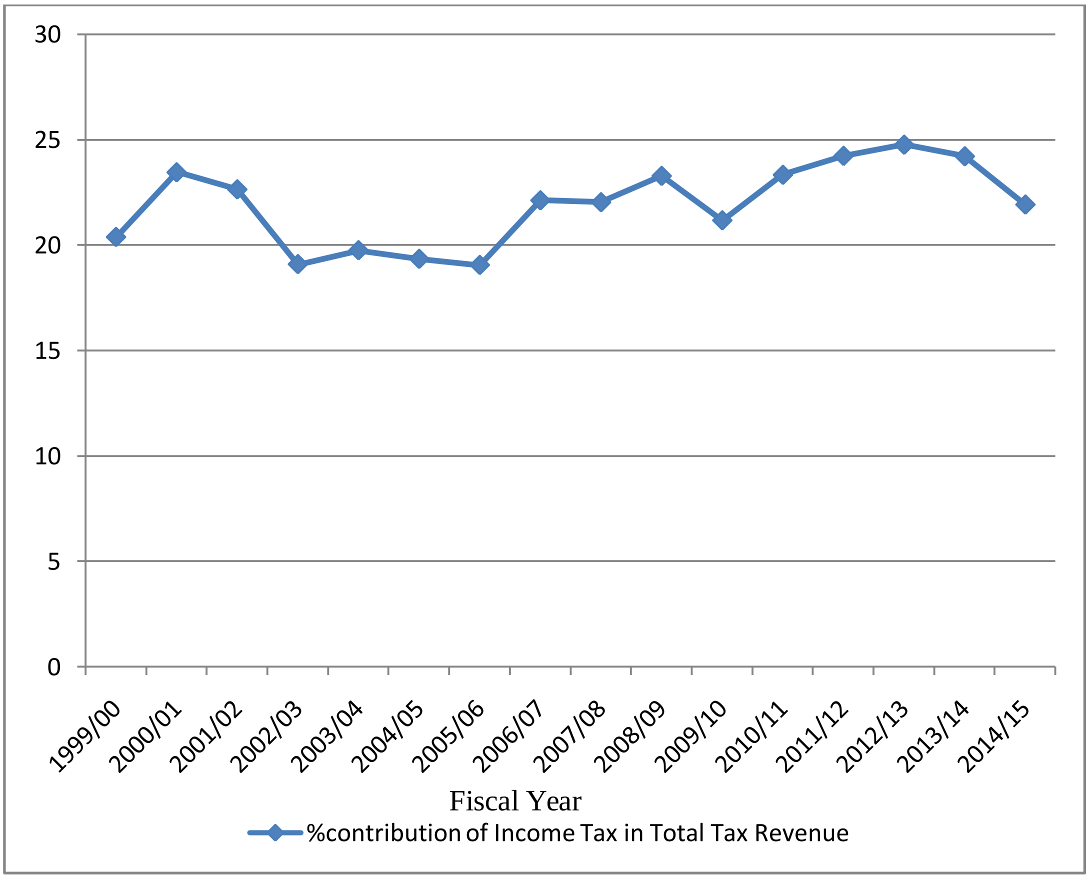
Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.7

Table 5.7 and Figure5.6 (B) show the contribution of income tax to total revenue over the study period of 17 years. The maximum contribution of income tax to total revenue is 21.68 percent in FY2012/13 while the minimum contribution stands at 14.46 percent in FY2002/03. Similarly the average contribution of income tax to total revenue is 18.16 percent. In overall the contribution of income tax to total revenue is in increasing trend after the FY2002/03 under this study but there is little decrease in contribution of income tax to total revenue at the FY 2013/14 and FY 2014/15 which is 20.83 and 18.56 percent respectively.

Figure: 5.6 (C)

Contribution of Income Tax to Total Tax Revenue



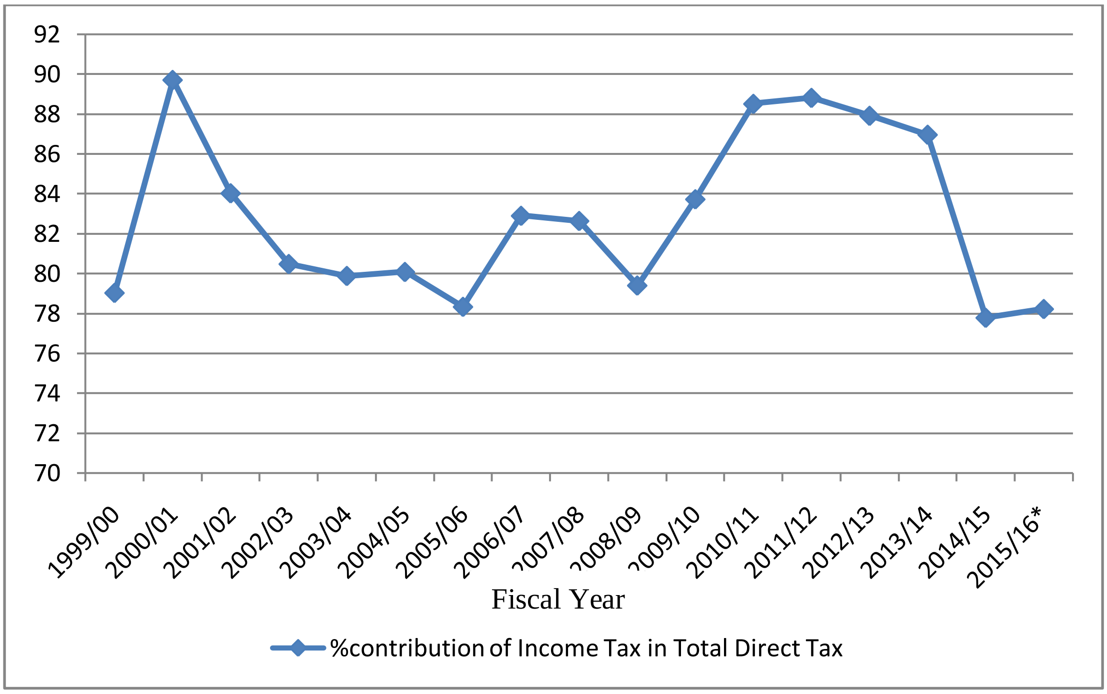
Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.7

Table5.7 and Figure5.6 (C) show the contribution of income tax to total tax revenue over the study period of 17 years. The maximum contribution of income tax to total tax revenue is 24.76 percent in FY2012/13 while the minimum contribution stands at 19.05 percent in FY2005/06. Similarly, the average contribution of income tax to total revenue is 21.98 percent. In overall the contribution of income tax tototal revenue is in fluctuating trend.

Figure: 5.6 (D)

Contribution of Income Tax to Total Direct Tax Revenue



Note: An asterisk denotes FY 2015/16 revised estimate.

Source: Based on Table 5.7

Table 5.7 and Figure5.6 (D) show the contribution of income tax to total direct tax revenue over the study period of 17 years. The dominant part of direct tax revenue is income tax. The maximum contribution of income tax to total tax revenue is 89.71 percent in FY 2000/01 while the minimum contribution stands at 77.77 percent in FY 2014/15. Similarly the average contribution of income tax to total revenue is 82.84 percent. In overall the contribution of income tax to total revenue is in fluctuating trend.

CHAPTER VI

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

6.1 Summary of Findings

Nepal is the least-developed country in the world with low per capita income having 774 US$. Its economic growth rate is very low (0.77% in FY2014/15 and has projected 5.5% in FY2016/17).23.8% of total population lives below poverty line(MoF, 2016). Financial resource gap is the major constraint of the Nepalese economy. In other words, there is growing difference between public expenditure and public revenue in Nepalese economy. Due to increasing gap between expenditure incurred and revenue collection, Nepal has heavily depends on both the external as well as internal debt to fill the budget deficit. Nepalese economy is highly dependent on external loan and internal loans which is considered undesirable for the economy.

The government of every nation requires sufficient revenue to lunch the development programmers, handle day to day operation, keep peace and security and lunch other public welfare programs. Government revenue should be increase to fulfill the financial resource gap. Income tax is one of the major instruments to fulfill the gap. The government collects revenue from various sources such as taxes, fees, fine and penalties etc. Among them tax is the main source of collecting the public revenues because it occupies the most important part of the government revenues.

The major findings of this study are summarized as below:

- There is a dominant share of tax revenue in Nepalese total government revenue. The contribution of tax revenue shows the fluctuating trend as it has contributed 77.29 percent in FY 1999/00 on the total revenue,which increases to 89.58 percent in the FY 2015/16.

- In Nepalese economy tax revenue comprises of direct and indirect taxes. The contribution of direct and indirect tax revenue was 27 percent and 73 percent respectively in FY1999/00. The contribution of direct tax to total tax revenue is little increase to 29.24 percent in FY 2015/16 whereas the percentage of indirect tax to total tax revenue was little decreased to 70.76 percent in FY 2015/16.

- The major components of direct tax are income tax, house and land tax, property tax, vehicle tax. Among them income tax occupies the large share, which is 79.02 percent of direct tax in the FY 1999/00 as a beginning of the study period and 78.20 percent at the end of study period FY 2015/16.
- The trend of the contribution of income tax to government revenue has been fluctuating trend, which justifies the need to focus on appropriate implementation of the income tax acts for a better revenue generation.
- The tax exemption limit in Nepal has been continuously increased from Rs. 15,000 for an individual, NRs. 20,000 for couple in the FY1992/93 to FY1996/97 and increased to NRs. 3,50,000 for an individual, NRs. 4,00,000 for couple and family during FY2015/16.
- Corporate income tax, individual income tax and investment income tax are the major types of income tax in Nepal. Corporate income tax is collected from Government Corporations, Public Limited Companies, partnership firms and private limited companies. Individual tax is collected from remuneration, industry and business profession etc and investment tax is collected from dividend tax, interest tax, royalty and rent tax.
- The share of income tax as a percentage of GDP increased from 1.84 percent in the FY 1999/00 to 4.19 percent at the end of study period FY 2015/16. This shows that share of income tax as a percentage of GDP is in increasing trend.

6.2 Conclusion

Income tax is one of the important and suitable means of raising government revenue.Contribution of income tax to government revenue is not satisfactory. In other word Nepalese income tax system is not efficient because various problems existed in the income tax such as increasing habit of tax evasion, defective income tax law, lack of experts in tax administration, lack of awareness of tax payers, etc.

The current Nepalese income tax administration is not active and effective.The effectiveness of income tax completely depends upon implementation of income tax laws and provisions, which are the major responsibilities of income tax administration.Public awareness program is necessary for raising government revenue.Tax evasion is the major reason for unsatisfactory contribution of income tax to government revenue. To increase the contribution of income tax to government revenue, self-assessment method is more appropriate while assuming income tax.Progressive tax rate is suitable for Nepal.

One of the major problem is there is a lengthy process while paying tax.There is a possibility to make the current provision of fines and penalties reasonable by increasing them.Clear act, rules and regulation are most important factors for effectiveness of income tax in Nepal for raising government revenue.Current fines and penalty is reasonable and we should implement it properly to bring the tax evaders into tax net.The role of income tax is very important in revenue mobilization of Nepal to meet the government expenditure and there is vital role of income tax to fulfill the resource gap problem of Nepal.

6.3 Recommendations

On the basis of this study and analysis, the following suggestions have been recommended for effective and efficient income tax system in Nepal:

- It is necessary to increase the share of direct tax in total tax revenuethrough effective and efficient taxation system.
- Tax ratio should be increase gradually on long run basis to meet the government expenditure. For this the tax basis should be widened.
- The terms and procedure under income tax act should be simplified so that every person could understand easily.
- The provision of fines, penalties and punishment should be made at higher rate for income tax evaders.
- There must be coordination between the departments of tax.
- For the specialization of income tax matter separate income tax department should be established.
- There is a necessity of Public awareness program for raising government revenue.
- Progressive tax rate is suitable for Nepal so there must be strong commitment to implement it.
- Tax principle should be adopted according to ability to pay.

- The provision of reward, prize and incentives should be introduced in the act to encourage the taxpayers to pay tax voluntarily rather than coercive measures.
- The percentage of direct tax to total tax can be increased by applying self-assessment of income tax along with promotional activities and awareness programs.
- The member involved in formulating income tax act and policy must have deep knowledge about the economic condition, living standard, economic indicator and existing income tax acts of the country.

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