TREND AND STRUCTURE OF INCOME TAX IN NEPAL

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LETTER OF RECOMMENDATION

This thesis entitled **TREND AND STRUCTURE OF INCOME TAX IN NEPAL** has been prepared by **Ms. Bishnu Maya Aryal** under my guidance and supervision for the partial fulfillment of the requirement for the Master of Arts in Economics.

I hereby, recommend this thesis for its evaluation and approval.

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APPROVAL LETTER

This is to certify that this thesis submitted by **Ms. Bishnu Maya Aryal** entitled **TREND AND STRUCTURE OF INCOME TAX IN NEPAL**has been approved by this department in the prescribed format of the Faculty of Humanities and Social Sciences. This thesis is forwarded for the evaluation.

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Bishnu Maya Aryal

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LIST OF ABBREVIATIONS/ ACRONYMS

ADB	Asian Development Bank
CBS	Central Bureau of Statistics
CE	Current Era
etc	et cetera
GDP	Gross Domestic Product
GON	Government of Nepal
IMF	International Monetary Fund
i.e	That is
IMF	International Monetary Fund
IRD	International Revenue Development
MOF	Ministry of Finance
NRB	Nepal Rastra Bank
OECD	Organization of Economic Cooperation and Development
SAARCE	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Agreement
VDIS	Voluntary Disclosure of Income Scheme.
WTO	World Trade Organization

CHAPTER I

INTRODUCTION

1.1 Background of the Study

In developing countries like Nepal, lack of sufficient financial resources is the main constraint for national economic development. Prime concern of every nation of the world is rapid economic development and Nepal is no exception to this. A lot of money has to be spent to achieve maximum national objectives. Either to pay regular expenditure or to be development works, government requires large amount of revenue.

Total expenditure is increasing at faster rate than increase in total revenue. The problem of bridging this gap has become the main issue in the country. The sources of government revenue can be classified into two categories: External sources and internal sources. Internal sources of the government revenue can be divided into two parts. They are tax and non-tax revenue.

Non-tax revenue includes different sources like administrative income, business income, loans, grants, gifts, fees and fines, penalties, dividends, interest, royalty, sales of the government property, principal repayments, etc. The administrative income denotes the amount charged by the governments for providing administrative services like registration fees, passport fee and license fee, etc. Business income means the income received by the government enterprises through providing various goods and services to the people like electricity, water supply and telephone and postal services, etc. In Nepal, around 20 percent of the revenue comes from these sources (GoN, 2015) Loans, grants and gifts means the cash or commodity provided by the local and foreign people ,institutions, organizations, agencies and the government of one country to another country. If the government does not need to pay back such cash and commodity, it is called grant and gifts otherwise loans.

Another sources of government is tax revenue which include income tax, wealth (property) tax, profit tax, interest tax, Value Added Tax (VAT), sales tax, export tax and import tax, etc. The main objective of imposing tax is to collect government revenue on the basis existing tax law. However, tax is the main sources of the government of the getting around 80 percent of the total revenue from these sources

(GoN,2015). Hence, tax is the compulsory payment of the people and institution imposed by the government in order to finance the government expenses incurred in the common interest of all without reference to special benefit conferred. The tax payer cannot receive any quid-pro-quo for the payment of tax. It means the tax payers do not need to receive any kind of benefits from the government equivalent to their payments.

In fact, tax revenue not only contributes in the process of capital formation of the nation but also serves as the tool to curb the income inequality among the people in the society. So, it helps to reduce the unequal distribution of income and wealth. Therefore, taxes are considered as the better source of public revenue and effective tools for raising the public fund. Taxes are generally classified into indirect and direct taxes. Indirect tax is the compulsory payment imposed by the government on the production, sales, distribution and transit of goods and services from one place to another place .The burden of indirect tax can be shifted partly or wholly to others like VAT, sales tax, hotel tax, entertainment tax, export tax and import tax etc. direct tax is the compulsory payment imposed by the government on income, wealth (property), profit and interest earnings, etc. The burden of indirect tax cannot be, shifted from one person to another person.

Income tax is levied on the income generated by a person ,family, household, private forms, factory, industry, situations, organizations, government enterprises, semi-government agencies in the form of remuneration, profit, interest earnings, etc. The concept of income tax in Nepal was initiated in the early 1959 introduced income tax in Nepal in which only the remuneration and business profit had been considered as the taxable income. After three years in 1962, the taxable income was further categorized into five heads since 1974 like income from agricultural sector, industrial or business sector, remuneration, rental and other sources. The latest income tax act of 2002 has also included capital gain in taxable income.

However, in developing countries like Nepal, the objective of income tax is generating government revenue in order to finance in regular and development activities of the government. It is the also helps to establish social justices through the reduction of unequal distribution of income and wealth among the people in the society.

The linkages between rising inequality and the fragility of sustainable growth both in advanced and developing economies has received greater attention. Many economists alleged that the relationship between inequality and the financial cycle sowed the seeds for crisis (Rajan,2010).

1.2 Statement of the Problem

The major concern of every nation is economic growth and development. Nepal has started following the development activities through national economic plans since 1956 for which a huge amount of government revenue was require. So, the government of Nepal introduced direct and indirect taxes system. The contribution of income tax on GDP is also not much satisfactory as it ought to be. Lack of managerial efficiency is one of major problems of income tax in Nepal. Also lack of effective personal management, reward and punishment system, poor income tax assessment procedure, not effective implementation of self-assessment of tax, poor tax information system, very narrow coverage of income tax, tax evasion, not proper utilization of tax planning, corruption are the major problems of income tax in Nepal. Besides since the time of introduction of income tax in Nepal in 1959, a several changes have been made in tax policy, tax acts tax laws, tax system and procedure etc.

There is a high resources gap in the budget of the nation which is fulfilled through the internal and external borrowings. It is the bitter reality of each and every budget of the government of Nepal. Tax and non-tax revenue is the major sources of the internal revenue where tax is playing more vital role than non-tax revenue. In tax revenue, indirect tax is playing more significant role than direct tax. It means Nepal’s tax structure is mainly based upon indirect taxes. The experience of the developed countries has clearly shown that the tax is one of the major components for the increment of internal revenue. But in Nepal its contribution has not increased significantly. It has already been mentioned above that there is a significant resource gap in government finance. The gap between revenue and expenditure is ever increasing. Therefore, the resource gap has becomes a serious bottleneck for the process of socio economic development of Nepal. To increase the government revenue, it is very necessary to raise its sources of revenue. Although, there are various sources of government revenue, the tax revenue is one of the major sources.

Nepal taxation system is the suffering from different inherent problem like increasing resources gap, dominance of indirect tax to total tax revenue, dominance of tax revenue in the total revenue, low responsiveness and productivity of tax yield, growing reliance on foreign loans. Low Tax-GDP ratio, weak tax administration, low level of voluntary compliance, narrow tax base, high tax rate, inelastic tax system, wide spread tax evasion and frequent charge in tax rates.

For the last many years is facing acute shortage of sources resulting in increasing budgetary deficit. The overall budgetary deficit was Rs. 24710 million in FY 2012/13 fiscal deficit is Rs. 3815 million in FY 2013/14 and fiscal deficit is Rs. 10328 million FY 2014/15. As a result, dependence on external as well internal borrowings has inordinately been increased in budgetary structure of Nepal (MoF, 2015).

Therefore, there is a greater need of improving tax structure Nepal. This need becomes more appreciable when the higher tax ratio to GDP in developed county. This has generated the strong believe among economist that the present tax ratio in Nepal is very low that can be increased substantially and would be a solution of resources problem. Moreover, how this ratio can be raised and in what magnitude present tax structure is able in rising revenue becomes subject matter of study (Dahal, 2009).

Owning to so many reasons including unemployment weak governance and impractical educational system, a large number of youngsters are migrating to foreign countries in search of job. Remittance income is coming from all over the world to Nepal where Nepalese people are migrated. However, most of the immigrants are unskilled and earn less as compared to skilled manpower. The small amount of remittance which they send to home is used in unproductive fields including houses, conspicuous consumption, purchasing of land and luxuries goods. Therefore the remittance income is not playing the actual role for the alleviation of the poverty and the overall development of the entire country (MoF, 2015).

Following are the research questions of the research study:

- What is the structure and trend of income tax in Nepal?
- How can the trend of major tax heads and other sub-heads tax be compared?

1.3 Objectives of the Study

The main objective of this study is to analyze the structure and trend of income tax in Nepal. The study is guided by the following specific objectives:

- To analyzed the tax structure and the trend of different taxation in Nepal,
- To compare the trend of major tax heads and other subhead tax during the study period.

1.4 Significance of the Study

In the context of developed and developing country there are so many crucial aspect or sector help for economic development. In such “income tax” is one of the fundamental sectors, which plays vital role for the overall economic development of country. Contribution of income tax in government revenue collection is relatively more than other taxes. Therefore the few study have been chosen as a relevant topic for the present study.

Nepal is predominately agriculture based developing country as agriculture contributes a major share to the GDP. With low pace of industrialization process, Nepal has faced serious problem in revenue collection. Marginally high tax rates, leakages in tax collection, inefficient, limited tax base, indifferent and corrupt tax administration and poor property record are some of the major problems of taxation in Nepal (Dahal, 2009). Therefore, it is the obligation of the government to explore different sector of the economy for revenue generation.

A country’s prosperity is largely related with the development, in turns depends on national income. The availability of fund for the economic development and maintaining the stability of the country is the main objective of the taxation, which helps to distribute the national income of the country to equality. It is regarded as the transfer of resources from private sector to public sector.

Sustainable economic development has been the major concern of developing countries. Nepal government has targeted the economic growth of 6 percent this year (FY 2015/16) on the ground that reconstruction activities would speed up after the major earthquake of April 25 and the powerful aftershock of May 12 (MoF,2015) but reconstruction work is just started as the full body of the reconstruction authority has been formed very recently. On the other hand, continued protests in the Terai region for the last five months followed by an unofficial blocked imposed by India, Nepal will see a decrease the economic growth (0.77%). The blocked which started on September 23, three days after Nepal promulgated the new constitution, has badly hit all sectors of the economy. Paddy production was hit hard owing to the shortage of chemical fertilizers; if the current situation continues, it will hit wheat production as well. Major hydropower projects that had been closed after the earthquake have not come into operation yet and road and irrigation projects have been hit by the lack of fuel.

Taxation, as a major fiscal policy instrument and important government policy tool has an important role in increasing the rate of the capital formation and thereby achieving a high rate of economic growth. Income tax is the one of the major sources of government revenue. It plays a vital role for the overall economic development of the country. The contribution of income tax on GDP has been increasing gradually. Given the aforementioned complex economic and political environments of the country the study aims to explore and identify how taxation helps economic development of Nepal and what are some of the pitfalls that Nepal faced when dealing with such taxes. The study also provides specific policy recommendations for the overall socioeconomic development based on the finding of the study. Thus, this study is considered very important in the contemporary economic situation of Nepal and it can be proven as one of the milestone for further studies as well.

1.5 Limitations of the Study

- This study has been conducted confining income taxes in Nepal. Hence, the general conclusion derived from this study may not be applicable globally.
- The study is highly based on secondary data and information. Thus, the conclusion and recommendations of the study are constrained by the validity of that information obtained.
- The study has mainly used time series data from FY 1996/97 to 2014/15. But some study has used data from 2002/03 and 2011/12 to 2014/15 due to unavailable data

1.6 Organization of the Study

This study has been organized in five chapters. The first chapter is introductory, which includes general background of the study, statement of the problem, objectives of the study, significance of the study, and limitations of the study. The second chapter provides literature review which includes review of international and national and theoretical background of income tax in Nepal. The third chapter highlights to research methodology used in the study. The fourth chapter analyzes the trend and structure of income tax in Nepal. The fifth chapter presents major findings and recommendations.

CHAPTER II

REVIEW OF LITERATURE

Literature review is basically a stock of previous knowledge obtained from different sources available and it review provides the status of the knowledge of the field of research. Literature review is an important tool to find out what related research work has been carried out on the field of related study area.

In a democratic country, political power is more evenly distributed than economic power. Rising income inequality in advanced and developing economies has coincides with growing public support for income redistribution. Therefore, higher inequality may create pressures for redistribution. A majority of voters will have the power and incentive to vote for redistribution but this need not be the case if the rich have a more political influence than the poor. Indeed, the creation of the income taxes which is relatively a modern invention has largely motivated by concerns about inequality.

One of the importance goals of any government is to increase the well beings of its citizens through improved fiscal and monetary policy. Fiscal policy in general and rate of income tax in particular is the primary tool for the government to affect income distribution. Both tax and spending policies can alter the distribution of income, both over the short and long term. For example fiscal instruments, such as income taxes and cash transfers, can reduce the inequality of disposable income.

There is a very large body of literature on the issues of taxation and growth. It is generally assumed that a higher income tax rate leads to a higher tax revenue collection which in turn, enhances the economic development of the economy (Robert, 2013).

However, traditional school of through advocates that a reduction in the tax rate will lead to increased economic growth and prosperity. The fact is that the benefits of reduction in the tax will go to the rich, as they pay the most taxes. On the other hand, economic theory suggests that the marginal utility which is the incremental value of anything including money declines as its quantity increases in the hand of the of a human being. The implication is that as income raises the personal burden from any given of tax declines, and it’s implicitly supports a progressive tax rate rather than a proportionate (flat) rate. A tax cut does not necessarily help or hurt an economy, it largely depends on what the revenue from those taxes those taxes is being spent on. Both changes in the level of revenues and changes in the structure of the tax system can influence economic activity but not all tax changes have the same effects on long-term growth. In this backdrop this study investigates how income taxes affect economic growth and development.

2.1 History of Income Tax: A Global Perspective

The personal income tax is a modern invention; however, the general concept of taxation is an age - old idea that has a long history. The first, known, written record of taxes dates back to ancient Egypt around 3000-2800 BC. Taxes where such an important part of ancient Egyptian life that many of the surviving hieroglyphic tablets are about taxes. Although many of them complain about higher rate of taxes. There was a proverb in Ancient Sumerians "You can have a load, you can have a king, but the man to fear is the tax collector"(Adams,1992).

"The budget should be balanced, the treasury should be refilled, public debt should be reduced, should be curtailed lest Rome become bankrupt, the mob should be forced to work and not depend on government for substance, and prudence and frugality should be put into practice" (Caldwell, 1965, p.15).

However, the implementation of an income tax was not found until 1799. The income tax, viewed as a temporary one was introduced into Great Britain by Prime Minister William Pitt the Younger in his budget of December 1789, to help the British raise money to fight the money to fight the French forces led by napoleon. The inception date of the modern income tax is therefore accepted as 1799 (Harris, 2006).

After the World War I, the income tax became an important source of tax revenue in many developed countries. In India, the income tax was introduced in 1860 by the British to relive from economic burden created due to the first democratic revolution. It was discontinued for some years and then regularly collected after the participation of income tax 1886. In this way, income tax became the regular source of national income for all countries of the world. In the beginning income tax generally levied at a flat rate. The principle of progressive tax was introduced in the United Kingdom and

New Zealand in 1999. Nowadays, a progressive rate of income tax is generally used all over the world.

2.1.1 Concept and Meaning of Income Tax

Income is defined in the framework for the preparation and presentation of financial statement as increase in economic benefits during the accounting period in the form of enhancements of assets or decrease of liabilities that result in increase in equity, other than those relating to contributions from equity participations. Income Tax Act, 2058 is as well recognizes that encompasses both revenue and gains. Revenue is treated as gross receipt from the disposal of goods.

Income tax is charged on the taxable income. Taxable income is derived by deducting the Income is derived for a certain period. In Nepal the period for twelve month commencing from classified that the taxable income into three classes, Income from Employment, Income from Business and Income from Investment. The total of the income of a person is said to be an income of the person. Income as shown by financial statements may differ from the taxable income tax is payable on the income. Thus, income tax is defined as tax chargeable on income of a person as per the relevant Income Tax Act (Khadka,1994).

2.2 Income Tax in Nepal

2.2.1 Evolution of Income Tax in Nepal

Before Rana Regime

In Nepalese context, the history of tax system goes back to Veds, Smiritis and Purans. Directives propounded by Manu, Yagnablakar, Chanakya etc. guided taxation system. The principle of collecting tax from people was based on imposing the tax without harming the activities of the people (Kandel, 2003). During lichhavi and Malla regimes taxes on agriculture and business were the major source of government revenue. Agriculture income tax was called Bhaga. Income tax, which was levied on business income, was called kara. Though reliable records about taxation in ancient and medieval period are not available, taxes were levied on the merchants, traders and famers in the form of cash, kind or labor.

During the period of 1825-1903, expenses for administration, military and other operational activities were increased significantly. During the period, taxation was taken as the main source of revenue. Different types of taxes like land tax, transit tax, market duties, export of forest product, mimes and mint, bird animals and various levies and fines were levied. Local governments were directed to take whatever is paid willingly by the people. Taxes were collected from the three tiers: (i) royal palace (to finance occasional and ceremonial needs),(ii) government (to finance administrative, military and other purposes) and (iii) local (prerequisites of local official functionaries). Various taxes levied during this period were narrow in base and were imposed like darshanbhet, salami, walak etc. After the unified period, land tenure system was divided into five min forms: raikar, birta, guthi, sera, and kipat. However, the main sources of revenue from land were birta and kipat.

King Prithivi Narayan shah had introduced Pota tax in 1772, which can be regarded as a revolutionary measure in fiscal system of Nepal. It was based on flat rate system and limited on small birta owners. There was no taxation on income in the form of modern income tax.

During Rana Regime

Imposition and collection of taxes during the 104 years' autocratic rule of the Rana family in Nepal was privilege of the federal rulers. Budget, including income and expenditure of the state, would not public there was no difference between the income of the Prime Minister. The major sources of the revenue were land tax, custom and excise duties in the form of lump sum contracts, royalties, entertainment tax and a few other minor taxes. There were no other direct taxes in the country except land tax collected on a contractual basis and salami, which the government employees used to pay out of their salaries at a very small percentage. Rana Prime Minister levied taxes for meeting specific expenditure of the royal household and extraordinary expenditure necessitated for war or other crisis rather than mobilizing revenue in the nation.

Taxation in Modern Nepal

The modern tax system in Nepal gained its momentum with the establishment of democracy in 1951. Nepal presented its first budget in 1952 and the first five years plan was initiated in 1956. The planned activities of the government needed huge amount of resources and thus Nepal government initiated to levy tax on income as permanent sources. The first finance ordinance appeared in 1959 to impose tax on business profit and remuneration. In 1960, Business profit and Remuneration Act was enacted which was the first income tax act in Nepal. It was replaced by the Income Tax Act, 1962 with the purpose of raising government revenue; reduce income inequality with social justice and to create taxpaying habits of tax payers (MoF, 1962). The Income Tax Act 1974 was the third law relating to income tax administration in Nepal (MoF, 1974). In 1982 income tax rule 1982 was enacted. To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend and integrate the laws relating to the income tax, the Income Tax Act 2002 was enacted which has been the fourth income Tax Act of Nepal (MoF, 2002). This Act is based in global income tax principle and has brought all sources of income into the network (Kandel,2003, Bhattari and Koirala, 2004).

There are various provisions in this Act. The has classified income tax in four groups: (i) individual income tax,(ii) corporate income tax, (iii) interest tax, and (iv) house and land tax. The main objectives of Income Tax Act, 2002 were: to levy tax on all income sources and income earning transaction; to make income tax revenue more productive and elastic, to develop the tax system by means of extended scope, clear-cut, transparent and simple procedure, to make accountable and improved tax administration, to reduce economic cost neutralizing income tax, to emphasis statement based on accounting system; to impose uniform tax to all people and all sources, to make the taxpayer responsible by introducing the process of process of self –assessment.

The key features of Income Tax Act, 2002 are:

- All income tax related matters are confined within the act abolishing all tax related concessions, rebates and exemption provided by different Acts; broadened the tax base; tax rates and concessions are harmonized on equality ground and tax rates are spelled out.
- Introduced taxation on capital gain; provided liberal set-off and carry forward backwards provision and stringent fine and penalty for the defaulters.

- Introduced a provision for administrative reviews to allow the tax administration to correct mistake made by tax administration internally.
- Global income of a resident are made taxable; list of expenses is inclusive; all expenses relating to income have been made admissible.
- Separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayer from criminal liabilities.

2.2.2 Main Provision of Income Tax Act

The Income Tax Act 2002 (MoF, 2002) imposes tax on those activities contributing towards the creation of wealth. Wealth is created with the help of labor, capital and capital-labor mix activities that generate income from employment, investment and business respectively. The act has made broad classification of income encompassing almost all income –earning activities including employment, investment and business (profit and gain of a person from conducting a business for an income year).

The taxpayers on whom income tax is impose are persons can be a natural person, who is an individual or a couple but include also a proprietorship, or it can be an artificial persons i.e. an entity. An entity means a partnership, trust, company, and foreign permanent establishment or government body. Under this act, resident individual and domestic companies are tax on their worldwide income while non-resident individuals and offering companies are taxed only on their income sources on Nepal. For every person the tax is imposed and calculated for an income year.

The taxable income of a person for an income-year is equal to the amount as calculated by subtracting reduction, if any, claimed for the total of the person’s assessable income for the year from each of the income heads which include business, employment, investment, and windfall gain. The government allowances to windows, elderly citizen or disable individuals, gifts, bequest, inheritance, scholarship, income foreign officials, government bodies and non–profit organization have been exempted for the income tax.

Income of corporative societies, registered under cooperative Act 1991, from business mainly based on agriculture and forest products and rural community based saving and credit cooperatives are exempt from tax. Dividends distributed by such societies are also exempt from tax. The income of an approved retirement fund is free from tax but retirement payments in the hands of employees are taxable.

According to the Act, a company is liable to tax separately for its shareholders. The share, loans and advances to directors and shareholders, distribution made on liquidation are also brought under the tax in order to plug loopholes for avoidance. Capital gains are taxed explicitly under this act after four decades of the introduction of income tax. The act has introduced the concept of medical tax credit under which resident individuals may claim a medical credit of 15 percent the amount of approved medical costs. This act focuses on self-assessment. The act has introduced the concept of administrative review to correct the administrative mistakes. According to the Act windfall gain includes income from lottery, gifts, prize, tip, win-rings and other similar causal incomes.

2.2.3 Principles of Taxation

There are two fundamental principle related to equal treatment in tax which undergird most taxes (Basu,2013) and have different economic and political ramification: (i) ability to pay principle and (ii) benefits received principle. A concept of tax fairness that states that people should pay taxes in proportion to the benefits they received from government goods and services. The benefit principle is the idea that people should pay taxes based on the benefit they receive from government services. An example is a gasoline tax. The tax revenues from a gasoline tax are used to finance the highway system; people who drive the most also pay the most towards maintaining roads. In the same way, people who use the toll road should pay the toll; people who use the park should pay the park fees etc.

The benefit received principle of taxation asserts that households and business should purchases the goods and services of government in basically the same manner in which other commodities are bought. It follows the same principle as the market. The individuals who receive the benefit of a goods or service should pay the tax necessary to supply that goods or services. However, it is not always easy to figure out the benefits different people receive from some public services, such as national defense.

This principle has been subjected to severe criticism. If the state maintains a certain connection between the benefits conferred and the benefits derived, it will be against the basic principle of tax. A tax is compulsory contribution made to the public authorities to meet the expenses of the government and the provisions of general benefits (Robert,2013). There is no direct quid pro quo in the case of a tax. Moreover, the expenditure incurred by the state is for the general benefits of its citizens, it is not possible to estimate the benefit enjoyed by a particular individual every year. If this principle I applied in practice, then the poor will have to pay the heaviest taxes, because they benefit more from the services of the state. If the government gets more from the poor by way of taxes, it is against the principle of justice.

It seems that if the taxes are levied on this principle as stated above, then justice can be achieved but in practice problem arises with the definition of ability to pay (Robert,2013). The economists are not unanimous as to what should be the exact measures of a person's ability to pay. Some economists are of the opinion that ownership of the property is a very good basis of measuring one's ability to pay. However, if a person earns a large income but does not spend on buying any property, he will then escape taxation. On the other hand, another person earning income buys property; he will be subjected to taxation. It is ridiculous and unjustifiable that a person, earning large income is exempted from taxes and another person with small income is taxed.

It appears very just and fair that if the income of a person is greater than that of another, the former should be asked to pay more towards the support of the government than the latter. That is why in the modern tax system, income has been accepted as the best test for measuring the ability to pay off a persons.

2.2.4 Role of the Government for Taxation

In modern times, all the countries of the world have witnessed an enormous increase in public expenditure. In the laissez- faire era the state was assigned a very limited role to play based on the principle of least interference or 'that government is the best which spends the least'. The functions of the state where restricted (i) to protect the society from violence and invasion of other independent societies, (ii) to protect against injustice, and (iii) erecting and maintaining certain public works. In recent time, public expenditure has been increased manifold. The modern states are no more police states but welfare states.

2.2.5 Nature and Purpose of Taxation

The revenue is generated through direct and indirect forms if taxation. Direct taxes are paid on income. The more income one earns the greater his/her contribution is expected by the government. Indirect taxes are levied on expenditure which is imposed on the basis of the individual consumption. Thus, an individual pays only on what he consumes. However, it must be noted that taxation is used not only to raise revenue but also to regulate consumption and may even be used to curtail various forms of business activities. For instance, alcoholic beverages and tobacco may be taxed heavily on the grounds that their use is hazardous to the health of individuals.

The regulatory aspects of taxation are more apparent in indirect taxes, such as customs duties and taxes, than indirect taxes such as income tax. For instance, government can control private consumption, especially of imported goods, by increasing customs tariffs. An increase in taxation on personal income on the other hand, may result in a decrease in private savings without affecting the level of consumption. The effectiveness of any government taxation depends on the willingness of the people governed to surrender or exchange a measure of control over their persons and property, in return for protection and other services. Taxation is one form of this exchange.

In designing tax systems, government customarily consider three basic indicators of taxpayers wealth or ability to pay: (i) what people own, (ii) what they spend, and (iii) what they earn. The kind of taxes raised by government for revenue are numerous the most common are personal income taxes, corporate income taxes, property taxes, sales taxes, death and gift taxes, and import-export duties (Robert,2013).

In order for a tax system to operate effectively, certain principles must be put in place.

- Fairness: the tax must be fair, that is, citizens should be taxed in proportion to their abilities to pay.
- Efficiency: a good tax system should be structured so that it can Administered efficiently and economically. Taxes that are difficult or costly to administer divert resources to non-productive uses and diminish confidence in both the levy and the government.

- Fiscal adequacy or productivity: In trying to raise more revenue, the government should not have stifled the production capacity of the economy.
- Flexibility: economy is not static; the tax system should not be rigid. It should be capable of being quickly adjusted to meet the changing needs of the economy.
- Economy: no use to introduce a tax that will cost more money to collect than the money it will bring to the government. It would be meaningless and a waste of public funds to continue with that type of tax.
- Simplicity: tax system should be easy to understand such that the tax payer can even work out his tax liability. If a tax is complicated and difficult for the taxpayer to understand, some tax officials may take advantage of that to oppress and export money from the tax payer.
- Diversity: a variety of taxes (both direct and indirect taxes) in the economy ensure that as many people as possible are made to contribute to the government revenue.

Taxes have three main purposes:

- Taxes have an economic significance. Taxes are used to promote goals such as full employment, satisfactory rates of economic growth, and stability of the money supply. The economic goals of taxation are achieved by raising or lowering tax rates. Conversely, the more taxes they pay, the less money they have available for themselves.
- To provide money that makes it possible for the government to function smoothly such as to meet out the administrative and development expenses of the government and for development and welfare program in the country.
- Taxes are used as a redistribution of wealth. The purpose of income redistribution is to lessen the inequalities of wealth in the society. This is done through what is called a system of transfer payments. The effect of the system is to transfer money from those who have a good deal of it to those who have very little. Two of the most common example are social security payments and welfare payments made to people who, for one reasons or another, do not work.

2.2.6 Classification of Taxes

The tax can be classified in to two categories namely direct tax and indirect tax.

a. Direct Tax

If the tax amount is bearing and paid by the same persons and that cannot be shifted to other persons, it is called direct tax. "A direct tax is really paid by the same person on whom it is legally imposed."A direct tax is a tax on income, wealth, profit and interest earnings etc. The main features of direct tax are the ability to pay, equitable as per the income and wealth, certain as per the process and amount of payment, time of payment and elastic in nature etc. The examples of direct tax are income tax, land tax, profit tax, and tax on income earnings etc.

Income tax plays a significant role in the national economy. It is one of the important sources of revenue to the government. In addition, it is also looked up as a tool for achieving the social and economic objectives because it can be used as a tool to narrow down the disparities in distribution of income and wealth; to remove the regional economic imbalances; to enhance the industrialization; to channelize the resources towards developmental activities and so on. Thus, besides being of sources of revenue, income tax has become an effective instrument to ensure imbalanced socio- economic growth and development. The term income that is generated from various ways is the part of income tax. But all income generated from all ways are not taken under income tax act. Income, in a broad sense is the economic gain of any person that he has experienced during a period of time. In general, individual income is defined as the function of the consumption of an individual plus net increased in his wealth. Income tax is a state share out of the taxable earnings of an assessed. It is charged on the total income of the previous year at the rate applicable during the relevant assessment year. Total income is computed with reference to residential status of assesses. Some earnings are not included in the total income like festival bonus, medical expenses etc. Income tax can be broadly classified into two types like individual income tax and corporate income tax.

i) Individual Income tax

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

ii) Corporate Income Tax

Government corporation and public and private limited companies are subjected to flat rate corporate income tax. Corporate income tax is levied on the income of a company which is derived from the sources in Nepal and income received abroad from activities carried out in Nepal. For the foreign company, tax is levied only on the income earned from source in Nepal (Khadka, 1994).

b. Indirect Tax

Indirect tax is that one where person paying the tax and the persons bearing the tax are different. According to Dalton, "An indirect tax is imposed on one person but paid partially or wholly by another person". An Indirect tax is a tax on production, consumption, exchange, distribution, export and import of goods and services. The main features of indirect tax are benefit to pay, mass participation, convenient to pay limited evasion, shifting of incidence etc. The example of indirect tax are production tax, value added tax, sales tax, contract tax, customs duties (export and import tax) and so on.

2.2.7 Income Tax

Income tax is a prime source of government revenue. Government enforces a certain percent as a tax on financial income generate by all entities within their jurisdiction it is known as income tax (World Bank,1991). Hence, an income tax is a tax levied on the financial income of persons, corporation, or other legal entities. Moreover, 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 taxable income of a person or a company after deducting allowable expenses. In this perspective, one thing must be very clear that accounting profits may differ from taxable profits. To obtain the taxable income, generally incomes are added expenses are subtracted and losses, which are allowed to deduct under the provision of income tax act are also subtracted, tax-free income allowances and common expenses also deducted. Thus after giving the exemption limit as per law, the amount of tax to be levied on this computed income is the income tax.

In most of the advanced countries particularly the US, UK, Canada and others, the income tax is defined in terms of the 'flow of wealth of receipt in money or goods from the tax payer (Due & Friedlandr, 1977). Rations of tax revenue to gross domestic product (GDP) in developing countries are typically in the range of 15 percent to 20 percent, compared with 30 percent in industrialized nations (World Bank, 1991). An optimal tax rate has to compromise between the country's revenue and its economic development. A high tax rate would deter saving and development, while a lower tax rate would lead to less revenue to the state. As income tax directly influences the savings of individuals and companies, it is a double edged sword used to curtail consumption activity abs at the same time, allow the tax payers to save money in different development activities.

2.2.8. Income Tax and Government Revenue

The ratio of government revenue to GDP that remained 19.7 percent in FY 2012/13 has reached 20.55 percent in FY 2013/14(MoF,2015). However, the ratio of Government expenditure to GDP in FY 2012/13 was 21.2 percent which increased to 22.2 percent in FY 2013/14. The gap between Government's revenue and expenditure was 3.3 percent of GDP FY 2011/12, which was 1.5 percent in FY 2012/13 due to lower growth rate of expenditure. However, it grew to 2.0 percent in FY 2013/14. As per the government's income and expenditure estimate for FY 2014/15, percentages of income, expenditure, and budget deficit to GDP are likely to be 24.23 percent, 29.09 percent and 4.86 percent respectively if income and expenditure targets are fully met.

As in many developing countries, revenue and foreign grants are the major sources of government income in Nepal. Government income is estimated to be grown by 29.9 percent in FY 2014/15 reaching Rs. 514.82 billion (MoF,2015). Contribution of revenue and foreign grant in total income which stood at 88.7 and 10.6 percent respectively in FY 2012/13, reached to 89.83 percent and 8.55 percent respectively in FY 2013/14. Contribution of foreign grants to the government income is expected to be grown and reached 14.22 percent while that of revenue is estimated to be declined to 82 percent in the FY 2014/15. Government revenue that recorded an average annual growth rate of 20 percent from FY 2009/10 to FY 2013/14 is estimated to be grown only by 18.6 percent in the FY 2014/15.

Of the Government's income sources, tax revenue has registered an average annual growth rate of 22.0 percent between FY 2010 and 11 and 2013/14 (MoF,2015) Collection of tax revenue in the FY 2014/15 is estimated to be Rs. 374.70 billion. Though estimated tax revenue collection has met its target, its growth rate (19.9 percent) is likely to be remained lower than the average growth rate of last four years.

Government income had covered 88.7 percent of total expenditure in FY 2012/13 while such coverage accounted for 89.83 percent in FY 2013/14(MoF, 2015). This coverage is estimated to come down to 81.92 percent in FY 2014/15. Analyzing the sources of financing of government expenditure, contribution of revenue, which stood at 88.7 percent in FY 2012/13 grew to 89.83 percent in FY 2013/14. In the FY 2014/15, revenue and domestic borrowings put together are estimated to contribution 80 percent to the total expenditure, while remaining 20 percent to be shared by foreign grant of 11.9 percent and foreign borrowing of 8.1 percent.

2.3 Theoretical Review

2.3.1 International Level

By and large, income tax rates are increased due to factors such as enormous reduction in the purchasing power of money, heavy tax erosion, urgent need for yield and dynamic public expenditure (Fossati,1992). Aron and Gale (1996) have suggested while dealing with the income tax rate that income tax rate change would revolve around three factors: (i)The tax base (ii) allowable deduction and (iii) economic development. Holger (2003)suggested that one should study the effects created by these rates, especially the impact of income tax rate on economic growth.

This literature review is mainly concentrated on how changes to the individual income tax affect economic growth. However, an exhaustive review of the literature is beyond the scope of this study. In this section an attempt has been made to review several notable researches particularly published in peer reviewed international journals, books and webs. Some unpublished study reports, dissertations, and thesis are also reviewed in the Nepalese context.

There is a very large body of literature on the relationship between level of taxation and growth performance. Theoretically, there are two schools though it understanding the impact of income tax rate on the economic growth and development: (i) the traditional school and (ii) the modern school. The tradition of school of thought advocates that while holding other determents of growth constant, low tax rates and low government spending is associated with higher growth (Slemrod, 2002). The higher the marginal tax rate, the greater the chances of higher income tax payers diverting extra time from productive operations to leisure activities. Further, tax reduction may encourage individuals to work, save, and invest. On the other hand, the modern school of thought argues that the higher marginal tax rates would secure greater revenue, which when invested in the country's education and infrastructural development, would boost the economy and lead to greater economic development in the long run.

Long - term economic growth has a direct link with the country's tax policy (John & Pamela, 2003). The World Bank (1991) asserted that economic development is directly correlated to the level of taxation, more so in developing nations where the lower marginal tax rates have higher economic growth. A majority of empirical studies of income taxes and economic growth published in peer reviewed academic journals support the World Bank's arguments that tax increases harm economic growth.

Arnold, Brys, and Heady (2011) found that corporate taxes were most harmful followed by taxes on personal income, consumption, and property for 21 OECD countries during 1971 and 2004. Shift of tax revenue from income taxes to consumption and property taxes would increases GDP per capita in the long run. Corporate taxes reduced investment and productivity growth.

Alesina and Ardgna (2010) found that fiscal stimuli based upon tax cuts more likely to increases growth than those based upon spending increases for OECD countries during 1970 and 2007. Further, fiscal consolidations based upon spending cuts and no tax increases are more likely to succeed at reducing deficit and debt and less likely to create recessions.

Gale and Potter (2002) estimated that the 2001 tax cut would have little or no net effect on GDP and could have even reduced it. The authors found that the negative effect of higher deficits and the decline in national saving would outweigh the positive effective of reduced marginal tax rates. However, the improved incentives of reduced tax rates, analyzed in isolation, increase economic activity by raising labor supply, human capital, and private saving.

Romer, David andRomer (2010) investigated that the tax changes have large and persistent effects on growth. The findings showed that with a tax increase of 1 percent, lowers real GDP by roughly 2 to 3 percent mostly through negative effects on investment in the US after World War II.

Diamond and Viard (2008) estimated the effect of a tax cuts and concluded that the tax cuts do raise the size of the economy in the long - term but lower the welfare of members of future generations.

Reed (2008) described that the strong, negative, and robust effects of state and local taxes including income tax on growth. The author regressed state- level data on the change in the log of real per capita personal income between the current year, t, and t-4 on the change in overall tax revenues, as a share of personal income, in t - 4, for six 5- year periods from 1970 to 1999. Notably, the author found strong, negative impacts of income tax on per capita income growth across a wide variety of specifications.

2.3.2 National Level

Khadka (1994) described the introduction, existing structure, development, major problem and possible direction of reform in income tax in Nepal. He has evaluated the Nepalese tax system based on conventional and theoretical concept and also suggested various measures for its improvement. He has identified the major problem of income tax and possible direction of reform. He has identified weak administration, imbalance and inadequate organizational pattern, lack of adequate information system, lack of coherent tax policy and adequate physical and other facilities as the major problem of Nepalese income tax system. In order to overcome these problems, Khadka has suggested the following remedies:

- There should be honest, fast and strong organizational administrative setup regarding income tax.
- Organizational setup should be decentralized backed by adequate and well trained manpower with essential authority.
- Taxation policy should be reviewed and update according to the requirement of the time and trend of the rest of the world.
- Physical and other technical and infrastructural facilities should be well developed so as to curb down the leakages and other various irregularities.
- There should be direct and target group focused information system related to tax system.

Malik (2003) played a vital role in the literature of modern income tax system is Nepal by presenting the complicated provision of new income tax act and simplest way with sufficient illustrations. He criticized the Nepalese tax system on various ground; provision of tax concession, provision of tax holiday and provision of taxation on benefits. He has further shown the weakness of a resident persons, income from retirement benefits and so on. He has suggested bringing such income in to taxable brackets on the basis of neutrality, fairness and equality so that it could bring effectiveness, efficiency, justice and horizontal equality in the society.

Adhikari (2003) included theoretical as well as practical aspects of taxation in Nepal. In the theoretical aspect, he has presented historical background of Nepalese income tax system and theoretical framework of the present tax laws. In the practical aspect, he has presented the method and techniques of computation of taxable income and exemption amount etc. In his book, he has pointed out the following shortcomings of taxation policy in Nepal.

- Nepalese tax system is not clear regarding income from fringe benefit like income from lottery, gift, etc.
- The process of income tax simplification has becomes further complex as the existing tax law has adopted multi- tax system because the classification of income head, provision of tax exempted organization, income accounting and assessment system, etc. are vague.

- Similarly, in the tax management side, he has pointed that organizational model, limit of managerial control, responsibility and accountability and dissimilarity in the positional series are defective.
- In organizational setup side, he has shown there is no positional different between the officers of internal revenue department (IRD) and leader or officers of the supervisory or apple court relating to taxation this has created technical problem by weakening the span of control. This has further emphasized the centralization of the tax offices as it ought to be decentralized.
- Transfer pricing should be made more descriptive and well managed.
- Income tax should be based on net income.
- There should be different provision for lease income for the purpose of income taxation.
- Metropolitan and sub- metropolitan cities should be mapped for the purpose of tax assessment.
- There should be simple and easy administrative process for the purpose of paying back the excess amount paid by the tax payers as tax under voluntary disclosure of income scheme (VDIS).

Kandel (2003) explained about the present tax laws of Nepal in detail in his book and one part of the book is about the income tax law of Nepal. In his book unlike other, he has mainly mentioned the positive aspects of present tax law, i.e. 'Income Tax Act-2001'.They are as follows:

- Present income tax act has brought all kinds of income under tax law.
- It is absolutely tax payer bases tax system because it is guided by the sprit that – tax is the liability of the payer otherwise they should face legal consequence by themselves.
- This tax system follows the core theme of the world tax system as it treats all tax payers equally and is not bias towards anybody.
- All treatments regarding the income tax are treated under the provision of tax law, act and economic bill.
- This tax system is more liberal on the basis of providing the facilities.

Agrawal (2004) suggested that about theoretical as well as the practical aspect of 'Income Tax Act- 2001'. The main aim of this book is to serve the knowledge of income tax and its practical aspect like calculation of taxable income tax deduction etc. to the concerned people like tax practitioners, chartered accountants, registered auditors, accountants and other managerial persons in big organization. The book is also a source of information on the subject of income tax. He has briefly explained about fixed assets and depreciation treatment on income tax purpose. He has also provides a schedule for depreciation.

2.4 Empirical Review

2.4.1 International Level

Chernick (1997) discussed that the progressivity of income taxes negatively affects GDP growth in US states from 1977 to 1993. studied the relationship between tax and growth of developed and developing countries and concluded that tax- financed spending reduces growth in developed countries but increases growth in developing countries.

Padovano and Gallio (2001) described that the using the data from 1951 to 1990 of the 23 OCED countries found effective marginal income tax rates negatively correlated with GDP growth. The study investigated that a 10 percent reduction in marginal tax rates raises the growth rate by 0.11 percent points.

Dennist (2004) explained that the effect of a generic 10 statutory in all income taxes, including those applying to dividends, capital gains, and the alternative minimum tax. In the three scenarios where the tax cuts are financed in the long run by increases in income taxes, the long- term effects are generally negative. In the Ramsey model and the closed economy overlapping generation model, GDP and GNP falls significantly. In the open economy model, GDP raise slightly, but GNP falls by even more than in other models. The chain of events creating this outcome is that the tax cuts reduce national saving and hence increases capital inflows. The inflow, in conjunction with increased labor supply, is sufficient to slightly raise (by 0.2 percent) the output produced on American soil.

Lent (1993) conducted their research taking Mexico and Pakistan as a sample. As per their study investment tax credit, investment allowance and accelerated capital consumption allowance were most effective promoting investment than more general tax incentives such as corporate tax rate reduction. From that research they research they reached at the summary and Conclusions on the elasticity of rental rate of capital, which respect tax instrument, on the tax sensitivity of capital stock and on the benefit cost ratio.

Ferede and Dahlby (2012) suggested that negative effective between income tax and growth in Canadian provinces between 1977and 2006. The study estimated that every 1 percent reduction in corporate income tax raises annual growth by 0.2percent.

Mertens and Ravn (2012) observed that the impact of exogenous changes in personal and corporate income taxes to growth in the US post –war period. The study found a 1 percentage point cut in the average personal income tax rate raised real GDP per capita by 1.4 percent in the first quarter and by up to 1.8 percent after three quarter. In the same way a 1 percentage point cut in the average corporate income tax rate raised real GDP per capita by 0.4 percent in the first quarter and by 0.6 percent after one year.

Blanchard and Perotti (2002) suggested that unexpected increases in total revenue including income tax negatively affect private investment and GDP in US after WWII period.

Bleaney, Gemmell and Kneller (2001) found strong support for positive, long –run growth effects associated with productive public expenditure and budget surpluses and negative effects for distortionary income taxes in OECD countries from 1970 to 1995.

2.4.2 National Level

Various governments have different approaches and method of fixing the income tax rate. The tax system in Nepal is characterized by high share of indirect taxes on goods and services. Further, these taxes have been increasing at a higher rate than the indirect tax items, indicating a possible welfare loss and increased progressivity of the tax system in Nepal. Several reforms had been undertaken by the government in the past to simplify and modernize the tax system. The reforms consists of three types: (i) reform in the tax laws and regulations (ii) reforms in environment, (iii) reforms in tax administration (Dahal, 2009).

Adhikari (2011) found that the share of the tax revenue was always greater than the non- tax revenue, the contribution of indirect tax revenue ;and tax structure of Nepal was the consumption of tax from government sector, public sector, private corporate bodies and remuneration tax.

Shrestha (2001) analyzed the legal provision, structure of income tax and income tax administration in Nepal. The author found that the tax/GDP ratio of Nepal not satisfactory with compared to SAARC countries. The study found various problems of income tax in Nepal including narrow tax coverage, lack of consciousness among tax payers, widespread evasion and avoidance of income tax, unscientific tax assessment procedure, inefficient tax administration, complicated tax laws and procedures, instability in government policies.

Dahal (1995) covered various issues relating to tax such a low elasticity, higher burden of indirect tax to direct tax, lack of voluntary compliance and leakage. The exemption of income tax from the agriculture sector has marked as a main cause of narrow base. The study suggested that tax rates were unnecessarily high. Low real per capita income growth rate showed the low taxable capacity of the people. The study suggested to increasing the total taxpayers and to increases the per capita income. The study further suggested that there is a scope about 40 percent extra resources mobilization if better tax policy and program were in place. The study recommended various practical ideas to widen tax base.

Kandel (2004) described that the most of the development countries need tax incentives. As per the empirical studies done in various countries the conclusion is that among different types of tax incentives, investment allowance or investment tax credit and accelerated depreciation are superior to other types of tax incentives. Tax holiday is the most inferior type of tax incentives, which causes revenue loss without enhancing the investment environment. Meanwhile, most of the researchers have opposed the tax holiday system both with in Nepal and outside the Nepal.

Koirala (2004) reported that the contribution of employment income to total income tax revenue of Nepal has not been satisfactorily due to various reasons like low pay scale of employees, ineffectiveness in the implementation of the Act, evasion and so on. Similarly, current exemption limit is not satisfactory. The author suggested that the separated provision should be made regarding exemption limit to couple and family, and they should be given higher exemption limit in corporation limit in comparison to the individuals. Some of the recommendation given by the author are income tax Act should make effective in the implementation aspect, the contribution of income tax revenue to tax revenue and direct tax revenue should be increased by checking tax evasion and bringing few taxpayer into tax network, couple should be provided more tax exemption as compared to individuals because of the cost of living of them, pension income should be taxed by giving enough exemption limits to the pension holders because in the old age pension holders lack other sources of income and the troubles faced by employees should be minimized.

Bhandari (2007) studied that the Nepalese tax structure, rate and contribution of income tax on national revenue. The author asserted that there is a dominant role of direct tax in Nepalese tax revenue structure. The author recognized that important factors for raising government revenue in Nepal where clear Act, rules and regulation, effective tax administration, conscious and honest tax payers, morals and honest tax officers, political non- interruption. The study recommended that income tax policy should be formulated on the basis of critical analysis of existing situation.

Timlsina (2008) examined that the income tax evasion tendency in Nepal. The study identified a serious problem of financial resources gap in Nepalese economy and recommended that government should timely correct the problems of resources gap by increasing tax coverage through different programs. Tax evaders should be taken legal action while corruption on the part of tax administration should be reduced by discouraging the corrupt officers.

2.5 Research Gap

This research helps the reviewers to find the updated and changed situation in the economy and the behavior of the investment and businessman towards the income tax system. As the above research work mainly concerned with the income tax of Nepal. Income tax is becoming the backbone of the government revenue to leading the indirect tax in the past. There were not enough development of information, technology and Inland Revenue office in different cities of the country. But now it is has been improving as the major revenue sources of government, for implementing income tax system. Government and its concerned agencies are making plan and policies to collect the maximum revenue in the country for the welfare of the people in Nepal.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Design

The research design applied in this study is descriptive as well as analytical. The descriptive research is generally used to describe characteristics of a population being studied. A descriptive approach to research is called as a foundation for research and therefore, does not answer questions about how, when, why the characteristics occurred. Rather it attempts to determine, describe, or identify what is. The characteristics used in this study to describe the situation are some kind of categorical such as income groups, ethnic groups, occupation groups, groups of socioeconomic indicators and the like. Descriptive research generally precedes explanatory research. Based on the descriptive design all the primary data are presented in the table and analyzed in the descriptive way using ratio, averages, ratio and other statistical calculations. Moreover, this study uses description, classification, measurement, and comparison to describe the income tax.

In this study, analytical means, there are various causes and effect relationship of taxation which are logically linked and analyzed to make the study more robust. The simple statistical as well as scientific tools are used to describe ad analyze the data. This study attempts to find out the trend, structure and composition of the income tax on the basis of its performance and excises. This study describes the trend and composition occurring at present status by accumulating the past information and facts. Basically the data and information of the study are concerned with past phenomena of the performance. Thus, it can be also regarded as a historical research design, though it is descriptive as well as analytical in nature. This study attempts to show the figure of the income tax trend and composition from FY 2002/3 to 2014/15. So, descriptive research will be adopted to conduct the research.

3.2 Nature and Sources of Data

The nature of this study is descriptive as well as analytical. In this study, mainly secondary data are used. The data and information are basically depended on the published and unpublished secondary sources. The secondary sources of data are pure reviewed journal articles, books related to the income tax, budget speeches and economic surveys of Ministry of Finance, publications of Center for economic Development and Administration (CEDA), records of Department of Taxation, economic reviews and indicators from Nepal Rastra Bank, newspapers and unpublished reports, thesis and dissertations related to taxation available at Central Library of Tribhuvan University.

3.3 Data Processing

This study, being descriptive types of research mainly used the descriptive methodology of data analysis. Collected data from the secondary sources was tabulated in the master table and then categorized into the various simple and complex table formats according to the adopted design for the study. Most of the data have been presented in table and trend line has been used to present and interpret the facts and findings of the study visibly.

Data analysis procedure is at heart of any research study. It is the attempt to fully and accurately summarize and represent the data has been collection and more importantly techniques used to analyze the data. Data from various sources is gathered, reviewed, and then analyzed to from some sort of findings. The collected data were processed through the statistical computer package of Microsoft excel for the data analysis.

3.4 Tools of Data Analysis

All the data are present and analyzed to fulfill the objectives. Tables, figures, charts, diagrams, time series analysis, have been used for the data presentation to evaluate contribution of the income tax to GDP. Statistical tools have been used for the purpose of data analysis on the basis of which interpretation has been made.

3.5 Analysis and Interpretation of Data

In the process of data analysis, data are presented with the help of tables, bar diagrams and other diagrams and analyzed in descriptive manner according to the requirement of the study the description is given the table so that it has been easy to understand.

3.6 Statistical Methods

It attempts to establish the nature of relationship between dependent and one or more independent variables. It also provides a mechanism for prediction or forecasting. The regression of $Y_{revenue}$ on X_{GDP} is used to estimate the value of dependent variable Y_{GDP} for any given value of independent variable and vice versa.

To examine the relationship between independent and dependent variables, the estimated equation is

$$Y = a + bx$$

Y = dependent variable (TR)

X = independent variable (GDP)

a = constant   b = coefficient

3.6.1 Statistical Test of Significance

Standard errors of estimates (SEE). like SD, measure the reliability of the estimating equation and estimating coefficients. The larger SEE, the greater happens to be the dispersion of scattering of given observation around the regression line (or coefficients) and no better the estimates. On the other hand the smaller value of SEE, better the regression line (or coefficients) and the better the estimated based on the equation for this line. With help of SEE, it is possible to ascertain how good and representative the estimated regression line (or coefficients) are as a description of the average relationship between two series. For this study, the SEE, for regression coefficients have been calculated by using package software.

3.6.2 Test of the Goodness of Fit (R^2)

After estimating the regression parameters, R^2 is used for judging the explanatory power, which measures the dispersion of observation around the regression line. It is essential, because the closer the observation to the line, the better the goodness of fit, that is the better explanation of the variations of Y by the change in the explanatory variables. R^2 shows the percentage of the total variation of the dependent variable that can be explained by the independent variables of the multiple determinations and is the square of the correlation coefficient. The formula to derive R^2 is mentioned below:

$$R^2 = \frac{\hat{b}_1 \sum y_{x1} + \hat{b}_2 \sum y_{x2} + \cdots + \hat{b}_n \sum y_{xn}}{\sum y^2} \qquad \text{or, } R^2 = \frac{SSR}{SST}$$

Where,

$y = Y - \overline{Y}$ $\qquad$ $x = X - \overline{X}$

3.6.3 Test of Significance of the Parameters Estimates

It is applied for judging the statistical reliability of the estimates of the regression co-efficient. The following tests have been performed to test the hypothesis of the study.

T – test

This test performs in order to identify the statistical reliability of the estimates of the regression co- efficient and the formula for calculating the value is:

$$t = \frac{\hat{b}}{SE(\hat{b})}$$

Where, $\hat{b}$ = estimated value of b $\qquad$ SE($\hat{b}$) = standard error of b

SE($\hat{b}$) = $\sqrt{}$var$\hat{b}$

The calculated t- values are compared with tabulated t- values at a certain level of significance, for a given degree of freedom. If the calculated t- value exceeds the tabulated value, it is inferred that estimated co- efficient is significantly different from zero.

F- test

F – test is used to examine the overall significance of the model

The formula for calculation is $F = \frac{R^2/_{k-1}}{(1-R^2)/_{N-K}}$

Where,

R^2 = co-efficient of determination

K = Number of explanatory variable

N = Number of observation in the sample

The calculated F-variance ratio is compared with the tabulated value at a specific level of significance with (K-1) and (N-K) degree of freedom.

If $F_{cal} < F_{tab}$, we accept null hypothesis

If $F_{cal} > F_{tab}$, we reject null hypothesis or we accept alternative hypothesis

CHAPTER IV

ANALYSIS AND INTERPRETATION OF DATA

The main aim of this chapter is to examine, and empirically investigate the structure and trend of income taxation to GDP per capita in Nepal. This chapter also deals with the analysis and presentation of trend and composition of income taxes.

4.1 Structure of Government Revenue and Taxation

As in many other countries in the world, the government revenue in Nepal is composed of tax and non- tax revenue. When the government of Nepal presented first national budget in FY 1951/1952, the revenue structure was typically hat of traditional economy with 73 percent of government receipts coming from non - tax sources and land tax. In FY 1960/61, the share of non-tax revenue declined drastically because of the increasing contribution of indirect tax on foreign trade. In the FY 1996/97, the share of tax revenue was 80.4 percent amounting Rs. 24424.1 million out of the total revenue Rs. 30 373.4 million. After his year, the share of tax revenue continuously decreased till FY 2005/06 and then increased gradually and reached 87.6 percent amounting Rs. 312441.0 million out of the total revenue 356620.5 million on the FY 2013/14 and then increased reached 87.70 percent amounting 355955.7 million out of the total revenue Rs. 405866.5 million in the FY 2014/ 15. Table 5.2 and graph 5.2 illustrate of government tax and non - tax revenue.

Table 4.1

Structure of Government Revenue

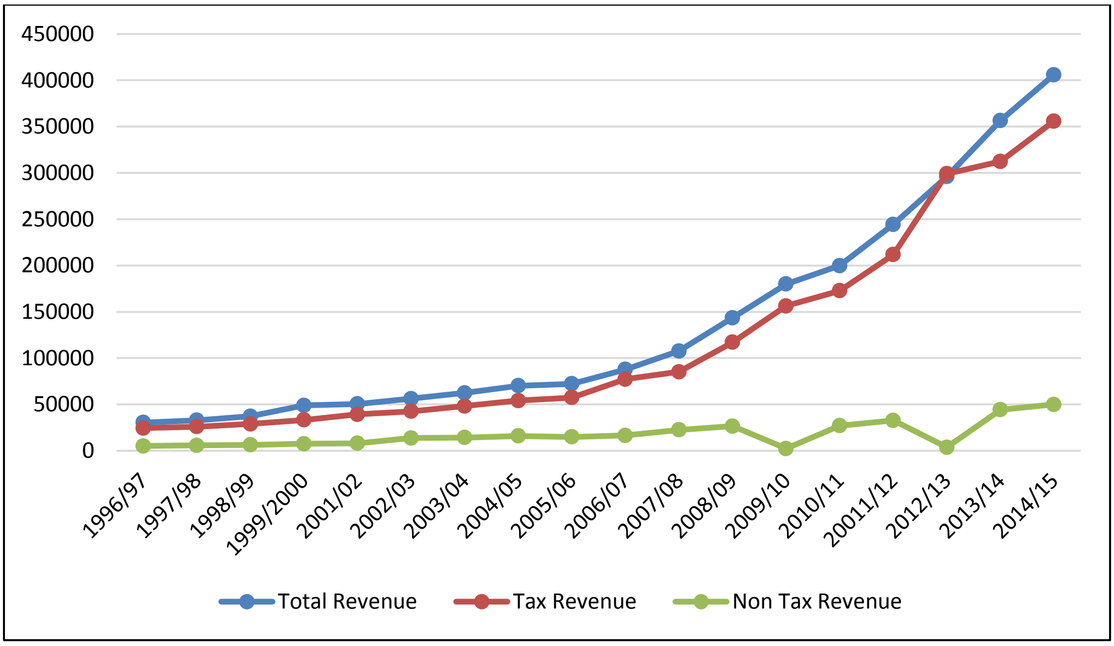
(Rs. in million)

Fiscal Year	Total Revenue	Tax Revenue	%of TR	Non- Tax Revenue	% of TR
1996/97	30373.4	24424.1	80.4	5086.2	19.6
1997/98	32937.4	25926.6	78.7	5749	21.2
1998/99	37251	28926.6	77.1	6256.4	16.8
1999/2000	48893.6	33148.3	77.2	7558.4	17.6
2001/02	50445.6	39332.2	79.9	7971.5	16.3
2002/03	56229.7	42587	75.7	13642.8	24.3
2003/04	62331	48175.7	77.3	14155.3	22.71
2004/05	70124.7	54106.4	77.1	16017.9	22.84
2005/06	72282.1	57427	79.4	14855.1	22.55
2006/07	87712.1	77168	81.1	16544.1	18.86
2007/08	107622.7	85147.1	79.1	22475.6	20.88
2008/09	143474.4	117058	81.5	26422.6	18.41
2009/10	179940.4	156291	86.9	2364.9	13.41
2010/11	199819.6	172755	86.5	27064.3	13.54
20011/12	244369.7	211718	86.6	32661.4	13.36
2012/13	295936.5	299144	87.5	3672.29	12.43
2013/14	356620.5	312441	87.61	44179.5	12.4
2014/15	405866.5	355955.7	87.70	49910.7	12.30

Source: Quarterly Economic Bulletin, NRB 2016

Figure 4.1

Structure of Government Revenue



Source: Based on Table 4.1

The non-tax revenue comes from property income (interest, dividends, rent and royalty), sales of goods and services (sales of goods, administrative fees and services) penalties, fines and forfeiture, voluntary transfers other than grants, miscellaneous revenue (administrative fee-immigration and tourism, charges for issuing passports, visa fees, tourism fees), other duties and fees, other revenue, capital revenue (sales of government land and building). There is some scope of generating more revenue through the rationalization of non-tax sources particularly by improving pricing policies and operational performance. These sources cannot be used effectively as revenue raiser since most of these sources are levied not for revenue purpose.

4.2 Contribution of Tax Revenue and Non-Tax Revenue

In order to understand the growth pattern of taxation properly, it would be describe to examine the share of total revenue, tax revenue and non- tax revenue in GDP, table 4.2 presents an account of total revenue, tax revenue and non – tax revenue as the percent of GDP. With respect to the contribution of GDP, tax revenue has been increasing much higher than the non-tax revenue over the past years. The table shows, that the total revenue in the increasing trend with the exceptions of the FY 1998/99, 2005/06 and 2010/11. In FY 1996/97, the share of total revenue to the GDP was 10.8 percent which increased to18.7 percent in FY 2013/14. The share of tax revenue was 1.9 percent at the Beginning of the FY 1996/97 which increased to 18.4 percent in FY 2014/15. The share of non –tax revenue on GDP was 7.1 percent in the FY 1996/97 which reached to 11.9 percent in the FY 2014/15.

Table 4.2

Tax Revenue and Non- tax Revenue (as % of GDP)

(Rs. in million)

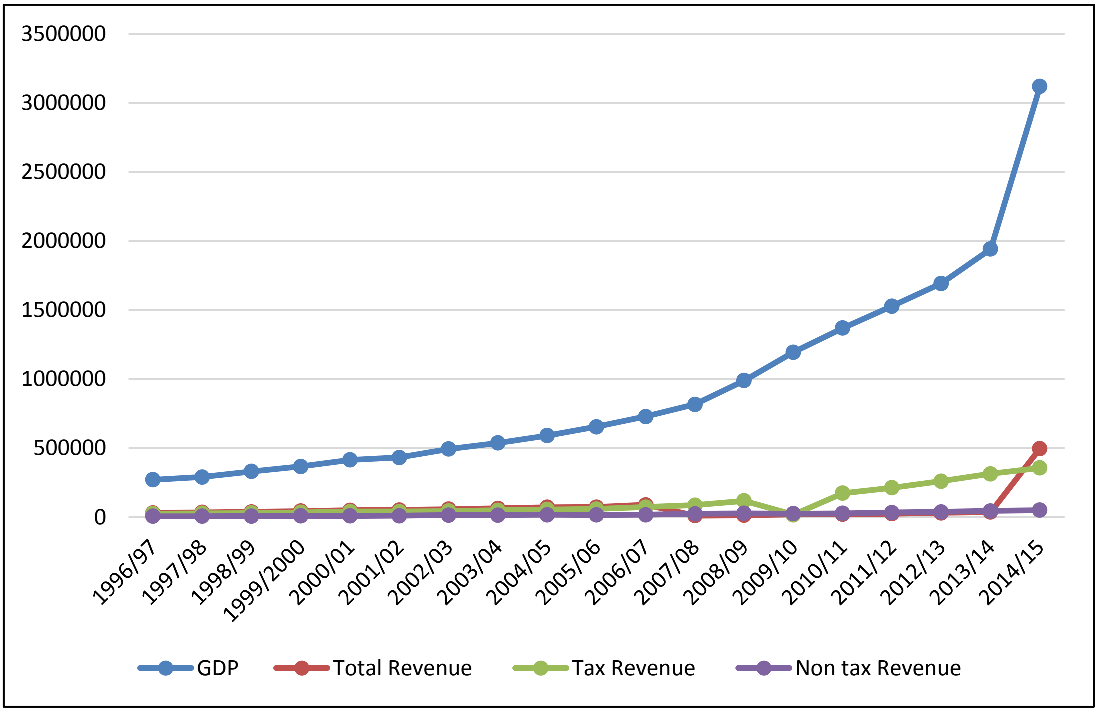
Fiscal Year	GDP	Total Revenue	%of GDP	Tax Revenue	%of GDP	Non- tax Revenue	% of GDP
1996/97	269570	30373.4	10.8	24424.1	1.9	5086.2	7.1
1997/98	289798	32937.9	10.9	25926.6	2	5749	6.9
1998/99	330018	37251	10.5	28753	2.1	6256.4	6.5
1999/2000	366251	42889.6	11	33148.3	2.3	7558.4	6.7
2000/01	413429	48893.6	11.3	38865	2.2	7971.5	7.2
2001/02	430997	50445.6	11.1	39332.2	2.2	9226.1	6.9
2002/03	492200	56229.8	11.4	42587	2.1	13642.8	6.5
2003/04	536800	62331	11.6	48175.7	2.2	14155.3	6.7
2004/05	589400	70124.9	11.9	54107	2.1	16017.9	7
2005/06	654100	72282.1	11.1	57427	2.1	14855.1	6.7
2006/07	727800	87712.1	12.1	71168	2.6	16544.1	7.2
2007/08	815700	10762.7	13.2	85147.1	2.8	22475.6	6.7
2008/09	989300	12347.4	14.5	117051.8	3.5	26422.6	8.4
2009/10	1193700	17994.04	15.1	15629.07	3.5	23649.7	9.6
2010/11	1369400	19981.96	14.6	172755.2	3.6	27064.3	9.1
2011/12	1527300	24436.97	16	211718.3	4.4	32651.4	9.5
2012/13	1692600	29593.65	17.5	259143.6	4.8	36792.9	10.5
2013/14	1941624	35662.05	18.7	312441	5	44179.5	11
2014/15	3120000	495866.5	18.4	355955.7	5.3	49910.7	11.9

Source: Economic Survey of Various FY; Quarterly Economic Bulletin, NRB 2016

Graph 4.2 illustrates the trend of revenue, tax revenue and non- tax revenue as a percentage of GDP.

Figure 4.2

Tax Revenue and Non-Tax Revenue



Source: Based on Table 4.2

4.3 Structure of Direct Tax and Indirect Tax

Excluding foreign aid, taxation is the main sources of national budget. To be self – reliance in the economy, the government has to extend the various domestic and international income generating sources and increase the per capita income of the people. For a developing country like Nepal, the role of taxation in process of economic development is considerably significant. In this respect, the tax structure has a vital role in economic development of the nation. Nepal government has introduced several taxes mainly to raise revenue. Total tax revenue is composedtwo tax systems i.e. direct tax, and indirect tax. As table 4.4 depicts, there has been simultaneous increase in direct tax, indirect tax and total tax revenue in the past.

In the FY 1996/97, the direct tax, indirect and total tax was Rs. 5233.6 million, Rs. 19190.5 million, and Rs. 24424.1 million respectively. In the FY 2014/15 these amounts where increased to Rs. 113991.1 million, Rs. 241951.8 million, and Rs. 355942.9 million respectively. The basic reason for increment was due to the expansion of both the tax base and tax rates. The amount of direct tax is continuously increased from FY 1996/97 to 2014/15 but its share in total tax revenue was fluctuating. In FY 1996/97 its share was 21.43 percent amounting Rs.5233.6 million, the share reached to 32.02 percent amounting Rs.113991.1 million in FY 2014/15. The share of indirect tax has been in a decreasing trend. The contribution of indirect tax in FY 1996/97 was 78.83 percent amounting Rs. 19190.5 million and in 2014/15, the share of indirect tax decreased to 67.97 percent amounting Rs. 241951.8 million due to increase in direct tax. While direct tax revenue represent only about one quarter of the total tax revenue, it would, however not be very difficult to understand as to why the indirect tax has lion share in the total tax revenue.

Table 4.3

Structure of Direct and Indirect Tax

(Rs. in million)

Fiscal Year	Total Revenue	Total Tax Revenue	Direct tax	%of TR	Indirect Tax	%of TR
1996/97	30373.4	24424.1	5233.6	21.43	19190.5	78.83
1997/98	32937.9	25926.6	6015.3	23.28	19911.3	76.8
1998/99	37251	28753	7296.8	25.38	21456.2	74.62
1999/2000	42889.6	33148.3	5851	25.8	24597.3	74.2
2000/01	48893.6	38865	9769.7	25.14	29095.3	74.86
2001/02	5044.56	39332.2	10039.3	25.52	29292.9	74.47
2002/03	56229.8	42587	10105.8	22.55	32481.2	77.44
2003/04	62331	48175.7	11901.9	24.7	36273.8	75.29
2004/05	70124.9	54107	13061.3	24.14	41045.7	75.86
2005/06	72282.1	57427	13961.5	24.31	43465.5	75.68
2006/07	87712.1	71168	18979.6	26.67	52188.3	73.33
2007/08	107622.7	85147.1	23070.8	27.1	62076.3	72.25
2008/09	143474.4	117051.8	34552.6	29.52	82499.2	70.48
2009/10	179940.4	156290.7	41760.5	26.72	114530.2	73.28
2010/11	199819.6	172755.2	48641	28.15	124114.3	71.84
2011/12	244369.7	211718.3	66906.7	31.6	144811.6	68.39
2012/13	295936.5	259143.6	81937.5	31.23	177206.1	68.26
2013/14	356620.5	312441	97065.4	31.1	215375.6	68.93
2014/15	405866.5	355942.9	113991.1	32.02	241951.8	67.93

Source: Economic Survey of various F/Y; Quarterly Economic Bulletin, NRB 2016.

4.4Contribution of Direct Tax and Indirect Tax

Table 4.4 shows that the contribution of total revenue on GDP was 10.8 percent in the FY 1996/97. The share of total revenue on GDP reached 19.14 percent in the FY 2014/15.With the exception in few years, the tax revenue showed increasing trend. Its share was 9.1 percent in the FY 1996/97 which reached to 16.7 percent in the FY 2014/15. In the same way, the share of direct tax on GDP also has increasing trend with exception of few years (from FY 2000/01 to 2005/06). The share was 1.9 in FY 1996/97 and it became 5.37 percent in the FY 2014/15. The share of indirect tax to GDP showed slightly ups and down up to FY 2005/06. After this FY, the share of indirect tax on GDP showed an upward trend and reached 11.41 percent in the FY2014/15.

Table 4.4

Total Revenue and Tax Revenue (as % of GDP)

(Rs. in Million)

Fiscal Year	Total GDP	Total Revenue as % of GDP	Tax Revenue as % of GDP	Direct Tax as% of GDP	Indirect tax as % of GDP
1996/97	269570	10.8	9.1	1.9	7.1
1997/98	289798	10.9	8.9	2	6.9
1998/99	330018	10.5	8.6	2.1	6.5
1999/00	366251	11	9	2.3	6.7
2000/01	413429	11.3	9.4	2.2	7.2
2001/02	430397	11.1	9.1	2.2	6.9
2002/03	492200	11.4	8.6	2.1	6.5
2003/04	536800	11.6	8.9	2.2	6.7
2004/05	589400	11.9	9.1	2.1	7
2005/06	654100	11.1	8.8	2.1	6.7
2006/07	727800	12.1	9.8	2.6	7.2
2007/08	815700	13.2	10.4	2.8	7.6
2008/09	988300	14.5	11.8	3.5	8.4
2009/10	1193700	15.1	13.1	3.5	9.6
2010/11	1369400	14.6	12.6	3.6	9.1
2011/12	1527300	16	13.7	4.4	9.5
2012/13	1692600	17.5	15.3	4.8	10.5
2013/14	1941624	18.4	16	5	11
2014/15	2120000	19.14	16.7	5.37	11.41

Source: A Hand Book of Financial Statistics (NRB, 2015)

Table 4.5 shows that the GDP, total revenue, tax revenue, non-tax revenue, direct tax, and indirect tax.

Table 4.5

Total Revenue, Tax Revenue and Non-Tax Revenue

(Rs. in Million)

Fiscal Year	Total GDP	Total Revenue	Tax revenue	Non -Tax Revenue	Direct Tax	Indirect Tax	Income Tax
1996/97	269570	30373.2	2442.41	508.62	5233.6	19190.5	3829.4
1997/98	289798	32937.9	2492.66	574.9	6015.3	19911.3	4499
1998/99	330018	37251	2875.3	625.64	7296.8	21456.2	5646.5
1999/2000	366251	42889.6	3314.83	755.84	8551	24597.3	6757
2002/01	413429	48893.6	3886.5	797.15	9769.7	29095.3	9153.9
2001/02	430397	50445.6	3933.22	922.61	10039.3	29292.9	8903.6
2002/03	492200	56229.8	4258.7	1364.28	10105.8	32981.2	8132.2
2003/04	536800	62331	4817.57	1415.53	11901.9	36273.8	9504
2004/05	589400	70124.9	5410.7	1601.79	13061.3	41045.7	10456
2005/06	654100	72282.1	5742.7	1485.51	13961.5	43465.5	10933.5
2006/07	727800	87712.1	7116.8	1654.41	18979.6	52188.3	15730
2007/08	815760	107622.7	8514.71	2247.56	23070.8	62076.3	19067.5
2008/09	988300	143474.4	11705.8	2642.26	34552.6	82499.2	27499.7
2009/10	1193700	179940.4	15629.1	2364.97	41760.5	114530.2	33832.1
2010/11	1369400	199819.6	17275.5	2706.43	48641	124114.3	42066.3
2011/12	1527300	244369.5	21171.8	3265.14	66906.7	144811.6	51313.7
2012/13	1692600	295936.5	25914.4	3679.29	81937.5	177206.8	64178.3
2013/14	1941624	356620.5	31244.1	4417.95	97065.4	215375.6	75609.2
2014/15	2120000	405866.5	355942.9	49903.5	113991.1	241951.8	9101.83

Source: A Hand Book of Government Financial Statistics (NRB, 2015)

Table 4.5 shows that the total GDP was increased gradually from FY 1996/97 amounting Rs. 269570 million to Rs. 2120000 million in FY 2014/15. Total revenue was increased from Rs. 30373.2 million in the FY 1996/97 to amounting Rs. 405866.5 million in the FY 2014/15. The share of tax revenue was Rs. 2442.41 million in FY 1996/97 which was increased to Rs. 355942.9 million in the FY 2014/15. The share of non –tax revenue also increased from Rs.5086.2 million in the FY 1996/97 to Rs. 49903.5 million in the FY 2014/15. There is gradual increased increase in the total direct tax from Rs. 5233.6 million in the FY 1996/97 to Rs.113991.1 million in the FY 2014/15. The share of total indirect tax also increased consistently from Rs. 19190.5 million in the FY 1996/97 to Rs. 241951.8 million in the FY 2014/15. Income tax Followed increasing trend starting at Rs.3829.4 in the FY 1996/97 to 9101.83 million in the FY 2014/15.

4.5 Trend, Structure and Contribution of Income Tax

Until FY 1993/94, income tax revenue was divided into corporate income tax, individual income tax, and tax on remuneration. However, from FY 1994/95, income tax revenue has been divided into four groups including corporate income tax, individual income tax, house and rent tax and interest tax.

Corporate income tax is collected from the government corporations, public and private limited companies, and partnership firms. Individual tax is collected from individuals and proprietorship firms. Interest tax is collected from banks or finance companies as they pay interest on all types of deposits. House rent tax is levied on income obtained from the renting of houses and land in urban areas. From FY 2002/03, the income tax has been revised and now components of income tax includes corporate income tax, individual and sole traders tax on remuneration, tax on investment, windfall gain and others. The corporate income tax includes tax revenue obtain from government corporation public limited corporation and private limited corporation. Individual income tax comprises personal or sole trading income taxes. Similarly, the income tax on investment includes tax on lease or rent an interest.

The system of income taxation in Nepal has 45 years history commencing from FY 1959/60. Income tax was initially levied on business income and salary income. For every year, Finance Act prescribes the exemption limit for individual, family and couples. The rate of income tax has been changing continuously since its inception and the exemption limit has also been gradually increased. The exemption limit for the FY 2015/16 has been Rs. 250000 for an individual and Rs. 300000 for the couple and families. Table 4.6 presents the tax rate and tax exemption limit for a residential individual or residential couple having taxable income from employment.

Table 4.6

Tax Exemption and Tax Rate for an Individual or a Couple

(Rs. in million)

For Individual	For Couple	Tax Rate
Up to Rs.250000	Up to Rs. 300000	1%
Next Rs.100000	Next Rs.100000	15%
Next Rs. 2150000	Next Rs. 2100000	25%
Balance	Balance	40%

Source: MoF (2016)

A resident or a couple having taxable income exceeding Rs. 25 lakh is imposed an additional Tax of 40 percent of tax liability. The resident share normally taxed as two single individuals. A resident individual and the resident spouse of the individual may be treated as couple. Even if the assessable income from employment is less then exemption limit, 1 percent social service tax is imposed on whole exemption amount. An individual having pension income is entitled to a 25 percent additional exemption.

A disable resident individual or couple is taxed only after deducing 50 percent of additional exemption from their taxable income. A female having taxable income from employment is taxed after deducting 10 percent from payable tax amount. If a resident has invested (life) insurance, annual premium paid for Rs. 20000 (whichever is lower) is subject to deduction from taxable income. An individual working in a remote area is entitled to a hardship allowance called a remote area allowance up to a maximum of Rs. 50000 by way of additional basic exemption.

A specific relief is provided for resident individual taxpayer running a small business. If such taxpayer has income exclusive from a business having a source in Nepal, income and annual turnover do not exceed Rs. 200000 and they elect to apply this provision for the year, they are imposed as a fixed amount that depends on the area where the business is conducted. For a Non- resident individual with their income source in Nepal, the tax imposed on this income is 25 percent but if the income is subject to withholding ax, the withholding rate is applied (IRD, 2010).

Gain from the disposal of non-business chargeable assets i.e. obtained in the course of private activity, are taxed at the rate of 5 percent. However, if the ownership of disposed of a business chargeable asset (land and house) has been more than 5 years, only 2.5 percent tax is applicable on such gain. If the ownership of the disposed of non-business chargeable assets (land and house) has been less than 5 years, 5 percent is applicable on such gain.

Income Tax Act 2002 has provided rebates of facilities to special industries. So, only 20 percent tax is levied on the income of special industries. Entities are taxed on a flat basis. The percentage of the rate depends on the nature of entity or the kind of the entity's business. Income of an estate of a resident individual or trust of an incapacitated resident individual is taxed as a resident individual. Taxable income of a non- resident person providing shipping, air transport or Telecommunication service is taxed at the rate of 5 percent. Windfall gain or causal income is taxed as final taxed income at 25 percent.

As discussed earlier, for every year, finance Act prescribes the exemption limit for individual, family and couple. Above the exemption limit, different income tax rate has been levied in different fiscal year. The exemption limits in the different fiscal year are shown in the following table:

Table 4.7

Income Tax Levied on Different Years

(Rs. in million)

Fiscal Year	Individual	Couple	Family
1992/93-1996/97	15000	2000	2000
1997/98	25000	3500	3500
1998/99	30000	4000	4000
1999/2000	40000	5000	5000
2000/01	50000	6000	6000
2001/02	65000	7500	7500
2002/03	80000	7500	7500
2003/04	80000	8500	8500
2004/05	80000	100000	100000
2005/06	100000	125000	125000
2006/07	100000	125000	125000
2007/08	115000	125000	125000
2008/09	115000	200000	125000
2009/10	160000	200000	125000
2010/11	160000	200000	125000
2011/12	160000	200000	125000
2012/13	160000	200000	200000
2013/14	200000	250000	250000
2014/15	250000	300000	300000

Source: IRD, Annual Report

The trend and structure of income tax is shown on the Table 5.7.

Table 4.7 shows that the amount of total income tax has been gradually increased from Rs. 8132.2 million in the FY 2002/3 to Rs. 86168.0 million in the FY 2014/15. In the same way, the aggregate amount of corporate income tax has been gradually increased from Rs. 5554.0 million in the FY 2002/03 to Rs. 51900.3 million in the FY 2014/15. Corporate income tax has been a major share among other components of income tax. The percentage of corporate income tax to the total income tax in the FY 2002/03 was 68.37 percent which gradually decreased to 60.23 percent in the FY 2014/15. The percentage became maximums in the FY 2008/09 with 71.49 percent. The amount of individual income tax in the FY 2002/03 was Rs. 1249 million which was 15.35 percent of the total income tax. Its share decreased from FY 2006/07 to 2010/11 and finally increased to 26.36 percent in the FY 2014/15. The share of investment income amounted to Rs. 1321.5 million in FY 2002/03 which was 16.25 percent of the total income tax collected. The share increased to Rs.11575.8 million in the FY 2012/13 which was 18.03 percent of the total income tax. However, its share decreased to 13.2 percent amounting Rs. 11549.7 million in the FY 2014/15.

Table 4.8

Component of Income Tax and their Share

(Rs. in million)

Fiscal Year	Total Income Tax	Corporate Income Tax	% to Total Income Tax	Individual Income Tax	% to Total Income Tax	Investment Income TAX	% to Total Income Tax
2002/03	8132.2	5554	68.37	1249	15.35	1321.5	16.25
2003/04	9504	6805	71.6	1392.9	14.65	1291.9	13.59
2004/05	10456	7331.3	70.11	1678.2	16.05	1425.9	13.63
2005/06	10933.5	7576.5	69.29	1771.1	16.19	1546.6	14.14
2006/07	15730	11604.9	73.77	2006.8	12.75	2080.1	13.22
2007/08	19067.5	13263.2	69.55	5452	12.85	3271.7	17.15
2008/09	27479.7	19646.4	71.49	3398.5	12.36	4169.7	15.17
2009/10	33832.1	24054.3	71.09	4420	13.06	5087.9	15.03
2010/11	42066.3	28807.2	68.48	5863.8	13.93	7108.9	16.89
2011/12	52880	30415.8	59.27	12382.7	23.41	8515.3	16.1
2012/13	64178.3	37069.6	57.76	15532.9	24.2	11575.8	18.02
2013/14	75609.2	45429.8	60.09	19433.2	25.7	10746.3	14.2
2014/15	86168.0	51900.3	60.23	22718.1	26.36	11549.7	13.40

Source: IRD, Annual Report

As discussed earlier, of income tax was introduced in Nepal very late. At the beginning income tax was levied only one business profit and salaries. After the introduction of the new Income Tax Act 2002, the share of income tax has been gradually increased.

Table 4.9

Component of Income Tax as a Part of Direct Tax

(Rs. in million)

Fiscal Year	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
Direct Tax	10106	11902	13061	13962	18980	230711	34553	41761	48641
Income Tax	8132	9504	10456	10934	15730	19068	27480	33832	42066
Corporate Income Tax	5554	6805	7331	7577	11605	13263	19646	24054	28807
Govt. Corporation	1251	2057	1332	196	1020	183	960	1133	1282
Public Ltd Co.	3235	1531	2468	3406	5716	7207	9428	1204	13967
Private Ltd Co.	1167	1240	1527	1703	2310	3135	4201	6269	7333
Individual & sole trade. Firm	1802	1870	1877	1959	2303	2452	4482	3842	4896
Others	100	108	128	313	256	285	576	787	1430
Remuneration Income	1249	1393	1678	1771	2007	2452	3399	4420	5868
Investment	1313	1292	1426	1547	2080	3272	4170	5088	7109
Income Others	8	14	21	39	39	81	265	270	287

Source: Quarterly Economic Bulletin, NRB (2015)

Table 4.9 shows that the corporation income tax has been increased gradually from Rs 5554.0 million in the FY 2002/03 to Rs. 28807.0 million in the FY 2010/11. The share of Public limited company and private company is also increasing at faster rate. The Remuneration income has been increased gradually from Rs. 1249.0 million in the FY 2002/3 to Rs. 5868.0 million in the FY 2010/11. Investment income has been also increased at faster rate from FY 2004/05. And it's become Rs. 7109 million in the FY 2010/11. In the same way all taxes increased from FY 2010/11 to FY 2014/15.

Table 4.10

Component of Income Taxes

(Rs. in million)

Headings	2011/12	2012/13	2013/14	2014/15
Direct tax	**66906.7**	**81937**	**97065.4**	**113,991.1**
a. Income, profit and capital gain	52313.7	64178.3	75609.2	86168.0
i. Individual and sole traders.	12382.7	15532.9	19433.2	22718.1
ii. Enterprise and Corporation	30415.8	37069.6	45429.8	51900.3
iii. Investment and Others Income	851.3	22575.8	107446.3	11549.7
b. Payroll and workforce	`1566.2	1880.9	2449.2	2927.9

Source: Quarterly Economic Bulletin NRB (2015)

Table 4.10 Shows that total direct tax was collected as Rs. 66906.7 million in the FY 20111/12 which increased to Rs. 113991.1 million in the FY 2014/15. The increased in the total direct tax supported by the increased in income, profit and capital gain and payroll and workforce tax. Income, profit and capital gain tax amounted to Rs 52313.7 million in the FY 2011/12 which increased to Rs. 86168.0 million in the FY 2014/15. Similarly, Individual and sole traders tax, enterprise and corporation, investment others income tax has been increased in the FY 2014/15. Payroll and workforce tax increased from Rs. 1566.2 million in the FY 2011/12, to Rs. 2927.9 million in the FY 2014/15.

The role of income tax in the economic development can be justified reviewing the magnitude and share of income tax on GDP total revenue, tax revenue and direct tax. Table 4.11 shows the contribution of the income tax on different revenue heads.

Table 4.11

Contribution of Income Tax on Different Revenue Heads

(Rs. inmillion)

Facial Year	Income Tax	%of Total GDP	%of Total Revenue	%of Tax Revenue	%of Direct Tax
1996/97	3829.4	1.4	12.6	15.67	73.16
1997/98	1824.3	1.5	13.7	17.35	74.79
1998/99	5646.5	1.7	15.2	19.63	77.38
1999/2000	6757	1.8	15.8	20.38	79.01
2000/01	9153.9	2.1	18.7	23.35	93.69
2001/02	8903.6	1.9	17.6	22.63	88.68
2002/03	8132.2	1.7	14.5	19.09	80.47
2003/04	9504	1.8	15.2	19.72	79.85
2004/05	10456.6	1.8	14.9	19.23	80.05
2005/06	10933.5	1.7	15.5	19.03	78.31
2006/07	15730	2.2	17.3	22.01	82.87
2007/08	19067.5	2.3	17.7	22.39	78.25
2008/09	27479.7	2.8	19.2	23.47	79.53
2009/10	33832.1	2.8	18.8	21.17	81.01
2010/11	42066.3	3.1	21.1	23.73	86.48
2011/12	51313.7	3.5	21.6	24.23	79.03
2012/13	64178.3	3.8	21.7	24.76	78.32
2013/14	75609.2	3.9	21.2	24.02	77.09
2014/15	86168.0	4.6	21.23	24.20	75.59

Source: Quarterly Economic Bulletin NRB(2015).

There has been gradual growth of income tax the FY 1996/97 with Rs. 3829.04 million to the FY 2013/14 amounting Rs. 75609.02 million. With regard to the share of income tax to the GDP, it was 1.4 percent in the FY 1996/97 which increased to 4.06 percent in the FY 2013/14. The share of income tax as a percent of total revenue was remained at 12.6 percent in the FY 1996/97 to 21.2 percent in the FY 2013/14. Its share became 21.23 at the end of the FY 2014/15. Similarly the share of income tax as a percent of tax revenue remained 15.67 percent in the FY 1996/97 and increased to 24.20 percent in the FY 2014/15. Income tax has a major share in the total direct tax;

its share remained 73.16 percent in the FY 1996/97 ad increased to 75.59 percent at the end of the FY 2014/15.

The chapter was the key component of this study as it provided the empirical findings of the study. This chapter analyzed the various kinds of taxes and its effects in GDP per capita. The result shows that, among the tax variables, the parameter of total income tax has positive sign and parameters of all other tax variables including individual income tax, corporate income tax and other direct taxes have negative signs. The positive sign of the parameter for total indirect tax indicates that the GDP per capita can be increased with the increase in the ratio of total indirect tax to the GDP per capita. However, the negative signs of parameters for individual income taxes, corporate income taxes and other direct taxes imply that an increase in the ratio of these variables can reduce the GDP per capita .Corporate income tax has the most negative consequences for GDP per capita, followed by other taxes and individuals (personal) taxes. Personal income taxes seem to have considerably less negative effects on economic performance which appear to be the least harmful.

Among the control and physical capital variables, estimated parameters for input variables including human capital formation (education), trade openness, gross fixed capital formation and population growth have positive signs. This implies that these variables have also positive contribution to the GDP per capita. The highest coefficient value of human capital formation indicates that is the most important variable determining the GDP per capita.

4.6 New Avenues for the Successful Implementation of Income Tax

Income tax can be a major revenue source only if certain pre-requirements or conditions are fulfilled. These are:

(a) Existence of Predominantly Monetized Economy

It means that every economic activity should be monetized. Higher the monetized economy, greater will be the possibility to introduce new taxes. Due to the lack of predominant monetized economy in list developed countries like Nepal, it is not able to properly mobilized resources through direct taxes.

b) A High Standard of Literacy

If the society is highly literate, voluntary compliance will be high. People would also realize why they should have to pay taxes.

c) Large Degree of Voluntary Compliance

Voluntary compliance means voluntarily declaration of income and paying taxes according to the rule and regulation of tax. If voluntarily compliance is higher, a great amount of resources can be mobilized through income taxation.

d) Reliable Record of Accounting

In the absence of reliable records of accounting, one cannot, actually calculate the income of individuals. There is greater possibility of tax evasion. Therefore, there should be reliable records of accounting for the proper implementation of income tax.

e) Honest and Efficient Administration

Honest along with efficient tax administration is required for making a good tax system, but minimum acceptable standard appear to be higher or income tax than for many other levies. It may be difficult in establishing a satisfactory administration. It is probably the condition for successful income tax that can be met most quickly. The experts, nevertheless, must guard against the assumption that only a tidy organization and political staffing assure neither good administration nor can be confident that the best attainable administration will eliminate obstacles to heavy reliance on income taxes.

f) Improve the Tax Administration

In order to improve tax administration the following should be done.

- Tax payer must get the message that tax evasion would be punished.
- Every tax administration must get the message that honesty is honored and rewarded while corruption gets punished.

In a large and growing population of tax payer, it is not possible to check the return by every excess. So, it is needed to be proceeding on the basis of self –assessment. It means that tax authority should accept whatever is declared by tax payers on their own subject to random checks. It may not be very wise to concentrate only on large case.

- In order to facilitate income tax enhancement, extension of the scheme of withholding over wide areas such as salary, interest, dividend and even rental income with efficient information system should be adopted.

g) Others

- Increase the extent of tax base.
- Rationalization of tax rates compatible with SAFTA and WTO provision.
- Self-assessment system should be made more effective.
- Improving the efficiency of the tax administration.
- Developing an effective data and information system by using new technology.
- Gradual elimination of exemption.
- Effective implementation of voluntary disclosure of income schemes (VDIS).

4.7 Relationship Between Total Revenue and GDP

This analysis indicates the relationship between GDP (dependent variable) and total revenue (independent variable). For this regression equation is given by:

TR = a+bGDP

The Result of this equation is:

TR = 111050.5281+0.1958306GDP …………………(i)

Std. Error = (3864.3215)   (0.00645258)

R^2 = 0.98

F value =(921.0724) (6.61)

T value =(30.3492) (2.110)

5 Percent level of Significance

Equation (i) shows the relationship between Total Revenue and GDP where TR is dependent variable and GDP is independent variable. The value of b is 0.1958306, which show the positive impact of total GDP in TR of Nepal or the economic growth of Nepal. It shows that one unit increases in GDP would lead to 0.1958306 unit increase in TR. On the other hand, the value of intercept a is 111050.5281, which indicates that Rs.111050.5281, if independent variable GDP is zero.

The coefficient of determination (R^2) is 0.98 which indicates that 98 percent of the variation of TR is affected by explanatory variable (GDP). The value of R^2 shows the goodness of fitness.

The table value of df (k-1: 2-1: 1) at 5 percent level of significance is 6.61. Since, the calculated **F** value is921.0724, which is more than critical value ie6.61. So, we reject null hypothesis.

Similarly, the Table value of df (18-1): 17 at 5 percent level of significance is 2.110since, the calculated value of **t** is 30.3492,which is more than critical value ie 2.110.So, we reject null hypothesis.

CHAPTER V

SUMMARY OF MAJOR FINDINGS, CONCLUSION, AND RECOMMENDATIONS

5.1 Summary of Major Findings

Conclusions of this study are derived mainly from the literature review, analysis of the tax trend and structure of different taxes on the basis of results. The facts and findings of the study are summarized as follows:

- With regard to improving governance, the tax system plays an important role. A sound macroeconomic policy is a crucial precondition for stability, equity and long - term growth. An adequate fiscal policy and its administrative implementation, effective revenue collection and accountable financial
- Managements are core elements for any strategy aiming at improving economic growth.
- Increasing revenue collection through taxes, fee or user charges reduce the dependence of the state on foreign transfers. The government has to be able to finance and provide public goods be it justice, security, or social services independent of the conditionality of external donors. The underlying assumption is that there exists a close link between mobilizing internal revenue and good governance.
- The majority of developing and developed nations depend on the tax revenue. The range of income tax influence is greater in developing nations than in developed nations but there is a wide variation in income tax collection per head.
- Using data from FY 1996/97 to FY 2014/15 this study has investigated that all income taxes including individual, corporate and other direct taxes are negatively and significantly related to GDP per capita growth. The estimated effects very depending on variable specification, estimation procedure, and time period. Nevertheless, the finding of negative and statistically significant tax effects is robust.

- Among the tax variables, the parameter of total indirect tax has positive sign and parameters of all others tax variable including individual income tax, corporative income tax and other direct taxes have negative sign. The positive sign of the parameter for total indirect tax indicates that the GDP per capita can be increased with the increase in the ratio of total indirect tax to the GDP per capita. However, the negative sign of parameters for individual income taxes, corporate income taxes and other direct taxes imply that an increase in the ratio of these taxes would not be beneficial to increase in GDP per capita. Instead, increase in the ratio of these variables can reduce the GDP per capita given the present situation.

- There has been a largest share of tax revenue in the total government revenue. However, there is fluctuating trend of contribution of tax revenue to total government revenue. For instance, in the FY 1996/97 the tax revenue contributed to 80.4 percent in the total revenue but the contribution increased to 87.70 percent in the FY 2014/15.

- Nepalese tax revenue comprises of direct taxes and indirect taxes but there is dominant role of indirect taxes. The contribution of direct tax and indirect tax on total tax revenue were 21 percent and 79 percent respectively in the FY 1996/97. However, the contribution of direct tax on the total tax revenue increased significantly to 32.0 percent and the indirect tax to total tax revenue decreased to 67.97 percent in the FY 2014/15.

- The contribution of total revenue, tax revenue, direct tax and indirect tax on GDP was 10.8 percent, 9.0 percent and 7.1 percent respectively in the FY 1996/97. The contribution of total revenue, tax revenue, direct tax, and indirect tax on GDP was 19.14 percent, 16.07 percent, 5.37 percent, 11.41 percent respectively in the FY 2014/15. These show that all taxes have been increased but the rates of increment are very slow.

- At Present, among the various sources of government tax revenue, income tax has occupied third position after custom duty and VAT. There is fluctuating trend of contribution of income taxes to total tax and direct tax. The contribution of income axes on the total revenue was 12.6 percent, on tax revenue 15.67 percent, and on the direct tax 73.16 percent in the FY 1996/97.

which continuously increased slowly and reached 21.23 percent, 24.20 percent, and 75.59 percent respectively in the FY 2014/15. The highest contribution of income tax in total revenue was in FY 2010/11. In the same way the contribution was highest on tax revenue in FY 2012/13. And on direct tax in FY 2006/07. The contribution of income tax on GDP was 1.4 percent in the FY 1996/97 which rose to 4.06 percent in the FY 2014/15.

- The major components of direct tax are income tax, property tax and other tax. Among them income tax occupies largest share which contribution 80.47 percent in the FY 2002/03, 78.33 percent in the FY 2012/13 and 75.59 percent in the FY 2014/15.
- Income tax is the composition of corporate income tax, individual income tax and investment income tax. Corporate income tax is collected from Government Corporation, public limited companies, partnership firms and private limited companies. Individual tax is collected from remuneration, industry and business profession and investment tax is collected from dividend tax, interest tax, royalty and rent tax.
- Among the component of income tax has a dominant share amounting Rs. 5554 million in FY 2002/03 which increased substantially to Rs. 86168.0 million at the end of FY 2014/15. The share of corporate income tax to total income tax has been decreased from 68.37 percent in the FY 2002/03 to 60.23 percent in the FY 2014/15. The share of individual income tax has showed gradual increment from 15.35 percent in the FY 2002/03 to 26.36 percent in the FY 2014/15. The share of investment income tax has also increased from 16.25 percent in the FY 2002/03 to 18.03 in the FY 2012/13 and then decreased to 13.40 percent at the end of the FY 2014/15.
- There has been a gradual and consistent increase in the collection of windfall gain tax, investment tax, tax from personal and sole trading firm. The institutional income tax has also been increased gradually contributing to the overall increase in the total income collection.

5.2 Conclusion

While some policy makers argue for reduction in tax and others argue foe increasing in tax rate, empirical literature has suggested that empirical study from different aspects of taxation in a nation, within reasonable ranges, is very important. By expanding on current research into this question, this study analyzes the tax structure, trend and explores the impact of several tax variables to per capita GDP.

For the empirical analysis of the effect of income tax on GDP, this study has used macro level time series data extracted from various volumes of the Economic Survey Report, published but the Ministry of finance, Government of Nepal and publications of Nepal Rastra Bank including a Handbook of Government Finance Statistics and various volumes of Quarterly Economic Bulletin. The time series covers 20 years between FY 1995/96 and FY 2014/15.The current values of relevant variables were converted to constant prices by using the GDP deflator before constructing dependent and independent variable.

For the last few decades, the government expenditure of Nepal has been surpassed the increase revenue. This has lead to the increasing gap between expenditure ad revenue collections in the country which have escalated the problem of the resources gap in the economic. The foreign loan and grants are conditional, uncertain inconvenient though the country is till greatly dependent upon the donors. Indeed, it is not a good symptom for the national economy. To address this problem, the Government of Nepal has to mobilize the internal resources to the optimal level. Eventually, the government expenditure has to be maintained by the government revenue.The utilization of internal resources particularly tax revenue can be used as a measure to narrow down the revenue expenditure gap.The non-tax sources cannot be used efficiently as revenue raise because most of these sources are levied not for revenue generating purposes. So, tax revenue plays a vital role for the revenue collection in Nepal.

Like many other developing countries, Nepal is facing series of problems in the process of economic development. Lack of enough finance resources is one of the main problems for economic development. A huge amount of fund is must to address the objectives of economic development. However, due to the poor performance on internal resources collection and mobilization, Nepal is not being able to collect necessary fund so that Nepal has been heavily depending on foreign loans and grants. The dependency is increasing which is not good for any economy. Thus, it is more important to mobilize the internal fund to the optimal level.

To increase the government revenue, Nepalese government is trying to attract money from people through taxation. Tax revenue is combination of direct taxes and indirect taxes but the contribution of indirect taxes are higher than direct taxes. Within direct taxes, income taxes are the most important source of government revenue. It is considered as a good medicine to cure growing gap between revenue and expenditure problems in Nepal.

The history of income tax in Nepal began only on late fifties .Initially, the income tax was introduced as a trial on business profit and remuneration income. From the very beginning, the concept of exemption, concession, deduction and other form of tax relief in income tax have emerged. Currently, income e tax constitutes corporate income tax, individual income tax, investment income tax and others.

At present, the income tax revenue in Nepal is collected according to Income Tax Act 2002.The government is planning to bring all the income groups into the tax net including capital gain and dividend tax. The act has made provisions of self-tax assessment every year, to increase voluntary compliance by tax payers and to create tax fair, equitable, transparent and acceptable tax system. Eventhough, the income tax system has some good aspects, there are various challenges in the implementation Phase.

The act, rules and regulations are not consistent and the tax education on the part of people is very low. The government has not forwarded any kind of effective motivation program to the tax payers to pay tax by giving them special facilities such as employment allowance medical facilities and education facilities. Nevertheless, the tax system is continuously improving. If the problems relating to the income tax system can be address and resources through income tax will be fruitful and the nations objective of economic development can be achieved.

5.3 Recommendations

The following suggestions have recommended for the effective and efficient income tax system:

- This study examines the relationship between tax structures and GDP per capita growth by entering income taxes into growth regressions model, in which both the accumulation of physical and human capital are accounted for. Tax reforms towards property and consumption taxes, and especially away from income taxes namely corporate, individual and other direct taxes, are likely to enhance the prospects for economic growth. The results of the regression analysis suggest that income taxes are generally associated with lower economic growth than taxes on consumption and property.
- Property taxes, and particularly recurrent taxes on immovable property, seem to be the most growth friendly, followed immediately by consumption taxes. Personal income taxes seem to be significantly inferior, and corporate income taxes have the most negative effects on GDP per capita. The government has to develop tax policy based on this finding.
- Tax payers should pay tax and should continuously watch whether money they pay in the form of tax is rightly spent. Tax payers should realize their duty to contribute to the overall development of a nation. They should pay tax and work as watchdog to insure best utilization of tax so paid.
- The tax system bears an inherent conflict between the state and the citizen, which is due to different levels of rationality. While in theory, a capable state should serve in principle all citizens and, therefore, each citizen should be willing to contribute financially to strengthening the states capacity. However, in reality citizens usually follow a free riders attitude and avoid taxation state must ensure that tax collection is based on transportation and contestable rules in a fair manner.
- The tax administration is not very active in looking out for new taxpayers. Taxpayers are registered as a result of their first officially recorded business transaction, which mean that taxpayers initiate registration themselves.
- In order to create an impartial and impersonal tax system, tax procedures ought to be taken out of the hands of tax officials and be handed automatically. The single most important contribution to promote accountability in the tax administration and to reduce the risk of rules being bent by tax officials is to establish an efficient information technology system

that provides a reliable, complete, and accessible data base for authorized officers.

- Strengthening the capacity of non- governmental institutions (universities, research institutions) in the tax policy formulation contributes to intensifying the tax policy debate among civil society. At the same time, internal capacity of the existing system needs to be strengthened in order to enhance the quality of the tax policy dialogue. This will increase the transparency of the tax policy.
- Large informal sector is major challenge of implementation of income tax law.
- Some provisions which are the translated version of foreign low are not only difficult but also odd resulting in difficulty to understand.
- Tax officer are often recruited from students not of a economic background. Reviewing financial statements is beyond the capacity of employees of non-economic background as they fell psychologically dominated. Government seems to be failed to address this problems.
- Investment has been made to make all tax system Information communication Technology based. If manual system completely phase out by increasing investment in information technology, corruption as a result of close physical and psychological contact between tax officers and taxpayers reduces.
- Tax administration is the government's arm to administer income tax related matter staying within the boundary of income tax law. Income tax being one of the main contributors to total government revenue should be of national priority and government function should be as per the need of the nation. Effective implementation of income tax law depends upon how efficiently tax administration acts. There are issues of structural adjustment of tax administration however it is the matter of further debates and discussion at the large scale.
- The information management system of the government is very weak. Information of house owners, current taxpayers, prospective tax payers and different areas which are to be covered within tax net have not been stored and managed. Having PAN number is not sufficient. Other information regarding

earning activities which are very important from perspective of income tax is not available. Information management includes getting, storing, processing and retrieving information. As income related issue is matter of privacy, so preservation of information for the sake of safety of taxpayers is another issue. Tax administration whose information management system is weak cannot be efficient.

- Traditional awareness campaigns cannot give good result rather using mass media and social media tool is very important for raising awareness because taxpayers these days are generally not out of access of social media (facebook, twitter etc.) and mass media (Radio, Television, Newspapers).
- As Nepalese revenue structure is heavily dominated by indirect taxes occupying the share of more than three fourth in total tax revenue, it is necessary to increase the share of direct tax through effective and efficient taxation system.
- To have even a minimum level of development, a huge investment from the government as well as private sector is unavoidable. Government should be capable in collecting and mobilizing internal revenue for which an efficient governance and tax administration is needed.
- Government is the most responsible institution whose function determines whether tax law gets fully implemented. Corruption, misallocation and misuse of public found by government stimulate tax payers to evade tax. In developing countries like ours expectation of fully transparent government may not exist but people have to pressurize for the better management of public fund.
- As every sector of the economy has not been included in the income tax net and income tax collection is relatively low, the tax base should be broadened .Broadening the tax base in Nepal would mean the extension of income tax to agricultural income, capital gain and dividends, a reduction in tax incentives, the identification of new tax payers. Neither a reduction in deduction nor the removal of exemptions in the case of labor income as experience in many countries would be a significant help in Nepal as the scope of remuneration income is very limited.

- The tax should be collected through banking channel only. This eradicates cash counter corruption. Corrupt employees should be treated as enemy. Other mechanisms should set up for reducing chances of nexus between employees and tax defaulters.
- All the responsible actors of society should work in such a way that income tax is generated at the maximum possible level so that state dependence on foreign aid for socio- economic development of nation can be minimized and replaced soon by sustainable source of internal revenue. Each responsible actor should act to mitigate the problem and bringing every income into tax net through effective implementation of income tax law.
- Parliamentarian should raise voice to table the amendment bill in parliament to correct problems in the income tax law.
- Through fundamental changes may not be required in the existing income tax law, matter of complexities and confusion should be removed, problem of maintaining equity should be presented in the parliament.
- Transparency and accountability of taxation system are very important to increase its credibility so that tax payers believe that tax is utilized in the proper way. Corruption free society should not only be the policy but also be the practice.
- Formation of medium term revenue policy is required for identifying the possibility of generating income tax, to justify the rationality of rebates, concessions and tax holidays and to promote economic activities.
- Should work as facilitators to bring harmony of efforts among all the departments directly and indirectly involved in the revenue matter.
- Moral education and awareness programs for tax payers and tax personal should be implemented to control tax evasion and corruption.
- Strategies like incentives and appreciation to the regular taxpayers and on the other hand heavy fine and penalties to those who do not pay tax on time are to be followed.

- Until and unless the political commitment for the substantial development of the country is not made, optimal revenue collection through income taxation will not be possible.
- The members involved in formulating income tax police must have depth knowledge about income tax. The provision of rewards, prize, and incentives should be introduced in the policy to encourage the tax payers to pay tax voluntarily rather than through coercive measures.
- The provision of fines, penalties and punishment should be made at higher rate for income tax evaders.
- Income tax, rules and regulation should be clear and simple for all the taxpayers as well as for tax administrators. The definition made in Income Tax Act should be further clarified and well defined in simple language.
- Clear provisions should be made in case of deductions. All the items of deductions should be clearly defined in the tax policy. To promote export, more deduction should be provided.
- A research and intelligence center should be established in each tax office for proper planning and to collect the information in regard to income tax evaders, potential new taxpayers and non –residents who have conducted business without registration.

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Appendix

Fiscal Year	Total GDP	Total Revenue
1996/97	269570	30373.2
1997/98	289798	32937.9
1998/99	330018	37251
1999/2000	366251	42889.6
2002/01	413429	48893.6
2001/02	430397	50445.6
2002/03	492200	56229.8
2003/04	536800	62331
2004/05	589400	70124.9
2005/06	654100	72282.1
2006/07	727800	87712.1
2007/08	815760	107622.7
2008/09	988300	143474.4
2009/10	1193700	179940.4
2010/11	1369400	199819.6
2011/12	1527300	244369.5
2012/13	1692600	295936.5
2013/14	1941624	356620.5
2014/15	2120000	405866.5