A STUDY OF CONTRIBUTION OF INCOME TAX ON GOVERNMENT REVENUE OF NEPAL

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RECOMMENDATION LETTER

This thesis entitled **A STUDYOFCONTRIBUTION OF INCOME TAXONGOVERNMENT REVENUE OF NEPAL** has been prepared by **Manoj Pandey** under my supervision. I hereby recommended that this thesis for examination by the thesis Committee as partial fulfillment of the requirements for the Degree of Masters of arts in Economics.

Prof. Dr. R.K. Shah

(Thesis Supervisor)

Date: 9/6/2073 BS

APPROVAL LETTER

We clarify that this thesis entitled **A STUDYOFCONTRIBUTION OF INCOME TAX ONGOVERNMENT REVENUE OF NEPAL**submitted by**Manoj Pandey**to the Central Department of Economics, Faculty of Humanities and Social Science in partial fulfillment for requirement of Masters of Arts in Economics has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the said degree.

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ABBREVIATIONS/ACRONYMS

ADB	-	Asian Development Bank
CBS	-	Central Bureau of Statistics
CPI	-	Consumer Price Index
FY	-	Fiscal Year
GDP	-	Gross Domestic Product
IRD	-	Inland Revenue Department
IT	-	Income Tax
ITA	-	Income Tax Act
Ltd	-	Limited
IMF	-	International Monetary Fund
MOF	-	Ministry of Finance
NPC	-	National Planning Commission
No	-	Number
NRB	-	Nepal Rastra Bank
NRs.	-	Nepalese Rupees
SAFTA	-	South Asian Free Trade Area
TU	-	Tribhuvan University
VAT	-	Value Added Tax-
WB	-	World bank
WTO	-	World Trade Organization

CHAPTER I

INTRODUCTION

1.1 Background of the Study

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

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

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

- Direct tax
- Indirect tax

Direct taxes are those which are levied on permanent and recurring occasions, and indirect taxes changes on occasional and particular events. In modern times taxes are classified into direct and indirect taxes on the basis of assessment. Those taxes which are levied on the receipt of income are called direct taxes and those which are imposed on expenditure are regarded as indirect taxes. On this basis, income tax, profit tax, and capital gain tax would be examples of direct taxes. Excise duties, custom duties and sales tax are indirect taxes. It will be possible to reduce the gap in income by imposing higher rate to those who are having higher income and from that collected amount providing necessary assistance to the people with very poor economic condition. Hence it will help to make equitable economic distribution in the society. Balanced regional economic development is also possible through the provision of income tax. The government should charge higher income tax on the income from urban area and less on the income from remote area. Income tax holidays and incentives would help to develop the income tax is the main source of revenue of the government, which is paid by people (ie tax payer) in developing countries as well as developed countries, government conducts welfare projects for people by the help of tax collection. That the income tax is prerequisites for the development of the nation and daily operation of government activities (Devkota, 2011).

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

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

1.2 Statement of the Problem

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

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

For the economic development of the country, contribution of direct tax is more essential rather than indirect tax, but the main tax structure of Nepal is dominated by indirect tax. Among the direct tax, income tax plays the significant role but it is unpleasure to quote that the contribution of income tax to the national revenue is very low in Nepal. To increase its contribution to national revenue, many research and analysis should be conducted in the field of income tax, but the studies and research work is lacking in the area of income tax. So to identify the problem and to overcome them and to improve income taxation, study in the field of income tax is essential. To rise government revenue there is necessary to rise its internal resources of revenue. An internal resource of revenue includes tax and non-tax revenue. Revenue mobilization, foreign grants and loan, domestic borrowings and change in cash reserve are used as fiscal instruments for financing government expenditure.

Following research questions are raised in this study:

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

1.3 Objectives of the Study

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

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

1.4 Significance of the Study

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

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

1.5 Limitations of the Study

This study has following limitations:

1. Secondary data have been usedso, the reliability and validity of the findings depend upon the reliability of available data.
2. The coverage of fiscal year in this study is from FY1999/20 to up to FY2013/14. Hence findings are based on those fiscal years only.

1.6 Organization of the Study

This study is divided into six chapters.

The first chapter is Introduction/background of the study, statement of the problem, objectives of the study, significance of the study andlimitation of the study.

The second chapterreviews different books, dissertations, related articles and journals.

The third chapter deals with research methodology. This chapter analyzed the research design, nature and sources of data, tools and techniques of data collection, statistical tools and methods of data analysis.

The fourth chapter is related with historical background of income tax in Nepal and it also includes conceptual framework of the study.

The fifth chapter is related with presentation and analysis of data i.e. empirical investigation as well as finding of the study.

The last chapter concludes the summary of findings and recommendations.

CHAPTER II

REVIEW OF LITERATURE

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

Reviews of related studies and the research gap are remains under this chapter. In theoretical framework, review of what has been written in academic books is carried out while review of related studies is further divided into review of journals, articles and review of master degree thesis.

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

2.1Review at National Context

Bhattrai & Koirala (2011) have presented the description of tax laws and tax planning. A simplified version of income tax Act 2058 and Value Added Tax Act 2052 are given in summarized form at the end of part A and part C. He has presented theoretical as well as practical aspect on taxation in this book. This book is useful to anyone who is interested in the subject of taxation. This book is also helpful to research work. The aim of writing this book is to provide the readers with basic knowledge of general principles and practices of tax law in Nepal and to develop in them basic skills to handle the tax matter in the text has been presented in a very simple and clear manner for better understanding of the law.

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

- Marginally high tax rates.
- Limited tax base.
- Low tax elasticity.
- Poor voluntary compliance.
- Inefficient, indifferent and corrupt tax administration.

The studies and reports on taxation exhibit that several reform have had been under taken by the government in the past to simplify and modernized the tax system. The reform in taxation in Nepal consists of three types:

- Reform in tax laws and regulations.

- Reforms in environment.
- Reforms in tax administration.

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

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

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

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

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

Kadel & Lamsal (2012)have embraced sufficient numerical examples and questions, changed provision of the Act. A new chapter covering the problems related to resident and non-resident is added as per the demand of the teachers and students. It is updated as per the finance act, 2067. He has described about historical background, income tax act, rules and administrative aspects, house and land tax but has not shown problems related to income tax. Due to numerous changes and not availability of amended acts in English, the present edition of the book has not been able to update the act and so it is dropped out.

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

Nepal. Training and career development should be provided to the tax personal time to time and also tax administration should be free from political pressure.

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

Mallik (2003)has explained income tax act, 2058 with explains wherever necessary. The author has presented the complex Act in simple and lucid manner so that it will be easy to understand the act. He has shared his expertise in his book. His book is descriptive and analytical. All the provisions in the act have been clarified in simple language. The author has also clarified why some of the tax exempted amounts have been brought into tax net by the new Act. In some cases he has also compared the provision of the old Act and the new Act.

Neupane (2007) has shownthat contribution of income tax to total tax revenue, has decreased from 23.93 percentage to 20.83 percentage in the FY056/57 to 061/62. It may be due to the collection of the property tax by municipalities. But it is not only the cause; emphasis should be given to the income tax collection. To facilitate tax collection, Inland Revenue Department has implemented e-tads, e-pan and e-filing for the better tax compliance. There is provision of tax plate also. But the frequent change in the act decreases tax compliance which is a major drawback of instable political condition.

Sharma & Duwali (2013) have presented a paper entitle Tax Compliance and Enforcement Trend in Nepal on fourth IMF-Japan high level tax conference, Tokyo, Japan, April 2-4, 2013. In this paper they have presented major compliance issues and incentives for compliance enhancement, which are as follows:

The Major Compliance Issues were as follows:

- Low registration (income tax and vat).
- No supportive environment for compliance.
- No new policy and no new tax rates for the last one year.
- Large no of case pending in Revenue Tribunal.
- Huge amount of tax dues.
- Tax fraud (Fake VAT case).
- Data mismatch (difference in reporting).
- Under invoicing and none invoicing.

Incentives for Compliance Enhancement:

- Tax system reform year announcement.
- Implantation of 5 year strategic plan and 3 year reform plan.
- Initiation of organizational restructuring.
- Human resource management plan prepared.

- National Tax Day celebrated for the first time.
- Application of service to enforcement strategy.
- Communication strategy (Bulletin, Radio, TV, News, Print etc.)
- Revenue research and forecasting unit established.
- Online taxpayer service (call center, etc)
- Initiation of tax information network (TIN)
- Data link with Company Registrar office has already been started.
- Integrated market monitoring and billing enforcement program.

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

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

2.2 Review at International Context

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

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

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

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

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

DoF (2012) has estimated that the relationship between corporate income tax collection with GDP and a dummy variable. In relating the income tax revenue with GDP the model used was: IT=a+By, where, IT=income tax revenue in a year, Y is the GDP income, a=constant and b=elasticity coefficient. After using logarithm, it concluded that the income tax collection is a function of GDP and GDP is the function of inflation, money supply and interest rate. The model showed that the variation in both corporation and individual income taxes could very well be explained by the variation in the level of economic activities represented by GDP, money supply, inflation, interest rate leading to the changes in the tax structure.

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

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

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

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

2.3 Historical Background of Income Tax in Nepal

2.3.1 Concept of Tax

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

2.3.2 Direct Tax

Direct tax is collected directly by the government from the person who bears the tax burden. The impact and the incident are on the one and the same person. In other words the same person pays and bears the tax burden. Following taxes are remains under the direct tax; which are:

- Income tax
- Property tax
- Interest tax
- Capital gain tax
- Vehicle tax

- Death tax
- Gift tax
- Expenditure tax

Advantages of Direct Tax:

- It is impose on person as per the income so it is equitable.
- Time, procedure and amount of tax to be paid is known with certainty.
- In the direct tax tax payer knows his contribution to the government revenue so they can insist the government to spend their contribution for the welfare of the community.

Disadvantages of Direct Tax:

- Tendency to evade tax may increase to avoid tax burden.
- It gives mental pinch to the taxpayer as they have to curtail their income to pay to the government.
- The tax payers are limited in direct tax so the direct tax lacks mass participation.

2.3.3 Indirect Tax

Indirect tax is imposed on one person but partly or wholly paid by another. In indirect tax the imposed and incident of tax are on different persons. In other words, the person paying and bearing the tax is different. Following taxes are remains under indirect tax; which are:

- Value Added Tax (VAT)
- Excise duty
- Sales tax
- Import and export duties
- Entertainment tax
- Hotel tax

Advantages of Indirect Tax

- There is less chance of tax evasion because the tax payers pay the tax collected from customer.
- Each and every consumer pays tax while consuming the goods and services. So there is mass participation.
- The government can reduce the consumption of harmful goods by imposing higher taxes.

Disadvantages of Indirect Tax

- It is not equitable because the burden to the rich and the poor is same.

- Most of taxes are included in the price of goods or services. As a result the taxpayers do not know how much tax they are paying to the government.
- There is uncertainty of government revenue from indirect tax. With the fluctuation in demand, the tax amount can also fluctuate.

2.3.4Objectives of Tax

Tax is a permanent instrument for revenue collection. It is a major source of revenue in the developed countries as well as developing countries. Tax has been an instrument of social and economic policy for the government. The main objectives of tax are:

i. To rise more revenue

ii. To redistribute wealth for the common good

iii. To prevent concentration of wealth in a few hands

iv. To remove regional disparities

v. To reduce unemployment

vi. To boost up the economy

2.3.5 Meaning of Income Tax

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

2.3.6Types of Income Tax

2.3.6.1The Individual or Personal Income Tax

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

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

2.3.6.2 Corporation Income Tax

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

2.3.6.3 Income Tax in International Context

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

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

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

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

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

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

In India, the income tax was introduced in 1860 by the British to relieve from economic burden created due to the first domestic revolution. It was discontinued for some years and then regularly collected after the participation of income tax 1886. (ADB, 2009).

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

2.3.6.4 Evolution of Income Tax in Nepal

- **Income Tax in Ancient Nepal**

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

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

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

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

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

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

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

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

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

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

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

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

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

- **Income Tax Act 2002**

The parliament of Nepal enacted Income Tax Act 2002 with effective from 1 April 2002. The government of Nepal framed Income Tax Rules 2004.To clarify the act. This act consists 143 section along with 24 chapters. This is a forth income tax act of Nepal. It has been made to minimize the weakness of previous acts and maximize government revenue by improving collection procedure of revenue.

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

i. Individual income tax

ii. Corporate income tax

iii. Interest tax

iv. House and Land tax

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

- Narrow base of tax.
- Levying tax only on the income originated in Nepal.
- Dispersion of tax related acts, i.e. income tax related provisions were given in different acts.

- Low penalty rate to tax evader.
- Incompatible to self-assessment, and
- Unsuitable to modern economy.

Main objectives of Income Tax Act, 2002 are as follows:

- Bringing all income generating activities into tax net.
- Harmonizing tax rate and concession on equity ground.
- Widening the tax base.
- Making income tax elastic and revenue productive.
- Developing a tax payer friendly taxation system by making it clear and transparent.
- Minimize tax avoidance and tax evasion.
- Making tax payers more responsible by enforcing the self assessment systems.
- Integrating Nepalese tax system with the tax system of the foreign countries.
- Confining all the income tax related matters within the act.
- Reducing the scope of discretionary interpretation of the tax authorities.

Special features of Income Tax Act, 2002 are as follows:

- The act has introduced a bock system of charging depreciation. A provision has also made for depreciating intangible assets.
- The act has first introduced the capital gain taxation.
- Global income of a resident are made taxable. Non residents are also taxed on their incomes with source in Nepal.
- The act has made provision for international taxation. Foreign tax credit has been introduced for the first time.
- The act has broadened the tax base. Tax rate have been spell out in act. The tax rate and concession have been harmonized on equity ground.
- The act has made the provision of fine and penalty more stringent for the defaulters.
- This act has classified all incomes into three headings which are as follows: a)Employment, b)Business, and c)Investment
- All natural persons have given right to claim medical tax credit and extra exemption limit has been provided for the taxpayers of different remote areas.
- The appeal system has been further streamlined by making mandatory for the taxpayers to file an objection with the Inland Revenue Department for administrative review before appealing to the Revenue Tribunal.
- There has the special provision for deduction pollution control and research & development expenses.

- The act has provided liberal loss-set off and carry forward /backward provisions. Inter-head adjustments of losses have been clearly specified. Such provision has been made from international prospective.
- All income tax related matters are confined with the act by abolishing all tax related concession, rebates and exemption provided by different acts. This act has been made super in regard to all income tax matters.
- A full-fledged self assessment system is implemented and presumptive taxation and current year taxation system are strengthened.

Income Tax Act 2002 has classified the sources of income for the purpose of assessment under the following heads:

i) Income from Employment

ii) Income from Business

iii) Income from Investment

2.3.7Methods of Income Tax Assessment

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

2.3.7.1 Self-Tax Assessment

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

2.3.7.2 Jeopardy Assessment

When an assessment is made under jeopardy assessment with respect to a full income year, the assessed person will not file a return of income for the year. In this situation the assessment done by the department on it best judgment prior to the due date for filing a return of income in the circumstances specified in the Act. in section 100 of ITA, 2002 also makes provision for the jeopardy assessment under such special circumstances as when

- The person became bankrupt, is wound up, or goes into liquidation.
- The person is about to leave Nepal identity.
- The person is otherwise about to cease activity in Nepal.
- The department otherwise consider it appropriate.

2.3.7.3 Amended/Management Tax Assessment

Reassessment of an assessment by Inland Revenue Department which is already assessed by the assesee is amended assessment. It is the assessment done by the department on its best judgment prior to the due date for filing a return of income in the circumstances specified in the act. In case the assessment is inaccurate by the reason of fraud, the department may amend an assessment at any time. But assessment must be done within one year on receipt of information. However the department may not amend an assessment if the assessment has been amended or reduce pursuant to an order of the revenue tribunal or a court of competent jurisdiction expect where the order is reopened.

2.4 Research Gap

Many times the research has been conducted on this topic 'Contribution of Income Tax to Government Revenue'. There is gap between present research and previous research conducted. Context has been changed every year and new problems, issues were found every year.

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

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

CHAPTER III

RESEARCH METHODOLOGY

This chapter includes the brief discrimination about research methodology used to fulfill the objectives of this research study. It includes research design, source of data collection, and statistical tools used in the study. This chapter is concerned with detail discussion of the methodology used in this study by covering the procedure of getting research problems answers as per the objectives.

3.1 Research Design

. This study is based on descriptive and analytical method using secondary data. To assess the structure of income tax the data from FY 1999/00 to FY 2013/14 were taken into consideration. This study analyzes the structure of income tax in Nepal using descriptive method to describe the data, illustrating the data in tables, graphs and charts for clarity of the available data and information.

3.2 Nature and Sources of Data

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

- Economic survey of various year of Ministry of Finance(MOF).

- Official website of Ministry of Finance, GON:www.mof.gov.np
- Official website of Inland Revenue Department, GON: www.ird.gov.np
- Reports and records of Ministry of Finance (MOF)& Inland Revenue Department (IRD), GON.
- Related text booksand reference books of income tax and public finance available at national and international level.
- Related Dissertations, available at the library of Central Department of Economics, Central library, and other.
- National and International Magazines, Journals, Newspapers and so on.

3.3 Tools and Techniques of Data Collection

In order to analyze the study, different statistical and mathematical tools were used.

3.4 Analysis and Presentation of Data

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

To show the relationship between income tax and total revenue, scatter diagram was used. This diagram was helpful to show the relationship between two variables which wasincome tax and total revenue.

Similarly, different statistical tools such as diagram, graph, chart,pie chart, trend line were used and mean, percentage, computer software also were used to validate of the study.

CHAPTER IV

ANALYSIS AND PRESENTATION OF DATA

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

4.1 Income Tax Rate and Tax Exemption Limit in Nepal

The income tax is a fairly general tax. The system of income taxation in Nepal has forty-five years of history starting from the fiscal year 1959/60 as business profit and remuneration tax. During this period, exercises with four income tax Acts were formulated with numerous tax rates and exemption limit schedules. Income tax was initially levied on busyness income and salary income. The rate of income tax has been changing continuously since its introduction in FY 1959/60 to the present time. For every year, Finance act prescribes the exemption limit for individual, family and couples. Above the exemption limit, different income tax rate have been levied. From 1992/93-1996/97, an individual was exempted up to NRs. 15000, income tax for couple and family was exempted up to NRs. 20000. The exemption limit was gradually increased till the end of the study period. The exemption limit for the FY was NRs. 100000 for an individual and NRs. 125000 for the couple and family. At the end of FY2012/13, the exemption limit for an individual was NRs. 160000, and NRs. 200000 for the couple and family.

For Individual and Couple

i. A resident individual or a resident couple having taxable income from employment is taxed as:

Table 4.1

Individual or a Couple having Taxable Income from Employment

For Individual	For Couple	Tax Rates (%)
Upto NRs. 160000	Upto NRs. 200000	1
Next NRs. 100000	Next NRs. 100000	15
Next NRs. 22,40,000	Next NRs. 22,40,000	25
Balance	Balance	40

Source: IRD Report, 2011/12

ii. A resident individual or a resident couple having taxable income from business and/or investment only is taxed as under:

Table 4.2

Individual or a Couple having Taxable Income from Business and/or Investment

For Individual	For Couple	Tax Rates (%)
Upto NRs. 160000	Upto NRs. 200000	1
Next NRs. 100000	Next NRs. 100000	15
Next NRs. 22,40,000	Next NRs. 22,40,000	25
Balance	Balance	40

Source: IRD Report, 2011/12

iii. A resident or a couple having taxable income exceeding Rs.25 lakh is imposed an additional tax of 40 percent of tax liability.

iv. A resident individual or a resident couple having taxable income from employment and business and/or investment is taxed as under:

Table 4.3

Tax rates from Individual and Couple of Business and Investment

For Individual	For Couple	Tax Rates (%)

Upto NRs. 160000	Upto NRs. 200000	1
Next NRs. 100000	Next NRs. 100000	15
Next NRs. 22,40,000	Next NRs. 22,40,000	25
Balance	Balance	40

Source: IRD Report, 2011/12

Even if the assessable income from employment is less than exemption limit, 1% social service tax is imposed on whole exemption amount enjoyed by taxpayer.

i. Tax is imposed only at 20 percent instead of 25 percent as highest rate to the individual engaged in a special industry.

ii. Taxable income of an individual earned from exports is taxed at 15 percent on the slab where 25 percent tax rate applicable normally.

iii. The resident couples are normally taxed as two single individuals. A resident individual and the resident spouse of the individual may elect to be treated as couple section 50 of the Act, 2001.

v. An individual working in a remote area is entitled to a hardship allowance call a remote area (Area 'A') allowance up to a maximum of Rs 50,000 by way of additional basic exemption. The exemption limit specified in rule 38 of ITR, 2002 is as under:

Table 4.4

Additional Tax Exemption Under Region for Individual and Couple of Business and Investment

Area ‘A’	NRs. 50,000
Area ‘B’	NRs. 40,000
Area ‘C’	NRs. 30,000
Area ‘D’	NRs. 20,000
Area ‘E’	NRs. 10,000

Source: IRD, 2011/12 Yearly Report

An individual having pension income is entitled to a 25 percent basic exemption as additional exemption.

i. A disable resident individual is entitled to a 25 percent basic exemption as additional exemption.

ii. Nepalese diplomas working abroad and diplomatic mission are taxed only after deducting 75 percent of foreign allowance from their taxable income.

iii. If a resident has invested (life) insurance, annual premium paid for NRs. 20,000 (which is lower) is subject to deduction from taxable income.

iv. 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 exchange NRs.200,000 and respect and if 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. The annual tax will be as follows:

- Metropolitan or sub-metropolitan NRs.3500
- Municipalities NRs.2000
- Anywhere else in Nepal NRs. 1250
- The tax applicable to public transport is as follows:

Table 4.5

AnnualTax for Rental Vehicle

Type of Vehicles	Annual Tax Per Vehicle (NRs.)

Minibus, Mini Truck, Truck, Bus	1500
Car, Jeep, Van, Micro Bus	1200
Three wheeler, Auto Riksha, Tempo	850
Tractor and Power Tiller	750

Source: IRD Report, 2011/12

v. Gains from the disposal of non-business chargeable assists 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. But, 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.

vi. For non-resident individual taxable with their income source in Nepal the tax imposed on this income is 25 percent. But if the income is subjected to withholding tax, the withholding rate is applied.

The income tax rate for partnership firms, corporation and non-resident was 15 percent to 60 percent for different slabs in the FY1995/96 which decreased to 30 percent to 25 percent for total taxable income. Income Tax Act 2002 has provided rebates or facilities to the special industries. So only 20 percent tax is levied on the income of a special industries. According to Income Tax Act

2002, entities are taxed on flat basis. The percentage of the rate depends on the nature of the entity or the kind of the entity's business respectively. Such as;

i. The taxable income any entity is generally taxed at the rate of 25 percent unless prescribed otherwise.

ii. The income of an approved retirement fund is exempt from tax.

iii. Bank's, financial institution, general insurance companies, liquor and tobacco industries or entity established under Nepal Petroleum Act, 2040 are taxed at the rate of 30 percent.

iv. Entity wholly operating as special industry and entity that has operated any road, bridge, tunnel, rope-way, flying bridge etc after their construction or entity has operated trolley bus or train are taxed as at the rate of 20 percent.

v. Entity wholly engaged in projects to build public infrastructure, own operate and transfer it to the government, or entity engaged in power generation, transmission and distribution is taxed at the rate of 20 percent.

vi. Export income of an entity that has earned income from export its taxed at the rate of 20 percent.

vii. Income of an estate of a deceased resident individual or trust of an incapacitated resident individual is taxed as a resident individual.

viii. Repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal is taxed at the rate of 5 percent.

ix. Taxable income of a non-resident person providing shipping, air transport or telecommunication service (however 2 percent tax is applied in case these services are being provided within Nepal) is taxed at the rate of 5 percent. (Bhattrai &Koirala, 2011)

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 years. The exemption limits in the different fiscal years are shown in the following table:

Table 4.6

Income Tax Levied

(Amount in NRs.)

Fiscal Year	**Individual**	**Couple**	**Family**
1992/93-1996/97	15000	20000	20000
1997/98	25000	35000	35000
1998/99	30000	40000	40000
1999/00	40000	50000	50000
2000/01	50000	60000	60000
2001/02	55000	75000	75000

2002/03	55000	75000	75000
2003/04	65000	85000	85000
2004/05	80000	100000	100000
2005/06	100000	125000	125000
2006/07	100000	125000	125000
2007/08	100000	125000	125000
2008/09	160000	200000	200000
2009/10	160000	200000	200000
2010/11	160000	200000	200000
2011/12	160000	200000	200000
2012/13	160000	200000	200000
2013/14	160000	200000	200000

Source: IRD Report, 2011/12

4.2 Government Revenue Structure of Nepal

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

Table 4.7

Composition of Total Revenue

(NRs. in billion)

Fiscal year	Total Revenue (Rs)	Tax Revenue		Non-tax Revenue	
		Amount	%	Amount	%
1999/00	4289.37	3315.21	77.29	974.16	22.71
2000/01	4889.39	3886.51	79.49	1002.88	20.51
2001/02	5044.56	3933.06	77.97	1111.50	22.03
2002/03	5622.97	4258.70	75.74	1364.27	24.26
2003/04	6233.10	4817.50	77.29	1415.80	22.71
2004/05	7012.27	5410.47	77.16	1601.80	22.84
2005/06	7228.19	5743.04	79.45	1485.15	20.55
2006/07	8771.21	7112.67	81.09	1658.54	18.91
2007/08	10762.25	8515.55	79.12	2246.70	20.88

2008/09	14347.45	11705.19	81.58	2642.26	18.42
2009/10	17799.09	15978.53	89.77	1820.56	10.23
2010/11	19837.59	17722.72	89.34	2114.87	10.66
2011/12	24437.29	21172.18	86.64	3265.12	13.36
2012/13	29602.11	25921.49	87.57	3680.62	12.43
2013/14	36292.36	31243.99	86.06	5048.37	13.94

Source: Economic Survey, 2014/15, Ministry of Finance

Figure: 4.1

Trends of Total Revenue, Tax revenue and Non Tax Revenue

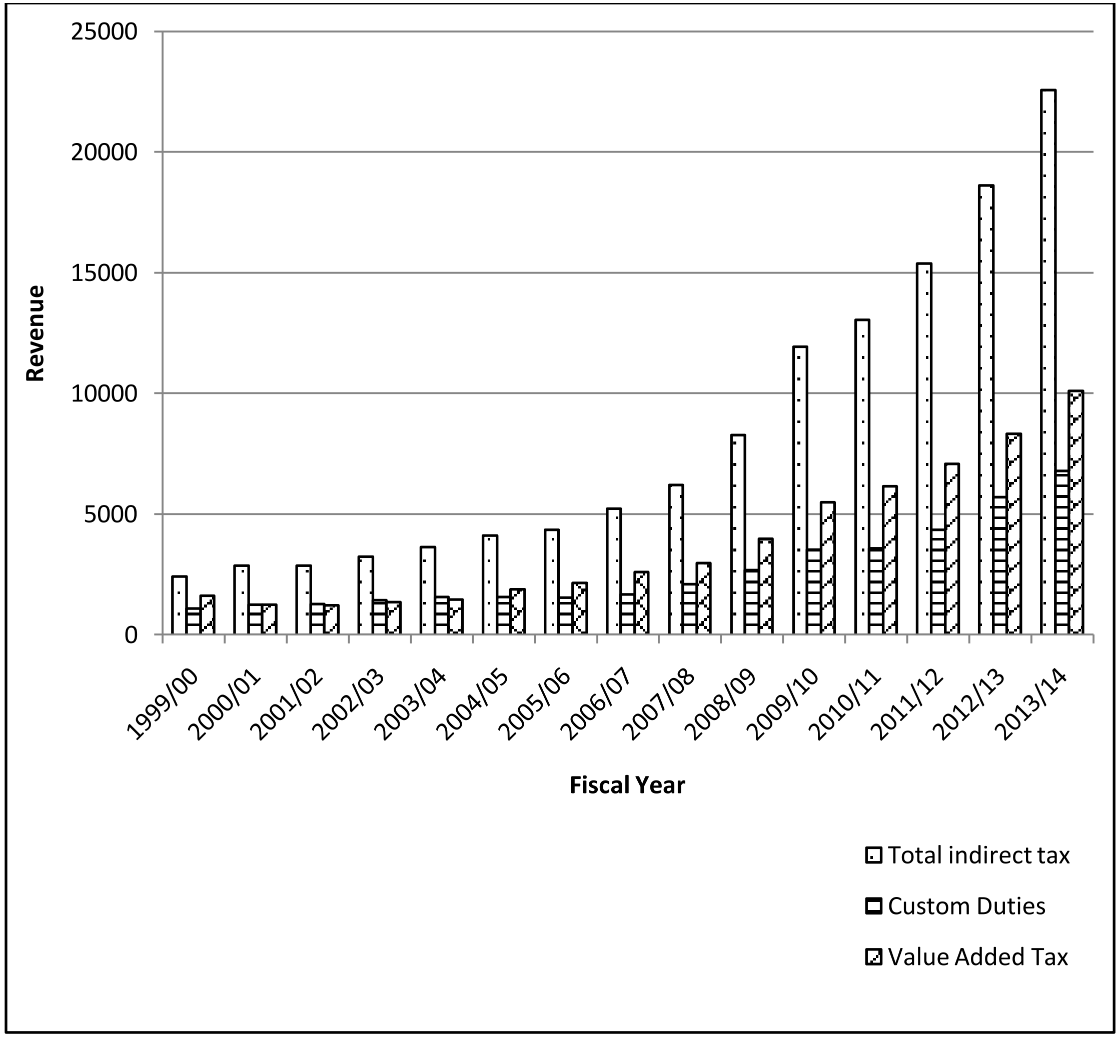

25000
20000
15000
10000
5000
0
Revenue
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11
2011/12
2012/13
2013/14
Fiscal Year
Total indirect tax
Custom Duties
Value Added Tax

Table4.7 and Figure4.1 show that the role of tax revenue is very important in revenue mobilization of Nepal to meet the government expenditure. In FY1999/00 the government revenue mobilization has stands at Rs 4289.37 billion out of which Rs 3315.21 billion (77.29 percent) is mobilized from tax revenue source. The remaining Rs 974.16 billion (22.71 percent) is collected from non-tax sources such as fees, fines, interest and dividends. In FY2013/14 government revenue increases to Rs 36292.36 billion with contribution of tax revenue being 86.06 percent. The share of revenue from non-tax source decreases to 13.94 percent. The highest contribution of tax revenue to total revenue is 89.77 percent during the study period. It can be shown clearly that the tax revenue of the government is very high in comparison to non-tax revenue and total revenue is in increasing trend.

4.3 Composition of Tax Revenue in Nepal

Tax revenue is divided in to two classes one is direct and the other is indirect. A direct tax is such type of tax, which is imposed upon the person out of his income or property. A direct tax is really paid by the person on whom it is legally imposed. Income tax, property tax, gift tax, vehicle tax and others are the best examples of direct taxes. On the other hand, and indirect tax is such type of tax which is imposed upon any person without direct collecting from him. An indirect tax is imposed on person but paid partially or wholly by another. Sales tax, vat, entertainment tax, custom, excise duty are the good examples of this tax. The figure of direct tax and indirect tax revenue from FY1999/00 to FY2013/14 is presented in the following table:

Table: 4.8

Composition of Total Tax Revenue

(NRs. in billion)

Fiscal Year	Total Tax Revenue	Direct Tax		Indirect Tax	
		Amount	%	Amount	%
1999/00	3315.21	895.15	27	2420.06	73
2000/01	3886.51	1015.94	26.34	2870.57	73.66
2001/02	3933.06	1059.75	26.94	2873.31	73.06
2002/03	4258.70	1010.58	23.73	3248.12	76.27
2003/04	4817.50	1191.26	24.73	3626.04	75.27
2004/05	5410.47	1307.18	24.16	4103.29	75.84
2005/06	5743.04	1396.81	24.32	4346.23	75.68
2006/07	7112.67	1898.03	26.69	5214.64	73.31
2007/08	8515.55	2308.77	27.11	6206.77	72.89
2008/09	11705.19	3432.07	29.32	8273.12	70.68
2009/10	15978.53	4039.60	25.28	11938.93	74.72
2010/11	17722.72	4672.03	26.36	13050.69	73.64
2011/12	21172.18	5777.02	27.29	15395.16	72.71
2012/13	25921.49	7301.26	28.17	18620.23	71.83
2013/14	31243.99	8673.65	27.78	22570.34	72.22

Source: Economic Survey, 2014/15, Ministry of Finance

Figure: 4.2

Total Tax Revenue, Direct Tax and Indirect Tax

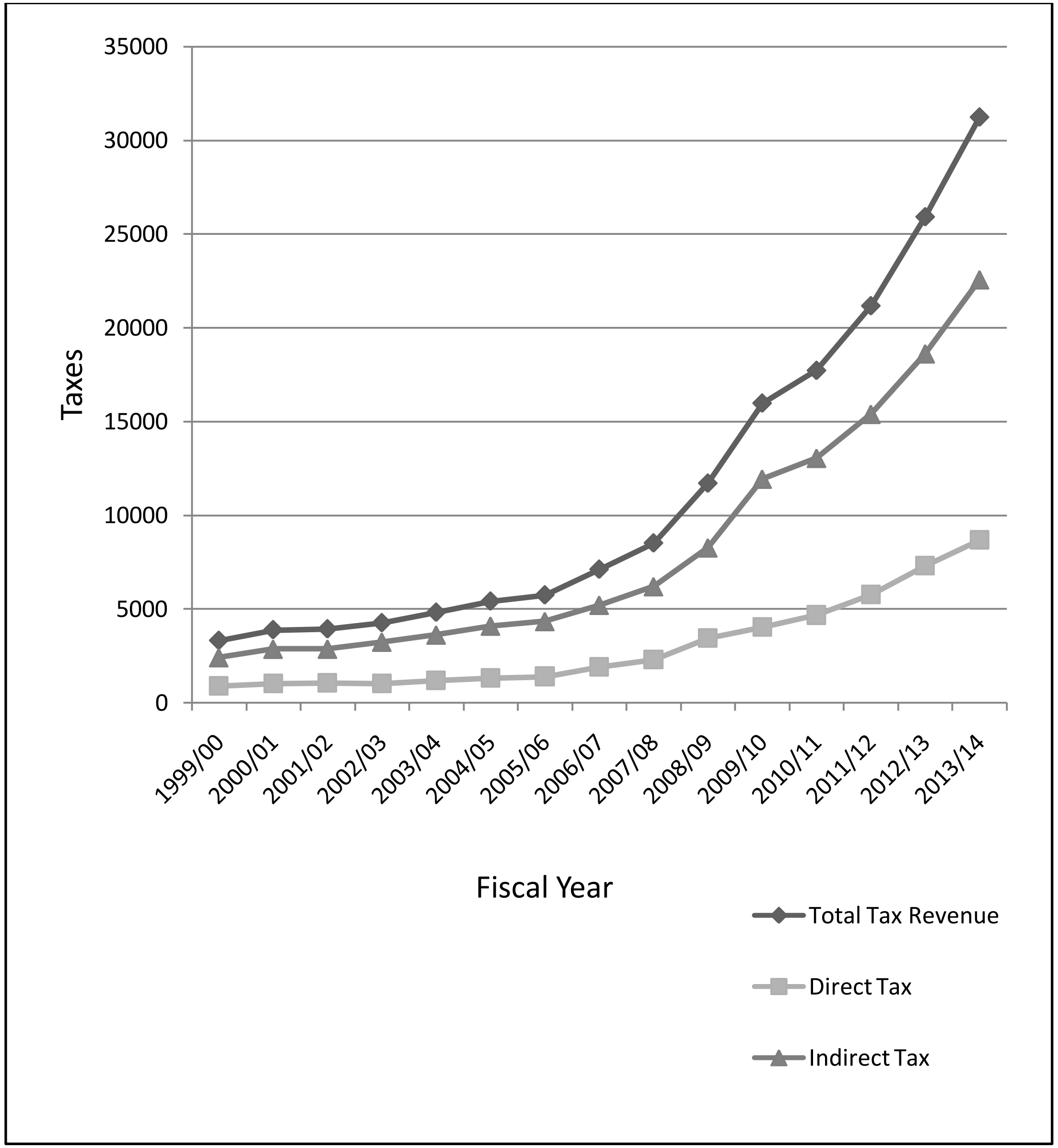

35000
30000
25000
20000
15000
10000
5000
0
Taxes
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11
2011/12
2012/13
2013/14
Fiscal Year
Total Tax Revenue
Direct Tax
Indirect Tax

Table4.8 and Figure4.2 show that total tax revenue, direct tax and indirect tax are in increasing trend. The amount of direct tax is NRs. 895.15 billion in first FY1999/00. It is increasing each year and has reached to NRs.8673.65 billion inFY2013/14. Contribution of direct tax to total tax revenue is fluctuating over the study period from 27 percent to 27.78 percent. Similarly the amount of indirect tax is NRs. 2420.06 billion in FY1999/00. It is increasing each year and has reached to NRs. 22570.34 billion in FY 2013/14. Contribution of indirect tax to total tax revenue is fluctuating over the study period from 73 percent to 72.22 percent.

4.4 Composition of Direct Tax Revenue

The major components of direct tax are income tax, property tax, social security tax and other tax (including land revenue and registration). The share of major components of direct tax is given below in the following table 4.9:

Table 4.9

Composition of Direct Tax Revenue

(NRs. in billion)

Fiscal Year	Total Direct Tax	Income Tax		Property Tax		Social Security Tax		Other Taxes (Including Land Revenue and Registration)	
		Amount	%	Amount	%	Amount	%	Amount	%
2000/01	1015.94	911.40	89.69	-	-	-	-	-	-

2001/02	1059.75	890.37	84.03	56.06	5.29	-	-	113.18	10.68
2002/03	1010.58	813.19	80.45	36.89	3.65	-	-	160.78	15.90
2003/04	1191.26	951.47	80.00	68.50	5.75	-	-	169.75	14.25
2004/05	1307.18	1046.61	80.07	80.65	6.17	-	-	179.92	13.76
2005/06	1396.81	1093.94	78.32	84.76	6.07	-	-	218.11	15.62
2006/07	1898.03	1573.18	82.89	99.50	5.24	-	-	225.35	11.87
2007/08	2308.77	1907.78	82.63	106.92	4.63	-	-	294.07	12.74
2008/09	3432.07	2724.74	79.39	185.00	5.39	-	-	522.33	15.22
2009/10	4039.60	3382.13	83.73	551.10	13.64	-	-	106.37	2.63
2010/11	4672.03	4135.03	88.51	357.25	7.65	70.98	1.52	108.77	2.33
2011/12	5777.02	5130.30	88.81	358.84	6.21	155.50	2.69	132.38	2.29
2012/13	7301.26	6418.67	87.91	534.02	7.31	188.06	2.58	160.52	2.20
2013/14	8673.65	7560.82	86.96	667.12	7.69	244.90	2.82	200.81	2.32

Source: Economic Survey, 2014/15, Ministry of Finance

Figure 4.3

Composition of Direct Tax Revenue

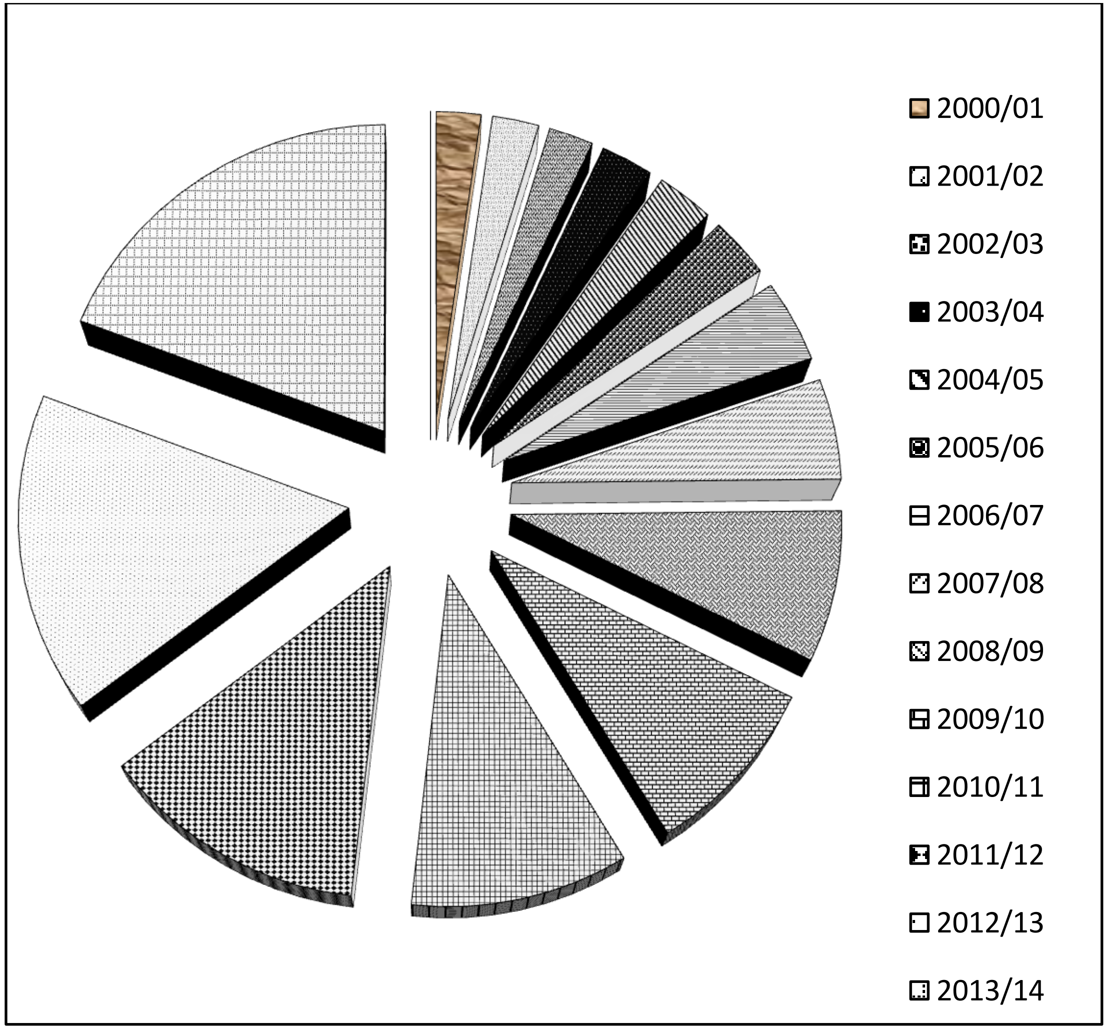

2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11
2011/12
2012/13
2013/14

Table 4.9 and Figure4.3 show that collection trend of direct tax is increasing every year during last 11 year. The table also shows that the contribution of income tax to direct tax is higher than other tax and it has occupied the largest share in the direct tax. The percentage share of income tax to direct tax is 80 percent amounting NRs. 1191.26 billion in FY 2003/04. It is 86.96 percent amounting NRs. 7560.82 billion in FY2013/14. On the other hand, the percentage of property tax, social security tax and other tax to direct tax is very lower in comparison to income tax. There percentage of contribution to direct tax revenue are fluctuating during the study period.

4.5 Composition of Indirect Tax Revenue

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

Table 4.10

Composition of Indirect Tax Revenue

(NRs. in billion)

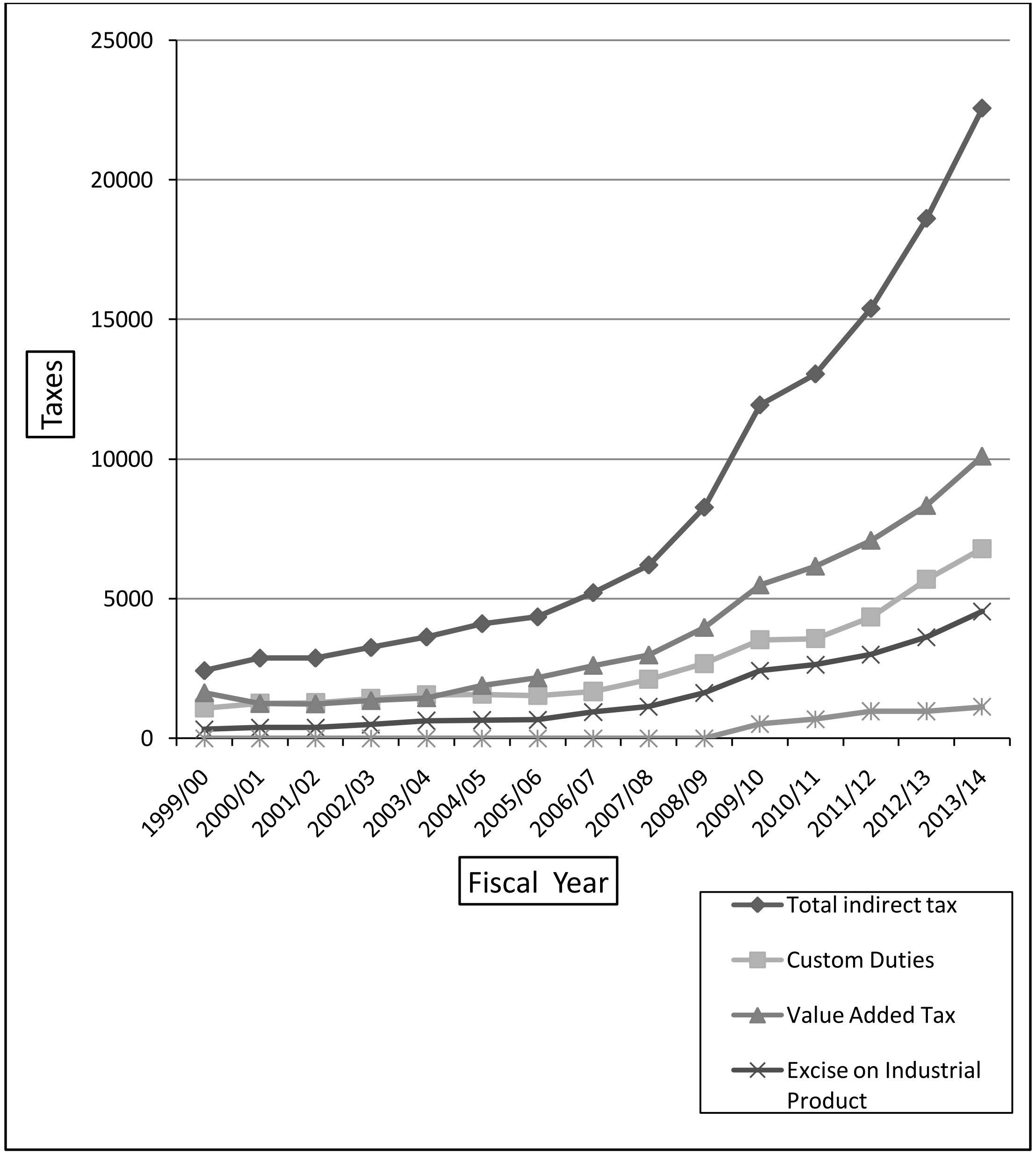
Fiscal Year	Total Indirect	Custom Duties	Tax on Consumption and Product of Goods and Services

	Tax			Value Added Tax		Excise on Industrial Product		Other Taxes	
		Amount	%	Amount	%	Amount	%	Amount	%
1999/00	2420.06	1081.33	44.68	1625.97	42.40	312.76	12.92	0.00	-
2000/01	2870.57	1255.21	43.73	1238.24	43.13	377.12	13.14	0.00	-
2001/02	2873.31	1265.88	44.06	1226.73	42.69	380.70	13.25	0.00	-
2002/03	3248.12	1423.64	43.83	1345.97	41.44	478.51	14.73	0.00	-
2003/04	3626.04	1555.48	42.90	1447.89	39.93	622.67	17.17	0.00	-
2004/05	4103.29	1570.16	38.27	1888.54	46.03	644.59	15.70	0.00	-
2005/06	4346.23	1534.40	35.31	2161.07	49.72	650.76	14.97	0.00	-
2006/07	5214.64	1670.76	32.04	2609.56	50.04	934.34	17.92	0.00	-
2007/08	6206.77	2106.24	33.93	2981.57	48.04	1118.96	18.03	0.00	-
2008/09	8273.12	2679.29	32.39	3970.09	47.99	1622.09	19.61	1.65	0.02
2009/10	11938.93	3521.89	29.50	5492.09	46.00	2414.76	20.23	510.19	4.27
2010/11	13050.69	3571.35	27.37	6166.36	47.25	2633.85	20.18	679.13	5.20
2011/12	15395.16	4339.06	28.19	7093.04	46.07	3001.61	19.50	961.45	6.24
2012/13	18620.23	5693.18	30.58	8341.84	44.80	3623.47	19.46	961.74	5.16
2013/14	22570.34	6798.06	30.12	10111.06	44.80	4541.10	20.12	1120.12	4.96

Source: Economic Survey, 2014/15, Ministry of Finance

Figure: 4.4

Composition of Indirect Tax Revenue



25000
20000
15000
10000
5000
0
Taxes
1999/00
2000/01
2001/02
2002/03
2003/04
2004/05
2005/06
2006/07
2007/08
2008/09
2009/10
2010/11
2011/12
2012/13
2013/14
Fiscal Year
Total indirect tax
Custom Duties
Value Added Tax
Excise on Industrial Product

Table4.10 and Figure4.4 shows that the custom duty and VAT have occupied major portion in indirect tax revenue. The contribution of custom duty to indirect tax is 44.68 percent amounting NRs. 1081.33 billion in FY1999/00. Then it has decreased and reached to 30.12 percent amounting 6798.06 at the end of the study period i.e. FY2013/14. The VAT has become an important source of overall tax revenue. The contribution of VAT has 42.40 percent which is NRs. 1625.97 billion in the FY1999/00. The percentage contribution of VAT has increased and reached to 50.04 percent amounting Rs 2609.56 in the FY2006/07. Then it is continuously decreases and reaches to 44.80 percent which is NRs. 10111.06 billion in the FY2013/14. The share of excise duty is 12.92 percent which is Rs 312.76 billion in the FY1999/00. The contribution of excise duty to indirect tax fluctuates during the study period and finally reaches to 20.12 percent which is NRs. 4541.10 billion. There is no seems the contribution of other taxes in the initial phase of study period. It starts from FY2008/09 in which the contribution of other taxes in FY 2008/09 is 0.02 percent amounting 1.65 billion NRs. The contribution of other taxes is increased and it reaches to 4.96 percent amounting NRs. 1120.12 billion at the last year of the study period which is FY2013/14.

5.6 Contribution of Income Tax

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

Table: 4.11

Contribution of Income Tax

(NRs. in billion)

Fiscal	Income	GDP Basic	Total Revenue	Total Tax	Total Direct

Year	Tax	Price				Revenue		Tax	
		Amount	% of GDP	Amount	% of	Amount	%	Amount	%
2000/01	911.40	41342.9	2.2	4889.39	18.64	3886.51	23.45	1015.94	89.71
2001/02	890.37	43039.7	2.07	5044.56	17.65	3933.06	22.64	1059.75	84.02
2002/03	813.19	46032.5	1.77	5622.97	14.46	4258.70	19.09	1010.58	80.47
2003/04	951.47	50069.9	1.9	6233.10	15.26	4817.50	19.75	1191.26	79.87
2004/05	1046.61	54848.5	1.91	7012.27	14.93	5410.47	19.34	1307.18	80.07
2005/06	1093.94	61111.8	1.79	7228.19	15.13	5743.04	19.05	1396.81	78.32
2006/07	1573.18	67585.9	2.33	8771.21	17.94	7112.67	22.12	1898.03	82.89
2007/08	1907.78	75525.7	2.53	10762.25	17.73	8515.55	22.03	2308.77	82.63
2008/09	2724.74	90952.8	3.00	14347.45	18.99	11705.19	23.28	3432.07	79.39
2009/10	3382.13	108341.5	3.12	17799.09	19.00	15978.53	21.17	4039.60	83.72
2010/11	4135.03	124848.2	3.31	19837.59	20.84	17722.72	23.33	4672.03	88.51
2011/12	5130.30	138748.2	3.70	24437.29	20.99	21172.18	24.23	5777.02	88.81
2012/13	6418.67	152285.3	4.22	29602.11	21.68	25921.49	24.76	7301.26	87.91
2013/14	7560.82	172459.6	4.38	36292.36	20.83	31243.99	24.21	8673.65	86.96

Source: Economic Survey, 2014/15, Ministry of Finance

Figure: 4.5(A)

Contribution of Income Tax to GDP

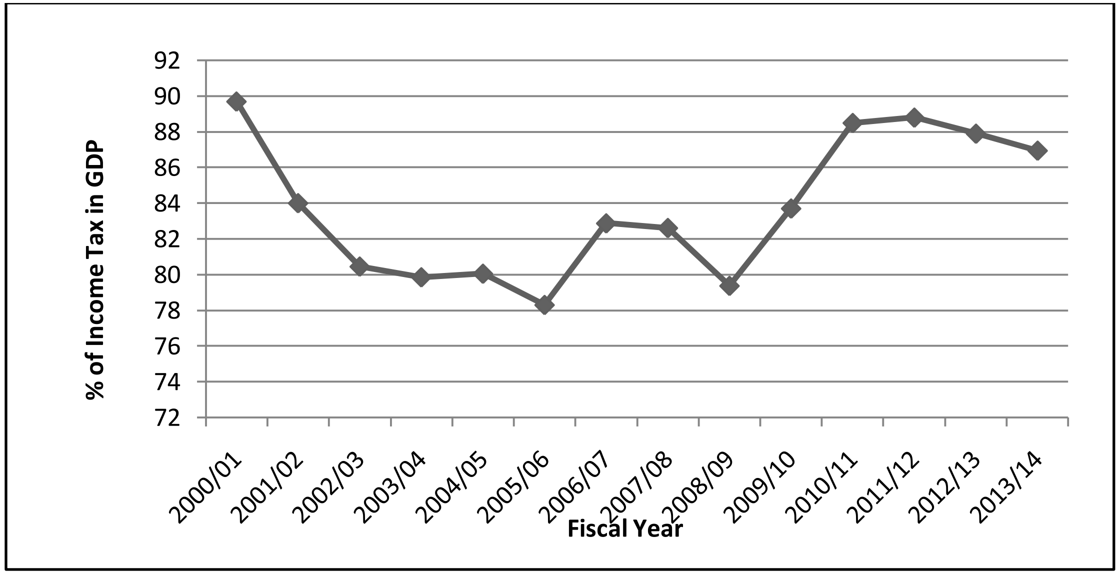


Table4.11 and figure4.5 (A) show the contribution of income tax to GDP over the study period of 9 years. The maximum contribution of income tax to GDP is 4.38 percent in FY2013/14 while the minimum contribution stands at 1.77 percent in FY2002/03. Similarly the average contribution of income tax to GDP is 2.73 percent. In overall the contribution of income tax to GDP is in increasing trend after the FY2002/03 under this study.

Figure: 4.5 (B)

Contribution of Income Tax to Total Revenue

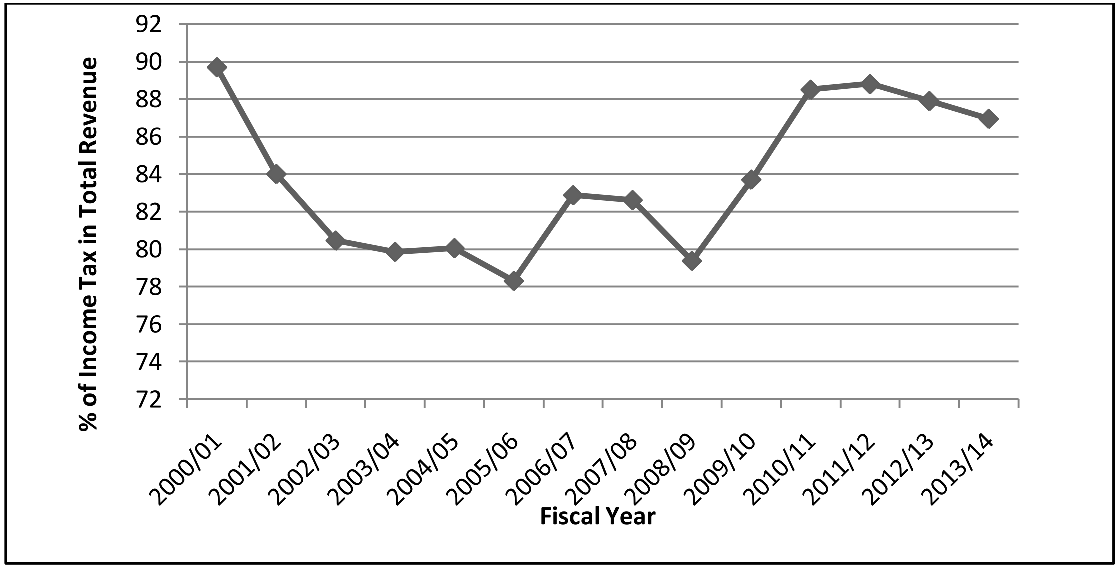


Table4.11 and Figure4.5 (B) show the contribution of income tax to total revenue over the study period of 15 years. The maximum contribution of income tax to total revenue is 21.68 percent in FY2012/13 while the minimum contribution stands at 14.46 percent in FY2002/03. Similarly the average contribution of income tax to total revenue is 18.15 percent. In overall the contribution of income tax to total revenue is in increasing trend after the FY2002/03 under this study but there is little decrease in contribution of income tax to total revenue at the FY 2013/14 which is 20.83 percent.

Figure: 4.5 (C)

Contribution of Income Tax to Total Tax Revenue

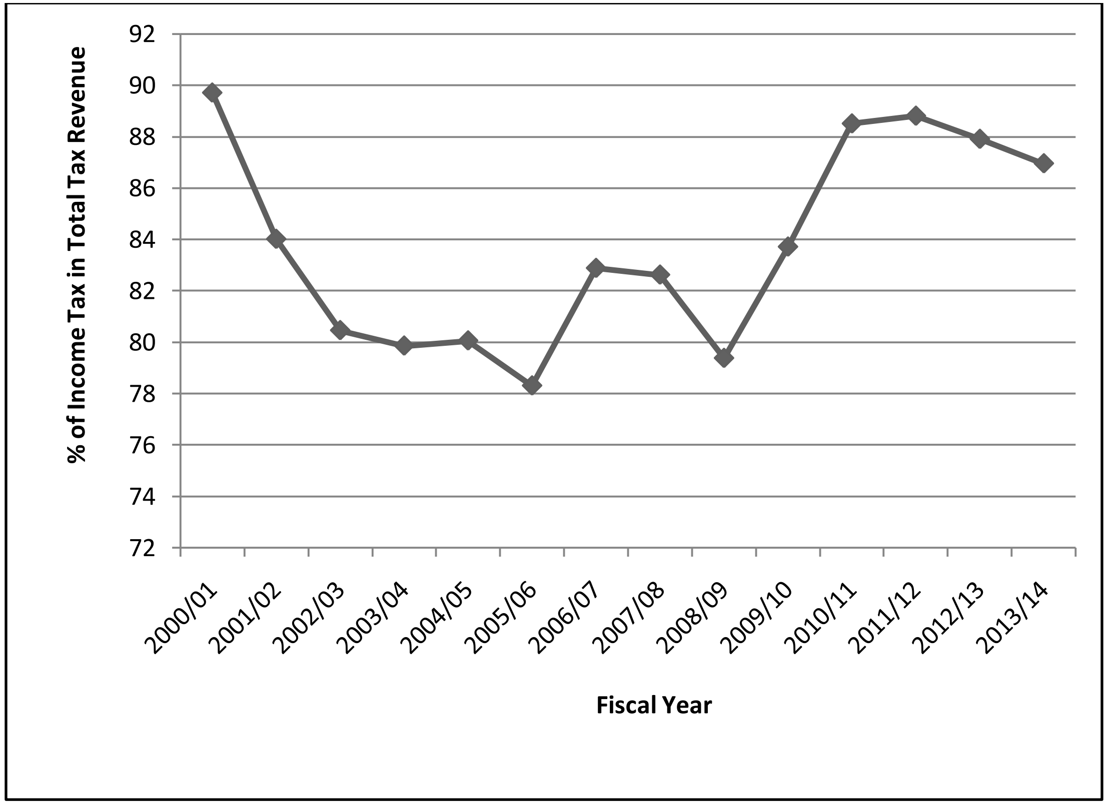


Table4.11 and Figure4.5 (C) show the contribution of income tax to total tax revenue over the study period of 15 years. The maximum contribution of income tax to total tax revenue is 24.76 percent in FY2012/13 while the minimum contribution stands at 19.05 percent in FY2005/06. Similarly, the average contribution of income tax to total revenue is 22.03 percent. In overall the contribution of income tax tototal revenue is in fluctuating trend.

Figure: 4.5 (D)

Contribution of Income Tax to Total Direct Tax Revenue

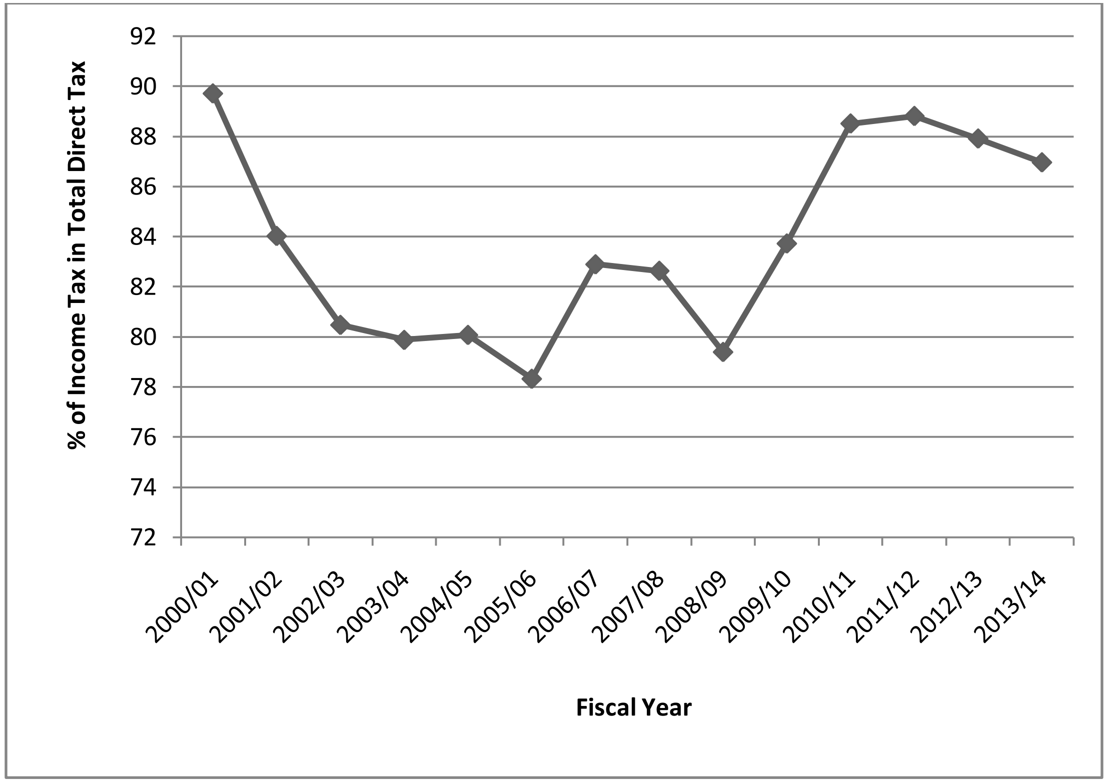


Table4.11 and Figure4.5 (D) show the contribution of income tax to total direct tax revenue over the study period of 15 years. The dominant part of direct tax revenue is income tax. The maximum contribution of income tax to total tax revenue is 89.71 percent in

FY 1999/00 while the minimum contribution stands at 78.32 percent in FY 2005/06. Similarly the average contribution of income tax to total revenue is 83.81 percent. In overall the contribution of income tax to total revenue is in fluctuating trend.

4.7 Trend of Income Tax in Nepal

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

Table: 4.12

Trend of Income Tax in Nepal

(NRs. in billion)

Fiscal Year	Income Tax
2000/01	911.40
2001/02	890.37
2002/03	813.19
2003/04	951.47
2004/05	1046.61
2005/06	1093.94

2006/07	1573.18
2007/08	1907.78
2008/09	2724.74
2009/10	3382.13
2010/11	4135.03
2011/12	5130.30
2012/13	6418.67
2013/14	7560.82

Source: Economic Survey, 2014/15, Ministry of Finance

Figure: 4.6

Trend of Income Tax in Nepal

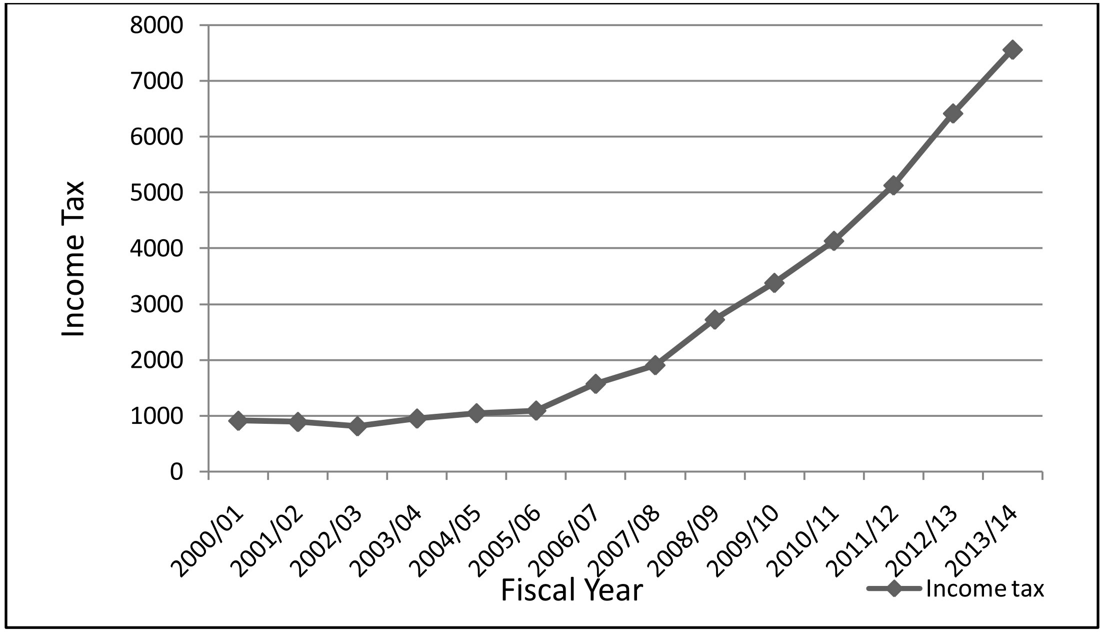


Table 4.12 and Figure4.6 show that the trend of income tax is increasing every year during last 11 year, but in initial 2 year income tax is in decreasing trend.The amount of income tax is NRs.911.40 billion in the FY 2000/01. Then after in FY 2001/02 and 2002/03 income tax is decreases and reached to NRs. 813.19 billion in FY 2002/03. From FY 2003/04 income tax is increasing each year and has reached to NRs.7560.82 billion in the FY 2013/14. It shows nowadays the trend of income tax in Nepal is in positive or growing situation from FY 2003/04, which is right trend for Nepal.

4.8 Relationship between Income Tax and Total Revenue

Table: 4.13

Relationship between Income Tax and Total Revenue

(NRs. in billion)

Fiscal year	Income Tax	Total Revenue
2000/01	911.40	4889.39
2001/02	890.37	5044.56
2002/03	813.19	5622.97
2003/04	951.47	6233.10
2004/05	1046.61	7012.27
2005/06	1093.94	7228.19
2006/07	1573.18	8771.21
2007/08	1907.78	10762.25
2008/09	2724.74	14347.45
2009/10	3382.13	17799.09
2010/11	4135.03	19837.59
2011/12	5130.30	24437.29
2012/13	6418.67	29602.11

2013/14	7560.82	36292.36

Source: Economic Survey, 2014/15, Ministry of Finance

The data presented in table shows that for each value of the income tax and total revenue. The value of income tax and total revenue is random and there is no unique relationship between each other but there exist different types of relationship.

Once we plot the data into graph, we obtain the following scatter diagram.

Figure: 4.7

Relationship between Income Tax and Total Revenue

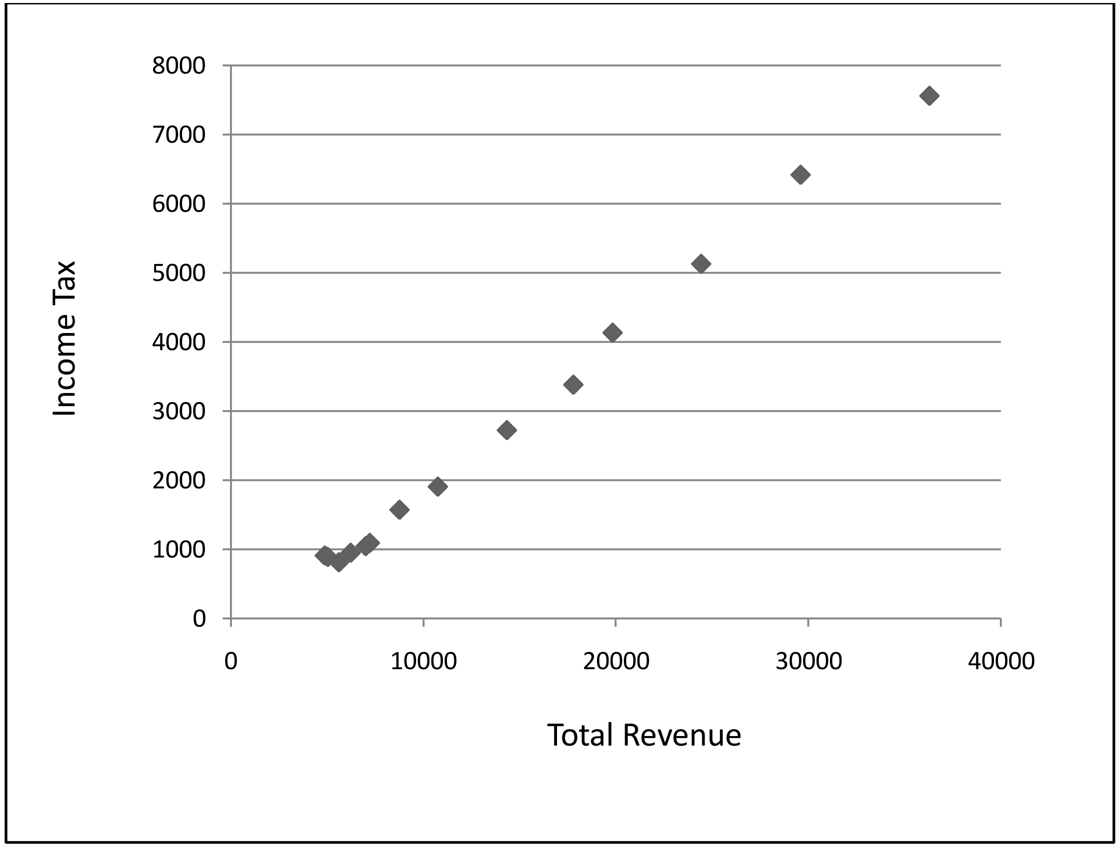


Figure 4.7 shows that scattered points exhibit a tendency to move in upward direction ie. The average total revenue increases as income tax increases. If we join the all scattered point we obtained the line which has positive slope or upward sloping from left to right. All points of this line show the combination of income tax and total revenue in which there is positive relationship between each other.

CHAPTER V

MAJOR FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Major Findings

Nepal is one of the least developed country in the world with low per capita income. Its economic growth rate is very low and 23.8% of total population lying below poverty line. Financial resource gap is the major constraint of the Nepalese economy. In other words there is growing difference between public expenditure and public revenue in Nepalese economy. Due to increasing gap between expenditure incurred and revenue collection Nepal has heavily depend on both the external as well as internal debt to need the budget deficit. Nepalese economy is highly dependent on external loan and internal loans which is considered undesirable for the economy.

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

The major findings of this study are summarized as below:

- There is a dominant share of tax revenue in Nepalese total government revenue. The contribution of tax revenue shows the fluctuating trend as it has contributed 77.29 percent in FY 1999/00 on the total revenue,which increase to 86.06 percent in the FY 2013/14.

- In Nepalese economy tax revenue comprises of direct and indirect taxes. The contribution of direct and indirect tax revenue was 27 percent and

  73 percent respectively in FY1999/00. The contribution of direct tax to total tax revenue is little increase to 27.78 percent in FY 2013/14 whereas the percentage of indirect tax to total tax revenue was little decreased to 72.22 percent in FY 2013/14.

- The major components of direct tax are income tax, house and land tax, property tax, vehicle tax. Among them income tax occupies the large share, which is 89.69 percent of direct tax in the FY 2000/01 as a beginning of the study period and 86.96 percent at the end of study period FY 2013/14.

- The trend of the contribution of income tax to government revenue has been fluctuating trend, which justifies the need to focus on properly implementing the income tax acts for a better revenue generation.

- The tax exemption limit in Nepal has been continuously increased from Rs. 15,000 for an individual, NRs. 20,000 for couples and family in the FY 1992/93 to 1996/97 and increased to NRs. 1,60,000 for an individual, NRs. 2,00,000 for couples and family at the end of the FY 2013/14.

- Corporate income tax, individual income tax and investment income tax are the major types of income tax in Nepal. Corporate income tax is collected from Government Corporations, Public Limited Companies, partnership firms and private limited companies. Individual tax is collected from remuneration, industry and business profession etc and investment tax is collected from dividend tax, interest tax, royalty and rent tax.

- The share of income tax as a percentage of GDP increased from 2.2 percent in the FY 2000/01 to 4.38 percent at the end of study period FY 2013/14. This shows that share of income tax as a percentage of GDP is in increasing trend.

6.2 Conclusion

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

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

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

6.3 Recommendations

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

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

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

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