

# CHAPTER - 1

## INTRODUCTION

### 1.1 General Background of the Study

Nepal is the one of the least developed countries surrounded by two fast growing Asian economies, India and Peoples Republic of China .In its modern history the country opened up to the outside world only in 1950s.The first budget came up in 1951,who also coincides with the inflow of foreign aid in Nepal.. The year 1956 heralds a new era in Nepal's drive at economic modernization. It is the year when Nepal started its first five year national economic development plan. The central bank and the public service commission were also established in the same year.

The economic condition of Nepal is relatively poor than neighbor countries .The economic growth of china is increasing trend on the other side the economic growth of India also in increasing trend. Economic growth rate of both countries affect the Nepalese economy directly and indirectly. In this situation Nepalese economy cannot stay alone without considering these countries economy. On the other hand Nepal had so many Possibilities for financial development. Because Nepal is reach in natural resources. But Nepal has been facing many problems; these are unemployment, poverty, rapid growth of population, Political instability, Lack of development scholar's etc.

The main objective of government of any developing country is to improve Living standard of people through the development process. In order to achieve this objective every government should launch different economic, social, cultural, and other development activities. For this government needs huge amount of financial source. In other words, In developing countries 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 for education or for other development 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 social economic infrastructures. Protection expenditure includes the purchase of arms and ammunition, maintenance of army and police force and administration of justice & Jail. For manage this kind of activities any government needs heavy amount of revenues as financial sources. To meet the growing public expenditure the government has to manage its funds from

different sources. For the prospect of Nepal these sources may be external and internal. External sources of fund are foreign grants and loans. This kind of fund is received from foreign countries and international organizations. External source of funds are more important for underdeveloped and undeveloped countries like Nepal. It is used for economic development, reconstruction, foreign exchange, to recover from the crisis condition etc .But there are many negative results of external source of funds. Nobody becomes ready to provide grants and loans without conditions. External sources are uncertain, incontinent and not good for healthy development of nations because they have to be paid after certain period of time. so internal source of funds are better source than external source .Continuous uses of external sources of funds to raise necessary public fund is not good because it reduces the liquidity position of the government so internal source of fund are more important not only for financing necessary funds but also for mobilization of internal sources. It is better to mobilize internal source rather than looking with beggar's eyes to the donors. Internal source of fund includes debt and revenues. The internal debt collected within the country. The debt financing of the government also known as deficit financing.

The revenue on other hand come basically from two sources Tax and Non Tax. The government collects non tax revenues from various sources such as revenue from public enterprises, especially assessment fees, fines, grants and assistant etc .The tax is main source of government revenues. In general, Tax can be defined as a levy or other type of financial charge or fees imposed by state or central government on legal activities to individuals. The person who pay tax do not get corresponding benefits from the government .Tax sources includes custom duty, excise duty, VAT, income tax.

### **1.1.1 Introduction of Tax Administration: Inland Revenue Department.**

Income tax is administrated directly by the Inland Revenue Department. It is responsible for the implementation and administration of the act. Inland Revenue Department is formed for in 2001 by merging the department of VAT. Currently there are 22 Inland Revenue offices all over Nepal. Inland Revenue department headed by a director general, gazette first class officers who are assisted by two deputy director general and one liquor specialist, who are also gazette level first class officers, 20 gazette level second class officers including chartered accountants and economist and 43 gazette third class officers.

Government of Nepal is the highest authority of the tax administration. Ministry of finance carries out the functions related to taxation on behalf of the government of Nepal. The revenue department of ministry is responsible for formulating tax related policies and co-coordinating the activities of all revenue departments. Similarly, customs department, revenue investigation department, resource administration training center are also involved in the administration of income tax.

### **1.1.2 Historical background of evolution of income tax system in Nepal.**

Great Britain is the first country in the world to introduce the modern income tax. It introduced income tax in 1799 to finance the war fought with France. USA introduced income tax in 1862 to generate revenue to finance civil war. In India, while 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.

Although the tax was collected in various forms in ancient era, the history of modern income tax is not very old in Nepal. The idea of introducing income tax in Nepal originated in the early 1950s when a multy party democratic political system was introduced. In 1951, the then finance minister in his budget speech declared the intention of the government to introduce and income tax.

Attempts were then made to introduce income tax in subsequent years. In 1954, an income tax with Rs. 10000 basic allowance and progressive taxes ranging from 5 to 25 Percent was proposed. Due to political instability, it could not be introduced until 1958.

The first elected government in 1959 finally introduced business profits and salaries tax act, 1960 in Nepal. At that time, income tax was levied only on business profits and salaries. After about three years experience of income tax, the government replaced the prevailing tax act by income tax act, 1962. The coverage was then extended in the act. In 1974, Income tax act, 1974(2031) was enacted. The act classified income sources into five groups (a) Agriculture (b) Industry, Trade, Profession or occupation (c) Remuneration (d) House and compound rents (e) Other sources .However, agricultural income was kept outside the tax net except few years through the finance acts.

The parliament of Nepal enacted income tax act, 2002(2058 B.S.) with effective from 1st April 2002(chaitra 19, 2058 B.S) 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 income tax. This act has replaced income tax act, 1974(2031), which was amended for eight times and existed for a period of 28 years. The government of Nepal framed income tax rules, 2059 in 2059 to help clarifying the act.(*Source: Bhattarai, Ishwor and Koirala, Girija Prasad 2066*)

## **1.2 Focus of the study**

Tax are general contribution of wealth levied upon person, natural on corporate to defray expenses incurred in conferring common benefits upon the residents of states. It is compulsory levy imposed by the government without having any direct personal benefits. Nobody gets any benefits from the government those who paid tax. So theoretical and practical knowledge required to implement and evaluate tax properly.

So this study is closely relates with Nepalese financial status and Nepalese taxation policies .This study analysis and evaluates the Nepalese tax structure and its practice properly. This study also analysis the amount received from tax different years at different heads of income. This study will provide clear idea and knowledge to those persons who are interested to know about Nepalese revenue, tax collection system etc. This study also provides the clear idea about the tax system in Nepal. This study focuses the practical difficulties of tax collection system in Nepal and provides the suggestions of different persons to make effective technique to collect tax .This study also focus to analyze for find out how Nepalese are aware to paid income tax to government from his own income.

## **1.3 Statement of Problem**

Economic development is the prime concern of every nation. To full fill this objective every nation is accomplishing various activities. However developing countries are facing serious problems in the process of economic development. Nepal is not exception to this condition. The government can't operate the development project due to lack of funds. Government expenditure is increasing day by day due to

increase in price level and other circumstances. The government revenues are less than the government expenditures. Most of the industries are not properly in operations because of lack of fund and political instability. The government is not became success to collect internal revenue properly. On the other hands there many negative results of foreign loans. Nepal has been suffering from resources constraint, massive poverty, rapid growth of population, increasing unemployment rate and political instability etc.

To solve these problem the government should be create the maximum employment should be operate. The government can't conduct these works properly without sufficient funds. To generate sufficient fund government should collect tax within country.

Income tax is not collected properly and tax collection expenditure is increasing trend. The problem underlying it is there is not provision of tax education in the secondary level and only a few number of people know about the tax and its importance towards economic development of the nations .Because of the absence of proper knowledge of tax system, Nepalese tax payer's do not make tax planning .Tax evasion and avoidance are increasing tremendously.

The income tax system of Nepal has been criticized in many ways, especially in terms of its policies, laws and management .Nepal is facing very serious problem of income tax management .To fulfill the desired goal, existing short comings in the income tax system must be avoided.

It may some questions summaries as below

1. Why tax rates of corporation cannot be pushed too high for collecting more income tax revenue?
2. The main problem of this study is; what will be measured?
3. What relationship will be examined?

#### **1.4 Objective of the study**

The main objective of this study is to analyze the effectiveness of income tax administration of Nepal. However, the following specific objectives have been set out for the study.

1. To examine the composition of Nepalese tax revenue.
2. To measure the effectiveness of tax administration in Nepal.
3. To identify major problems related to tax administration in Nepal.

## **1.5 Significance of the study**

Nepal is least developed country of the world. The importance of the income tax cannot be minimized in the public finance of a nation. Developing country like Nepal can fulfill its financial income tax can be maximized either by imposing taxes at higher rate or introducing new tax rate or collecting income tax properly within existing portfolio. Increment in income tax rates may be more burdensome to the poor people. Moreover the collection of tax depends on good income tax system (i.e. laws, policy and effective administration). Unfortunately, Nepal's income tax system is not free from the problems. Like the country is heavily dependent on the foreign aids, grants nowadays remittances to undertake its developmental activities. Though this field is of high importance, sufficient timely researchers are not being made in the field so far.

## **1.6 Scope of the Study**

This study will attempt to cover the tax administration system in Nepal. It aims to find out the effectiveness of tax administration in Nepal. However the major areas of the study will be as follows;

1. Structure of government revenue in Nepal;
2. Administrative aspects of income tax in Nepal;
3. Role of income tax in Nepal ;
4. Existing position of income tax in Nepal;
5. Factors affecting in the collection of tax;

## **1.7 Limitation of the Study**

Every study has its own limitations. So this study will also not far from the limitations. Major limitations regarding to the study will be follows;

1. This study will be completed on the basis of primary data collected within tax offices of Kathmandu Valley only.
2. All respondents may not response positively & finding of the study will depend upon the perception of the respondent.
3. This study will cover the data of last ten fiscal years.

## **1.8 Organization of the study**

### **Chapter I: Introduction**

It includes General Background of the study, Statement of the Problem, Objective of the study, Significance of the study, Scope of the study and Organization of the study.

### **Chapter II: Review of Literature**

It is related with review of available literatures in the field of the Study being conducted. This section includes review of the theories of the concerned topic, review of books and review of various empirical studies.

### **Chapter III: Research Methodology**

It includes tool and techniques that will use analysis of the data as well. This chapter includes research design, sources of data, methods of data analysis and various financial and statistical tools.

### **Chapter IV: Presentation and Analysis of data**

It includes Data presentation and Analysis is devoted to the presentation, analysis and interpretation of the study through definite course of research methodology. This chapter also contained major finding of the study.

### **Chapter V: Summary, Conclusion and Recommendations**

It includes summary, conclusion and Recommendation is conclusive and suggestive way and also has described conclusion of the major finding and recommendation for further improvement.

Besides these, bibliography and appendices are presented at the end of the thesis. Similarly acknowledgement, table of contents, lists of tables, list of diagrams, abbreviations are included in the front of this report.

## **CHAPTER-2**

# **CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE**

Literature review is an essential part of the studies. This Chapter basically highlights the conceptual frame work of research, existing legal provisions and existing literature and work related to the present research being conducted with the view of finding out what had already been explained by the previous researchers and how the current research adds further benefits to the field of research. While conducting the research study, previous studies cannot be ignored, so that information would help to check the chances of duplication in the present study. Thus one can find what research studies have been conducted and what remains to go with. It enables the researchers to know.

What research has been done in the subject?

What others have been done in the study?

What theories have been advanced?

The approach taken by the other researchers.

Area of agreement or disagreement.

Whether there gaps that can fill through the proposed research?

This chapter has been classified in to following subgroups.

### **2.1 Theoretical Framework**

The government of a country requires sufficient revenues to carry out development plans to handle day to day administration, to maintain peace and security and to lunch other public welfare activities. In order to carry out such activities, the government collects revenues from various sources such as tax, revenues from public enterprises, special assessment, fees, fines, grants and assistance etc. Among them, tax is the main source of government revenue.

Tax is a kind of money of which it is the legal duty of every citizen of a country to pay honestly. Many economists 3are of the view that the tax is a compulsory payment to the government by taxpayer without any expectation of some specified return.



Tax is compulsory contributions to public authorities to meet the general expenses of the government which have been incurred for the public good and without reference to special benefits.

According to Plehn “Tax are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefit upon the resident of the state.” (Dhakal 1998; 2)

### **2.1.1 Objectives of Taxation**

Taxation has been a very much essential element of a government from the very beginning of the state system. However the main objective of the taxation has been different for different epochs. In the early stage, the main objective of the taxation was to make the state sound in respect of resources. Till the time of Adam Smith the chief motive of collecting the revenue was to provide resources to the government for providing security to an individual and society against violence, invasion and injustice and maintaining public institutions.

In modern days the main objective of taxation has been shifted from security perception to the economic development. The modern objective of taxation is not only to maintain peace and security but also to conduct development activities. We can enumerate the objective of taxation as follows:

- a. To increase the revenue for a welfare state
- b. To have equitable distribution of income and property
- c. To increase the production of particular goods
- d. To increase the employment, saving and investment
- e. To prevent concentration of wealth in a few hands
- f. To minimize regional disparity
- g. To boost up the economy
- h. To implement government policy and
- i. To control the production of certain goods

From the above, we can conclude that the tax has the objectives of raising revenue to have resource mobilization, equal distribution of wealth and income in the society encouragement in production of certain products encouragement in employment , saving and investment, removal of regional imbalances and enforcement of government policy.

### **2.1.2 Concept and meaning of income tax:**

Generally, income means the inflow of cash to the person or firm. Most of the people do not take the kind as an income. It is a best measure of economic well being of a person as well as of nation. Higher income denotes the high living standard and lower income from rendering various types of services, selling goods and producing crops for their own use. Thus income may be cash or kind that is received by a person for livelihood.

The first problem encountered in establishing as income tax is the definition of income. Income, as the economic gain received by the person during the particular period, is most satisfactory defined by Henry Simons as the algebraic sum of two items:

- a. The person's consumption during the period
- b. The net increase in the individual's personal wealth during the period.

It is very much difficult to define the income clearly. So income is exemplified rather than defined income tax laws of various countries. For example, sec 2 of the India Income tax Act,1961 keeps profits and gains, dividend, voluntary contributions received by charitable trust, value of any perquisite or profit on lieu of salary, any capital gain, winning from lotteries, crossword puzzles etc. under the head income.

According to income tax Act 2002, sec.2 (h), income means a person income from any employment, business or investment and the total of that income as calculated in accordance with this Act.

### **2.1.3 Income Tax Management**

In these days, income taxation has become the most important source of national revenue. It is good instrument for resource mobilization in the country. It must be mobilized properly for the achievement of goal of development. To develop the country it needed huge amount and the amount can be collected through income tax.

Many development activities should be under taken each year to fulfill the minimum requirements of people. To collect the targeted revenue income tax management should be sound. Collection of income tax is a difficult task. Therefore sound income tax management helps for planning, directing and collection of income tax.

The first work of income tax management is to identification of objectives and goals and then policy regarding income tax directs to make tax Imposition specifying to whom, how, when and where the tax must be imposed.

### **2.1.3.1 Components of Income Tax Management of Nepal**

The following are the components of income tax of Nepal;

#### **1. Parliament**

Parliament provides different types of acts and supporting laws to impose the income taxation. Legal support is necessary to impose the income tax and to manage the tax administration. Through parliament is not directly associated with day to day operation of income tax management, it is the first and the most important component of income tax management in Nepal.

#### **2. Inland Revenue Department (IRD)**

The Inland Revenue Department is the most important component of tax management in Nepal. Its functions to fulfill the objectives and goals set by the Ministry Of Finance. It launches various programs, plans and policies related to the implementation of income tax. It manages personnel and implements various policies relating to income taxes and other taxes as well as non tax revenue. It also organizes the structure of taxation, manages personnel, improves the systems and controls the defective system and personnel as well.

#### **3. Ministry of Finance (MOF)**

Ministry of Finance of Nepal Government is the highest organization of total taxation management. It concern with the total revenue and expenditure of the government, manages to borrow internal as well as foreign debts as demanded by the budget. The finance ministry is the apex, which administers the income tax including all other tax but of all the management works regarding income tax cannot be finished by MOF itself.

### **2.1.4 Income tax administration in Nepal**

Administration is the design of implementation of government policies. An efficient and effective administration is essential to achieve the target objective of any system. So it is also taken as the heart of any system. Tax administration is regarded as tool for including some responsibility for determining the policies and the programs of government related to tax. Specifically, it is the planning, organizing,

directing, controlling and coordinating of government organizations related to taxation. The shape of tax system in practice is determined to a great extent by the way it is administered. Administrative reform must go hand in hand with structural tax reform, while stressing the central role of administration in successful tax reform in developing countries, attention was drawn to three aspects of tax technology;

- I. The role of administrative incentives.
- II. Costs of taxation & other quantitative questions &
- III. The link between expenditure.

The Inland Revenue Department administers income tax of Nepal. The Ministry of Finance, Customs administration, Revenue investigation administration & the Revenue administration Training center are also involved in the administration of income tax directly or indirectly. The Ministry of Finance is at the apex of the tax administration. It is responsible for overall administration of the government's fiscal & the monetary policy. The Revenue Division of this ministry is responsible for formulation tax policy & setting up appropriate tax administration to implement tax policy. It coordinates the activities of all revenue departments, including the Inland revenue Departments & monitors the positions of revenue collection. It is responsible for the research, planning & analysis of the tax system. The custom administration collects advance income tax on imports. The Revenue Investigation administration investigates cases where revenue leakage was involved, with or without collusion between taxpayers & tax collectors. The Revenue Administration Training Center impacts training, workshops & seminars for tax officials.

Tax administration has become challenging & more complicate with the changing environment of international tax system. Inland Revenue Department has taken the responsibility of administration of income tax. Tax administration was created as the tax Directorate in 1959, the internal revenue department in 1963/64. In 1964, there were tax offices in six places i.e. Kathmandu, Birgunj, Biratnagar, Nepalgunj, Bhairahawa & Janakpur. In Kathmandu there were two offices, eastern & Western. The Tax offices were classified as zonal offices & branch offices over the years. For e.g. there were 12 zonal offices & 12 branch offices & branches offices were converted in to tax offices.

Inland Revenue Department was established in mid April, 2001merging tax department & VAT Department. Forty tax offices under tax department & 17 tax

offices under VAT. Department were also merged. Now there are 21 Inland Revenue Offices & one Large Taxpayers' Office (LTO) and 25 taxpayer's service offices in different places under the Inland Revenue Offices (IRO) all over the nation.

#### **2.1.4.1. Functions of Tax Administration**

The main functions of tax administration are as follows:

##### 1. Registration

The first function of tax administration is the registration of the taxpayer in tax offices. Registration of taxpayer also includes the investigation about taxpayer's activities. After registration a number is given to the taxpayer, which is known as permanent account number (PAN) of taxpayer identification number (TIM).

##### 2. Assessment

The second function of tax administration is assessing the tax. However, tax office is authorized to assess the tax only if the taxpayer doesn't obey the tax law. Tax office assesses the tax only if there is mistake in the assessment made by the taxpayer.

##### 3. Audit

The third function of tax administration is tax audit. Here audit means, auditing the tax assessment form submitted by the taxpayer. Tax audit can be of two types- Prima facie audit and detail audit. In the prima facie audit the tax office examines only the mathematical errors where as detail audit covers site visit audit and the detail examination of the document submitted by the taxpayer.

##### 4. Collection, Refund and Remission

The next function of tax office is the collection of tax amount for this purpose; the tax office can use the banks also. If over collection is made from any taxpayer, the taxpayer should refund the amount. Sometimes, if it is thinks that it is impossible to collect taxes from certain taxpayer, the tax administration can sacrifice the due amount. Such sacrifice is called tax remission.

## **2.2 Legal Provision of Income Taxation in Nepal**

The revenue collection has remained as one of the key activities of the government from ancient time in Nepal. During that time very few economic activities were operated in the country. Hence government could not collect huge amount of money in the form of tax. At that time, taxes were levied to the merchant,

travelers and farmers in the form of cash, kind or labors. In some occasion gold and agricultural products were also paid as taxes but the nature of these taxes were temporary and taxes were raised for special purposes (Regmi 1971; 55)

In the Lichavis regime, income taxes from agriculture income and business were introduced as a direct tax for the first time in Nepal. Tax on agriculture income was called “Bhaga” and tax on business was called “Kara”. Irrigation tax and religious monuments preservation taxes also existed at the time of king Ansubarma of Nepal. During the period of 1768- 1846 A.D, different types of taxes were levied to generate maximum revenue. The major sources of revenue were: Birta and Kipat taxes on land, monopolies customs, transit and market duties, mines and mints and the export of forest products, birds, animals. Taxes were collected at three levels; Royal palace levies, government levies and local levies. The various taxes levied during that period were narrow in base and were imposed primarily on occupations and economic activities, not in income or property. There was no taxation of income in the modern sense of income tax.

During the period of Rana Regime, there was not formal provision for imposition and collection of taxes. Taxes were imposed according to the objectives, needs of the ruling the Prime Minister. There was not provision of separating the personal income of prime minister and state treasury. There was not system of preparing government budget. The surplus of revenue over expenditure was considered the personal income of the Rana prime minister.

The major source of revenue in Nepal till 1951, were land tax, custom and excise duties in the form of lump sum contracts, royalties on forest, royalties on supply of porters and soldiers, entertainment tax and a few other minor taxes. Incomes were not taxed for raising regular revenues of the state treasury but for meting specific expenditure of the house hold of extra ordinary expenditure necessitated by war or other emergencies.

### **2.2.1 Income Taxation in modern Nepal**

After the independence of the country in 1951 (2007B.S), the role of government has changed. Since the government was enforced to operate development activities, besides governing the regular function of maintaining law and order and the collection of revenue (Bhatta and Shrestha, 1981:3). A sound and efficient income tax system is necessary to maximize the revenue collection from income tax. Whole

income tax system is made of three sub system i.e. income tax policy, income tax laws and income tax administration. The government itself through Ministry of Finance determines income tax policy. Income tax policy should be such that the main objectives of the income tax can be attained.

Parliament makes the laws to implement the various policies. The government Levy and collect the income tax in accordance with law. The constitution of the kingdom of Nepal, 1990 has made the clear provision about it. “No taxes shall be levied and collected except in accordance with law” (Constitution of the kingdom of Nepal, 1990). Present legal provision of income tax is associated with constitution of the kingdom of Nepal, 1990; Income tax Act 200; Income tax rules 2002; Finance act of concerned financial year etc.

### **2.2.2 Income Tax Act 2002**

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 income tax, the parliament of Nepal enacted Income Tax Act, 2002 (2058) since, 19<sup>th</sup> chaitra 2058 B.S (first April 2002). This Act was brought in Nepal to avoid the following defects of income tax Act 1974 (Kandel, 2002:11):

- I. Tax was not levied on worldwide income, on capital gain etc. tax base was too narrow.
- II. Income tax related provisions were given in different act such as Employee Provident Fund Act 1962, Citizen Investment Trust Act 1992, Industrial Enterprises Act 1992, and Electricity Act 1992 etc.
- III. There was not provision for controlling transfers pricing, controlling interest expenses, controlling of thin capitalization etc.
- IV. Income tax is the tax of equity. That means persons having same income should impose equal amount of tax and person having lower income should imposed low tax. But under income tax act 1974, tax was levied on the basis of nature of organization, nature of income, nature of person. Natural person's taxable income had declared on the basis of organization's memorandum and objectives rather than transaction.
- V. Penalty rate under income tax act 1974 was very low. It was not appropriate to the present time to control the tax evasion.

- VI. After 8<sup>th</sup> amendment, provision of self-tax assessment was made. But necessary definition, explanation and legal provision related to tax administration was not made. There was not clarity about the accounting system and design and also lack of high penalty who did not maintain account accordingly.
- VII. Act became incapable to fulfill the need of time. So, it became compulsory to replace to it by new Act.

#### **2.2.2.1 Objectives of Income Tax Act 2058:**

Following are the main objectives of Income Tax Act 2058;

- I. Bringing all income generating activities into tax net.
- II. Harmonizing tax rates and concessions on equity grounds.
- III. Widening the tax base.
- IV. Confining all the income tax related matters within the Act.
- V. Making income tax elastic and revenue productive.
- VI. Developing a tax payer-friendly-taxation system by making it clear and transparent.
- VII. Reducing the scope of discretionary interpretation of the tax authorities.
- VIII. Minimizing the tax avoidance and tax evasion.
- IX. Making tax payer more responsible by enforcing the self-assessment systems.
- X. Integrating Nepalese tax system with the tax system of foreign countries.

#### **2.2.2.2 Main features of Income Tax Act 2058**

The act has broadened the tax base. The tax rates are spelled out in the act itself and the tax rates and concessions are harmonized on equity grounds.

- ) A full-fledged self-assessment system is implemented and the presumptive taxation and current year taxation system are strengthened.
- ) The scope of discretionary interpretation of the tax administration is drastically reduced ensuring simplicity, uniformity and the transparency. The act has also defined the power and authority of the tax administration.
- ) The act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the tax payers from criminal liabilities.



- ) The appeal system is further streamlined by making it mandatory for the taxpayers to file an objection with the Inland Revenue Department for administrative review before appealing to the Revenue Tribunal. (Source: *www.ird.gov.np*)

### 2.2.2.3 Tax Rates

The taxable income of a resident individual for an income year 2068/69 will be taxed at the following rates.

Up to Rs. 160000 ----1%

From Rs. 160000 to Rs. 260000 ---- 15% plus Rs. 1600

Above Rs. 260000 --- 25% plus Rs. 16600

Taxable income of a couple, if they choose to be treated as a couple will be taxed at the following rates.

Up to Rs. 200000 ---- 1%

From Rs. 200000 to Rs. 300000 ---- 15% and plus Rs. 2000

Above Rs. 300000 ----25% plus Rs. 17000

Entity implies the following institution or organizations.

- a. Partnership, trust or company.
- b. Village Development Committee, Municipality or District Development Committee.
- c. Nepal Government.
- d. A foreign or political sub-division of the foreign government or a public international organization established on the basis of a treaty.

Dividend means distribution made by an entity.

Procedure for assessment (sec. 33), collection (sec. 35), payment and refund of tax (sec. 37, 38, 39), have been specified.

Provision for fine and penalty has been made (sec. 37a, 59, 60, and 63). The provision of self tax assessment is made for the first time in Nepal.

### **2.2.3 Sources of Income**

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

- a) Business Income
- b) Employment Income and
- c) Investment Income

#### **2.2.3.1 Business Income**

Income Tax Act 2002 has defined the business income for income tax purpose. For the purpose of computing income of business for any year of income, the income of such person shall include as profits or gains made by him from business and should include:

(See Income Tax Act 2002 for Details)

- a. Service charge (sec.7.2)
- b. Sales or disposal of business/trading stock. (sec.7.2)
- c. Net gain from the disposal of person's business assets/liabilities of the business calculated as under chapter 8 (sec.7.2)
- d. Amount received against the disposal of depreciable assets (sec.7.2)
- e. Prize or gift in connection with business. (Sec.7.2)
- f. Amount received instead of acceptance of any restriction regarding business. (Sec.7.2)
- g. Amount included under change of accounting method. (Sec.24)
- h. Excess amount received due to the exchange rate currency. (Sec.28)
- i. Bad debt recovered. (Sec.25)
- j. Proportionate amount under long-term contract. (Sec.26)
- k. Under paid interest amount according to market price. (Sec.29)
- l. Amount received for compensation. (Sec.31)
- m. Other amount received under business income. (Sec.72)

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

- a. Exempt amounts under section 10.
- b. Taxation of dividend under section 54.

- c. Final withholding payments under section 92.

#### **2.2.3.2. Income from Investment**

- a. Any dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from an unapproved retirement payment or retirement fund from approved retirement fund (sec 9.2)
- b. Net gain from the disposal of the person's non- business chargeable assets of investment. (Sec.9.2)
- c. Excess amount of incoming over the depreciation basis including outings on the disposal of the depreciable assets of the investment of the person. (Sec. 9.2)
- d. Gifts or prizes received in connection with investment. (Sec. 9.2)
- e. Retirement contribution including those paid to a retirement funds in respects of the person and retirement payments on respect of investment (sec. 9.2)
- f. Amount received instead of acceptance of any restriction regarding investment (sec. 9.2).
- g. Amount included under change of accounting method (sec. 24).
- h. Excess amount received due to exchange rate currency (sec. 28).
- i. Bad debt recovered allowed previously (sec. 25)
- j. Proportionate amount under long-term contract (sec. 26).
- k. Under paid interest amount according to market price (sec. 9.2).
- l. Amount received as compensation (sec. 31).
- m. Other amounts required being included on tax accounting or quantification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business (sec.9.2).

#### **The following amounts are excluded income from investment for tax purpose:**

- a. Exempt amounts under section 10.
- b. Taxation of dividends under section 54.
- c. Final withholding payments under section 92.
- d. Amounts that is included in calculating the person's income from any employment or business.

**Admissible Expenses (Expenses allowed for deduction):**

- a. All the expenses are allowed to deduct provided that the expenses are made by the same tax payer in the same year in the production of income (sec. 13)
- b. Interest on loan taken for the business purpose is deductible. However the amount of such interest will not exceed 50% of the tax payer's taxable income for the year calculated without including the interest received or without deducting any interest incurred by the tax payer in case of the person controlled by tax exempt entity (sec.14).
- c. The cost of trading stock is deductible. The allowable for trading stock is calculated by adding opening value of stock plus purchase value minus closing value of trading stock (sec. 15).
- d. The cost of repair and improvement of the depreciable assets used in business or investment are deductible such costs do not exceed 7% of the depreciable basis of the pool at the end of the income year (sec. 16).
- e. The act has allowed deducting pollution control device cost to the extent of 50% of the taxpayer's adjusted taxable income of the concerned year. Non-deductible cost can be capitalized depreciable asset under group 'D' in subsequent year (sec. 17).
- f. Act has allowed deducting research and department costs. If the expenditure is more than 50% of the taxable income of the concerned year. Remaining amounts can be capitalized as depreciable asset under group 'D' in subsequent year (sec.18).
- g. Depreciation of the depreciable assets used in business for the income year computed under the schedule 2 is allowed for deduction (sec.19).
- h. The loss can be set off from the profit of any business or investment in the same year in one hand and of the same business in subsequent four years while calculating the income in the other (sec. 20).

**Following are the Expenses not allowed for deduction Sec 21:**

1. Any personal/domestic expenses.
2. Income tax/ fine and penalty.
3. Dividends.

4. Reserve/ provision/funds (except special reserve created by a bank up to 5% of outstanding loan).
5. Expenses for earning non-taxable income of final withholding payments.
6. Expenses not related to business.
7. Cash payments in excess of Rs 50,000 at a time having annual transaction more than Rs 2000000.
8. Others: Capital Expenditure and Capital loss.

### **2.2.3.3 Income from Employment**

Income tax act 2002 has defined the remuneration income for income tax purpose. According to sec.8 of the act, an individual income from employment for an income year is the individual's remuneration from employment of individual for the year. According to this section, the remuneration received by a person from the employment is as following payments made by the employer (sec. 8):

- a. Payments of wages, salary, levy pay, overtime pay, fees, commission, prizes, gifts, bonuses and other facilities.
- b. Payments of allowances including any cost of living, rent entertainment and transportation cost.
- c. Payments of reimbursement of cost incurred by the individual or an associate of the individual.
- d. Payments for the agreement of any conditions of the employment.
- e. Payments for the termination or loss or compulsory retirement.
- f. Retirement contributions including those paid by the employer to the retirement fund in respect of the employer and retirement payments.
- g. Other payments in respects of the employment.
- h. Other amount as given in chapter six of the perquisites and gains due to the change in tax accounting required to be included.

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

- a. Prizes and gifts.
- b. Other payments made in respects of employment.
- c. The amount of difference of the interest of interest on loan paid by employer lower rate than the market rate.
- d. Market value of the assets in case of the transfer of the assets.

- e. For the payment other than stated above the value of benefit of the payment to the third person.

### **Excludable amount in the Employment Income**

While computing the net income from employment of natural person, the following amounts are excluded on employment income:

- I. Amounts exempt under section 10 and final withholding payments.
- II. Meals or refreshment provided in premises operated by or behalf of an employer to the employer's employees that are available to all the employees in similar terms.
- III. Payments of prescribed small amounts, which are so small and thus unreasonable or administratively impractical to make accounting for them.

### **2.2.4 Methods of Income Tax Assessment:**

Income tax Act, 2058 has specified 3 types of assessments. They are as follows:

1. Self Assessment (sec.99)
2. Jeopardy Assessment (sec. 100)
3. Amended Assessment (sec.101)

#### **1. Self Assessment:**

Act has fully applied the self-assessment of tax system. It has made more responsible to taxpayer. It reduces the compliance cost. Under this system, taxpayer himself determines his tax liability with fine and penalty.

#### **2. Jeopardy Assessment:**

Under the section 100 of the act, the provision of jeopardy assessment is made. The department will make jeopardy assessment when the person becomes bankrupt, is wound up, or goes into liquidation, the person is about to leave Nepal indefinitely, the person is otherwise about cease activity in Nepal, or the department otherwise consider it appropriate. Whereas assessment is made under the Jeopardy Assessment with respect to full income year, the assessed person will not fill return of income for the year, however with respect to part of an income year, the assessed person is still required to file a return for the income year. Where the department makes a jeopardy assessment, it should serve of the assessment on the person.

### 3. Amended Assessment:

Tax department may amend an assessment made by the taxpayer under section 101. Department may re amend the amended assessment. The department may not amend as assessment if the assessment has been amended or reduced pursuant to an order the Revenue Tribunal or court of competent jurisdiction except where the order reopened.

#### **2.2.5 Appeal:**

A person who is not satisfied with the decision of tax officer concerning income tax has the right of Appeal.

##### **Appeal to Director General:**

A person who is aggrieved by a reviewable decisions have the right of appeal against such order to with the department within 30 days after the decision is made while filing the appeal the tax payer is required to deposit half of the amount of the tax payable.

##### **Appeal to Revenue Tribunal:**

If any taxpayer who is aggrieved by the decision made in the appeal to director general may appeal to the Revenue Tribunal in accordance with the Revenue Tribunal Act, 1974. If the person has appealed, he should file a copy of the notice of appeal with the department within 15 day. However, the operation and enforcement of an objection decision is not stayed or otherwise affected by an appeal. If Director General of the department has made the decision relating to administrative review, the appeal to Revenue Tribunal would effective.

If any taxpayer who is aggrieved by the decision made in appeal to Revenue Tribunal may appeal to the Appeal court. A taxpayer or the tax officer who is not satisfied with the decision made by Appeal court has the right to appeal in the Supreme Court.

#### **2.2.6 Fines and Penalties:**

##### **a. Penalty for Failure to Maintain Documentation or File Statements or Return of Income:**

A person who fails to maintain proper documentation for an income year or file return for an income year is liable to pay fees for each month and part of month during which the failure continue. The rate of fees would be as the highest of 0.1% per annum of the person's assessable income with a gross of any deductions or

Rs 1000 per month whichever is higher. Accordingly, a withholding agent who fails to file a statement as required is liable to pay a penalty at 1.5% per annum applied to the amount of withheld for each month and part of a month during which the failure continues.

**b. Interest for Understating Estimated Tax Payable by Installment:**

A person who understates estimated tax payable by installment basis is liable to pay interest for each month and part of a month from the date the first installment is payable until the date the tax is payable on assessment. The amount of interest is calculated at the standard interest rate.

**c. Interest for Failure to pay Tax:**

A person who fails to pay tax on or before the date on which the tax is payable is liable to pay interest for each month and part of a month for which any of the tax is outstanding calculated as the standard interest rate applied to the amount outstanding.

**d. Penalty for making False or Misleading Statement:**

A person who makes statement to the department that is false or misleading in a material particular or omits from a statement made to the department any matter or thing without which the statement is misleading in a material particular, is liable for penalty as follows:

- a) Where the statement is happened to be false or misleading without knowingly or recklessly, 50% of the underpayment of tax; or
- b) Where the statement is made false or misleading knowingly or recklessly, 100% of the under payment of the tax.

**e. Penalty for Aiding and Abetting:**

A person who knowingly or recklessly aids or abets another person to commit an offence related to failure to comply with this act, failure to pay tax, makes to false or misleading statements or impends tax administration to counsels or includes another person to commit such an offences, is liable for penalty equal to 100% of the under payments of tax.



## 2.3 Review of Related Studies

### 2.3.1 Review of Thesis

**Koirala, Girija Prasad (2004)** done research work entitled “*Contribution of Employment Income to Income Tax Revenue of Nepal*”.

- ) From this research he wants to analyze the role of employment income i.e remuneration income in income tax revenues in Nepal and other income tax related phenomena.
- ) He declares that from this thesis, the income tax collection policy of the government is not efficient.

**Bastola, Pabitra (2007)** Conducted a research entitled “*Role of income tax in National economy and income tax management in Nepal.*”

The main objectives of her thesis work are as follows:

- ) To find out the share of income tax to government revenues.
- ) To examine the Nepalese income tax structure.
- ) To review the trend of income tax collection and tax revenue as well.
- ) To indentify the factors to increase taxpaying habit of income tax payers.
- ) To identify the problems of income tax management.

The major findings of her study are as follows:

- ) Income tax is a suitable source of mobilizing internal resources.
- ) The major objectives of income tax are to meet the revenue requirement of the governments, promote distribute justice and promote private sector investment.
- ) Income tax system in Nepal is not efficient due to inefficient income tax management, inadequate income tax policy and defective income tax act.
- ) Corporate tax rate in Nepal is suitable.
- ) Contribution of direct tax and indirect tax to the total tax revenue is 21.9% and 78.1% respectively.
- ) Contribution of income tax to GDP is only 2.11%.
- ) Contribution of income tax in total tax revenues is in an average 19%.

**Barakoti, Krishna Raj (2008)** submitted a thesis “*Effectiveness of Income Tax System in Nepal*”. According to his thesis he had analyzed the effectiveness of income tax in Nepal and what is the effectiveness of tax administration in present situation. He also writes about present problems in revenue collection and he has given some suggestion. The main objectives of his study are as follows;

- ) To analyze the effectiveness of income tax system in Nepal,
- ) To evaluate the contribution of income in national revenue,
- ) To evaluate present tax administration etc.

His major findings are;

- ) The study shows that the contribution of tax revenue to total revenue is 79.45% and non-tax revenue is 20.55% in FY 2006/07.
- ) The contribution of direct tax is 26.14% and indirect tax is 73.86% in 1999/2000 which become 24.32% and 75.68% in FY 2006/07.
- ) The contribution of customs, excise duty and VAT on indirect tax revenue was 35.30%, 14.97% and 49.72% in FY 2006/07.

**Shrestha, Akhanda (2009)** conducted thesis work on title “*Revenue Collection from Income Tax & its Practical Differences in Nepal*”.

The main objectives of his research work are as follows:

- ) To find out the revenue collection in different year.
- ) To review the tax collection system.
- ) To find out the contribution of income tax to national revenues.
- ) To find out the problems in tax collection system.
- ) To provide suggestions for effective tax collection.

Major findings of his research work is divided into two parts, major findings from primary data and from secondary data. According to my review, the major findings of his research are as follows:

- ) Government expenditure is in increasing in trend.
- ) Increment in the number of tax payers are very much essential in order to boarden the tax base.
- ) Income tax is suitable means of raising government revenues.

- J Public awareness programme is necessary to increase tax consciences and raising the government revenues.
- J Mass poverty and low income level, increasing habit of tax evasion, inefficient income tax administration etc. are the major reasons for the low contribution of income tax to national revenues.
- J Contribution of direct tax to total revenues is not effective.
- J Progressive income tax rate is considered as the suitable means of tax in Nepal.
- J Income tax system of Nepal has not reached at the satisfactory level yet.

**Adhikari, Ramesh (2010)** conducted a study entitled “*A Study on Corporation Income Tax in Nepal*”. The objectives of his study were;

- J To study and evaluate the status of income tax as major source of revenue.
- J To examine the Nepalese income tax structure.
- J To review and analyze the trend of income tax collection and tax revenue.
- J To identify the factors to increase taxpaying habit of income tax payer.
- J To evaluate the problems of income tax management.

His major findings are;

- J The share of tax revenue has always been greater than the share of non-tax revenue.
- J The contribution of indirect tax has been always greater than direct tax revenue during the study period from 2000/01 to 2008/09.
- J Income tax is an important source of direct tax. Its structure of Nepal is the composition of tax from government sector, public sector, private corporate bodies and remuneration tax.

**Sapkota, Umesh (2010)** conducted the research work entitled “*Resource Mobilization through income tax in Nepal*”

The main objectives of his research is as follows:

- J Role of income tax in resource mobilization in Nepal.

- ) To compute elasticity of income tax in Nepal during the period 1990/91 to 2007/08.
- ) To analyze the legal aspect of income tax in Nepal.
- ) To project future trend of income tax in Nepal.

The major findings of his research work are as follows:

- ) There is poor performance of domestic resource mobilization.
- ) Contribution of tax revenue to GDP was 10.1%.
- ) Contribution of direct tax and indirect tax revenue where 16.75% and 83.24% respectively in fiscal year 1990/91, which contributed 27.1% and 72.9% in fiscal year 2007/08.

**Bhandari, Dipak Raj (2011)** conducted the thesis work entitled “*Effectiveness of Income Tax Collection and its Role in Total Tax Revenue of Nepal*”

The Main objectives of his research are as follows:

- ) To analyze the contribution of income tax to total tax revenues and national revenues of Nepal.
- ) To examine the effectiveness of income tax revenue collection in Nepal.
- ) To review the trends of income tax collection and tax revenue as well.
- ) To find out the problems of income tax system.
- ) To analyze the legal aspect of income tax in Nepal.

Major findings of his research are as follows:

- ) Tax is the main source of government revenues, In Nepal in an average 80% of the government revenue comes from taxation.
- ) In an average, role of income tax in total tax revenues is 20%.
- ) VAT is the main source of tax in Nepal. In an average role of VAT in total tax revenues is 63%.
- ) Role of tax revenues in GDP is around 11%.
- ) Income tax collection growth rate is very slow therefore effectiveness of income tax collection is not significant.

### **2.3.2 Review of Books and Articles**

**Bhattarai, Ishwor and Koirala, Girija Prasad (2066)** in this book entitled “*Taxation in Nepal with Tax Laws and Tax Planning*” as a academic books for MBS/MBA has analyzed the legal aspect of income tax with updating financial

directions and regulations have presented the legal provision as well as practical aspects related to income tax and VAT. A simplified version of income tax act 2058 are given in summarized form at the end of part A and part C respectively in this book. While studying this book, I felt that this book wants to provide the readers the knowledge of the major provisions of those acts at a glance.

**Dhakal, Kamal Deep Dhakal (2002)** wrote his revised edition of his book, “*Aayakar Tatha Ghar Jagga kar sambandhi Kar ra Lekha.*” This book was based on Income Tax Act 2031. This book is very much useful in getting knowledge about the history of taxation and the practice under previous Act.

**Mallik (2003)** in this book entitled “*Modern Taxation System in Nepal*” has presented the history of modern income tax periodically from the very beginning to income tax act 2002 with the justification of changes and amendments made in the act and regulation. The author has presented income tax act 2002 in simple and clear crystal manner with suitable examples and explanations where ever necessary.

**Amatya, Surendra Keshar, Pokharel, Dr. Bihari Binod and Dhakal, Rewanta Kumar (2004)** wrote a book entitled “*Taxation in Nepal.*” Amatya, Pokharel and Dhakal have described the provisions made under income tax laws. This book is divided in thirty-one chapters in their book. They have described about income tax and its development in Nepal, tax accounting qualification, allocation and characterizing of amounts exemptions, concession and tax rates, expenditure expressly disallowed for deduction, capital or revenue incomes and expenditure. Taxpayer have special provision for natural person and entity, investment income need and sources, income from employment and from business, set off and carry forward of losses, net gain, international taxation, right and duties of tax payers, appeal property tax in Nepal. This book has been written to fulfill the course requirement of Tribhuvan University. It is based on BBS 3<sup>rd</sup> year/Law/CA and it also for MBS.

**Agrawal, Jagadish (2004)** published a book named “*Income Tax: Theory and Practice.*” This book is useful to anyone who is interested in the subject of taxation. In this book Agrawal has explained Income Tax Act 2058. The book is also sources of

information of the subject of income tax. He brief explain the new terms and provisions, for examples, foreign Permanent Establishment, controlled Foreign Entities, Transfer pricing, Non Business chargeable Assets, Qualification, Allocation and characterization of Amounts etc.

**Mr. Saroj Raj Regmi (2007)** in his article entitled “*Income tax evasion is a crime in Nepalese Legislation*” has explained that the current trend of collection of income tax & the contribution of it in the national revenue is far from satisfaction. This study has also suggested tax law with particle solutions & well set up mechanisms. (Regmi; 2007)

### **2.3.3. Research Gap**

There are so many research work has been done regarding taxation in Nepal. This research work is mainly focused to the income tax. Primary as well as secondary data is used in this study. Opinion survey method is the main technique of collecting primary data for this study. This is my original research work which will prove from description and analyzing style of this research work. At least this study will be different from the above in terms of data, description area, data presentation and analysis style, research methodology and interpretation style.

## **CHAPTER - 3**

### **RESEARCH METHODOLOGY**

This chapter is devoted to the research methodology applied in the study of achieve the goals and objectives. This is concerned with detail discussion of the methodology used in this study by covering the procedure of getting research problems answer as per the objectives. There are five parts as Research Design, Population and Sampling, Nature and Source of Data, Data collection Procedure and Data processing and analysis Procedures.

#### **3.1 Research Design**

Research design is an overall plan or framework for the collection and analysis of data. Research design provides the framework for the study and guidelines for the collection and analysis of data. According to Kerlinger, “Research design is a plan structure and strategy of investigation so as to obtain answer to research questions and to control the variance.”

To achieve the stated objective of the study, primary information is collected through structured questionnaire. The opinions of tax administrations, tax experts and taxpayers are also included in the research as primary information. Therefore, this research is an empirical research. The collected data from primary as well as secondary sources have been described and analyzed using different tools. So, the study follows the described as well as analytical research design. In this way the research design of this research is descriptive, analytical and empirical.

#### **3.2 Population and Sample**

In order to fulfill the objectives of the study 120 persons have been considered as total sample. Tax administrators, tax experts and taxpayers are considered as the total population. Out of 120 persons: 40 tax administrator, 40 tax experts, and 40 taxpayers have been considered as the target sample for the study. Persons included in the sample are carefully selected by consultation with lectures and best judgment of the researcher. The respondents have been divided into three groups. The following table shows the groups of respondents and size of samples.

**Table No.3.1: Group of Respondents and Size of Samples**

<b>S.N</b>	<b>Group of Respondents</b>	<b>Sample Size</b>	<b>Code Used</b>
1	Income Tax Administrators	40	A
2	Tax Experts	40	B
3	Tax Payers	40	C
	<b>Total</b>	<b>120</b>	

### **3.3 Data Collection Procedure**

Data and information used in this study is collected from primary and secondary sources. To get accurate and actual information in time all questionnaires were distributed and collected personally through field visit. The secondary data are collected by visiting Inland Revenue Office, visiting library, Economic Survey of Ministry of Finance, Budget Speeches, Thesis, Reports, Magazines, Books etc.

### **3.4 Nature and Sources of Data**

Necessary data information to describe this study has been collected from primary as well as secondary sources. The major sources of data are as follows:

#### **3.4.1 Primary Data**

Primary data and information have been collected through administering structured questionnaire to sample of population. The same questionnaire was distributed to all respondents. Tax administrators are selected from tax department and various sectors of tax offices. Tax experts are the lecturer, auditor, chartered accountants etc. Tax payers are selected representing various sectors i.e. manufacturing company, trading company, private banks, insurance company, finance company, department store etc.

#### **3.4.2 Secondary Data**

Secondary data and information are obtained from various sources specified as below:

1. Economic survey and budget speeches Ministry of Finance, Government of Nepal.
2. Report and records of Inland Revenue Department.
3. Published documents of Nepal Rastra bank and Planning Commission, Kathmandu.



4. Dissertations, published articles on different journal news magazines.
5. News papers, published articles on different journal news magazines.
6. Different publications of Central Bureau of Statistics.
7. Internet, E-mail.
8. Various books written by tax officers and scholars related to income tax.

### **3.5 Data Processing and Analyzing Procedure**

Data collection from various sources cannot be directly used in their original form. Further they need to be verified and simplified for the purpose of analysis data. Information figures and tabulated for computation. Data are analyzed and interpreted using different tool like: Tax GDP Ratio, Simple Average, Percentage, graphs, charts, diagrams and other tools which are related to the study.

## **CHAPTER - 4**

### **PRESENTATION AND ANALYSIS OF DATA**

This is the major chapter of the study. In this chapter, the data related to the study have been tabulated, presented, analyzed and interpreted. The reliability of the study depends upon the data available and sources of data.

#### **4.1 Analysis of Secondary Data**

Secondary is defined as data collected earlier for a purpose other than the one currently being pursued. Secondary data are often in the form of raw data and published materials. However, the unpublished data such as records or statistics gathered or compiled by others prior to the study are secondary data. In this section data collected from different sources such as IRD, CBS, MOF, NRB etc. has been presented in tabular form/diagram/chart and analyzed.

##### **4.1.1 Resource Gap in Nepal**

Like other developing countries in the world, Nepal has been suffering from resource constraint, mass poverty rapid growth of population, aggressive dependence on agriculture, subsistence living standard etc despite over four decades planned development efforts.

In Nepal the resource mobilization is still poor that does not cover the growing expenditure of the government instead of the low revenue performance in Nepal. That is why the country is facing the increasing burden of foreign loan. Widening trend of the different resource gap is shown in table 4.1

**Table No. 4.1**  
**Resource Gap in Nepal**

(Rs. In Million)

<b>Fiscal Year</b>	<b>Total Expenditure</b>	<b>Total Revenue</b>	<b>Resource Gap (A)</b>	<b>Foreign Grants</b>	<b>Resource Gap (B)</b>	<b>Foreign Loans</b>	<b>Resources Gap (C)</b>
	<b>(A)</b>	<b>(B)</b>	<b>(A-B)</b>	<b>(C)</b>	<b>(A-(B+C))</b>	<b>(D)</b>	<b>(A-(B+C+D))</b>
2000/01	79835.10	48893.80	30941.30	6753.40	24187.90	12044.00	12143.90
2001/02	80072.20	50446.60	29625.60	6686.10	22939.50	7698.70	15240.80
2002/03	84006.10	54538.90	29467.20	11339.10	18128.10	45460.40	13581.70
2003/04	89442.60	62331.00	27111.60	11283.40	15828.20	7629.00	8199.20
2004/05	102560.40	70112.70	32437.70	14391.20	18046.50	9266.10	8780.40
2005/06	110889.20	72281.90	38607.30	13827.50	24779.80	8214.30	16565.50
2006/07	133604.60	87712.10	45892.50	15800.80	30091.70	10053.50	20038.20
2007/08	161349.90	107622.50	53727.40	20320.70	33406.70	8979.90	24426.80
2008/09	219662.00	143474.50	76187.50	26382.80	49804.70	9968.90	39835.80
2009/10	259689.10	179945.80	79743.30	38545.90	41197.40	1123.40	29974
Average	132111.12	87736.98	44374.14	16533.09	27841.05	7759.26	.18878.63

*Source: Economic Survey Fiscal Year 2009/10, 2010/11 (page no. 22-27)*

**1. Resource GAP (A) = (A-B)**

As shown in the table resource gap 'A' was Rs 30941.3 million in the F/Y 2000/01 and Rs. 79743.3 million in the FY 2009/10. The average resource gap was Rs. 44374.14 million for last 10 year. The amount of resource gap was increasing trend up to FY 2001/02 and the amount was Rs. 29625.6 million. In the FY 2003/04 resource gap was decrease in Rs. 27111.6 million and then resource gap in increasing 32437.30 million in FY 2004/05, the amount was Rs. 79743.3 million in F/Y 2009/10.

**2. Resource GAP (B) = [A- (B+C)]**

This resource gap is taken as the different between total expenditure and total revenue plus foreign grants. In the FY 2000/01 the gap was Rs. 2418709 million which was decreased in to Rs. 15828.2 million in FY 2003/04 which was due to the high proportionate incriminate in foreign grants strum Rs. 11283.4 million in the

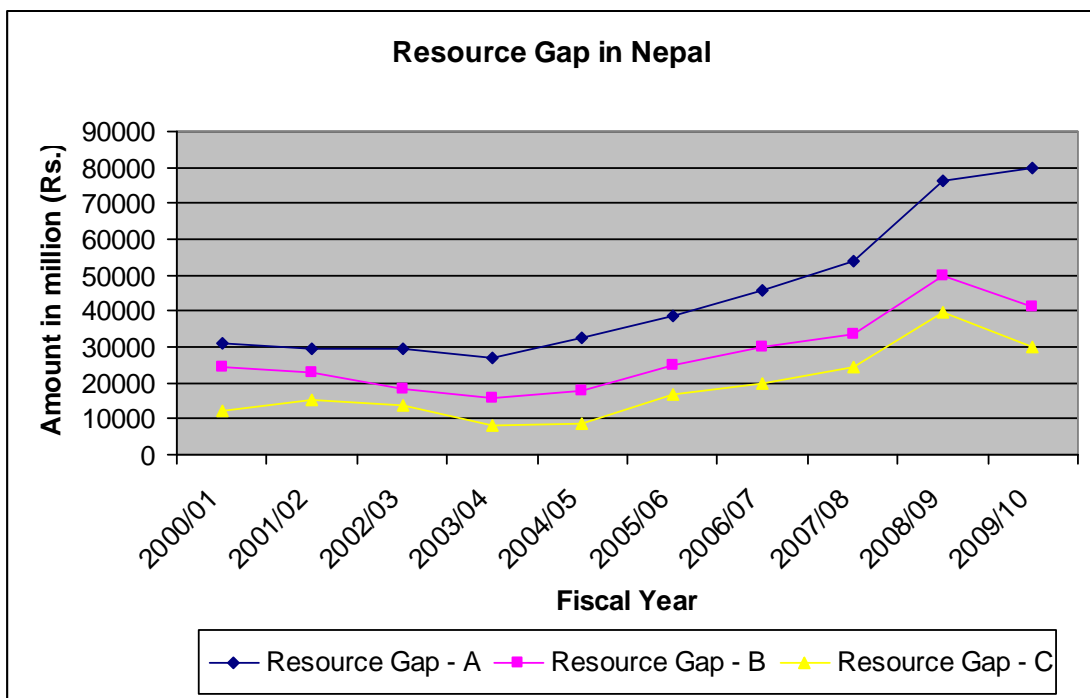
fiscal year 2003/04 . And then after the amount of resource gap was increasing trend up to Rs. 41197.4 million in fiscal year 2009/10. The average resource gap was Rs. 27841.05 million for the 10 years.

**3. Resource GAP (C) = [A- (B+C+D)]**

This resources gap is taken as the different between total expenditure and total resource plus foreign grants plus foreign loan. In the F.Y. 2000/01 the gap was Rs. 12143.9 million, it is increase to Rs. 15204.8 up to in fiscal year 2001/02 and then decreasing to Rs. 13581.7 million in fiscal year 2002/03 and Rs. 8199.2 million in fiscal year 2003/04. and then resource gap is increasing Rs. 8780.4 million in fiscal year 2004/05, the amount was Rs. 39835.8 million in fiscal year 2008/09. And fiscal year 2009/10 the resource gap is decreased in Rs. 29974 million. It shows that the resource gap was fluctuating in fiscal year 2000/01 to fiscal year 2009/10. The average resource gap was Rs. 18878.63 million for 10 years

We can show the resource gap in following diagram.

**Figure 4.1 Resource gap in Nepal**



#### 4.1.2 Revenue GDP Ratio

Total revenue to GDP ratios, tax revenue to GDP ratios and non tax revenue to GDP ratios for the period of last ten years have been presented in the table no. 4.2

**Table No. 4.2 Revenue GDP Ratio in Nepal**

(Rs. In Percent)

<b>Fiscal Year</b>	<b>Total Revenue GDP Ratio</b>	<b>Tax Revenue GDP Ratio</b>	<b>Non Tax Revenue GDP Ratio</b>
2000/01	11.83	9.40	2.43
2001/02	11.72	9.14	2.58
2002/03	11.50	8.7	2.80
2003/04	11.60	9.00	2.60
2004/05	11.90	9.20	2.70
2005/06	11.10	8.80	2.30
2006/07	12.10	9.80	2.30
2006/08	13.20	10.40	2.80
2008/09	14.50	11.80	2.70
2009/10	15.40	13.30	2.10
Average	12.485	9.954	2.531

*Source: Economic Survey Fiscal Year 2009/10, 2010/11 (page no. xx, vol. 1)*

From the above table the total revenue to GDP ratio was 11.83% in fiscal year 2000/01.. It reaches 11.50% in fiscal year 2002/03. similarly 11.90% in F/Y 2004/05, after fluctuating 11.10%, in fiscal year 2005/06, then after continuously increasing by 12.10%, 13.20%, 14.50% and 15.40% in fiscal year 2006/07, 2007/08, 2008/09 and 2009/10 respectively. The average ratio to revenue-GDP was 12.485%. Similarly tax revenue and non-tax revenue ratio with GDP was 9.40% and 2.43% respectively in fiscal year 2000/01. it reaches to 13.30% and 2.10% in fiscal year 2009/10. The average ratio of tax revenue and non-tax revenue with GDP was 9.954% and 2.531% respectively.

### 4.1.3 Nepalese Government Revenue Structure

Government collects revenue from different sources. Basic sources of the government revenue are classified into tax and non-tax revenue. Nepalese economy is characterized by a low revenue performance in contrast to growing public expenditure, the composition of government revenue since last 10 years is presented in the table no. 4.3.

**Table No. 4.3**  
**Composition of Total Revenue**

(Rs In Million)

Fiscal Year	Total Revenue	Tax Revenue		Non Tax Revenue	
		Amount	Percentage	Amount	Percentage
2000/01	48893.80	38865.00	79.49	10028.80	20.51
2001/02	50446.60	39330.60	77.96	11116.00	22.04
2002/03	54538.90	40896.00	74.99	13642.90	25.01
2003/04	62331.00	48173.00	77.29	14158.00	22.71
2004/05	70122.70	54104.70	77.16	16018.00	22.84
2005/06	72281.90	57430.40	79.45	14851.50	20.55
2006/07	87712.10	71126.70	81.09	16585.40	18.91
2007/08	107622.50	85155.50	79.12	22467.00	20.88
2008/09	143474.50	117051.90	81.58	26422.60	18.42
2009/10	179945.80	156294.90	86.86	23650.90	13.14
<b>Average</b>	<b>87736.98</b>	<b>44683.38</b>	<b>79.499</b>	<b>16894.11</b>	<b>20.501</b>

*Source: Economic Survey Fiscal Year 2010/11 (page no. 24 -27)*

From the above table, the tax revenue was Rs. 38865.00 million in the fiscal year 2000/01 the base year for the research it was 79.49% of total revenue. In the fiscal year 2009/10 Tax revenue was Rs. 156294.90 million and 4.02 times higher than of tax revenue in the FY 2000/01. Average tax revenue for 10 years was Rs 44683.38 million that occupies on average 78.499% share of total revenue. It indicates that the tax revenue was continuously increasing in every year since FY 2000/01 to 2009/10 amounting Rs. 38865.00 million to Rs 156294.90 million. But the percentage contribution of tax revenue was found fluctuating in every year. The

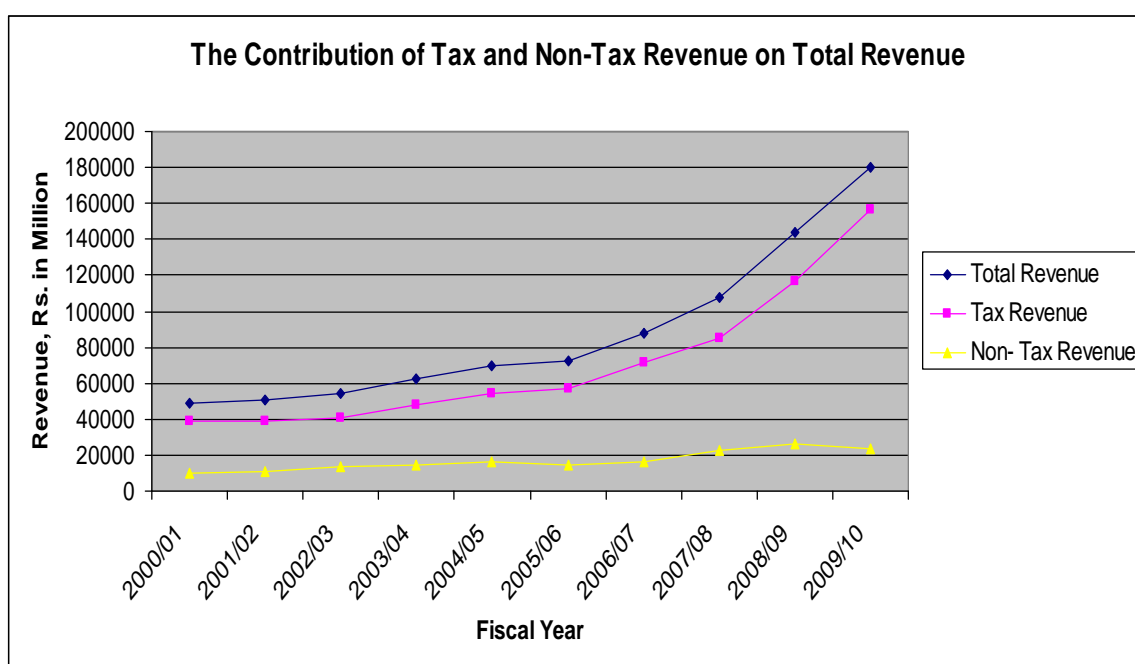
contribution of tax revenue was highest 86.86% in FY 2009/10 and lowest 74.99% in FY 2002/03.

Non-tax revenue was Rs. 10028.80 million in the fiscal year 2000/01, 20.51 % of total revenue it increased to Rs. 11116.00 million representing 22.04% of total revenue in FY 2001/02. In next year, non-tax revenue amount of Rs 13642.90 million, 25.01% of total revenue in FY 2002/03. Similarly it decreases to Rs 14851.50 million, 20.55% of total revenue in FY 2005/06 and then increase to Rs. 26422.60 million, 18.42% of total revenue in FY 2008/09. Then after fluctuates Rs.23650.90 million, 13.14% of total revenue in fiscal year 2009/10. The average of non-tax revenue was Rs. 16894.11 million, and 13.14%.

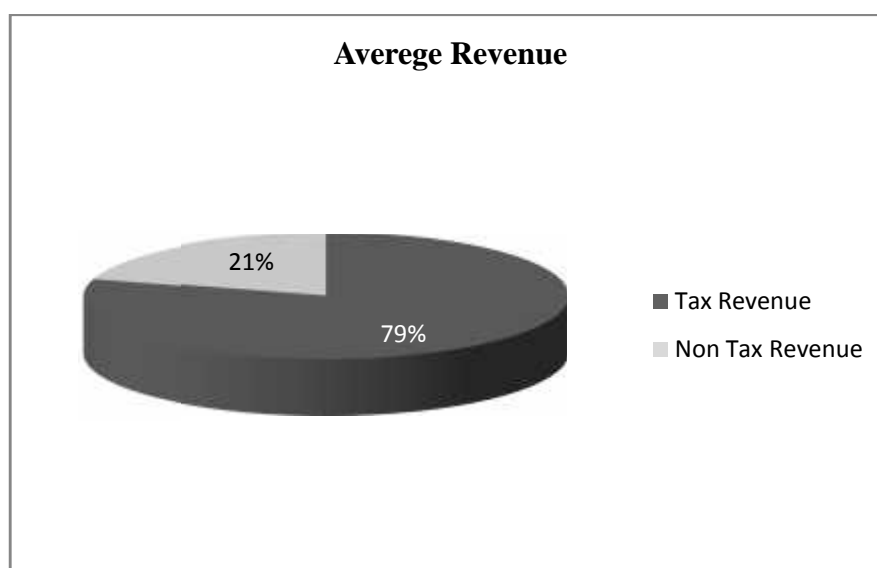
Total revenue collection was seen in the increasing trend. It was Rs 48893.80 million in fiscal year 2000/01 and reached to Rs. 179945.80 million in FY 2009/10. The average total revenue collection in last 10 years was Rs 87736.98 million. Total revenue includes tax revenue and non-tax revenue. The average tax revenue was Rs. 44683.38 million and non-tax revenue was Rs 16894.11 million.

The contribution of tax and non-tax revenue in total tax revenue is shown in the following figure.

**Figure 4.2 Composition of total revenue**



**Figure 4.3 Average Contribution of Tax and Non- Tax Revenue on Total Revenue**



#### **4.1.4 Composition of Tax Revenue**

The revenue is composed of direct tax and indirect tax. Income tax, property tax, tax and interest are included in direct tax. Indirect tax includes customs, excise duty, VAT etc. The composition of Nepalese tax revenue is presented in Table 4.4 in terms of direct and indirect tax revenue from FY 2000/01 to 2009/10.

**Table No. 4.4 Contribution of Direct and Indirect Tax on Total Tax Revenue**

Fiscal Year	Tax Revenue	Total Direct Tax	% Share of Direct Tax	Total Indirect Tax	% Share of Indirect Tax
2000/01	38865	10159	26.14	28706	73.86
2001/02	39331	10598	26.94	28733	73.06
2002/03	40896	10882	26.61	30014	73.39
2003/04	48173	11913	24.73	36260	75.27
2004/05	54105	13072	24.16	41033	75.84
2005/06	57430	13968	24.32	43462	75.68
2006/07	71227	18980	26.65	52146	73.21
2007/08	85156	23088	27.11	62068	72.89
2008/09	117052	34321	29.32	82731	70.68
2009/10	156295	41750	26.71	114545	73.29
Average	70853	18873.10	26.27	51969.8	73.73

Source: Economic Survey, 2010/11

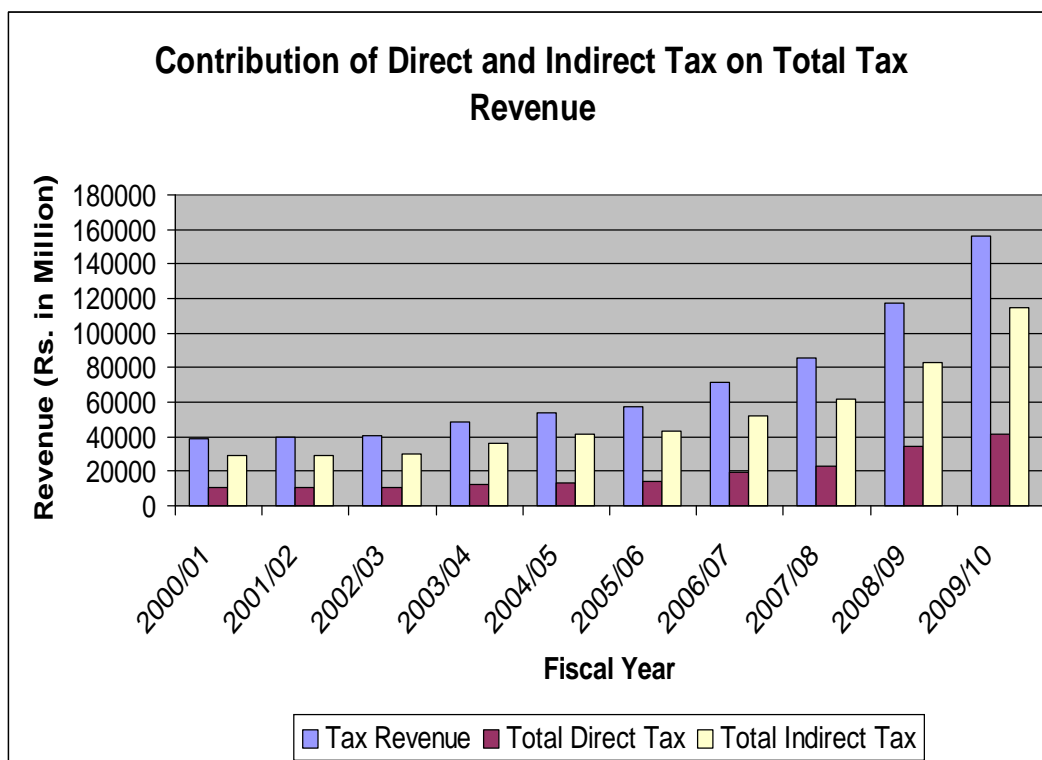


The above table shows the increasing trend of total tax revenue thereby increasing its contributing factor i. e. direct and indirect tax. In FY 2000/01 the amount of direct and indirect tax is Rs. 10159 million and 28706 million respectively. The direct tax and indirect tax are in sharp increasing trend.

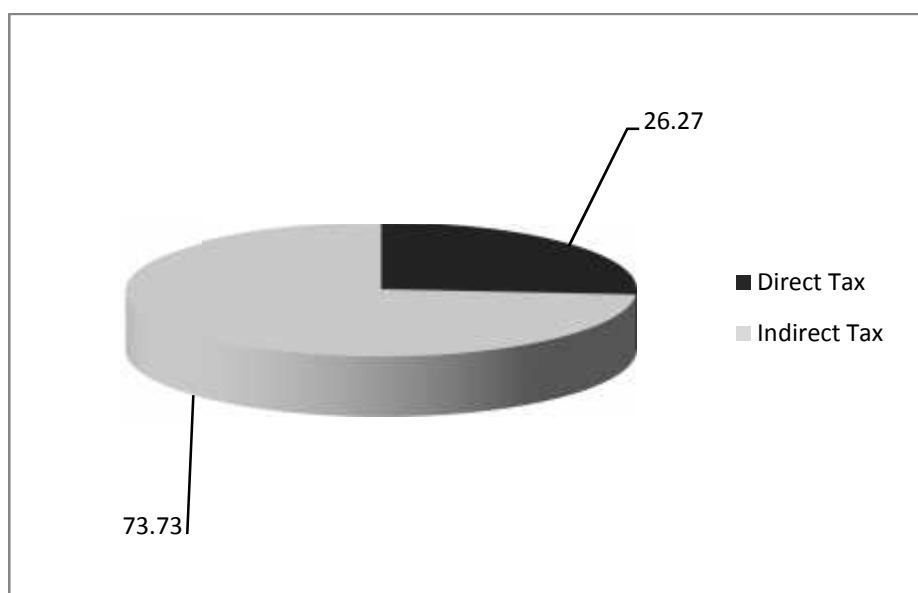
The % share of direct and indirect tax to total tax revenue is 26.14% and 73.86% respectively in FY 2000/01. But in FY 2003/04 this portion is changed into 24.73% and 75.25% respectively. The contribution of direct tax to total tax revenue is decreased to 24.16% in FY 2004/05 which is lowest among other years. But it increased gradually and covered 29.32% in FY 2008/09. Similarly, the share of indirect tax also decreased to 70.68% of total tax revenue. The share of indirect tax is maximum i.e. 75.84% in FY 2007/05. This means that the share of direct tax is minimum and share of indirect tax is maximum in the same fiscal year i. e. 2004/05. It may be due to unfavorable economic environment in the country.

The contribution of direct and indirect tax on total tax revenue can be shown in figure no. 4.4 and 4.5.

**Figure No. 4.4 Contribution of Direct and Indirect Tax on Total Tax Revenue**



**Figure No. 4.5 Pie Chart showing Contribution of Direct and Indirect Tax**



Above figures make us clear that major portion of tax revenue is covered by indirect tax. And it is also in increasing trend. The share of indirect tax has increased from 73.86% in FY 2000/01 to 73.29% in FY 2009/10. But direct tax is 26.014% in 2000/01 and decreased to 24.16% of total tax revenue in FY 2004/05. It indicates that the income level of people is in decreasing trend in one hand and promotion of importing goods from other countries on the other. To direct the economy in the channel of development, it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax. Therefore attention should be paid on the sufficient resource mobilization through internal sources.

Also figure 4.5 shows that the average contribution of indirect tax and direct tax to total tax revenue is 73.73% and 26.27% respectively.

#### **4.1.5 Composition of Indirect Tax Revenue**

The tax Structure of Nepal is mainly dependent on indirect tax. The major tax components of indirect tax in Nepalese tax structure consists custom duty has been classified mainly into import duty and export duty and other component of indirect tax like entertainment tax, hotel tax, air flight tax, other tax contribution normal share zero. Table shows the consumption of indirect tax given as follows.

**Table No. 4.5**  
**Composition of Indirect Tax Revenue**

Rs in Million

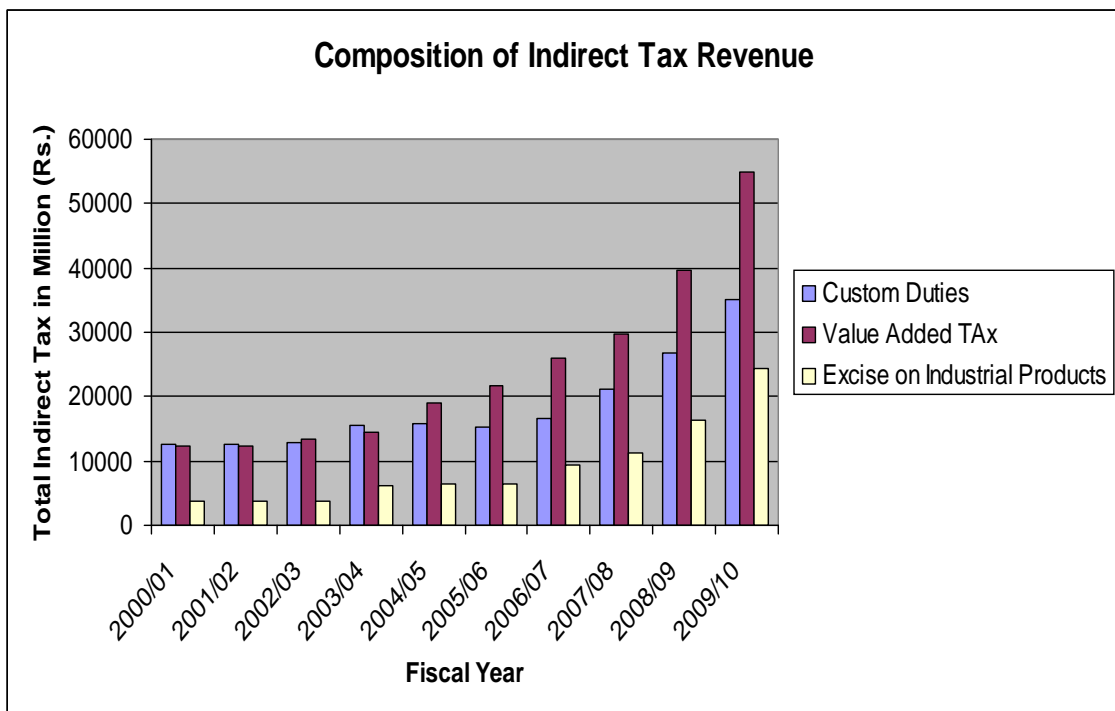
Fiscal Year	Total Indirect Tax	Custom Duties		Tax on Consumption and Product of Goods and Services			
				Value Added Tax		Excise on Industrial Products	
		Amount	%	Amount	%	Amount	%
2000/01	28705.70	12552.10	43.72	12382.40	43.14	3771.20	13.14
2001/02	28724.30	12650.00	44.04	12267.30	42.71	3807.00	13.25
2002/03	30014.10	12783.20	42.59	13459.70	44.84	3771.20	12.56
2003/04	36260.40	15554.80	42.90	14478.90	39.93	6226.70	17.17
2004/05	41032.90	15701.60	38.26	18885.40	46.03	6445.90	15.71
2005/06	43462.30	15344.00	35.30	21610.40	49.72	6507.60	14.98
2006/07	52146.40	16707.60	32.04	26095.60	50.04	9343.20	17.92
2007/08	62067.70	21062.40	33.93	29815.70	48.04	11189.60	18.03
2008/09	82714.70	26792.90	32.39	39700.90	48.00	16220.90	19.61
2009/10	114377.80	35150.80	30.73	54920.90	48.02	24306.10	21.25
<b>Average</b>	<b>46579.16</b>	<b>18429.94</b>	<b>37.59</b>	<b>24361.75</b>	<b>46.04</b>	<b>9158.94</b>	<b>16.36</b>

*Source: Economic Survey Fiscal Year 2010/11*

The above table 4.5 revealed that the custom duty and VAT occupies major portion in indirect tax. In fiscal year 2000/01 the contribution of custom duty was 43.72% which is fluctuation between 43.72% to 30.73% in the fiscal year 2009/10. The average percentage contribution of custom duty to indirect tax was 37.59% during the study period.

Average share of VAT to indirect tax was 46.05%. Amount of VAT in fiscal year 2000/01 was Rs 12382.40 million and had reached to Rs. 54920.90 million in FY 2009/10. Similarly the amount of excise on industrial products was increasing each year without fiscal year 2002/03 but percentage was fluctuating. In average its contribution of excise on industrial products on total indirect tax was Rs. 9158.94 million, 16.36% for the period of last 10 years. We can show in following figure.

**Figure 4.6 Composition of Indirect tax**



#### **4.1.6 Composition of Direct Tax Revenue**

If the person paying and bearing the tax is same, it is called direct tax. A direct tax is really paid by the same person on whom it is legally imposed. The character is tactics of a direct tax are equitable as per the property or income; certainty as per the process of payment, amount to be paid and time of payment; elasticity in nature etc. The major components of direct revenue are income tax, house and land registration fee, land revenue, tax on property etc. The share of major components of direct tax is given in table no. 4.6.

**Table No. 4.6: Composition of Direct Tax Revenue**

Fiscal Year	Total Direct Tax	Land Revenue and Registration				Tax on Property, Profit and Income				
		Land Revenue	House and Land Registration Fees	Total	% of Total Direct Tax	Income Tax	Tax on Property	Other Tax	Total	% of T D Tax
2000/01	10159.40	5.10	607.80	612.90	6.03	9114.00	432.50	0	9546.50	93.97
2001/02	10597.50	0.80	1131.00	1131.80	10.68	8903.70	562.00	0	9465.70	89.32
2002/03	10881.90	0.00	607.80	607.80	5.58	9675.80	432.50	0165.80	10274.10	94.42
2003/04	11912.60	0.00	1697.50	1697.50	14.25	9425.90	700.60	268.60	10215.10	85.75
2004/05	13071.80	0	1799.20	1799.20	13.76	10159.40	806.50	306.70	11272.60	86.24
2005/06	13968.10	0	2181.10	2181.10	15.61	10373.70	847.60	565.70	11787.00	84.39
2006/07	18980.3	0	2253.50	2253.50	11.87	15034.00	995.00	697.80	16726.80	88.13
2007/08	23087.70	0	2940.70	2940.70	12.74	17311.20	1092.20	1766.60	20147.00	87.26
2008/09	34320.70	0	5223.30	5223.30	15.22	25142.40	1850.00	2105.00	29097.40	84.78
2009/10	41750.00	0	5511.10	5511.10	13.20	31285.60	2417.90	2535.40	36238.90	86.80
<b>Average</b>	<b>18873.00</b>	<b>0.59</b>	<b>12395.30</b>	<b>2395.89</b>	<b>11.894</b>	<b>13084.562</b>	<b>1013.68</b>	<b>814.16</b>	<b>16477.11</b>	<b>88.106</b>

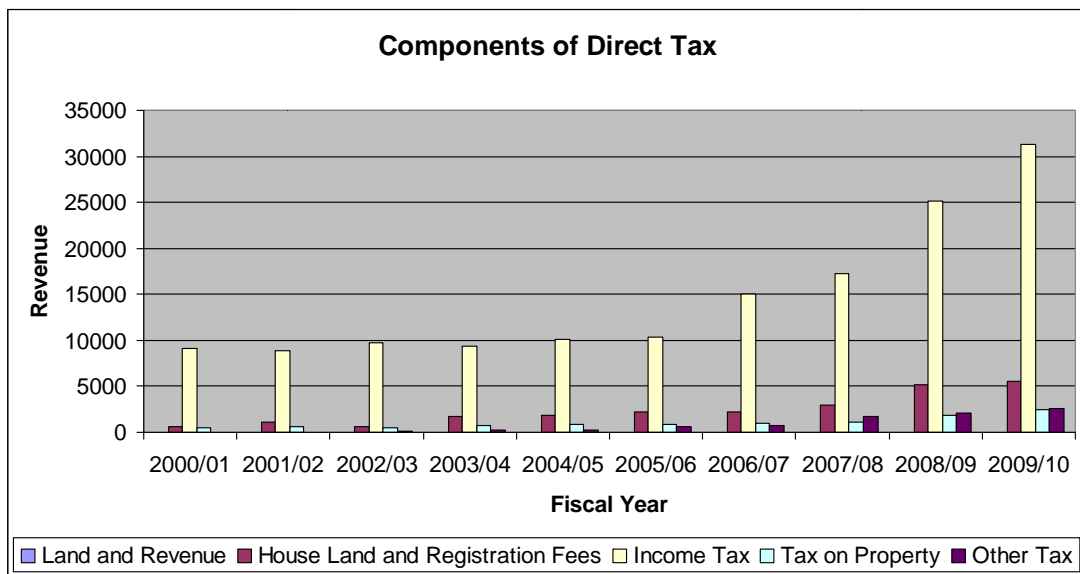
*Source: Economic Survey Fiscal Year 2010/11*

From the above table (4.6), Direct tax is classified into land revenue, property tax, land revenue and registration fees and other tax. The share of land revenue and registration was Rs. 612.90 million in fiscal year 2000/01 then increase Rs. 1131.80 million in fiscal year 2001/02 and decrease in fiscal year 2002/03. Then it was in increasing trend. Since fiscal year 2009/10 and reached to Rs. 5511.10 million. The average of land revenue and registration was Rs. 2395.89 million in the period of last 10 years. Percentage contribution the highest percentage contribution was 15.61% in fiscal year 2005/06 and lowest was 6.03% in fiscal year 2000/01. In average land revenue and registration has covered 11.894% of the total direct tax revenue.

From the above table, another source of direct tax revenue is property tax. It can be classified into income tax, tax on property and other tax. Income tax includes income tax from public enterprise, semi-public enterprise, private corporate bodies, individual, remuneration and tax on interest. Similarly, tax on property includes urban house and land tax and vehicle tax. The share of tax on property, profit and income was Rs. 9546.5 million in fiscal year 2000/01. It was in increasing trend and reached

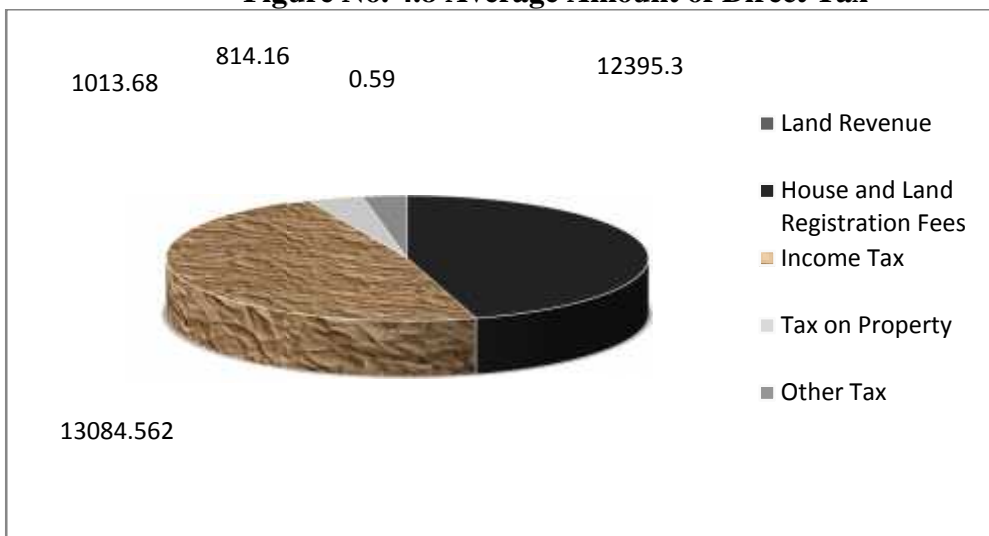
to Rs. 36238.90 million in fiscal year 2009/10, except fiscal year 2001/02. In this year the amount was decrease to Rs. 9465.70 million. Average contribution of tax on property, profit and income was Rs. 16477.11 million in the period of last 10 years. In case of percentage contribution was fluctuating. The highest percentage contribution was 94.42% in fiscal year 2002/03 and lowest contribution was 84.39% in fiscal year 2005/06 and the average was 88.106%.

**Figure 4.7 Composition of Direct Tax Revenue**



The following pie chart shows the average contribution of income tax, house and land registration fee, land revenue, tax on property and other tax on total direct tax revenue in the study period.

**Figure No. 4.8 Average Amount of Direct Tax**



#### **4.1.7 Structure of Income Tax in Nepal**

The structure of Nepalese income tax is composed up of income tax from public enterprises, Income tax from private bodies, income tax from individuals, income tax from remunerations and income tax from interest

**Table No. 4.7: Structure of Income Tax in Nepal**

Rs. In Million

Fiscal Year	Total Income Tax Revenue	Public Enterprises		Private Corporate Bodies		Individuals		Remuneration		Taxation Interest	
		Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
2000/01	9114.00	2928.00	32.13	1924.30	21.11	3200.50	35.12	597.30	6.55	463.90	5.09
2001/02	8903.70	1769.30	19.87	1412.00	15.86	4419.10	49.63	835.60	9.38	467.70	5.25
2002/03	9675.80	2928.00	30.26	1924.30	19.89	3362.20	34.75	597.30	6.17	864.00	8.93
2003/04	9245.90	2056.60	22.74	1531.30	16.56	3533.40	38.22	1391.20	15.05	733.40	7.93
2004/05	10159.40	1332.40	13.11	2467.80	24.29	3926.30	38.65	1675.90	16.50	757.00	7.45
2005/06	10373.70	195.70	1.89	3404.30	32.82	4234.70	40.82	1764.10	17.07	774.00	7.47
2006/07	15034.00	1019.70	6.78	5717.10	38.03	5234.40	34.82	2007.90	13.35	1054.90	7.02
2007/08	17311.20	204.60	1.18	7186.50	41.52	6381.20	36.86	2451.00	14.16	1087.90	6.28
2008/09	25142.40	959.10	3.82	9425.10	37.49	9877.50	39.27	3195.60	12.71	1685.10	6.71
2009/10	31285.60	1131.80	3.62	12234.40	39.10	11039.90	35.29	4413.10	14.11	2466.40	7.88
Average	14624.57	1452.52	13.50	4722.70	28.66	5520.92	38.34	1892.90	12.50	1035.52	7.00

Source: Economic Survey Fiscal Year 2010/11



This table presents the structure of income tax in Nepal which shows that the total income tax is increased every fiscal year except in the fiscal year 2001/02 and 2003/04. It increased from Rs. 9114.00 million in the year 2000/01 to Rs. 31285.60 million in fiscal year 2009/10. In the year 2001/02 it was decreased to Rs. 8903.70 million from Rs. 9114 million on the FY 2000/01 and in FY 2002/03 it started to increase but in year 2003/04 it was again decreased. After the fiscal year 2003/04 it started to increase in each year till fiscal year 2009/10 the amount was Rs. 31285.60 million.

The contribution of public enterprises decreased from Rs. 2928.00 million in fiscal year 2000/01 to Rs. 1769.30 in the year 2001/02 and till 2002/03 it decreased, the amount was Rs. 2928.00 (ie.30.26%). In the year 2003/04 it started to decrease till year 2004/05 the amount was Rs. 1332.40 (i.e. 13.11%). According to this, it continuously fluctuated till the fiscal year 2009/10, the amount was Rs. 1131.80 million and its contribution was 3.62% in total income tax revenue. The average of public enterprises was Rs. 1452.52 million and its contribution 13.50% of total income tax revenue.

The total tax from private corporate bodies has also fluctuated till year 2002/03. In the year 2000/01 the amount was Rs. 1924.30 million, in 2001/02 was Rs. 1412, in the year 2002/03 was Rs. 1924.30 and in the year 2003/04 the amount was Rs. 1531.30 it was the 16.56% contribution in total income tax revenue. After the fiscal year 2004/05 it continuously increased till 2009/10, its contribution reached to 39.10% in total income tax revenue with amount Rs. 12234.40 million. The average of private corporate bodies was Rs. 4722.71 million and its average contribution was 28.66%.

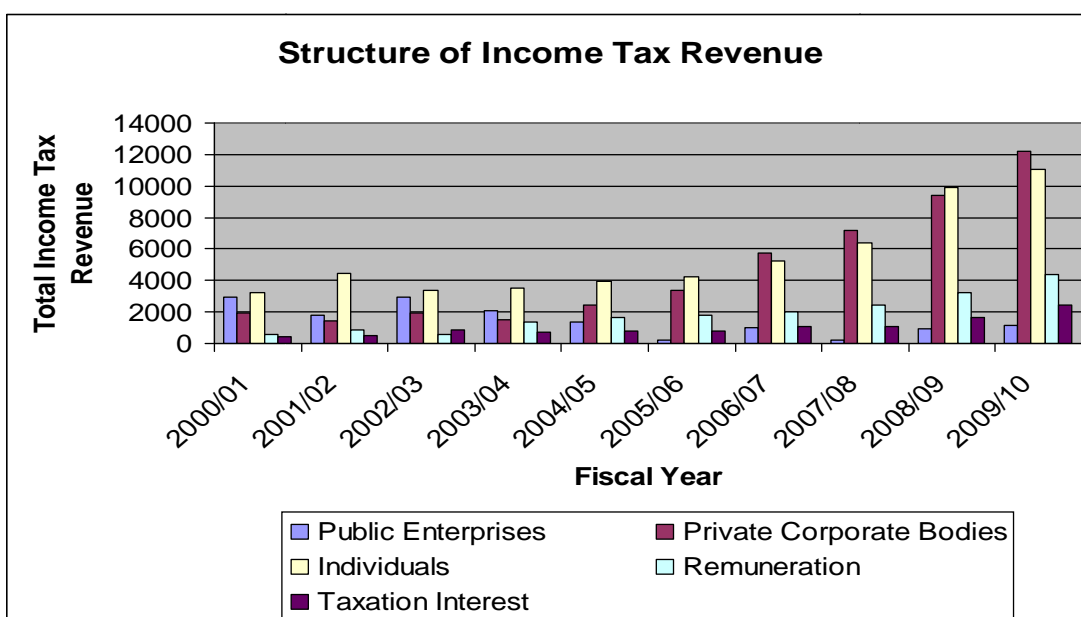
In the starting period, the contribution of individual income tax was also fluctuated. After the fiscal year 2002/03 it increased. It reached to Rs. 3533.40 million in the year 2003/04. In the year 2009/10 its contribution was 35.29% with amount Rs. 11039.90 million. The average of individual income tax was Rs. 5520.92 million and its average contribution was 38.34%.

The collection of income tax from remuneration had also been in fluctuating in starting period. After the fiscal year 2002/03 it was in increasing trend. In 2000/01 it was Rs. 597.30 million and its contribution was 6.55%. In the fiscal year 2009/10 it was contributed 14.11% amounting by Rs. 4413.10 million in total income tax

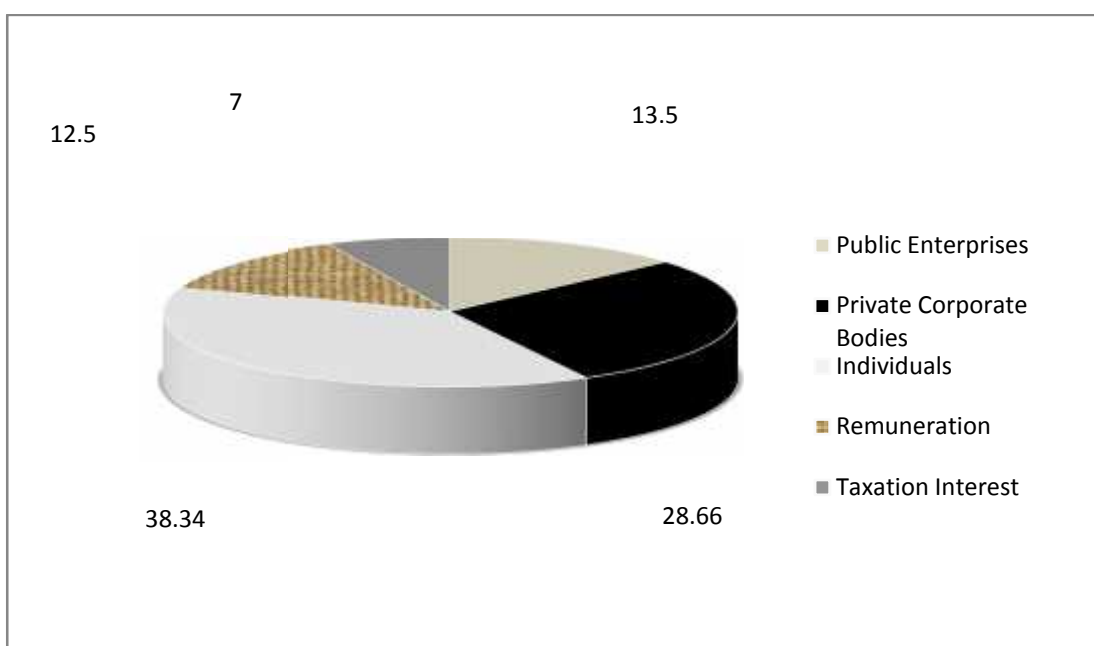
revenue. The average of remuneration was Rs. 1892.90 million and the average contribution was 12.50%.

Income tax from interest was in increasing trend from FY 2000/01 to FY 2002/03 it decreased to Rs. 733.40 million in FY 2003/04 from Rs. 864 million in FY 2002/03 then it increased and Rs. 2466.40 million in FY 2009/10 and its contribution was 7.88%. The average tax on interest was Rs. 1035.52 million and average contribution was 7.00%.

**Figure 4.9 Structure of Income Tax Revenue**



**Figure 4.10 Structure of Income Tax Revenue by showing Pie Chart**



#### **4.1.8 Contribution of Income Tax**

Income tax has played the important role for contribution of total revenue. Contribution of income tax to direct tax revenue, total tax revenue total direct tax and GDP in Nepal is shown in Table No. 4.8.

##### **4.1.8.1 Contribution of Income Tax on total Government Revenue**

Total government constitutes tax and non-tax revenue. In Nepalese government revenue, tax revenue has occupied the 2/3 parts in total revenue. We can show contribution of income tax on total government revenue in following table.

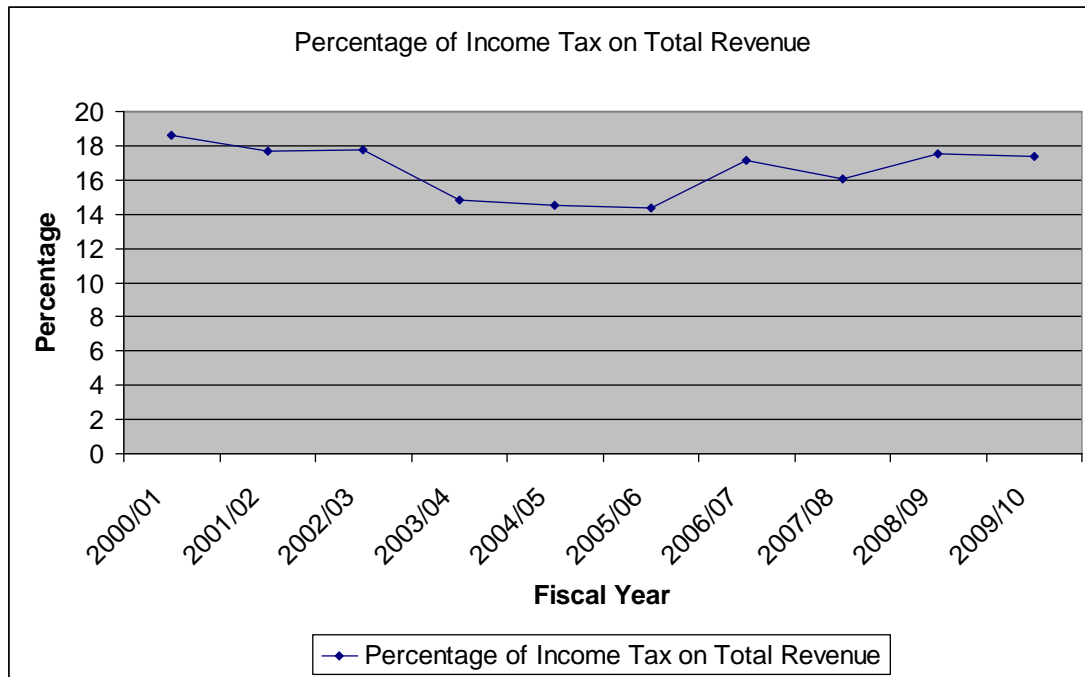
**Table No. 4.8**  
**Contribution of Income Tax on total Government Revenue, Total Tax Revenue, Direct Tax Revenue and GDP**  
**(Rs in Million)**

Fiscal Year	Total Income Tax Revenue	Total Govt. Revenue		Total Tax Revenue		Direct Tax Revenue		GDP Current Price	
		Amount	% of Income Tax on Total Revenue	Amount	% of Income Tax on Total Tax Revenue	Amount	% of Income Tax on Total Revenue	Amount	% of Income Tax on Total Revenue
2000/01	9114.00	48893.80	18.64	38865.00	23.45	10159.40	89.71	413428.00	2.20
2001/02	8903.70	50446.60	17.65	39330.60	22.64	10597.50	84.02	430396.00	2.07
2002/03	9675.80	54538.90	17.74	40896.00	23.61	10881.90	88.92	460325.00	2.10
2003/04	9245.90	62331.00	14.83	48173.00	19.19	11912.60	77.61	500699.00	1.85
2004/05	10159.40	70122.70	14.49	54104.70	18.78	13071.80	77.72	548485.00	1.85
2005/06	10373.70	72281.90	14.35	57430.40	18.06	13968.10	74.27	611118.00	1.70
2006/07	15034.00	87712.10	17.14	71126.70	21.14	18980.30	79.21	675859.00	2.22
2007/08	17311.20	107622.50	16.09	85155.50	20.30	23078.70	74.98	755257.00	2.29
2008/09	25142.40	143474.50	17.52	117051.90	21.48	43320.70	58.04	909309.00	2.76
2009/10	31285.60	179945.80	17.39	156294.90	20.02	41750.00	74.94	1060881.00	2.95
Average	14624.57	87736.98	16.584	70842.83	20.87	18873.00	77.942	636575.70	2.199

*Source: Economic Survey Fiscal Year 2010/11*

According to above table the share of income tax as a percentage of total government revenue was 16.584% in average in the study period. In fiscal year 2000/01 it was 18.64%. It was in fluctuating trend and reached to 14.35% in FY 2005/06 and 17.39% in fiscal year 2009/10. The following figure shows the contribution of income tax on total government revenue.

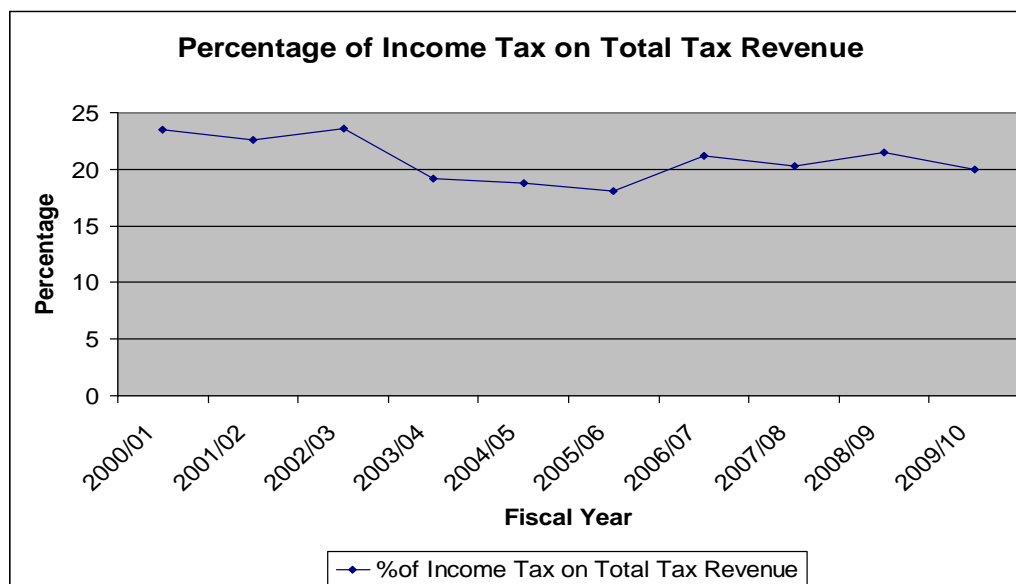
**Figure 4.11 Contribution of Income Tax to total Revenue**



#### 4.1.8.2 Contribution of Income Tax on Total Tax Revenue

Total tax revenue consist direct tax and indirect tax revenue. There is dominant role of the indirect tax revenue in the Nepalese tax revenue structure. The contribution of income tax to the total tax revenue was presented in table no. 4.8. According to table no. 4.8 the share of income tax as a percentage of total tax revenue was 20.87% in average for the period of last 10 years. In FY 2000/01 it was 23.45%. It was in fluctuation. It increased to 23.45% in the FY 2000/01 and decreased to 20.02% in FY 2009/10. The following figure shows the contribution of income tax on total tax revenue.

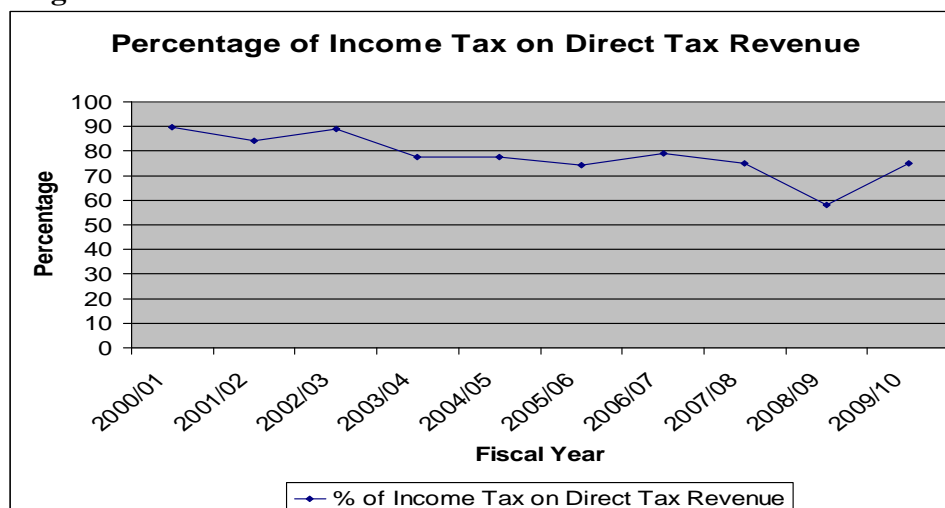
**Figure No. 4.12 Contribution of Income Tax on Total Tax Revenue**



#### 4.1.8.3 Contribution of Income Tax on Direct Tax Revenue

Income tax is the major part of direct tax revenue. In Nepal income tax has occupied more than 80 percent of the total direct tax revenue. Table no. 4.8 shows that the share of income tax as a percentage of direct tax revenue was 77.942% in average in the study period. In FY 2000/01 it was 89.71%. It was in fluctuation trend. It was 74.94% in FY 2009/10. The following figure shows the contribution of income tax on total direct tax revenue.

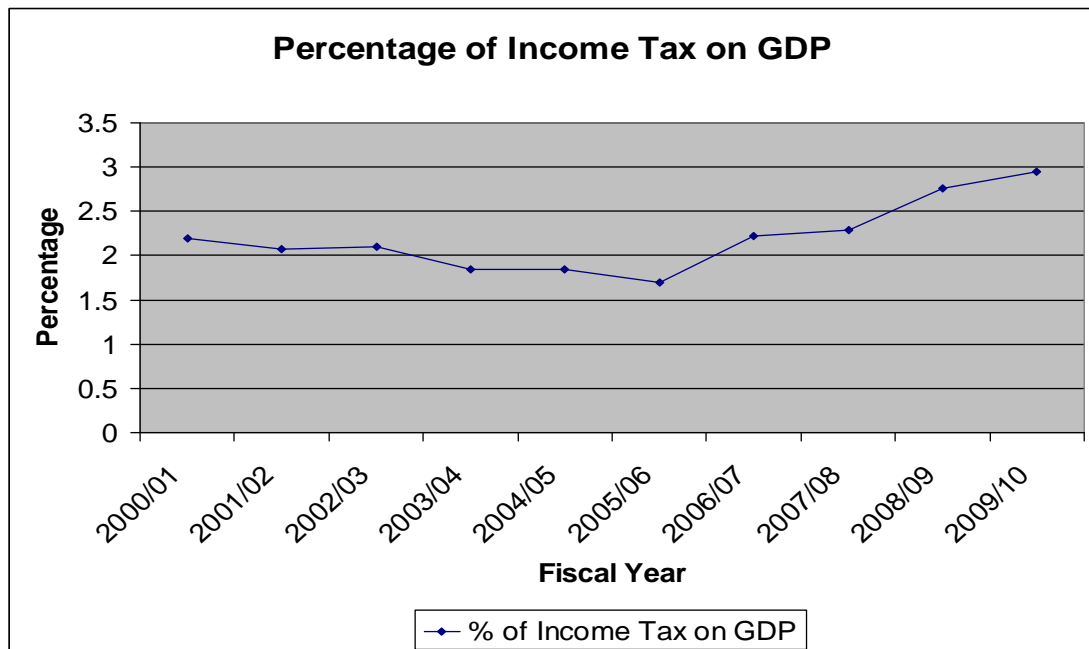
**Figure No. 4.13 Contribution of Income Tax on Direct Tax Revenue**



#### 4.1.8.4 Contribution of Income Tax to GDP

According to the table no. 4.8 contribution of income tax to GDP was 2.199% in average for the period of last 10 years. Contribution of income tax in GDP was 2.20% in FY 2000/01. It was also fluctuating trend. In FY 2009/10 contribution of income tax to GDP is shown in following diagram.

**Figure No. 4.14 Contribution of Income Tax on GDP**



#### 4.1.9 Income Tax Collection Performance in Nepal

In table (4.9), Income tax and estimates and collection of last 10 years are presented. According to table, tax was collected excess than estimate in fiscal year 2003/04, 2006/07, 2007/08, and 2009/10. In fiscal year 2000/01, 2001/02, 2002/03, 2004/05, 2005/06, and 2009/10 tax collection is less than estimates. In last 3 years tax revenue collection trend was increasing except year 2009/10. But in last year performance was 100.59%. The highest percentage of income tax collection was 113.09% in the year 2007/08 and lowest in the year 2001/02. After the study we can conclude that revenue collection from income tax in increasing trend but the performance is not satisfactory.

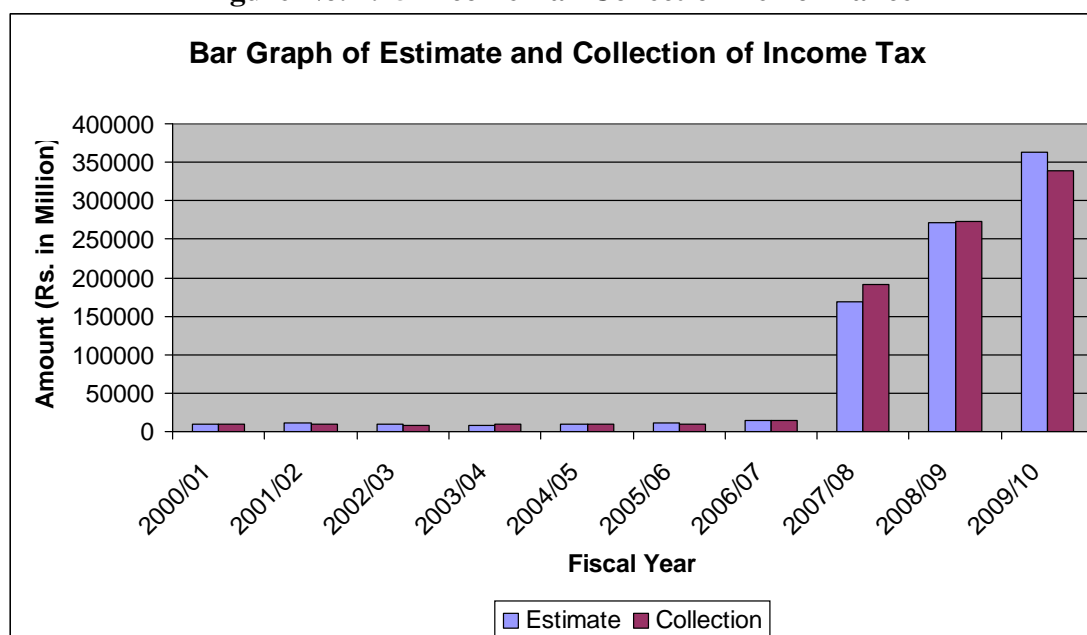
**Table No. 4.9: Income Tax Collection Performance in Nepal**

(Rs. In Million)

Fiscal Year	Estimate	Collection	Difference	Collection as Per % of Estimates
2000/01	9980	9914.00	- 866.00	91.32
2001/02	11140	8903.7	- 3236.30	79.93
2002/03	9862.5	7966.20	- 1896.30	80.77
2003/04	8679.5	9245.90	566.40	106.53
2004/05	10250	10159.40	- 90.60	99.12
2005/06	10999.6	10373.70	- 625.90	94.31
2006/07	14607.4	15034.20	426.80	102.92
2007/08	168692	190778.10	22086.13	113.09
2008/09	270870	272473.90	1603.87	100.59
2009/10	362980	338213.30	- 24766.70	93.18

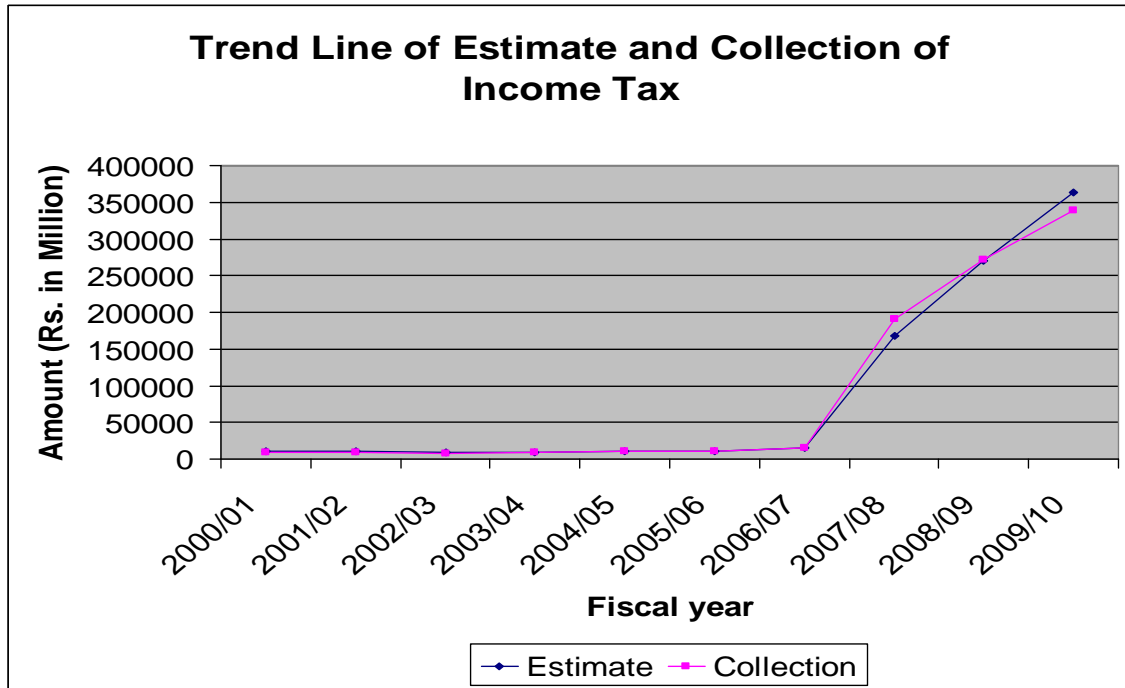
Source: Budget speeches, Economic Survey and Annual reports of IRD

**Figure No. 4.15 Income Tax Collection Performance**





**Figure No. 4.16 Trend Line of Estimate and Collection of Income Tax**



#### **4.1.10 Corporate Tax Rate Structure in Nepal**

Tax rate is the base of measurement of tax liability. Tax should not be so high only for minimum revenue realization but should be activator for the private investment. Developing countries like Nepal needs to boost up their economic conditions by developing industries and trade within the country. For this, corporate tax rate also plays a crucial role. Imposition of tax on corporate profit was started with the enactment of Business Profit and Remuneration Act, 1960. The starting corporate tax rate was 25% and it was levied on progressive way. The tax amount was calculated on different slabs before FY 1985/86. The corporate tax structure was combined with individual tax rate structure. The reason was the numbers of companies were limited and private companies were generally managed by family. In the year 1985/86 the progressive tax rate structure was abolished in the fiscal year 1995/96.

The corporate tax rate structure was increased up to 60% the maximum rate in the FY 1995/96 from 25%. During 1960/61 to 1975/76, the tax again decreased up to 51% and 50%. This rate was again increased to 55% and remains continued from FY 1982/83 till 1987/88. In the year 1987/88, the listed public limited companies were levied by 10% less than others. This concession was given to such companies by only 5% in the year

1985/86. After the FY 1987/88, the tax rate was continuously decreasing. Now it is 20% to industry (except cigarette and alcohol), 25% to general companies and 30% to banks and finance companies. Special fee of 3% of taxable income was levied to all corporate bodies. The corporate tax rate structure of different years is presented as below:

**Table No. 4.10: Corporate Tax Rate Structure in Nepal**

Fiscal Year	Maximum Marginal Tax Rate		Nature of Tax
	Private Co.	Public Co.	
1960/61 – 1962/63	25	25	Progressive
1963/64 – 1964/65	30	30	"
1965/66 – 1966/67	40	40	"
1967/68	55	55	"
1968/69 – 1974/75	55	55	"
1975/76	60	60	"
1976/77 – 1978/79	51	51	"
1979/80	50	50	"
1980/81 – 1981/82	50	50	"
1982/83	55	55	"
1983/84 – 1984/85	55	55	"
1985/86	55p	55f	Progressive (P) & Flat (F)
1986/87 – 1987/88	55p	50f	"
1988/89 – 1989/90	50p	50f	"
1990/91 – 1991/92	40p	40f	"
1992/93 – 1994/95	35p	35f	"

1995/96	33	33	Flat
1996/97	30	33	"
1997/98 – 2001/02	20, 25 & 30	20, 25 & 30	"
2002/03 – 2009/10	20, 25 & 30	20, 25 & 30	Flat & additional 1.5% for all Cos

*Source: Income Tax Act 2058*

**Notes:**

20% tax rate for special industries.

25% tax rate for general industries producing cigarette, bidi, liquor and industries uses as raw material.

30% tax rate for non industries for banking and insurance business.

**4.1.11 Corporate Tax Base in Nepal**

Under the income Tax Act, 2058 of Nepal, corporate tax is levied on the total taxable income of the previous year. It has assumed the global or total as well as scheduler income tax. This act has divided the source of income into three major heads they are: income from business, income from investment, and income from employment. The third amendment of Income Tax Act, 2058 has further clarified about calculating the adjusted taxable income and net taxable income from business, investment and employment. All the taxable income are added as per law and deduction allowable expenses such as general deduction, cost of trading stock, interest expenses, repair and maintenance expenses, depreciation, reserve and rise-bearing fund and expenses related with business and investment were deducted as per the law, which occurs adjusted taxable income. Then in case of business income, pollution control and R & D expenses should be deducted taking the adjusted taxable income as base, after that we get assessable income from business before loss adjustment. Then, loss from business in current year and previous year are deducted to get the net assessable income from business. Likewise, loss in business and investment of current year and business loss of previous year are deducted to get the net assessable income from investment.

Total assessable income is calculated by adding the net income from business and investment from where common expenses and donation expenses can be deducted as per law to get total taxable income. No exemption Limit is provided to the companies. Special additional fee of 15% of taxable income is charged to the second slab where 25% tax rate is charged.

## 4.2 Empirical Investigation

An empirical investigation has been conducted in order to find out various aspects of income tax imposition in Nepal. This chapter analyzes information collected from primary sources i.e. through questionnaire. The questionnaire was distributed to the Tax administrators, Tax experts/auditors, and Tax payers. The response received from various respondents have been arranged, tabulated and analyzed in order to facilitate the descriptive analysis of the study. The respondents were requested to response or questionnaire by four ways.

They were requested to response simply by "Yes" or "No" response.

They could response by selecting one or more options.

They could response by ranking the choices starting from 1 to 10, starting from most important to least.

Respondents had also option to put their views by writing wherever necessary.

Following table shows the no. of groups, no. of respondents in each group and code used to represent them.

**Table No. 4.11: Groups of Respondents and Number from Each Group**

S. N.	Groups of Respondents	Sample Size	Code Used
1	Income Tax Administrators	40	A
2	Income Experts/ Auditors	40	B
3	Income Tax Payers	40	C
	Total	120	

#### 4.2.1 Public Awareness towards Income Tax System in Nepal

In order to know whether the people are well informed about income tax system in Nepal, a question was asked "Do you think people are well informed about the income tax system in Nepal?" The respondent's response was presented in the following table.

**Table No. 4.12 Information about Income Tax System in Nepal**

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	10	25	30	75	40	100
B	16	40	24	60	40	100
C	12	30	28	70	40	100
Total	38	31.67	82	68.33	120	100

*Source: Opinion Survey, 2011*

From the opinion survey, it is found that 75% of Tax Administrators believe that people are not well informed about income tax system in Nepal. Only 40% of Tax Experts/ Auditors said that people are well informed about income tax system whereas 60% claim that people are not properly informed. And 30% Tax Payers believe that people are well informed about income tax system in Nepal. In total, 68.33% of respondents believe that people are not well informed about income tax system in Nepal.

Above survey approved that public awareness program is necessary in Nepal for making people well informed about income tax system. Awareness should be given through local newspaper and mass media in order to make the people conscious.

#### 4.2.2 Attitude towards the Income Tax System of Nepal

To know the respondents opinion about the income tax system of Nepal, a question was asked, "In your opinion is the income tax system of Nepal is sound and efficient?" The responses received from the respondents are tabulated as follows:

**Table No. 4.13 Attitude towards the Income Tax System of Nepal**

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	12	30	28	70	40	100
B	16	40	24	60	40	100
C	18	45	22	55	40	100
Total	46	38.33	74	61.67	120	100

*Source: Opinion Survey, 2011*

The table No. 4.13 showed that 38.33% of the respondents approved that the income tax system is sound and efficient and 61.67% of respondents showed their dissatisfaction regarding the income tax system is not sound and efficient. In conclusion it can be said that most of the respondents opinioned that the income tax system of Nepal is not sound and efficient. But it is going to be progressive trend not completely bad.

#### **4.2.3 Income Tax as a Suitable Means of Rising Government Revenue**

In order to know whether income tax as a suitable means of raising government revenue or not a question, "Do you consider that income tax as a suitable means of raising government revenue?" was asked. The responses of respondents are summarized in the following table.

**Table No. 4.14: Income Tax as a Suitable Means of Raising Government Revenue**

S.N	Respondents	Yes		No		Total	
		No.	%	No.	%	No.	%
1	Tax Administrator	28	70	12	30	40	100
2	Tax Experts	32	80	8	20	40	100
3	Tax Payers	30	75	10	25	40	100
	Total	90	75	30	25	120	100

*Source: Opinion Survey, 2011*

According to above table, it is found that 70% tax administrators, 80% tax experts and 75% taxpayers recognize income tax as a suitable means of raising government

revenue. In average 75% of respondents are in favors of income tax as a suitable means of raising government revenue. Only 25% of respondents don't recognize it.

#### 4.2.4 Contribution of Income Tax Revenue

To know whether the contribution of income tax revenue is satisfactory or not, a question was asked to respondents "In your opinion is contribution of income tax to national revenue is satisfactory?" The result is presented in following table.

**Table No. 4.15 Contribution of Income Tax Revenue Satisfactory or Not**

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	8	20	32	80	40	100
B	12	30	28	70	40	100
C	14	35	26	65	40	100
Total	34	28.33	86	71.67	120	100

*Source: Opinion Survey, 2011*

Only 20% tax administrators, 30% tax experts/ auditors and 35% tax payers believe that contribution of income tax to national revenue is satisfactory. And rest 80% tax administrator, 70% tax experts and 65% tax payers reacts adversely. In total, 71.67% of total respondents believe that contribution of income tax to national revenue is not satisfactory.

#### 4.2.5 Reasons for Low Revenue Collection from Income Tax

71.67% of the total respondents believe that contribution of income tax on national revenue is not satisfactory. So in order to find out the major causes of low collection from income tax, the respondents are asked to rank among ten options as per their priority. The ranking result is as follows:

**Table No. 4.16 Main causes of low Revenue Collection from Income Tax in Nepal**

S. No.	Major Causes	Total Points Received			Total	Percentage %	Ranks
		A	B	C			
i	Inconsistent tax acts, rules and regulations	81	92	81	254	8.12	2
ii	Loopholes in income tax act	122	68	77	267	8.53	3
iii	Inefficient tax administration	127	103	103	333	10.64	6
iv	Existence of smuggling	114	132	129	375	11.98	9
v	Improper billing system	84	63	133	280	8.59	4
vi	Lack of tax education	105	55	44	204	6.52	1
vii	Income tax returns not filing on time	140	70	150	360	11.5	7
viii	Instable political condition	108	89	110	307	9.81	5
ix	Increasing tendency of tax evasion	105	136	130	371	11.86	8
x	Mass poverty and low income level	114	119	145	378	12.1	10
Total					3129		

*Source: Opinion Survey, 2011*

In table no. 4.17 rank 1 is given to the lowest percentage and 10 to the highest. Here, lowest percentage is obtained by the cause, which is treated as the most important cause by the respondents.

From the above table, the major causes of low collection of income tax in Nepal are ranked in order of the preference of the respondents are as follows:

1. Lack of tax education
2. Inconsistent tax acts, rules regulations.
3. Loopholes in income tax act.



4. Improper billing system.
5. Instable political condition.
6. Inefficient tax administration.
7. Income tax returns not filing on time.
8. Increasing tendency of tax evasion.
9. Existence of smuggling.
10. Mass poverty and low income level.

From the above table, it can be concluded that, in the opinion of the respondents, the major causes of tax payer wise low calculation of income tax is lack of tax education. Inconsistent tax acts, rules and regulations, loopholes in income tax act etc. so major emphasis should be given on creating public awareness and modifying the difficulties of present income tax act.

#### 4.2.6 Appropriateness of Income Tax Rates

To know the respondents view towards income tax rates, the question was put "Is present income tax rates in Nepal High?" Opinion result is summarized in the table below.

**Table No. 4.17 Appropriateness of Income Tax Rates**

S. No.	Respondents	Yes		No		Total.	
		No.	%	No.	%	No.	%
1	A	10	25	30	75	40	100
2	B	16	40	24	60	40	100
3	C	28	70	12	30	40	100
Total		54	45	66	55	120	100

*Source: Opinion Survey, 2011*

From the above survey, 75% of tax administrators and 60% of tax experts/ auditors believed that income tax rate is not high in Nepal. They are in favor of present income tax rate. But 70% of the tax payers claimed that present income tax rate is high. It

means they are against the present income tax rates. And their recommendation is as follows:

**Table No. 4.18 Suggested Income Tax Rates**

S. No.	Tax Rate	Respondents						Total	%
		Answer							
		A	%	B	%	C	%		
1	20%	4	100	5	29.41	15	26.32	24	30.77
2	18%	-	-	-	-	-	-	-	-
3	15%	-	-	12	70.59	22	38.59	34	43.59
4	10%	-	-	-	-	20	35.09	20	25.64
Total		4	100	17	100	57	100	78	100

*Source: Opinion Survey, 2011*

From the above survey, cent percent tax administrators prefer income tax rate 20%, 29.41% tax experts and 26.32% tax payers prefer tax rate 20%. Whereas 70.59% tax experts and 38.59% tax payers prefer tax rate at 15% and 35.09% tax payers prefer income tax rate at 10%. So it can be concluded that major portion of tax payers found present tax rate high and they recommend the income tax rate at comparatively lower rate.

#### **4.2.7 Weaknesses of Income Tax Act 2058**

In order to know the weakness of income tax act 2058 for the low collection from income tax a question was asked to respondents "Do you believe that the contribution of income tax is not satisfactory because of income tax act, 2058?" Opinion result as follows.

**Table 4.19: Low Income Tax Collection because of Income Tax Act, 2058**

S. No.	Respondents	Yes		No		Total	
		No.	%	No.	%	No.	%
1	A	16	40	24	60	40	100
2	B	26	65	14	35	40	100
3	C	20	50	20	50	40	100
Total		62	51.67	58	48.33	120	100

*Source: Opinion Survey, 2011*

As 51.67% of total respondents believed that contribution of income tax is not satisfactory because of income tax act 2058, the major weakness of the act is assumed as follows:

**Table No. 4.20 Major Weakness of Income Tax Act, 2058**

S. No.	Major Weakness	Respondents						Total	%
		A	%	B	%	C	%		
1	Fully based on self-Assessment	8	44.45	6	23.08	0	0	14	22.58
2	Amended assessment is not in practice	4	22.22	4	15.38	0	0	8	12.90
3	Assessment of income tax is not based on best judgments	2	11.11	10	38.46	8	44.45	20	32.26
4	Complication due to the merging of tax and VAT administration	4	22.22	6	23.08	6	33.33	16	25.81
5	No harmony between VAT and income tax act	0	0	0	0	4	22.22	4	6.45
Total		18	100	26	100	18	100	62	100

*Source: Opinion Survey, 2011*

From the above table, 44.45% of tax administrators believed that the major weakness of income tax act, 2058 is that it is fully based on self assessment. And 22.225 said that complication had arisen due to the merging of tax and BAT offices. 38.46% of tax experts said that income tax assessment is not based on best judgment. And 23.08% of tax experts agreed with the opinion of tax administrators I. e. Complication due to the merging of tax and VAT administration. 44.45% of tax payers agreed that income tax assessment is not based on best judgment. 33.33% agreed with the opinion of tax administrators and tax experts whereas 22.22% said that problem arise due to the disharmony between VAT and income tax act. It means the common view of all the

respondents is that complication raised due to the merging of tax and VAT administration.

#### 4.2.8 Effectiveness of Income Tax Administration in Nepal

To know the situation of present income tax administration, the respondents are asked "What do you feel about present income tax administration of Nepal?" Whether it is efficient, inefficient or satisfactory their responses is tabulated as below.

**Table No. 4.21 Effectiveness of Income Tax Administration in Nepal**

S. No.	Responses	Respondents						Total	%
		A	%	B	%	C	%		
1	Efficient	26	65	10	37.5	6	25	42	35
2	Inefficient	6	15	15	12.5	24	50	45	37.5
3	Satisfactory	8	20	15	50	10	25	33	27.5
Total		40	100	40	100	40	100	120	100

*Source: Opinion Survey, 2011*

According to the above table, income tax administration in Nepal is not efficient. Only 35% of respondents believe that income tax administration is efficient. 37.5% respondents agree that income tax administration is inefficient and 27.5% of respondents believe that income tax administration is satisfactory. Therefore, it is clear that income tax administration of Nepal is inefficient. But the result of is not very bad because of the gap between efficient and inefficient is small i.e. 2.5% which is achievable.

Among 120 respondents, 6 tax administrators, 15 experts and 24 tax payers were in favor of inefficient tax administration. A question, "In your opinion what are the main causes of inefficient of income tax administration?" was asked to them who had said that income tax and administration is inefficient. They gave points to the options that are presented as below.

**Table No. 4.22 Major Causes of Inefficient Income Tax Administration**

S. No.	Major Causes	Respondents			Total Score	%	Rank
		A	B	C			
1	Complicated tax laws	10	75	190	275	18.62	2
2	Lack of trained and competent tax officials	16	70	195	281	19.03	1
3	Lack of effective communication	8	45	101	154	10.43	6
4	Lack of tax awareness to tax payers	7	35	125	167	11.30	5
5	Unnecessary outside pressure	6	24	112	142	9.61	7
6	Lack of co-ordination of the tax departments with other departments	5	65	140	210	14.22	4
7	Lack of proper direction	3	85	160	248	16.79	3
Total		55	399	1023	1477	100	

*Source: Opinion Survey, 2011*

According to above table, the causes of ineffectiveness of Nepalese income tax administration are ranked in order to preference of the respondents as follows.

1. Lack of trained and competent tax officials.
2. Complicated tax laws.
3. Lack of direction
4. Lack of co-ordination of the tax department with other departments among tax related departments.
5. Lack of tax awareness to tax payers.
6. Lack of effectiveness communication.
7. Unnecessary outside pressure.

It can be concluded that the lack of trained and competent tax personnel, complicated tax laws, lack of direction, lack of co-ordination of the tax department with other department are the most important causes of ineffectiveness of Nepalese tax administration.

#### 4.2.9 Corruption in Income Tax Administration of Nepal

In order to know the corruption existed in income tax administration in Nepal, a question, "Do you think that there is corruption in income tax administration of Nepal?" was asked. The responses received from various respondents are as follows:

**Table No. 4.23 Corruption in Income Tax Administration of Nepal**

S.N	Respondents	Yes		No		Total	
		No.	%	No.	%	No.	%
1	Tax Administrator	7	15	33	85	40	100
2	Tax Experts	30	80	10	20	40	100
3	Tax Payers	32	75	8	5	40	100
	<b>Total</b>	<b>69</b>	<b>57.5</b>	<b>51</b>	<b>42.5</b>	<b>120</b>	<b>100</b>

*Source: Opinion Survey, 2011*

From the above table it is clear that there is corruption in income tax administration on Nepal. 57.5% of respondents agree that Nepalese income tax administration is corrupt 42.5% respondents were disagreeing with this. Out of them most of the respondents were tax administrators.

The respondents, who agree that the Nepalese tax administration is corrupt, were asked a question related to the main causes of corruption. They were requested to give points to the options given in the questionnaire. The result has been given in the following table.

**Table No. 4. 24 Causes of Corruption in Income Tax Administration**

S.N	Major Causes	Point Received			Total Points	%	Rank
		A	B	C			
1	Low remuneration of tax personnel	18	49	85	152	15.11	5
2	Weakness of act rules and regulation	10	67	92	169	16.80	4
3	Dishonest tax payers	6	25	95	126	12.53	6
4	Dishonest tax personnel	7	71	105	183	18.19	2
5	Inefficient income tax administrator	9	65	120	194	19.28	1
6	Political instability	15	55	112	182	18.09	3
	Total	55	221	1005	1006	100	

*Source: Opening Survey, 2011*

The causes of corruption in income tax administration of Nepal are ranked in order to the preference of respondents as follows:

1. Inefficient income tax administrator
2. Dishonest personnel
3. Political instability
4. Weakness of act, rules and regulation
5. Low remuneration of tax personnel
6. Dishonest tax payers

From the above study it can be concluded that inefficient of tax administrator, dishonest personnel, and political instability are the most important causes of corruption in income tax administration of Nepal.

After this respondents were asked a question, "How can corruption existed in Nepalese income tax administration be minimized?" for this 6 options were presented and respondents were requested to give points on the options were presented and respondents were requested to give points on the options. The points received from the respondents are given as below:

**Table No.: 4.25 : Factors to minimize the Corruption in Income Tax Administration**

S. No.	Major Causes	Respondents			Total Score	%	Rank
		A	B	C			
1	Moral education to tax personnel	5	62	110	177	15.67	4
2	Reduction of tax officers discretionary power	3	45	125	173	15.31	5
3	Additional incentives to tax personnel	7	52	90	149	13.18	6
4	Regular supervision to tax personnel	6	60	134	200	17.70	3
5	Reward and punishment under performance and taking action to corruptors	10	72	135	217	19.20	1
6	Leadership commitment	9	75	130	214	18.94	2
Total		40	366	724	1130	100	

*Source: Opening Survey, 2011*

According to the above table, the options to minimize the corruption in tax administration of Nepal are given in order to the preference given by the respondents as follows:

1. Reward and punishment under performance and taking action to corrupters
2. Leadership commitment
3. Regular supervision to the tax personnel
4. Moral education to tax personnel
5. Reduction of tax officers discretionary power
6. Additional incentives



From the above study it can be concluded that the most important factors to minimize corruption are reward and punishment under performance and taking actions to the corrupters, leadership commitment, regular supervision to the tax personnel and moral education to the tax personnel etc.

#### 4.2.10 Attitude towards Exemption and Deduction

Adequate exemption and deduction is necessary to promote the business enterprises. Many exemption and deduction provided by 'Industrial Enterprises Act 2049' and Income Tax act 2031' has curtailed by new 'Income Tax Act 2058'. The question "Are exemption and deduction provided by act appropriate?" was asked to find out the opinion of the respondent regarding the exemption and deduction. Opinion result is summarized in the table as below.

**Table No. 4.26: Attitude towards Appropriateness of Exemption and Deduction**

S.N	Respondents	Yes		No		Total	
		No.	%	No.	%	No.	%
1	Tax Administrator	22	65	18	35	40	100
2	Tax Experts	30	80	10	20	40	100
3	Tax Payers	18	45	22	55	20	100
	<b>Total</b>	<b>70</b>	<b>58.33</b>	<b>50</b>	<b>41.67</b>	<b>120</b>	<b>100</b>

*Source: Opinion Survey, 2011*

Most of respondent i.e. 58.33% agree with present exemption and deduction. And 41.67% respondents disagree with the present exemption and deduction. Majority of the respondent, who disagree with present provision of exemption and deduction, was view of increase the deduction and exemption unit to promote special industry.

#### 4.2.11 Attitude toward Problem in Paying Income Tax

To know the problem facing by the taxpayers while paying income tax, the respondents were requested to rank their choice from 1 to 5 according to their preference.

The question was, "In your thinking, what types of problems are facing by the tax payer while paying income tax?" Responses received from respondents are tabulated as below:

**Table No. 4.27: Problems in Tax Paying**

S. No.	Causes	Point Received			Total Points	%	Rank
		A	B	C			
1	Consuming unnecessary time and lengthy process	28	33	35	96	23.76	1
2	Friendliness and behavior of tax personnel are poor and expectation of illegal incentives by tax personnel	11	25	30	66	16.34	5
3	Vague and complicated provision in income tax laws	22	29	37	88	21.78	2
4	Poor education level of tax payers related to business transactions	30	25	20	75	18.56	4
5	Lack of co-operation and co-ordination by tax administrator	24	25	30	79	19.56	3
	Total	115	137	152	404	100	

*Source: Opening Survey, 2011*

From the above table, the major problems facing by the tax payers while paying income tax are ranked in order of preference of the respondents are as follows.

- 1 Consuming unnecessary time and lengthy process
- 2 Vague and complicated provision in income tax laws
- 3 Lack of co-operation and co-ordination by tax administrator
- 4 Poor education level of tax payers related to business transactions
- 5 Friendliness and behavior of tax personnel are poor and expectation of illegal incentives by tax personnel

According to the above study it can be concluded that consuming unnecessary time and lengthy process, vague and complicated provision in income tax laws, etc are the main problems facing by the tax payers while paying income tax.

#### 4.2.12 Submission of Income Tax Returns

It is found that each year only about 60% of the total tax payers submits income tax return to the revenue office. We had asked the respondent that is it the main cause of low collection from income tax. Their opinion is as below:

**Table No. 4.28: Belief on Few Submission of ITR, the main Cause of Decreasing Income Tax**

S. No.	Respondents	Yes		No		Total	
		No.	%	No.	%	No.	%
1	A	22	55	18	45	40	100
2	B	34	85	6	15	40	100
3	C	30	75	10	25	40	100
Total		86	71.67	34	28.33	120	100

*Source: Opinion Survey, 2011*

Since 71.67% of the total respondents believed that few submission of income tax return is the main cause of low collection from income tax, we further asked them for the measures to increase the submission of income tax returns. Their recommended measures among the four options are as below:

**Table No. 4.29: Measures of be Followed to Increase the Income Tax Returns**

S. No.	Recommended Measures	Respondents						Total	%
		A	%	B	%	C	%		
1	Heavy fines and penalties should be levied	8	36.36	4	11.76	4	13.33	16	18.61
2	Awareness should be given through news paper and mass media	6	27.28	24	70.59	18	60	48	55.81
3	Certain exemption for timely submission of income tax returns	8	36.36	4	11.76	6	20	18	20.93
4	Provision of reward	0	0	2	5.89	2	6.67	4	4.65
Total		22	100	34	100	30	100	86	100

*Source: Opinion Survey, 2011*

From the above analysis, 55.81% of the total respondents believed that public awareness should be created through newspaper and mass media in order to increase the timely submission of income tax returns. Presently, we have the problem of information dissemination. When people are timely informed, they will submit their returns which ultimately will help to increase the income tax collection. Respondents were also in favor of giving certain exemption to those who submits the returns on time.

#### 4.2.13 Appropriate Method of Income Tax Assessment

Method of income Tax assessment is very important in the assessment of income tax. Sound and appropriate assessment procedure is essential for the collection of the large amount in the form of income tax. It is very important in managing the income tax because the amount of income tax is realized through the assessment. To find out an appropriate method of income tax assessment a question was forwarded to the respondents "What method is more appropriate in Nepal for assessing income tax?" The response received is tabulated below.

**Table No. 4.30 Appropriate Method While Assessing Income Tax**

S. No.	Methods	Respondents						Total	%
		A	%	B	%	C	%		
1	Assessment on the basis of accounts submitted by the tax payers	10	25	8	20	20	50	38	31.67
2	Self assessment	12	30	30	75	18	45	60	50
3	Assessment on the basis of judgment	18	45	8	5	2	5	22	18.33
4	Assessment by the committee	0	0	0	0	0	0	0	0
Total		40	100	40	100	40	100	120	100

*Source: Opinion Survey, 2011*

From the opinion survey, it has been clear that self assessment method is most appropriate for Nepal while assessing income tax 50% of the respondents are in favor of self assessment while 31.67% of respondents prefer assessment as the basis of account submitted by taxpayers.

#### 4.2.14 Most Important Factor for Effectiveness of Income Tax in Nepal

In order to know the most important factor for effectiveness of income tax in Nepal respondents were requested to rank their responses on given choices. The question was. "What is the most important factor for effectiveness of income tax in Nepal?" Under the table gives a breakdown of responses:

**Table No. 4.31 Most Important Factor for Effectiveness of Income Tax in Nepal**

S. No.	Factor	Respondents			Total Score	%	Rank
		A	B	C			
1	Honest tax officers	21	34	32	87	24.30	2
2	Honest tax payers	24	32	30	86	24.02	3
3	Clear act, rules and regulation	31	35	36	102	28.49	1
4	Effective income tax administration	27	26	30	83	23.19	4
Total		103	127	128	358	100	

*Source: Opinion Survey, 2011*

The most important factors for effectiveness of income tax were ranked in order of the preference of the respondents were as follows:

- 1 Clear acts, rules and regulation
- 2 Honest tax officers
- 3 Honest tax payers
- 4 Effective income tax administration

It can be concluded that clear act, rules and regulation is needed fir he effectiveness of income tax in Nepal.

#### **4.2.15 Suggestions for Achieving Effectiveness of Income Tax in Nepal**

To know the other important factors for effectiveness of income tax, a question was asked "Do you have any others suggestions for achieving effectiveness of income tax in Nepal?"

The responses are as follows:

1. Tax system should be simple, transparent and clearly understandable to the general public.
2. Training programs should be organized to the tax personnel in order to make them up-date and to develop effective tax management system.
3. Public awareness is necessary for successful application of income tax. So, tax education should be given from the school level, it should be included in school curriculum.
4. There should be proper co-ordination among tax related departments such as Department of Revenue Investigation, Custom Department, and Inland Revenue Department. And networking of information system should be developed accordingly.
5. Tax Payers friendly' environment should be created in tax offices.
6. Government should have ability to convince the tax payers about the proper utilization of money, which they have paid as tax.

### **4.3 Major Findings of the Study**

On the basis of data presentation and analysis in above mention sub-chapter some important findings of the study are summarized below.

1. The resource gap 'A' is increasing every year. It was Rs. 30941.30 million in FY 2000/01 and increased to Rs. 79743.30 million in FY 2009/10. It shows the poor performance of domestic resource mobilization.

Resource gap 'B' is Rs. 24187.90 million in FY 2000/01, which is gradually decreased to Rs.15828.20 million in FY 2003/04. And gradually increased to Rs. 49804.70 million in FY 2008/09. In further decreased to Rs.41197.40 million in FY 2009/10.

Resource gap 'C' is taken as the difference between total expenditure and total revenue plus foreign grants plus foreign loan. In FY 2000/01 the gap was Rs. 12143.90 million which was increased to Rs. 15240.80 million in 2001/02, decreased to Rs. 8199.20 million in FY 2003/04. And it was started to increase gradually. It was Rs.39835.80 million in GY 2008/09 and decreased to Rs. 29974 million in 2009/10.

It shows that, there was clear indication of the time serious and growing financial resource problem in Nepal. The increasing magnitude of resource gap clearly indicates that there is an urgent need of mobilizing additional resources. Income tax has appeared one of the most effective fiscal policy instruments to mobilize additional resources and achieving the desired development objective of Nepal. The major reason of growing resources gap is increase in regular expenditure and development expenditure.

- 2 Low tax revenue GDP ratio indicates the weak administration and large scale of tax avoidance and tax evasion. In this situation, total revenue GDP ratio , tax revenue GDP ratio, and non tax revenue GDP ratio were 11.83%, 9.40%, and 2.43% in FY 2000/01 respectively and it is increased to 15.40%, 13.30%, and 2.10% in FY 2009/10, in average it were 12.483%, 9.954% and 2.531% respectively of the last ten years. It shows that these ratios are not suitable for the countries; it means it is low comparing to the other countries.
- 3 The study shows that the average contribution of tax revenue is 79.499% and non tax revenue is 20.501%. The contribution of tax revenue to total revenue is 86.86% and non tax revenue to total revenue is 13.14% in FY 2009/10. The share of tax revenue is in increasing trend.
- 4 Nepalese tax revenue is composed of both direct and indirect tax revenue. There is a dominant role of indirect tax revenue in Nepalese tax structure. The contribution of direct tax and indirect tax to total tax revenue was 26.14% and 73.86% in FY 2000/01 which become 26.71% and 73.295 in FY 2009/10. Whereas the average contribution of direct and indirect tax is 26.27% and 73.73%. Although the total

amount of both taxes is increasing, there is not satisfactory growth in collection of both taxes.

- 5 The contribution of custom duties, VAT and excise duty on indirect tax revenue were 43.72%, 43.14% and 13.14% respectively in FY 2000/01 and contribution of each taxes were reached to 30.73%, 48.02% and 21.25% respectively in FY 2009/10. It shows that custom duty is in decreasing whereas VAT and excise duty if in increasing trend. The average contribution of custom duties. VAT and excise duty on indirect tax revenue were 37.59%, 46.04% and 16.36% respectively.
- 6 The average contribution of land revenue and registration (land revenue plus house and land registration fees) and tax on property, profit and income (income tax, tax on property and the other tax) on direct tax revenue were 11.894% and 88.106% respectively. Among them, their contributions were 6.03% and 93.97% in FY 2000/01. The contribution from other taxes under the heading of tax on property, profit and income was nil (zero) during that period in FY 2000/01 and 2001/02, this was reached to 13.20% and 86.80% in FY 2009/10. The contribution of other taxes was increasing that land revenue under the heading of land revenue and registration was nil (zero) after the FY 2001/01. In the composition of direct tax, income tax was the giant one which contribution seems to be fluctuating every year.
- 7 Total income tax is the composition of public enterprises, private corporate bodies, individuals, and remuneration and taxation interest. The major component of income tax is corporate tax public enterprises and private corporate bodies is decreasing trend. The contribution of individuals, remuneration and taxation interest are fluctuating and increasing trend and the remuneration tax was doubled in last ten years. It has reached to 12.50% in FY 2009/10 which was 6.55% in 2000/01.
- 8 Income tax has been considered as suitable source for mobilizing internal resources. It can be used as a positive instrument to boost up government revenue collection, to develop the economic condition of Nepalese people, to promote distributive justice and to eliminate the resource gap problem. The income tax on total revenue, total tax revenue, direct tax revenue and GDP ratio were 18.64%,



23.45%, 89.71% and 2.20% respectively in FY 2000/01 which had been charged to 17.39% 20.02%, 74.94% and 2.95% respectively in FY 2009/10. And the average contribution of income tax on total government revenue, total tax revenue, direct tax revenue and GDP was 16.584%, 20.78%, 77.942% and 2.199% respectively. It shows that there is decreased in every ratio except GDP current price for the last ten years.

- 9 Revenue collection from income tax is in increasing trend each year but the performance is not satisfactory. Income tax estimates and collections of last ten years shows that in FY 2000/01, 2001/02,2002/03, 2004/05 and 2005/06 tax collection was less than estimate but in FY 2003/04,2006/07, 2007/08 and 2008/09 the tax collection were excess than estimates. In the last year 2009/10 the tax collection was less than estimates.
- 10 The corporate tax rates have been revised for several times. Nowadays, special industries, general industries and non tax industries banking and insurance business are taxed at a flat rate of 20%, 25% and 30% and additional 1.5% respectively in spite of the progressive, progressive and flat tax rate in previous years.

**On the basis of empirical analytical analysis some major findings can be drawn which are summarized as given below:**

- 1 68.33% of total respondents believe that people are not well informed about income tax system in Nepal. 68.33% of the total respondents are favor of income tax as a suitable means of raising government revenue. Only 31.67% of respondents don't recognize it.
- 2 61.67% of the total respondents showed their dissatisfaction regarding the income tax system is not sound and efficient.
- 3 78.33% of the total respondents believe that contribution of income tax to national revenue is not satisfactory. The major causes of tax payer wise low calculation of income tax is lack of tax education , inconsistent tax acts, rules and regulations, loopholes in income tax act etc.

- 4 45% of total respondents believe that present income tax rate is appropriate in Nepal. However, 55% of the respondents' think that present income tax rate is high. Out of which 30.77% if the total respondents prefer tax rate 20%/ whereas 43.59% prefer tax rate at 15% and 25.64T prefer income tax rate at 10%.
- 5 As 51.67% of total respondents believed that contribution of income tax is not satisfactory because of income tax act 2058, the major weakness of the act is that the assessment of income tax is not based on best judgment.
- 6 35% respondents believe that income tax administration is efficient. 37.5% respondents agree that income tax administration is inefficient and 27.5% respondents believe that income tax administration is satisfactory. The lack of trained and competent tax personnel, complicated tax laws, lack of direction, lack of co-ordination of the tax department with other departments among tax related departments , lack of tax awareness to tax payers, lack of effectiveness communication are the most important causes of ineffectiveness of Nepalese tax administration.
- 7 Corruption is the major problem of income tax administration of Nepal, Inefficient income tax administrator, dishonest personnel, political instability, weakness of act, rules and regulation , low remuneration of tax personnel, dishonest tax payers are the major causes of inefficient income tax administration of Nepal. There are 57.50% of respondents agree that Nepalese income tax administration is corrupt, 42.50% respondents were disagreeing with this.
- The most important factors to minimize corruption are reward and punishment under performance taking action to corrupters, leadership commitment, regular supervision to the tax personnel, moral education to tax personnel, reduction to tax officers discretionary power, additional incentives etc.
- 8 Most of the respondents i.e. 58.33% agree with present exemption on deduction and 41.67% respondents disagree with the present exemption and deduction. Majority of the respondents who disagree with present provision of

exemption and deduction was view of increase the deduction and exemption unit to promote special industries.

- 9 Consuming unnecessary time and lengthy process, vague and complicated provision in income tax laws, lack of co-operation and co-ordination by tax administrator, poor education level of tax payers related to business transactions, friendliness and behavior of tax personnel are poor and expectation of illegal incentives by the tax personnel are the major problems facing by the tax payers while paying income tax
- 10 Self assessment method is the most appropriate method for Nepal while assessing income tax 50% of the respondents are in favor of self assessment while 31.67% of respondents prefer assessments as the basis of account submitted by tax payers.
- 11 Clear tax acts, rules and regulations, honest tax officers, honest tax payers, effective income tax administration are the most important factors for effectiveness of income tax in Nepal.

## CHAPTER – 5

# SUMMARY, CONCLUSION AND RECOMMENDATIONS

### 5.1 Summary

The government of any country requires sufficient revenues to lunch the development programs to handle the day to day administration to keep peace and security and lunch other public welfare programs. The government collects revenues from various sources such as fees, taxes, special assessment, fine and penalties, foreign grants etc. Among them tax is the main source of collecting the public revenues because it occupies the most important part of the government treasure. Lack of sufficient financial sources is the major constraints of economic development in development countries like Nepal. A 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 for education or other development activities. To meet the capital requirements government can use internal and external sources of funds. Internal sources of funds include both tax and non-tax revenues and external source of funds are foreign grants and loans. These kinds of funds are received from foreign countries and international organization.

Tax means compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred. A tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government. An administration who govern and operate the system smoothly. It is depend upon the whole part of the society; like as economic condition, social environment, political situation etc. This study mainly focuses on income tax administration and its effectiveness in Nepal. In our country, there is lack of the financial resources and a lot funds are required to do the development activities. Nepal has been suffering from the shortage of capital to accelerate the economic growth. There is so much resource gap so in order to fulfill the shortage, government is depending on the foreign grants and loans. So to fulfill the resource gap income tax, a direct tax is most important sources of internal revenue. Due

to the low economic activities and lesser development of the corporate sector, the contribution of income tax to the total revenue is very low.

The study shows that the percentage of tax revenue and non tax revenue to total revenue was 86.86% and 13.14% respectively in FY 2009/10 and average contribution was 79.499% and 20.5015 respectively in total revenue structure of Nepal during the period of last ten years. In this regards tax revenue has been found as a major instruments for additional internal financial resources mobilization.

In the economy, the percentage of direct tax to total tax revenue is 26.71% and indirect tax to total tax revenue is 73.29% in the FY 2009/10 and average direct and indirect revenue contribution is 26.27% and 73.73% respectively. It shows that the direct tax revenue portion to tax revenue is low which may be due to the low income level and loss improvements of the private sectors as well as public enterprises.

During the study period, the resource gap has been increasing every year. It was Rs. 30941.30 million in the FY 2009/10. This shows the poor performance of the domestic resource mobilization.

In order to find out the problems in the income tax administration, a set of questionnaires were distributed among tax administrators, tax experts and tax payers. On the opinion survey empirical investigation has found the weaknesses but also point out some suggestion to make effective income tax administration in Nepal.

According to survey 68.33% of the total respondents believe that people are not well informed about income tax system in Nepal. So awareness program and tax education were to be given to the tax payers. Large portion of the respondents showed their dissatisfaction regarding the income tax system is not sound and efficient. 68.33% of the total respondents are in favor of income tax as a suitable means of raising government revenue. Only 31.67% of respondents don't recognize it. 78.33% of the total respondents believe that contribution of income tax to national revenue is not satisfactory. The major causes of tax payer wise low calculation of income tax is lack of tax education, inconsistent tax acts, rules and regulations, loopholes in income tax act etc.

45% of total respondents believe that present income tax rate is appropriate in Nepal. However, 55% of the respondents' think that present income tax rate is high. Out of which 30.77% if the total respondents prefer tax rate 20%/ whereas 43.59% prefer tax

rate at 15% and 25.64% prefer income tax rate at 10%. As 51.67% of total respondents believed that contribution of income tax is not satisfactory because of income tax act 2058, the major weakness of the act is that the assessment of income tax is not based on best judgment.

35% respondents believe that income tax administration is efficient. 37.5% respondents agree that income tax administration is inefficient and 27.5% respondents believe that income tax administration is satisfactory. The lack of trained and competent tax personnel, complicated tax laws, lack of direction, lack of co-ordination of the tax department with other departments among tax related departments, lack of tax awareness to tax payers, lack of effectiveness communication are the most important causes of ineffectiveness of Nepalese tax administration.

There are 57.50% of respondents agree that Nepalese income tax administration is corrupt, 42.50% respondents were disagreeing according to the opinion survey. Corruption is the major problem of income tax administration of Nepal, Inefficient income tax administrator, dishonest personnel, political instability, weakness of act, rules and regulation, low remuneration of tax personnel, dishonest tax payers are the major causes of inefficient income tax administration of Nepal. And majority of the respondents who disagree with present provision of exemption and deduction was view of increase the deduction and exemption unit to promote special industries.

There are some problems facing by the tax payers while paying income tax mainly it was consuming unnecessary time and lengthy process, vague and complicated provision in income tax laws, lack of co-operation and co-ordination by tax administrator, poor education level of tax payers related to business transactions, friendliness and behavior of tax personnel are poor and expectation of illegal incentives by the tax personnel. The appropriate method of assessment system was found to be the self assessment method for Nepal while assessing income tax 50% of the respondents are in favor of self assessment while 31.67% of respondents prefer assessment as the bases of account submitted by tax payers. Most of the respondents believed that clear act, rules and regulation are needed for the effectiveness of income tax in Nepal.

## 5.2 Conclusion

Nepal is least development country in the world and it is economically poor but rich on natural resources. As Nepal is adopting the mixed economy for last five decades and have been liberalized from 1990's. By constitution, Nepal has encouraged the foreign investments. Various corporate friendly, laws rules has been formulated. Many public enterprises has been privatized and liquidated, some are in the process of privatization. Nepal has entered to WTO from 23<sup>rd</sup> April 2004 and has given emphases to foreign trade and foreign direct investments. Also the rate of custom duties has been lowered and relief in other trade barriers. Due to liberalized economy number of multinational companies has been established, though there is establishment of multinational companies, they are facing various challenges. The challenges are open boarder, improper billing, tax evasion, political instability, strike, insecurity and unhealthy relation between labor union and the management. The resource gap has been increasing every year. The internal source of revenue cannot meet the regular expenditure so for the development activities depend on the foreign grants and loan. There is always trade loss in foreign trade. The trade deficits have been increasing every year.

Income tax is very important source of tax for the generation revenue from internal sources. We can see the status of a country with the contribution of income tax to national revenue. If the ratio of contribution is high then the status of development is more. So in developed countries the contribution from income tax to national revenue is very high.

The corporate sectors are in the initial stage of development. The role of industrials sector is very poor. We have to depend on the foreign countries for raw materials as well as technologies. Due to land locked nature the carriage cost of the industrial raw materials is very high. Also our economy is more or less depended on the Indian economy. So most of the profits are diverted to foreign countries these days after the restoration of democracy in 2063 B. S. due to the peaceful nature and feeling of security there is chances for good business environment. The hotel and tourism sector are progressing these days and is the future for Nepalese economy.

The income tax act 2058 has encouraged developing the corporate culture in the country. It has transformed the ad-hoc based accounts to account based self assessment. The strength of the act is broad base. Appropriate rate of tax, appropriate method of calculation of depreciation provision for loss carry forward for consecutive year, provision of installment and use of the information technology.

In the opinion survey, it has been found that there is poor taxpaying habit of Nepalese people for which lack of incentives for regular tax payers is the main reason. There is problem in income tax administration. However, income tax act 2058 is modern and effective that the pervious act. But, contribution of income tax on national revenue is not satisfactory. There is corrupt practice in the income tax administration. On the opinion of the respondents the most powerful reason for corrupt practice is low remuneration of tax personnel, weakness of act rules and regulation, dishonest tax personnel and political uncertainty.

Due to the reforms, the corruption existed in income tax administration can be decreased, the efficiency and transparency can be improved and the tax administration will treat the tax payers as a responsible citizens to a considerable extent. The cost of tax collection to tax payers, government and economy as a whole can be reduced to some extent.

Though the act have good aspects, in the implementation there are following challenges, the acts, rules and regulation are not consistent, the tax education part is very poor, there is problem of under invoicing, improper billing and after registration to VAT, taxpayers use to evade the tax by6 showing less transaction . Also there is smuggling of goods due to he open boarder and inefficiency of the administration. Though the tax department is applying income tax, it is not well educated to tax payers as well as the tax personnel. The tax personnel don't get appropriate training. The manpower development planning is desired for the efficiency of tax personnel so as to improve the tax administration and tax compliance. Hence tax compliance can be improved with the remedy of the above challenges.



### 5.3 Recommendations

On the basis of tax related this research, following recommendations are made for helping the higher amount of tax collection and in order to increase the contribution of income tax on government revenues of Nepal.

- ) Income tax law should be clear and Practical.
- ) There must be easy and simple procedure of tax payment.
- ) Income tax policy should be formulated according to the economic policy of the country.
- ) Income tax policy should be revised timely.
- ) Tax ratio should be increased gradually on long run basis to meet the deficit in budget. For this tax base should be widened.
- ) Tax experts and specialists which have depth knowledge about income tax must be involved in formulating income tax policy.
- ) There must be maintained record of income tax assesses in income tax office.
- ) The salaries and incentives of government personnel who worked in IRD should be increased in accordance with their contribution on tax collection and with inflation which is help to motivate the personnel towards their works.
- ) Tax personal must be promoted and demoted to their job performance.
- ) There must be the provision of high penalty and fines to the corrupted personnel.
- ) Tax education activities and awareness programme should be conducted in all over the country through available communication media, i.e. Radio, Television , Newspaper, Internet sites etc.
- ) There must be better communication system between taxpayer and tax personnel. And there should not exist wide gap of communication between taxpayers and related tax office.
- ) The provisions of rewards, prize, incentives should be introduced in the act to encourage the taxpayers to pay tax voluntarily rather through coercive measure.
- ) Tax assessment procedure should be simplified and there must be the provision of better incentives for regular tax payers and heavy penalties and fines to irregular tax payers.

- ) Effective control and penalties to the corrupted personnel and Control the illegal business activities especially at open borders with India.
- ) For taxable income calculation purpose, clear provision is made in case of deduction .that means all the terms of deductions should clearly defined in the act.
- ) For promoting exports, more deduction should be provided.
- ) A research and intelligence centre should be established in each tax office for proper planning and to collect the information in regards to income tax evaders, potential new tax payers and non-residents who have conducted business without registration.
- ) Separate income tax department should be established so that specialization could be achieved in matter of income tax.
- ) Computerized information system in necessary to keep up to date records of income tax.
- ) There must be co-ordination between the departments of tax.
- ) The habit in business sector of not keeping the complete accounts of the transactions of not submitting the real account for tax assessment must be abolished.
- ) Effective public participation is necessary to minimize the income tax evasion. Tax authority should do continuous effort in order to develop the taxpayer's positive attitude towards taxation.
- ) There must be partnership between the government and the private sector leadership like FNCCI, CNI etc. in respect of making the taxpayers aware of the taxation.
- ) There is insufficient number of tax offices within and outside the Katmandu valley. Therefore the numbers must be increased to provide the services conveniently.
- ) The government of Nepal must launch more effective programs to collect more revenue from income tax.
- ) Exemption limit of the income tax should be increased.

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## **APPENDIX I**

### **QUESTIONNAIRES**

These questionnaires are conducting a research on "**A Study on Composition of Nepalese Tax Revenue and its Effectiveness in Nepal**". It would be very much appreciated if you could spare of your time for fulfilling this. Your kind help and valuable suggestions are essential for the completion of the research.

Yours sincerely

Gokul Pandey

Roll No: 1565/064

Shanker Dev Campus

## APPENDIX II

Name:

Office:

Occupation:

Designation:

You are requested to tick ( ) the answer of your choice or from the following questions or wherever appropriate please give points them in order to preference from first to last in the basis of number of alternatives. Number 1 stands for least important and last number of the most.

### Questionnaires to Tax Administrators/ Tax Experts/ Tax Payers

1. Do you think people are well informed about the income tax system in Nepal?
  - i. Yes ( )
  - ii. No ( )
  
2. In your opinion is the income tax system of Nepal is sound and efficient?
  - i. Yes ( )
  - ii. No ( )
  
3. Do you consider that income tax as a suitable means of raising government revenue?
  - i. Yes ( )
  - ii. No ( )

4. In your opinion is contribution of income tax to national revenue is satisfactory?

i. Yes ( )

ii. No ( )

If no, what are the main causes of tax payers wise low collection from income tax in Nepal?

(Please rank according to the priority)

i. Inconsistent tax acts, rules and regulation ( )

ii. Loopholes in income tax act ( )

iii. Existence of smuggling ( )

iv. Improper billing system ( )

v. Inefficient of tax administration ( )

vi. Lack of tax education ( )

vii. Income tax returns not filing on time ( )

viii. Instable political condition ( )

ix. Increasing tendency of tax evasion ( )

x. Mass poverty and low income level ( )

xi. Other, Please specify ...

5. Is present income tax rate in Nepal High?

i. Yes ( )

ii. No ( )

If yes, what should be the maximum rate of income tax?

i. 20% ( )

ii. 18% ( )

iii. 15% ( )

iv. 10% ( )

v. Others ( )



6. Do you believe that the contribution of income tax is not satisfactory because of income tax act, 2058?

i. Yes ( )

ii. No ( )

If yes, what is the major weakness in income tax act 2058, for low contribution from income tax?

i. It is fully based on self assessment. ( )

ii. Amended assessment is not in practice. ( )

iii. Assessment of income tax is not based on best judgment ( )

iv. Complication due to the merging of Tax and VAT administration ( )

v. No harmony between VAT and Income tax act ( )

vi. Others please specify.....

7. What do you feel about present income tax administration of Nepal?

i Efficient ( )

ii. Inefficient ( )

iii. Satisfactory ( )

If inefficient, what are the major causes? (Please rank)

i. Complicated tax laws ( )

ii. Lack of trained and competent tax officials ( )

iii Lack of effective communication ( )

iv. Lack of tax awareness to tax payers ( )

v. Unnecessary outside pressure ( )

vi. Lack of co-ordination of the tax department with other departments ( )

vii. Lack of proper direction ( )

Others, if any please specify.....

8. Do you think that there is corruption in income tax administration of Nepal?

i. Yes ( )

ii. No ( )

If yes, what are the major causes? (Please give points)

- i. Lower remuneration of tax personnel ( )
- ii. Weakness of acts, rules and regulations ( )
- iii. Dishonest tax payers ( )
- iv. Dishonest tax personnel ( )
- v. Inefficient income tax administration ( )
- vi. Political instability ( )

9. How can corruption existed in Nepalese income tax administration be minimized?

(Please give points)

- i. Moral education to tax personnel ( )
- ii. Reduction of tax officers discretionary power ( )
- iii. Additional incentives to tax personnel ( )
- iv. Reward and punishment under performance and taking action to corruptors ( )
- v. Regular supervision to tax personnel ( )
- vi. Leadership commitment ( )

10. Are exemption and deduction provided by act appropriate?

- i. Yes ( )
- ii. No ( )

11. In your opinion, what types of problems are facing by the tax payer while paying income tax? (Please rank)

- i. Consuming unnecessary time and lengthy process ( )
- ii. Vague and complicated provision in income tax laws ( )
- iii. Lack of co-operation and co-ordination by tax administrator ( )
- iv. Poor education level of tax payers related to business transactions ( )
- v. Friendliness and behaviour of tax personnel are poor and expectation of illegal incentives by tax personnel ( )

12. Each year only about 60% of the total tax payers submits income tax return to the revenue office. Do you believe that it is the main cause of low collection from income tax?

- i. Yes ( )
- ii. No ( )

If yes, what should be done to increase the submission of income tax return?

- i. Heavy fines and penalties should be levied ( )
- ii. Awareness should be given through news paper and mass media ( )
- iii. Certain exemption should be given for timely submission of income tax returns ( )
- iv. Provision of reward ( )
- v. Others please specify.....

13. What method is more appropriate in Nepal for assessing income tax?

- i. Assessment on the basis of accounts submitted by the tax payers ( )
- ii. Self assessment ( )
- iii. Assessment on the best judgment ( )
- iv. Assessment by the committee ( )
- v. Others please specify.....

14. What is the most important factor for effectiveness of income tax in Nepal?

(Please rank)

- i. Clear acts, rules and regulation ( )
- ii. Honest tax officers ( )
- iii. Honest tax payers ( )
- iv. Effective income tax administration ( )
- v. Others please specify .....

15. Do you have any others suggestions for achieving effectiveness of income tax in Nepal?

**APPENDIX III**  
**ORGANIZATIONAL STRUCTURE OF IRD**

