CHAPTER-I

INTRODUCTION

1.1 Background of the Study

Nepal is an independent multiparty democratic country on the southern part of Asia continent. It is landlord country covering an area of 147181 square kilometers. It is between China and India. The main occupation of Nepalese's peoples is agriculture. It is situated between longitudes 80°4'E to 88°12'E and latitudes 26°22'N to 30°27'N, along the Southern slopes of the Himalayas (snow peaks). The economic condition of Nepal is very poor as compared to other country, followed by the 3.90 percent growth rate in the last year. Nepalese economy has not become successful in creating an investment friendly environment (Kantipur, 13 July2009).

Nepal’s per capita income is very low. Nepal’s per capita income has been American Dollars 484.” (Kantipur, 13 July2009). “Economic Survey 2064/65 published by Ministry of finance states that the per capita income has been reached to Dollar 484.” It is one of the lowest in the world. Income distribution is significantly influenced by disparities in the distribution of assets and income generating opportunities. Lower saving of individuals has been the major cause for the lower saving of the household and lower investment. Very low levels of revenue generation and relatively higher expenditure in social and economic infrastructures have been the features of Nepalese economy. As a result, budget deficit continues to remain at high level. Most of development projects & programs are financed through foreign loan and aid leading to problems of increasing debt servicing.

The main objective of the modern government of any developing country is to improve living standard of its people through proper utilization of resources. Capital plays a vital role in the economic development programs to solve the various socio-economic problems. The constitution of Nepal has clearly directed Nepalese government for a self reliant economic system, encouragement to national enterprises, prevention of economic exploitation as well as upgrading the standard of the people for self-reliant economic system and sound infrastructure for the development, the government should generate sufficient government revenue.

Government revenue is the most important source of financing government expenditure. To achieve the national objectives the government is required to make and implement various policies and planning, acts and procedures. Besides these functions revenue mobilization is one of the most important functions of the government. Government collects funds from different internal and external sources to fulfill its requisites. External sources of government are foreign loan, grants, external borrowings etc. Tax, income from public enterprises, special assessment, fees, penalties, and fines are internal sources of revenue. The income of the government is called government revenue. The government revenue can be classified broadly into two groups i.e. tax revenue and non-tax revenue. Government receives tax revenue as compulsory payment and non-tax revenue a conditional sources. Duty & fees, penalty, fines and forfeitures, receipt from sales and rent of government services, dividends, interest, royalty and sales of government property, principle repayment, donation and miscellaneous income etc are the sources of non-tax revenue; Income tax, Sales tax, Custom duties, hotel tax, revenue from land registration etc. are the sources of tax revenue. The major sources of internal revenue of government are tax revenue.

Taxes are divided into two categories. They are direct tax and indirect tax. A direct tax is really paid by the person on whom it is legally imposed. Direct taxes are levied on the income and property. The direct taxes have been used to bridge the gap of income and wealth inequality in the society. An indirect tax is imposed on one person but paid partly or wholly by another. Indirect taxes are generally imposed on the consumption of goods and services. The taxes on such goods and services are integrated with their price. Selling those goods and services on higher price, the tax payers easily transfer the burden on general consumer. (Kandel, 2004)

The role of direct and indirect tax has the importance mostly in the developing countries. But the importance of these taxes varies from one country to another and from time to time. In the initial stage of economic development, indirect taxes have a significant role but after a certain stage of economic development is reached, direct taxes have a significant role.

Income tax is direct tax that is imposed on the earning of individual and corporation. The underlying reason for the imposition of income tax is to generate more revenue to finance development activities and to help in achieving social justice.

Income tax should be justifiable to achieve maximum social and economic objectives. It helps in redistribution of economic means by the transformation of wealth from person with higher economic level to lower economic level. It should minimize gap between haves and have not. Regional economic imbalances may also be reduced by providing incentives and concession in income tax for promoting industries in backward areas. It has become on effective instrument to ensure balanced socio-economic growth. (Siwakoti, 1987)

Income tax also helps to increase the consciousness of the people because the people who have paid the income tax are keen towards public expenditure. It is also helpful for generating the concept of social responsibility towards the nation. In fact income tax system has been originated recently as on internal sources to strengthen the sources of tax for economic growth of a country and to meet the slogan of economic revolution by searching additional sources of revenue. One of the important characteristics of income tax system is that it is impartial and just as compared to other taxes. The reason is that it is imposed keeping in view the capacity of taxpayer to bear the burden of tax. People, whose income level is under prescribed limit, are exempted from income tax liability Income tax is basically charged for two purposes. One is for collecting to meet expenses for public welfare activities and another is to create equalitarian society by minimizing the economic gap between haves and have not. Income tax is based on the principle of certainty. It also follows the cannon of economy.

The objectives of sound financial system and creation of unexploited society cannot be achieved until the mobilization of economic resources effectively through direct tax like income tax. It is therefore given high priority in almost of the countries, developed as well as developing because they have potential for increasing the yield of the tax system and achieving a system of taxation that satisfies the demand for equity and social justice. It more or less affects on production, growth, economic activities of the government, reduction of dependency on external sources, industrialization, redistribution of income, employment and generation of society justice.

Taxes in income are the most important source of revenue for governments of developed countries. But developing countries at present produce far less revenue than costume duties and taxes on internal transactions. But these taxes are emphasized in all developed as well as developing countries, because they have the potential for increasing the yield of the tax system and achieving a system of taxation that satisfies the demand for equity and social justice (Singh, 2001). Income tax may be levied on the individuals as well as business firms. The former is known as personal or individual income tax or simply tax, while the next is known by the name of corporate income tax or corporation tax

A company or corporation body is a legal organization that is voluntarily created, organized or cratered under law. It is artificial people which can own property execute contracts rise debts, and generate profits. Therefore, business tax is a tax levied on companies or business bodies in contrast to uninbusinessd enterprises. It is the tax on capital income that occurs in the form of profit and originates the business sector i.e. company. There are some obvious arguments in favor of raising a large amount by way of corporation taxation in developing countries. The first is the ease of collection. Corporations are easily identifiable, keep accounts and cannot escape tax liabilities by, for instance, rapid changes of their place of residence. In these respects they are almost and administrators dreams. The term business includes a past, present or prospective business. So, preliminary or pre operation expenses incurred prior to the commencement of a business should be claimed in the year of insurance, which will be the loss due to not conducting of business transactions. Such loss should be carried forward to against profits of coming years (ITA, 2058).

In Nepalese context, there are only a limited number of business firms in Nepal. Not only this, their economic performance is also very dismal. Because of these two reasons, the contribution of business tax to the government treasury is not much satisfactory in Nepal. Furthermore, the low revenue productivity from business tax is also the result of the various types of incentives especially, the provision of tax holyday to the incentives. The comparison of contribution of Nepalese business sector to government treasury with the counterpart of other countries shows that the contribution of Nepalese business sector to government is far lower than in OECD countries and India (Kandel, 2004).

Nepal's income tax has features of both global and scheduler income tax system. Especially, after 1990's, there is re-emergence of the liberalization, globalization and privatization system that focuses on the minimum intervention of the estate on private economic matters. The 1950's concept of high incentive, high tax rate is changed to the concept of low rate, wide net'. This trend in tax system is followed by most of the countries of the world. Nepal is also not an exception in this respect and Nepalese administrators and policy makers too have tried to change the tax policy of the country.

The taxes were 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 multiparty democratic system was introduced. In 1951, the finance minister in his budget speech decleare the intention of the government to levy an income tax. The first elected government in 1959 finally introduced "Business profits and salary 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 extended in the act. In 1974, "Income tax act, 1974(2031)" was enacted. (Bhattarai, 2008)

Although Nepal has a long history of taxation business tax was introduced only in 1960 when the Business profits and Remuneration Tax Act, 1960 was enacted. At the beginning, it was not differentiated from the personal income tax. The same tax rate with progressively and exemption limit were prescribed by the Finance Acts of 1960 to 1964 to all companies, private firms, individuals and families. From the financial year 1965/66, the tax exemption given to companies similar to personal taxpayers was with drawn. A separate tax system to companies was introduced by the Finance Act, 1976, Finance Act 1985 made a provision of giving 5 percent tax rebate from highest marginal rate of 55% to listed public companies and government enterprises. Financial year 1986/87 was the year when the business tax was really recognized by imposing a flat rate of 40 percent tax on taxable income of listed companies. By the same coin, Finance Act imposed tax on dividend also to be deducted at source at the rate of 20 percent which after the filing of return by shareholders was to be reconciled. But this dividend tax was changed exempting divided to a level of 85 percent in 1987/88 and cent percent in 1990/91. Finance Act, 1992/93 introduced compulsory self fax assessment system for public and private limited co. Besides these changes, taxing business income at flat rate to the private limited company was enacted from the financial year 1994/95. This change at last ended the discrimination between private company and the public company. Another major change carried out in recent years is the inclusion of divided of non-industrial companies within the tax net, since the financial year 1998/99 (Kandel, 2004).

The corporation sector has been classified into three groups according to establishment and ownership. The major three groups are government sector, public sector and private sector. There are also special industries and normal industries, taxable industries and non-taxable industries according to nature and liability of paying tax. Special sector's companies are levied 20 percent tax rate on the taxable income of the companies, as per Income Tax Act 2058. Normal industries including trading company and manufacturing industries have been taxed at 25% & 20% flat rate respectively and other industry at 25%. Banking and insurance industries have been taxed @30% flat rate. The industries established in backward areas are provided certain facilities, concessions, rebates and tax holding as per the ITA 2058 and Industrial Enterprise Act 2049. Similarly, dividend and capital gain have been also included in tax net.

1.2 Statement of the Problem

Most of the Nepalese people are dependent on agriculture income. The professional man and business firms are grow up slowly. But the habits of tax payers of Nepalese people are poor. The income tax is not properly implementation because off lack of education, corruption, harassments, tax evasion and tax avoidance etc.

There are many problems in Nepalese income tax system. Government is already not able to increase the income tax as per requirement after the ambitious change in law. Inefficient tax administrative system, widespread income tax evasion, complicated and frequent change in tax rate and lack of awareness and feelings of responsibility in taxpayers are appearing as major factors for low contribution of income tax in national revenue. Internal conflict of nation and political instability has affected the economic system indirectly but very seriously. It has damaged as well as destroyed the environment for generating more income. Where income is limited, certainly the tax from income will not be so optimistic.

Income tax is one of the component of taxation and major sources of government revenue. Income tax in developing nations has been regarded as an instrument of growth and social justice. But Government of Nepal is being unable to mobilize the expected income tax from personal as well as corporation. Most of the personal tax payers do not reveal the income sources even they proper accounts. Similarly, many research reports have addressed that tax evasion has become a serious problem as a result the actual collection of income tax is being very low. So the role of business income tax revenue is justifiable. Business firms are easily identifiable, keep their accounts and cannot escape tax liabilities. But business sector is in initial stage of development in Nepal. The performance of business sector, especially, the industry is very poor. Their number, profitability, investment in fixed assets, share in market transaction are all in weak position. There is no agreement as regards to various issues in business tax area. The debate is going on as regards to base of tax, method of taxing corporation, method and rate of depreciation, use of appropriate type of tax incentive, treatment of tax inflation etc. To examine the business income tax and its impact of national revenue is the main aim of this study. So this study has tried to access the following research questions.

1. What is the present status of business or professional income tax system in Nepal?
2. How much contribution made by the tax payers in Nepal through business tax?
3. What is the impact of income tax on government revenue?
4. How to improve the no of business tax payers in Nepal?

1.3 Objectives of the Study

The basic objective of this study is to examine the present status of business tax system in Nepal and appropriate suggestion to the government for improvement by which government can collect more revenue. The specific objectives of this study are mentioned bellow.

1. To examine the present status of business income tax in Nepal.
2. To determine the types of business income and the contribution to national revenue.
3. To find out the impact of income tax to national revenue.
4. To suggest the improvement of business income tax system of Nepal.

1.4 Significance of the Study

Nepal is an agro-based developing country with low speed in industrialization process. There are only a limited number of business bodies and their economic performance is very dismal. So, there is need to growth and development of business sector in our nation. The government need huge amount of funds to spend on daily expenses as well as development activities. Every year, Nepalese government has been presenting deficit budget, there is increment in resource gap. Most of the development activities depend on bilateral and multilateral grants and loans. The nation is hardly bearing the burden of the loan and the internal source of revenue is not sufficient even to meet the ordinary expenses. In this context the easy and long lasting way to increase revenue to strengthen the internal source in which business income tax is one of the major components. Thus, the contribution of business income tax in government revenue and its impacts on fulfilling resource gap has been chosen as a relevant topic for the study.

The study is useful to economists, planners, tax officers, tax administrators, government and other interested person about the contribution of business sector in internal resources and the problem and prospects of business sector. It also provides the information about trends and projection of business income tax.

This study is significant in the following ways.

-To examine the application of income tax act 2058, special reference to business income.

-To explorer the problem of business income tax.

-It will be useful to the potentials investors, lenders, managers and policy makers in Nepal.

-Last but not least, it provides literature to the researcher who wants to carry on future research in this field.

1.5 Delimitation of the Study

The study has the following limitations:

a. The extent of this study is based on the availability of reliable data and literatures.

b. The study is mainly based on secondary data. The reliability depends on it

c. The secondary data of 18 years (from fiscal year 1991/92 – 2008/09) are taken into consideration.

d. Main focus is given to business income tax of Nepal.

e. This study has been conducted to fulfill the requirement of the MBS programms of T.U. for the prescribed time, not for generalization purpose.

f. This study is confined to Nepalese laws, acts, rules and regulations to the income tax.

g. The subject matter is very vague but each and every aspect of the concern topic may not be covered.

1.6 Organization of the Study

This study has been organized in five chapters.

The first chapter is introduction chapter. It constitutes general concept about the chosen topics under general background and problems appeared related to subject matter under statement of the problem. Objectives and limitations of study have also been pointed in this chapter.

The second chapter is Review of Literature. It constitutes Review of Literature through different relevant books, articles and unpublished dissertation & definition, legal provisions and income tax system. It is focused on defining the related terms such as revenue, tax, income tax etc and developing the concepts on them. History of income tax and provisions in act has been analyzed on comparative aspects.

The Third chapter is Research Methodology. It includes types of research, research design, population and samples, nature and source of data, data collection procedure and data processing and analysis procedure.

Presentation and Analysis of primary and secondary data has been presented in the chapter four. This is one of the most important chapter and has been included the data related to the topic extracted from economic survey and annual reports published by the government of Nepal in their respective way and their analysis has been presented accordingly with suitable methods of presentation. Primary data collected from tax exports and tax payers and analysis in this chapter. In this chapter major findings is subchapter. In subchapter the findings of analysis is covered.

The fifth chapter includes Summary, Conclusion and Recommendation. It is the last but not the least chapter. Suggestions for betterment of income tax system in Nepal have been made within the frame of conclusions of study.

CHAPTER-II

REVIEW OF LITERATURE

Review of literature is basically of stock taking of available literature in the field of research. It supports the researcher to explore the relevant and true facts for the reporting purpose in the field of study. Here literature means the related printing materials about the subject matter of research work. It may be in various forms like book, booklet, thesis report etc. In the course of research review of the existing literature would help to check the chance of duplication in the present study. Thus one can find what studies have been conducted and what remains to go with review of literature is vital while doing research work as it gives the finding of previous study, it can be used as a secondary data, and it gives the valuable information about the subjects.

This chapter highlights the literature available related to the present study. This chapter comprises the following two parts, review of conceptual framework and review of previous related studies.

2.1 Conceptual Framework

2.1.1. Revenue

Revenue is regular income of government from internal resources for execution of different bodies of nation.

"Revenue means the amount that is to be paid to government as costume duty, excise duty, income tax, entertainment tax, hotel tax, sales tax, vehicle tax, rent tax, contract tax, property tax and the word also indicates other taxes according to existing law."(ICA, 2052)

Revenue amount is collected through different medium from public people and spent from state for welfare of people, so it is also called public income. Government levies costume, excise, income tax, VAT, land tax, fees and penalties as source of revenue. Revenue can be divided into tax revenue and non tax revenue. Government income specified in act and law to be paid by person, firm, industry, business, trade, profession or organizatic ɔr execution of some task or work or for holding of some kinds of assets is known as tax revenue. For example:- costume duty, excise duty, land tax, VAT etc. Revenue gained by government for distribution of public service or for public service or for direct facilities provided or for fees and penalties to state against violation of rules and regulation is known as non tax revenue. For example: income from sales of government goods and services, principle, interest, dividend, royalty, fine, penalty, seizing etc. are non tax revenue. The sources of revenues are tax, Fees, amount for goods and services provided, fine and penalty, franchise costs, gifts and donations etc.

2.1.2. Tax

Tax is an important source of revenue for government. It is compulsory provision to citizen imposed by law to pay as monetary term to government without any expectation of some specified return. Economists and scholar have expressed their view in tax as follows:

"A tax is a compulsory contribution of wealth of a person or body of persons for the service of public powers." – Bastable

"A tax is a compulsory payment to government without expectation of direct expenses of direct return in benefit to the taxpayer." – P. E. Taylor

"Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefit upon the residents of the states." – Plehn (Dhakal, 1998)

"Tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interests of all without reference to special benefits conferred." – Professor Saligman (Lekhi, 2000)

Among above, the first three states that the tax is compulsory levy and the taxpayer does not have any right to receive direct benefits from tax paid. The remaining definitions also clears about the expense of collected tax in common interests of residents of nation.

According to definition, tax has major three characteristics:

a) It is a compulsory monetary contribution.
b) Taxpayers should not expect special treatment as a return of tax.
c) Amount collected from tax should be expended for public of whole nation.

Taxes are levied primarily to raise revenue for the government expenditures, although they raise other purposes as well. The concept of modern tax contains different fundamental principles such as:

a) No taxation without representation. Tax can be levied only with the approval of citizens through their representatives.
b) Foreigners are to pay more tax than citizens
c) Progressive principle i.e. more tax for more income.
d) Tax should be collected compulsorily.
e) Taxpayers are compelled to pay as their liability.

Tax can be classified into direct and indirect tax.

i) Direct tax:

Direct tax is paid by same person who is legally imposed. It is paid according to the income or property earned by a person. It is found equal with property. There is certainty about time, design and process of payment. Taxpayers can easily estimate their liability and government can easily increase or reduce according to needs. Income tax, contract tax, vehicle tax are examples of direct tax.

Direct tax is levied on direct persons, so they may not be ready to pay voluntarily. And of course they try to pay lowest tax as possible as and also exercise for tax evasion. Direct tax is also expensive for collection. Direct tax discourages private saving and investment and there is lack of mass participation.

ii) Indirect tax:

Indirect tax is imposed on one person but paid partly or wholly by another. It is transferable and people pay tax when they receive or consume goods or services. It is transferable and people don't feel burden of lump sum. There is mass participation because every person pays tax for receipt of goods or services. Indirect tax can be charged at higher rate for harmful goods such as cigarette and alcohol to discourage them. So indirect tax is flexible. Examples of indirect taxes are customs, excise, value added tax, entertainment tax etc.

There are some limitations of indirect tax. Every person either rich or poor has to pay equal amount of tax for reception of goods or services so it is tougher for poor. The higher rate, if imposed, may reduce consumption and it effects on production and employment. There is no certainty about collection of indirect tax.

2.1.3 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 denotes to the low living standard of people. People generate 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.

Economists define the term 'income' in a broad sense. It is a economic gain or receipt to a person during a particular period by way of wages, interest, profit and rent. The money income of the people is generally used for two purposes. Part of income is spent on consumption and part is saved. This definition can be expressed in the formula as follows:

$$Y = C + S$$

Where,

Y = Income

S = Saving

C = Consumption

But the purpose of taxation the definition of income is somehow different from the aforesaid definition. According to Income Tax Act 1974 (2031) "Income means the income earned or received in cash or kind from the sources mentioned in sec.5". In this section five different heads of income were mentioned. They were as follows: [ITA, 1974).

1. Agriculture
2. Industry, Business or Vocation
3. Remuneration
4. House and land rent
5. Other sources

The existing Income Tax Act 2002 (2058), which has been enacted since 2058 Chaitra 19, (1st April, 2002), has defined income in section 2)a' as "person's income from any employment business as calculated in accordance with this Act (ITA, 2002)]. It includes all sorts of income received for the provision of labour or capital or both of whatever form or nature in the taxable income.

Tax is, in simple terminology, a liability to pay an amount to the government. It is a compulsory contribution to the national revenue from the tax payers according to law. In the word of Seligman, taxation is the "Compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred."

From the definition given above it can be said that firstly, 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. Secondly, tax payer cannot receive any quid pro quo for the payment of tax. The tax payer does not receive equivalent benefit from the government. Thirdly, the tax is paid to the government for running it. Fourthly, in case of tax, the amount is spent for common interest of the people. The tax is collected form haves and basically, spent for the interest of have-nots in the society. Fifthly, a natural or an artificial person pays the tax (Kandel , 2004).

In conclusion, it can be said that a tax is a liability to pay an amount to the state. The basis of a minimum amount from certain specified or that they own certain tangible or intangible property or that they carry-on certain activities which have been chosen for taxation (Kandel, 2004).

Income tax refers to the tax levied on the income of a person and profits of corporation for the specific time period, particularly one year. Income tax is levied on the taxable income of a person or a company after deducting allowable expenses. Accounting profits may differ from taxable profits. For the computation of taxable income, generally incomes are added and expenses are subtracted and losses, which are allowed to deduct under the provision of income tax act are also subtracted. Then, tax-free incomes allowances and common expenses are also deducted to get taxable income. After giving the exemption limit as per law, the amount of tax to be levied on this computed income is the income tax.

2.1.4 Evolution of Taxation

In early days, taxes were collected at the time of emergencies, to finance means and to provide communal services. Taxes were levied on the basis of welfare of the people. At that time tax was not compulsory payment. People voluntarily paid the tax because non-payment of tax was taken as six in the Hindu tax system. According to Hindus' scripture, the duty of king was to serve and secure his people, maintain peace and harmony and carryout social works. For those purpose king used to levy tax by collecting crops and cattle from farmers, gold and silver and other metallic goods from traders.

Great Britain was the first country in the world to introduce the income tax in 1799. It imposed income tax in order to finance war with France. Similarly, in U.S.A. the first federal income tax was imposed in 1862 with the same objective (to finance civil war). However, in the beginning these countries imposed income tax as temporary until 1860. Thereafter, since 1913 it was accepted as permanent tax. This, income tax was adopted by different countries gradually. Italy started it in 1864, and New Zealand adopted in 1891, Australia and Canada had followed the income tax in 1915 and 1917 respectively. After that world war, the income tax became an important source of tax revenue in many developed countries. By 1939, it had become the most important source of revenue in most developed countries and had made appearance in a number of developing nations (Agrawal, 1980).

In our neighboring country India, the income taxation was started in 1860 by the British government to relief from economic burden created due to first democratic revolution. It was then regularly collected after the publication of Income Tax Act 1886 (Dhakal, 1998).

In this way, income tax has become the regular source of national receipts for many developed and developing countries of the world. In the beginning, income tax was generally levied at a flat rate. The principle of progressive rate of income tax had been adopted by the United Kingdom and New Zealand since 1909. Now-a-days the progressive rate is commonly used rather than flat rate in all over the world.

2.1.4.1 Taxation in Ancient Nepal

Reliable records about taxation in ancient and medieval Nepal are not available. However, tax has been one of the major sources of government's revenue from the ancient time in Nepal. Taxes were then levied on the merchants, travelers and farmers in the form of cash, kind and labour. On some occasions gold and agricultural products were also paid as taxes; but the nature of these taxes was temporary. In the Lichhavis regime, income taxes from agriculture and business were introduced as a direct tax for the first time in Nepal. Agricultural income tax was called "Bhaga". The farmers were supposed to pay agricultural income tax to the government in 1/6, 1/8, and 1/12 quality of the land that they owned. Income tax, which was levied on business income, was called 'kara'. There did also exist irrigation and religious tax during the regime of king of Ansubarma of Nepal (Shauh, 1995).

2.1.4.2 Taxation in Unified Nepal (1768–1846)

After unification of kingdom of Nepal, expenses for administration, military and other operational activities were increased significantly. During that period, taxation has been taken as main source of revenue and different types of taxes like land tax, transit tax, market duties, various levies and fixes, forest product tax and mining tax were levied. Local administrations were directed "to take whatever is paid willingly by the people". Taxes were collected from the three levels (Agrawal, 1980).

1. Royal Palace: To finance occasional and ceremonial needs. The taxes were broad based and progressive.
2. Government: To finance administrative, military and other purposes assessed on official functionaries, occupational groups and other people.
3. Local: Prerequisites of local officials, functionaries and mendicants.

The various taxes levied during this period were narrow in base and were imposed primarily on occupations and economic activities, not on income or property. The system of direct taxation was confined to land tax and special levies like "Darhsanbhet", "Salami", "Walak" etc. After the unified period, land tenure system was divided into five main forms: Raikar, Birta, Guthi, Sera and Kipat. The main sources of revenue from land were Birta and Kipat.

King Prithvi Narayan Shah had introduced 'Pota' tax in 1772, which was regarded as a revolutionary measure in the fiscal system of Nepal. It was based on flat rate system and limited on small Birta owners. There was no taxation of income in the sense of modern income tax.

2.1.4.3 Taxation in Rana Regime (1846–1950A.D.)

Imposition and collection of taxes during 104 years oligarchic rule of the Rana family in Nepal prior to 1951 was the prerogative of the feudal rulers. Only those taxes, which suited the objectives, needs and whims of the ruling Prime Minister, were imposed. No budget was framed during the Rana regime. Taxes were collected at the time of requirement due to lack of income tax act and finance act. The collected taxes were directly deposited into the Prime Minister's Account.

Land tax, custom and excise duties in the form of lump sum, contracts, royalties on felling trees, royalty on supply of porters and soldiers, entertainment taxes were the major source of revenue. There was no direct tax in the country except land tax collected on a contractual basis and "Salami" which the government employees used to pay out of their salaries at a very small percentage.

Rana Prime Minister levied taxes for meeting specific expenditure of the royal household or extraordinary expenditure necessitated by war or other crisis rather than mobilizing revenue in the nation. During Nepal- Tibet war (1855/56), the first Rana Prime Minister Jung Bahadur had imposed a tax on the income of selected groups. Similarly, Bir Shamsher imposed a levy of 1% on the official value of Jagir assignment of government employees in 1891, to finance the transportation of water pipe supply in the capital. Ranoddip Singh imposed a 50% tax on the income made by fishermen in Deukhuri from the sale of fish in 1882.

2.1.4.4 Income Tax in Modern Nepal

Actually, the modern income tax act was started in the year 1959 in Nepal. After the political revolution in February 1951 (2007 B.S. Falgun), the role of government has increased to developmental as well as philanthropic works. The government of Nepal had presented its first budget in 1952 (2008, Magh 21). The first five year plan started in 1956. The planned activities of the government needed huge amount of source and means. So huge revenue was demanded and Nepalese government started to levy tax on income as permanent source. As a result, it issued first finance ordinance in 1959 (2016) to impose tax on business profit and remuneration. In 1960 (2017) the income tax act named "Business Profit and Remuneration Act, 2017" was made with the provisions of finance ordinance 1959. That was the first income tax act, which had 22 sections. But that act was found narrow and vague. So it was replaced by the Income Tax Act 1962 (2019). That act continued for 12 years and it was also replaced by the Income Tax Act, 1974 (2031). That act was amended for eight times. That tax act was replaced by new Income Tax Act, 2002 (2058). This is the fourth income tax act of Nepal.

2.1.5 Gradual Developmental of Income Tax Act and Laws

2.1.5.1 Business Profit and Remuneration Tax Act, 1960 (2017 B.S.)

The Finance Act 1960, made provisions for the taxation of business profits and remunerations. An ordinance was issued by the king to collect the tax. In 1960, parliament of Nepal, enacted, "Business Profit and Remuneration Tax Act 1960 (2017)", which consisted of 22 sections. With the enactment of that act, the salary tax or personnel income tax was levied upon those individuals whose personal income exceeded Rs.6,000 per year. In the first three years, the exemption was Rs.7,000. An examination of tax files in the Kathmandu District Office disclosed 557 personal income tax files of individuals who had paid taxes in one or more years.

The following were the silent features of the Act (BP & RA, 1960).

1. Only remuneration and business profit were subject to tax. Deduction was not specified for the purpose of calculating the income.
2. Tax on remuneration was to be deducted at source.
3. The basis for calculating the tax liability for remuneration was the income of the current year and for the business profit, it was the profit of preceding year.
4. In case of default, fines up to Rs.5,000 were prescribed.
5. The tax payer was given the right to appeal against the tax assessment to local "BadaHakim". Thereafter appeal could be lodged at Revenue court. Every appeal was to be accompanied by security deposit for the amount of tax payable.
6. The tax officers were empowered to assess tax on the basis of best judgment estimates.
7. Profits from industries were granted a rebate of 25 percent and profits from small industries were granted a rebate of 50%.

As high discretionary power in assessment of income tax granted to tax officers, various loopholes, narrow and vague tax base were the major shortcomings of that act which cause the Income Act 1962 (2019) came into existence.

2.1.5.2 Income Tax Act, 1962 (2019)

The main purpose of the imposition of this act was not only to raise government revenue but also to reduce inequality of income and wealth distribution with social justice and to create regular tax paying habit of the taxpayer. The Income Tax Act 1962 had 29 sections and it was amended in 1972 (2029 B.S.). It had provision of imposition of income tax in agricultural income, but this provision was abolished by the Finance Act, 1966 (2023). The additional features of this act were as follows (ITA, 1962).

1. Income was defined as kinds of income including income derived from business, remuneration, profession and occupation, house and land rent, investment in cash or kinds, agriculture, insurance business, agency and any other sources.
2. The personal as well as residential status of the tax payer for the tax purposes was defined.
3. The income tax assessment and collection procedure were specified along with the method of computing net income. Certain deductions were allowed to calculate net income.
4. The basis was specified for assessing tax on the best judgment estimate of the tax officer.
5. Provision was made for the installment as well as advance payment of the tax for the first time.
6. Carry forward of loses was allowed for two years.
7. Provision was made for the exemption of income tax for the new industries for a period of not exceeding ten years.
8. The Act granted power to constitute a net income assessment committee.

The changing socio-economic environment of the nation had forced to change the income tax act. As a result Income Tax Act, 1974 (2031) came into existence.

2.1.5.3 Income Tax Act, 1974 (2031)

The Income Tax Act, 1974 can be said to be the refined form of Income Tax Act, 1962 [Dhakal, 2057]. It had 66 sections. This act has explained various aspects of taxes, containing many provisions for taxation. This act was amended for eight times i.e. 1977 (2034); 1979 (2036); 1980 (2037); 1984 (2041); 1985 (2042); 1986 (2043); 1989 (2046); and 1992 (2049) to make it more practical and to eliminate confusing terms. His Majesty's Government enacted the Income Tax Rule 1982 (2039}, in 1982 (2039–1–27) in accordance with the authority given under sections 65 of Income Tax Rule 1982, the financial act is also equally applicable for the proper administration of income tax in Nepal. Some of the features are as follows:

1. This act had clearly defined about income tax, taxpayer, year of income, personal status of taxpayer, non-resident taxpayer, net income and so on.
2. Five heads of income sources were specified viz. a) Agriculture, b) Industry, Business, Profession or Vocation, c) Remuneration, d) House and Land Rent and e) Other sources.
3. Methods of computing the taxable income from each head had been specified with deductions allowable.
4. The Act had made it obligatory for taxpayer to register their industries, business, profession or vocation in the tax office and any changes should be notified.
5. Carry forward of losses is allowed for within subsequent three years.
6. Provision was made for self-assessment of tax for the first time in Nepal.
7. Provision was made relating to deduction for life insurance premium and contribution made for philanthropic purpose.
8. Taxpayer was required to keep accounts and records of the income and to be preserved for six years.
9. Provision was made to make agreement for avoidance of double taxation with foreign government.
10. Provision was made relating to reassessment or additional assessment of tax.

2.1.5.4 Income Tax Act, 2002 (2058)

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 1st April 2002 (19th Chairta, 2058).

This act was brought in Nepal to avoid the following defects of Income Tax Act 2031 [Kandel, 2004].

a) Narrow base of tax.
b) Taxing only the income originated in Nepal.
c) Dispersion of tax related acts, i.e. income tax related provisions were given in different acts.
d) Low penalty rate to tax evader.
e) Incompatible to self-assessment, and
f) Unsuitable to modern economy.

Income Tax Act, 2058 has been amended two times by the finance ordinance of 24th Ashadh and 22nd Paush of 2059 B.S.

1. To levy tax on all income sources and income earning transactions.
2. To impose uniform tax to all people and all sources.
3. To make income tax revenue more productive and elastic.
4. To develop the tax system by means of extended scope, clear-cut, transparent and simple procedure.
5. To make accountable and improve tax administration.
6. To reduce economic cost neutralizing income tax.
7. To emphasize statement based on accounting system.
8. To make responsible to income taxpayers emphasizing procedure of self-assessment system.

The key features of Income Tax Act, 2058 are:

1. All income tax related matters are confined within the Act by abolishing all tax related concessions, rebates and exemption provided by different Acts.
2. The Act has broadened the tax base. Unlike previous tax Act, tax rates are spelled out in the Act. The tax rates and concessions are harmonized on equity grounds.
3. The Act has introduced a pool system of charging depreciation. Intangible assets are also depreciated.
4. The Act has first introduced taxation on capital gains.

5. The Act has provided liberal loss set-off and carry forward/backward provisions. Interhead adjustments of losses are clearly specified.
6. The Act has introduced a provision for administrative reviews to allow the tax administration to correct mistakes made by tax administrators internally.
7. The Act has provided a stringent fine and penalty for the defaulters.
8. Global incomes of a resident are made taxable. Non-residents are also taxed on their incomes with source in Nepal.
9. List of expenses are inclusive. All expenses relating to income have been made admissible.
10. The Act has made provision of international taxation. Foreign tax credit has been introduced for the first time.
11. The Act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.

2.1.6 Business Tax and Its Development in Nepal

2.1.6.1 Concept of Business Tax

Business means an industry, a trade, a profession, or at him like isolated transaction with a business character and includes a past, present, or prospective business. However, the term does not include employment. (Sec.2ka.Ja. ITA 2058). A business body or company is an artificial person created by law. A company is a legal person just as much as individual. It is separate and distinct from its individual members. A company like a natural person can do every thing. It can conduct a lawful business and enter into contacts with others in its own name. A company or business body is a legal organization that is voluntary created, organized or chartered under law. It is an 'artificial person' which can own property, execute contracts, raise debts and generate profits. Business tax, therefore, is a tax levied on companies or business bodies in contrast to uninbusinessd enterprise. It is the tax on capital income that occurs in the form of profit and originates in the business sector i.e. company. The history of tax was started from 1909 in USA when 1% excise was levied on corporation i.e. companies on the ground of the privilege they enjoy. Since then, business tax is contribution a substantial amount of revenue to the state treasury of most of the developed and developing countries. The statutory rate percent, however, was very low in initial period increased vehemently later on after First World War and again started to be down turned since 1980s (Kandel, 2004).

2.1.6.2 Development of Business Tax in Nepal

The history of business tax was not so long. This tax was introduced only in 1960 with the enactment of the Business Profit and Remuneration Tax Act, 1960 at the first time. Initially, business income tax was not differentiated from personal income tax. All the taxpayer persons, companies and private firms were imposed at the same rate with progressive and exemption limit prescribed by Finance Act of 1960 to 1964. The tax exemption given to companies as similar to personal taxpayer was withdrawn from the financial year 1965/66. A separate tax system to companies was introduced by the Finance Act, 1976.

Nepal originally combined business income tax with individual income tax. The same rate structure was designed for business income and other income for many years. In 1986/87, a flat rate business tax was introduced for government corporations and public limited corporations listed with security exchange center. Business tax was extended to private limited companies in 1993/94 and partnership firms in 1995/96 (Khadka, 2001).

The third income tax act was introduced in 1974 with making new changes and provisions than old one. A separate tax system to companies was introduced by the finance act, 1976. Finance Act, 1985 made a provision of giving 5% tax rebate from highest marginal rate of 55 % to listed public companies and government enterprises. Fiscal year 1986/87 was the year when the business tax was really recognized by imposing a flat rate of 40% tax on taxable income of the listed companies. The same finance Act imposed tax on divided also to be deducted at source at the rate of 20 % which after the filing of return by shareholders was to be reconciled. But the dividend tax system was changed exempting dividend to a level of 85% in 1987/88 and cent percent in 1990/91. Compulsory self tax assessment system for public and private limited company was exacted from the financial year 1994/95. This change support to end the discrimination between private company and public company, another major changes was carried out in the fiscal year 1988/99, was the inclusion of dividend of non-industrial companies within the tax net.

After enactment of income tax act 2002, the business tax levied upon general industries is 25%, 30% for insurance company and financial instructions. Trading company's is levied tax at the rate of 25 %, manufacturing industry at 20% and specials section company at 20%. Export profit was taxed at a level of 8% or 0.5% of sales as per finance act 2057 was changed by the fiscal Act 2058 by levying tax at the rate of 15% or 0.75% of sales as per income tax act 2058 has recommend, export profit from industry sector and trading sector are taxed at 20% and 25% respectively.

2.1.6.3 Business Tax Base in Nepal

There are controversies as regards to the choosing of business tax base since there may be various bases of taxation. For instance, these bases may be income, cash flow, turnover, total assets and added value etc. Among these, two bases-incomes and cash flow are mostly considered by the tax expert (Kandel, 2004).

The standard tax base is business income, which is the difference between the revenues from the sale of goods and services plus financial income on the one hand, and wages, depreciation, inventory costs plus interest on the other. Such costs are broadly revenue expenses incurred in the ordinary course of conducting day to day operation, and amortization of capital costs. Under the income-based tax system, many developing countries provide substantial tax incentives in the form of exemptions and deductions such as accelerated depreciation, investment tax credits or allowances, tax holidays, etc.

Tax base may depend on the relation between business tax rates and personal tax rates. Different countries of the world have different choice of base for business tax. Most of the countries prefer business-profits or book profits as the tax base. For, book profit as a tax base is stronger and superior than other types of tax bases. (Khadka, 2001)

If income is taken as the base of taxation, it is called income basis or net profit basis. It means deductions of interest on debt and depreciation of fixed asset from gross profit and adjustment of capital gain, stock appreciation or depreciation etc. Since it is calculated on the basis of profit, it is also called p-based tax. The general rule for calculating tax base is adding up all the incomes of the company and deducting expenses incurred in earning the income. However, because of its cumbersomeness in finding out taxable income, modern tax experts are in favor of replacing it.

The main causes of the cumbersomeness are treatment of revenue and expenses on accrual basis, treatment of depreciation under historical cost, measurement of capital gain and effect of inflation either in interest or valuation of stock. The cash flow tax, on the other hand, is the alternative considered by economists and tax experts to replace income based taxation (Kandel, 2004).

Like other countries of the world, Nepal is also following the method of making income as base for business taxation. The procedure of finding out taxable income is adding up the all items of revenues that are taxable and deducting all expenses which are allowable.

2.1.6.4 Business Tax Structure

This chapter deals with the business tax structure including business tax rate and tax base. Dividend tax two sections, the first section presents the rate structure of business income tax while the second reveals the present base followed by Nepalese business sector.

2.1.6.4.1 Business Tax Rate Structure in Nepal

ITA, 2031 and earlier income tax laws had not specified the tax rates and Finance Act used to specify the tax rates for each income year. Unlike earlier income tax laws, ITA, 2058 has specified the tax rates applicable to different taxpayers in schedule 1. Tax rates differ in structure and in terms of percentage depending on whether the taxpayer is an individual or an entity.

Individual:

The tax rates for single individuals and couples have a progressive three-tier structure. First, a basic exemption threshold remains tax free, i.e., is taxed at the rate of 0%, representing the taxpayers' basic living amounts. Second, after the exemption threshold, the middle part of the taxable income is taxed at the rate of 15%. Third, the part of the income exceeding a certain upper limit or ceiling of income is taxed at the highest rate of 25%. The amounts of the basic exemption threshold, the middle part of the income and the upper limit vary depending on whether the taxpayer is taxed as a single individual or a couple.

1. The basic tax rate and exemption of FY 2065/066 are as follows.

Individual	Couple	Tax Rate
1st Rs. 1,15,000	1st Rs. 1,40,000	Nil
Next Rs. 85,000	Next Rs. 85,000	15%
Balance	Balance	25%

2. A resident individual should pay tax on the amount only after deducting 7% of insured sum on his or her life or Rs. 10,000 or actual insurance premium whichever is lower.
3. A specific relief is provided for resident individual taxpayers running a small business. If such taxpayers have income exclusively from a business having a source in Nepal, income and annual turnover do not exceed Rs. 1,50,000 and Rs. 15,00,000 respectively and if they elect to apply this provision for the year, they are imposed a fixed amount depending on the area where the business is conducted. The annual tax will be as follows:

Metropolitan or sub metropolitan cities	Rs. 2,000
Municipalities	Rs. 1,500
Any where else in Nepal	Rs. 1,000

4. The tax applicable to public transport is as follows:

Type of vehicle	Annual tax per vehicle (Rs.)
a. Minibus, Minitruck, Trucks, Bus	1,500
b. Car, Jeep, Van, Micro Bus	1,200
c. Three Wheeler, Auto Rickshaw, Tampo	850
d. Tractor and Power Tiller	750

If the owner is a natural person, the tax will be final.

Entities:

Entities are taxed on a flat rate basis. The percentage of the flat rate depends on the nature or the kind of the entity's businesses.

1. The taxable income of an entity is generally taxed at the rate of 25 percent unless prescribed otherwise.
2. The income of an approved retirement fund is exempt from tax.

3. Banks; financial institutions; general insurance companies; liquor and tobacco industries; or entity established under Nepal Petroleum Act, 2040 are taxed at the rate of 30 percent.
4. Entity wholly operating as special industry and the entity that has operated any road, bridge, tunnel, rope-way, flying bridge etc. after their construction or entity that has operated trolley bus or tram, Cooperatives except involved in tax exempt transaction established under "Cooperative Act, 2048" are taxed at 20 percent.
5. Entity wholly engaged in the projects to build public infrastructure, own, operate and transfer it to government, or entity engaged in power generation, transmission and distribution is taxed at the rate of 20 percent.
6. Export income of an entity that has earned income from export is taxed at the rate of 20 percent.
7. Income of an estate of a deceased resident individual or trust of an incapacitated resident individual is taxed as a resident individual.
8. Repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal is taxed at the rate of 5 percent.
9. Taxable income of a non-resident person providing shipping, air-transport or telecommunication services (however, 2% tax is applied in case these services are being provided within Nepal) is taxed at the rate of 5 percent. For clearing the detail chart is as follows.

Business Tax Structure in Nepal

Fiscal Year	Maximum marginal tax rate		Nature of tax rate
	Private Co.	Public Co.	Progressive
1960/61-1962/63	25	25	,,
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 & Flat
1986/87-1987/88	55P	55F	,,
1988/89-1989/90	50P	50F	,,
1990/91-1991/92	40P	40F	,,
1992/93-1294/95	33P	33F	,,
1995/96	33	33	Flat
1996/97	30	30	..
1998/99-2009/10	20-25 & 30	20-25 & 30	..

Source: Kandel, P. R. (2000), Business Tax System & Investment Behavior in Nepal, Budget Speeches, 2009/10, Finance Acts of varies years.

Note: 20% tax rate for special industries

25% tax rate for general industries producing cigarette, bindi, liquor, product and industries uses these as raw materials

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

2.1.6.4.2 Business Tax Base in Nepal

Under the Income Tax Act, 2058 of Nepal Business 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 remuneration. 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 remuneration. All the taxable incomes 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 risk-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 the law to get total taxable income. No exemption limit is provided to the companies. Special additional fee of 15 percent of taxable income is charged to the second slab where 25 percent tax rate is charged.

Business income mainly refers to different types of income earned from different sources of business. The amounts that are included in computation of income from business are as follows:

a) Services fees,

b) Amount received from disposal of trading stock,

c) Net profit or gain from the disposal of business assets or business liability calculated as per chapter 8,

d) Amount treated as net profit from disposal of depreciable assets calculated as per schedule 2,

e) Gifts received in respect of the business,

f) Amount received in view of any restriction accepted in relation to the business operation,

g) Amounts derived in connection with business operation and not included in the income from investment,

h) Income according to section 25

  - Bad debt written off but subsequently recovered,
  - Any liability, which is not payable now,
  - Any expenses claimed but not payable,

i) Any income derived proportionately from a long term contract (sec. 26)

j) Income under chapter 7

  - Interest charged on loan and advance at the rate lower that the prevailing market rate i.e. different amount (sec. 27)
  - Income deemed to be derived from transfer pricing and other arrangement between associates (sec. 33)

k) Income of general insurance (sec. 60)

l) The amount to be adjusted due to the change in accounting system.

The following incomes are exempted from tax of a business firm.

a) Income derived from sources in Nepal during an income year by a person from agriculture other than those by a firm, company, partnership and organized entity or those stated in sec 12 D and E of Land Related Act 2021 are exempted from income tax. Here agriculture business means the business of producing crops from public or private land as a result of personal labour or deriving rent from a tenant using land who produces crops from public or private land as a result of personal labour.

b) Income of co-operatives registered under co-operative Act 2048 related to agriculture and forestry and saving and credit co-operative based on rural community. The dividends distributed by such organization are also tax-free.

The following expenses are allowed for deduction while computing income from business.

i) General deduction: for the purpose of calculating income from business all expenses incurred during the year, by the person and in the production of income from the business are deductible.

ii) Interest: The interest incurred during the year for the debt obligation of the person shall be available for deduction to the extent that.

    a) The borrowed money is used in that year or

    b) If the money is borrowed for purchase of an asset, that asset is used for that year.

    c) The debt obligation is created in the production of income from business.

iii) Cost of trading stock (sec. 15): Trading stock includes raw material, chemicals, work in progress, finished goods, stores etc. the cost of trading stock is derived as follows:

	Rs.
Cost of opening stock	×××
Add: purchase or production during the year	×××
Less: cost of closing stock	(×××)
Cost of trading stock consumed or sold	×××

The cost of trading stock should be taken at cost price or selling price which ever is lower. The person keeping account on cash basis can adopt either of the prime cost of factory cost as basis for valuation. But, the person keeping accounts on accrued basis must adopt factory cost basis for valuation of trading stocks. In case of actual cost could not be derived for the particular trading stock, either of the FIFO or weighted average cost can be adopted.

iv) Repair and maintenance expenses: The repair and maintenance expenses is allowed for deduction up to 5% of depreciation base of assets of each group and the rest of the expenses should be capitalized in respective group. The Finance Ordinance 2060 has increased the allowable limit up to 7% of depreciation base.

v) Pollution control expenses: Pollution control expenses, though these are of capital nature, are allowed for deduction to an extent from the profit. That deduction should not be more than 50% of (taxable profit before pollution control cost plus donation plus Research & Development expenses). The portion of the pollution control expenses not allowed, as deduction shall be capitalized in Group D of the assets.

vi) Research & Development expenses: Research & Development expenses, though these are of capital nature, are allowed for deduction to an extent from the computation of taxable income. That deduction should not be more than 50% of (taxable profit before R & D expenses plus donation plus pollution control expenses). The portion of the R & D expenses not allowed, as deduction shall be capitalized in Group D of the assets.

vii) Depreciation expenses: Depreciation at the prescribed rate is allowed on used depreciable assets owned by the person. The group wise details and rate of depreciation are given as follows:

'Group A' includes building, structures and similar works of permanent nature. Rate of depreciation for this group is 5%.

'Group B' includes computer, data processing equipment, fixtures, office furniture and office equipment. The rate of depreciation for this group is 25%.

'Group C' includes automobiles, buses and minibus and the rate of depreciation for this group is 20%.

'Group D' includes construction and earth moving equipment and any tangible assets not included in above groups and portion of pollution control cost and research and development cost not absorbed. The rate of depreciation applicable for this group is 15%.

'Group E' includes intangible assets like goodwill, patent rights, copyright etc. for this group, rate is calculated as divided by the useful life of the assets in the pool at the time the assets is most recently acquired by the person and rounded down to the nearest half year.

viii) Donation and contribution: Donation or contribution given to any tax exempted institutions, who have registered in the Inland Revenue Department, shall be deducted from the taxable income of the person subject to the limitation of Rs. 100,000 or Actual amount or 5% of taxable income which ever is less.

<u>The following expenses are not allowed for deduction from the taxable income</u>

- Expenses of domestic or personal nature,
- Tax payable as per this Act,
- Penalty or any other fines payable as per any Acts,
- Expenses incurred to derive the amount exempted under sec 10 or final with holding payment,
- Cash payment for more than Rs. 50,000 at a time to a particular person by a person having annual transaction more than Rs. 2 million,
- Distribution of income,
- The amount where the deduction is not allowed by any sections.

2.1.7 Concept of Tax Incentives

An income tax is a disincentive to save or invest and therefore, the incentive is to mitigate the disincentive. Tax incentive may imply a partial or complete exemption from one or a variety of taxes and special allowances for a certain period to motivate the behavior of saver or investor (Agrawal, 1988). The main aim of tax incentive is to increase savings and encourage and canalized the investment to desired area or sector. It is supposed that they encourage investment in selected manufacturing activities or improvement of product quality or utilization of domestic resource in manufacturing.

Tax incentives are concessions facilities and rebates granted to business bodies. These incentives reduce the tax burden of an organization. It may imply a partial or full exemption from one or a variety of taxes and special allowances for a certain period for motivation the new as well as existing organizations for balanced regional development, production of primary goods and development of the business bodies. It increases the habit of saving and encourages the investment by means of equity shares purchasing of an organization. Thus, tax incentives are a phenomenon developed specially to accelerate the slow rate of investment in most of the developing countries.

2.1.7.1 Present Provisions Related to Tax Incentives in Nepal

ITA 2058 has provided business exemption and concession in sec 11.

1. Income derived by a landlord, holding the land within the ceiling prescribed in Land act, 2021 from an agriculture business is exempt from income tax. But, income from an agriculture business derived by a registered from or company or partnership or a corporate body or through the land above the holding ceiling as prescribed in the land act, 2021 is not tax exempt. Here the agriculture business means the business or producing crops from public or private land or deriving rent from a tenant using land.

2. Income derived by cooperative societies, registered under cooperative Act, 2048, from business mainly based on agriculture and forest product such as sericulture and silk production, horticulture and fruit processing, animal husbandry, diary industries, poultry farming, fishery, tea gardening and processing, coffee farming and processing, herb culture and herb processing, vegetable seeds farming, bee-keeping, honey production, rubber farming, floriculture and production and forestry related business such as lease-hold forestry, agro-forestry, cold storage established for the storage of agriculture tools (other than machine operated) and rural community based saving and credit are exempt from tax . Dividends distributed by such societies are also exempt from tax. Here, rural community excludes municipalities and adjoining VDCs.

3. A natural person or an entity operating special industry during the whole income year is taxed as under:

    - If the industry is providing direct employment to 600 or more Nepalese citizens throughout the whole year, 90% of the applicable tax is applied for the year.

- The industry operating in remote, underdeveloped area will have to pay 70%, 75% and 80% of the applicable tax rate respectively up to ten income years commencing from and including the year in which the operation commences.

For tax purpose, special industry means a manufacturing industry other than a liquor or tobacco as categorized in section 3 of the Industrial Enterprises Act 2049.

4. Any income of an industry established in Special Economic Zone (SEZ) and dividend distributed by such industry are subject to following exemption:
   - Income of an industry established in SEZ located at mountainous district and GON specified hilly districts is exempt from tax for the first ten years of its operation and then after taxed at 50% of tax rate otherwise applicable.
   - Income of an industry established in SEZ (other than specified above) is exempt from tax for the first five years of its operation and then after taxed at 50% of tax rate otherwise applicable.
   - Dividend distributed by an industry established in SEZ is exempt from tax for the first five years and then after taxed at 50% of tax rate otherwise applicable for next three years.
   - The royalty, foreign technology or management service fees earned by a foreign investor establishing industry in SEZ are taxed at 50% of the tax rate otherwise applicable.
5. An industry established in remote area is exempt from tax for the first ten years of its operation.
6. An income of IT oriented industry established in GON specified IT Park is subject to an exemption of 25% of tax rate otherwise applicable.
7. If there is an agreement between a person and the government of Nepal for building and operating infrastructure, the person is entitled to enjoy all tax related concessions prevalent at the time of agreement for a period covered by the agreement irrespective of the provision in present Act.

8. The income received under business exemptions and concessions by a person is required to calculate separately assuming that those incomes are received by separate person.

9. If more than one exemption is available to the same income, only one exemption is available as per the selection made by the taxpayer.

10. If the assets used by the special industry were used previously by another person operating the similar type of special industry, the ten year for the latter will be counted from the period of such use by the another person previously. However, industry established in SEZ and IT oriented industry established at IT Park cannot enjoy this facility.

The Income Tax Act, 2058 has also provided various types of tax incentives such as tax credit, accelerated depreciation, and loss setoff and carry forward of losses. An individual may claim medical tax credit (sec. 51) for tax offset of medical expenses incurred for tax offset of medical expenses plus any amount carried forward in respect there from the previous year. Maximum amount that can be claimed in an income year will not exceed Rs. 750 as per rule 17. Likewise a resident person may claim a foreign tax credit as per section 71 for an income year for any foreign income tax paid by the person to the extent to which it is paid with respect to the person's assessable foreign income for the year.

Special provision of loss carry forward and carry backward is as follows.

- Business or investment loss can be carried forward up to next 7 years.
- Loss of BOT/BOOT can be carried forward up to next 12 years.
- Loss of entity conducting petroleum business can be carry forward up to next 12 years.
- Loss can be carry backward as per the notice of the Department in case of long-term contract.
- Donation and retirement contribution cannot be reduced if there is loss instead of assessable In case of more than one business or investment, tax payer may choose in which calculation the loss or part of loss is deducted.

- Loss from business or investment during the periods of full or partial tax exemption cannot be carried forward.
- Loss prior to the change in the ownership cannot be deducted after the change.

2.2 Review of Related Materials

2.2.1 Review of Research Reports and Articles

A senior researcher in the field of Nepalese taxation, Dr. Govinda Ram Agrawal (1978) had conducted a research entitled, “Resource Mobilization for Development: The Reform of Income Tax in Nepal” published by CEDA in July 1978. The main objective of his study were to examine the problem of growing resource gap in Nepalese finance in the context of the role of income tax, to examine the buoyancy and elasticity of income tax in Nepal including projection of income tax, to examine the ways and means for increasing tax consciousness in Nepalese people etc.

The main reasons for growing resource gap he had included in his report were increasing cost of maintenance and debt servicing burden, increasing government investment in public sector enterprises and rising rate of inflation. He also added that, poor utilization of natural resource base, small and stagnant industrial sector, partial monetization of the economy, poor performance of public sector enterprises, poor rate of economic growth, inadequate tax efforts, deficiencies in tax policies, laws and administration, lack of adequate and reliable data base and unwanted pressures from vested interest group etc. wee the major constraint in resource mobilization.

From his research he concluded that mobilization of additional resources from domestic sources to finance rising expenditure is the better options to fulfill resource gap. Domestic resource can be mobilized either through tax or through gap. Domestic resource can be mobilized either through tax or through non-tax measures. Tax contribution is more than 80% of total government revenue in Nepal. Buoyancy of income tax with respect to GDP for period 1967/76 was 2.18 and elasticity was 2.01.

Lastly he had recommended mobilizing additional domestic resources through taxation, tax structure should be redesigned in order to increase the role of direct tax, and income tax should be reformed in Nepal etc.

Review of revenue consultant committee (2001) MOF, GON report had studied the overall taxation situation in depth. This report suggested to widen the income tax base by including all kinds of taxpayers and income and to find out the tax payers of the sector. For this, the report suggested to make the act more transport and clear in order to attract foreign and domestic investment. This report recommended for written communication between taxpayers and tax administration rather that the informal relation. It suggested bringing all potential taxpayers in to tax net to widen the tax coverage including agriculture, electricity and other sectors to increase voluntary compliance this report highly emphasized to simplify the tax policy. Income tax exemption limit was suggested to increase taking into consideration of purchasing power and inflation report gave suggestion for GON to expand the Permanent Account Number (PAN) out side the valley and reduce the land and house registration rate and to rationalization the tax deduction at source (TDS). (Revenue Consultation Committee, 2001)

Damber Bahadur Pant (2004) had written an article entitled, "Problems in Tax Administration and their Remedies" published in Journal of Finance and development. 'Rajaswa' 2004, April Vol.1. He had comprehensively explained about the problems and their remedies related with tax revenue. The major types of practical problems and challenges, in tax administration he had mentioned in his article are; showing limited amount of transaction, showing low selling price, lack of issuing and taking bills, lack of showing the real factory cost, commercial fraud, lack of co-operation in testing the tax, legal ambiguity and complexity in implementation and lack of coordination between Inland Revenue Department and Revenue Investigation Unit. Meanwhile, he had recommended some valuable suggestions to solve the problems and to overcome the challenges. They are statistical and information system should be properly managed, fixed norms and standards should be used to assess selling price and factory cost, the billing system should be made compulsory, coordination between Inland Revenue Office with various entities of Government of Nepal, Revenue Investigation Department and its related units should play the important role and auditing on the topic "Business Tax Structure and Production" in 1993 which was prepared by Jeffrey Bernstein and Anwar Shah. They have conducted their research taking Mexico and Pakistan as a sample. As per their study investment tax credits, investment allowances, and accelerated capital consumption allowance are most effective promoting investment than more general tax incentives such as business tax rate reduction. From that research, they reached at the summary and conclusion on the elasticity of rental rate of capital which respect tax instrument, on the tax sensitivity of capital stock and on the benefit-cost ratio.

Dr. Puspa Raj Kandel (2004) had written an article entitled, "Are Tax Incentives Useful? If so, which one?" published in Journal of Finance and Development, 'Rajaswa', Volume 1 2004 April. In that article he had tried to seek the answer from the survey of various empirical studies earlier done in Nepal, India, Pakistan and other western countries. He found that the tax incentives are still the controversial matter whether they promotes the investments or not. But he argues that most of the developing countries need tax incentives.

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

He further adds that the survey of the studies indicate that accelerated depreciation system has positive impact on investment. The work of reducing tax rate, especially, followed after 1990s to such lowest rate was not a proper decision. That is why, it Nepal wants to go to tax incentives again, it should adopt investment allowance or investment tax credit, not the full tax holiday in future.

United Nations published a journal on public finance entitled, "Guidelines for improving tax administration in developing countries" in 1977. The study was dividend into four separate parts. Among them reforming the structural organization of the tax administration and explained in two separate sub topics i.e. guidelines for appropriate initiatives and underlying consideration and explanatory commentary. Functions of tax administration are identification and registration of tax payer, assessment, collection, auditing and supporting functions, taxpayer's education, information provider and assistance etc. The study had detailly explained these two functions and the study had recommended some valuable suggestions to the developing countries.

2.2.2 Review of Books

Dr. Rup Bahadur Khadka (1994) had written a book entitled, "Nepalese Taxation: A Path for Reform", in 1994. The book dealt with both national and international taxes. The written had detail describe the scenario of Nepalese tax system from origin of income tax, to adoption of quasi-global or a limited scheduler system, segregation of business income tax from individual income tax, increasing dependence on the presumptive basis, basic allowance and progressive rate structure, move from joint taxation to individual taxation and shift from itemized to flat system of standard expenses, experiment with an advance tax on impacts and the existing structure, commodity taxes and poverty taxes. He had evaluated the Nepalese tax system base on conventional, theoretical concepts and suggested various measures for its improvement. The book had not been directly focused on business tax only but explains the whole Nepalese taxation system and structure for its reform.

Bidhyadhar Mallik (2003) had written a book entitled, "Nepalko Adhunik Aayakar Pranali" in 2003. This book especially deals with the thorough analysis of Income Tax Act, 2058 with example. Every section of income tax act has been clarified with suitable examples. He has written about the development of existing income tax and need and importance of income tax system in Nepal. The new provision made by Income Tax Act, 2058 about tax base, computation of income, tax exempt amount, deduction allowable, accounting of tax, capital gain, retirement saving and tax, dividend tax, capital gain and international taxation have been clarified precisely in his book. Similarly, the book has also explained about tax administration, documentation, information collection payment of tax, installment tax, income statements, tax-assessment, tax collection, review and appeal, fess and interest, fine and penalties, tax rates and determination of provision of depreciation etc.

K. P. Aryal and S. P. Paudel (2004) have written a book entitled, "Taxation in Nepal" in 2004. They have explained about the income tax system in Nepal along with house and land tax and value added tax. The book has been designed based on the curriculum of B.B.S. It has been divided into three parts. In the first part of the book introduction and development of income tax, capital and revenue nature expenses and income items, entity and retirement saving, dividend tax, computation of income from business, remuneration and investment have been explained with numerical and theoretical examples. House and land tax and value added tax have been explained in the second and third part respectively. The book also includes proper bibliography and adequate appendix where various income tax, house and land rent and VAT related forms, schedules and format have been described.

In 1980, Dr Govinda Ram Agrawal had wrote a book entitled, "Resource Mobilization in Nepal" published by CEDA. The book is mainly concerned with resource mobilization in Nepal, especially through the reform of income tax. The book has been divided into eight chapters; the first chapter deals with resource mobilization through taxation in developing nations with special reference to Nepal. The second chapter deals with fiscal policies in developing nation and Nepal and third chapter looks at income tax in Nepal from the historical perspective. The fourth chapter deals with structure of Nepalese taxation.

In the fourth chapter related to tax structure, the writer had concluded that taxation trend in Nepal have shown that role of indirect taxes have been predominant in the tax structure. More than 60 percent of tax revenue is derived from foreign trade alone. However, since 1974/75 the role of income tax has been increasing.

He further adds that the design of tax structure must take into account the tax objectives. The tax structure of Nepal has failed to take account of the prevailing economic structure and patterns of income distribution. The low share of direct taxes is a clear indication of the ineffective use being made of taxes to effective ineffective distribution. This is the result of policy decisions taken in the past as to design the tax structure.

Dr. Agrawal had made an empirical study taking tax policy makers, tax experts, tax administration, tax lawyers and accountants and tax payers of different parts of Nepal. From that study he concluded that Nepalese taxpayers are favorably disposed to income tax. However, the major constraints in the effective functioning of tax system seem to be administrative deficiencies, poor tax paying habits, law of taxpayers' education, complex procedures and defective tax information system.

R.K agrawal (1994)**,** had wrote a book entitled, "Corporate taxation" published by hind law publishers. The book is mainly concerned with the corporate taxation of India. This book shows contribution of income tax from corporate sectors to public revenue includes historical background, contribution of income tax to the public revenue. Briefly explain of Indian Tax laws and others rules made by their government.

2.2.3 Review of Thesis

Shiva Narayan Shauh (1995) has conducted a research on the topic, "Contribution of Income Tax in National Revenue of Nepal," in the year 1995. His research problems were the increasing resource gap and how income tax can be the means for resource mobilization. The main objective of this research were; to show the contribution of income tax in government revenue, to show the resource gap in Nepalese finance, to highlight the importance of income tax as a source to avoid financial deficit, to find out the rate and per capita burden of income tax and trend and structure of income tax in Nepal.

His research design was historical cum descriptive. He has used only secondary data of 21 years from 1974/75 to 1994/95. Data collection and analysis procedures were; consulting the required governmental and non-governmental offices, and simple arithmetic rule chart and diagrams were applied to analyze data. From that research he has found out and calculated that income tax can be the vital source for internal resource mobilization to fulfill resource gap. Only 0.35% of total population came under the categories of tax payers in Nepal during his research period. He found that collection of income tax was gradually growing and the contribution of income tax in total tax revenue and total national revenue was 9.95% and 7.94% respectively. Similarly he also concluded that individual tax payer had higher contribution in income tax than salaried tax payer.

In 1997, Karna Bir Poudyal 'Kshetry' has submitted a Ph. D. thesis entitled, "Business Tax Planning in Nepal". This thesis report was aimed to examine the implications of tax factors in strategic planning, project planning and operational planning in Nepalese companies. He has found that the majority (90%) of the companies (sample size of the study) considered tax factors while selecting the line of business. He also found the positive correlation (+0.8) between tax rate and the debt equity ratio because of interest paid on debt is a tax-deductible item. Similarly, the correlation coefficient between average fixed assets and business tax was (+0.75) in small companies and (+0.12) in medium size companies. As against this, in large companies, there was a negative correlation (–0.2), which showed that increase in fixed assets in large companies resulted in decrease in the business tax. He addressed that the tax planning should be considered while making business planning and so companies should set up separate tax section to get maximum benefit of provisions, provided by tax law. However, tax assessment under the best judgment blocked the application of tax planning in business planning. He had recommended that tax incentives should be given to non-industrial companies too, and tax rate should be differentiated for resident and non-resident companies.

Puspa Raj Kandel (2000) also presented the ph-D thesis entitled, "Business Tax System and Investment Behavior in Nepal" in 2000. He undertook the research work to find out the problems relating to business tax, which blocks the development of the private investments. The main objectives of his study were to evaluate the business tax system in general, to examine the sensitivity of certain policy like inflation, capital gain tax, dividend tax and interest tax etc. based on their impact on tax burden. He showed the relationship of private investments with average effective tax rate (AETR), marginal effective tax rate (METR) and tax incentives in Nepal. He found that the METRs for debt-financed project due almost negative i.e. 17% and positive for equity financed project and debt-equity ratio project by 27% and 19% respectively. He had also found the impact of inflation to the METR. According to him, the statutory tax rate deduction had impact on private investments by 60% to 20%. In his regard, he had showed the adjusted R^2 value 0.87 at 5% level of significance. He had concluded that the statutory tax rate was in moderate level under the financing options: debt: mix and equity is it was not much distortive. The relationship between inflation rate and effective tax burden in Nepal was negative.

Bharat Kumar Lamsal (2001) has also presented a thesis entitled, "A study on Contribution of Income Tax on Government Revenue", in 2001. His research had mainly focused on the removing and controlling income tax evasion for better source mobilization. As his main objective was to analyze the impact of income tax evasion in government revenue of Nepal, he set further objectives to identify the ways and causes of income tax evasion, to estimate the volume and tendency of income tax evasion in small trade sectors and to examine the role of income tax in utilizing the resources in Nepal.

Mr. Lamsal has conducted that research following analytical as well as descriptive research design. Most of the data were from secondary sources and some were form primary sources. Primary data were collected through opinion survey, field visit and interviews. Simple statistical analysis such as average and percentage were used as for data analyzing, tools; Graphs, charts and tables were used to interpret visually the finding of the research.

From that research he has concluded that there was widespread evasion in income tax in Nepal is a suitable means for raising domestic resources. He had recommended for controlling tax evasion by controlling illegal business activities, increasing penalties and fines to tax evades, compulsory maintenance of accounts etc.

Miss Jyanti Poudel (2002) presented a dissertation entitled “Income taxation in Nepal: A study of its structure and productivity”. The objectives of her study were: to analyze the structure of income tax in Nepal, to estimate the elasticity and buoyancy of income tax in Nepal, to evaluate the success of voluntary disclosure of income scheme (VDIS) program in brief and to provide the suitable recommendation for improving the scenario of income tax. She has found that overall revenue of Nepal showed on annual growth of 16% indirect taxation has more significant contribution in total tax revenue, income tax occupied the first rank among the direct taxes, personal income tax slabs has been changed radically from seven slabs in 1975/76 to two slabs in 1999/2000, VDIS could not attract more potential taxpayers into tax net due to lack of good planning and adequate home work of the government working procedures of the tax administrators are still traditional and cost of administration has not been bought to the satisfactory level (Poudel, 2002).

Mr. Keshav Raj Gautam (2004) has described about contribution of income tax to national revenue of Nepal. He has mainly focused about conceptual framework, legal provision, and structure of income tax. He has connected an empirical investigation about various aspects of income tax in Nepal.

He has found that the contribution of direct and indirect tax revenue were 20.63 percent and 79.40 percent respectively in 2002/03. Income tax revenue has occupied third position based on mean contribution other sources of revenue; the contribution of income tax to total revenue was 8.84 percent. It may enhance the revenue of government, promote to distribute justice and encourage private sector investment. Nepalese government expenditure is increasing at the faster rate than the increase in revenue the resource gap has existed in Nepalese economy and it is increasing trend, tax/GDP ratio of Nepal is found satisfactory, the exemption limit is not satisfactory. He has mode the specific suggestion for a sound and effective income tax system. They were establishment, promotion and reward system to efficient and honest tax personnel, increasing public participation to minimize the tax evasion, strict action against corruption, income tax, rules, and regulation should be clear and simple. The provision of times, penalties and punishment should be mode at higher rate for income tax evaders; more deduction should be provided for export promote and separate income tax department should be established (Gautam, 2004).

Mr. Khomraj Koirala (2005) has described about “Effectiveness of Advance Taxation on income tax generation in Nepal”. The objectives of his study were: To evaluate the feasibility and effectiveness of advance taxation on income tax and overall revenue generation in Nepal, to examine the current position of advance taxation in Nepal. He has found that advance taxation is also one of the tax assessing and tax collecting procedure as per Income Tax Act 2007. Income Tax Act 2002 has absolutely embraced the self assessment system abolishing existing assessment system. Small tax payers are imposed tax on the presumptive system. This Act has made provision of amended assessment to adjust the assessed person’s liability to tax. Main source of advance tax is the business sector that carries more than 80% of the advance tax and the individual sector carries less than 20% of the advance tax on total advance tax collection. The contribution of the advance tax on total revenue was very poor but contribution on income tax is increasing in recent years.

He has recommended the individual sector should be prompted to pay the advance tax, the business sector should be encouraged to pay the advance tax by providing tax incentives., the administration, tax low and provision need to be very simple and clear so it should be amended unclear and some contradictorily provisions as far as possible, government should give the strong attention to impose the existing law rules and policy.

He has recommended various types of problems that the employees faced while paying remuneration tax. So the problems faced by employees should be minimizing. Tax administrators should be made more responsible, procedural simplification should be made, tax clearance certificate to be provided, taxation knowledge to the employees should be provided, refund of tax should be made with only delay, unclear and cumbersome provisions of the tax act and rules should be simplified and made understandable, and employees should be made such that they do not feel mentally pinched by paying income fax by giving them a sense of contributing to the nation.

Mr Jhalak Mani Lamsal (2005) has presented a dissertation entitled “Effectiveness of Remuneration Tax in Nepal”. The objectives of his study were to identify the major problems and weakness of remuneration tax in Nepal, to check out the, major facilities and benefits provides by Income Tax Act 2058 on the remuneration tax. He has found that contribution of remuneration tax in total income tax revenue of Nepal has not been found satisfactory due to unfair and weal administration, complexity in income tax policy, rules and regulation, no provision of educating any expenditure, it is high burden of tax on low level income earners. He has also found that current exemption limit for the senior and disable citizen should not be necessarily more than that of other citizen.

Mis Laxmi Devi Bashyal (2008) has presented a dissertation entitled "Impact of Income Tax in National Revenue before and after enactment of Income Tax Act 2058". The objectives of this studies are find out the parts of national revenue occupied by income tax and its trend, analysis the composition of income tax revenue from various sources, analysis the contribution of income tax in national revenue before and after enactment of Income Tax Act 2058, To analysis the strengths & weaknesses of Income Tax Act 2o58 and to provide suitable suggestions for the betterment of income tax system in Nepal. Her research shows income tax system in Nepal is not fully satisfactory. Due to economic liberalization and globalization, very important sources of revenue i.e. custom duty is not in condition to bare its current share in coming days. So importance of internal sources such as income tax will increase in coming days. But there are many problems in Nepalese income tax system.

2.3 Research Gap

All the research studies mentioned above were concerned with study of laws, provisions, administrative aspects and structure of tax. Most of them have indicated the inefficiency of tax administration, widespread tax evasion. No attention was paid on a particular problem. Many of them have taken various problems as their research objectives and no thoroughly study on a particular subject problems was done except few of the research work.

Nepalese business sector is small and stagnant in nature and the performance of public sector, private sector and even government sector is poor. Contribution of income tax from business sector plays vital role in Nepalese economy. Regarding the fact that the considerable contributions of business sector in the economy of other developing countries the researcher found no more study done in the contribution of business income tax to government revenue of Nepal. So this study has been undertaken analytically and intensively to analyze the structural composition of business sector, its contribution to government revenue and fulfilling the resource gap from an internal source. So this study will be fruitful to those interested persons, scholars, students, teachers, government & businessmen for academically as well as policy perspectives.

CHAPTER - III

RESEARCH METHODOLOGY

Methodology part of every research work serves as the bridge linking two edges of river. It is the road map of every research work whether scientific or applied research. It suggests every researcher to get the easy and efficient destination achievement stated in research objectives.

"Research methodology refers to the various sequential steps to be adopted by a researcher in studying problem with certain object in view. It would be appropriate to mention that research project are not susceptible to any one complete and inflexible sequence of steps and the type of problems to be studied will determine the particular steps to be taken and their order too." (C.R. Kothari, Quantitative Techniques, 1994)

By above definition research methodology is a technique of analyzing the obtained data to solve the research problem. It consists of descriptive approach and statistical tools. Descriptive approach is used to analyze the research problem, and other theoretical problem. Statistical tools are used to analyze the numerical data. Researcher has used the following methodology to complete the research.

3.1 Types of Research

This study includes three types of research as descriptive and analytical and empirical.

3.2 Research Design

Research design means an overall framework or plan for the collection and analysis of data. "Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research questions and to control variance." (Fred N. Kerlinger, Foundation of Behavioral Research, 1978)

To conduct the research of this study, descriptive, analytical and empirical research design has been adopted. The study is based on historical data and an "ex post facto" research because no variables are in the control of researcher and no variables in this research is manipulated during the study period. Descriptive research design is used for conceptualization, problem identification, conclusion and suggestion. Analytical research design is used for analyzing the data to find out the result. This study is based on secondary data.

The research study is focused on role of income tax and composition of income tax revenue and its trend before and after enactment of Income Tax Act 2002 in Nepal. To achieve the stated objectives, data has presented and analyzed from different sources. Thus, the study is descriptive and analytical. An opinion survey is carried out with 40 respondents associated with different denomination related to income tax i. e. tax experts and taxpayers. The opinions were collected through structured questionnaire. The questionnaire included the role of income tax, effectiveness of income tax system, trend of income tax and reason, suggestion to reform income tax system, most important factors of new act etc. Thus, the study is descriptive, analytical and empirical.

3.3 Population and Sample

To fulfill the objectives of the study, 40 samples size is selected from different denomination. Persons selected for empirical study are carefully selected by consultation with lecturers and best judgment method. The respondents are from two groups. The group of respondents and size of sample is stated in table 3.1.

Table 3.1

Group of Respondents and Size of Samples

S. No.	Groups of Respondents	Sample Size
1.	Income Tax Experts	20
2.	Income Tax Payers	20
	Total	40

3.4 Nature and Sources of Data

The data collected to describe this study are from primary and secondary sources. The major source among them is stated below:

1. Primary Data:

To know the views of different persons related to income tax, an opinion sample survey is carried out through structured and unstructured questionnaire to tax payers and tax exports. The questionnaire was same for all the respondents. The persons involved in survey are from different parts. Tax experts are the lecturers, auditors, CAs tax administrators are from IRD and various sectors of tax offices etc. Selection of taxpayers is made from various sectors manufacturing, service, trading, financial etc.

2. Secondary Data:

The comparative progress study and other basic analysis of study is made by secondary data. The sources of secondary data during this study are:

i. Economic Survey of various years, Ministry of Finance, GON.
ii. Budget Speech of various years, Ministry of Finance, GON.
iii. Reports of Internal Revenue Departments of various years.
iv. Different books related to income tax and public finance.
v. Dissertations related to income tax.
vi. Different Newspapers, journals, souvenir, magazines.
vii. Web sites of different organizations such as World Bank, IMF, MOF, IRD etc.
viii. Other relevant records and data.

Secondary data from FY 1991/92 to 2008/09 has been used in this study.

3.5 Data Collection Procedure

Necessary data for this study are collected from various sources, out of them only related data are taken into consideration. Primary data and secondary data are collected through following method:-

a) Questionnaire Method

To know the views of different persons related to income tax, questionnaire method has been used. Opened method is used to collect the data. Yes/No question, multiple choice question and descriptive questions with ranking are design to get the response. Due to various limitations only 60 questionnaire forms are distributed to the income tax experts and income tax payers. Thirty questionnaires are distributed to each group and only 40 of them are collected during research period.

b) Interview Method

To make the study more reliable, interview of some concerned personals are taken. Interviews are related to income tax from business income contribution to national revenue, its impacts, tax paying awareness and practice etc. Structured and unstructured interview has been used for the data collection. Formal and informal discussions are holding with students, teachers of taxation and related person of concerned companies in order to make the study reliable.

c) Historical Data Record Method

It is the main sources of the data for this study. Historical data are collected from reliable sources as accurate as possible by researcher and has to visit different offices, libraries and bookstalls and various GON reports, prospectus of concerned companies and newspaper. Previous data, which has used by other party, are also useful for this study.

3.6 Data Processing and Analysis Procedure

Collected data from various sources are thoroughly reviewed and sorted on the basis of their homogeneous nature and resemblance of the facts. The sorted data are arranged and presented systematically in suitable tables. The processed and tabulated data were analyzed through different statistical tools such as percentage, simple average, graphs, tables, charts etc for clear and systematic presentation of findings. To analyze the data obtain from various sources, statistical, mathematical and financial tools are used. Brief explanations of such types of statistical tools used in this study are as follows:-

a) Percentage

Percentage is the proportion of one unit on the whole unit. It measures the proportion of one unit among all units. To find out the resource gap in Nepal, composition of total revenue in Nepal, composition of tax revenue in Nepal, composition of direct tax revenue in Nepal, it is important.

b) Average

Average measures, which condense a huge unwieldy data into single value, which represents the entire data. Since an average represents the entire data, it's value lies between the two extreme observations i.e. largest and the smallest items.

c) Correlation Co-efficient (r)

Correlation analysis is the statistical tool that can be used to describe the degree to which one variable is linearly related to another. The coefficient of correlation measures the direction of relationship between two sets of figures. It is the square root of the coefficient of determination. Correlation can either be negative or it can be positive. If both variables are changing in the same direction, then correlation is said to be positive but when the variations in the two variables take place in opposite direction the correlation is termed as negative.

The strength of correlation between the variables can be quantified. This is achieved by calculating the correlation coefficient. The correlation coefficient varies between +1 and –1; with +1 representing perfect positive correlation and –1 representing perfect negative correlation.

Calculation of Rank Correlation by formula,

$$R = 1 - \frac{6 \quad d^2}{n(n^2 - 1)}$$

$$Pr = 6.6745 \times \frac{1 - r^2}{\sqrt{n}}$$

d) Coefficient of Determination (r^2)

The coefficient of determination is a measure of the degree (extent or strength) of linear association or correlation between two variables. One of which happens to be independent and other being dependent variables. In other words, r^2 measure the percentage of total variation in dependent variable explained by independent variables. The coefficient of determination has value range from 0 to 1. If r^2 is equal to 0.85 that indicates that the independent variables used in regression model explain 85% of the total variation in the dependent variable. A value of one occur only if the unexplained variation is zero which simply means that all the points in the scatter diagram fall exactly on the regression line.

g) Statistical Table

Collected data from primary and secondary sources are setting on the various types of table. Simple and complex statistical table has been used for the study. Such types of table are formulated according to the required of research objectives.

h) Statistical Diagrams and Trend Line.

For analyzing the collected data, various statistical diagrams are used according to the requirement of the objectives. Multiple bar diagram and line graph has been utilized for this study.

CHAPTER-IV

PRESENTATION AND ANALYSIS OF DATA

Presentation and Analysis of primary and secondary data has been presented in the chapter four. This is one of the most important chapter and has been included the data related to the topic extracted from economic survey and annual reports published by the government of Nepal in their respective way and their analysis has been presented accordingly with suitable methods of presentation. Primary data collected from tax exports and tax payers and analysis in this chapter.

4.1 Analysis of Secondary Data:

This part is devoted to the analysis and presentation of secondary data. The secondary data have been obtained from economic survey, economic bulletin, budget speech and other related newspaper. The available data have been tabulated and presented into graphs, charts and analyzed to reach at come findings.

4.1.1 Nepalese Government Revenue Structure

Nepal's public economy is suffering from low revenue performance and growing public expenditure. The basic sources of revenue are tax revenue and non-tax revenue but collection of these revenues is not sufficient to cover expenditure. The composition of tax revenue and non-tax revenue from FY 1991/92 to 2008/09 is presented in table 4.1.

Table 4.1

Composition of Total Revenue in Nepal

Rs in million

Fiscal year	Total Revenue	Tax revenue		Non-tax Revenue	
		Amount	Percentage	Amount	Percentage
1991/92	13512.7	9875.6	73.08	3637.1	26.92
1992/93	15148.4	11662.5	76.99	3485.9	23.01
1993/94	19580.9	15371.5	78.5	4209.4	21.5
1994/95	24605.1	19660	79.9	4945.1	20.1
1995/96	27893.1	21668	77.68	6225.1	22.32
1996/97	30373.5	24424.3	80.41	5949.2	19.59
1997/98	32937.9	25939.8	78.75	6998.1	21.25
1998/99	37251	28752.9	77.19	8498.1	22.81
1999/00	42893.8	33152.1	77.29	9741.6	22.71
2000/01	48893.6	38865.1	79.49	10028.8	20.51
2001/02	50445.5	39330.6	77.97	11115	22.03
2002/03	56229.8	42587	75.74	13642.7	24.26
2003/04	62331	48173	77.29	14158	22.71
2004/05	70122.7	54104.7	77.16	16018	22.84
2005/06	72282.1	57430.4	79.45	14851.7	20.55
2006/07	87712.1	71127	81.09	16585.1	18.9
2007/08	107622.5	85155.5	79.12	22467	20.88
2008/09	143474.5	117051.9	81.58	26422.6	18.42

Source: Economic Survey 2009/10, GON Ministry of Finance, 2010

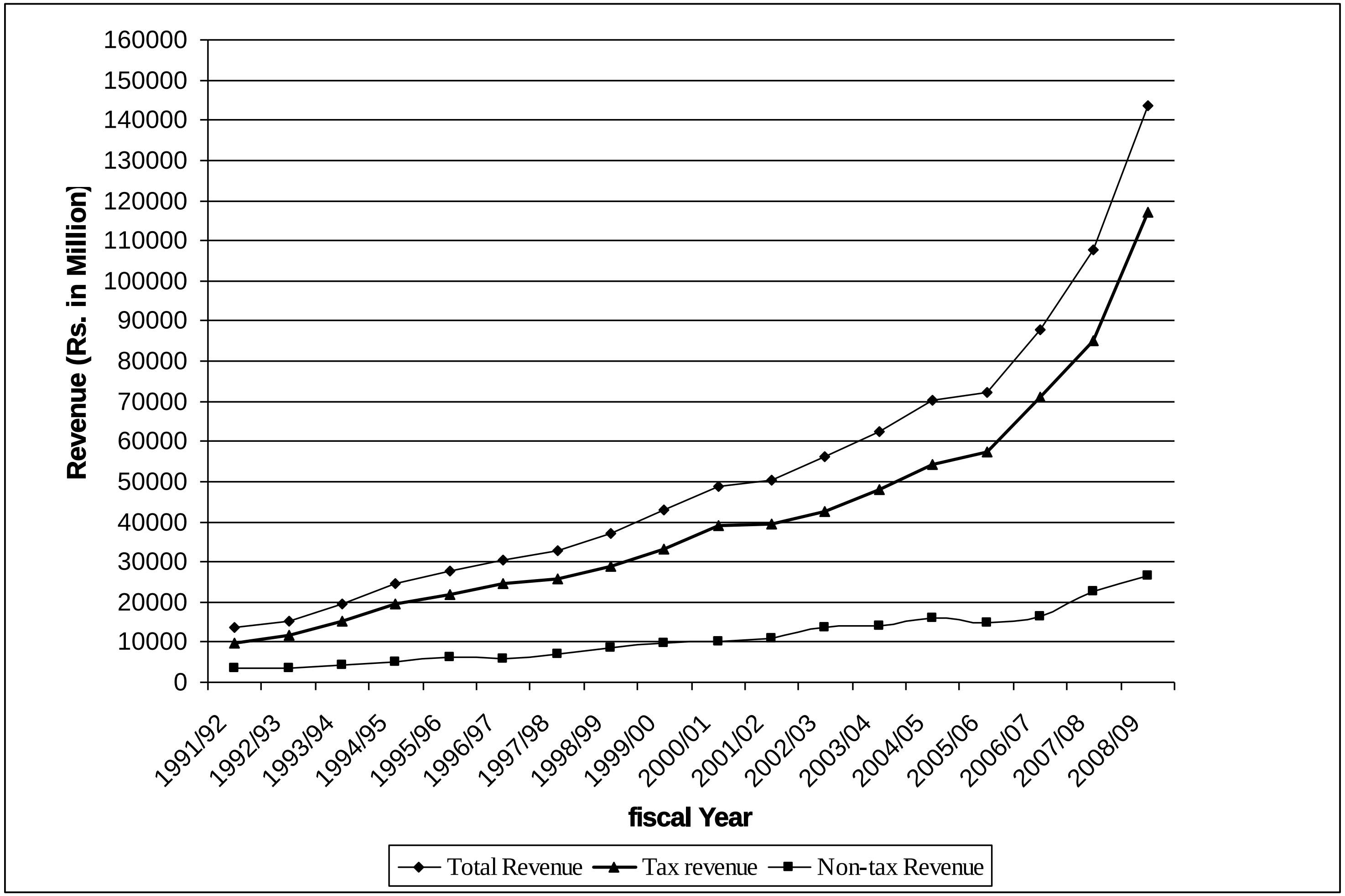
This table shows the dominated role of tax revenue as 73.08 percent of total revenue in 1991/92 and 81.58 percent in 2008/09. Share of non-tax revenue for the same period seems to be 26.92 percent and 18.42 percent respectively. The amount of tax revenue is continuously increasing but that of non-tax revenue is fluctuating, that's why the share of tax revenue and non-tax revenue are not uniform. The tax revenue seems to be 81.58 percent as maximum and 73.08 percent as minimum contribution to national revenue in 2008/09 and in 1991/92 respectively within the study period.

The tax revenue contributed amount of 9875.6 million and 117051.9 million in 1991/92 and in 20087/09 respectively. Figure 4.1 shows that the increase is generally in constant rate. The contribution of non-tax was 3637.1 million and 26422.6 in subsequent fiscal years. It shows the increasing nature of non-tax revenue but it has also decreased comparing to former year in FYs 1992/93, 1996/97, and in 2005/06. But the last year it's increase. The increase of non-tax revenue within study period is 626.47 percent. Mean contribution of tax revenue and non-tax revenue within study period are found as 78.26 percent and 21.74 percent respectively.

Composition of tax revenue and non-tax revenue is shown in figure 4.1. The figure shows that both tax and non tax revenue are gradually increased in last years. The trend line shows that the tax revenue is increase grater than non tax revenue. So the tax revenue is the major part of total Revenue. In the figure X-axis shows the fiscal years and Y-axis shows revenue. From FY19991/92 to FY 2008/09 all revenue trend lines are increase. Figures show that the tax revenue is increasing more than non tax revenue.

Figure 4.1

Composition of Total Revenue in Nepal



4.1.2 Composition of Tax Revenue in Nepal

Tax revenue is the major source of government revenue. In Nepal contribution of tax revenue is about 81 percent. It is the tools to mobilize internal resources effectively. The tax revenue constitutes direct and indirect tax. Direct tax includes income tax, land and revenue and registration, urban house and land tax, vehicle tax and indirect tax generally includes costumes, VAT, excise etc.

The share of direct tax and indirect tax in total tax revenue is presented in figure 4.2 this shows the increasing trend of both direct and indirect tax. Indirect tax has a leading role in total tax revenue up to 83.85 percent within the study period. Although the amount of indirect tax is increasing, its share to total tax is decreasing. Its share was 83.85 percent in FY 1991/92 and reduced to 73 percent in 1999/00 and gradually increased to 70.68 percent in 2008/09. In the other hand direct tax has an increasing trend. Its share became 29.32 percent in 2008/09 from 16.15 percent in 1991/92. The share of direct tax revenue in F/Y 2008/09 is 29.32%, and indirect tax revenue is 70.68%.

Table 4.2

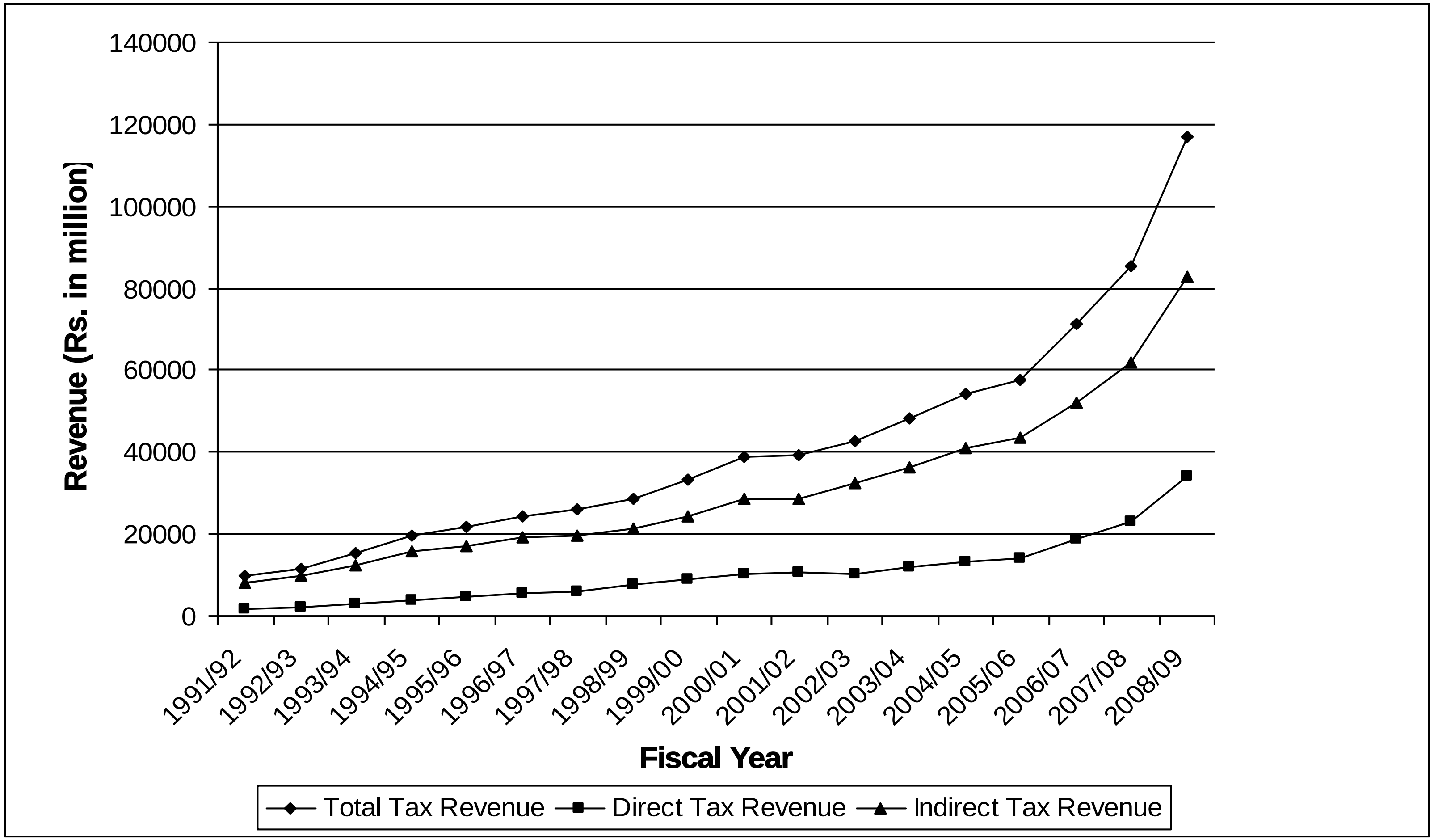
Composition of Tax Revenue Rs in Million

Fiscal year	Total Tax Revenue	Direct Tax Revenue		Indirect Tax Revenue	
		Amount	Percentage	Amount	Percentage
1991/92	9875.6	1595.2	16.15	8280.4	83.85
1992/93	11662.5	2036.2	17.46	9626.3	82.54
1993/94	15371.5	2855.3	18.58	12516.2	81.42
1994/95	19660	3849.3	19.58	15810.7	80.42
1995/96	21668	4655.9	21.49	17012.1	78.51
1996/97	24424.3	5340	21.86	19084.3	78.14
1997/98	25939.8	6187.9	23.85	19751.9	76.15
1998/99	28752.9	7516.1	26.14	21236.8	73.86
1999/00	33152.1	8951.5	27	24200.6	73
2000/01	38865.1	10159.4	26.14	28705.7	73.86
2001/02	39330.6	10597.5	26.94	28733.1	73.06
2002/03	42587	10105.8	23.73	32481.2	76.27
2003/04	48173	11912.6	24.73	36260.4	75.27
2004/05	54104.7	13071.8	24.16	41032.9	75.84
2005/06	57430.4	13968.1	24.32	43462.3	75.68
2006/07	71127	18980.3	26.68	52146.7	73.31
2007/08	85155.5	23087.8	27.11	62067.697	72.89
2008/09	117051.9	34320.7	29.32	82731.2	70.68

Source: Economic Survey of various years, GON Ministry of Finance, 2010

Figure 4.2

Composition of Tax Revenue



The graph of composition of direct tax and indirect tax revenue presented in figure 4.2 shows the totally correlation between indirect tax and total tax revenue due to dominating role of indirect tax revenue. Figures shows direct and indirect tax are gradually increase in last years. In the figure 4.2 X-axis shows the fiscal year and

Y-axis shows revenue in millions. There are three trend line indirect tax revenue, direct tax revenue and total tax revenue. Total tax revenue is the addition of direct and indirect tax revenue. All trend lines are increasing in figures. The share of total tax revenue, indirect tax revenue is grater than direct tax revenue.

4.1.3 Composition of Direct Tax Revenue

Direct tax is levy to government for income generation and holding of wealth by natural person as well as business enterprises. It is paid by the imposed person himself and it follows the progressive principle. In Nepal direct tax is the composition of land revenue and registration tax and tax on property, profit and income. A Direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is same. Share of different components of direct tax are shown in table 4.3.

Table 4.3

Composition of Direct Tax Revenue Rs in Million

Fiscal Year	Total Direct tax	Land Revenue and Registration				Tax on Property, Profit and Income				
		Land Tax	House land registration	Total	% of Direct Tax	Income Tax	Tax on property (Vehicle)	Other tax	Total	% of Direct Tax
1991/92	1595.2	64.8	571.3	636.1	39.88	875	67.7	16.4	959.1	60.12
1992/93	2036.2	69.4	685.5	754.9	37.07	1198.2	80	3.1	1281.3	62.93
1993/94	2855.3	61	772.2	833.2	29.18	1921.2	49.8	51.1	2022.1	70.82
1994/95	3849.3	34.9	902.8	937.7	24.36	2823.4	88.2	0	2911.6	75.64
1995/96	4655.9	18.2	1048.4	1066.6	22.91	3431.4	157.9	0	3589.3	77.09
1996/97	5340	5.9	1009.5	1015.4	19.01	4123.4	201.2	0	4324.6	80.99
1997/98	6187.9	3.6	1000.6	1004.2	16.23	4898.1	285.6	0	5183.7	83.77
1998/99	7516.1	1.4	1001.8	1003.2	13.35	6170.3	342.7	0	6513	86.65
1999/00	8951.5	4.6	1011.3	1015.9	11.35	7420.6	515	0	7935.6	88.65
2000/01	10159.4	5.1	607.8	612.9	6.03	9114	432.5	0	9546.5	93.97
2001/02	10597.5	0.8	1131	1131.8	10.68	8903.7	562	0	9465.7	89.32
2002/03	10105.8	0	1414.3	1414.3	13.99	7966.2	559.5	165.8	8691.5	86.01
2003/04	11912.6	0	1697.5	1697.5	14.25	9245.9	700.6	268.6	10215.1	85.75
2004/05	13071.8	0	1799.2	1799.2	13.76	10159.4	806.5	306.7	11272.6	86.24
2005/06	13968.1	0	2181.1	2181.1	15.61	10373.7	847.6	565.7	11787	84.39
2006/07	18980.3	0	2253.5	2253.5	11.87	15034	995	697.8	16726.8	88.12
2007/08	23087.8	0	2940.7	2940.7	12.74	18991.3	1069.2	86.5	20147	87.26
2008/09	34320.74	0	5223.4	5223.4	15.22	26983.3	1850.0	264.1	29097.3	84.78

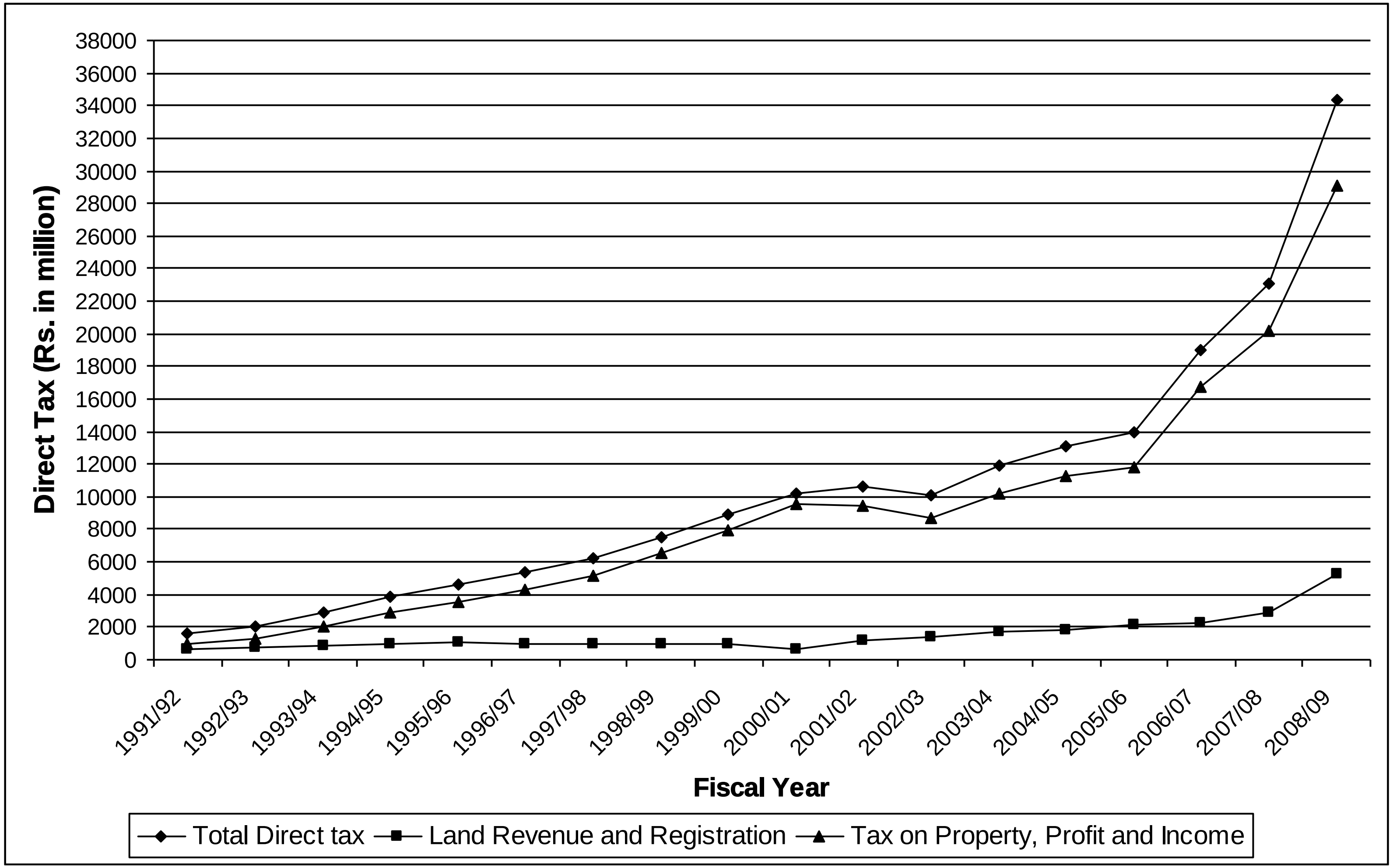
Source: Economic Survey of various years, GON Ministry of Finance, 2010

Direct tax is classified into land revenue and registration and tax on property profit and income. Land revenue and registration is sub classified into land tax, and house and land registration. The role of land tax is very nominal, nil for last five years, started to declining from 1992/93 amounting 64.8 millions up to 2001/02 amounting 0.8 million. The land revenue and registration category is fully dependent on house and land registration. It is in increasing trend up to 1995/96 and started to decline slowly for next three years. It increased gradually for 1999/00 and became the lowest share to revenue in 2000/01, when its share to direct tax is only 6.03 percent amounting 612.9 million. it is further in increasing trend after that and has reached to 5223.4 million, occupying 15.22 percent of direct tax revenue at FY 2008/09. In FY 2006/07 the percentage share of direct tax revenue is decreased by 3.74% in comparison to the FY 2005/06 but in FY 2008/09 it was increased by 2.48% in comparison to the FY 2007/08. The highest percentage contribution from this category was in 1991/92 as 39.88 percent. The mean contribution of land revenue and registration is 18.19 percent, which is lower about to the share in latest FY of study by 0.17%.

Other source of direct tax revenue tax on property, profit and income has been subdivided into income tax, tax on profit and other tax. Income tax is the major sources within them and constitutes income tax from public enterprises, income tax from private corporate bodies, income tax from individuals, income tax from remuneration and tax on investment. Tax on property includes vehicle tax and urban house and land tax. This category of direct tax seems to be in increasing trend up to 2000/01 and it fluctuation for remaining years. It is further increasing after 2003/04. Highest share is in 2000/01 with 93.97 percent and lowest in 1991/92 with 60.12 percent. Mean contribution is 81.81 percent which is highest about to the share in latest FY of study by 0.17% which is graphically described in figures 4.3

Figures: 4.3

Composition of Direct Tax



Above Figure 4.3 shows the trend line of composition of direct tax. In figure X-axis shows fiscal years and Y-axis shows revenue in millions. In figure there are three trend lines which are total direct tax, land revenue and registration tax and tax on property, profit and income. Total direct tax is the combination of land revenue and registration tax and tax on property, profit and income. Trend line shows that tax on property, profits and income is the main sources of total direct tax. The tax on profit, property and income is rapidly increased from last three fiscal years. Land revenue and registration tax is minimum in FY 2000/01 and slowly increase after that.

4.1.4 Composition of Income Tax

Income tax is the major source of direct tax revenue. It was first introduced as business profit and remuneration tax in 1959/60 in Nepal. The firsts elected government in 1959 introduced Business Profits and Salaries Tax Act, 1960 in Nepal. At that time, income tax was levied only on business profits and salaries. It contributed only 203 thousands in that FY. It reached 26983.3 million after 49 years in FY 2008/09, which is out of range of compare. The income tax collections in different income years are shown in table 4.4.

Table 4.4

Composition of Income Tax Revenue Rs in Million

Fiscal Year	Total Income Tax Revenue	Government Enterprises	Private corporate bodies	Individuals	Remuneration	Tax on Investments
1991/92	875	176.4	6.5	617.9	54.7	19.5
1992/93	1198.2	257.9	9.5	800.7	56.7	73.4
1993/94	1921.2	536.2	19.7	1184.8	83.8	96.7
1994/95	2823.4	860.2	440.1	1293.1	118.4	111.6
1995/96	3431.4	1144.5	563.9	1470.1	133.1	119.8
1996/97	4123.4	1231.1	858.4	1711.4	168.1	154.4
1997/98	4898.1	1317.8	925.1	2120.8	322.2	212.2
1998/99	6170.3	1526.5	1155	2772.7	396.5	319.5
1999/00	7420.6	2198.8	1339.5	3016.4	451.5	414.4
2000/01	9114	2928	1924.3	3200.5	597.3	463.9
2001/02	8903.7	1769.3	1412	4419.1	835.6	467.7
2002/03	7966.2	1251	1236.3	3362.3	1252.6	864
2003/04	9245.9	2056.6	1531.3	3533.4	1391.2	733.4
2004/05	10159.4	1332.4	2467.8	3926.3	1675.9	757
2005/06	10373.7	195.7	3404.3	4234.7	1764.1	774.9
2006/07	15034.2	1019.7	5717.1	5234.4	2007.9	1054.9
2007/08	18991.3	204.6	7186.5	6924.7	2451	2224.5
2008/09	26983.3	959.0	9425.1	9240.6	3196	4162.9

Source: Economic Survey of various years, GON Ministry of Finance, 2010

Total Income tax is increasing each year without in 2001/02 and 2002/03. The amount from income tax was only 875.0 million in 1991/92 and its increasing trend is optimistic up to 2000/01 while it reaches to 9114.0 million. Then it declined for next two years. It became 8903.7 million in 2001/02 and further decreased to 7996.2 million in 2002/03. Its trend is gradually increasing after this within study period.

Income tax constitutes Income tax from public enterprises, semi public enterprises, private corporate bodies, individual, remuneration and tax on investments. The share of these different sources is presented in above table 4.4.

The table shows that role of income tax from public enterprises is significant. It has contributed 14.01percent to total income tax in average. The trend of income tax from public enterprises is fluctuating. It was 176.4 million in 1991/92 and gradually rises up to 2928.0 million in 2000/01. After 2001/02 its trend is declining and has not met the record of 2000/01. Its condition in 2005/06 is very low as 195.7 million and just covers 1.9 percent of total income tax. It is slightly increased in year 2006/07 which has been 6.78% contribution into the total income tax. In FY 2008/09 it became 959 million only. The share of income tax from private corporate bodies is 26.48 percent in average. It was in increasing trend up to 2000/01 from 6.5 million in 1991/92 to 1924.3 million. It also declined for next tow years after 2001/02 and slightly increased in 2003/04 than former year. It seems to catch the trend before 2000/01 in recent years. In FY 2008/09 it became 9425.1 million.

Same trend appears in case of income tax from individual. It has the major role in income tax and bears dominating role in former period of the study. It has contributed up to 70.6 percent in 1991/92. Although the amount is increasing up to 2001/02, its share is in declining trend. After a huge contribution of 4419.1 in 2001/02, it declines to 3362.3 million in next fiscal year and unable to met the record in subsequent year up to 2005/06 while the amount is 4234.7 million after slow growth in preceding years. Only one sub category of income tax is income tax from remuneration, which has never declined. It was 54.7 million in 1991/92 and reached to 3196 million in 2008/09 with regular growth. Its share in total income tax is also positive. Tax on investment is another source of income tax which had slow increasing trend in amount up to 2002/03 from 54.7 million in 1991/92 to 864.0 million. But it declines for next year to 733.4 million, slowly increased for 2004/05 to 757.0 million and again decreased notably to 565.7 million in 2005/06. It is slightly increase in year 2006/07 i.e. 1054.9 million. It was highly increased in FY 2008/09 up to 4162.9 million. The cause of highly increases in this year is the percent of rent tax is increase in highly. Its average contribution is 8.7 percent in total income tax revenue in 17 years study period.

In the figures 4.4 and 4.5 shows that the compositions of income tax revenue by bar diagram and trend line. This figures show tax and investment and private corporate bodies shares are increase. The government enterprises shares are up and down in varies years. The share of these different sources of income tax is presented in bellow figure 4.4 and 4.5.In both figures X-axis denotes fiscal years and Y-axis denotes revenue in millions. In Figures 4.4 every year there are six diagrams which are total income tax revenue, tax from government enterprises, tax from private corporate bodies, tax from individual, remuneration tax, and tax on investments. Above data's are put in the below figures for clarification. In figure 4.5 shows the trend of income tax revenue. Total tax revenue line is increase up to FY 2000/01 and decrease 2001/02 and 2002/03. After that it increases in every year.

Figure 4.4

Composition of Income Tax Revenue

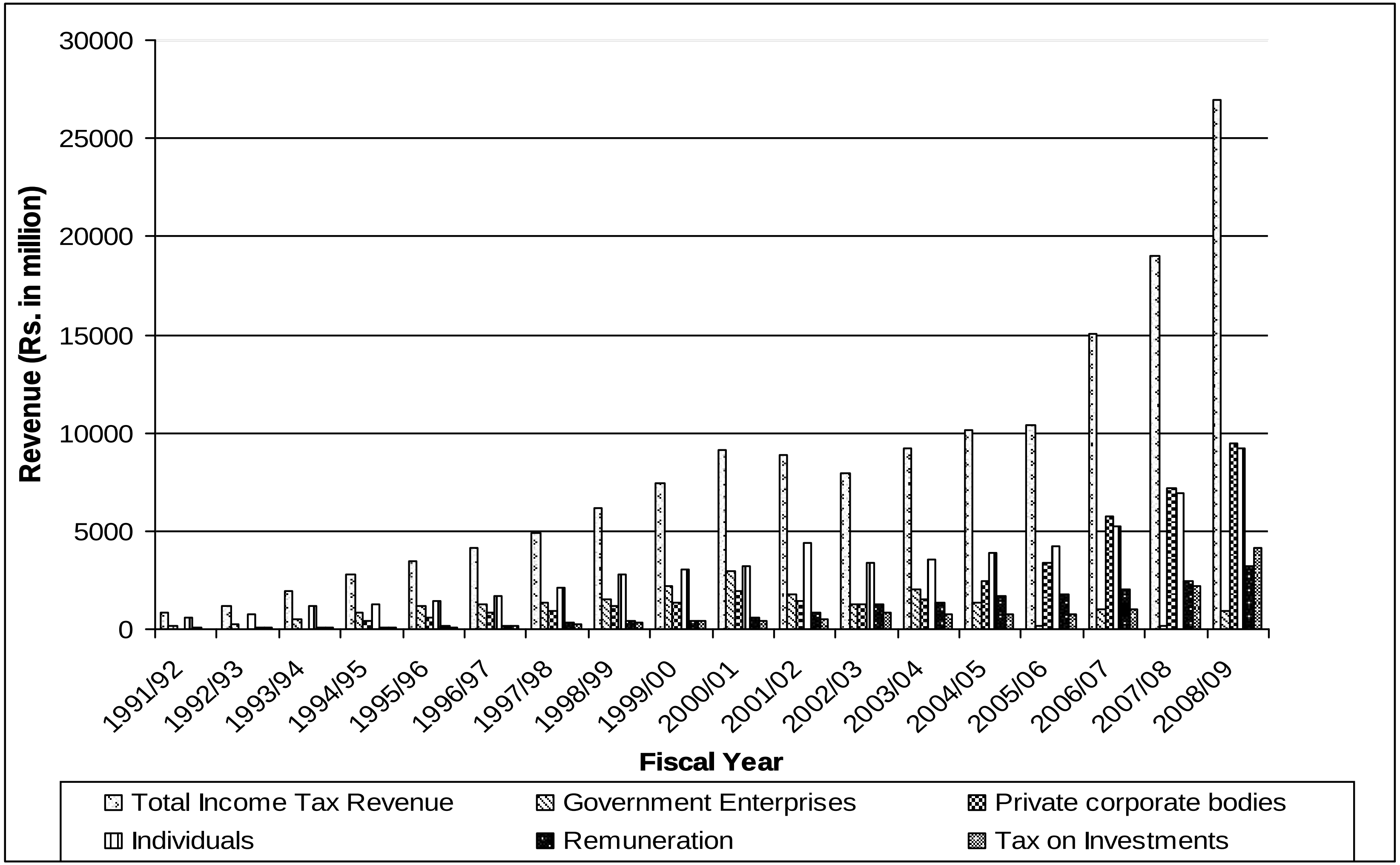
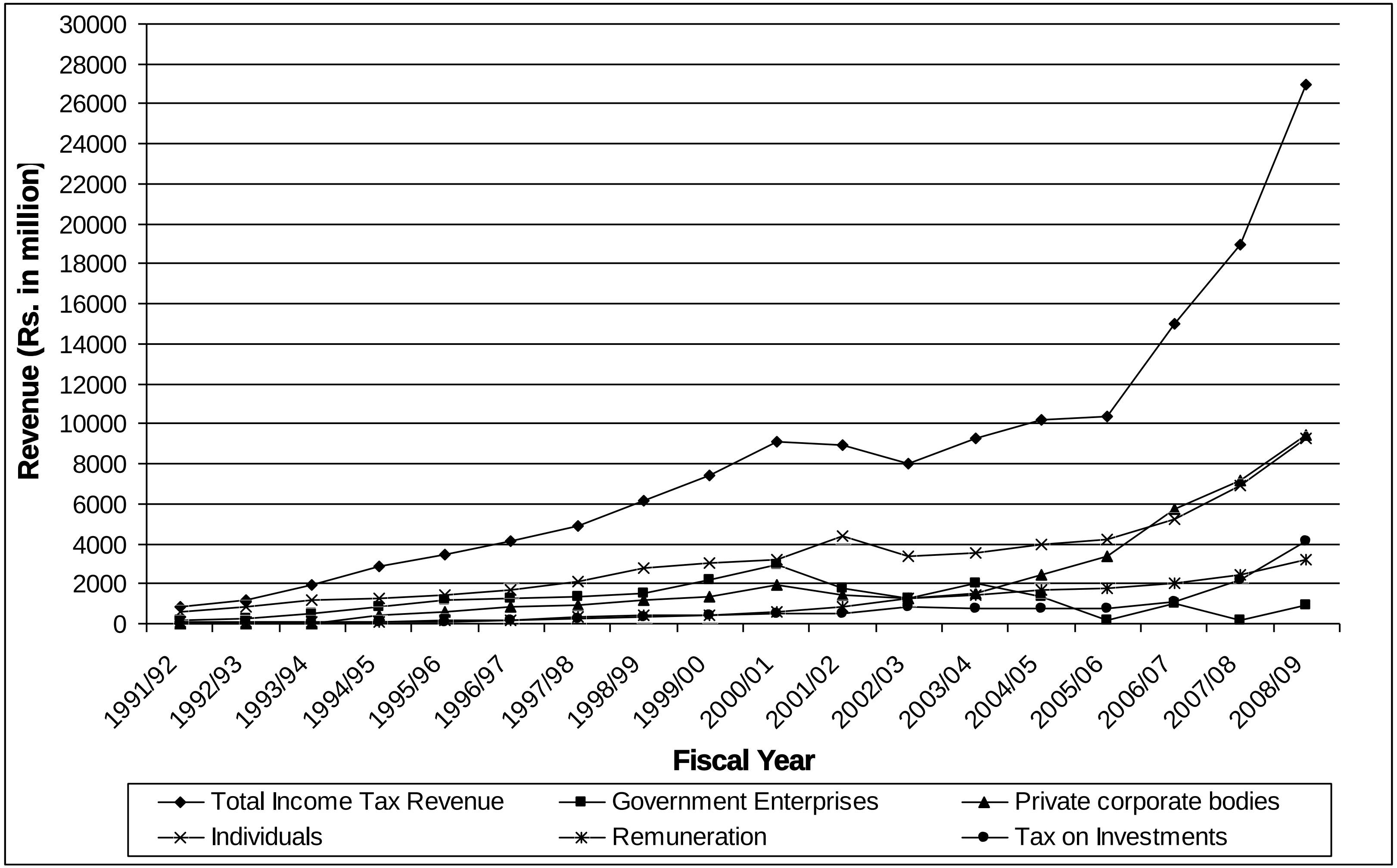


Figure 4.5

Trend Composition of Income Tax Revenue



4.1.5 Structural Composition of Business Income Tax

The business income tax structures comprises of government sector, public and private sector and individuals also. Business taxable income is calculated by adding all the taxable business income and deducting all the allowable expenses. The corporate tax base is explained and presented in the above subchapter 2.1.6.4.2. After the enactment of Income tax act, 2058, the books of account of corporate sector have been kept a little bit differently. From the FY 2002/03, the total business sector income tax is computed by adding government, public and private sector including individual and sole trading firm and income from other profession too. The following table has been drawn to show the structural composition of business income tax from the FY 1991/92 to 2008/09.

Table 4.5

Structural Composition of Business Income Tax Rs. in Million

Fiscal Year	Total Income Tax Revenue	Government Enterprises	Private corporate bodies	Individuals business and profession
1991/92	875	176.4	6.5	617.9
1992/93	1198.2	257.9	9.5	800.7
1993/94	1921.2	536.2	19.7	1184.8
1994/95	2823.4	860.2	440.1	1293.1
1995/96	3431.4	1144.5	563.9	1470.1
1996/97	4123.4	1231.1	858.4	1711.4
1997/98	4898.1	1317.8	925.1	2120.8
1998/99	6170.3	1526.5	1155	2772.7
1999/00	7420.6	2198.8	1339.5	3016.4
2000/01	9114	2928	1924.3	3200.5
2001/02	8903.7	1769.3	1412	4419.1
2002/03	7966.2	1251	1236.3	3362.3
2003/04	9245.9	2056.6	1531.3	3533.4
2004/05	10159.4	1332.4	2467.8	3926.3
2005/06	10373.7	195.7	3404.3	4234.7
2006/07	15034.2	1019.7	5717.1	5234.4
2007/08	18991.3	204.6	7186.5	6924.7
2008/09	26983.3	959	9425.1	9240.6

Source: Table 4.4

The above structural composition of business tax shows that major portion was covered by Private corporate bodies sector. It was 9425.1 million in the FY 2008/09 while the Government Enterprises sector contributed 959 million and Individuals business and profession 9240.6 million respectively. The share of government sector was increased up to FY 2000/01. After that Percentage of government sectors was decreases. In FY 2007/08 it share was only 204.6.But last year it also increase up to 959 millions.

A private corporate body is the most important factors of business income tax. The share of income tax from private corporate bodies is 26.48 percent in average. It was in increasing trend up to 2000/01 from 6.5 million in 1991/92 to 1924.3 million. It also declined for next tow years after 2001/02 and slightly increased in 2003/04 than former year. It seems to catch the trend before 2000/01 in recent years. In FY 2008/09 it became 9425.1 million. The percentage of business income tax is declined because of remuneration income tax and investments income tax was increase in ratio. In investments income tax is increase by Rent Tax in last FY 2008/09. The share of business income tax is also clear by Table 4.6 and Figure 4.6.

Table 4.6

Structural Composition of Business Income Tax Rs in Million

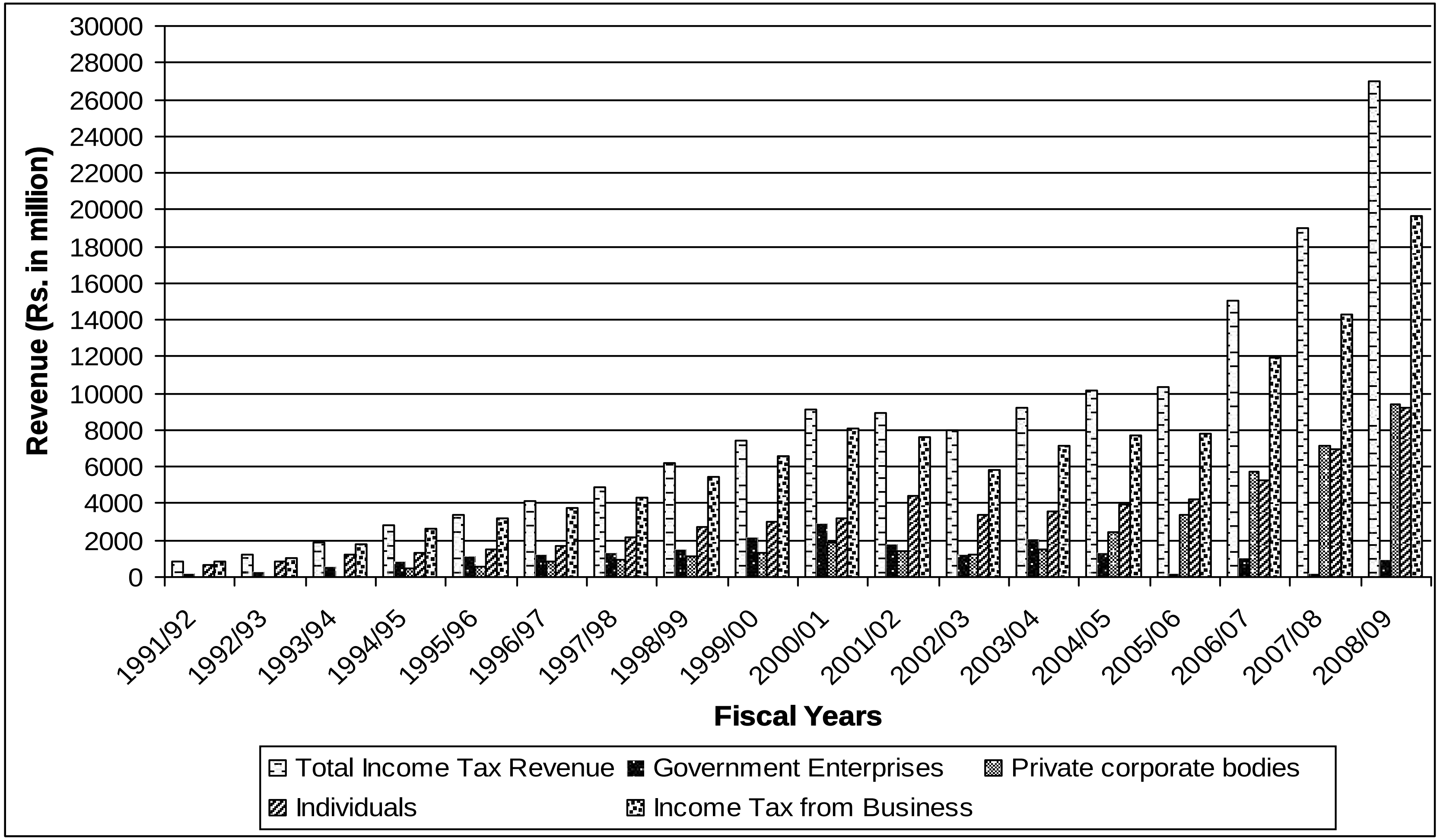
Fiscal Year	Total Income Tax Revenue	Government Enterprises	Private corporate bodies	Individuals	Income Tax from Business	Share of Business income Tax in %
1991/92	875	176.4	6.5	617.9	800.8	91.52
1992/93	1198.2	257.9	9.5	800.7	1068.1	89.14
1993/94	1921.2	536.2	19.7	1184.8	1740.7	90.60
1994/95	2823.4	860.2	440.1	1293.1	2593.4	91.85
1995/96	3431.4	1144.5	563.9	1470.1	3178.5	92.63
1996/97	4123.4	1231.1	858.4	1711.4	3800.9	92.18
1997/98	4898.1	1317.8	925.1	2120.8	4363.7	89.09
1998/99	6170.3	1526.5	1155	2772.7	5454.2	88.39
1999/00	7420.6	2198.8	1339.5	3016.4	6554.7	88.33
2000/01	9114	2928	1924.3	3200.5	8052.8	88.36
2001/02	8903.7	1769.3	1412	4419.1	7600.4	85.36
2002/03	7966.2	1251	1236.3	3362.3	5849.6	73.43
2003/04	9245.9	2056.6	1531.3	3533.4	7121.3	77.02
2004/05	10159.4	1332.4	2467.8	3926.3	7726.5	76.05
2005/06	10373.7	195.7	3404.3	4234.7	7834.7	75.52
2006/07	15034.2	1019.7	5717.1	5234.4	11971.2	79.63
2007/08	18991.3	204.6	7186.5	6924.7	14315.7	75.38
2008/09	26983.3	959	9425.1	9240.6	19624.7	72.73

Source: Table 4.5

In the figures 4.6 Structural Composition of business income tax and total income tax by bar diagram. Bar diagram shows that total income tax is gradually increase. For clarify above tables data was presented in figures 4.6. Figures show the structural composition of business income tax. There are five diagrams in every year. Business income tax is the addition of government enterprises, private corporate bodies and individuals which are compares to total income tax revenue.

Figure 4.6

Structural Composition of Business Income Tax and Total Income Tax



4.2 Share of Business Income Tax in Different Economical Factors

The contribution of Income tax to GDP, total revenue and total tax revenue are described in bellow.

4.2.1 Contribution to GDP

Gross Domestic Product (GDP) is the total market value of all final goods and services produced in a country in a given year, equal to total consumer, investment and government spending, plus the value of exports, minus the value of imports. For national GDP business income tax also contributes. It's contributes is shown in bellow tables.

Table 4.7

Contribution of Business Income Tax to GDP

Fiscal Year	Total Income Tax Revenue	Business Income tax revenue	Percentage of income tax to GDP	Percentages of business Income Tax to GDP
1991/92	875	800.8	0.6	0.55
1992/93	1198.2	1068.1	0.73	0.65
1993/94	1921.2	1740.7	1	0.91
1994/95	2823.4	2593.4	1.34	1.23
1995/96	3431.4	3178.5	1.43	1.32
1996/97	4123.4	3800.9	1.53	1.41
1997/98	4898.1	4363.7	1.69	1.51
1998/99	6170.3	5454.2	1.87	1.65
1999/00	7420.6	6554.7	2.03	1.79
2000/01	9114	8052.8	2.2	1.94
2001/02	8903.7	7600.4	2.15	1.84
2002/03	7966.2	5849.6	1.85	1.36
2003/04	9245.9	7121.3	2	1.54
2004/05	10159.4	7726.5	2.02	1.54
2005/06	10373.7	7834.7	1.78	1.34
2006/07	15034.2	11971.2	2.24	1.78
2007/08	18991.3	14315.7	2.31	1.74
2008/09	26983.3	19624.7	2.81	2.04

Source: Economic Survey of various years, GON Ministry of Finance, 2010

Table 4.7 shows the contribution of income tax and business income tax to GDP. The contribution of income tax to GDP in FY 1991/92 was just 0.6 percent. It was continuously increasing rapidly up to 2000/01 and reached at 2.20 percent. It cannot be continued for the following period of new act and started declining. It declined to 2.15 percent in 2001/02 and again to 1.85 percent in 2002/03. It slowly increased to 2.00 percent and 2.02 percent for following two years and again declined to 1.74 percent in 2005/06. Then again increase in FY 2006/07, 2007/08 and 2008/09 up to 2.24, 2.31 and 20.81 percent. The maximum contribution of income tax to GDP was in year 2008/09 between the study periods, which were 2.81 percentages. The amount contribution of income tax to GDP at this year was 26983.3 million while the total amount of GDP of that year was 960012 million.

The business income tax contribution to GDP was increase up to 2000/01 by 0.55 percentage to 1.94 percent. It declined to 1.84 and 1.36 percent in FY 2001/02 and 2002/03. In FY 2003/04 and 2004/05 the contribution to GDP by business income tax was same 1.54 percent. The business income tax contribution of 2005/06 was 1.34, 2006/07 was 1.78 and 2007/08 was 1.74 percents. In last year its contribution was 2.04 percentages which was 0.3 percentages bigger than last year. The maximums contribution of business income tax to GDP was in FY 2008/09 by 2.04 percent.

4.2.2 Contribution to Total Revenue

The contribution of business income tax to total revenue was 5.93 percent in FY 1991/92. It is positively correlated with time up to 2000/01. It's share in 2000/01 was16.47 percent. It declines for next two years to 15.07 and 10.40 percent. It gradually increased for 2003/04 year to 11.42 percent and again decreased to 11.02 and 10.92 percent for last two years. In fiscal year 2006/07 the percentage of business income tax to total revenue was 13.65%, which is 2.73% higher than the contribution of income tax to total revenue in year 2005/06. The contribution of business income tax in FY 2007/08 was 13.30 percent and in FY 2008/09 was 13.68 percent. The contribution of business income tax to total revenue is shown in table 4.8.

Table 4.8

Contribution of Business Income Tax to Total Revenue

Fiscal Year	Income Tax from Business income	Total Revenue	Percentage of Business income tax to Total revenue
1991/92	800.8	13512.7	5.93
1992/93	1068.1	15148.4	7.05
1993/94	1740.7	19580.9	8.89
1994/95	2593.4	24605.1	10.54
1995/96	3178.5	27893.1	11.40
1996/97	3800.9	30373.5	12.51
1997/98	4363.7	32937.9	13.25
1998/99	5454.2	37251	14.64
1999/00	6554.7	42893.8	15.28
2000/01	8052.8	48893.6	16.47
2001/02	7600.4	50445.5	15.07
2002/03	5849.6	56229.8	10.40
2003/04	7121.3	62331	11.42
2004/05	7726.5	70122.7	11.02
2005/06	7834.7	71733.1	10.92
2006/07	11971.2	87711.2	13.65
2007/08	14315.7	107622.5	13.30
2008/09	19624.7	143474.5	13.68

Source: Economic Survey of various years, GON Ministry of Finance, 2010.

4.2.3 Contribution of Business Income Tax to Total Tax Revenue

The tax structure shows that indirect tax has major role in total tax revenue. So business income tax as not so effective share in total tax. It was only 8.11 percent in 1991/92 and increased with slow growth rate to 20.72 percent in 2000/01. It decreased to 19.32 percent and 13.74 percent after FY 2001/02. It broke the decreasing trend in 2003/04 and continued to decrease in 2004/05 and 2005/06 and its contribution is 16.83 percent in FY 2006/07. Last year of study its contribution was 16.77 percent. Table 4.9 shows the data in detail.

Table 4.9

Contribution of Business Income Tax to Total Tax Revenue

Fiscal Year	Total Tax Revenue	Total Business Income Tax	Percentage of IT on Total Tax Revenue
1991/92	9875.6	800.8	8.11
1992/93	11662.5	1068.1	9.16
1993/94	15371.5	1740.7	11.32
1994/95	19660	2593.4	13.19
1995/96	21668	3178.5	14.67
1996/97	24424.3	3800.9	15.56
1997/98	25939.8	4363.7	16.82
1998/99	28752.9	5454.2	18.97
1999/00	33152.1	6554.7	19.77
2000/01	38865.1	8052.8	20.72
2001/02	39330.6	7600.4	19.32
2002/03	42587	5849.6	13.74
2003/04	48173	7121.3	14.78
2004/05	54104.7	7726.5	14.28
2005/06	57430.4	7834.7	13.64
2006/07	71127	11971.2	16.83
2007/08	85155.5	14315.7	16.81
2008/09	117051.9	19624.7	16.77

Source: Economic Survey of various years, GON Ministry of Finance, 2010

4.3 Empirical Investigation:

4.3.1 Introduction

An empirical investigation has been conducted in order to find out various aspects of income tax from the experience of real life situation. The major tool used for this purpose is an opinion questionnaire. A total of 40 sets of questionnaire were distributed to the tax experts and tax payers. The responses received from various respondents have been arranged, tabulated and analyzed in order to facilitate the descriptive analysis of the study.

The questionnaire either for a Yes/No response or asked for ranking the choice according to number of alternatives where first choice was most important and last choice was least important, for analysis purpose, choice were assigned weights according to number of alternatives. If the number of alternatives were seven, then the first preferred choice got seven points and last preferred choice got one point. Any alternative, which was not ranked, did not have any point. The total points available to each choice were converted into percentage in reference to the total points available for all choice. The choice with the highest score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as last choice. The following table shows the group of respondent and code used to represent them.

Table 4.10

Groups of Respondents and Code Used

Groups of Respondents	Sample Size	Code
Income Tax Experts	20	A
Income Tax Payers	20	B
Total	40	

4.3.2 Business Income Tax is an Important Source of Government Revenue of Nepal

To know that respondents opinion about role of income tax is raising government revenue. A question was asked, “Do you think that business income tax is an important source of Government revenue of Nepal? The responses are tabulated bellow.

Table 4.11

Business Income Tax is an Important Source of Government Revenue of Nepal.

Responses / Respondents	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Experts	17	85	3	15	20	100
Tax Payers	15	75	5	25	20	100
Total	32	80	8	20	40	100

Source: Opinion Survey, 2010

From the above table, it is clear that 80 percent of the respondent approved the income tax as a suitable means of raising government revenue and only 20% respondents did not recognize income tax as a suitable means of raising government revenue. Thus, the conclusion can be drawn out that the income tax is a suitable means of raising government revenue of Nepal.

4.3.3 Government Success to Collect the Income Tax from Business Income

To know the respondents view Government success to collect the income tax from business income, a question was asked “Do you think that the Government success to collect the income tax from business income?” The responses have been tabulated below:

Table 4.12

Government Success to Collect the Income tax from Business Income

Responses / Respondents	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Experts	14	70	6	30	20	100
Tax Payers	11	55	9	45	20	100
Total	25	62.5	15	37.5	40	100

Source: Opinion Survey, 2010

From the above table, is clear that 62.5% of respondents have approved that the Government success to collect the income tax from business income. But 37.5% of Respondents think that there is not Government success to collect the income tax from business income. However, majority of respondents approved that Government success to collect the income tax from business income.

4.3.4 Tax Paying Habit of Nepalese People

To know the respondents view about tax paying habit of Nepalese people, a question was asked, “In your opinion, is the tax paying habit of Nepalese people is poor?” The responses have been tabulated below:

Table 4.13

Tax paying Habit of Nepalese is Poor

Responses / Respondents	Yes		No		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Experts	18	90	2	10	20	100
Tax Payers	15	75	5	25	20	100
Total	33	82.5	7	17.5	40	100

Source: Opinion Survey, 2010

From the above table, is clear that 82.5% of respondents have approved that tax paying habit of Nepalese people is poor. But 17.5% of Respondents think that there is not poor habit of Nepalese people to pay tax but they have no capacity to pay tax. However, majority of respondents approved that tax paying habit of Nepalese people is poor.

4.3.5 Perception Towards the Business Exempt and Concessions for Income Tax

To know respondent's opinion towards the respondents Perception towards the business exempt and concessions for income tax, a question was asked, “What is your Perception towards the business exempt and concessions for income tax?” The responses are summarized below.

Table 4.14

Perception Towards the Business Exempt and Concessions for Income Tax

Responses / Respondents	Positive		Negative		Total	
	No	Percentage	No	Percentage	No	Percentage
Tax Experts	19	95	1	5	20	100
Tax Payers	18	90	2	10	20	100
Total	37	92.5	3	7.5	40	100

Source: Opinion Survey, 2010

From the opinion Survey, it was found that 92.5% of respondents have positive that Perception towards the business exempt and concessions for income tax,7.5% of Respondents think that Perception towards the business exempt and concessions for income tax are negative. So it can conclude that the Perception towards the business exempt and concessions is positive.

4.3.6 Income Tax System of Nepal is Efficient

To know respondent's opinion towards the sound efficient and effective utilization of collected tax revenue in Nepal a question was asked, "In your opinion is the income tax system of Nepal is efficient?" The responses are summarized below.

Table 4.15

Income Tax System of Nepal is Efficient

Responses	Yes		No		Total	
Respondents	No.	Percentage	No.	Percentage	No.	Percentage
Tax Experts	0	0	20	100	20	100
Tax Payers	1	5	19	95	20	100
Total	1	2.5	39	97.5	40	100

Source: Opinion Survey, 2010

From the opinion survey, it was found that 100%of tax experts and 95% of tax payers did not agree with the efficient of income tax system of Nepal and efficient utilization of collected tax revenue of Nepal. In Total 2.5% of total respondents think that there was efficient income tax system of Nepal while 97.5% respondents did not agree. Those respondents who did not agree, another question was asked to know the priorities towards the main causes of disagree. The following table shows the responses of priorities.

4.3.7 Major Problem of Income Tax System of Nepal:

In Question No 5 we asked to respondent is the income tax system of Nepal is Efficient? But 97.5 Respondent Response of the income tax system of Nepal is not efficient. Only one taxpayer's response to tax system of Nepal is Efficient. Who said No we asked the major problem of income tax system of Nepal. 20 tax export and 19 tax payers responsed as bellow:

Table 4.16

Major Problem of Income Tax System of Nepal

S.No	Major problem of income tax system of Nepal	Total Points			%	Rank
		Tax export	Taxpayer	Total		
1	Complexity in income tax	28	33	61	26.07	III
2	Lack of training facility and sufficient incentives to the employees.	56	39	95	40.60	I
3	Illegal business activities	36	42	78	33.33	II
	Total	120	114	234	100	

Source: Opinion Survey, 2010

The Major problems of income tax system of Nepal are ranked in order of the preference of the respondents are as follows:

1. Lack of training facility and sufficient incentives to the employees.
2. Illegal business activities.
3. Complexity in income tax.

From opinion survey 40.6 percent's of respondent think that lack of training facility and sufficient incentives to the employees. 33.33 percents people think that illegal business activities is the problem of income tax system and 26.07 percents respondents responses that complexity in income tax act, rules and regulation.

4.3.8 Major Causes of Ineffectiveness of the Income Tax Administration of Nepal:

To know respondent's opinion towards the Major causes of ineffectiveness of the income tax administration of Nepal. The respondent response is as follows.

Table 4.17

Major Causes of Ineffectiveness of the Income Tax Administration of Nepal

S.No	Causes of ineffectiveness	Total Points Received: Tax exports	Tax Payers	Total	Percentages	Rank
1	Lack of trained and competent tax personnel	112	96	208	18.57	I
2	Complicated tax laws	76	91	167	14.91	IV
3	Lack of Proper communication	104	93	197	17.59	II
4	Lack of proper direction	88	100	188	16.79	III
5	Unnecessary outside pressure	68	68	136	12.14	VI
6	Lack of Direction	60	92	152	13.57	V
7	Others	52	20	72	6.43	VII
	Total	560	560	1120	100.00	

Source: Opinion Survey, 2010

Major causes of ineffectiveness of the income tax administration of Nepal, seven causes were presented and asked respondents to know their opinion. The choices of respondents are summarized and tabulated in table 4.5.5.

From the opinion Survey, the Major causes of ineffectiveness of the income tax administration of Nepal is Lack of trained and competent tax personnel. Serially other causes are as listed below:

1. Lack of trained and competent tax personnel

2. Lack of Proper communication
3. Lack of proper direction
4. Complicated tax laws
5. Lack of Direction
6. Unnecessary outside pressure
7. Others (Corruption, illegal business activities, not awareness of people, etc)

To know the Major causes of ineffectiveness of the income tax administration of Nepal, we can test rank correlation coefficient.

Hypothesis:

There is no significant relationship between the views of tax exports and taxpayers with respect to Major causes of ineffectiveness of the income tax administration of Nepal.

Calculation of Correlation by formula,

$$R \,\mathrm{X} 1 \mathrm{Z} \frac{6 \quad d^2}{n(n^2 \,\mathrm{Z} 1)}$$

$$\mathrm{Pr} \,\mathrm{X} 6.6745 \mid \frac{1 \mathrm{Z} r^2}{\sqrt{n}}$$

Let variable x and y denote views of tax exports and taxpayers respectively.

	Causes of ineffectiveness	Total Points X	Rank (R1)	Total Points Y	Rank (R2)	Difference of Rank (R1-R2)	Square of Difference $(R1-R2)^2$
1	Lack of trained and competent tax personnel	112	1	96	2	-1	1
2	Complicated tax laws	76	4	91	5	-1	1
3	Lack of Proper communication	104	2	93	3	-1	1
4	Lack of proper direction	88	3	100	1	2	4
5	Unnecessary outside pressure	68	5	68	6	-1	1
6	Lack of Direction	60	6	92	4	2	4
7	Others	52	7	20	7	0	0
	Total						d^2 =12

$$R = 1 - \frac{6(12)}{7(7^2 - 1)} = 0.79$$

$$Pr = 0.6745 \times \frac{1 - (0.79)^2}{\sqrt{7}} = 0.10$$

Here, r is greater than Pr. The relation is not significant because to be significant r should be 6 times greater than Pr. So null hypothesis is rejected. That means the opinions of tax exports and taxpayers' regarding Major causes of ineffectiveness of the income tax administration of Nepal are significantly different. But there is some relationship between their views because the value of r is moderate.

4.3.9 Improvement of the Total Tax Collection through Business Income in Nepal:

To know respondent's opinion towards the how to improve of the total tax collection through business income in Nepal, the respondent response is as follows.

Table 4.18

Improve of the Total Tax Collection through Business Income in Nepal

S.No	Causes	Total Points Received				
		Tax exports	Tax Payers	Total	Percentages	Rank
1	Increasing the tax rate	81	64	145	12.95	V
2	By reducing the exemption limit	76	84	160	14.29	III
3	By reducing the concession and rebate	74	72	146	13.04	IV
4	By awe ring the people	135	105	240	21.43	I
5	By making clear act, rules and regulation.	98	132	230	20.54	II
6	By applying high penalty and fines an assessee fails to submit the statement	68	59	127	11.34	VI
7	Others	28	44	72	6.43	VII
	Total	560	560	1120	100.00	

Source: Opinion Survey, 2010

To improve of the total tax collection through business income in Nepal, Seven causes were presented and asked respondents to know their opinion. The choices of respondents are summarized and tabulated in table 4.5.5.

From the opinion Survey, Improve of the total tax collection through business income in Nepal is by awe ring the people. Serially other causes are as listed below:

1. By awe ring the people
2. By making clear act, rules and regulation.
3. By reducing the exemption limit
4. By reducing the concession and rebate
5. Increasing the tax rate
6. By applying high penalty and fines an assesses fails to submit the statement
7. Others (Social welfare scheme, increasing tax payers etc.)

4.3.10 Way to Make Taxpayers More Responsible:

Responsible taxpayers are the most important factor of effective and sound tax system. Our tax system cannot be exception. Whether the question is raised about tax system, we must look at different factors related to taxpayers. These factors may be degree of awareness, feelings of responsibilities, attitude of taxpayers, economical environment etc. If our tax system is seems to be not efficient, we must consider the side of taxpayers. To know how the respondents think to improve attitude of taxpayers, question was asked, "What is the most suitable way to make taxpayers more responsible?" Suggestions made by respondents are tabulated below:

Table 4.19

Way to Make Taxpayers More Responsible

Responses / Respondents	Awareness through media		Harder provisions in rules		Incentives such as prize and respect		Nothing is required	
	No.	%	No.	%	No.	%	No.	%
Tax Experts	8	40.00	5	25.00	7	35.00	0	0
Tax Payers	7	35.00	2	10.00	11	55.00	0	0
Total	15	37.50	7	17.50	18	45.00	0	0

Source: Opinion Survey, 2010

From the opinion Survey, it was found that 40 percent tax expert and 35 percent of taxpayers think taxpayers not to be aware. So they recommend for awareness through different media. 17.50 percent of respondents have opinion that taxpayers are aware but have intension to evasion so it requires harder provisions in rules. Fines, penalties, punishments etc. can bring them in track. Other 45.00 percent respondents including 55 percent of tax payers, 35 percent of tax expert identify the tax payers as responsible citizens and argued incentives such as prize and respect will motivate them. According to survey result, all provisions are to be implemented simultaneously.

4.3.11 Way of Improving Effectiveness of Tax Administration System:

To know about way of improved the effectiveness of tax administration system what should be the degree of change was asked to respondents as "How can be improved the effectiveness of tax administration system?" The respondent response differently as shown in the table:

Table 4.20

Change Required in Tax Administration

Responses / Respondents	No Change		General improvement such as decentralization and delegation		Evolutionary change	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Experts	0	0.00	9	45.00	11	55.00
Tax Payers	0	0.00	7	35.00	13	65.00
Total			16	40.00	24	60.00

Source: Opinion Survey, 2010

To know about way of improved the effectiveness of tax administration system which includes remarkable representation of tax administrators, i.e. 40 percent of them think general improvement such as decentralization and delegation will solve the problem. But 55 percent of tax experts and 65 percent of tax payer's feels evolutionary change is lacking for betterment of income tax administration.

4.3.12 Any Other Comments and Suggestions About Income Tax on Business Income in Nepal:

All respondent we asked in last question "you have any other comments and suggestions about income tax on business income in Nepal? Please specify", but few respondents responses this question. The responses are summaries as bellow.

1. Making Clear act, rules and regulation.
2. Increasing the numbers of tax payers.
3. Making provision to increase incentives such as prizes and respect.
4. Making hard rules to decrease corruptions.
5. Reduce the tax rates. Etc.

4.5 Major Finding of the Study

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

1. The study shows that the contribution of tax revenue to total revenue was 81.58% and that of non- tax revenue was 18.42% in FY 2008/09. It shows that taxation has been a major source of government revenue. But the contribution of tax revenue was in the decreasing trend. Its contribution was 81.09% in FY 2006/07 on total revenue, which was slightly decreased to 79.12% in FY 2007/08 but increase in 2008/09 by 81.58%.

2. The tax revenue constitutes direct and indirect tax. Within indirect tax the VAT and costume are in first and second position by their share in total indirect tax in recent years. Indirect tax has a leading role in total tax revenue. Its share was 83.85 percent in FY 1991/92 and reduced to 73 percent in 1999/00 and gradually increased to 75.68 percent in 2005/06.and again reduced to 72.89% in year 2007/08 and 70.68% in year 2008/09.

3. Direct tax is levied by government for income generation and holding of wealth. In Nepal direct tax is the composition of land revenue and registration tax and tax on property, profit and income. The land revenue and registration is in increasing trend and has reached to 5223.4 million and occupies 15.22 percent of direct tax in FY 2008/09.

4. Income tax is the major source of direct tax revenue. The amount from income tax was 875.0 million in 1991/92 and was 26983.3 million in 2008/09. Income tax constitutes Income tax from public enterprises, semi public enterprises, private corporate bodies, individual, remuneration and tax on investment.
5. The role of income tax, from public enterprises is significant. It has contributed 14.01 percent to total income tax in average. The share of income tax from private corporate bodies is 26.48 percent in average. Income tax from public enterprises has mostly effected. Its contribution was 2928.0 million in 2000/01 and is unable to meet the record again. It declined to 1769.3 and 1251 for first two years of new act. It has positive symptom in 2003/04 when growth of 64 percent occurs but after this, its condition is poor and for year 2007/08 its decline to 204.6 million. But last year it increase up to 959 millions. The effect in income tax collection from private corporate bodies is declined for first two years of new act, slow growth for third year and rapid growth for last three years. The effects of act seem to be very positive, as its contribution to total income tax has risen to 38.02 percent for FY 2007/08 and 37.84% for FY 2008/09.
6. Income tax from individual has the major role in income tax and bears dominating role in period of the study. It has contributed up to 70.62 percent in 1991/92. Its lowest share is 34.25 percent in 2008/09 and average share is 39.47 percent. Income tax collection from individual has increased by 14.52 percent in 2001/02. Its share of 4419.1 million in FY 2001/02 but it decreased for 2002/03 to 3362.3 million. Income from individuals for 2008/09 is 9240 million and the share of income tax from individuals is 39.47percent in average.
7. In income tax, business income tax is the main source of it. The role of business income tax is significant. It has contributed 84.29 percent to total income tax in average. The share of income tax from private corporate bodies is 33.1 percent in average. The share of income tax from government enterprises is 17.5 percent and share of income tax from individuals is 49.4percent in average with compare to total business income.
8. The total income tax revenue/GDP ratio in FY 1991/92 was 0.6percent which increased to 2.81percent in the FY 2008/09. But which is not satisfactory increment for the developing country like Nepal. The share of total income tax is 1.60 percent in average with respect to GDP.

9. The business income tax revenue/GDP ratio in FY 1991/92 was 0.55percente which increased to 2.04 percent in the FY 2008/09. But this ratio is not regarded as satisfactory increment

10. Business income tax portion in total revenue was 16.47 percent of maximum in 2000/01 and the lowest in FY 1991/92 and it was 5.93 percent. On average, business income tax revenue had contributed 11.97 percent to total revenue. This shows that BITR occupied major portion in income tax. But the massive fluctuation in BITR collection and its percentage contribution was due to the effect of unfriendly political and economic environment and lack of developing competency by public and private sector.

11. On an average, BITR had contributed 15.25 percent to total tax revenue. The contribution trend was fluctuating from 20.72 percent of maximum in FY 2000/01, to 8.11 percent of minimum in 1991/92. This indicates the business income tax is the main portion of total tax revenue.

12. From the opinion survey with various respondents i.e. income tax experts, and income taxpayers, the following finding have been drawn:
    1. Income tax is an important source of government revenue of Nepal
    2. Average respondent approved that the Government success to collect the income tax from business income. So we can say that the government collects the income tax in moderate condition.
    3. The tax paying habits of Nepalese people is poor.
    4. The perception towards the business exempt and concessions is positive.
    5. Maximum respondent did not agree to income tax system of Nepal is efficient.
    6. Lack of training facility and sufficient incentives to the employees, Illegal business activities and Complexity in income tax, are the problems of income tax system of Nepal.
    7. Tax administrative system of Nepal is not effective and needs some kind of treatments
    8. To improve the total tax collection through business income in Nepal, we can do awe ring the people, making clear act, rules and regulation etc.
    9. For to make tax payers more responsible the most suitable way are incentives such as prize and respect, awareness through media and harder provisions in rules.

CHAPTER -V

SUMMARY CONCLUSION AND RECOMMENDATION

5.1 Summary

The role of government is increasing as concept of welfare state is introducing. It requires fund to improve lifestyle of people, lunch public welfare program and maintain law and order. Fund is collected by government through external and internal sources. External sources such as foreign loan, grants, borrowing etc is not certain and not good for sustainable economic development of country so any government has to emphasis on internal sources such as tax and non tax revenue to collect necessary fund.

Nepal is one of the least developed countries of the world. Besides it is trying on planned development over five decades, already suffering from resource constraints, massive poverty, rapid growth of population, increasing frictional and seasonal unemployment, diseases, aggressive dependent on the agriculture, subsistence living standards and poor infrastructure. To overcome such serious problems government requires lots of fund but resource mobilization is still poor in Nepal. The resources gap i.e. the gap between government expenditure and internal source is widening continuously. There is no alternative to mobilize internal resources and collect funds internally through revenue for rapid and sustainable economic growth.

Revenue constitutes tax and non-tax revenue. Direct tax and indirect tax are branches of tax revenue and income tax is one of the major sources of direct tax. Income tax is imposed on net income of natural as well as legal person. It is called personal income tax if levied from natural person and called corporate income tax if levied from any corporation.

History of income tax starts from eighteenth century in world, initiated from Britain. In Nepal systematic provisions of income tax was introduced in 1959 through economical act. Business Profits and Remuneration Act 1960 and Nepal Income Tax Act 1962 made the provisions more systematic and effective. Income Tax Act 1974 was introduced after long consultations and homework according to economic policy of nation then. Different amendments were made in the act for timely corrections. To make timely improvement in Nepalese tax system according to modern economy and tax system of other countries and facilitate the system with concept of world trade, globalization, economic liberalization etc, Income Tax Act 2002 was passed through legislation and carried in practice.

This act has broadly divided the income into three categories: Employment income, Business income and Investment income. It has some new features such as concept of capital gain, pool system of depreciation, resident and non-resident person, international taxation etc and has made timely improvement in some other provisions.

The definition of business is not limited in the purchasing and selling of goods as is defined in directly, it has now wide area coverage. Business in wide scope covers trade, commerce, production, profession, vocation etc. Income from business is the maximum revenue earner with large number of taxpayers. Tax is the legal practice of collecting fund from different economic involvement as revenue in order to carryout several fund different economic involvement as revenue in order to carryout several social, political, cultural, developmental and other activities for the welfare of nation. In Nepal business is the first targeted source of income when the taxation concept was emerged. Formal tax act in Nepal was named as 'Business profits and Remuneration Tax Act, 2017', which was introduced by first elected government of Nepal.

In income tax, business income tax is the main source of it. The role of business income tax is significant. It has contributed 84.29percent to total income tax in average. The share of income tax from private corporate bodies is 33.1 percent in average. The share of income tax from government enterprises is 17.5 percent and share of income tax from individuals is 49.4 percent in average with compare to total business income.

5.2 Conclusion

In developing countries like Nepal, lack of sufficient financial resources is the main constraint for national economic development. The history of income is not so long. It started only on late fifties. Though, the percentage share of income tax to government revenue is in an increasing trend at present but is not regarded satisfactory in comparison to other developing countries currently income tax system of Nepal encompasses four taxes i.e. business income tax, remuneration income tax, house rent tax and interest tax. Among them contribution of business sector is highest.

The sound economy of a nation largely depends on the well developed business sector. Development of business sector is possible through business friendly rule, law and regulation in one hand the process of industrialization in the other hand. It is also important to develop the business culture in Nepalese business sector.

In the context of Nepal, she has been adopting the mixed and dual economy in the last many decades. The economy has been liberalized after the restoration of democracy in 1990. Numbers of public and government enterprises have been privatized in this period and some of them have been either liquidated or merged. Likewise, Nepal has entered in WTO mainstream of trade in 23 April 2004, which has given the potentiality to increase foreign direct investment and access of Nepal to international market. But in reality, it has strongly challenged the Nepalese small entrepreneur and the business house too in the side of quality and price and it has also increased the possibility of Nepal being as a dumping side of giant multinational companies. So, Nepalese business sector has been facing serious challenges. The main reasons are significant expansion of regular government activities, increasing cost of maintenance, increasing debt servicing charges etc.

Resource gap in Nepal has been increasing every year. The internal revenue is sometimes insufficient even to meet regular expenditure and most of the development activities depend on foreign aid where Nepal has been compelled to harmonize the donor. The major problems of domestic resource mobilization are poor utilization of the natural resource base, small and stagnant industrial sector, poor performance of public sector enterprises, poor economic growth and inadequate tax effort etc. So, in this context, revenue generation from internal sources is very important in which income tax is one of the sources.

Business sector is in initial stage of development in Nepal which is small and motionless in nature comparing to other developing country. The performance of business sector, especially the industry is very poor. Their numbers, profitability, investment in fixed assets, share of market transaction are all in weak position. In spite of that, the important and contribution of business income tax to government revenue is equally important to Nepal like developing country.

Business income tax is based on socio-economic infrastructure and environment. In the business income tax structure the debate is going on use of appropriate type of tax incentives, treatment of inflation, method and rate of depreciation. The present provision of tax incentives are found insufficient in the changing global economic scenario especially for revival of sick industrial unit. The statutory business tax rates are found frequently changed during the study period.

The contribution of BITR to GDP, total revenue, total tax revenue during the study period seemed to be 1.34 percent, 11.97 percent, 15.25 percent in average. But

The new Income Tax Act, 2058 has clarified by giving the format for method of taxing business income. But there are still controversies in methods and rates using in depreciation calculation for assets taken in lease and installment payment basis.

From the opinion survey conducted towards the tax experts, and income tax payers, the conclusion can be drawn out that business income tax as a suitable means of welting government revenue.

Unclear vision of government to business sector, frequent changes of rule and regulations and unstable political-economic environment of Nepal has sharply damaged the business sector.

5.3 Recommendation

On the basis of finding mentioned above the major areas of recommendation are mentioned as follows:-

1. Total tax consists of direct tax revenue and indirect tax revenue. Nepalese tax revenue is having dominated by indirect tax revenue. So to direct the economy in the path of direct tax revenue. Because of the direct tax revenue plays more significant role in the economic development of the country than indirect tax. Resource mobilization through direct taxation should be focused.
2. Out of total tax revenue, the contribution of income tax revenue is very low. So the contribution of income tax revenue to tax revenue and direct tax revenue should be increased by checking income tax evasion, bringing new tax payers into tax brackets, tax incentives programs with the help of sound tax planning.

3. Nepalese income tax/GDP ratio is contribution 1.60 percent and business income tax/GDP ration is 1.34 percent only on an average. So the government should use appropriate methods to collect the tax. For that it can increase the portion of direct tax by bringing the education, public transportation etc. into tax net.

4. The government can increase the tax collection from VAT, income tax and excise duty etc. So, the government should encourage the entrepreneur, to join in VAT, taking PAN by offering different benefits and it should systematize the customs and boarder etc.

5. Structural composition of business tax was found to be dominated by public private sector. In spite of decrease in tax collection government enterprises sector, its contribution percentage to BITR was fluctuated. But the performance of private sector is not also satisfactory in overall. Government should do proper homework before privatizing the enterprises and company and a research should be undertaken, why the performance of private sector is poor even then government giving more emphasis to it.

6. Government should reduce resource gap by increasing internal revenue and subsidies. Likewise government should only take the foreign loan for productive sector or purposes which has high revenue generating possibility.

7. As per the Income Tax Act, 2058, the same flat rate is levied both to resident and non-resident companies in Nepal. In many countries like, India, Belgium, Germany, Indonesia and New Zealand, foreign companies are taxed at the higher rate than domestic companies. It feels that in Nepal also, tax rate should be higher, say more then 25 percent in case of foreign companies as against 20 to 25 percent in case of domestic company.

8. Proper tax incentives should be given for revival of sick industrial unit. Provisions should be made under the Income Tax Act for carry forward and set off of accumulated losses and unabsorbed depreciation of sick units if it is amalgamated with another company.

9. Major causes of ineffectiveness of tax administration in Nepal are lack of trained and competent tax personnel, lack of Proper communication, lack of proper direction, complicated tax laws, lack of Direction, unnecessary outside

pressure etc. So, the government should control this causes to proper tax administration.

10. To increase the business income tax revenue the government focused the increase the no of tax payers. By awe ring the people, making clear act and regulation, incentives such as prize and respect to tax payers, the government can increase the no of tax payers.

11. Taxpayers are the most important factor of tax system. Suggestions regarding tax payers are as follows:
    a. Awareness and brain storming of taxpayers should be emphasized. Workshops and media should be used to educate taxpayers and improve their attitude.
    b. Regular and effective reward system should be started for responsible taxpayers to encourage paying tax voluntarily.
    c. Harder provisions of fines, penalties and punishment should be well implemented to intentional tax evaders.

12. Different recent technologies such as e-taxation should be introduced and promoted to avoid complexities and delay in income tax administrations. Tax audit system should be timely improved and equipped to work with modern technologies of account keeping. The challenge is to control tax leakages after identifying the possible leakage areas. Areas such as the expansion of tax base and change in tax rates should be reviewed revised and implemented them in addition to developing programs related to tax education and tax awareness so as to increase revenue mobilization. For effectiveness of business income tax efficiency of tax administration, effectiveness and professionalism, imparting the training for the human resources to effect structural changes in the tax administration seems inevitable. Corruption is the main Degases of Nepalese politics, so it can stop.

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WEBSITES:

www.ird.gov.np

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Appendix-I

QUESTIONNAIRE

Dear Sir/Madam

I have been writing a thesis on **"Income tax on Business income in Nepal and its impact on Revenue collection "** in Partial fulfillment of the requirement of Master of Business Studies (MBS). This questionnaire has been developed and presented towards you as a part of study. The issues raised in this questionnaire are related to the study of researcher.

I humbly request you to fill it up at the best of your knowledge. Your kind cooperation in this regard will be great value for me. I shall be highly obliged for prompt responses as for as possible.

Thank you

Agni Prasad Adhikari
Researcher
Faculty of Management,
P.N.Campus, Pokhara,
Red No.: 7-2-48-836-2003
Roll No.:125/063

Name of Respondents: ....

Designation: Tax Expert / Tax Payer Phone No....................... (Office)

Office/Department: .... Mobile No....................................

Questionnaire for Income Tax

(Please tick your answer in the following box if the question is provided with two or three alternatives and rank in order of preference from one to last number if there are four or more alternatives)

1) Do you think that business income tax is an important source of Government revenue of Nepal?

a) Yes [.....] b) No [.....]

2) Do you think that the government success to collect the income tax from business income?

a) Yes [.....] b) No [.....]

3) In your Opinion, is the tax paying habit of Nepalese people is poor?

a) Yes [.....] b) No [.....]

4) What is your perception towards the business exempt and concessions for income tax?

a) Positive [.....] b) Negative [.....]

5) In your opinion is the income tax system of Nepal is efficient?

a) Yes [.....] b) No [.....]

6) If No, what are the major problems of the income tax system of Nepal? (Please rank your answer in the order of priority)

[.....] Complexity in income tax act, rules & regulation.

[.....] Lack of training facility and sufficient incentives to the employees.

[.....] Illegal business activities

7) What are the major causes of ineffectiveness of the income tax administration of Nepal? (Please rank)

[.....] Lack of trained and competent tax personnel.

[.....] Complicated tax laws.

[.....] Lack of proper communication

[.....] Lack of proper direction

[.....] Unnecessary outside pressure.

[.....] Lack of co-ordination

[.....] Other, (Please specify)……………………..

8) How to improve the total tax collection through business income in Nepal? (Please rank)

[.....] By increasing the tax rate.

[.....] By reducing the exemption limit.

[.....] By reducing the concession & Rebate.

[.....] By awe ring the people.

[.....] By making clear act, rules and regulation.

[.....] By Appling high penalty and fines an assessee fails to submit the Statement.

[.....]Others, (Please specify)………………………….

9) What is the most suitable way to make taxpayers more responsible? (Please rank your answer in the order of priority)

[.....] Awareness through media.

[.....] Harder provisions in rules.

[.....] Incentives such as prize and respect.

[.....] Nothing is required.

10) How can be improved the effectiveness of tax administration system?

[.....]No change

[.....]General improvement such as decentralization and delegation

[.....]Evolutionary change

11) You have any other comments and suggestions about income tax on business income in Nepal? Please specify ... ...

Appendix-II

List of Sample Respondents

S.No.	Name of Respondents	Post	Organization and Address
	Tax Experts		
1.	Narayan Sapkota	Tax Officers	Inland Revenue Office, Pokhara
2.	Jiban Kumar Ghimire	Tax Officers	Inland Revenue Office, Pokhara
3.	Kishor Bartaulla	Tax Officers	Inland Revenue Office, Pokhara
4.	Bishowbandhu Paudel	Tax Officers	Inland Revenue Office, Pokhara
5.	Ananda Kafle	Tax Officers	Inland Revenue Office, Pokhara
6.	Prakash Dhakal	Tax Officers	Inland Revenue Office, Pokhara
7.	Sita Bartaulla	Tax Officers	Inland Revenue Office, Pokhara
8.	Ashok Dhakal	Tax Officers	Inland Revenue Office, Pokhara
9.	Bishbu Khanal	Tax Officers	Inland Revenue Office, Pokhara
10.	Birendra Sing Gajmeer	CA, Finance Control	Pokhara Grand
11.	Shiva Prasad Dahal	CA, Auditor	Pokhara Grand
12.	Arjun Khawas	Register Auditor	Pokhara
13.	Sandesh Subedi	Register Auditor	Pokhara
14.	Madhab Krishna Bastola	Register Auditor	Pokhara
15.	Mani Dev Bhattarai	Director	IRD, Kathmandu
16.	Lok Prasad Newpaney	Tax Officer	IRD, Kathmandu
17.	Khim Bahadur Kunwar	Tax Officer	IRD, Kathmandu
18.	Pramila Karki	Director	IRD, Kathmandu
19.	Manish Upreti	CA	Kathmandu
20.	Mahesh Remal	CA	Pokhara
	Tax Payers		
1.	Sameer Acharya		NIC Bank, Pokhara
2.	Kiran Paudel		Pokhara Trade house, Pokhara

3.	Lekhnath Poudel		Poudel Interprises, Pokhara
4.	Bishnu Poudel		Kaligandaki Medico Pharma, Pokhara
5.	Yadav Prasad Adhikari		Machhapuchhre Metal and Machinery Works Pvt. Ltd., Pokhara
6.	Baburam Panta		Pokhara Multimetal Pvt. Ltd., Pokhara
7.	Rudra Kunwar		Pokhara Noodles Pvt. Ltd., Pokhara
8.	Khilendra Paudel		IME, Kathamndu
9.	Nabin Sharma Poudel		IME Financial Institution, Kathmandu
10.	Prasanna Baskota		Ncell, Kathmandu
11.	Deepak Sameep		Goshali Packaging Pvt. Ltd., Pokhara
12.	Jhalak Acharya		Pokhara Foods Pvt. Ltd., Pokhara
13.	Bishnu Prakash Bhandari		Sugal Foods Pvt. Ltd.Pokhara
14.	Bishow Mohan Adhikari		City Development Bank, Pokhara
15.	Ramji Prasad Gyawali		Chandrodaya Engineering Pvt. Ltd., Pokhara
16.	Ganesh Dhakal		Tourism Development Bank, Kathmandu
17.	Yogendra Sigdel		Gandaki Medicine Suppliers, Pokhara
18.	Rabi Chandra Khanal		Standard Finance, Pokhara
19.	Tekraj Poudel		Pragati Medicine suppliers, Pokhara
20.	Kedar Pokhrel		Syangja Ausadhi Pasal, Pokhara

CURRICULUM-VITAE

Name : **Adhikari, Agni Prasad**

Date of Birth : 2042/01/09 BS (21st April 1985)

Marital Status : Married

Sex : Male

Blood Group : O+ve

Nationality : Nepali

Religion : Hindu

Language skills : Nepali, English, Hindi

Permanent Address : Kristi Nachnechour-1, Kaski, Nepal

Temporary Address : Pokhara-11, Phoolbari, Kaski, Nepal

Cell No . : 9846085131,

E-M@il : agni_adhikari@hotmail.com

ACADEMIC QUALIFICATION:-

S.N	Levels	School,Campus	Board/ University	Passed Year	Divisions	%
1	Masters In Business Studies(MBS)	P.N. Campus , Pokhara, Nepal	Tribhuwan University (TU)	1st Year 2nd Year	2nd 1st	59.11 69.11 Thesis not submitted
2	Bachelors In Business Studies(BBS)	P.N. Campus , Pokhara, Nepal	Tribhuwan University (TU	2063 BS 2006 AD	2nd	54.57
3	Higher Secondary Education Level (10+2)	Chhorepatan Higher Secondary School, Pokhara 17, Kaski	HSEB, Nepal	2050 BS 2003 AD	2nd	48.40
4	School Leaving Certificate (SLC)	Bhabishya Nirman Secondary School, Kristi Nachnechour -1, Kaski	SLC Board Nepal	2057 BS 2001 AD	2nd	57.50

WORK EXPERIENCE:-

Assistant (Credit, Account)
IME Financial Institution Ltd (Since 04, Oct, 2009 to till now)
Account Officer
Pokhara Noodles Pvt. Ltd., Pokhara, Nepal (22, May, 2005 to 04, Oct, 2009)

Training:-
Computer Diploma (Well known on recently used Accounting Software)
Citizenship No: - 136729 (Kaski),

All the information stated in this CV is true & best of my knowledge.