CHAPTER I
INTRODUCTION

1.1 General Backgrounds

Nepal confronts with a number of economic challenges at present: low economic growth, low per capita income, higher level of poverty, poor social and economic indicators, underdeveloped physical infrastructure, and high-cost economy leading to higher cost of production and so on. While the world economy in general and the emerging and developing economies, India and China at our door steps in particular, are moving fast along the trajectory of economic growth, Nepal still finds itself grapped with a host of problems that demand early and effective solutions to ensure on inclusive, just and high economic growth on a suitable basis.
(Source: Economic Survey 2006/07)

The extremely unfavorable weather, among other things, caused this high decline in agricultural production, especially that of the paddy. The impact could clearly be seen on the over all agricultural production index which increased by a mere 0.4 percent in 2006/07 against the increase of 1.1 percent in the preceding year. Conversely, the production index of major industrial products grew by 2.1 percent this year compared to the growth of 1.9 percent last year. In the current F/Y 2006/07, GDP growth rate at current producer's prices is estimated to remain 11.1 percent, the highest at current prices since F/Y 2000/01
(Economic Survey 2006/07)

According to the economic survey of fiscal year 2006/07, Nepal's economic indicators are very miserable. It has shown that Nepal's economic growth rate is only 1.9% in FY 2006 which is the smallest figure among the SAARC countries where as the global economy expanded by 5.4% in 2006. On the other hand annual percent change in the price of Nepal FY 2006 is 8% which is the third highest among the SAARC countries. According to the human development report of world bank published on. Nepal has the lowest per capita GDP in US $ i.e. 331.1 in among the SAARC countries.

Table 1.1
Per capita GDP in US $ of SAARC countries.

Country	**Per capita GDP in US $**
Sri – Lanka	1503.7
India	946.1
Pakistan	844.6
Bangladesh	460.1
Nepal	331.1
Bhutan	NA
Maldives	NA

Source: World Bank Report, 2007
NA: Not Available

Table 1.2
Annual percentage change in price of SAARC countries.

Countries	**2004**	**2005**	**2006**	**Projection**	
				2007	**2008**
Bangladesh	24.2	13.2	12.3	5.5	5.9
Bhutan	4.6	5.3	5.2	5.5	5.3
India	3.8	4.2	6.1	6.2	4.3
Maldives	6.3	3.3	3.5	7.0	6.1
Pakistan	4.6	9.3	7.9	6.5	6.0
Sri - Lanka	7.9	10.6	9.5	14.0	6.5
Nepal	4.0	4.5	8.0	7.0	6.1
Afghanistan	24.2	13.2	12.3	5.5	5.9

Source: Economic Survey, 2006/07

Major parts of Nepal's land area is covered by high mountains and hills accounting for about 83%. Remaining 17% consists of Terai region. Because of its landlocked situation, the historical and topographical features and other problems of development, the country presents its own distinctive and unusual features in the process of economic development. More than 85% of Nepalese people live in rural areas and more than 40% of them have income below the poverty line. Most of the people living in rural areas are not getting even minimum facilities of life because of underdevelopment and wide spread poverty.

Nepal is an agricultural country. The predominant position has been occupied by agriculture sector in the Nepalese economy. 81% of the population of this country is dependent upon agriculture, which contributes 39% of the total GDP. Agriculture is the major supplier of raw material to industries.

The contribution of agriculture and non-agriculture sectors in terms constant price GDP in F/Y 2006/07 has been 36.1% and 63.9% respectively as compared to the contributions of 36.8 percent and 63.2 percent during the previous year, there by reflecting a decline of 0% percentage point in the contribution of the agriculture and the same percentage point rise in the contribution of the non-agriculture during the current year. *(Economic survey, 2006/07)*

The constitution of Nepal has clearly directed Nepalese government for a self-reliant economic system, encouragement to nation 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. Beside these functions, revenue mobilization is one of the most important functions of the government. (Pradhan, 2001:1)

In any country of the world, capital plays a vital role in its development programs. For the economic development of a nation, bulk capital is needed to conduct any developmental program. The capital is raised from external and internal sources. The external sources are foreign aids and loans; internal sources are tax revenue and non-tax revenue. The government receives the tax revenue as compulsory payment where non-tax revenue is a conditional source. Fees, penalty, fines and forfeitures; receipt from rent of government property and services; dividends, interests, royalty and sale of government property, principle payment, donation and miscellaneous income etc. are the sources of non tax revenue. Income tax, sales tax/VAT, custom duties, hotel tax, revenue from land registration etc. are the sources of tax revenue. Of them, tax revenue is major source of the internal revenue as well as the macro-economic fiscal instrument of the government (Paudel, 2002:1).

According to Goode, "A tax is compulsory contribution to government made without reference to a particular benefit received by the tax payer. It is a personal obligation to pay tax and there is no direct relationship among tax, benefit and individual taxpayers."
(Google Search)

According to Adam Smith, the father of political economy, "A tax is a contribution from citizens for the support of the state." The primary purpose of the taxation is to divert control of economic resources from taxpayers to the state for its own use or transfer to others. Bringing about economic growth, elasticity in the tax structure, control of inflationary pressure and reduction of inequality are the main objectives of tax policy.

Taxes are broadly classified into two groups: direct tax and indirect tax. Direct tax is a personal tax. If the same person to whom the tax is legally imposed and there is no possibility of shifting pays it, then it is called direct tax. Examples include income tax; profit tax, property tax etc. On the other hand, indirect tax is a commodity tax. If any tax is legally imposed for one person but the incidence of the tax is borne by another person through backward and forward shifting process, then it is called indirect tax. Value added tax (VAT), hotel tax, custom duty etc. are some of the indirect taxes.

Income tax can be classifies into two types: personal/individual income tax and corporation income tax. Individual income tax is a modern tax, which is measure of ability to pay of any individual. It is based on the progressive rates. Corporate income tax is levied on business enterprises having a legal personality, distinct from their owners. Taxes on corporate ultimately come from the income or wealth of individuals. Generally, flat rate is applied to corporate income tax. Reducing inequality of income distribution, stabilizing the economy and checking inflation are main objectives of income tax. Among them, reduction of inequality of income distribution is the greatest merit of the income tax.

"Income tax should be justifiable to achieve maximum social and economic objective. it helps in redistribution of economic means by the transformation of wealth from persons with higher economic level to lower economic level. It should minimize the gap between rich and poor. Regional economic imbalances may also be reduced by providing incentives and concessions in income tax for stating new industries in backward areas. It has become an effective instrument to ensure balanced socio-economic growth. Income tax also helps to increase the consciousness of people because the people who have paid the income tax are interested on public expenditure. Though, they cannot expect any direct benefit from their tax paying, they can observe the use of the collected fund from them in the form of income tax. It is also helpful for generating the concept of social responsibility towards the nation and keeps the people vigilant to see that public money may not be misused. Income tax is essential not only for collecting government revenue but also for controlling over consumption, for promoting saving and for generating more employment" (Lal, 1996).

The Great Britain was the first country that introduced modern income tax in 1799 to collect revenue to finance Napoleonic War with France. In 1862, United States of America (USA) introduced income tax to generate revenue to finance Civil War. The Federal Corporation Income Tax was introduced in 1909. In India, modern tax was adopted in 1860. In Nepal, income tax was introduced in 1959. Both individuals and companies were taxed in similar way during the earlier period but later on companies were levied with a flat rate and individuals with progressive rates (Paudel, 2002:5).

This study has also been designed to study the contribution of tax, especially income tax to government revenue of Nepal. PEs play catalytic role in social and economic development process of nation. In Nepal, after the dawn of democracy in 1950, there emerged an environment in which the needs and aspirations of the people were given primary. Accordingly, HMG has initiated a system of establishment and functioning of PEs with huge investment for economic development. PEs highly contribute in national exchequer by various ways i.e., direct participation in the production, distribution of goods and services and other income generation including income tax.

PE_s have become both necessary and useful as vehicles for development in developing nations. They are being loaded upon as effective instrument of program implementation of accomplishing the desired national development goals. PEs constitute a large and rapidly growing sector of the economy in the majority of countries in the world today, including Nepal.

The economy of Nepal is basically mixed economy, where the public and private sector freely operate in the business environment except in the case of defense, which is not open to private sector. There is coexistence of both the public and private sectors in Nepal for the overall development of the country.

Nepal is one of the under developed country which is still in its crawling stage of industrial development. So, in Nepal, PE_s are not matter of choice, rather, they are a matter of necessity. In various sector of economy, where private sector has not come forward or has only in limited extent, the public sector has to come into existence. The area in which they operate, range from basic infrastructure, industrial estates, banking, trading and commercial sectors to big and small PE_s to create industrial base in the country, to provide better goods/services to the people, to generate employment opportunities, to mobilize the domestic resources into best productive uses and to fulfill the government plans and objectives. PE_s have helped to increase the standard of living to keep regional balance of development and they have contributed through import substitution, export promotion and strengthening the revenue generation of HMG and save foreign currency by reducing import as well as to provide the consumable goods/services at a fair price (Acharya, 2000:3-4).

It is sure that Nepal needs to make fairly extensive use of PEs as a catalytic agent in the process of moving towards development oriented economy at a certain stage in the development process.

According to the annual report 2062/063 of Inland Revenue Department, total government revenue was Rs 71733127 (in thousand) out of which tax revenue was Rs 40202336 (in thousand). In this tax revenue, Enterprises income tax has highest 49% contribution.

The majority of PEs, where billions of rupees from the resources of a poor country Nepal have been poured, have failed to deliver expected services, their productivity is low and the quality of their products are short of standard. The returns are negligible. PEs are becoming more and more burdensome and unable to shoulder their own burden.

1.2 Statement of Problems

Nepal is facing too many problems such as political instability, conflicts and violence, socio cultural changes, economic problems etc. Among them resource gap is the major, problem which give birth to many other problems. Resource gap is the difference between total expenditure and total revenue. Nepal has been facing serious resource gap problem from the beginning of it's development phase. The financial expenditure of the HMG has been increasing at a faster rate than that of revenue. Every year the resource gap is increasing at a faster rate due to slow increase in the rate of revenue to fulfill the expenditure requirement, owing to the inefficiency of tax administration and incomprehensive tax act and people's unwillingness towards tax payment.

Nepal is least developed and agricultural based, country in the world. Its gross domestic product (GDP) per capita income is $ 331.1 (according to world Development report, 2007). Nepal's GDP per capita income is the lowest in SAARC countries. Agriculture sector which contributes 36.1 percent of GDP (Economic Survey 2006/07) is still free from the income tax. About 42 percent of total population is below absolute poverty line. That's why the government can generate only small portion of GDP as revenue and Nepal is always facing a problem of source resources for development activities. Few rich people have captured major economic sources and they are under taxed either of tax avoidance or evasion and most of the poor people suffer from commodity tax.

Resource Gap[1] (A – B): If it is considered that resource gap as the difference between total expenditure and total revenue, there has been a serious resource gap problem in Nepal. The resource gap was Rs 223228 million in FY 1998/99 which has increased to Rs 38607.1 million in FY 2005/06 which is the highest resource gab among all the fiscal years.

Resource Gap[2] [A - (B + C)]: If it is considered that resource gap as the difference between total expenditure minus total revenue plus foreign grants, there was no resource gap in the first budget speech 1950/51. This type of gap started from the budget speech of 1956/57. In that year it was Rs 0.7 million which stood at Rs 3047.5 million in 1982/83. It further rose in subsequent years and reached to Rs 24779.6 in FY 2005/06.

Resource Gap[3] [A - (B + C + D)]: If resource gap is taken as the difference between total expenditure and total revenue plus foreign grants plus foreign loan. This type of resource gap started from 1964/65 when the gap was Rs 5.9 million. In 1982/83, the gap was 2061.7 million. In FY 2005/06 it reached to Rs 16565.3 million, which increased by 8.03 folds as compared to FY 1982/83.

Resource Gap[4] [A - (B + C + D + E)]: If resource gap is taken as the difference between total expenditure and total revenue plus foreign grants plus foreign loan plus domestic loan, there was no resource gap in the FY 2004/05 and there was highest resource gap of Rs 7241.9 million in FY 2001/02 and a very low resource gap in the FY 1999/00 i.e. Rs 354.8 million.

Table 1.3
Resource Gap in Nepal (1998/99 to 2005/06)

Rs in Millions

Year	Total Expenditure	Total Revenue	Resource Gap	Foreign Grants	Resource Gap[2]	Foreign Loan	Resource Gap[3]	Domestic Loan	Resource Gap[4]
	A	B	A - B	C	[A-(B+C)]	D	[A-(B+C+D)]	E	
1998/99	59579.0	37251.0	22328	4336.6	1799136	11852.4	6139	4710.1	1429.0
1999/00	66272.5	42893.8	23378.7	5711.7	17667	11812.2	5854.8	5500.0	354.8
2000/01	79835.1	48893.6	30941.5	6753.4	24188.1	12044.0	12144.1	7000.0	5144.1
2001/02	80072.2	50445.5	29626.7	6686.1	22940.6	7698.7	15241.9	8000.0	7241.9
2002/03	84006.1	56229.8	27776.3	11339.1	16437.2	4546.4	11890.8	8880.0	3010.8
2003/04	89442.6	62331.0	27111.6	11283.4	15828.2	7629.0	8199.2	5607.8	2591.4
2004/05	102560.4	70122.7	32437.7	14391.2	18046.5	9266.1	8780.4	8938.1	-157.7
2005/06	110889.2	72282.1	38607.1	13827.5	24779.6	8214.3	16565.3	11834.2	4731.1

Source: Economic Survey, Fiscal Year 2006/07

If any government has a resource gap, it has to resort a deficit budget. There was a large portion of foreign grants to meet the budget deficit in the early years budgets in Nepal. But in recent years, the percentage of foreign loans in rising and of grants is decreasing. It is not a desirable direction for our country. Excess reliance upon foreign loan creates extra burden to the economy because debt-servicing charge increases every year. The foreign loan should be taken as a complementary resource to the internal resource mobilization.

In fiscal year 1998/99, the foreign loan in Nepal was Rs. 4336.6 million. Then it started to increase and reached to Rs 13827.5 million in 2005/06.

In most of the developing countries, the governments collect about ¾ of the tax revenue from indirect taxes because of the several reasons such as administrative difficulty, lower level of public awareness about paying taxation, easiness of collection. But theoretically, direct taxes are more progressive and justifiable on the ground of equity. The indirect tax is a extra burden to the people, especially for poor people by raising prices of commodity. It does not create public consciousness and it has a little role to reduce income inequality. But Nepalese tax structure is severely dominated by the indirect taxes. However, its relative contribution is declining which is a positive development.

In 1998/99, the share of direct tax to total tax was 26.14 percent and that of indirect tax to total tax was 73.86 percent. In 2005/06, it was 24.32 percent and 75.68 percent respectively. The contribution of indirect tax is about ¾ of the total tax yet. The table 1.4 is given below:

Table 1.4
Contribution of Direct Tax and indirect tax to Total Tax Revenue.

Year	Direct Tax	Indirect Tax	Total Tax	% Share of Direct Tax in Total Tax	% Share of Indirect Tax in Total Tax
1998/99	7516.10	21236.80	28752.90	26.14	73.86
1999/00	8951.50	24200.60	33152.1	27.0	73.0
2000/01	10159.40	28705.70	38865.1	26.14	73.86
2001/02	10597.50	28733.10	39330.6	26.94	73.06
2002/03	10105.80	32481.20	42587.0	23.73	76.27
2003/04	11912.60	36260.40	48173.0	24.73	75.27
2004/05	13071.80	41032.90	54104.7	24.16	75.84
2005/06	13968.10	43462.30	57430.4	24.32	75.68

Source: Economic Survey of Various years, Ministry of Finance G/N.

Richer Nepalese people have lock of tax paying habit and tax consciousness. The tax evasion and avoidance habit is increasing day-by-day due to low standard of education for tax responsibility to taxpayers. Where as in western and developed countries the tax evasion is considered as a social crime. In Nepal, this act is regarded as an intelligent and clever on the part of the taxpayer.

Nepalese people do not support the tax offices by giving their true information regarding tax evaders. They do not like to maintain the books of accounts and get them audited. This stops the communication for providing information regarding the actual financial position of the business to the taxpayers. Tax officers also do not encourage account maintenance by rejecting the books of accounts. In the regard, books of accounts do not get a reasonable importance while assessing the income tax.

The main objective of Nepalese tax system are to make funds available for economic development to maintain reasonable economic stability, and to reduce inequality in distribution of income and wealth. But the objectives of Nepalese tax system are not fulfilled reasonably. The main problem underlying is, weak tax administration and tax management procedure. Nepalese tax administration is weak basically due to the lack of trained and competent employee, complicated tax laws, lack of voluntary compliance by taxpayers etc.

Because of tax evasion habit of Nepalese people, role of public enterprises towards income tax revenue is very justifiable. Income tax from public enterprises should be adopted as a fiscal instrument in government revenue, which helps to achieve the goal of national development. But the majority of public enterprises have been unable to deliver their expected services productivity and returns are very poor. Financial position of public enterprises is unsatisfactory and public enterprises are likely to become an increasing burden on government. They cannot even maintain their books of accounts and most of them have not audited regularly. Even profit making PEs are escaping from income tax because of not maintaining the books of accounts, un-audited financial statement, intention to hide their inability, low level of moral and honesty etc.

1.3 Focus of the study:

This study is mainly focused on the classification and status of tax payer and contribution of tax on government revenue. This study will focus on the contribution of direct tax, indirect tax, as well as non-tax revenue on government revenue generation and GDP (Gross Domestic Production) as well.

The well focus of the study are as below:

- Classification of tax payers.
- Contribution of both tax and non-tax revenue on total government revenue.
- Contribution of tax and non-tax revenue on GDP (Gross Domestic Production)
- Comparative study of tax revenue and non tax revenue on total government revenue and GDP

1.4 Objective of the study:

The main objectives of the study are as follows:

1. To classify the tax payers according to tax act 058.
2. To analyze the contribution of tax and non tax revenue on total government revenue.
3. To analyze the contribution of tax and non tax revenue on GDP.
4. To analyze the problems in income tax system in Nepal.

5. To provide suitable recommendations to increase the share of income tax to government revenue and GDP.

1.5 Importance of the study:

Various studies have been conducted regarding tax system in Nepal and different reports about the taxation system are also available. But very few studies have been done in classification status of tax payer and contribution of tax on government revenue. So this is the main reason to undertake this study.

Tax plays an important role in the overall economic development in developing country like Nepal. Both developed and developing countries tax contributes a lot in the share of government revenue. In the world, share of tax in the total government is increasing because of its importance for the economic betterment of the country.

Nepal is one to the lowest taxed economic in the world as her tax/GDP as well as Tax/GNP ration are the lowest among SAARC countries and among the rest of the world as well. This indicate the poor tax management in Nepal.

This study is undertaken to examine the contribution of tax on government revenue and economic development of the country. Tax revenue is very much essential to meet the increasing financial need of HMG for development purpose.

This study will be helpful for the following groups, individuals and institutions.

- Further researcher
- University students
- Major parties who are interested in tax revenue
- Inland revenue department (IRD)
- Others

1.6 Research Methodology

Research Methodology is the methods of solving the research problems in systematic manners. Both primary as well as secondary data have been used in this study. Opinion survey, through questionnaires and interviews will be used to collect the primary data. Economic surveys, Bulletin, Budget speech, News papers, etc. are the major sources of secondary data statistical tools such as x^2-test, Rank correlation co-efficient are used to analyze the primary data.

1.7 Hypothesis of the study:

The following hypothesis has been posed in this study:

Hypothesis 1:

Null Hypothesis, HO:P_s = 0: There is no significant relationship between the views of tax administrators and tax payers regarding the problems in tax act 058.

Alternative Hypothesis, $H1:p_s \neq 0$:

There is significant relationship between the views of tax administrators and tax payers regarding the problems in tax act 058.

Hypothesis 2:

Null Hypothesis, $HO:P_s = 0$: There is no significant difference between the views of tax administrators and tax payers regarding the contribution of tax revenue on total government revenue.

Alternative Hypothesis, $H1:p_s \neq 0$:

There is significant difference between the views of tax administrators and tax payers regarding the contribution of tax revenue on total government revenue.

Hypothesis 3:

Null hypothesis: $HO:P_s = 0$: There is no significant relationship between the views of the tax administrators and tax payers regarding the role of Tax in economic development and poverty alleviation.

Alternative Hypothesis, $H1:p_s \neq 0$:

There is significant relationship between the views of the tax administrators and tax payers regarding the role of tax in economic development and poverty alleviation.

Hypothesis 4:

Null hypothesis: $HO:P_s = 0$: There is no significant relationship between the views of tax administrators and tax payers regarding the low Tax/GDP as well as tax/GNP ratio.

Alternative Hypothesis, H1:$p_s \neq 0$:

There is significant relationship between the views of tax administrators and tax payers regarding the low Tax/GDP as well as Tax/GNP ratio.

Hypothesis 5:

Null hypothesis: HO:$P_s = 0$: There is no significant relationship between the views of tax administrators and tax payers regarding tax avoidance and tax Evasion are the major problems of tax administrators in Nepal.

Alternative Hypothesis, H1:$p_s \neq 0$:

There is significant relationship between the views of tax administrators and tax payers regarding tax avoidance and tax Evasion are the major problems of tax administrator of Nepal.

Hypothesis 6:

Null hypothesis: HO:$P_s = 0$: There is no significant relationship between the views of tax administrators and tax payers regarding ineffective tax administration is the cause of increasing resource gap problem in Nepal.

Alternative Hypothesis, H1:$p_s \neq 0$:

There is significant relationship between the views of tax administrators and tax payers regarding ineffective tax administration is the cause of increasing resource gap problem in Nepal.

Hypothesis 7:

Null hypothesis: HO:P_s = 0: There is no significant relationship between the views of tax administrators and tax payers regarding agriculture income should be taxed to increase the contribution of tax revenue on total government revenue.

Alternative Hypothesis, H1:$p_s \neq 0$:

There is significant relationship between the views of tax administrators and tax payers regarding agriculture income should be taxed to increase the contribution of tax revenue on total government revenue.

Hypothesis 8:

Null hypothesis: HO:P_s = 0: There is no significant relationship between the views of tax administrators and tax payers regarding the exemption limit and tax rate provided to individual and couples by Income Tax Act 2058.

Alternative Hypothesis, H1:$p_s \neq 0$:

There is significant relationship between the views of tax administrators and tax payers regarding the exemption limit and tax rate provided to individual and couples by Income Tax Act 2058.

Hypothesis 9:

Null hypothesis: HO:P_s = 0: There is no significant relationship between the views of tax administrators and tax payers regarding the low number of new tax payers registered in the F/Y 2005/06.

Alternative Hypothesis, H1:$p_s \neq 0$:

There is significant relationship between the views of tax administrators and tax payers regarding the low number of new tax payers registered in the F/Y 2005/06.

Hypothesis 10:

Null hypothesis: HO: $P_s = 0$: There is no significant difference between the views of tax administrators and tax payers regarding the bases of classification of income tax payers being scientific and systematic for the assessment of taxable income.

Alternative Hypothesis, H1:$p_s \neq 0$: There is significant difference between the views of tax administrators and tax payers regarding the bases of classification of income tax payers being scientific and systematic for the assessment of taxable income.

1.8 Limitation of the Study

This study is not free from limitations. The limitations of the study are as follows.

1. The extent of this study is based on the availability of reliable data and sufficient literature.
2. Only the views of 50 tax administrators and tax payers are considered in this study which may not represent the whole populations.
3. This study has covered the last 8 economic years from fiscal year 2056/2057 to 2062/2063.

4. Primary data have been collected from only the Kathmandu Valley due to time constraints and others difficulties.
5. This study has to be done with in short time frame.

1.9 Plan of the study.

The study is divided into the five chapters. They are as follows

Chapter I: Introduction

Chapter II: Conceptual Framework and Review of Literature

A: Conceptual Framework

B: Review of Literature

Chapter III: Research Methodology

Chapter IV: Presentation and Analysis of Data

A: Analysis of Taxpayers

B: Analysis of Secondary Data

C: An Empirical Investigation

Chapter V: Summary, Conclusion and Recommendations

CHAPTER II
CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

A: CONCEPTUAL FRAMEWORK

2.1 Introduction to sources of government Revenue:

The government of any country needs sufficient revenues to carry out development plans to handle day-to-day administration, to maintain peace and security and to launch various public welfare activities. The government collects these revenues from various sources such as tax, revenue from public enterprises, special assessment, fees, fines, grants and assistance etc. Among them, tax is the main sources of government revenue. The incomes collected by the government through various sources are termed as public revenue. The major sources of public revenue or government revenue are as follows:

2.1.1 Tax

Tax is compulsory contribution to the government from a person according to law. It is contributed to the government without any quid pro quo (direct benefit) to the tax payer. In Nepal, about 77% of total revenue comes from tax revenue and rest 23% from Non-tax revenue.

2.1.2 Revenue from public enterprises

The enterprises owned by the government known as public enterprises (PE_s), pay amount to the government for the monopoly right given to them.

2.1.3 Special Assessment

It is the amount collected from special sector for specific purpose.

2.1.4 Fees

It is the amount paid to the government for the services rendered by the government offices.

2.1.5 Fines

It is the amount to be paid to the government for violating acts, rules regulations, etc.

2.1.6 Grants and Assistances

It is the amount received by the government from foreign countries, international organizations etc.

2.2 Concept of Tax

The government of any country requires sufficient revenues to launch the development programs, to handle the daily administration, to keep peace and security and to launch other public welfare programs. The government or public revenues are collected through various sources. These sources can be: (a) taxes (b) revenues from government corporations and public enterprises (c) fees (d) special assessment (e) fines and penalties and (f) foreign grants. Among them, tax is the main source of collecting the public revenues because it occupies the most important part of the government treasury. In Nepal, about 77% of total revenue comes from tax revenues and the rest 23% from non-tax revenues.

Tax is a compulsory payment to the government from a person according to law. It is contributed to the government without expectation of any quid pro quo (direct benefit) to the taxpayer. The government mobilizes these taxes for public interests.

According to Prof. Seligman "A tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit." *(Amatya, Surendra Keshar, Pokharel Dr. Bihari Binod and Dahal, Rewanta Kumar. 2060. Taxation in Nepal. M.K. Publishers & Distributors.)*

In the words of Taylor "A tax is a compulsory payment to the government without expectation of direct benefit in return to the taxpayer." *(Amatya, Surendra Keshar, Pokharel Dr. Bihari Binod and Dahal, Rewanta Kumar. 2060. Taxation in Nepal. M.K. Publishers & Distributors.)*

Similarly, Bastable has opined that "A tax is a compulsory contribution of wealth of a person or body of persons for the service of public powers."

From the above definitions, it can be said that:

- A tax is a compulsory contribution to the state from a person,
- the natural person and artificial person (entity or corporate body) having tax liabilities pay the taxes to the government.
- the taxpayer does not receive the equivalent benefit from the government,
- there is no discrimination among the taxpayers other than specified by the law,
- tax is paid to the state to perform the functions of the government, and
- The amount of tax is spent for common benefits and interest of the people.

Tax is a compulsory payment to the government tax payers does not get any direct benefit from the state by paying tax. Tax is not a fine. Government collects tax with the permission of legislature to fulfill financial needs of the state. Tax is a compulsory payment to government for the compensation of public expenditure. Tax fulfills the needs of central or local government to spend for philanthropic work. The main objective of tax is to distribute wealth and income equally. Mainly, tax is classified in two groups. They are direct tax and indirect tax (Adhikari, 2003:2)

According to classical economist Adam Smith, "A Tax is a contribution from citizens for the support of the state."

According to Frindly Shirras, "Tax is a compulsory contribution to public authorities to meet the general expenses of government which have been incurred for the expenses of government which have been incurred for the public good and without reference to special benefits."

According to Bastable, "A Tax is compulsory contribution of wealth of a person or body of persons for the service of public powers."

According to classical economist Dalton, "A tax is a compulsory contribution imposed by a public authority irrespective of the exact amount of service rendered to the taxpayer in return and not imposed a penalty for a legal offence."

According to economist Plehn, "Tax is general contribution of wealth to levied upon persons, natural or corporate to defray expenses incurred in conferring benefits upon the resident of the states."

In classical economist, tax was taken as an extra burden to the people and the economists were in the favour of small government, which only had to maintain law and order in the state. But now, the time has changed and the government has to provide maximum social welfare to the people and the government has to broden its revenue to meet the increasing welfare program.

In modern economics, tax is not taken as a extra burden to the people but it is taken as a responsibility of a good citizen.

2.3 Classification of Taxes

Tax can be classified into two categories:

- Direct Tax
- Indirect Tax

2.3.1 Direct Tax

A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying the tax and bearing the tax is the same. Examples of direct tax are Income tax, Gift tax, interest tax, property tax, vehicle tax, House & Land Tax, contract tax.

Merit of direct tax

1. **Equitable:** Direct tax is levied on the basis of incomes and properties of a taxpayer. So the amount of tax is increased or decreased according to proportional increase or decrease in income or properties. More tax is imposed on more income and properties while less tax is levied on less income or properties. Thus, direct tax is equitable as it is based on a taxpayer's income and properties.
2. **Certainty:** The taxpayers are informed about the amount, time and procedure of payment of direct taxes. So, direct tax has a quality of certainty.

3. **Elasticity:** The amount of direct tax is increased or decreased according to proportional increase or decrease in income and properties. Furthermore, the government can easily increase or decrease the rate of direct tax in a proper economic situation of the country.
4. **Economy:** Direct tax has a quality of economy because low cost is incurred in levying and collecting tax.
5. **Public awareness:** Taxpayers are conscious about the development programs of the country because they feel that there is also their contribution in the national budget through direct tax.

Demerits of direct tax

1. **Economic burden:** Direct tax is imposed on taxpayers' own income or property but the government does not provide them any direct benefits. So they may feel the tax as an economic burden. Furthermore, the taxpayers always feel high tax rate as an unnecessary financial burden.
2. **Possibility of tax evasion:** If taxpayers feel direct tax as an unnecessary burden, they attempt to pay the tax as much less as possible. As a result, there will be a chance of tax evasion by hiding income or properties.
3. **Lack of mass participation:** Direct tax is levied only on those taxpayers who have taxable income or properties. Therefore, there is limited participation of tax payers in public through direct tax.
4. **Discourages saving and investment:** A certain portion of earned income is to be paid as direct tax. So saving of each taxpayer will decrease which will result in reduction of investment.

5. **Inconvenience:** A taxpayer has to maintain the books of accounts appropriately and submit them to the tax office for checking whether they are appropriate or not. Furthermore, the tax officer assesses the tax liability on judgmental basis and sometimes on estimation basis. In such cases, the taxpayers feel inconvenient.

2.3.2 Indirect Tax

An indirect tax is a tax imposed on one person but partly or wholly paid by another. In indirect tax, the person paying and bearing the tax is different. Examples of indirect tax are Export/Import duty (customs tariff), Excise duty, Sales tax, value added tax, Entertainment tax, Hotel tax, passenger tax etc.

Merits of indirect tax

1. **Convenient:** Indirect tax is added to the price of goods sold or services provided to the customers. The customers who are the real taxpayers do not feel any burden of tax because they do not pay the bulk amount as tax. Thus, it is convenient for the real taxpayers.
2. **Mass participation:** All the customers become taxpayers because indirect tax is added to the price of goods or services and collected along with the sales. Hence, there is the mass participation in national revenue through indirect tax.
3. **Elasticity:** The government can easily change the rate of indirect tax. So, indirect tax has a quality of elasticity and flexibility.
4. **Less chance of tax evasion:** Indirect tax is imposed on one person but the person collects it from the customers. So, the

businessperson does not feel it as economic burden and there will be less chance of tax evasion.

5. **Control in consumption:** The government can control or discourage consumption of luxurious and harmful goods by charging higher tax rates on these goods. On the other hand, the government can encourage the consumption of necessary goods by charging lower tax rate. Likewise, the government encourages domestic products and discourages foreign goods through higher rates of indirect tax.

Demerits of Indirect tax

1. **Uncertainty:** If the demand of goods or services increases, the amount of indirect tax will be increased and vice versa. Since the demand of goods or services is not constant, the government cannot collect revenues through indirect tax on estimation basis.
2. **Inequitable:** Both high-income group and low-income group need daily consumption goods in similar quantity. As they consume similar goods in similar quantity, these groups equally contribute to the national revenue through indirect tax. Since both high-income and low-income groups pay indirect tax in similar amount, it is quite inequitable.
3. **Bad Effect:** If indirect tax rate is high, the price of goods or services will be increased. Accordingly, the consumption of these expensive goods or services may be reduced. As a result, the high tax rate may cause bad effect on consumption, production and employment.
4. **Lack of awareness:** The consumers may be unknown about the indirect tax which they pay along with the purchase of goods or

services. Hence, they will be ignorant of the utilization of revenues collected through indirect tax.

5. **Consumer exploitation:** Normally indirect taxes are added to the cost of each taxable product and collected through the agent such as producer, distributor and retailer. The agent may not pay all collected taxes to the government. Thus, there may be the chance of consumer exploitation. Furthermore indirect taxes inflate the cost of the product so as to reduce the purchasing power of the people.

2.4.1 Objective of Tax

In every country, the government collects its revenues through different sources. Out of which, taxes contribute a significant amount in the public revenues. The government mobilizes its revenues through budget in development programmes, daily administration, peace and security and public interests. Thus, the good tax policies are considered as tools of social and economic revolution. Furthermore, tax policies are formulated to achieve the following objectives.

a) **To raise more revenues:** The government needs revenues to perform development and welfare programs of the nation. The government imposes taxes to raise more revenues.
b) **To reduce economic inequalities:** The government levies more tax upon high-income group and mobilizes it to improve the economic conditions of low-income group. As result, the economic inequalities will be reduced.
c) **To maintain the welfare state:** The government must perform different welfare programs, such as, education, health, communication, transportation, sanitation, electricity, etc.

Likewise, it should maintain economic stability in the country. Thus, the government collects taxes in order to perform such welfare programs.

d) **To encourage production of essential goods:** The tax policy attempts to levy the tax with a low rate or to provide tax exemptions to the industries which produce essential goods. On the other hand, the policy attempts to impose the tax with high rate to the industries which produce luxurious and harmful goods. As a result, the production of essential goods is encouraged while production of luxurious and harmful goods is discouraged.

e) **To remove regional Economic disparity:** The government provides tax exemptions, rebates and concessions to those industries which are operated in the backward and remote regions. As a result, the economic activities will be increased in these regions so as to remove the regional economic disparity.

In conclusion, it can be summarized the objectives of taxation as raising revenue for resource mobilization, equal distribution of wealth and income in the society, encouragement in production of certain products, encouragement in employment, saving and investment, removal of regional imbalance and enforcement of policy.

2.4.2 Principles/canons of taxation

There are some principles or canons which help to formulate appropriate and good tax policies. The commonly adopted principles while formulating the tax policies are as follows:

- **Canon of equity:**

  Canon of equality emphasizes on paying the tax on the basis of the ability to pay. Tax should be levied on equal ground to all the tax payers having equals incomes.

- **Canon of certainty:**

  Canon of certainty implies that a taxpayer should be informed about the rate, time & procedures of payment of tax. Furthermore, the government should fix its target of revenues that come from taxes.

- **Canon of Convenience:**

  This is the another important quality of good tax system. Most of the taxpayers are ordinary people who neither have sufficient tax related knowledge nor the capacity to hire tax experts. That is why the tax system should be easy to follow by ordinary people in the society. The time of payment and the manner of payment should be convenient.

- **Canon of Economy:**

  Canon of economy implies that if the expenditure for collecting tax is more than or equals to the amount of tax, such tax policy will not result in surplus to the public revenue and will not be beneficial to the country.

2.5.1 Concept of Income Tax

The concept of Income tax is different in different country because of economic structure, nature of the government and status of people. In United States, income tax is viewed as a matter of practice, recurrent is not relevant to the tax status. In United Kingdom, the original concept of the tax was that \of a levy on recurrent income and the tax was applied to five schedules, any item not falling within one of the five schedules not being subjected to tax. In India, the personal income tax is levied on the net income of all individuals, joint Hindu families, unregistered firm and other associations of persons (Chelliah, 1959:111).

Income tax is a personal tax imposed on the net income of individuals and corporations. In most of the countries especially the United States of America, Canada and other counties; the income tax is defined in terms of the 'flow of wealth' of receipt in money or goods from the tax payer during the period. In flow of wealth method, taxation is imposed on a realization rather than as an accrual basis, and the applies only when a transaction occurs between other persons and taxpayers (Due, 1959: 125-126).

According to tax economists "An income tax is a levy imposed upon the income of individuals after the exemption limit. Income tax is direct tax based on the total income of the payer from all sources and is graduated on a special system of exemption and abatements" (Siwakoti, 1987:21).

"An income tax is also levied on the capital gains of individuals. All income above tax emption level are subject to income is depended upon the income tax act of the country" (Due, 1959:181).

Income tax is levied according to the ability to pay as the principle of taxation. Here, the person, who is liable to pay tax or who may be deemed to be liable to pay tax on income is called 'assessee.' In this case, a person implies individual, firm, company, corporation etc., which have liability of paying income tax. The taxpayer whom the tax is imposed must bear the burden of tax.

In Nepal, income tax is defined as the tax levied on the net income derived after deducting all allowable deductions and relieves from the total income. Income tax is levied on the income derived from business, employment and investment. Income tax is always levied on the net income i.e., total income less the allowable deductions.

Income tax can be classified into two types: personal/individual income tax and corporate income tax. Individual income tax is modern tax, which is a measure of ability to pay of any individual. It is based on the progressive rates. Corporate income tax is levied on business enterprises having a legal personality, distinct from their owners. Taxes on corporate ultimately come from the income or wealth of individuals. Generally, flat rate is applied to corporate income tax.

2.5.2 Historical perspective of Income Tax on International Context

Income tax reached to its developed stage during and after the World war. Today, the personal income tax raises substantial amount of revenue in all industrialized countries of the free world and is employed although to a lesser extent in most developed countries. Today, the income tax has become the "sheet-anchor" of the revenue system in the most advanced countries.

Income tax was first introduced in 1799 in Great Britain in order to finance wars with France. The supporting documents were not found about the presence of income tax before that period. The main reason for the introduction of this tax was that it was preferable as a substitute for customs and excise duties in raising revenue. It remained more or less a temporary tax until 1860 when it got accepted as a permanent tax (Siwakoti, 1987:26)

In USA, the first federal income tax was imposed in 1862 to finance civil war expenditure. However, it became permanent feature only in 1913 after the 16th amendments to US contribution. Income tax of a sort was established in Italy in 1864, in India in 1860. New Zealand adopted income tax in 1891, Australia in 1915, Switzerland in 1840 and Canada in 1917. After World War I, the income tax became an important source of tax revenue in many developed countries and had made appearance in a number of developing nations (Agrawal, 1980:8).

In the beginning, income tax was levied at a flat rate. The principle of taxing the income by progression of income was introduced in the United Kingdom and New Zealand in 1909.

Tax collection by the state was started paralleled to the origin of state. The ancient Hindu Philosopher and writer Kautillya, Manu and Yagyanbalka argued "As the ripe fruit is picked from the garden leaving out the unripe ones, tax also should be taken only from those who are able to pay" (Bhandari, 1994:33).

2.5.3 Taxation in Ancient Nepal

No reliable records are available about taxation in ancient and medieval Nepal. However, taxation took its earliest form in the actions of petty rulers, scattered in various parts of the country, who extracted levies from the travelers and merchants. Though, land tax was the major source of revenue, there were also irrigation and religious monuments preservation tax in the time of king Amsuverma of Nepal. There was tax for purification of caste as well as cremation of the dead. At the Lichhavi era, there were two main taxes. One was imposed in a certain place for certain product and other imposed equally throughout the country. In the inscription of Amsuverma, it is noted that, there were three taxes called "Trikar": (a) Bhaga (b) Bhoga (c) Kara. Agriculture tax was called "Bhaga", animal husbandry was called "Bhoga", and "Kara" was in general the business tax and customs. The tax was payable according to the ability of the taxpayer (Bajracharya, 1973:97).

The farmers were supposed to pay agriculture income tax to the government in 1/6, 1/8 and 1/12 shares of their total production depending upon the quality of land that they owned (Poudyal and Timsina, 1990:1).

2.5.4 Taxation in Unified Nepal (1776-1846)

Taxation has a broad sense in the unified Nepal. During this period, certain improvements were made in the taxation system. Revenue maximization was only the main objective of tax policies. Land tenure system was divided into five main forms: Raikar, Birta, Guthi, Sera and Kipat. The major sources of revenue were: Birta, and Kipat taxes on land; royal palace levies like Walak, Gadimubarak, Chumawan, Godan; Government levies like Darshanbhet, Salami; Local levies on forests and water source; commercial taxes like customs, transit and market duties; mines and mints; export of forest products like wild life, herbs, drugs, wax, birds, elephants; and judicial fines. Taxes were collected at three levels. Royal place levies, Government levies, and local levies.

'Walak' was collected from each family on a regular basis and in period of national celebration of festival or ceremonial occasion. 'Gadimubarak' was collected to finance of coronation ceremony of a new king. 'Chuman and Goddhawa' was collected to finance the scared thread investiture and marriage ceremonies of royal prices and princesses. 'Godan' was levied to finance funeral expenses when a reigning king died. 'Darshanbhet' was collected from both civil and military employees at the time of their appointment and confirmation. "SAlami" was collected from local revenue collection functionaries in the Terai region as an annual payment.

Taxes were imposed primarily on occupations and economic activities not on property. Tax base was very narrow. The Birta owner class had much influential role in political and administration. However, Pota tax was introduced by Prithvi Narayan Shah in 1772 was regarded as revolutionary measures in Nepal's fiscal system. It was not based on progressive tax principle. It was limited on small Birta owners and privileged of the members of the nobility person did not pay Pota. Only common people who lived on Raikar lands paid the homestead taxes and other Pota levies. There was no taxation of income in the modern sense of income tax (Regmi, 1971:55-74).

2.5.5 Taxation in Rana Regime (1846-1950)

During the Rana rule of years, there were no formal taxes levied, but were imposed by the prime ministers. There were no budgets prepared or any proper records kept. There was no difference between Rana purse and government funds. Income and expenditure were not made public. The main sources of revenue were the land tax, customs and excise duties in the form of lump sum contracts, royalty on supply of porters, solders and other business activities. Taxes were also collected from the government employees. There was no proper tax administration for collection of revenue.

There were three traditional sources under which the state was able to acquire goods and utilize manpower without using money as a means of exchange.

a. Mineral resources belonged to the state.
b. The state paid emoluments to its employees and functionaries partly or wholly through assignment of 'Jagir' or taxable lands and village tax rather than through payments in cash, and;

c. The 'Jhara' system entitled the nineteenth century Nepali state to exact porter age and other labour services from its subject without paying wages.

There were four main categories of agencies which collected revenues: Rajya, Birta, Guthi and Kipat. The royal family traditionally acquired income from special levies such as Darsan Bhet, Tika Bhet and Fattemubarak. 'Tika Bhet' was collected on the occasion of Vijaya Dashami festival. 'Fattemubarak' was collected at the time of the Indrajatra festival, commemorating Prithvi Narayan Shah's conquest of Kathmandu in September 1768. Other three levies known as Chumawan, Gadimubarak and Goddhawa were collected on a countrywide basis on special royal occasions. Saune and Fagu were the most important levies, which were collected for meeting festive, ceremonial or extraordinary expenses at the royal place. Main sources of state revenue were:

a. Tax: During the Rana regime, incomes were not taxed for raising regular revenues of the state treasury but for meeting specific expenditures of the royal household or extraordinary expenditures necessitated by war or other emergencies. During 1855-56 Nepal-Tibet War, Jung Bahadur had imposed a tax on the incomes of selected groups. In 1891, Bir Shamsher imposed a levy of 1 percent on the official value of jagir assignments of government employees to finance transportation of water pipes supply in the capital. In 1882, Ranoddip Singh imposed a 50 percent tax on the income made by fishermen in Deukhuri in the western inner Terai from the sales of fish.
b. Receipts from the state sector: The government got revenue from the state ownership of natural resources mainly agricultural lands, mines and forests.

c. State intervention in trade: There were two main forms of state intervention in trade namely, monopoly and state trading. The government conducted the activities of buying and selling of specific commodities for raising revenue and supplied the scarce commodities itself.

Kausi Tosakhana had been established after political unification. Its main functions were to receive and disburse revenues; obtain, store and issue supplies required by the government and perform other general function related to fiscal administrations. In the Rana regime, Junga Bahadur created new department of treasury known as Sadar Mulukikhana to receive and account for government 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. The Salami was abolished in 1951. The Rana rulers did not think of developing an effective revenue administration system (Regmi, 1988:29-40).

2.5.6 Politics, government, and taxation

The unification of Nepal in 1769 under the Shah dynasty of Gorkha failed to prevent 2 centuries of intrigue among the aristocratic families of Kathmandu. From 1846 onwards, hereditary prime ministers from the Rana family governed in the name of the Shah kings. Their downfall in 1951 led to a succession of governments appointed by royalty. Nepal had its first democratic elections in 1959, and the Nepali Comgress Party governed until a royal coup d'etat, or takeover, a year later. The partyless system known as Panchayat followed. This comprised public assemblies at village, district, and national levels, who were ultimately accountable to the king. Undercurrents of political dissent periodically rumbled beneath the Himalayan kingdom's facade of tranquility, but it took an economic crisis, a coalition of political parties, and widespread urban demonstrations before the ruling Hindu monarch, King Birendra Bir Bikram Shah Dev, was forced to dismantle the Panchayat system in favor of a multiparty democracy within a constitutional monarchy in 1990. More than a decade on from the introduction of democracy, Nepal has failed to achieve political stability. The turmoil of years past echoes among antagonistic factions and has led to much discontent, particularly in the neglected countryside, where a Maoist insurgency has claimed over 1600 lives in the 5 years from 1996. In June 2001, a massacre within the royal family, instigated by the Crown Prince, led to rioting and curfews in the Kathmandu Valley. The political situation remains fragile.

With the transition to democracy in 1990, the Nepali Congress Party was voted into power. Established in 1947, this party is the largest political organization in the country and has governed for most of the last decade. The old guard of political leaders, represented by Prime Minister Girija Prasad Koirala and Krishna Prasad Bhattarari, has held sway over this reform-oriented centrist party. The Nepali Congress had its roots in democratic socialism, but in the 1980s it modified its program to espouse a mixed economy. During a relatively stable tenure from 1991 to 1994, the pary implemented various economic reforms that facilitated privatization and foreign investment, and attempted to improve public enterprise management.

Left of the political spectrum, communist parties briefly worked with the Nepali Congress during the revolution of 1990. Parties within this United Left Front Coalition, however, differed widely in their socialist ideologies. The centrist United Marxist-Leninist Party (UML), which supports the creation of a welfare state (a political system in which the government assumes primary responsibility for the social welfare of its citizens), is the second largest party in Nepal, and remains a potent force despite a damaging split in 1998. The appointment of a minority UML government in 1994 slowed the process of liberalization, and subsidies to public enterprises increased. Other parties include 2 factions of the monarchist National Democratic Party and the Nepal Sadbhavana Party, which is based in the Terai region and favors closer economic integration with India. Political bickering has consumed the national agenda, resulting in 9 changes of government between 1991 and 2001. The struggle for political power has filtered down to public sectors, which have witnessed widespread corruption and politicization. Though inflation ahs remained moderate and the urban population has benefited from exposure to the global economy, there has been little progress in reducing rural poverty. If the current state of affairs continues, problems with law and order may seriously jeopardize the internal security of Nepal.

Management of the Nepalese economy has changed significantly over time. Prior to the 1950s, while feudal overlords vied for economic gain at the expense of the rural population, little planned development took place. Under the Panchayat regime, a succession of 5-year plans attempted to impose government control over all aspects of the economy. However, against a background of poor infrastructure, the country's geographical difficulties, and the spread of corruption, the lot of the rural majority was little change. Attempts to accelerate growth through increased government spending resulted in economic instability in the early 1980s. Under pressure from financial institutions such as the International Monetary Fund (IMF) and the World Bank (WB), certain structural reforms were implemented, which helped the growth of the private sector.

Before 1951, Nepalese administrations extracted revenue in the form of land tax and a tariff on foreign trade. Their reliance on middlemen reduced the revenue available and subjected traders and producers to exploitation that discouraged economic activity. Moreover, the income derived was rarely used for purposes of benefiting the economy. From the late 1950s, a combination of income, sales, and property taxes were introduced. Today, corporate tax stands at 25 percent, though certain industries are taxed at a maximum of 20 percent of their income. Income tax is progressive, with different exemption limits for individuals and families. Relative to average Nepalese incomes, income tax exemption is fairly high. Agreements are underway with other governments to avoid double taxation and encourage foreign investors. Government revenues have increased substantially in recent years, from just over 6 billion rupees in 1989 to a high of over 24 billion rupees in 1997, but falling to 17 billion the following year. Customs and consumption taxes (such as taxes of food and drink) have been the primary sources of revenue. A value-added tax was introduced from 1995. However, a weak tax administration, resulting in low tax compliance, limits this important source of development funds.

(Source: Google Search)

2.6.1 Income Tax in Modern Nepal

After the independence of the country in 1951, the role of government has drastically changed. Government was enforced to perform development activities besides regular functions. So it was realised to impose tax on business profits and remuneration. Consequently, Finance Act 1959 was passed. In 1960 (2017), a formal Income Tax Act was enacted in accordance with the provision in Finance Act, 1959 for the first time in Nepal. In three years experience, the Business Profit and Remuneration Act, 1960 was found very narrow and vague, and it was replaced by the Nepal Income Tax Act, 1962, (2019). The Income Tax Act 1962 remained till 1974 and Income Tax Act, 1974, also replaced it. Income Tax Act 2002 also replaced the Income Tax Act 1974.

"No tax shall be levied and collected except in accordance with law" (Constitution of Kingdom of Nepal, 2047, Sec. 73-1). The income tax law at present in force in Nepal is Income Tax Act, 2002 (2058) and Income Tax Rule 2002 (2059) made there under. Finance Act is passed every year to translate the economic policy contained in the budget speech into law. It generally prescribes the rates and exemption limit for tax purposes and may delete, add or modify the provisions contained in the income tax act. Decisions of Supreme Court in Nepal also act as precedents for income tax law purposes. The notification in Nepal Gazette or circular by Inland Revenue Department classifies and complements the legal provisions.

The legal aspects of income tax, therefore, consists of provisions in the constitution, Income Tax Act, Finance Act, Income Tax Rules and decisions of the Supreme Court. Together, they make up income tax law in Nepal. Historical development of income tax law in Nepal is given below:

2.6.2 Business Profit and Remuneration Tax Act 1960 (2017)

Income tax in Nepal was first introduced in the fiscal year 1959-60. It was then known as "Business profit and remuneration tax." The imposition of the tax was governed by the Business Profit and Remuneration Tax Act 1960 and rules made there under. This act consisted 22 sections. The silent features of this act were as follows.

a. The basis for calculating tax liability for remuneration was the income of the current year, and for business profits it was the profit of the preceding fiscal year.
b. Tax on remuneration was to be deducted at source but the specified deduction was not provided.
c. Only remuneration and business profits were subject to tax. Deductions were not specified for the purposes of calculated the taxable income.
d. Salary of any diplomatic representative; foreign citizen; dividend of shareholders; profits to be spend on religious or public welfare activity; profits of local autonomous organization; allowances granted by HMG to ministers, assistant ministers, speakers, deputy speakers, chairman, government chief whip and leaders of opposition; crop from own land; money drawn from provident or saving fund were exempted from tax.
e. The tax officer was empowered to assess tax on a best judgment estimation where tax return was not filed or a false return was filed.
f. The taxpayer had a right to appeal against the tax officer's assessment to the local 'Bada Hakim' or 'Magistrate.' If he had not

satisfied with the decision, he could appeal to the 'Revenue and Tax Court' after depositing fixed amount.

g. In case of defaults, the fines ranged from Rs. 500 to Rs. 5000 and for informants, there was a provision of 20 percent of total tax realized if the information had been proved.
h. Profits from large industries were granted a rebate of 25 percent and profit from small industries were granted at a rebate of 50 percent (Business Profits and Remuneration Act, 1960).

Aforesaid features of Business Profit and Remuneration Tax Act indicate that this Act was very narrow and vague. High discretionary power was granted to the tax officer in the matter of tax assessment. Many loopholes and inadequate provisions were the main weakness of Business Profit and Remuneration Act. Those were the basic reasons why this act was replaced by Income Tax Act 1962 (2019).

2.6.3 Income Tax Act 1962 (2019)

This act was an extension of the Business Profit and Remuneration Tax Act 1960 (2017). It had 29 sections. It was amended in 1972. The additional features of this amended act were as follows.

a. Income was defined as all kinds of income including income derived from business, profession, remuneration and occupation, house and land rent, investment in cash or kind, agriculture, insurance business, agency and other source.
b. The basis was specified for assessing tax on the best judgment estimate of the tax officer.
c. The personal as well as residential status of the taxpayer for tax purposes was defined.

d. The procedures for assessment and collection of income tax were clarified. Specific provisions were made for allowable deductions. Methods were also specified calculation of net income.
e. Tax payment could be installments as well as advance payment.
f. The provision was made to constitute the net income assessment committee with five members.
g. Provision was made for re-assessment of tax as well as rectification of arithmetical errors.
h. Carry forward of losses was allowed for a period of two years.
i. Provision was made for the exemption of income tax for new industries for a period not exceeding ten years.
j. Agriculture income was brought under the scope of income tax for the first time.
k. In agriculture income, only ¼ of the total income was taken as net earnings and remaining ¾ of the total income as expenditure while in case of net earning from rent of houses and land, from investments and from professions 90 percent to total income was taken as net earnings and 10 percent as expenditures.
l. There was additional provision of exemption for income of Nagar Panchayat, Village Panchayat, Public Organization; income of Nepal Rastra Bank, deposits of employees in the employees saving from salaries; any income notified in the Nepal Gazette.
m. There was special provision of newly opened industry in which the HMG might wholly exempt income tax for 10 years and 25 percent exemption after 10 years (Income Tax Act, 1962).

The Finance Act 1966 (2023 B.S.) exempted the agriculture income fully from income tax. The Finance Act 1973 (2030 B.S.) restored agriculture income under the scope of income tax. Ten bighas of land were exempted and presumptive value of income based on the classification of land was also specified. The Finance Act 1977 (2034) again exempted the agriculture income from income tax.

This act was also not far from weakness. In order to keep the law in tune with the changes in the socio-economic environmental milieu of the country, the need was felt for consolidating and amending the existing income tax law. Hence, Income Tax Act 1974 was introduced.

2.6.4 Income Tax Act 1974 (2031 B.S.)

Income Tax Act 1974 (2034) had been implemented in place of Income Tax Act 1962 (2019). Its basic framework had been derived from previous act and it had 66 sections with clear cut provision of self assessment, carry forward of losses for three years and precise definitions of related terms like tax, assessment of tax, year of income, income of non residence taxpayers etc. This act was amended in 1977, 1979, 1980, 1984, 1985, 1986, 1989 and 1992 to make it more practical and to eliminate confusing terms. In this act, certain provisions were added and some provisions were amended from time to time so the income tax act 1974 had become more scientific and better organized with the progress of time. His Majesty's Government enacted the income tax rules 1982 (2039) in accordance with the authority given under section 65 of Income Tax Act, 2031. Beside this act and the rules, the current finance act was also equally applicable for the proper administration of income in Nepal.

Some of the salient features of this act, 1974 as amended are as follows:

a. There were additional provisions of exemption from income tax then the former act such as income of Guthi, compensation for life insurance or after the expiry of the life insurance policy.
b. It had made provision for self-assessment of tax for the first time in Nepal
c. Carry forward of loss was allowed for subsequent three years.
d. It had clarified certain definitions specially relating to tax, tax payer, taxable income, gross income, net income, personal status of the taxpayers and not resident taxpayers, assessment of tax, philanthropic work, non-resident etc.
e. Five sources of income had been specified. They were: (i) agriculture (ii) industry, trade, profession or occupation, (iii) remuneration, (iv) house and compound rents and (v) others.
f. Method of computing net income from each source including the deductions allowable had been specified.
g. The act had made its obligatory for taxpayers to register their industry, business, profession or vocation in the tax office. Any changes had also to be notified.
h. Deduction was allowed for life insurance premium.
i. Taxpayers were required to keep accounts and records for their source of income and preserve these records for a period of six years.
j. Procedures for assessment, collection, payment and refund of tax have been streamlined. Powers for search and seizure had been specified. Penalties had been increased. Various forms related to income tax had also been specified.
k. Provision had been made for tax exemption, either full or partial, to the industrial enterprises, as provided in the existing Nepal law relating to industrial enterprises (Income Tax Act. 1974).

Although, Income Tax Act, 1974 (2031) was far ahead than the previous act, yet it had many deficiencies and weakness. It had used many vague or unclear words like 'reasonable', 'appropriateness' etc. It had also provided high discretionary powers to the tax officer in the matter of tax assessment.

2.6.5 Income Tax Act 2002 (2058 B.S.)

Income Tax Act 2002 has been implemented from 19/12/2058 B.S. This act has replaced the Income Tax Act 1974 (2031), and other acts related to income tax. His majesty's government enacted income tax rules 2059 B.S. in accordance with the authority given under section 138 of Income Tax Act 2002 B.S. Income Tax Act 2002 B.S. has 143 sections. Finance Ordinance 2059 and 2060 has amended income Tax Act 2002 first time. Amended Income Tax Act 2002 has dismissed the section 66. There is various additional provisions in this Act. Some of the salient features of the Income Tax Act 2002 as amended are as follows:

a. Income Tax Act 2058 B.S. has classified income into three headings: (i) business, (ii) employment, and (iii) investment.
b. The governmental allowances to widows, elder citizens or disabled individuals; gift; bequest; inheritance; scholarship; income of foreign officials, government bodies and non-profit organizations have been exempted from the income tax net. Amount of a person privileged under bilateral or multilateral treaty, an agricultural income, income of cooperate societies based on agricultural

products and dividend of such society etc. also exempted from income tax.

c. This act has defined the income as "a person's income from any employment, business or in accordance with this act". It includes all kind of income received for the provision of labor or capital or both in whatever from or nature in the taxable income.

d. When Income Tax Act 1974(2031) was in practice, there were several exemptions and deductions provided by the act and other related acts. But now, there are no more exemptions and deductions except the ones provided for by the act.

e. This act has given the option for husband and wife as a separate natural individual until they don't accept as a couple.

f. This act focuses on the self-assessment system, and every assessment is treated as a self-assessment. The tax officers can determine only the amended tax assessment within four years. The jeopardy assessment is essential when a person becomes bankrupt, is wound up, or goes into liquidation; a person is about to leave Nepal forever or to close down activity in any department or in Nepal.

g. Presumptive tax is limited to the small taxpayers whose annual net income is up to Rs. 120000 or annual turnover is up to Rs. 1200000 and are subject to flat annual taxes.

h. The Inland Revenue Department is responsible for the implementation and administration of this ace.

i. This act has introduced the concept of administrative review to correct the administrative mistakes. The Inland Revenue Department should given its decision within 90 days of the submission of objection and if the department does not give its decision within the given time limit, the taxpayers may appeal to the revenue tribunal.

j. This act has introduced the concept of medical tax credit under which resident individuals may claim a medical credit of 15 percent of the amount of approved medical costs.

k. A resident person may claim a foreign tax credit for any income year for any foreign income tax paid by the person to the extent to which it is paid with respect to person's assessable income for that year.

l. There is a provision of functional division of work among tax officers. The division is to be made under the direction of HMG and other tax officers are under the direction of HMG and Director General.

m. This act has guaranteed the rights and secrecy of taxpayers through the act and the strict punishment for not maintaining the secrecy are provided.

n. The penalties are divided into two parts. The tax officer can levy only fines and interest and the court can levy penalties and imprisonment.

o. This act determined the rate of income tax itself for the first time, which used to be determined by the Finance Acts in the previous years.

p. For the purpose of calculating a person's income from any business or investment, there are provisions of deduction related to overhead costs.

q. The act has based on global income tax principle and has brought all sources of income into the tax net and has treated in an equal manner. This act has abandoned the itemized system of deduction and expenses are taken into account on a global manner not on a line-by-line basis.

r. A pooled system of depreciation has been adopted in this act, in which assets are broadly classified into five categories. The depreciation rates are 5 percent, 25 percent, 20 percent, 15 percent for Class A, B, C, and D respectively which are based on diminishing balance method of depreciation for Class E, the rate is based on straight-line method.

s. Capital gains are taxed explicitly under this act after four decades of the introduction of income tax. In case of business capital gains, gains on the disposition of business property are taxed as an ordinary income and in case of non-business capital gains; only the gains from the causal sales of real property (land and buildings) and securities are subject to capital gains tax at a flat rate of 10 percent. There is also a clear provision for adjusting net loss during the fiscal year.

t. A person has been defined as a resident whose place of abode is in Nepal and who lives in Nepal at any time or who lives in Nepal for 183 days or more within the income year or who is an employee of HMG posted abroad during the income year.

u. Resident individuals and domestic companies are taxed on their world wide income while non-resident individuals and foreign companies are taxed only on their income sourced in Nepal.

v. The income of an approved retirement fund is free from tax. But retirement payments in the hands of employees are taxable.

w. Company is liable to pay tax separately from its shareholders. The bonus share, loans and advances to directors and shareholders, distribution made on liquidation etc. are also brought under the tax net in order to plug loopholes for avoidance.

x. Investment insurance premium can be deducted as 7 percent insurance policy amount or Rs. 10000 which ever is less.

y. A person can deduct pollution control expenses and research and development expenses up to maximum 50 percent of adjusted taxable income of total business run by him.

z. Donation amount can be deducted as a 5 percent of adjusted income or Rs. 100000 whichever is less.

aa. 7 percent of depreciation base amount of end of the year can be deducted as a repair and maintenance expenses and unreduced amount can be capitalized or excess repair and maintenance expenses can be added to depreciation base amount of coming income year (Income Tax Act, 2002).

Reference: Taxation in Nepal (Surendra Keshar Amatya, Dr. Bihari Binod Pokharel, Rewanta Kumar Dahal).

2.6.6 The Special features of the Act 2002

- The Act has broadened the tax base. Tax rates are spelled out in the Act itself and the tax rates and concessions are harmonized on equity grounds.
- A full-fledged self-assessment system is implemented and the presumptive taxation and current year taxation system are strengthened.
- The scope of discretionary interpretation of the tax administration is drastically reduced ensuring simplicity, uniformity and the transparency. The Act has also defined the power and authority of the tax administration.

- The Act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.
- The appeal system is further streamlined by making it mandatory for the taxpayers to file an objection with the Inland Revenue Department for administrative review before appealing to the Revenue Tribunal.

  (Google Search)

2.7 Income Heads

Income Tax Act, 2058 imposes tax on those activities contributing toward the creation of wealth. Wealth is created with the help of labor, capital and capital-labor mix activities that generate income from employment, investment and business respectively. The Act makes broad classification of income encompassing almost all income-earning activities. They are:

- Income from Employment (Sec 8)
- Income from Business (Sec 7)
- Income from Investment (Sec 9)

2.7.1 Income from Employment

An individual's remuneration income from employment is included in employment income. All payments or benefits received in respect of employment, including past or future employment are made taxable for example, payments relating to terms of employment, fringe benefits, various types of allowances, salaries, wages, payments received through third parties, etc are included in employment income.

Specimen

Computation of income from employment as per Income Tax Act, 2058

Particulars	Amount
Remuneration from Employment for this Income Year (Chargeable Incomes):	
Salary (including grades) and wages [8.2(a)]	xxx
Leave pay (salary in lieu of leave) [8.2(a)]	xxx
Pay for overtime [8.2(a)]	xxx
Fees [8.2(a)]	xxx
Prizes and gifts related to employment (in case in kind as per market value) [8.2(a)]	xxx
Bonus [8.2(a)]	xxx
Other facilities (Dasain bonus or Tihar bonus [8.2(a)]	xxx
Commission [8.2(a)]	xxx
Dearness allowance [8.2(b)]	xxx
Subsistence (Living allowance) [8.2(b)]	xxx
House Rent allowance [8.2(b)]	xxx
Entertainment and transportation allowances [8.2(b)]	xxx
Other personal allowances (children education allowance) [8.2(b)]	xxx
Reimbursement for personal expenses [8.2(c)]	xxx
Payment for accepting any condition regarding employment [8.2(d)]	xxx
Payment for discharge, loss or termination of the employment [8.2(e)]	xxx
Other payments made in respect of employment [8.2(f)]	xxx
Retirement payment and retirement contribution [8.2(g)]	xxx
Amount related to vehicle facility (0.5% of salary) [27.1(b.1)]	xxx
Amount related to provision of house or residence facility (2% of salary) [27.1(b.2)]	xxx
Amount related to housekeeper, driver, gardener or domestic assistants [27.1(c.1)]	xxx
Any meal refreshment or entertainment provided by employer [27.1(c.2)]	xxx
Amount related to services related to drinking water, electricity, telephones and other utilities in respect of the employee [27.1(c.3)]	xxx
Under payment of interest for the loan taken from employer [27.1(d)]	xxx
Others amounts to be included in remuneration (amount as per tax accounting)	
Total Remuneration from Employment (Assessable income from employment)	**xxx**

B) Computation of Taxable Income

Assessable Income from Employment	xxx
Assessable income from Business	xxx
Assessable income from Investment	xxx
Total Assessable income	xxx
Less: Contribution to recognized retirement funds (Employee Provident Fund and Citizen Investment Trust) 1/3 of assessable income or Rs. 300000 or actual whichever is less	xxx
Taxable income before Donation	xxx
Less: Donation (5% of taxable income before donation or actual or Rs. 100000 whichever is less or as prescribed	xxx
Taxable Income	**xxx**

C) Computation of Income Tax Liability

i) In the case of resident natural person

First Rs. 100000 for individual or Rs. 125000 for couple	Nil
Next amount from Rs. 6000 to Rs. 30000 as per category of remoteness for remote area allowance (irrespective of income head employment, business or investment)	Nil
Next amount equal to 25% of 100000 for individual (or 125000 for couple) or pension income whichever is less	Nil
Next Rs. 75,000 @ 15%	xxx
Next any amount @ 25%	xxx
Total tax liability	**xxx**

ii) In the case of non-resident natural person

(a) Taxable income	xxx
(b) Tax rate	25%
Total tax liability (a × b)	**xxx**

D) Computation of Income Tax payable:

Total Tax Liability		xxx
Less: Preceding income years' excess tax payment (if any)	xxx	
Less: Tax paid in advance including tax deduction at source and non-final withholding	xxx	
Less: Medical tax credit [15% of recognized medical expenses or Rs. 750 whichever is less (applicable to resident natural person only)]	xxx	xxx
Tax payable		**xxx**

Note: Budget speech of fiscal year 2007-08 has increased the Exemption limit to Rs 115000 for an individual and Rs 140000 for the couple.

2.7.2 Income from Business

Profit and gains from conducting the business are considered as business income for the purpose of income tax. This type of income may include service fees, amount derived from the disposal of trading stocks, net gain from the disposal of business assets (liabilities), gifts relating to business and other amounts.

Specimen

Computation of Income from Business

as per Income Tax Act, 2058

S.N.	Particulars	Rs.	Rs.
a.	Service Charge (7.2)	xxx	
b.	Disposal of trading stock (7.2)	xxx	
c.	Net gain from disposal of business assets or liability (7.2)	xxx	
d.	Gain from disposal of pool of depreciable assets (7.2)	xxx	
e.	Prizes or gifts in connection with business. (7.2)	xxx	
f.	Amounts received in lieu of accepting any restrictions regarding business (7.2)	xxx xxx	
g.	Amounts received from any investment directly related to business. (7.2)	xxx	
h.	Incomes to be included due to change in accounting methods. (22.6)	xxx	
i.	Incomes to be included under the provision of accounting methods. (24.3)	xxx	
j.	Excess amounts received due to exchange rate variation (24.4)	xxx	

k.	Bad debts recovered (25.1)	xxx	
l.	Proportionate amounts received under long-term contracts (26.1)	xxx	
m.	Under payment of interest according to market rate (27.1)	xxx	
n.	Receivable amounts paid to others (29)	xxx	
o.	Amounts received for compensation (31)	xxx	
p.	Other amounts received under the head of business income		xxx
	Gross income from business (A)		
	Less: Allowable Deductions		
a.	Interest expenses (14)	xxx	
b.	Cost of trading stock (15)	xxx	
c.	Repair and improvement cost (16)	xxx	
d.	Pollution control cost (17)	xxx	
e.	Research and Development cost (18)	xxx	
f.	Depreciation allowances (19)	xxx	
g.	Reserve fund for banks (59)	xxx	
h.	Other expenses	xxx	
	Total allowable deductions (B)		(xxxx)
	Assessable income from business before loss adjustment (A - B)		xxxx
	Less: Adjustment of business losses (20)		
a.	Unrelieved loss from other business this year (20)	xxx	
b.	Unrelieved loss from business of previous years (20)	xxx	
	Total adjustable business loss (a + b) = C		(xxxx)
	Assessable income from business (A - B - C)		xxxx
1.	Assessable income from business (as calculated above)	xxx	
2.	Assessable income from other business, if any	xxx	
3.	Assessable income from investment, if any	xxx	
4.	Assessable income from employment, if any	xxx	
	Total assessable income		xxx
	Less: Allowance reductions:		
	Donation (12)	xxx	
	Retirement contributions (63)	xxx	
	Total taxable income		xxx

2.7.3 Income from Investment:

Profit and gains conducting an investment are considered as investment income. All types of Investment incomes including dividend, interest, natural resources payment, rent, royalty, gain from investment, insurance, gain from unapproved retirement fund, retirement payment made by an approved retirement fund are included in investment income.

Specimen

Computation of Income from Investment as per Income Tax Act, 2058

S.N.	Particulars	Rs.	Rs.
a.	Dividend payment (except final withholding payment) (9.2)	xxx	
b.	Gain from as Investment Insurance (except final withholding payment) (9.2)	xxx	
c.	Interest received (except final withholding payment) (9.2)	xxx	
d.	Rent received (except final withholding payment) (9.2)	xxx	
e.	Payment received from natural resources (9.2)	xxx	
f.	Royalty income (9.2)	xxx	
g.	Gain from unapproved retirement fund (except final withholding payment) (9.2)	xxx	
h.	Gain from disposal of pool of depreciable assets (9.2)	xxx	
i.	Gifts received by the person in respect of the investment (9.2)	xxx	
j.	Retirement contributions, including those paid to retirement fund in respect of the person (9.2)	xxx	
k.	Amounts received in lieu of accepting any restrictions regarding investment (9.2)	xxx	
l.	Incomes to be included due to change in accounting methods (22.6)	xxx	
m.	Excess amounts received due to exchange rate variation (24.4)	xxx	
n.	Bad debts recovered (25.1)	xxx	
o.	Under payment of interest according to market rate (27.1)	xxx	
p.	Receivable amounts paid to others. (29)	xxx	
q.	Amounts received for compensation (31)	xxx	
r.	Income received from joint investment (30)	xxx	
s.	Other amounts to be included under investment incomes	xxx	
	Gross income from investment (A)		xxxx
	Less: Allowable deductions.		
a.	Interest expenses (14)	xxx	
b.	Repair and improvement cost (16)	xxx	
c.	Depreciation allowance (19)	xxx	
d.	Other expenses related to investment	xxx	
	Total allowable deductions (B)		(xxxx)
	Assessable income from investment before loss adjustment (A - B)		xxxx

	Less: Adjustment of loss		
a.	Unrelieved loss from business or other investment this year (20)	xxx	
b.	Unrelieved loss from business of pervious year (20)	xxx	
	Total adjustable loss (a + b) = C		(xxxx)
	Assessable income from investment (A - B - C)		xxxx

1.	Assessable income from investment (as calculated above)	xxx	
2.	Assessable income from other investment, if any	xxx	
3.	Assessable income from business, if any	xxx	
4.	Assessable income from employment, if any	xxx	
	Total assessable income		xxx
	Less: Allowable reductions:		
	Donations (12)	xxx	
	Retirement contributions (63)	xxx	xxx
	Total taxable income		xxx

2.8 Taxing Subjects

- The taxpayers on whom income tax is imposed are persons. A person can be a natural person, who is an individual or a couple but includes also a proprietorship, or it can be an artificial person, i.e. an entity. An entity means a partnership, trust, company, and foreign permanent establishment or government body.
- The Act distinguishes between resident and non-resident persons. A resident person is an individual whose normal place of abode is in Nepal and who is present at any time of the year, or who is present in Nepal for 183 days or more, or who is an employee of Government of Nepal posted abroad at any time during the year.
- A trust is a resident person if it is established in Nepal, or has a resident person as a trustee, or is controlled by a resident person. A company residing in Nepal and if it is incorporated under the laws of Nepal or has its effective management in Nepal. Partnerships are

always resident persons. Permanent establishments are places where a person carries on a business and are subject to tax if they belong to a non-resident person and are situated in Nepal.

2.9 Income Year

- For every person the tax is imposed and calculated for an income year. The income year corresponds with Government's Fiscal Year, i.e. the period from the start of Shrawan of a year to the end of Ashad of the following yea (mid-July to mid-July)

2.10 Assessable Income

- The assessable income of a person for an income-year from any employment, business, or investment is:

A. In the case of a resident person, the person's income from the employment, business, or investment of the year irrespective of the location of the source of the income and

B. In the case of a non-resident person, the person's income from the employment, business, or investment of the year but only to the extent the income has a source in Nepal.

- The assessable income does not include any income exempt under sections 11 or 64 of the Act (such as income from non-business agriculture and agriculture business conducted in the land of the type that is mentioned in clauses (d) and (e) of section 12 of the Land Act, 2021; income of cooperative society from business mainly based on agriculture and forest products and cooperative saving and credit scheme based on rural community; and income of approved retirement fund)

2.11 Taxable Income

- The taxable income of a person for an income-year is equal to the amount as calculated by subtracting reduction, if any, claimed for the year under section 12 (gifts to an exempt organizations) or 63 (retirement contribution to an approved retirement fund) from the total of the person's assessable income for the year from each of the following income heads:

Business

Employment and

Investment

2.12 Tax Rates

- The taxable income of a resident individual for an income-year will be taxed at the following rates:

  Up to Rs. 100, 000 - Not taxable

  From Rs. 100, 000 - upto Rs. 1,75,000 - @ 15%

  Above Rs. 1,75,000 - @ 25% plus Rs. 11250.
- The taxable income of a couple, if they chose to be treated as a couple will be taxed at the following rates;

  Up to Rs. 125,000 - Not taxable

  From Rs. 125000 - upto Rs. 200000 - @ 15%

  Above Rs. 200000 - @ 25% plus Rs. 11250

Note: Budget speech of fiscal year 2007-08 has increased the tax exemption limit to Rs. 115000 for an individual and Rs. 140000 for the couple

- Any individual or couple having pension income can enjoy 25 percent of the normal exemption limit as an additional basic exemption.
- Any individual working in prescribed remote area is entitled to deduct prescribed amount as remote area allowance from taxable income.
- Any individual is entitled to deduct the following amount from taxable amount, if he is having investment insurance policy:
  "Rs. 10000 or 7% of insured amount or the actual premium paid, which ever is less."
- Special duty on taxable income is reduced to 1.5%
- For the purposes of the Act, net gains from the disposal of non-business chargeable assets will be taxed at the rate of 10 percent.
- The presumptive tax for individuals conducting small businesses (who have a turnover of Rs. 1.5 million or an income of Rs. 150000) in the Metropolitan or Sub-Metropolitans, Municipalities and anywhere else in Nepal amounts to Rs 2000 Rs. 1500 and Rs. 1000 respectively.
- The taxable income of a non-resident individual is taxed at the rate of 25 percent.
- The taxable income of an entity will be taxed at the rate of 25 percent unless prescribed otherwise.
- The taxable income of a bank, or financial institution, or general insurance business, or an entity conducting petroleum work under Petroleum Act, 2040 for an income-year is taxed at the rate of 30 percent.

- Gain from Lump sum retirement payment made by an approved retirement fund or HMG/N is taxed the rate of 6 percent as a final withholding tax. Gain is calculated by deducting 50 percent of the payment or Rs. 500000 whichever is higher from the total lump sum payment.
- The taxable income derived by an individual from special industry or export business will be taxed at the rate of 20 percent.
- The taxable income derived by an entity engaged in an industrial enterprise or export business or derived from operating any road, bridge, tunnel, ropeway, or flying bridge. Construction business or any trolley bus or tram manufacturing business is taxed at the rate of 20 percent.
- The taxable income of an entity engaged in power generation, transmission, or distribution is taxed at the rate of 20 percent.
- The taxable income of an estate of a deceased resident individual or trust of an incapacitated resident individual will be taxed at the normal tax rate as though the estate or trust was a resident individual.
- The repatriated income of a foreign permanent establishment of a non-resident person situated in Nepal will be taxed at the rate of 10 percent.
- The taxable income of a non-resident person deriving income from providing shipping, air transport or telecommunication services in Nepal will be taxed at the rate of 5 percent.
- The taxable income of an entity wholly engaged in the projects conducted by any entity so as to build public infrastructure, own operate and transfer it to the HMG/N in power generation, transmission, or distribution for an income-year shall be taxed at the rate of 20 percent.

2.13.1 Tax Exempt Amounts as per section 10.

The following amounts are exempt from tax as per section 10.

a. Amount derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between Government of Nepal and a foreign country or an international organization.
b. Amount derived by an individual from employment in the public service of the government of a foreign country provided that:
    i. The individual is a resident person solely by reason of performing the employment or is a non-resident person; and
    ii. The amounts are payable from the public funds of the country.
c. Amounts derived from public fund of the foreign country by an individual who is not a citizen of Nepal or by a member of the immediate family of the individual.
d. Amounts derived by an individual who is not citizen of Nepal from employment by Government of Nepal on terms of a tax exemption.
e. Allowances paid by Government of Nepal to widows, elder citizens or disabled individuals.
f. Amounts derived by way of gift, bequest, inheritance, or scholarship except as required to be included in calculating income from business, employment or investment.
g. Amount derived by an exempt organization by way of:
    i. Gifts (Donation), or
    ii. Other contribution that directly relate to the exempt organization's function, whether or not the contribution is made in return for consideration provided by the organization. For example, subscription fee received by a club is exempt from tax.
    iii. Amount derived by Nepal Rastra Bank as per its objectives.

h. Pension received by a Nepali citizen retired from the army or police service of a foreign country provided the amounts are payable from public fund of that country.

2.13.2 Business Exemption and Concessions as per section 11.

ITA, 2058 has provided business exemptions and concessions in section 11.

a. Any agriculture income derived from sources in Nepal by a person other than the following is exempt from tax.
    - Income from an agriculture business derived by a registered firm company, partnership or corporate body.
    - Income through the land above the holding ceiling as prescribed in section 12 of Land Act 2021.
b. Income derived by co-operative societies registered under Co-operative Act 2048 from business mainly based on agriculture and forest products and dividend distributed by such societies are exempted from tax.
c. Any person operating special industry during the whole income year will be 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 rate (20%) is applied for the year.
    - The industry operating in remote, undeveloped and underdeveloped area will have to pay 70%, 75% and 80% of the applicable tax rate (20%) respectively up to ten income

years commencing from and including the year in which the operation commences..

- If both exemptions are available to the same special industry for same income, only one exemption is available as per the selection made by the industry.
- 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.
- The incomes received under business exemptions and concessions should be calculated separately assuming that these incomes are received by separate person. That is, incomes received under business exemptions and concessions should be separated from other general business and investment incomes.

2.14 Allowable Deductions

2.14.1 General Deductions (Sec. 13)

Subject to Income Tax Act, 2058, for the purpose of calculating a person's income from business or investment, there will be deducted all expenses to the extent incurred:

i. during the income year;
ii. by the person; and
iii. in the production of income from business or investment.

2.14.2 Interest (Sec. 14)

i. The interest incurred during the year for the debt obligation of the person will be available for deduction to the extent that:

   a. the borrowed money is used in that year;
   b. If the money is borrowed for purchase of an asset, that asset is used in that year; or
   c. In other case, the debt obligation is created in the production of income from business or investment.

ii. In case of a resident entity controlled by a tax exempted institution and that entity has paid interest to the controlling institution or related person, the resident entity may deduct the interest paid without exceeding the sum of (a + b).

   a. Total interest derived by that entity which is included in taxable income, and
   b. 50% of the entity's taxable income for the year calculated without including any interest derived (received) and deducting any interest incurred (paid) by the entity.

iii. Portion of the interest not deducted during the year because of the limitation, will be deducted in next income year.

iv. For this purpose, the control means holding of 25% or more of equity or managerial power at any time during the income year.

v. The tax exempted institution, here means:

   a. Tax exempted entity and related person,
   b. Entity getting business concessions and facility under sec. 11,
   c. Non-resident persons or his related persons, or
   d. Any combination or (a), (b) and (c).

2.14.3 Cost of trading Stock (Sec. 15)

a. Trading stock includes these stocks with a person: Raw materials, work-in-progress and finished goods. But it does not include stock in foreign currencies.

b. The cost of trading stock is derived as follows:

	Cost of opening stock	xxx
Add:	Purchase or produced during the year	xxx
		xxx
Less:	Cost of closing stock	xxx
	Cost of trading stock	xxxx

c. The closing stock of last year will be the opening stock for this year. Closing stock should be taken/valued at cost price or market price whichever is lower.

d. The person keeping accounts on a cash basis can adopt either the prime cost or factory cost as basis for the valuation of trading stocks.

e. The person keeping accounts on an accrual basis must adopt factory cost basis for the valuation of trading stocks.

f. In case of actual cost could not be derived for the particular trading stock; either FIFO or Weighted Average Cost Method can be adopted.

g. The prime cost is derived as follows:

Cost of raw materials consumed	xxx
Direct labour cost	xxx
Factory variable overhead	xxx
Prime cost	xxx

h. The factory cost is derived as follows:

Cost of raw materials consumed	xxx
Direct labour cost	xxx

Factory overhead (Fixed + Variable)	xxx
Factory cost	xxxx

2.14.4 Repair & Improvement cost (Sec. 16)

a. The repair and improvement cost incurred during the year for the depreciable assets owned and used by a person in generating income from business or investment is deductible.
b. Eligible repair & improvement cost is 7% of depreciation basis of asset pool at the end of the income year.
c. The unabsorbed repairs is capitalized at the beginning of the next income year in respective blocks (i.e, Blocks A, B, C and D).

2.14.5 Pollution control cost (Sec. 17)

a. Pollution control cost means cost incurred by a person with respect to a process or an asset that seeks to control pollution or otherwise protect or sustain the environment.
b. Pollution control costs though these are of capital nature are allowed for deduction to an extent from taxable income of the person.
c. The lower amount of the below is deducted:
    i. Actual pollution control cost, or
    ii. 50% of adjusted taxable income from all business.
d. The portion of pollution control cost not allowed as deduction will be capitalized at beginning of the next income year under Block 'D'.

2.14.6 Research & Development cost (Sec. 18)

a. R & D cost means cost incurred by a person for the purposes of developing the person's business and improving business products or process. However, it does not include cost in respect of natural resource prospecting, exploration and development incurred by a person in the production of the person's income from a business, which is treated as an outgoing for an asset used by the person in that production.

b. Research and Development cost though these are of capital nature are allowed for deduction to an extent from taxable income of the person.

c. The lower amount of the below is deducted:

   i. Actual Research and Development cost or,

   ii. 50% of adjusted taxable income from all businesses.

d. The portion of Research and Development cost not allowed as deduction is capitalized at the beginning of next income year under Block D.

2.14.7 Depreciation cost (Sec. 19)

Depreciation allowances are granted for depreciable assets, which are categorized in 5 classes A, B, C, D and E. The classes are based upon the average useful life of the assets belonging to one class. The assets of each class are place in a pool and a depreciation rate applies to each pool are 5%, 25%, 20%, 15% respectively for class A, B, C, D and for class E the rate in percent calculated as cost divided by the useful life of the assets in the pool at the time the asset is most recently acquired by the person and rounded down to the nearest half.

2.14.8 Bad debts (Sec. 25.2)

Under the following conditions, bad debts can be written off:

a. If the outstanding loan of bank or financial institution has become a bad debt in accordance with the standards prescribed by Nepal Rastra Bank.

b. In other case, the person receiving payment believes that the amount could not be recovered after taking reasonable steps (to recover the amount or loan.)

2.14.9 Allowable Reductions:

2.14.9.1 Donation to exempt organization (Sec. 12)

a. Donation made to an exempt organization, approved by Inland Revenue Department (IRD) is allowed for reductions from taxable income. Reductions allowed to an individual or an entity will not exceed Rs. 1,00,000 or 5% of adjusted taxable income. However, G/Nepal may prescribe, by a notification in the Nepal Gazette, as to allow full or partial deduction at the time of assessing income of the expense incurred for special purpose or donation given by the person.

b. Donation made to Pashupati Area Development Trust (PADT) and Lumbini Area Development Trust (LADT) is deductible up to Rs. 50 lakh.

2.14.9.2 Retirement contributions (Sec. 63)

An individual who is a beneficiary of an approved retirement fund may claim a reduction for retirement contributions made to the fund. However, claim made by an individual for an income year will not exceed Rs. 3,00,000 or one-third of the assessable income.

2.15 Setoff, Carry forward and Carry back of Losses (Sec. 20)

- Losses are in principle deductable but are treated differently depending on whether they result from conducting a business or an investment and whether they are of domestic or foreign nature. Losses from a domestic business can be offset against all types and sources of income, whereas losses from a domestic investment can be offset only against any type of investment income. Foreign losses can be offset only against foreign income. Foreign business losses can be offset against foreign business income or investment. Losses from foreign investment can only be offset against foreign investment income.
- Unrelieved business losses of previous 4f years are allowed to carry forward.
- In case of electricity projects involving in building power station, generating and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own, operate and transfer to the Government, any unrelieved loss of the previous seven years are allowed to carry forward.
- If a person incurs a loss for an income-year from any banking and general insurance business, the person may carry back the loss and deduct it in calculating the income from the business for any of the five preceding income-years.
- Special provisions exist in the Act on how to deal with losses incurred in conducting a business of global long-term contract.

2.16 Tax Accounting and Timing (ITA, 2058)

- For tax purposes, an individual is required to maintain his accounts on a cash basis in calculating the individual's income from an employment or investment and a company is required to maintain its accounts on an accrual basis within the basic framework of generally accepted accounting principle.
- Bad debts are allowed to be written off if a debt claim of a bank or financial institution has become bad debt as determined in accordance with the prescribed standards.
- Inclusions and deductions under a long-term contract are calculated according to the percentage of the contract completed during the year.

2.17 Quantification, Allocation and Characterization of Amounts (ITA, 2058)

- Cash payments are quantified as equivalent to the amount of transferred money or the market value of the asset. In case of a kind payment, it is equivalent to the value of the benefit of the payment. Compensations, including payments under insurance for income and losses are to be included in the calculation of income from employment, business or investment.
- Payments under an annuity, an installment sale or a finance lease are aggregated and the total is divided into a capital portion and an interest portion calculated according to the Act.
- Finance lease has been defined either as an agreement with the transfer of ownership at the end of the agreement or the option of the lessee to purchase the leased asset for a fixed price, or a

contract with a lease term exceeding 75 percent of the asset's useful life.

- The Department is given the right to correct and re-characterize arrangements targeted at minimizing the taxable income or payable tax. This refers to indirect payments, transfer pricing and other arrangements between associates if the agreement has not been conducted at arm's length, cases where persons attempt to split income with other persons, arrangements carried out as part of a tax avoidance scheme or without any substantial economic effect or of which the form of the arrangement does not reflect its substance.

2.18 Capital Gain Tax

- The Act has introduced capital gain tax. However, the Act does not cover all such gains i.e. only those gains, which are received from the disposal of business assets or liabilities and those from the disposal of non-business assets of an investment of a person, which are regarded as chargeable and will be taxed accordingly.
- Business assets comprise assets to the extent to which they are used in a business. Non-business chargeable assets mean securities or an interest in an entity as well as land and buildings. Both definitions exclude depreciable assets or trading stock. Not included in non-business chargeable assets are also private residences of an individual owned and lived in continuously for 3 years or more if they are not disposed of for more than Rs. 10 million. Since profits and gains are different bases of taxation they need to be calculated separately.

- The tax is imposed on the net gains, which are the total gains minus the total losses including unrelieved losses for the current income year and those from a previous income year, which thus can be carried forward forever. Gains and losses are defined as the difference between incoming and outgoing for the asset or liability.

2.19 Special provisions for Individuals

- A resident natural person and a resident spouse of the person may, by notice in writing, elect to be treated as a single individual for a particular income-year.
- Each spouse of a couple making an election as above with respect to an income-year is jointly and separately liable with the other spouse for any tax payable by the couple for the year.
- Budget speech of F/Y 2007/08 has increased the exemption limit to Rs 115000 for an individual and Rs 140, 000 for the couple.
- An individual working in a remote area is entitled to a rebate up to a maximum of Rs 30000 by way of additional basic exemption. The exemption limit specified in Rule 38 of ITR, 2059 are as follows:

Area A	Rs 30,000
Area B	Rs 24,000
Area C	Rs 18,000
Area D	Rs 12,000
Area E	Rs 6,000

- An individual having pension income is entitled to 25% additional basic exemption.

- A resident individual should pay tax on the amount only after deducting 7% of insured sum on his life or Rs 10,000 or actual insurance premium whichever is lower.
- A resident individual may claim a medical tax credit for an income-year not exceeding Rs. 750 for any approved medical costs paid by the individual him/herself or through others during the year in respect of the individual. Tax credit limit of Rs. 750/- is calculated by multiplying the total approved medical cost by 15%. Any unrelieved medical costs are carried forward. Medical Tax Credit facility is equally applicable to all individual taxpayers.

2.20 Special provisions for Entity

- An entity is liable to tax separately from its beneficiary who is defined as any person having an interest in an entity. Unless stated otherwise in the Act, transactions between any entity and its managers and beneficiaries are recognized.
- The profit of entities can either be retained or distributed to its beneficiaries such as shareholders. The entity can also repay capital or grant collateral benefits to them. Collateral benefit, which can be characterized as a kind of hidden distribution of profit. Distributions of profits and collateral benefits are dividends representing a return of interest in capital, and need to be distinguished from repayment of capital, which is the return of the capital itself. For that the Act provides a profit rule saying that a distribution is a return of capital to the extent that it is not a distribution of profits. If the entity repays capital it is free of tax.
- Dividends of a resident company are taxed to the company's shareholders in the form of a final withholding tax. The re-

distribution of such taxed dividend is tax free. Dividends of a non-resident entity, which are distributed to a resident beneficiary, are taxed by inclusion in calculating the income of the beneficiary.

- Besides these general provisions the Act contains detailed provisions for liquidations of entities, for dealings between an entity and a beneficiary, for changes in control of an entity and for dividend stripping.

2.21 Special Provisions for Retirement Savings.

- The Act distinguishes between the treatment of approved and unapproved retirement fund. In case where a resident person files an application with the Department intending to get approval for establishing a retirement fund, the Department shall pronounce the approval as prescribed.
- An individual who is a beneficiary of an approved retirement fund may claim a reduction of retirement contributions made to the fund for an income-year. The limit of the claim is the lower of Rs. 300000 or one third of his assessable income for the year. Contributions to an unapproved retirement fund are not deductable. The income of an approved retirement fund is free of tax where as an unapproved fund itself is subject to full income tax.

2.22 International Taxation

- For taxation purposes, all payments and gains need to be considered on the basis of the source country of the payment.

Details of the circumstances under which the source rules are defined are given in the Act.

- Tax is imposed on the repatriated income of a foreign permanent establishment of a nonresident person situated in Nepal.
- A non-resident person carrying on a business of character or air transport operator are taxed at a flat rate on their amounts derived from carriage of passengers, mail or goods which embark in Nepal, The provision is also applied to non-resident persons who transmit messages by any technical means if the apparatus is established in Nepal.
- A tax credit may be claimed for any foreign income tax paid with respect to foreign source income. The tax credits are calculated separately for assessable foreign income sourced in each country and will not exceed the average rate of Nepal income tax applied to the assessable foreign income.

2.23 Administration and Documentation

- The Department is charged with the responsibilities of administering the Act and the provisions thereto. Government is empowered to enact Rules. Accordingly, the Department may also issue public circulars serving the purpose to achieve consistency in the administration of the Act and to provide guidance to persons affected by the Act.

2.24 Record Keeping and Information Collection

- The Department may specify the form of documents required under the Act. It may issue a Permanent Account Number and require the taxpayer to show it in any return, statement or other documents used for the purposes of this Act.

- Every taxpayer is required to maintain, in Nepal and in Nepali or in English language, documents as prescribed by the Department, which are necessary to explain information to be provided in return, enable an accurate determination of the tax payable and substantiate deductions and outgoing. The documents must be retained for at least 5 years after the end of the income year to which they are relevant. If the documents are not in Nepali or English, the taxpayer may be requested to provide at his expense a Nepali translation by an approved translator.
- The Act grants, every officer with authorization from the Department, comprehensive rights to access to information, such as, full and free access to any premises, place, document or other assets situated in Nepal and right for seizure of any document that may be material in determining the tax liability of the taxpayer. Every officer of the Department will regard and deal with all documents and information coming into his possession or knowledge as secret and will not disclose it to a court, tribunal or other person except in cases explicitly allowed in the Act.

2.25 Installment Payment

- There is a provision of payment of Income Tax of the current year by 3 installments i.e. 40%, 70% and 100% by the end of Poush, Chaitra and Ashad respectively.

2.26 Annual Statement of Estimated Tax Payable

- Every person who is an installment tax payer for an income year is required to file annual statement of estimated tax by the end of Poush. Presumptive taxpayer and those who have only income from final withholdings need not file the estimate.

2.27 Returns of Income and Assessments

- In general, every taxpayers should file a signed return of income not later than 3 months after the end of each income year.
- Unless explicitly requested by the Department, no returns are required from taxpayers who have no tax payable for the year or are resident individuals who have income exclusively from an employment having a source in Nepal, who have only one resident employer at a time during the year and who do not claim a deduction of their taxable income by gifts to exempt organizations.
- Unless an assessment has been amended or reduced by order of the Revenue Tribunal or of a court, the Department may amend an assessment within 4 years in order to adjust the assessed person's liability to tax in such manner as, according to the Department's best judgment, is consistent with the intention of the Act. An assessment may be amended at any time in cases of fraud.
- Where the department makes a jeopardy or amended assessment, it will serve a written notice on the taxpayer.

2.28 Administrative Review and Appeal

- A taxpayer who is aggrieved by a review able decision may file an objection within 30 days after the decision is made. In doing so, such Taxpayer has to deposit 50% of due amount. The Department may extend this period for another 30 days upon request. The Department may stay or amend or do necessary corrections with regard to these review able decisions. If the Department fails to serve a taxpayer with a notice of an objection decision, within 90 days, the taxpayer may elect to treat the Department as having refused his objection and appeal to the Revenue Tribunal.
  (ITA, 2058, Sec: 31a)

2.29 Offences

- Offences are dealt with in the Act in a sense of criminal offences of taxpayers as well as tax administrators. They lead to punishment in the form of fines and imprisonment on conviction. The offences attracting both a fine and the imprisonment include failures to comply with the Act, failures to pay tax, maintaining documentation or filing income returns and statements of estimated tax, making false or misleading statement, impending or coercing the tax administration, offences by the authorized and unauthorized persons, offences of aiding or abetting, etc. In case if the Tax return file is not submitted within the period prescribed by the act, the late fee will be charged at the rate of 0.1% per year of the turnover.
  (ITA, 2058, Sec: 29)

2.30 The Super Act

- The Act is made super in regard to all income tax matters. No other Acts except this Act shall be made capable to make changes, amendment and other tax related provisions other than the provisions relating to imposition, assessment, reduction, increment, exemption, or remission of tax to be made by amending this Act itself by annual Finance Acts.

  (Source: Google Search)

B: REVIEW OF LITERATURE

2.31.1 Review of Related Books

Santosh Raj Poudyal (1993) wrote a book entitled "Income tax law and practice." Poudyal has described the most of the related terms in respect with the assessment of different income tax. This book has been divided in nine chapters. Mr. Poudyal has also described the meaning of tax, basic feature of income tax law, direct and indirect tax, brief history of income tax in Nepal, types of taxpayers, Industrial Enterprises Act 2049, income from remuneration. Method of computing net income from remuneration, method of computing net income from remuneration, method of computing net income from industry, business, profession and vocation of tax at source, income tax authorities, power of tax officer, penalties and appeals, right and duties of taxpayers have also been described in this book.

The book is also based on B.Com syllabus. The method of assessment of income tax have been dealt with numerical illustrations. Many practical problems have been solved in accordance with practices followed by tax office. Since this book was designed to given theoretical as well as practical ideas of income tax system of Nepal to the students of Bachelor's level, it does not provide complete information about all aspects of income tax system of Nepal.

Narendra Bahadur Pradhanaga (1993) wrote a book entitled "Income Tax Law and Accounting." Mr. Pradhanaga has described the provisions made under income tax laws. This book is divided in 20 chapters. In his book, Mr. Pradhanaga has described about income tax and its development in Nepal, Finance Act, Industrial Enterprise Act, agricultural income, income from remuneration, income from house and land rent, income form industry, business, profession, and vocation, income from other sources, computation of total net income. He has also described about fine, penalties and appeal, contribution of income tax for the development of nation, income tax administration and official, collection and return of income tax and admissible and inadmissible expenses etc.

This book has been written to fulfill the course requirement of Tribhuvan University. It is based on the syllables of B.Com level. Mr. Pradhanaga's book is informative rather than analytical. He has also included some numerical problems in regard to income tax assessment. But this book has not analyzed the importance of income tax, problems and defects in Nepalese income tax system. This book is very useful for the students of B.Com level but it has not analyzed the role of income tax and the major aspects of income tax system.

Narayan Raj Tiwari (1999) wrote a book entitled "Income tax system in Nepal." Tiwari has described the provisions under Income Tax Act 1974 in detail. This book is divided into 26 chapter. It has described th introduction of tax, theoretical concept of income tax, income tax system in Nepal, taxable income, Industrial Enterprise Act 2049 and income tax, admissible and inadmissible expenses, income tax administration and tax official etc.

This book has not shown the role of income tax in economic development of Nepal. The process, provisions and methods to assess the income tax have been illustrated with numerical examples. Beside some minor problems, others have not been analyzed. The major problems in Nepalese income tax system have not been dealt in the book.

Kamal Deep Dhakal (2001) wrote a book entitled "Income tax and house and compound tax law and practice." Dhakal has described the various provisions under Income Tax Act 1974. This book is divided into four parts. It has described about tax, income tax in Nepal, house and compound tax and value added tax etc.

This book is also based on B.Com and M.B.S. syllabus. It is useful for information but it has not analyzed the role of income tax, income tax structure etc. The provisions have been described with numerical examples but have not been analyzed critically.

Dr. Chandramani Adhikari (2003) wrote a book entitled "Modern taxation in Nepal." Dr. Adhikari has described the provisions and laws related to income taxation of Nepal according to new Income Tax Act 2002. Dr. Adhikari's book has been divided into five parts. Theoretical concept of taxation has been described in part one. Income tax system in Nepal, the writer has described about income taxation in Nepal, heads and sources of incomes, employment or remuneration income, retirement fund and contribution, tax on pension income, international taxation, provisions of advance tax, tax administration and rights of tax administrators, litigation/legal remedy appeal etc. VAT has been described in part three. Property tax/house and compound tax in Nepal has been described in part four. In part five, windfall gain tax and other provisions have been described.

This book is written for the students of Tribhuvan University, especially for B.B.S., M.B.S. and M.P.A. students. However, it is equally useful to the taxpayers, tax administrators and the persons who want to get theoretical as well as practical knowledge about income tax. But Dr. Adhikari has not analyzed the major problems of income tax system.

Bidhyadhar Mallik (2003) wrote a book entitled "Nepalko Adhunik Kar Pranali." Mr. Mallik has described the provisions made under income tax laws and the methods of income tax assessment have been described. Mallik's book has been divided into twenty-five chapters. Mallik has described about development of income tax system in Nepal, base of tax, computation of income, exempt amounts, admissible amount, capital gain, special provisions regarding to natural person, special provisions for entities. Mallik has also described about international tax, tax administration, payment of tax, income statement and tax assessment, tax rates, assessment of depreciation etc.

Mallik's book is informatics rather than analytical. He has not analyzed the role of income tax, income tax structure and defects of income tax system of Nepal. His book is more helpful to know about general information and provisions made under Income Tax Act 2002.

K.P. Aryal and Surya Prasad Paudel (2003) wrote a book entitled "Taxation in Nepal." This book is based on Income Tax Act 2002. This book is divided into three parts. It has described about tax, features of Income Tax Act 2058, capital receipt and revenue receipt, special provision for entities and retirement saving, classification of taxpayers, heads and sources of income, assessment, collection and recovery; tax authorities and their powers, rights and duties; fine, penalties and appeal in part one. House and compound tax has been described in part two and value added tax has been described in part three.

This book is also based on the syllabus of B.B.S. level. The methods of assessment of income tax have been dealt with numerical illustration. This book does not provide complete information about all aspects of income tax system of Nepal.

Dr. Govinda Ram Agrawal (1980) wrote a book entitled "REsource Mobilization in Nepal". This book was published by CEDA, Kathmandu. Dr. Agrawal contributed towards the new dimension inside of Nepalese income taxation. Dr. Agrawal, in his book, details explains about resource mobilization through income tax, Nepalese fiscal policy, effective tax system and tax policy, income tax system in Nepal, role of income tax in Nepalese tax structure, administrative and legal aspects of income tax in Nepal. His main contribution from his book is concerned to the empirical investigation of facts and figures about the income tax in Nepal. He also calculates the responsiveness and various projections for future about income tax.

Jagdish Agrawal published the book named "Income Tax Theory and Practice". This book was based on Income Tax Act 2058. It was very useful for the study of Income Tax Act 2058. It was the descriptive analysis of Income Tax Act 2058. (Agrawal, 2004)

In 2003, Mr. Ishwor Bhattarai and Mr. Girija Prasad Koiral published two books named "Taxation in Nepal" and "Tax laws and Tax Planning". First books has been designed in conformity with the syllabus of BBS 3rd year and the second one has been designed based on the syllabus of MBS 2nd year. Relevant theoretical and practical aspects have been discussed in the books. Both books have shown how taxable incomes are computed under employment, business and investment sources.

In 2003, Mr. Surendra Keshar Amatya, Dr. Bihari Binod Pokheral and Rewan Dahal wrote a book entitled "Taxation in Nepal". This book is also designed to meet the requirement of BBS 3rd year syllabus. Theoretical as well as practical aspects of taxation have been included in the book. This book is a descriptive one, not analytical.

2.31.2 Review of Related Thesis

In 2001, Miss Bibha Pradhan wrote a thesis entitled 'Contribution of Income Tax from Public Enterprises to Public Revenue of Nepal with reference to Nepal Telecommunication Corporation'. She has analyzed the contribution of income tax from public enterprises to public revenue of Nepal, examined the revenue collection from public enterprises, shown the contribution of income tax in total tax and total income tax revenue of Nepal, and analyzed the effectiveness of income tax revenue collection from NTC. She has also recommended possible measures to increase the present status. She has found that the contribution of income tax from PEs in Nepal is not satisfactory due to poor achievement, weaknesses in government's economic policy and deficiency in legislation. Existing corporate tax rate has been found suitable. Self-assessment of tax is more appropriate. Public enterprises have remained in the second place on total income tax revenue. Out of PEs, NTC has been contributing effectively to total income tax revenue of Nepal. NTCs contribution to total corporate income tax is high. She has found that the average share of NTC on corporate income tax was 35.76 during ten-year period i.e. from fiscal year 1989/90 to 1998/99. She has recommended possible measures to overcome the existing problems. Staff should be taught discipline and be motivated. Management should have the feeling to contribute to the state, etc.

In 2001, Miss Binita Shrestha wrote a thesis on "Revenue Collection from Income Tax in Nepal, Problems and Prospects". She has analyzed the effectiveness of income tax collection policy, examined the problems of revenue collection from income tax and recommended measures for improvement of income tax law and management in Nepal. She has found that the level of income tax collection has been rising. Income tax system of Nepal is suffering from various problems such as narrow tax coverage, mass poverty of Nepalese people, lack of conscious taxpayers, inefficient tax administration, instability in government policy, etc.

In 2001, Mr. Satyendra Timilsina wrote a thesis entitled "Personal Income Taxation in Nepal: A Study of Exemptions and Deductions". He has analyzed the existing system of tax exemption and the deductions and given suggestions to improve the tax system so that the government can collect more revenue and use it in the process of national development. He has measured the extent of exemption limit provided to the individual and the family and examined its appropriateness to its subsistence requirements and analyzed the existing nature of standard deductions. He has suggested the following:

- Standard deductions should be reintroduced.
- Exemption should be provided to the couple/family considering the dependents.
- Income tax revenue and personal income tax revenue is increasing every year.
- A minimum of Rs. 90,000 exemption should be provided in the assumption that the employment income of a section officer in government institution should not be taxed.
- Morale of the tax officials should be increased.

He has stated that exemption limit should be provided by considering the general expenses of two dependent children and the dependent parents for the year. Income from agriculture above some exemption limit must be taxed. The exemption limit must be adjusted with the inflationary condition of the country every year.

In 2001, Miss Jayanti Poudel 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 assess the role of income tax administration 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 an 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 homework of the government, working procedures of the tax administrators are still traditional and cost of administration has not been brought to the satisfactory level.

In 2003, Mr. Thaman Sherchan has studied about fines and penalties under Income Tax Act, 2058 in his thesis entitled "An Analysis of Fines and Penalties regarding to Income Tax System of Nepal". He has analyzed tax structure of Nepal, found out the share of income tax to government revenue, analyzed the provisions of fines and penalties under income tax law, tried to know the taxpayers" knowledge and tax officers' views about fines and penalties, shown the role of fines and penalties to increase the tax paying habit of Nepalese people and suggested regarding fines and penalties provisions under current income tax system. He has found fines and penalties are not the only effective methods of reducing tax evasion. He has suggested making provisions of fines and penalties effective. Education to the taxpayers to increase tax consciousness should also be provided.

In 2003, Mr. Dan Bahadur Palli Magar wrote a thesis entitled "Income Tax in Nepal: A study of Exemptions and Deductions". He has studied the exemptions and deductions provided by the Income Tax Act, 2058, problems and weaknesses in income tax system, contribution of income tax to government revenue and suggested possible areas of reform. He has stated the need for clarity in provisions and language of the Act. He has recommended ten slabs for taxing the incomes of a taxpayer-first rate being 5% and the last one being 55%. He has suggested the following expenses for deduction from remuneration income:

- Expenses for the better education of their children.
- Medical expenses made by the taxpayer.
- Expenses made for house rent.
- Education expenses for the taxpayer himself if he is studying in an educational institution.
- Life insurance premium of the taxpayer.

Kedar Bilas Pandey prepared the thesis on "An Analysis of Income Tax in Nepal" in his study, his major finding were the role of direct tax in total revenue and tax revenue, dominant role of indirect tax in Nepalese tax system and the role of income tax to control the inflationary trend of the country. Legal aspect, role and problems of income tax, structure and economic effect of income tax in Nepal, mode of mobilizing additional resource from income tax was also discussed in his thesis. His suggestions about income tax were capital gain should bring in tax net; income tax accounting assessment and collection method must be scientific.

(Pandey, 1978)

In 1981, Miss Rojalin Singh Silwal presented a dissertation entitled "Income Tax System in Nepal". Importance of income tax in solving financial resource gap problem in Nepal was major study of her study. She had also shown the rate and per capita burden of income tax in Nepal. She has shown the trend of income tax and effect of income tax on production in Nepal. She found that income tax is an important source of revenue to mobilize additional resources. The major problems in income tax collection as identified by her were, the absence of clear and comprehensive definition of income, low tax paying capacity and tax consciousness high tax rates, corruption etc. She had recommended some factors like increasing tax consciousness to the taxpayers, clear and comprehensive definition of the incomes for improvements to GN regarding income tax and tax administration for the collection of income tax in Nepal. (Silwal, 1981)

In 1983, Miss Naina Nepal also study about the income tax of Nepal. She had prepared the dissertation on "A Study of Problems and Prospects of Income Tax in Nepal". She had mainly concerned about examining the role of income tax in overall tax structure, analyzing the problems and prospects of income tax in Nepal. She had suggested for effective tax administration and one of the resource efficiently. (Nepal, 1983)

In 1984, Miss Roshani Shrestha prepared a dissertation entitled "Income Tax in Nepal". She had described the historical background of income tax in Nepal, the role of income tax in Nepalese tax structure and the problems of income tax in Nepal. She founded that tax evasion was the major problem of income tax implementation. The revenue collections from income of Nepalese peoples were to increase the share of income tax in total revenue collection of Nepal. She suggested that the practice of tax evasion must be checked and tax management of government should be efficient. (Shrestha, 1984)

In 1987, Prem Prasad Timilsina presented a dissertation entitled "Income Tax Evasion in Nepal". The objective of the study is mainly focused to examine income tax evasion tendency in Nepal to observe the general opinion about income tax evasion in Nepal, to estimate the volume of income tax evasion in Nepal and to draw suggestions for the elimination of income tax evasion in Nepal. He had also mentioned different methods of income tax evasion in Nepal; none reporting of income from illegal business, non maintenance of accounts, failure to submit income statements, none reporting of family member's income, under reporting of income from different sources, re-registration of business and failure to make tax deduction at source (TDS). He had found that income tax evasion was in decreasing trend in Nepal. But due to lack of authentic data, he was unable to prove it statistically. (Timilsina, 1987)

In 1989, Miss Shanti Baral presented a dissertation entitled "Income Tax Structure of Nepal". She had shown the tax structure of Nepal. She had shown the contribution of income tax in tax revenue and total revenue of Nepal. She found that total revenue have an increasing trend in Nepal, but low rate. She had mentioned that tax evasion as the major problem of income tax system in Nepal. She had found lack of public information and lack of scientific method of tax collection and trained tax collectors as main causes of income tax evasion. (Baral, 1989)

In 1994, Hari Bahadur Bhandari wrote a dissertation entitled "Contribution of Income Tax to Economic Development of Nepal". He had examined the collection of income tax and its contribution to the economic development of Nepal. He had stated that the revenue collection in Nepal was lower than the target set out. For this, he pointed out some responsible factors like tax paying habit of Nepalese taxpayers, poor tax administrative system, widespread income tax evasion etc. He also studied the income tax structure trend of income tax collection and the share of contribution of income tax to the development of Nepalese economy. He had put forward some suggestion to overcome those problems such as improving tax administration system checking income tax evasion etc. (Bhandari, 1994)

2.31.3 Review of Related Studies and Reports

The history of income tax in Nepal is not too long. Income tax started in Nepal since 1960. After this, many individuals, students, and institutions have studied in this subject regarding legal aspect, administrative problems.

Mr. Jagdish Agrawal published an article "Income Tax Problems" on Jan, 2005 which became very much useful to prepare this thesis. Some way the article "Revenue Auditing in Nepal" written by Ram Babu Nepal helped a lot to write this thesis. The other important reports studied while preparing this thesis are Annual Report 2062/63 published by Inland Revenue Department, the Economic Survey 2006/07 and Budget speech of Fiscal year 2007 - 08.

In 1955, Tax System Review Task force submitted a report entitled 'Review of Task System." This report was prepared by Madan Kumar Dahal and submitted to MOF, HMG/N. This report covered the various aspects of tax system at that time. Narrow tax base, low tax elasticity, higher burden of indirect tax to direct tax, lack of voluntary compliance, leakage etc. were the major defects of taxation identified by this report. This study identified the narrow tax base. The exemption of income from agricultural sector, which contributed 43 percent of GDP, was marked as main reason of narrow base. Including agricultural sector, income from domestic industries, social sector, and electricity sector which contributed 52 percent to GDP were exempted from income tax and only large industries, mines, construction, trade, hotel and restaurant which contributed 48 percent income to GDP were under income tax. All these provision made the tax base very narrow. The tax rates were unnecessarily high. Only 73000 taxpayers income was demarked which was less than 1 percent of the economically active population. Real per capita income growth rate at that time was only 0.3 percent, which showed the low taxable capacity of the people. This report suggested increasing the tax to GDP ratio from 10 percent to 15 percent, to increase the total number of taxpayers and to increase the per capita income.

This study further suggested about 40 percent extra resource mobilizations if proposed tax policy and program were in place. This study recommended various practical ideas to widen income tax base like 20 percent exemption from total tax assessment might be given to make self-tax assessment effective. It suggested raising the exemption limit of income tax for a person to Rs. 35000 and for family to Rs. 50000 and exemption should be based on inflation rate.

In 2001, Revenue Consultation Committee had studied the overall taxation situation in depth. This report suggested widening the income tax base by including all kinds of taxpayers and income and find out the taxpayers of new sector. For this, the report suggested to make the act more transparent and clear in order to attract foreign and domestic investors. This report recommended for written communication between taxpayers and tax administration rather than the informal relation. This report suggested to implement account based VAT more effectively. For small taxpayers having up to Rs. 2 million, tax collection should be based on sale and purchase description of there. For income taxation, self-assessment was fully recommended. This report suggested bringing all potential taxpayers into the 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. The report also certified Rs. 55000 for individual and Rs. 75000 for couple and family as exemption limit. The report gave suggestion for HMG to expand the permanent account number (PAN) outside the valley and reduce the land house registration rate and to rationalize the tax deduction at source (TDS).

Dr. Govinda Bahadur Thapa (2001) wrote an article entitled "Practical Issues in Income Taxation" in Rajaswa. Thapa has focused that income tax is an important source of revenue of the modern government. This tax is not only for revenue but also for attaining equity. However, being a direct tax on incomes and profit, these are several practical issues to be settled before it becomes revenue productive as well as equity achiever. Defining taxable income and tax paying units, determining appropriate rate structure and methods of tax assessment are some of such issues, which are instrumental to make the income tax system effective. This article also analyses and explains the theoretical basis to settle these issues. (Thapa, 2001: 20-30)

Narendra Lal Kayastha (1993) wrote an article in Rajaswa entitled "Problem and Prospects of Resource mobilization through Direct Taxation in Nepal". He had stated that there was utmost need for certain thax measures and widening of the tax bases. As per him drastic reforms in tax rates rules and the regulation in Income Tax Act may help to increase the domestic resource mobilization through taxation in Nepal. (Kayastha, 1993)

Puspa Kandel (2001) wrote an article entitled "Draft of Income Tax Act 2001 Critical Analysis" in Rajaswa. Kandel has criticized the Income Tax Act 2002 on several grounds. Exemption of agricultural income from income tax, expert duties levied on export, inequality between different capital earned income (i.e. tax on interest, dividend and capital gain), with drawl of the provision of exemption suddenly and no adjustment for inflation are the major issues he raised in his article. He also said criticized tax regime creates more tax burden then the former one. He further criticized the act for the provision of income tax from export as 0.5 percent of total export because it is not good choice of income tax base (Kandel, 2001: 65-73).

CHAPTER III
RESEARCH METHODOLOGY

This chapter describes research design, population and sample, sampling procedure, nature and sources of data, data collection procedure, data processing procedure and analysis tools and weight of choice.

3.1 Research Design

This research attempts to analyze the primary information (opinion of the respondents) as well as secondary data. Hence, descriptive and analytical both the research designs have been used. For an empirical research, an opinion survey has been conducted.

3.2 Populations and Sample

Tax administrators, tax experts and tax payers were considered as the total population. 18 questionnaire were distributed to tax administrators, 20 to tax experts and 30 to tax payers out of them, 15 tax administrators, 15 tax experts and 25 tax payers were considered as the target population for the study. In order to benefit this study, 55 sample size from Kathmandu Valley is selected. The respondents have been divided into three groups. The following table shows the groups of respondents and the size of sample.

Table 3.1

Groups of Respondents and Size of Sample included from Each Group

S.N.	Group of Respondents	Sample Size
1.	Tax Administrators	15
2.	Tax Experts	15
3.	Tax Payers	25
	Total	55

The name list of tax administrators, tax experts and tax payers from where the information was collected have been given in appendix B.

3.3 Sampling Procedure

Random sampling technique has been used to select the target and sample population. Tax administrators, tax experts, tax payers were selected on the basis of stratified selection.

3.4 Nature and Sources of Data

To meet the objective of the study, primary as well as secondary sources of data have been used.

a. Primary data were collected from the responses of persons representing from various sector through structured questionnaire (Appendix A). The same questionnaire was distributed to three groups i.e., tax administrators; tax experts and tax payers.

b. The secondary sources of data were the information received from books, journals, newspapers, reports and thesis as well as web sites of Inland Revenue department and ministry of finance like www.ird.gov.np & www.mof.gov.np. The major source of secondary data are follows:

    i. Economic survey and budget speeches, ministry of finance.
    ii. Report and records of Inland Revenue Department, Ministry of Finance.
    iii. Dissertations related to income tax available at central library, Tribhuvan University.
    iv. Rajaswa, Revenue Administration Training Centre, Kathmandu.
    v. Books related to income tax and public finance.
    vi. National newspapers, journals, souvenir and news magazines.
    vii. Other relevant records and data related to this study.

3.5 Data Collection Procedure

For primary data, information was collected by developing a schedule of questionnaires and distributing to three distinct types of respondents. Distribution was done through personally field visit to get accurate and actual information in time.

For secondary data, information was collected form published reports of different organizations.

3.6 Data Processing Procedure and Analysis Tools used:

Information collected through questionnaires were in raw form. They were classified and tabulated in the required form. Data analysis was made by applying different tools like simple percentage, simple average, and Spearman’s rank correlation coefficient. Graphs and charts are also presented in interpret the data visually.

a) Rank correlation coefficient is the measurement of relationship between the two variables with respect to their respective ranks. It is also called Spearman’s rank correlation coefficient and is given by:

$$r_s = 1 - \frac{6 \sum d^2}{n(n^2 - 1)}$$

Where,

r_s = Spearman’s rank correlation coefficient between variable x and y.

d = Different between the rank for each pair of observations.

i.e. $d = (R_1 - R_2)$

$R_1 - R_2$ = Rank of x and y series respectively.

n = Number of paired observations.

= notation meaning “the sum of”

Testing Hypothesis about Rank Correlation

For Small values of n (n less than or equal to 30), the distribution of r_s is not normal, and unlike other small sample statistics we have encountered, it is not appropriate to use the distribution for testing hypothesis about the rank correlation coefficient. Instead, Spearman's Rank correlation values are used to determine the acceptance and rejection regions for such hypothesis.

Setting the hypothesis:

Null hypothesis and alternative hypothesis are set as follows:

$H_1 : P_s = 0$: Null hypothesis: There is no correlation in the ranked data of the population.

$H_1 : P_s \mid 0$: Alternative hypothesis: There is a correlation in the ranked data of the population.

(Where P_s is Spearman's rank correlation coefficient in the population.)

~ X0.05⎝ level of significance for testing these hypothesis.

A two-tailed test is appropriate, so by looking at table values in the row for the number of paired observation and the column for a significance level of 0.05, it can be found the critical values for r_s ⎨ (positive or negative), that is, the upper limit of acceptance region is + (positive) and the lower limit of the acceptance region is – (negative).

Decision

If rank correlation coefficient (r_s) lies outside the acceptance region, null hypothesis is rejected.

If rank correlation coefficient (r_s) lies in the acceptance region, null hypothesis is accepted.

3.7 Weight of Choice

The questionnaire either asked for a yes/no response or asked for ranking of choices according to number of alternatives where first choice was most important and last choice was least important. For analysis purpose choices were assigned weight according to number of alternatives. If the numbers of alternatives were 10 then the first preferred choice got ten points and the last preferred choice got one point. Any alternative, which was not ranked, did not get any point. The total points available to each choice were converted into percentages in reference to total points available for all choices. 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.

CHAPTER IV
PRESENTATION AND ANALYSIS OF DATA

A: ANALYSIS OF TAX PAYERS

4.1 A brief introduction of IRD:

Organizational structure of income tax administration in Nepal includes Inland Revenue Department (IRD) at the middle level and Ministry of Finance (MOF) at the top level. IRD is one of the implementing level organizations, which is constituted under the control of Ministry of Finance. It covers various types of taxes so it does not deal only income tax. It constitutes personal administration, fiscal and system improvement, law, policy and appeal, audit, investigation and review, tax exemption and statistics section. All the tax field offices are under the control of IRD.

IRD is responsible for the enforcement of Tax Laws and administration of Income tax, value Added Tax, Excise Duty, Vehicle Tax and certain fee and duties like Entertainment fee (Film Development fee), Special fee. etc. Likewise, the Department is also responsible for monitoring the non-tax revenue such as dividends, royalties etc. of the government.

4.2 Functions carried out by IRD

1. Tax Administration (Income Tax and VAT)
2. Tax Policy
3. Tax Payer Services
4. Registration, Revenue Collection
5. Tax audit

6. Tax Enforcement and investigation
7. Review & Appeal
8. Tax Refund
9. Advance Ruling
10. Tax Treaty and International Taxation
11. Excises and Liquor Administration
12. Monitoring of non-tax

4.3 Taxpayer's Rights and Assurances

In addition to the specific rights and assurances provided in the concerned acts taxpayers in general are assured of the following rights. These assurances will be strictly adhered to. The Taxpayers rights, among others, include: *(Google Search)*

A. Each taxpayer is treated with due respect and honor.
B. Each taxpayer will get an immediate receipt of return submission whilst a receipt of other of other correspondences is to be provided in ONE hour.
C. Each taxpayer willing to seek an advance ruling may apply either in the Department or through concerned Inland Revenue Office. There is a legal provision that a decision should be made within 45 days after the request is made.
D. Each taxpayer can represent or make any correspondence by an authorized person including legal assistants and the accounts specialist or auditors just in case if he/she is unable to represent or make any correspondence.
E. Each taxpayer is to get copies of the documents related with him/her of submitted to IRO or documents or decisions affecting

her/him generally in TWENTY FOUR hours of his/her request in the concerned IRO.

F. Each taxpayer is to get refund of his excess input tax (VAT) and other taxes. The exporter will get refund generally within 15 days in IROs and 30 days in IRD upon receiving application for refund.

G. Each taxpayer is to get certificate/renewal of Excise/Liquor business generally within TWENTY FROUR hour after the request is made.

H. Each taxpayer is to get sales and purchase books certified by the Tax Officer generally within TWENTY FOUR hours after the request is made.

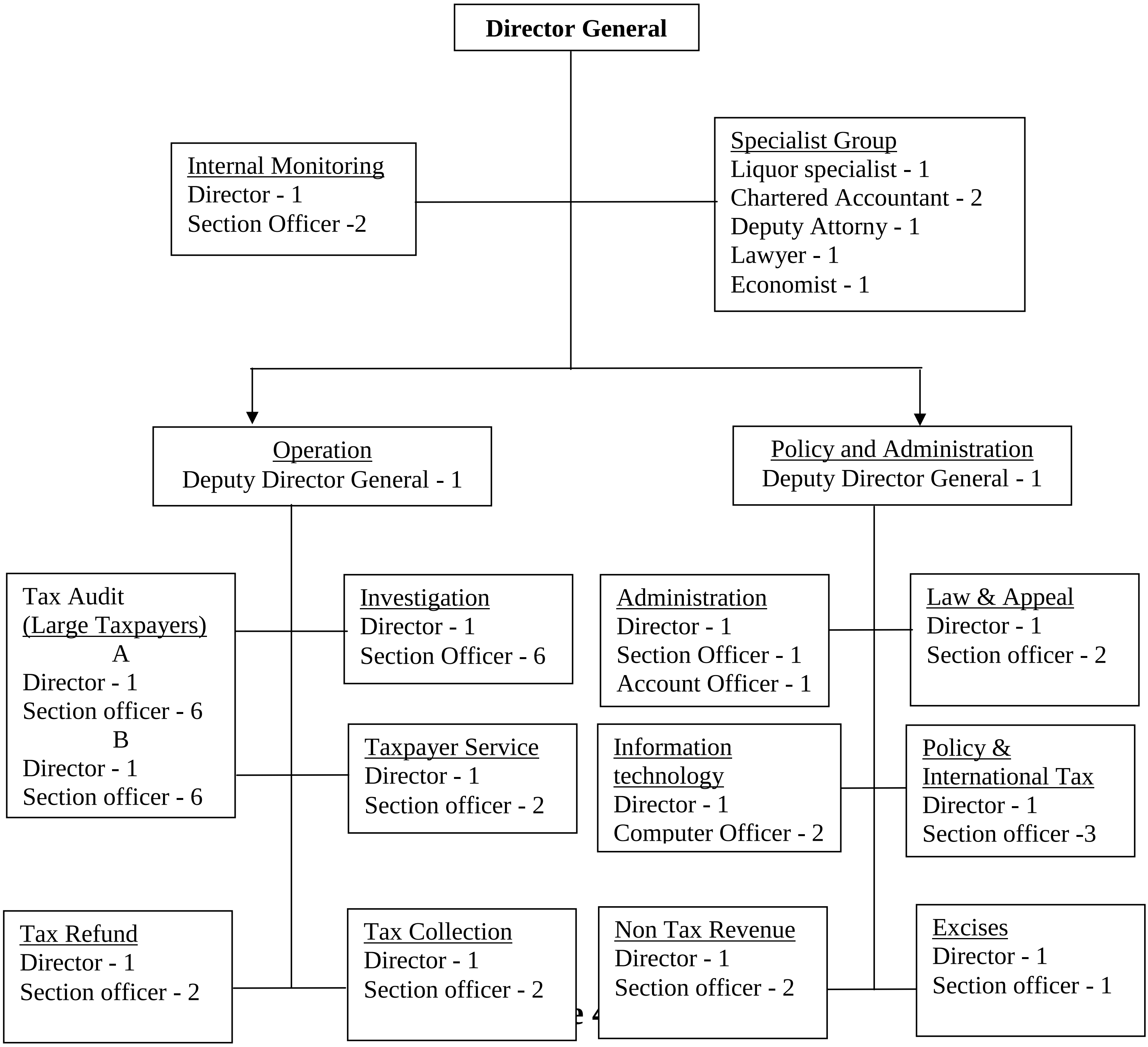
I. Each taxpayer is to get initials of the Tax Officer on stock transfer or sales to the non-registrants generally within TWENTY FOUR hours after the request is made.

J. Each taxpayer is to get Permanent Accounts Number (PAN) or the Certificate generally within 3 days after the request is made, and

K. Each taxpayer is to get Tax Clearance Certificate generally with TWENTY FOUR hours after the request is made.

4.4 Organizational Structure of the Inland Revenue Department.

IRD is centrally located in Kathmandu. There are 22 field offices throughout the Kingdom including a Large Taxpayers Office located in Kathmandu. The previous Department of Taxation was established in 1960. IRD and its district offices are totally running on functional line. Major functions include Taxpayer's Service and Collection.


Director General
Internal Monitoring
Director - 1
Section Officer -2
Specialist Group
Liquor specialist - 1
Chartered Accountant - 2
Deputy Attorny - 1
Lawyer - 1
Economist - 1
Operation
Deputy Director General - 1
Policy and Administration
Deputy Director General - 1
Tax Audit
(Large Taxpayers)
A
Director - 1
Section officer - 6
B
Director - 1
Section officer - 6
Investigation
Director - 1
Section Officer - 6
Administration
Director - 1
Section Officer - 1
Account Officer - 1
Law & Appeal
Director - 1
Section officer - 2
Taxpayer Service
Director - 1
Section officer - 2
Information technology
Director - 1
Computer Officer - 2
Policy & International Tax
Director - 1
Section officer -3
Tax Refund
Director - 1
Section officer - 2
Tax Collection
Director - 1
Section officer - 2
Non Tax Revenue
Director - 1
Section officer - 2
Excises
Director - 1
Section officer - 1

Personnel List of Inland Revenue Department as of 2064 Jestha

S.N.	Title	Class	No. of Personnel
1.	Director General	Gazetted 1st Class	1
2.	Deputy Director General	Gazetted 1st Class	2
3.	Chartered Accountant	Contract	2
4.	Liquor Specialist	Gazetted 1st class (technical)	1
5.	Director	Gazetted 2nd Class	13
6.	Deputy Attorney	Gazetted 2nd Class	1
7.	Economist	Gazetted 2nd Class	1
8.	Legal Officer	Gazetted 3rd Class	2
9.	Section Officer	Gazetted 3rd Class	35
10.	Account Officers	Gazetted 3rd Class	1
11.	Computer Officers	Gazetted 3rd Class	2
12.	Nayab Subba	Non-Gazetted 1st class(Rajashwa)	20
13.	Computer Operator	Non-Gazetted 1st class(Technial)	12
14.	Accountant	Non-Gazetted 1st class	3
15.	Kharidar	Non-Gazetted 2nd class (Rajashwa)	11
16.	Asst. Computer Operator	Non-Gazetted 2nd class(Technial)	3
17.	Driver	Non-Graded	6
18.	Peon	Non-Graded	15
19.	Sweeper	Non-Graded	1
	Total		132

Source: Inland Revenue Department.

4.5.1 Meaning of Taxpayer

A taxpayer is also known as an assessee. Taxpayer means a person who is under the obligation to pay income tax according to income tax law. The term also includes any person who has to pay tax and on whom the tax officer has served any notice or taken any action under income tax act. Income Tax Act, 2058 has not defined the taxpayer or assessee but has defined different persons. These persons, for the purpose of income taxation, are known as the assessee.

4.5.2 Classification of Taxpayers based on ITA 2058

The tax law has identified different types of persons. These persons may be known as taxpayers. Thus, the taxpayers may be classified on different bases as follows:

4.5.2.1 Classification on the basis of legal status

In Respect of the taxpayer, legal status refers to a natural person or an artificial person. According to section 2.ap, person means a natural person or an entity. Thus, on the basis of legal status, a person can be identified as natural person or entity.

a) **Natural Person:** A natural person is defined in section 2(ac). According to this section, it means a natural individual and the term also denotes, for the purpose of the act, any proprietorship firm (whether or not registered) and a couple making an election to be a single unit of taxpayer or separate unit of taxpayer under section 50.

b) **Entity:** An entity means the following institution or organization: a government, local bodies, company, partnership or trust. The term entity also includes a political subdivision of the foreign government, a public international organization established under treaty or a foreign permanent establishment.

4.5.2.2 Classification on the basis of marital status

Marital status refers to a natural person's status as an unmarried person or married couple. On the basis of marital status, the natural persons are further classified as individual and couple. Although a person is married and has living together his/her spouse, the person may be treated as single natural person as an individual for the tax assessment purpose if the person and spouse of the person jointly do not elect themselves to be a single unit of tax payer as a couple.

a) **Individual:** An individual means a natural individual and the term also denotes, for the purpose of the act, any proprietorship firm (whether or not registered). It includes an unmarried natural person. It also includes a husband or wife who does not elect to be a couple as single unit of taxpayer and such husband or wife with minors.
b) **Couple :** A married couple making an election to be a single unit of taxpayer is known as a couple. It includes husband and wife. It also includes husband and wife with minors.

4.5.2.3 Classification on the basis of residential status

On the basis of residential status, the persons are divided into resident and non-resident. Tax treatments of resident and non-resident are different in different countries. However, there is a common practice to levy income tax on the domestic source income of non-residents while residents are generally taxed on their worldwide income.

a) **Resident person:** The act has given clear definition in the different cases of resident persons.
   1. **In case of natural person:** Resident person includes a natural person whose normal place of abode is in Nepal; who is present in Nepal more than 182 days in any period of 365 consecutive days of any income year; or who is an employee or an official of HMG posted abroad at any time during the income year.
   2. **In the case of trust:** It includes a trust that is established in Nepal; that has a trustee that is a resident person for the income year; or that is controlled directly or through one or more

interposed entities by a person or persons one of whom is a resident person for the income year.

3. **In case of a company:** Resident person includes a company or such an entity that is established under the laws of Nepal; or that has its effective management in Nepal during the income year.
4. **In the case of a foreign government or its political subdivision:** Resident person includes such an entity if it is established under the laws of Nepal or has its effective management in Nepal during the income-year; and
5. **In the other cases:** According to the act, a resident person also includes a village development committee, municipality or district development committee, any partnership, any institution or entity established under treaty and a foreign permanent establishment of a non-resident person situated in Nepal.

b) **Non-resident person:** The act has not precisely defined the non-resident. It is defined as a person who is not a resident person.

4.5.2.4 Classification on the basis of submission of income return

According Income Tax Returns issued by IRD, taxpayers are classified into major four categories.

a. Natural person having only business income source in Nepal with annual turnover upto Rs. 10 lakh and income upto Rs. 1 lakh.
b. Natural person having income from employment and business source in Nepal with annual turnover less than Rs. 10 lakh (professionals such as auditor, medical doctor, engineer, advocate etc.) and other natural businesspersons having income from

employment and business source in Nepal with annual turnover less than Rs. 50 lakh.

c. Any person having income from employment, business and investment.

d. Natural person, without PAN, having gain from the disposal of non-business chargeable asset only.

4.6 Taxpayers and structural status of income tax:

A tax payer is also known as an assessee. Tax payers means a person who is under the obligation to pay income tax according to income tax law. The term also includes any person who has to pay tax and on whom the tax officer has served any notice or taken any action under income tax act. Income tax Act 2058 has not defined the tax payer or assessee but has defined different persons. These persons, for the purpose of income taxation, are known as the assessees.

In the F/Y 1999/2000, the no. of registered tax payers were 200085 which was more than 8921 (5%) than F/Y 1998/99, now in the F/Y 2006/07 the figure has reached to 2019605.

In F/Y 1998/99 returns filed was 129043 which reached 133577 in F/Y 1999/2000 with a growth 3.5%. In F/Y 2006/07 the number of returns filed has reached to 190622.

4.7.1 Status based on Number of Tax payers registered:

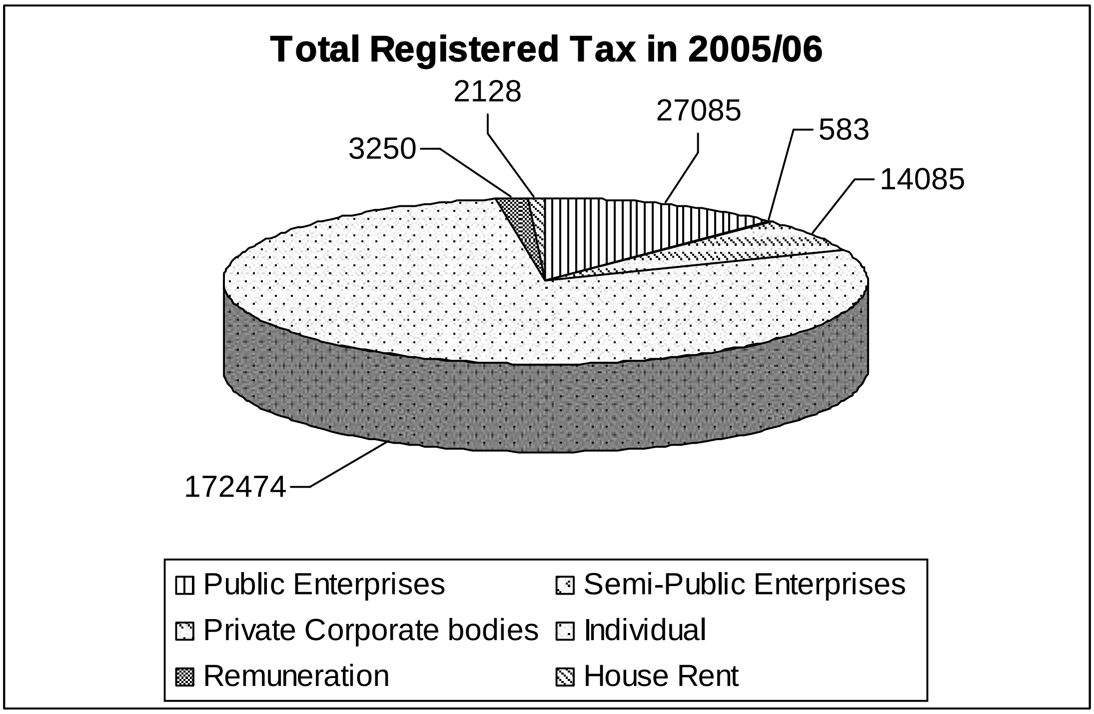
During the fiscal year 2062/63 the taxpayers registered with 40 tax offices under the department of Taxation totaled 219605. Among the registered, 27085 are public enterprises, 583 are Semi-Public Enterprises, 14085 are Private Corporate Bodies, 17247 are Individuals, 3250 salary earners, 2128 are house rent earners.

Table 4.2
No of Tax Payers Registered

Code No.	Types of Tax Payers	No. of Tax payers			
		Up to the end of 2005	Addition in the year 2005/06	Reduction in this year 2005/06	Total registered Tax payers in 2005/06
1.1.3.11	Public Enterprises	26991	96	2	27085
1.1.3.12	Semi-Public Enterprises	498	98	13	583
1.1.3.13	Private Corporate bodies	11476	2652	43	14085
1.1.3.14	Individual	151581	21584	691	172474
1.1.3.20	Remuneration	2824	426	0	3250
1.1.3.51	House Rent	2128	0	0	2128
Total		**195498**	**24856**	**749**	**219605**

Source: Annual Report 2062/63, IRD, Lajimpat

Figure: 4.1
Total Registered Tax payers in 2062/63



4.7.2 Status of taxpayers based on contribution on income Tax.

Corporate income tax includes income tax from public companies, public company limited and private company limited which contributes 49% of total income tax in F/Y 2062/63, like wise private income tax is composed of remuneration and other industry, trade and profession which contributes 39% of total income tax, same way House rent and interest tax contribution 5% and 7% respectively in the F/Y 2062/63

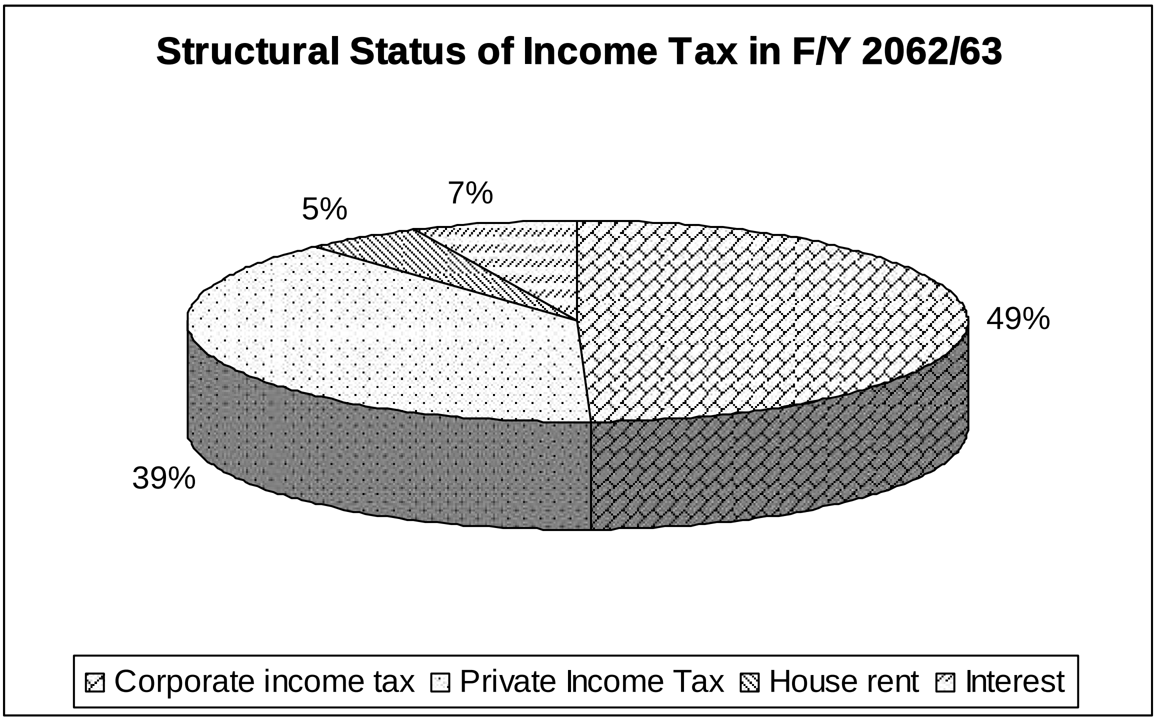
Table 4.3
Collection of Income Tax from different types of Tax payers in F/Y 2062/63

Rs. in thousands.

Types of taxpayers	**Income Tax in f/y 2061/62**	**Income Tax in F/Y 2062/63**
Corporate income tax	5327323	5395701
Private Income Tax	3871676	4234653
House rent	496306	509062
Interest	757332	757032
Total	10452637	10896448
Growth Rate	**9.9%**	**9.16%**

Source: Annual Report 2062/63

Figure 4.2
Structural Status of Income Tax in F/Y 2062/63



4.7.3 Status of taxpayers based on the submission of return of income

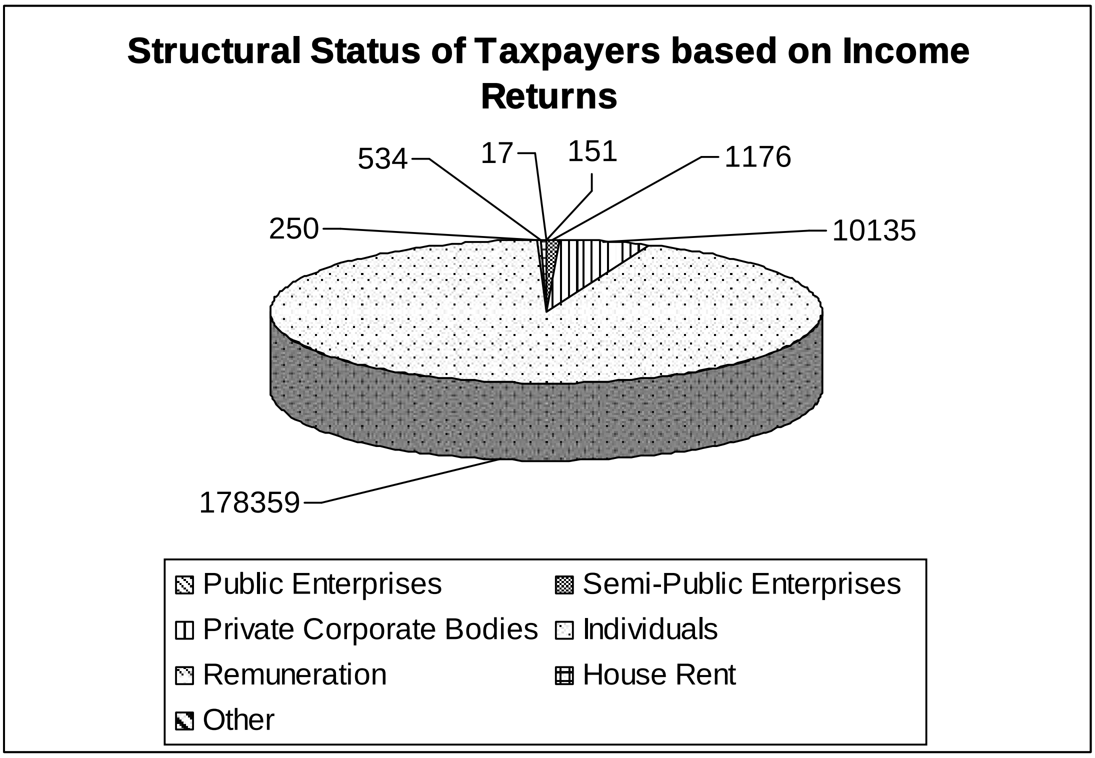
During the fiscal year 2005/06, total 190622 income returns were submitted in different IROs, out of which the highest no. of income returns was from Individuals i.e. 178359 from the public enterprises total 151 income returns were submitted during F/Y 2005/06. Same way 1176 from Semi-Public Enterprises, 10135 from Private Corporate bodies, 250 from salary earners, 534 from House rent & 17 from others income returns were submitted.

Table 4.4
Statement of income return

Types of taxpayers	No. of income returns received in 2004/05	No. of income returns received in F/Y 2005/06	Total no. of income returns received
Public Enterprises	135	16	151
Semi-Public Enterprises	708	468	1176
Private Corporate Bodies	5783	4352	10135
Individuals	114490	63869	178359
Remuneration	234	16	250
House Rent	517	17	534
Other	17	0	17
Total	**121884**	**68738**	**190622**

Source: Annual report 2062/63, IRD, Lajimpat

Figure 4.3
Structural Status of Taxpayers based on Income returns



4.7.4 Status of Tax payers based on the assessment of tax:

During the f/y 2062/63, 190622 income returns were received through different concerned IRDs including income returns received in f/y 2061/62, from different tax payers. Out of these income returns, income tax Rs. 3628378 (in thousand) was assessed from 3745 income returns received in f/y 2061/62. Some way income tax Rs. 1493984 (in thousand) was assessed from 5384 income returns received in f/y 2062/63 and 185238 income returns were forwarded for f/y 2063/64.

Table 4.5
Statement of Tax assessment

Rs. in Thousand

Types of Taxpayers	Total income return received	Assessment of Tax						Forwarded income returns for 2063/64
		Assessment from 2061/62		Assessment from 2062/63		Total		
		No.	Amount	No.	Amount	No.	Amount	
Public Enterprises	151	18	1868826	0	0	18	1868826	133
Public Limited Companies	1176	149	1002929	16	1065817	165	2068747	1011
Private Limited	10135	971	503731	454	242894	1425	746625	8710
Private & Partnership	169212	2542	215652	1128	165325	3670	380977	165542
Other Institution	9147	65	36915	41	6013	106	42928	9041
Remuneration	250	0	0	0	13059	0	13059	250
House Rent	534	0	0	0	0	0	0	534
Other	17	0	0	0	0	0	0	17
Total	190622	3745	3628378	1639	1493984	5384	5122362	185238

Source: Annual Report 2062/63, IRD, Lajimpat

4.7.5 Status of tax payers based on payment of tax by installment.

Table 4.6
Statement of payment of tax by installment

Rs. In Thousands

Types of Taxpayers	First installment 40%		Second installment 70%		Third Installment 100%		Total
	No. of Taxpayer	Amount	No. of Taxpayer	Amount	No. of Taxpayer	Amount	
Public Enterprises	2	151000	0	0	2	150000	301000
Public limited Companies	325	79982580	235	47744185	304	404923952	532650717
Private limited	1066	50079075	745	77211015	998	94641669	221931759
Private & Partnership	2783	232201179	1666	131560767	2416	158478147	522240092
Other institution	31	1636767	40	1522399	22	1648187	4807353
Remuneration	0	0	0	0	0	0	0
House Rent	0	0	0	0	0	0	0
Others	4	654	6	2949	3	183	3786
Total	4211	364051255	2692	258041315	3745	659842137	1281934707

Source: Annual report 2062/63, IRD, Lajimpat

Figure 4.4
Structural Status based on No. of Taxpayers in 3 Installments

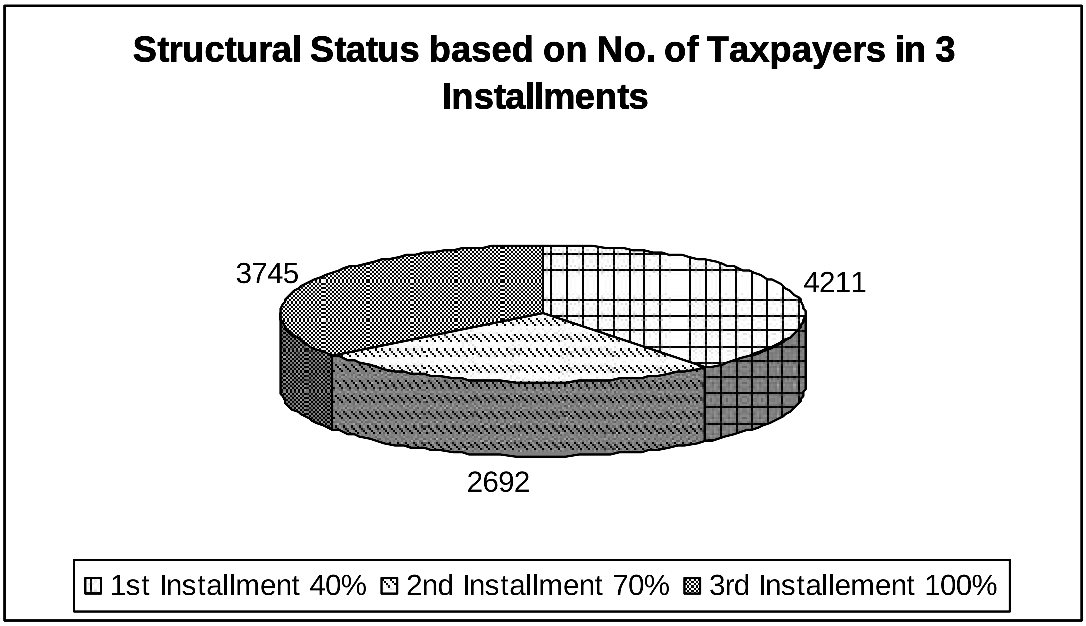
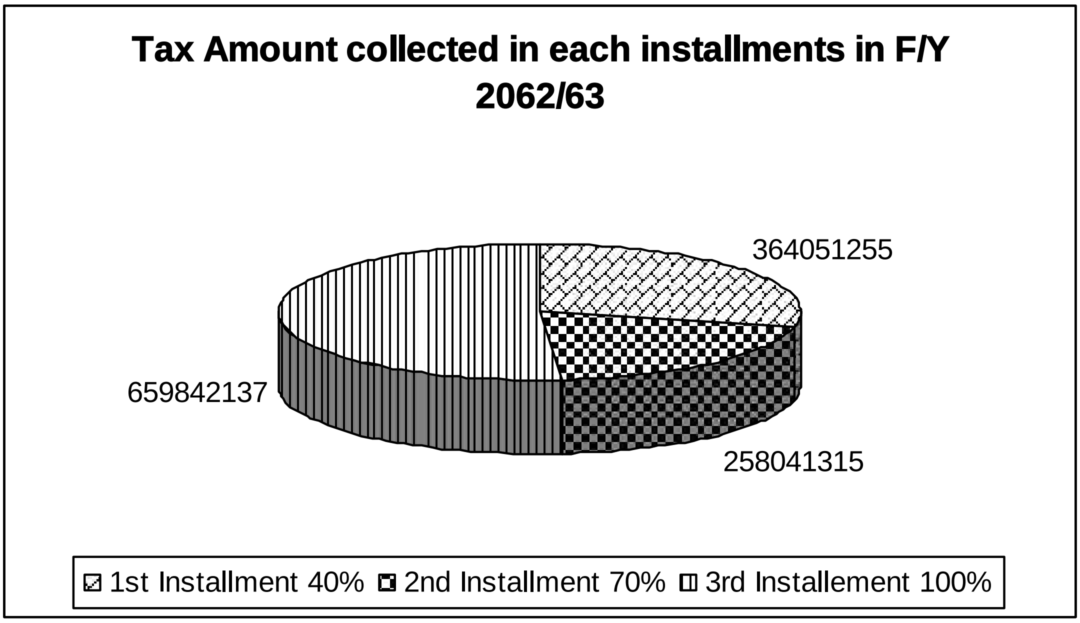


Figure 4.5
Tax Amount collected in each installments in F/Y 2062/63



A person who derives or expects to derive any assessable income during an income year from a business or investment is required to pay tax for the year by three installments as 40%, 70% and 100% of the estimated tax to the extent of excess of the tax paid by the end of poush, chaitra and ashadh respectively. In the f/y 2062/63, Rs. 36 crores, 40 lakhs, 51 thousands; two hundreds and 55 income tax was collected from 4211 tax payers as first installment, same way Rs. 25 crores, 50 lakhs, 41 thousands, 3 hundreds and 15 income tax was collected from 2692 tax payers as second installment and Rs. 65 crores, 98 lakhs, 42 thousands 1 hundred and 37 income tax was collected from 3745 tax payers in the third and final installment.

B: ANALYSIS OF SECONDARY DATA

This chapter is devoted to the analysis and presentation of secondary data. The data obtained from economic survey and annual report of IRD have been tabulated and presented into graphs and charts and have been analyzed to reach at some findings and conclusions.

This chapter has been divided into eleven sub headings. They are 1) Structure of Government Revenue of Nepal. 2) Contribution of Tax and Non-Tax revenue in Total Revenue. 3) Contribution of Direct tax and Indirect Tax in total Tax Revenue. 4) Structure of direct tax Revenue. 5) Contribution of Income Tax in Total Revenue, Tax Revenue and Direct Tax Revenue. 6) Contribution of Tax Revenue, Non-Tax Revenue and Income tax on GDP. 7) Structural status of Tax Revenue 2062/63. 8) Annual growth in inland Revenue collection. 9) Structural status of Income Tax. 10) Group structure and growth rate of income Tax. 11) Progress in Income Tax collection.

4.8 Structure of Government revenue of Nepal.

Government revenue of Nepal is comprised of tax revenue such as income tax, land revenue and registration tax, customs, excise, sales tax/VAT, tax on property, vehicle tax, tax on interest etc and non-tax revenues. The structure of government revenue in Nepal has been presented in Table 4.7 and Table 4.8 for 8 years period from 1998/99 to 2005/06.

Among the various tax and non-tax revenues, customs has the highest percentage of contribution in total revenue. It's contribution in millions of rupees has been increasing per year. In F/Y 1998/99, total revenue was Rs. 37251 millions and custom tax was Rs. 9517.7 millions, which was 25.55 percentage contribution in total revenue. In the fiscal year 2005/06, out of the total revenue Rs. 72282.1 millions customs had the share of Rs. 15344 millions which was 21.23 percentage contribution.

Though the percentage contribution of customs in total revenue has been decreasing as compared to the previous years, amount contribution in Rupees has been increasing as compared to the previous years. The average contribution of customs in total revenue over the eight years from F/Y 1998/99 to 2005/06 is 24.43 percentage.

Sales tax has appeared as the second important source of revenue in total revenue structure of Nepal. It's contribution in total revenue has become more than 23 percent in every fiscal year from 1998/99 to 2005/06. In F/Y 1998/99 total revenue was Rs 37251 millions and sales tax was Rs 8765.9 millions, which was 23.53 percentage contribution in total revenue. In the F/Y 2005/06, out of total revenue Rs. 72282.1 millions, sales tax had the share of Rs. 21610.7 millions which was 29.90 percentage contribution.

The average contribution of sales tax in total revenue over the nine years from F/Y 1998/99 to 2005/06 is 25.14 percentage.

In the fiscal year 2004/05 and 2005/06 the sales tax has higher contribution in total revenue than customs i.e. 26.93 & 29.90 percentage respectively whereas the customs had 22.39 & 21.23 percentage contribution in the respective fiscal year.

Non-tax revenue has the third highest contribution in the total government revenue of Nepal. Non-tax revenue consists of charges, fees, fines and forfeitures, receipts from sale of commodities and service, dividend, royalty and sale of fixed assets, principal and interest payment and miscellaneous items of revenue. The contribution of Non-tax revenue was Rs. 8498.1 millions which was 22.81 percentage of total revenue 37251 millions in the fiscal year 1998/99. In the fiscal year 2005/06 out of the total revenue Rs. 72282.1 millions the amount of Non-tax revenue was Rs 14851.7 millions and the percentage contribution was 20.55. The average contribution of Non-tax revenue in total revenue over the eight years from fiscal year 1998/99 to 2005/06 is 22.30 percentage.

Income tax has fourth largest contribution in total revenue of Nepal. The amount contribution of income tax in total revenue has been increasing except in some fiscal years but the percentage contribution has been fluctuating. In the fiscal year 1998/99 out of total revenue Rs. 37251 millions the amount of income tax was Rs. 6170.3 millions which was 16.56 percentage contribution. The contribution of income tax Rs. 10373.7 millions which was 14.35 percentage of total revenue Rs. 72282.1 millions in the fiscal year 2005/06. The average contribution of income tax in total revenue over the eight years from fiscal year 1998/99 to 2005/06 is 15.99 percentage.

Excise has occupied the fifth place regarding its contribution to the total revenue of Nepal. It had share of Rs. 2953.2 millions and Rs. 6507.6 millions in fiscal year 1998/99 and 2005/06 respectively i.e. 7.93 percentage contribution in 1998/99 and 9 percentage contribution in year 2005/06. Though the percentage contribution of excise has been fluctuating but amount contribution in total revenue has been increasing per year. The average contribution of excise in total revenue over the eight years from fiscal year 1998/99 to 2005/06 is 8.40 percentage.

Land revenue and registration occupies sixth place regarding its contribution to total revenue. It's contribution was Rs. 1003.1 millions in f/y 1998/99 and Rs. 2181.1 millions in f/y 2005/06 which was 2.69 percentage and 3.02 percentage of contribution in total revenue of respective fiscal year. It's both amount contribution and percentage contribution has been increasing since the fiscal year 2001/02.

Miscellaneous tax revenue occupies seventh and last place regarding its contribution to total revenue. Miscellaneous tax includes Urban house and land tax, vehicle tax and other tax. It's contribution was Rs. 342.7 millions in f/y 1998/99 and Rs. 1413.3 millions in f/y 2005/06 which was 0.92 percentage and 1.96 percentage of contribution in total revenue of respective fiscal year. It's both amount contribution and percentage contribution has been increasing since the fiscal year 2001/02.

Table 4.7
Structure of Government Revenue in Nepal from fiscal year 1998/99 to 2006/07

Rs. in millions

Year	Customs	Excise	VAT	Land Revenue and Registration	Income Tax	Miscellaneous	Non-Tax Revenue	Total
1998/99	9517.7	2953.2	8765.9	1003.1	6170.3	342.7	8498.1	37251
1999/00	10813.3	3127.6	10259.7	1015.9	7420.6	515	9741.6	42893.7
2000/01	12552.1	3771.2	12382.4	612.9	9114	432.5	10028.8	48893.9
2001/02	12658.8	3807.0	12267.3	1131.8	8903.7	562	11115.0	50445.6
2002/03	14236.4	4785.1	13459.7	1414.3	7966.2	725.3	13642.7	56229.7
2003/04	15554.8	6226.7	14478.9	1697.5	9245.9	969.2	14158.0	62331
2004/05	15701.6	6445.9	18885.4	1799.2	10159.4	1113.2	16018.0	70122.7
2005/06	15344.0	6507.6	21610.7	2181.1	10373.7	1413.3	14851.7	72282.1

Source: Economic Survey 2006/07, Ministry of Finance

Note:

1. Customs includes imports + exports + Indian Excise refund + others.
2. VAT includes sales tax; Hotel tax, Air Flight Tax and contract tax.
3. Income tax includes Income tax from public enterprises, Income tax from semi-public enterprises, Income tax from private corporate bodies, income tax from individuals and tax on interest
4. Miscellaneous includes urban house and land Tax, vehicle Tax and other tax.

Table 4.8
Structure of Government Revenue in Nepal
From F/Y 1998/99 to 2006/07

Year	Customs %	Excise %	VAT %	Land Revenue and Registration %	Income Tax %	Miscellaneous %	Non-Tax Revenue %	Total %
1998/99	25.55	7.93	23.53	2.69	16.56	0.92	22.81	100
1999/00	25.21	7.29	23.92	2.37	17.30	1.20	22.71	100
2000/01	25.67	7.71	25.33	1.25	18.64	0.88	20.51	100
2001/02	25.09	7.55	24.32	2.24	17.65	1.11	22.03	100
2002/03	25.32	8.51	23.94	2.52	14.17	1.29	24.26	100
2003/04	24.96	9.99	23.23	2.72	14.83	1.55	22.71	100
2004/05	22.39	9.19	26.93	2.57	14.49	1.59	22.84	100
2005/06	21.23	9.00	29.90	3.02	14.35	1.96	20.55	100

Source: Table 5.1

4.9 Contribution of Tax and Non-Tax revenue in Total Revenue

Total revenue of Nepal consists of tax revenue and non-tax revenue. Tax revenue includes customs, excise, sales tax/VAT, income tax, land revenue and registration and miscellaneous taxes. Table 4.9 shows the composition of tax and Non-tax revenue for the 8 years from F/Y 1998/99 to 2005/06 In Nepalese revenue structure, tax revenue, has always been greater than three times of Non-tax revenue. This means, tax revenue has high contribution in total government revenue of Nepal.

Tax revenue in amount has always been increasing per year. In the F/Y 1998/99 the tax revenue was Rs. 28752.9 millions this amount has doubled in the fiscal year 2005/06 i.e. Rs. 57430.4 millions.

Though the percentage contribution of tax revenue is higher in the total revenue than non-tax revenue, the percentage has always been fluctuating. In the fiscal year 1998/99 the percentage was 77.19 which fall down to 75.74 in the F/Y 2002/03 which is the lowest contribution among the studied fiscal years.

Non-tax revenue has the lowest contribution to the government revenue which has always remained below 25 percent. In the fiscal year 1998/99 Rs. 8498.1 millions was collected as non-tax revenue which was 22.81 percentage of total revenue.

Table 4.9
Contribution of Tax and Non-tax revenue in total revenue

Rs. In Million

Fiscal year	Total Revenue	Tax revenue	Non-tax Revenue	% of Tax Revenue on Total Revenue	% of Non-Tax Revenue on Total Revenue
1998/99	37251	28752.9	8498.1	77.19	22.81
1999/00	42893.7	33152.1	9741.6	77.29	22.71
2000/01	48893.9	38865.1	10028.8	79.49	20.51
2001/02	50445.6	39330.6	11115.0	77.97	22.03
2002/03	56229.7	42587.0	13642.7	75.74	24.26
2003/04	62331	48173.0	14158.0	77.29	22.71
2004/05	70122.7	54104.7	16018.0	77.16	22.84
2005/06	72282.1	57430.4	14851.7	79.45	20.55

Source: Economic Survey 2006/07, Ministry of Finance G/N.

4.10 Contribution of Direct Tax and indirect Tax in total tax revenue

Total tax revenue consists of direct tax revenue and indirect tax revenue. Direct tax includes income tax, Land revenue and registration, urban house and land tax, property tax, vehicle tax, tax on interest etc. Same way indirect tax includes sales tax, customs, excise, entertainment tax, hotel tax, air flight tax, contract tax, road and bridge maintenance tax etc.

Table 4.10 shows that indirect tax has high contribution in total tax revenue within the studied fiscal years, the contribution of direct tax revenue in total tax revenue has not more than 27% and the contribution of indirect tax in total revenue has not fallen down below 75%. This proves that indirect tax plays a vital role in government tax revenue of Nepal.

In the fiscal year 1998/99, the total government tax revenue was Rs. 28752.9 millions, out of which the direct tax was Rs. 7516.1 millions and the amount of indirect tax was Rs. 21236.8 millions and percentage contribution in total tax revenue was 26.14% & 73.86% respectively.

Now it is clear that Nepal's economy heavily depend upon indirect tax. So it is necessary to increase the share of direct tax for the sufficient resource mobilization.

Table 4.10
Contribution of Direct tax and Indirect tax in total tax revenue

Rs. in Millions

Year	Total Tax Revenue	In %	Direct Tax Revenue	Indirect Tax Revenue	% of Direct Tax Revenue on total tax	% of indirect Tax revenue on Total Tax
1998/99	28752.9	100	7516.1	21236.8	26.14	73.86
1999/00	33152.1	100	8951.5	24200.6	27.00	73.00
2000/01	38865.1	100	10159.4	28705.7	26.14	73.86
2001/02	39330.6	100	10597.5	28733.1	26.94	73.06
2002/03	42587.0	100	10105.8	32481.2	23.73	76.27
2003/04	48173.0	100	11912.60	36260.40	24.73	75.27
2004/05	54104.7	100	13071.80	41032.90	24.16	75.84
2005/06	57430.4	100	13968.10	43462.30	24.32	75.68

Source: Economic Survey, 2006/07, MOF

4.11 Structure of Direct tax revenue

Direct tax revenue includes income tax, land revenue and registration, urban house and land tax, vehicle tax and other tax.

The contribution of income tax is highest in the total direct tax revenue. Though the amount contribution of income tax in direct tax revenue is increasing, the percentage contribution is decreasing. In the fiscal year 1998/99, out of the total direct tax Rs. 7516.1 millions, the income tax was Rs. 6170.3 millions and the percentage contribution was 82.09%. In the fiscal year 2000/01 income tax contributed 89.71% in the direct tax revenue which is the highest contribution among all the studied fiscal years. In the fiscal year total direct tax was Rs. 10159.4 millions out of which income tax was Rs. 9114 millions. Since the fiscal year 2002/03 the percentage contribution of income tax in total direct tax decreased though there is increment in the amount contribution.

Land revenue and registration has the second highest contribution in the total direct tax revenue. Though the amount contribution of land revenue and registration has been increasing, the percent contribution has always been fluctuating. In the fiscal year 1998/99, out of the total direct tax revenue Rs. 7516.1 millions, the amount of land revenue and registration tax was Rs. 1003.1 millions and the percentage was 13.35. During the fiscal year 2000/01, the contribution of land revenue and registration in the direct tax revenue was 6.02% which is the lowest contribution among all the studied fiscal years. In the year total direct tax was Rs. 10159.4 millions and the amount of land revenue and registration tax was Rs. 612.9 millions only. In the fiscal year 2005/06, the contribution of land revenue and registration tax in total direct tax was highest among all the fiscal years from 1998/99 to 2005/06. In the year the land revenue and registration tax contributed 15.61% in the direct tax revenue. In the year, total direct tax was Rs. 13968.10 millions out of which the amount of land revenue and registration tax was Rs. 2181.1 millions.

Miscellaneous tax includes urban house and land tax, vehicle tax and other taxes. Miscellaneous tax has least contribution in the direct tax revenue. The percent contribution of miscellaneous tax was fluctuating from the fiscal year 1998/99 to 2001/02 though the amount contribution was increasing. During the fiscal year 1998/99 to 2001/02 the average contribution of miscellaneous tax in direct tax revenue was 4.97% but this average percentage increased to 8.49% from fiscal year 2002/03 to 2005/06. In the fiscal year 1998/99 out of the total direct tax revenue Rs.

7516.1 millions the amount of miscellaneous tax was Rs. 342.7 millions and the percentage was 4.56%. This percentage contribution of miscellaneous tax in direct tax revenue was more than double in the fiscal year 2005/06 i.e. 10.12%. In the fiscal year 2005/06 the amount of direct tax revenue was Rs. 13968.10 millions out of which the miscellaneous tax was Rs. 1413.3 millions.

Table 4.11
Contribution of various taxes in Direct tax Revenue

Fiscal year	Direct tax Revenue	In %	Income Tax Revenue	In %	Land Revenue & Registration	In %	Miscellaneous Taxes	In %
1998/99	7516.1	100	6170.3	82.09	1003.1	13.35	342.7	4.56
1999/00	8951.5	100	7420.6	82.90	1015.9	11.35	515	5.75
2000/01	10159.4	100	9114	89.71	612.9	6.02	432.5	4.27
2001/02	10597.5	100	8903.7	74.02	1131.8	10.68	562	5.30
2002/03	10105.8	100	7966.2	78.83	1414.3	13.99	725.3	7.18
2003/04	11912.60	100	9245.9	77.61	1697.5	14.25	969.2	8.14
2004/05	13071.80	100	10159.4	77.72	1799.2	13.76	1113.2	8.52
2005/06	13968.10	100	10373.7	74.27	2181.1	15.61	1413.3	10.12

Source: Economic Survey 2006/07, Ministry of Finance G/N.
Note: Miscellaneous Taxes includes urban house and land tax, vehicle tax and other taxes.

4.12 Contribution of Income tax in Total Revenue, Tax Revenue and Direct Tax Revenue

Nepal is facing a serious and growing fiscal resource gap and her need for mobilizing additional financial resources from domestic sources through taxation has been urgent. The base for levying taxes may be consumption, income and capital. Taxes on income and capital are known as indirect taxes. Tax structure of Nepal is composed of both direct and indirect taxes. Income tax has been a vital element on direct tax and it is playing an important role to generate government revenue for the development of national economy.

4.12.1 Income Tax in Total Revenue

The percentage contribution of income tax in total revenue has been presented in Table 4.12. The contribution of income tax in total revenue has fluctuating trend. In F/Y 1998/99, total revenue was Rs. 37251 millions and the income tax revenue was Rs. 6170.3 millions which was about 16.56 percentage of total revenue. In the F/Y 2005/06, total revenue was Rs. 72282.1 millions and the income tax revenue was Rs. 10373.7 millions which was about 14.35 percentage of total revenue.

The average contribution of income tax in total revenue is 15.99 percentage over eight years period from F/Y 1998/99 to 2005/06.

4.12.2 Income tax in tax revenue

The percentage contribution of income tax revenue in total tax has been presented in table 4.12. In the fiscal year 1998/99 the total tax revenue was Rs. 28752.9 millions, out of which the amount of income tax was Rs. 6170.3 millions which was about 21.46 percentage. In F/Y 2005/06 out of total tax revenue Rs. 57430.4 millions, Rs. 10373.7 millions was contributed by income tax which was 18.06 percentage of total tax revenue.

The average contribution of income tax in total tax revenue is 20.58 percentage over eight years period from F/Y 1998/99 to 2005/06.

4.12.3 Income tax in Direct Tax Revenue

The percentage contribution of income tax revenue in direct tax revenue has been presented in table 4.12. In the fiscal year 1998/99 the direct tax revenue was Rs. 7516.1 millions, out of which the amount of income tax was Rs. 6170.3 millions which was about 82.09 percentage of direct tax revenue. In the fiscal year 2005/06 out of direct tax Rs.

13968.10 millions, Rs. 10373.7 millions was contributed by income tax which was 74.27 percentage of direct tax revenue.

The average contribution of income tax in direct tax revenue is 80.89 percentage over eight years period from F/Y 1998/99 to 2005/06.

Table 4.12
Contribution of Income Tax in Total Revenue, Tax Revenue and Direct Tax Revenue

Rs. In Millions.

Fiscal years	Total Revenue	Tax Revenue	Direct Tax Revenue	Income Tax Revenue	Income Tax as percentage of Total Revenue	Income Tax as percentage of Tax Revenue	Income Tax as percentage of Direct Tax
1998/99	37251	28752.9	7516.1	6170.3	16.56	21.46	82.09
1999/00	42893.7	33152.1	8951.5	7420.6	17.30	22.38	82.90
2000/01	48893.9	38865.1	10159.4	9114	18.64	23.45	89.71
2001/02	50445.6	39330.6	10597.5	8903.7	17.65	22.64	84.02
2002/03	56229.7	42587.0	10105.8	7966.2	14.17	18.71	78.83
2003/04	62331	48173.0	11912.60	9245.9	14.83	19.19	77.61
2004/05	70122.7	54104.7	13071.80	10159.4	14.49	18.78	77.72
2005/06	72282.1	57430.4	13968.10	10373.7	14.35	18.06	74.27

Source: Economic Survey 2006/07, Ministry of Finance G/N

4.13 Contribution of tax revenue, Non-Tax Revenue and Income Tax on GDP

Tax revenue of Nepal comprises of customs, excise, sales tax, income tax, and revenue and registration and miscellaneous taxes. Tax revenue has higher contribution on GDP than Non-Tax revenue. The contribution of Non-Tax revenue on GDP has remain around 2 percentage whereas the, contribution of tax revenue on GDP has remain around 8 percent except in fiscal year 2004/05 and fiscal year 2006/07. In the fiscal year 2004/05 the contribution of tax revenue on GDP was more than 8 percentage i.e. 9.18 percent. In the fiscal year 2004/05 the GDP at producers price was Rs. 589412 millions and the amount of tax revenue was Rs. 54104.7 millions. In the fiscal year 2006/07 the percentage contribution of tax revenue on GDP was in two digits i.e. 10.35 percentage which is highest contribution among all the fiscal year from 2000/01 to 2006/07. The average contribution of tax revenue on GDP over the seven years period from 2000/01 to 2006/07 is 9.06 percentage.

Non Tax revenue consists of charges, fees, fines and forfeitures, receipts from sale of commodities and services, dividend, royalty, sale of fixed assets, principal and interest payment and miscellaneous items of revenue. The contribution of Non-Tax revenue remained around 2 percentage on GDP except in fiscal year 2006/07. In this year the contribution was lowest i.e. 1.99 percentage though the amount contribution was second highest among all the fiscal years from 2000/01 to 2006/07. And the amount contribution was Rs. 14336 millions. The average contribution of Non-Tax revenue on GDP over the seven years period from F/Y 2000/01 to 2006/07 is 2.44 percentage.

Income Tax includes Income Tax from public enterprises, Income tax from semi-public enterprises, Income Tax from private corporate bodies, income tax from individuals, income tax from remunerations and tax on interest. In the fiscal year 2000/01 the percentage contribution of income tax on GDP was highest among all the fiscal years from 2000/01 to 2006/07 and the percentage was 2.06 thought the amount contribution was lowest in the year 2000/01 among all the studied fiscal year and the amount was Rs. 9114 millions. Same way in the fiscal year 2005/06 the percentage contribution of Income tax on GDP was lowest i.e. 1.60 percentage though the amount contribution was second highest among all the studied fiscal years from 2000/01 to 2006/07 and the amount was Rs. 10373.70 millions. In the fiscal year 2006/07 the amount contribution of Income tax on GDP was Rs. 12223.50 millions which is highest amount contribution among all the studied fiscal year from 2000/01 to 2006/07.

The average contribution of Income tax on GDP over the seven years period from 2000/01 to 2006/07 is 1.77 percentage.

Table 4.13
Contribution of Tax revenue, Non-Tax revenue and Income tax on GDP

Rs. In Millions

Fiscal years	GDP	Tax Revenue	Non-Tax Revenue	Income Tax Revenue	Tax Revenue as percentage of GDP	Non-Tax Revenue as percentage of GDP	Income Tax Revenue as percentage of GDP
2000/01	441519	38865.1	10028.8	9114.00	8.80	2.27	2.06
2001/02	459443	39330.6	11115.0	8903.70	8.56	2.42	1.94
2002/03	492231	42587.0	13642.7	7966.20	8.65	2.77	1.62
2003/04	536749	48173.0	14158.0	9245.90	8.97	2.64	1.72
2004/05	589412	54104.7	16018.0	10159.40	9.18	2.72	1.72
2005/06	646471	57430.4	14851.7	10373.70	8.88	2.30	1.60
2006/07 P	719477	74490.5	14336	12223.50	10.35	1.99	1.70

P = Preliminary

Note: GDP = Gross Domestic product at producers price.
Source: Economic survey 2006/07, Ministry of finance G/N.

4.14 Structural status of tax revenue for F/Y 2005/06

During the fiscal year 2062/63 Rs. 40202336 thousands tax revenue was collected. If we see the targeted amount and collected amount of tax Rent tax seems to be very close to target. The targeted amount of the Rent tax was Rs. 520000 thousands out of which Rs. 509063 thousands i.e. 97.90% was collected.

The collection of excise in comparison to the target is only 81.91%. The targeted amount of excise was Rs. 7950000 thousands and the collected amount was only Rs. 6512225 thousands. It shows that the collection progress in excise is very low in comparison to the other taxes.

The collection progress of Income tax, Tax on interest, VAT & vehicle tax are 92.77%, 84.11%, 92.79% & 94.18% respectively.

The structural status of Revenue collection in the fiscal year 2062/63, has been presented in Chart 4.6. The sales tax/VAT stands at the first position in the structure and contributes 55 percentage in the total tax revenue and the amount is Rs. 21946014 thousands.

In this structural status the income tax stands at the second position and contributes 24 percentage in the total tax revenue Rs. 40202336 thousands and the amount is Rs. 9630353 thousands.

Same way excise stands at the third place contributing Rs. 6512225 thousands i.e. 16 percentage in total tax revenue and tax on interest and vehicle tax contributes 2 percentage in total tax revenue and occupy fourth place in the structural status.

Table 4.14
Structural Status of Tax Revenue of F/Y 2005/06

Rs. In Millions

Items	**Amount**	**Percentage**	**Position**
Customs	15344.0	26.72	2nd
Excise	6507.6	11.33	4th
VAT	21610.7	37.63	1st
Land Revenue & Registration	2181.1	3.80	5th
Income Tax	10373.7	18.06	3rd
Miscellaneous	1413.3	2.46	6th
Total Tax Revenue	57430.40	100	

Source: Economic Survey 2006/07, MOF

Note:

1. Customs includes imports + exports + Indian Excise refund + others.
2. VAT includes sales tax; Hotel tax, Air Flight Tax and contract tax.
3. Income tax includes Income tax from public enterprises, Income tax from semi-public enterprises, Income tax from private corporate bodies, income tax from individuals, income tax from individuals and tax on interest

4. Miscellaneous includes urban house and land Tax, vehicle Tax and other tax.

Tax Revenue of Nepal consists of the customs, excise, Sales Tax/VAT, Land Revenue & Registration Tax, Income Tax and miscellaneous Tax.

During the fiscal year 2005/06, Rs. 57430.40 millions tax revenue was collected and VAT had the highest contribution of Rs. 21610.7 millions which is 37.63 percentage of total tax revenue.

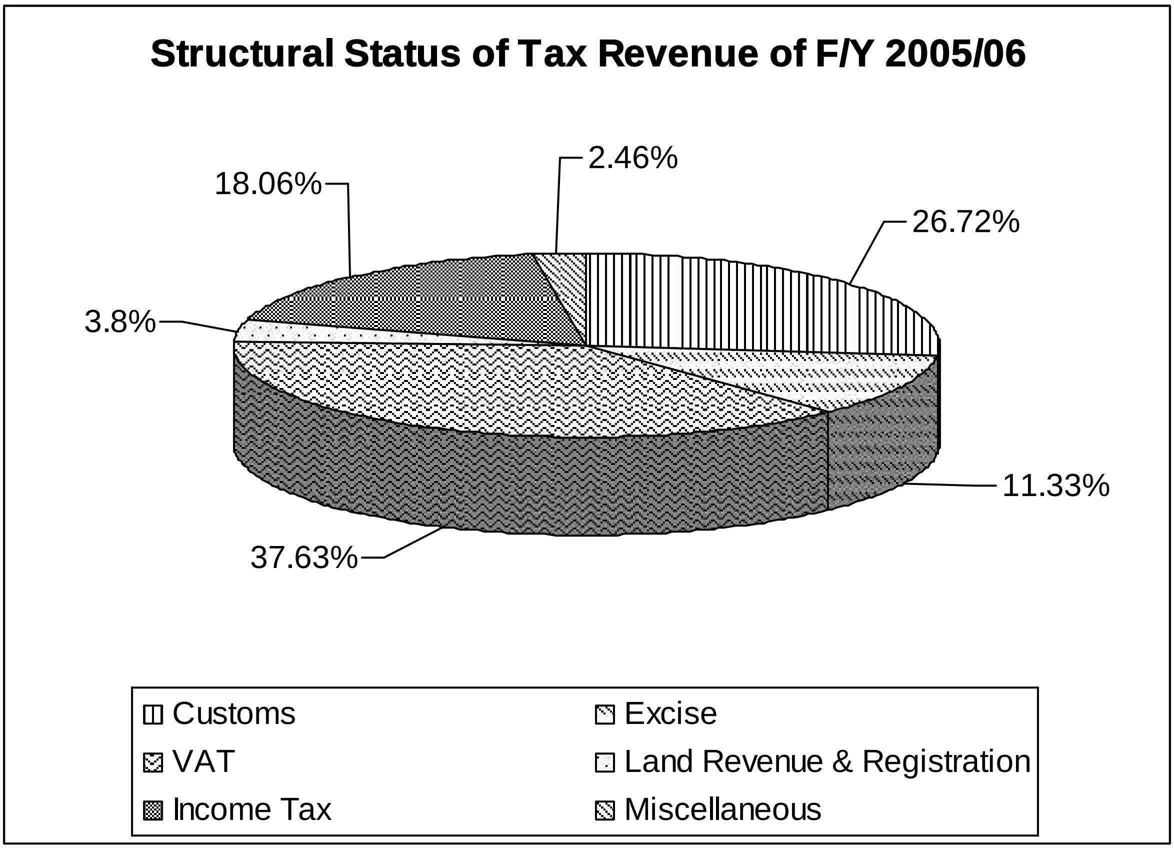
Same way customs had the second highest contribution in the total tax revenue. The amount of tax collected from customs was Rs. 15344.0 millions which was 26.72 percentage of total tax revenue.

Income Tax had the third highest contribution in the total tax revenue of F/Y 2005/06. The amount of income tax was Rs 10373.7 millions which was 18.06 percentage of total tax revenue.

Excise occupies the fourth place in the structural status of tax revenue of F/Y 2005/06. The amount of tax collected from excise was Rs. 6507.6 millions which was 11.33 percentage of total tax revenue.

Same way tax from Land Revenue & Registration and miscellaneous occupies fifth and sixth place respectively in the structural status of tax revenue of F/Y 2005/06. The amount of tax collected from Land Revenue & Registration was Rs. 2181.1 millions which was 3.80 percentage of total tax revenue and the amount of miscellaneous tax was Rs. 1113.3 millions which was 2.46 percentage of total tax revenue.

Figure 4.6
Structural Status of Tax Revenue of F/Y 2005/06



4.15 Annual Growth in Inland Revenue Collections

After analyzing the overall performance of the Inland Revenue collection the annual growth rate in revenue collection in comparison to the previous fiscal year 2004/05 is only 9.16 percentage. In comparison to the other tax revenue, the annual growth percentage of VAT seems to be satisfactory. In the fiscal year 2005/06, the annual growth percentage of VAT in comparison to the previous fiscal year is 16.15 percentage.

The annual growth percentage of Income tax in the fiscal year 2005/06 is not satisfactory in comparison to the previous fiscal year 2004/05 though the amount of income tax is higher in this fiscal year than previous fiscal year. The growth percentage of Income tax has been limited to 4.25 percentage in fiscal year 2005/06. The percentage was 9.86 in previous fiscal year 2004/05.

The annual growth percentage in the excise was highest i.e. 30.12 percentage in the fiscal year 2003/04. This growth percentage fall down to 3.53 percentage in the fiscal year 2004/05 and to 1.02 percentage in the fiscal year 2005/06. This proves that the growth percentage of excise in comparison to the previous fiscal years is not satisfactory thought the amount of excise is increasing each year.

The annual growth percentage of vehicle tax in the F/Y 2005/06 is 11.68 percentage in comparison to the previous fiscal year 2004/05. This growth percentage seems to be satisfactory in comparison to the previous fiscal year 2004/05 because this growth percentage was 8.34 in previous fiscal year. The amount of the vehicle tax and growth percentage has always been fluctuating.

Table 4.15
Annual growth in Inland Revenue collection

Rs. In thousands '000'

F/Y / Particulars	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Total Tax Revenue (A+B+C)	21210000	25690000	25537690	26853422	30920989	36552762	40202336
Annual Growth %	17.18	21.12	10.59	5.15	15.15	18.2	9.16
VAT (A)	9860000	12050000	11947955	13449123	14478896	18894627	21946014
Annual Growth %	25	22.21	-0.85	12.56	7.66	30.50	16.15
Income Tax (B)	7820000	9540000	8919680	8059575	9514782	10452637	10896449
Annual Growth %	20.26	21.99	-6.50	-9.64	18.06	9.86	4.25
Excise (C)	3130000	3770000	3807730	4785244	6226724	6446503	6512225
Annual Growth %	5.10	20.45	1	25.67	30.12	3.53	1.02
Vehicle Tax (D)	400000	330000	862325	559480	700587	758995	847648
Annual Growth %	83.13	-17.50	161.31	-35.12	25.22	8.34	11.68

Source: Annual Report, IRD, Lazimpat, Kathmandu

Figure 4.7
Total Tax Collection in Different Fiscal Years

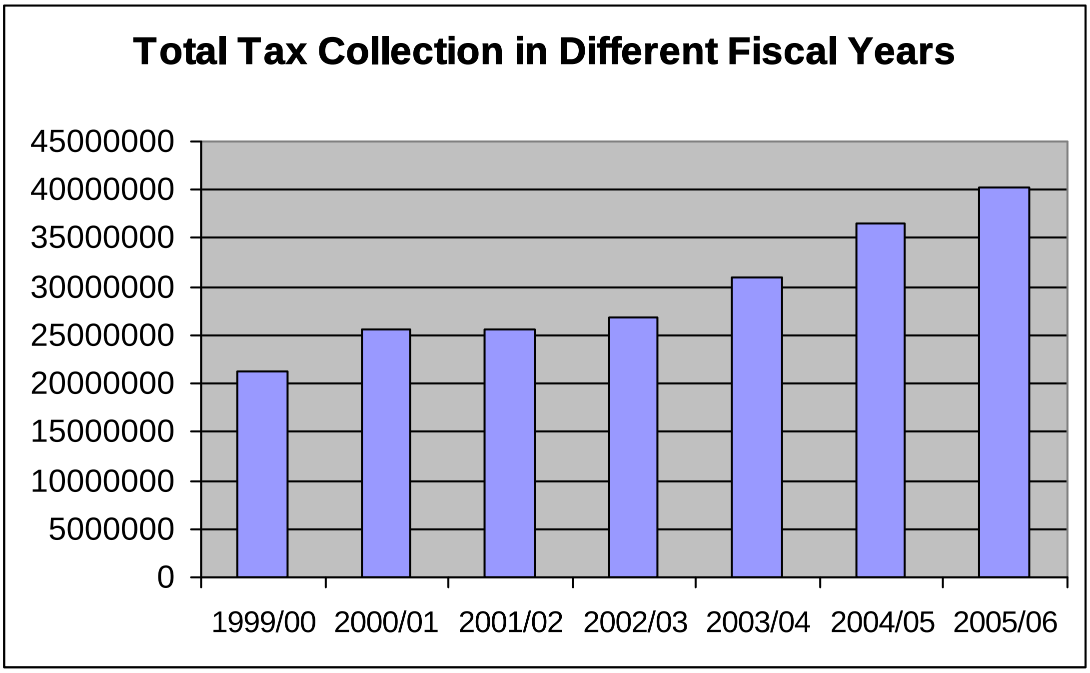


Figure 4.8
Annual Growth Percentage of Total Tax Revenue

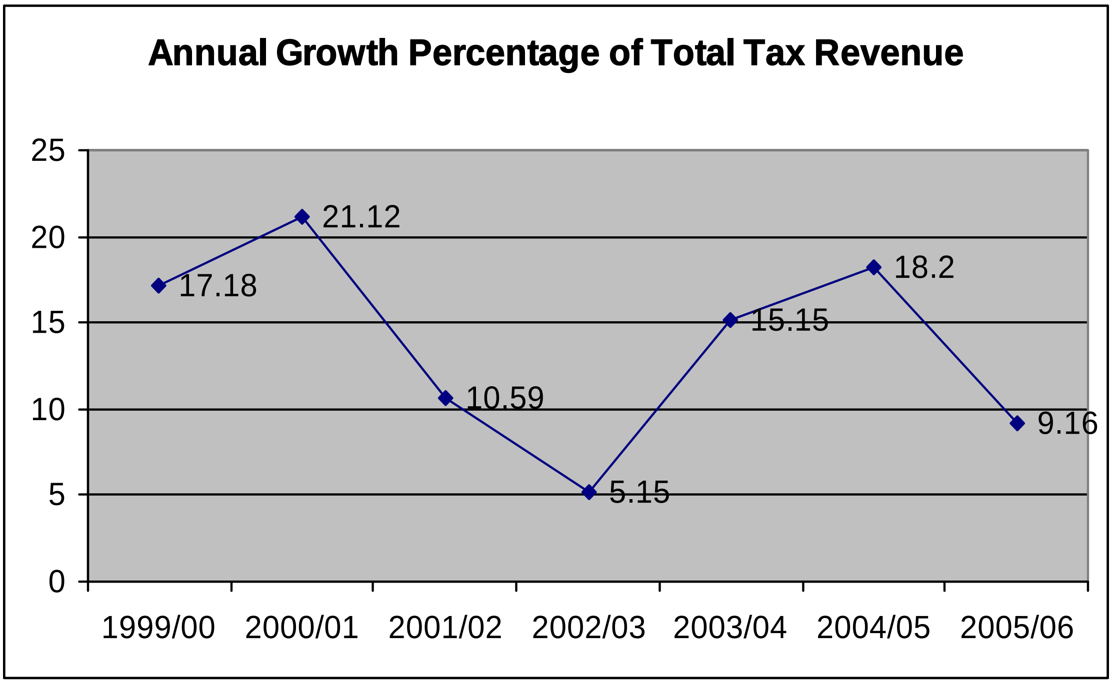


Figure 4.9
Collection of VAT from F/Y 1999/00 to 2005/06

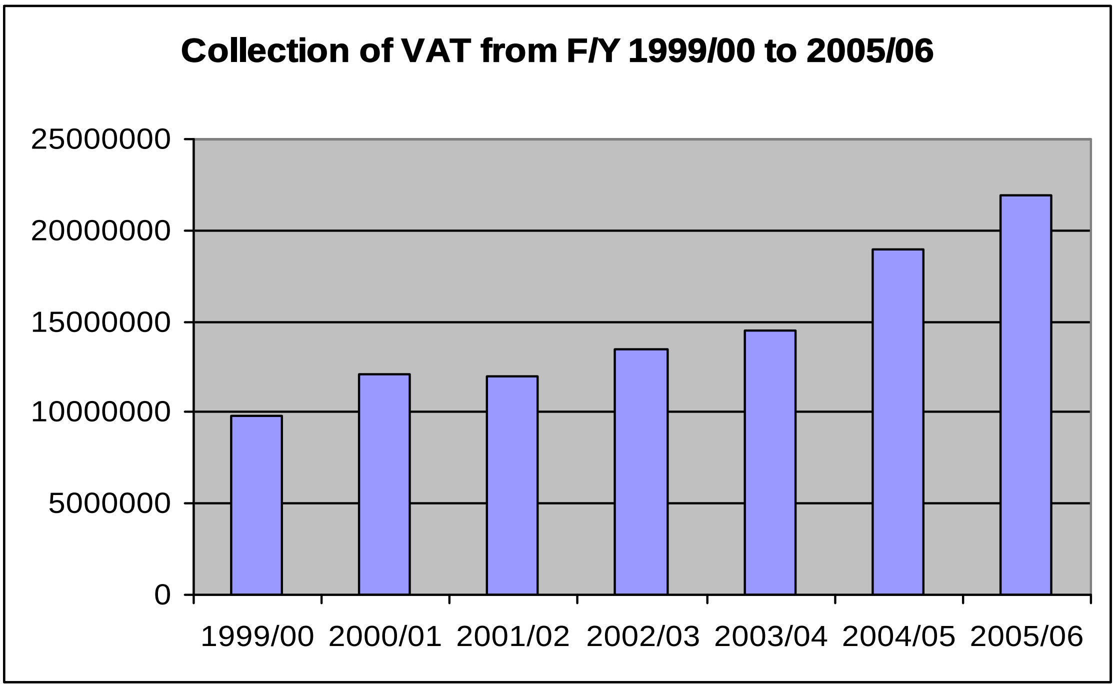


Figure 4.10
Income Tax Collection in different Fiscal Years

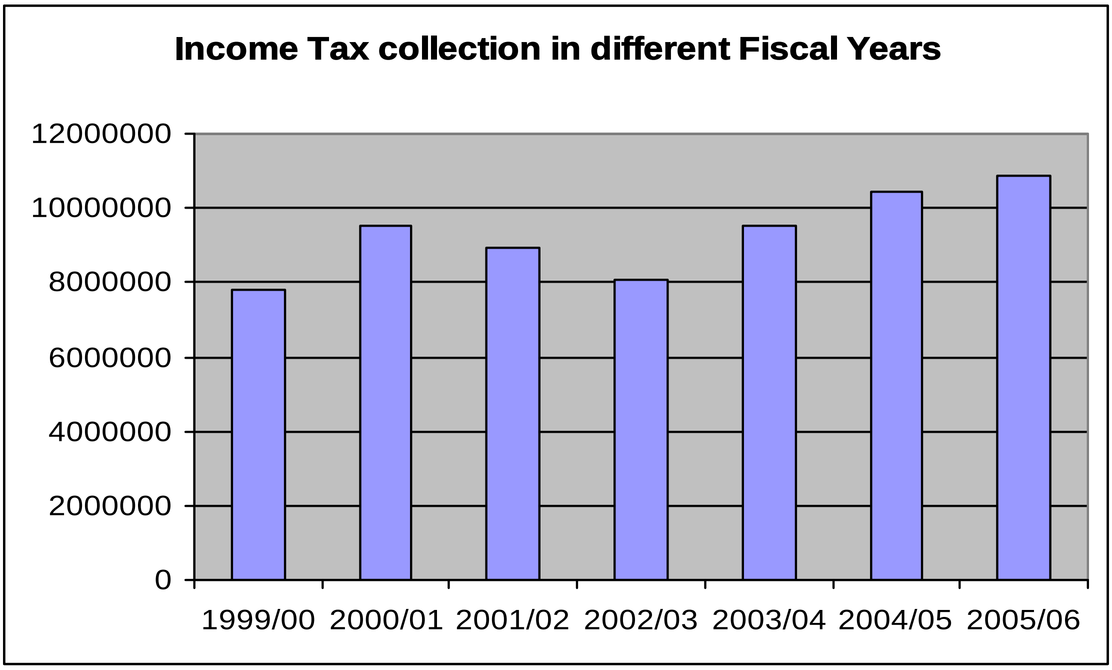


Figure 4.11
Excise Collection in different Fiscal Years

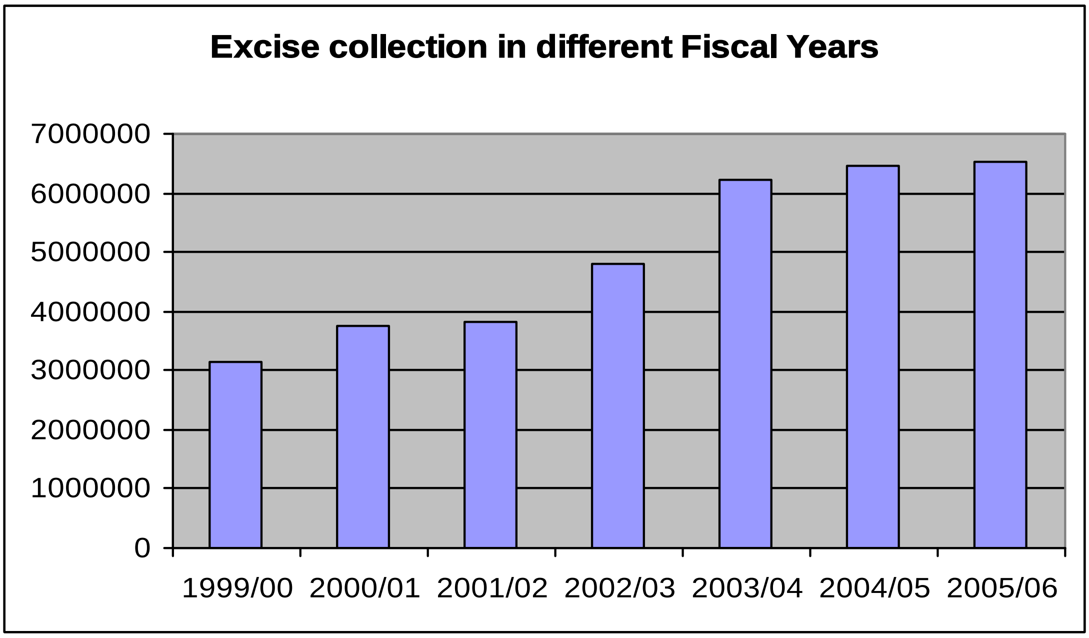
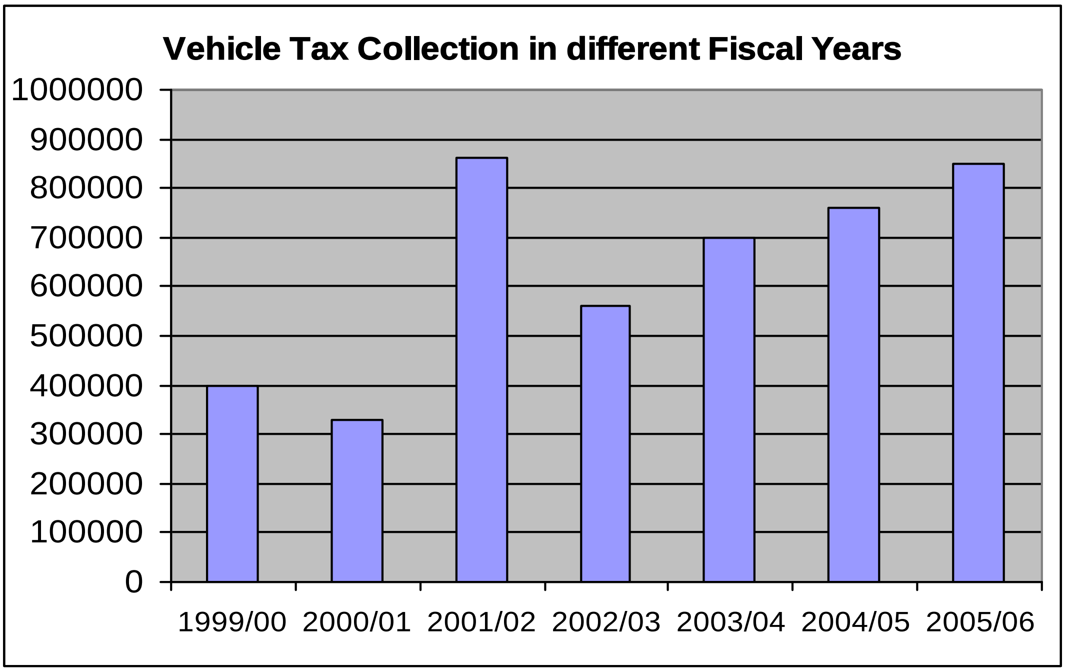


Figure 4.12
Vehicle Tax Collection in different Fiscal Years



4.16 Structural Status of Income Tax

Income tax includes income tax from Public Enterprises, Semi-Public Enterprises, Private Corporate Bodies, Individual, Remuneration and Tax on Interest.

The average contribution of Public Enterprises over the eight years from F/Y 1998/99 to 2005/06 is Rs. 1657.29 millions. The contribution of Public Enterprises was fluctuating from F/Y 1998/99 to 2004/05. But the performance became very poor in the F/Y 2005/06. In this year the contribution of Public Enterprises was only Rs. 195.7 millions. In the F/Y 1998/99 it was Rs. 1562.5 millions and Rs. 1332.4 millions in F/Y 2004/05. In the F/Y 2000/01 Public Enterprises had highest contribution of Rs. 2928 millions.

The contribution of Semi-Public Enterprises is zero in all the fiscal years from 1998/99 to 2005/06. In the F/Y 1993/94 it had the contribution of Rs.2.1 millions. Since than it's contribution on income tax has remained zero.

The average contribution of tax from Private Corporate bodies in Income Tax over the eight years period from F/Y 1998/99 to 2005/06 is Rs. 1808.81 millions. The contribution of tax from private corporate bodies in Income Tax is also fluctuating. In the F/Y 1998/99 the amount of tax from Private Corporate Bodies was Rs. 1155.0 millions which reached to Rs. 3404.3 millions in F/Y 2005/06.

The average contribution of Individual Tax in Income Tax over the eight years period from F/Y 1998/99 to 2005/06 is Rs. 3558.18 millions. The contribution of Individual Tax in income tax is also fluctuating. In the F/Y 1998/99 the amount of individual income tax was Rs. 2772.7 millions. In the F/Y 2001/02 the amount of individual income tax highest among all the studied fiscal years from 1998/99 to 2005/06 and the amount Rs. 4419.1 millions.

The average contribution of tax from Remuneration in Income Tax over the eight years from F/Y 1998/99 to 2005/06 is Rs. 1045.59 millions. The contribution of tax from Remuneration is increasing in every fiscal years. It was Rs. 396.5 in F/Y 1998/99 and reached to Rs. 1764.1 millions in F/Y 2005/06.

The average contribution of tax on Interest in income tax over the eight years period from F/Y 1998/99 to 2005/06 is 599.35 millions. The amount of tax on interest is fluctuating during the studied fiscal years. In the F/Y 1998/99 it was 319.5 millions and reached to Rs. 774.9 in F/Y 2005/06.

In the structural status of income tax of fiscal year 2005/06, Individual income tax occupies the first place contributing highest 40.82 percentage of the total income tax for the year and the amount is Rs. 4234.7 Millions. This contribution percentage is higher than the previous F/Y 2004/05. In the F/Y 2004/05 the contribution of Individual income tax in total income tax was 38.65 percentage and the amount contribution was Rs. 3926.3 Millions.

Income tax from private corporate bodies occupies the second place in the structural status of income tax of F/Y 2005/06. Which contributes 32.82 percentage in the total income tax and the amount is Rs. 3404.3 Millions. In the fiscal year 2004/05, the contribution of income tax from private corporate bodies in total income tax was 24.29 percentage.

Income tax from Remuneration occupies the third place in the structural status of income tax of F/Y 2005/06. Which contributes 17.01 percentage in the total income tax and the amount is Rs. 1764.1 Millions. In the fiscal year 2004/05, the contribution of income tax from Remuneration in total income tax was 16.50 percentage.

Tax on Interest and Income Tax from Public Enterprises occupies 4th and 5th place respectively in the structural status of income tax contributing 7.47% & 1.89% respectively. The percent contribution and amount contribution of Tax on Interest is higher in the F/Y 2005/06 than the F/Y 2004/05. But the contribution of Income Tax from Public Enterprises has fall down to 1.89% from 13.11%.

Table 4.16
Structural status of Income Tax

Rs. In thousands.

Fiscal Year	Public Enterprises	Semi Public Enterprises	Private Corporate bodies	Individual	Remuneration	Tax on Interest	Total income Tax Revenue
1998/99	1526.5	-	1155.0	2772.7	396.5	319.5	6170.20
1999/00	2198.8	-	1339.5	3016.4	451.5	414.4	7420.60
2000/01	2928	-	1924.3	3200.5	597.3	463.9	9114.00
2001/02	1769.3	-	1412	4419.1	835.6	467.7	8903.70
2002/03	1251	-	1236.3	3362.3	1252.6	864	7966.20
2003/04	2056.6	-	1531.3	3533.4	1391.2	733.4	9245.90
2004/05	1332.4	-	2467.8	3926.3	1675.9	757.0	10159.40
2005/06	195.7	-	3404.3	4234.7	1764.1	774.9	10373.70

Source: Economic Survey 2006/07, MOF

Figure 4.13
Structural Status of Income Tax of F/Y 2004/05

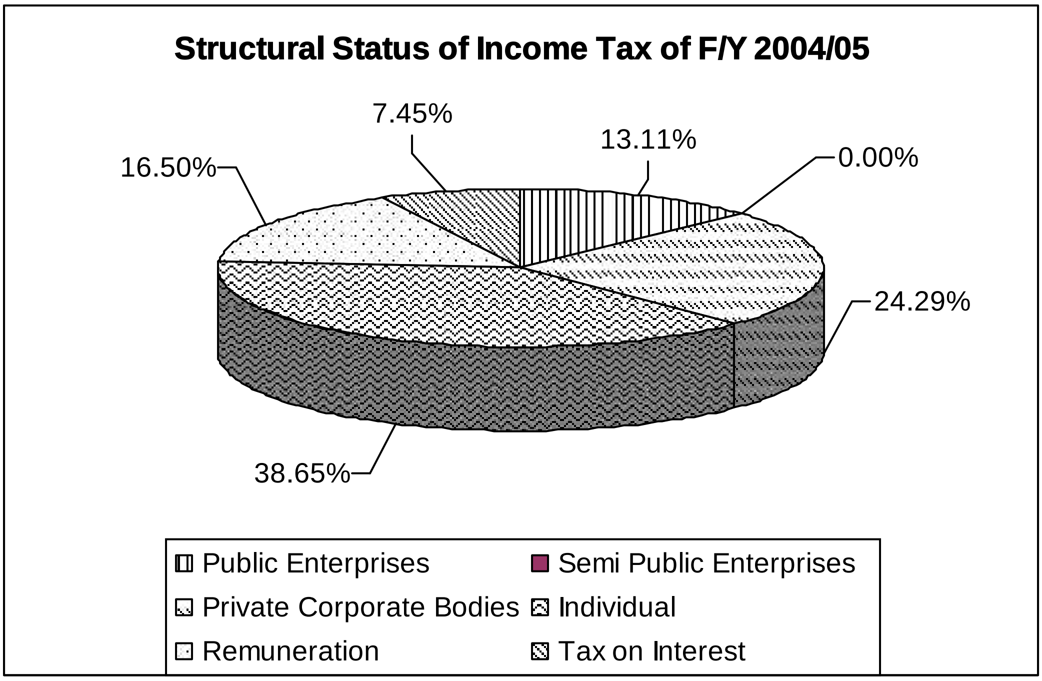
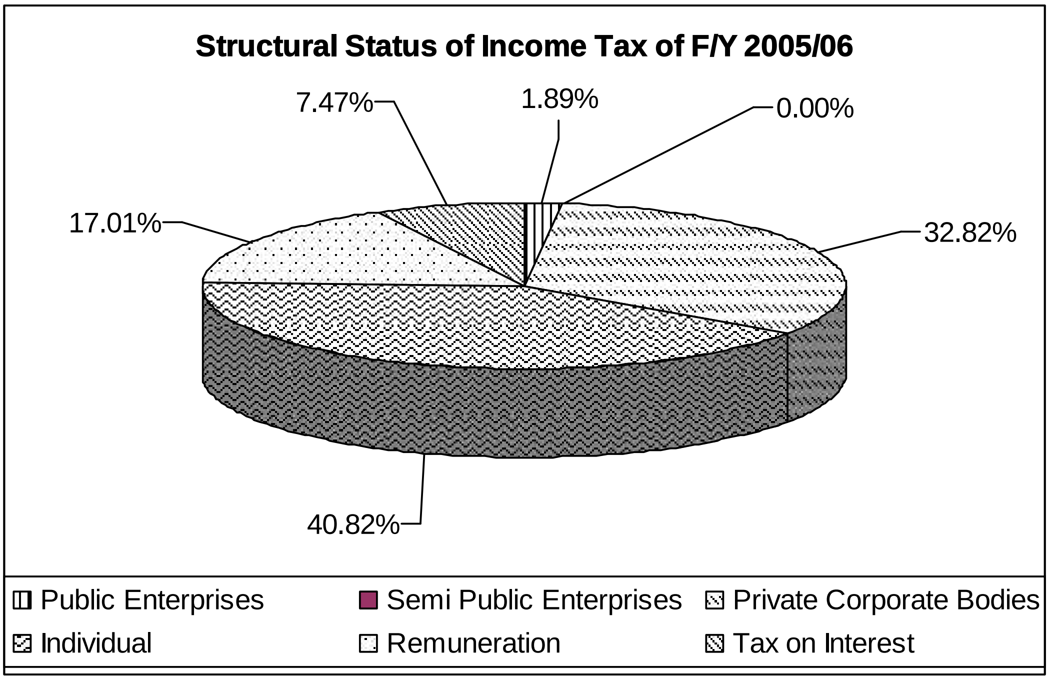


Figure 4.14
Structural Status of Income Tax of F/Y 2005/06



4.17 Group structure and growth rate of income tax.

Corporate Income Tax consists of Income Tax from Public Enterprises, Income Tax from Semi Public Enterprises and Income Tax from Private Corporate Bodies. The contribution of Semi Public Enterprises is almost nill in both the F/Y 2004/05 and 2005/06. So, in the Corporate Structural Status of Income Tax, Income Tax from Private Corporate Bodies occupies the first place contributing 94.56 percentage and Income Tax from Public Enterprises stands at the second position contributing 5.44 percentage in the corporate income tax.

Income Tax from Public Enterprises has been decreased by -85.31 percentage in the F/Y 2005/06 but the Income Tax from Private Corporate Bodies has been increased by 37.95 percentage in this F/Y 2005/06.

In the same way Income Tax from Individuals has been increased by 7.85 percentage and Income Tax from Remuneration has been increased by 5.26 percentage in the F/Y 2005/06.

There is slight increment in the Income Tax from Interest in the F/Y 2005/06 i.e. 0.14 percentage.

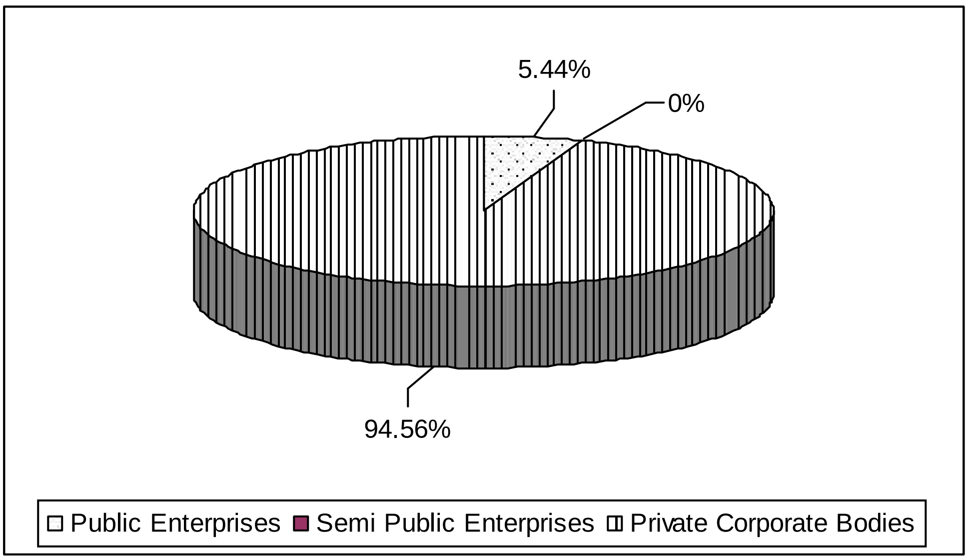
Table 4.17
Group Structure and growth rate of income tax

Rs. In Millions

F/Y / Particulars	2004/05	2005/06	Group Contribution in %	Growth Rate
1. Corporate Income Tax (A+B+C)	**3800.20**	**3600.00**	**100**	**-5.27**
Public Enterprises (A)	1332.4	195.7	5.44	-85.31
Semi Public Enterprises (B)	-	-	-	-
Private Corporate Bodies (C)	2467.8	3404.3	94.56	37.95
2. Individual Income Tax	**3926.3**	**4234.7**	**100**	**7.85**
3. Remuneration	**1675.9**	**1764.1**	**100**	**5.26**
4. Tax on Interest	**757.0**	**774.9**	**100**	**0.14**
Total (1+2+3+4)	**10159.40**	**10373.70**		

Source: Annual Report of F/Y 2062/63, IRD, Lazimpat, Kathmandu

Figure 4.15
Group Structure of Corporate Income Tax for the F/Y 2005/06



4.18 Progress in the income tax collection.

The target of Rs. 5906900 thousands was set for corporate income tax and Rs. 5395701 was collected which is 91.35 percentage of the target in F/Y 2062/63.

In the corporate income tax, the progress of public enterprises is not satisfactory. Only 12.63 percentage of target has been achieved in income tax from public enterprises. The target was Rs. 1471900 thousands out of which only Rs. 185888 thousands has been collected. On the other hand the progress of public limited company is quite satisfactory where the collection is more than the target. The target was Rs. 2550000 thousands and the collection is Rs. 3522765 which is 138015 percentage of the targeted amount. Same way 89.50 percentage of target has been achieved in income tax from private limited companies.

94.67 percentage of target has been achieved of individual income tax in the F/Y 2062/63. The target was Rs. 4473100 thousands and the collection was 4234653 thousands. The achievement of remuneration and other trade & profession is 97.31 & 92.89 percentage of target respectively.

The achievement of rent tax is very much close to the target. The targeted amount was Rs. 520000 thousands and the collection is Rs. 509063 thousands which is 97.90 percentage of target in F/Y 2062/63.

The progress of interest tax is good but not satisfactory. The targeted amount of interest tax was Rs. 900000 thousands out of which Rs. 757032 thousands was collected which is 84.11 percentage of targeted amount in F/Y 2062/63.

The overall achievement of income tx is 92.34 percentage. Rs. 11800000 thousands was projected from income tax of which Rs. 10896449 thousands has been collected in F/Y 2062/63.

Table 4.18
Progress in income Tax collection.

Rs. In thousands.

Particulars \ F/Y	2062/63 Target	2062/63 Collection	Progress
Corporate Income Tax (A)	5906900	5395701	91.35%
Public Enterprises	1471900	185888	12.63%
Public Limited Company	2550000	3522765	138.15%
Private Limited Company	1885000	1687048	89.50%
Individual Income Tax (B)	4473100	4234653	94.67%
Remuneration	1800000	1751505	97.31%
Other trade & profession	2673100	2483148	92.89%
Tax on Rent (C)	520000	509063	97.90%
Tax on Interest (D)	900000	757032	84.11%
Total (A+B+C+D)	11800000	10896449	92.34%

Source: Annual Report of F/Y 2062/63, IRD, Lazimpat, Kathmandu.

Figure 4.16
Target and Collection of Corporate Income Tax for F/Y 062/63

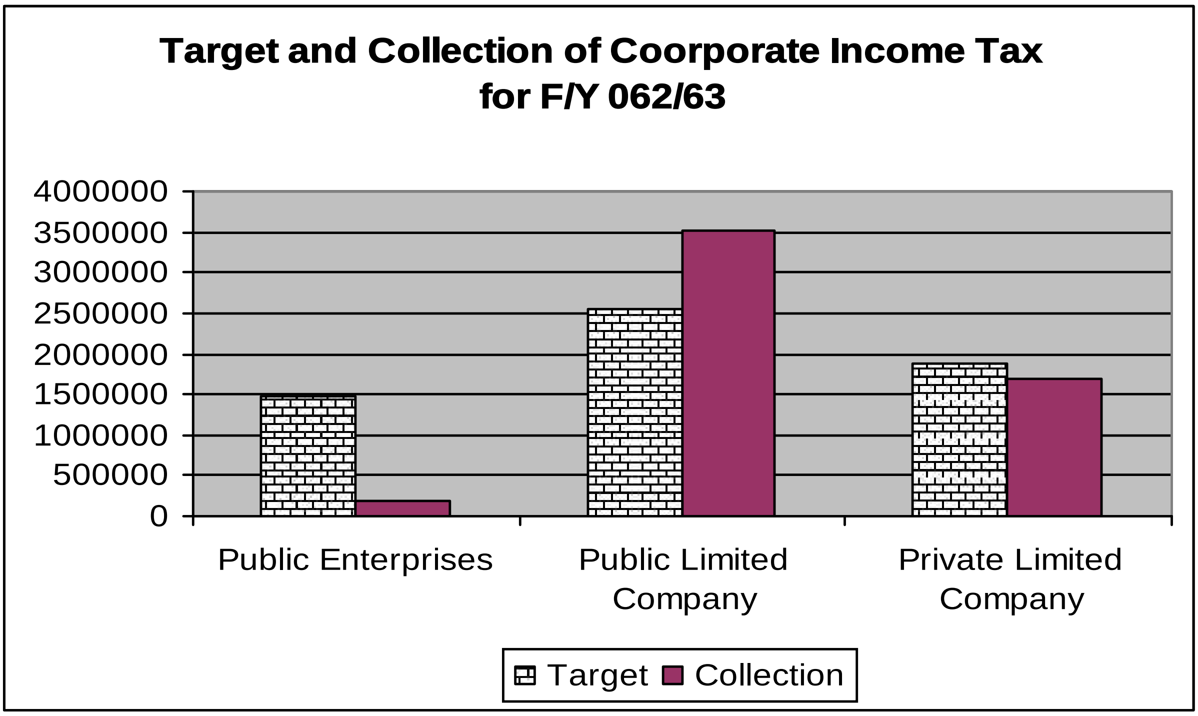


Figure 4.17
Target and Collection of Individual Income Tax for F/Y 062/63

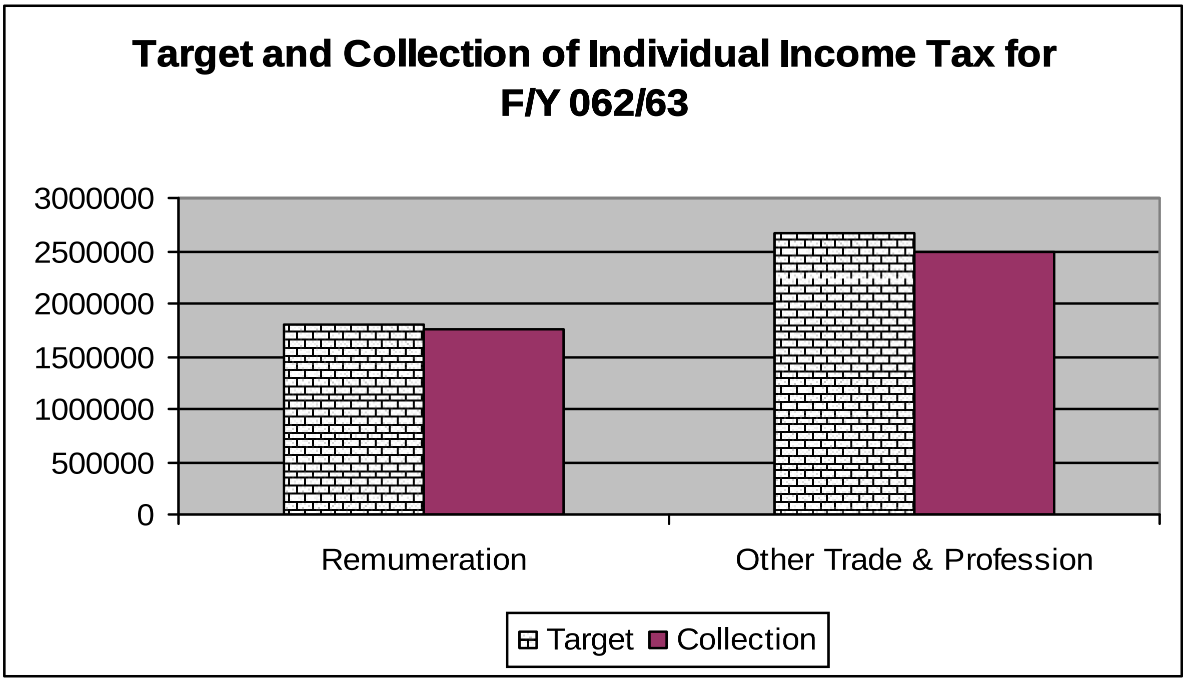


Figure 4.18
Target and Collection of Rent Tax for F/Y 062/63

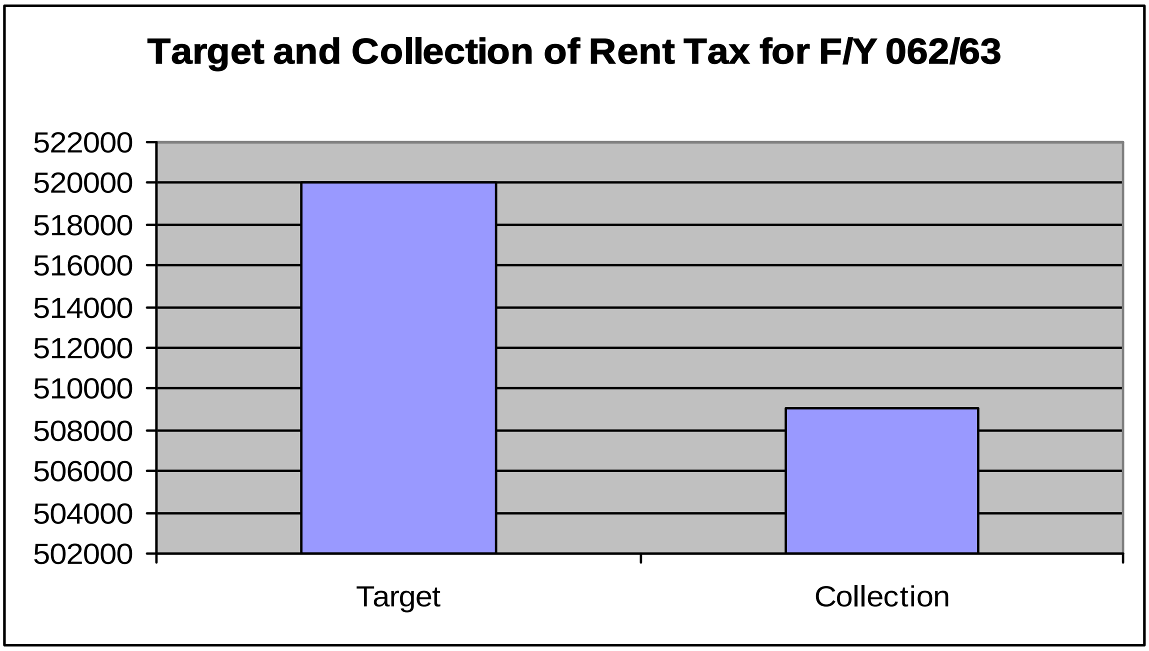
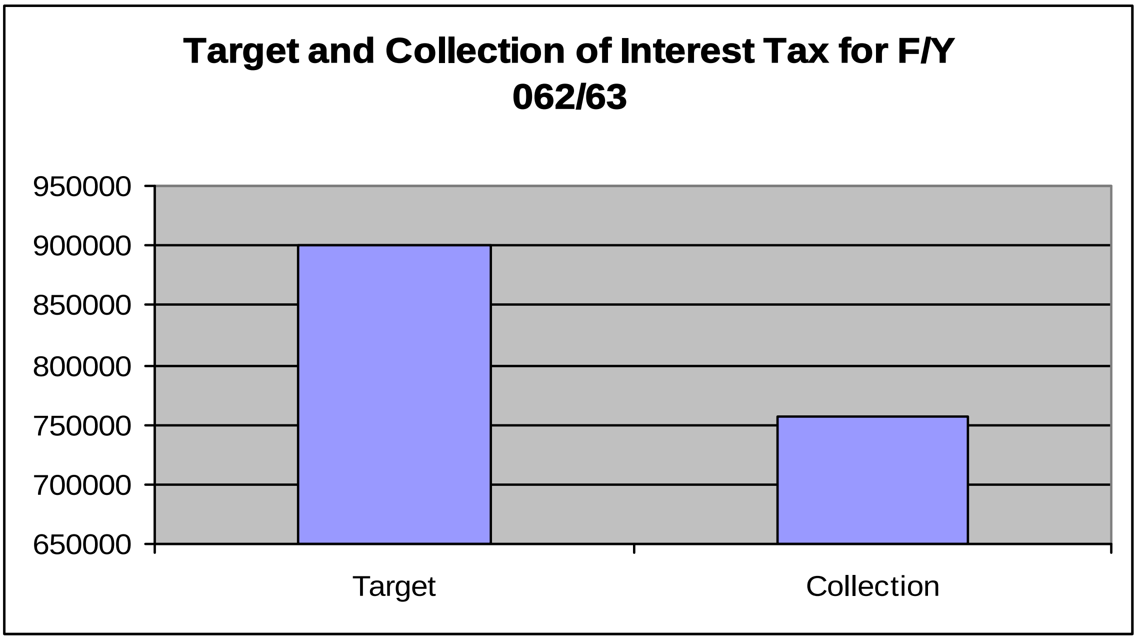


Figure 4.19
Target and Collection of Interest Tax for F/Y 062/63



C: AN EMPIRICAL INVESTIGATION

4.19 Introduction:

An Empirical investigation has been conducted in order to find out various aspects of tax, tax administration and income tax. The major tool used for this purpose is an opinion questionnaire. Questionnaires were distributed to the tax administrators, tax experts and tax payers. The responses received from various respondents have been arranged, tabulated and analyzed by using statistical tool in order to facilitate the descriptive analysis of the study. (See the format of questionnaire and the list of respondents in appendix A and B respectively)

The questionnaire either asked for a yes/no response or asked for ranking of choices according to number of alternatives where first choice was most important and last choice was the least important for analysis purpose, choices were assigned weights according to the number of alternatives. If the number of alternatives were five, the first preferred choice would get five points and the last preferred choice would get one point. Any alternative which was not ranked, did not get any point. The total points available to each choice were converted into percentages with reference to the total points available for all choices. The choice with the highest percentage score was ranked as the most important choice and the one with the lowest percentage was ranked as the last choice. Table 4.19 shows the group of respondents and code used to represent them.

Table 4.19
Group of Respondents and Code used

S.N	Group of Respondents	Sample size	Code Used
1.	Tax Administrators	15	A
2.	Tax Experts	15	B
3.	Tax Payers	25	C
	Total	55	

4.20 Attitude towards Income Tax System

Income Tax System has been blamed that it has many problems. To know whether the Income Tax System of Nepal has problems or not, a question was asked "Do you think that there are problems in Income Tax System?" The responses received from the respondents in this questions are tabulated in Table 4.20

Table 4.20
Attitude towards Problems in Income Tax System

Respondents	Code	Yes		No		Total	
		Number	%	Number	%	Number	%
Tax Administrator	A	13	86.67	2	13.33	15	100
Tax Experts	B	15	100	-	-	15	100
Tax Payers	C	22	88	3	12	25	100
Total	-	50	90.91	5	9.09	55	100

Source: Opinion Survey

From the above table it has become clear that Income Tax System has problems. About 90.91 percent of the respondents thought that there are problems in Income Tax System.

To know the problems of Income Tax System, respondents were asked the next questions. "What are the major problems of Income Tax System?" The respondents were requested to rank their answer from 1 to 5 scales. The first preferred choice would get 5 points and the last preferred choice would get 1 point.

The major problems of Income Tax System are ranked in order of preference of the respondents as follows:

1. Inefficient Tax administration
2. Complexities in Income Tax rules and regulations.
3. Lack of uniformity in the explanations of tax act, rules and regulations.
4. Lack of consciousness of Tax payers.
5. Inappropriate rate of tax and exemption limit.

Table 4.21
Major problems of Income Tax System

S.N.	Major Problems	Group			Total Points	Percent	Rank
		A	B	C			
1.	Complexities in Income Tax rules and regulation	53	70	73	196	26.13	2
2.	Inefficient Tax administration	44	65	96	205	27.33	1
3.	Lack of uniformity in the explanation of tax act, rules and regulations	59	32	95	186	24.80	3

4.	Lack of consciousness of tax payers	18	35	37	90	12	4
5.	Inappropriate rate of tax and exemption limit	21	23	29	73	9.73	5
	Total	195	225	330	750		

The major problems of Income Tax System are ranked in order of preference of the respondents as follows:

6. Inefficient Tax administration
7. Complexities in Income Tax rules and regulations.
8. Lack of uniformity in the explanations of tax act, rules and regulations.
9. Lack of consciousness Tax payers.
10. Inappropriate rate of tax and exemption limit.

According to the response of respondents it can be concluded that major problems of Income Tax System are:

1. Inefficient Tax administration
2. Complexities in Income Tax rules and regulations.
3. Lack of uniformity in the explanations of tax act, rules and regulations.

To know whether there is significant relationship or not between the views of tax administrators and tax payers regarding the problems in Income Tax System, spearman rank correlation coefficient is used.

Test of Hypothesis 1:

$H_o : P_s = 0$: There is no significant relationship between the views of tax administrators and tax payers regarding the problems in Income Tax System.

Table 4.22
Calculation of Rank Correlation Coefficient

S. N.	Major Problems	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	Complexities in Income Tax rules and regulations.	53	2	73	3	-1	1
2.	Inefficient Tax administration	44	3	96	1	2	4
3.	Lack of uniformity in the explanation of tax act, rules and regulations	59	1	95	2	-1	1
4.	Lack of consciousness of tax payers	18	5	37	4	1	1
5.	Inappropriate rate of tax and exemption limit	21	4	29	5	-1	1
	n = 5	195		330			$\sum d^2 = 8$

Source: Table 4.21
Note: A refers to Tax administrators and C refers to Tax payers.

Test statistic: Under H0, the test statistic is

$$r_s = 1 - \frac{6 \sum d^2}{n(n^2 - 1)}$$

Substituting the value

$$r_s = 1 - \frac{6(8)}{5(25 - 1)} = 1 - \frac{48}{120} = 0.60$$

The critical values of r_s at 5 percent level of significance for n = 5 are ± 0.9000, that is the upper limit of the acceptance region is 0.9000, and the lower limit of the acceptance region is – 0.9000.

Decision

Since r_s calculated lies in the acceptance region (< 0.9000). There fore, the null hypothesis is accepted i.e., there is no significant relationship between the views of tax administrators and tax payers regarding the problems in Income Tax System.

4.21 Tax as an important and major source of government revenue.

To know the respondents opinion about the role of tax in government revenue, the first role of tax in government revenue, the first question. “Do you think tax is a major source of government revenue?” was asked and the response received from the respondents are tabulated as follows:

Table 4.23
Tax as an important and major source of government revenue

Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax administrators	11	73.33	4	26.67	15	100
Tax experts	14	93.33	1	6.67	15	100
Tax payers	22	88.00	3	12.00	25	100
	47	85.45	8	14.55	55	

Source: Opinion Survey:

From the above table, it is clear that about 85.45 percent of the respondents approved tax as an important and major source of government revenue and only 14.55 percentage of respondents did not recognize tax as an important and major source of government revenue. So, the conclusion can be drawn out that tax is an important and major source of government revenue.

Test of Hypothesis 2:

Table 4.24
Tax as an important source of government Revenue

Respondents	Yes	No	Row Total
Tax administrators	11	4	15
Tax payers	22	3	25
Column Total	33	7	40

Null Hypothesis, H0: There is no significant difference between the views of tax administrators and tax payers regarding the contribution of tax revenue on total government revenue.

Test Statistic: Under H0, the test statistic is

$$\chi^2 = \sum \frac{(fo - fe)^2}{fe}$$

Where,

fo = observed frequency

fe = Expected frequency = $\frac{Rowtotal \times ColumnTotal}{GrandTotal}$

Calculation of χ^2:

(Row, Column)	fo	fe = (RT × CT)/N	fo – fe	(fo – fe)^2	$\frac{(fo - fe)^2}{fe}$
(1, 1)	11	(15 × 33)/ 40 = 12.4	- 1.40	1.96	0.1581
(1, 2)	4	(15 × 7)/ 40 = 2.6	1.40	1.96	0.7538
(2, 1)	22	(25 × 33)/40 = 20.63	1.37	1.88	0.0911
(2, 2)	3	(25 × 7)/40 = 4.4	-1.40	1.96	0.4455
					$\sum \frac{(fo - fe)^2}{fo} = 1.45$

Calculated $\chi^2 = \sum \frac{(fo - fe)^2}{fo} = 1.45$

Degree of freedom = (r – 1) (c – 1) = (2 – 1) (2 – 1) = 1 × 1 = 1

Level of significance, α = 5% = 0.05

Tabulated value of χ^2 at 5 % level of significance for 1 degree of freedom is 3.841

Decision:

Since the calculated value of χ^2 is less than the tabulated value, the null hypothesis is accepted i.e. there is no significance difference between the views of tax administrator's and tax payers regarding the contribution of tax revenue on total government revenue.

4.22 Attitude towards the role of Income Tax in economic development and poverty alleviation.

To know the attitude of tax payers and tax administrators towards role of Income Tax in economic development and poverty alleviation, respondents were asked the question. "Do you think that the Income Tax has an important role in economic development and poverty alleviation?" The responses received from the respondents in this question are tabulated in table 4.25

Table 4.25
Attitude towards the important role of Income Tax

Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax administrators	10	66.67	5	33.33	15	100
Tax experts	9	60	6	40	15	100
Tax payers	22	88	3	12	25	100
	41	74.55	14	25.45	55	100

Thus about 74.55 percent of respondents think that tax plays an important role in economic development and poverty alleviation and about 25.45 percent of the respondent think that tax does not play an important role in economic development and poverty alleviation.

The respondents were asked the another question "Why do you think that only the Income Tax is not enough for economic development and poverty alleviation?" The respondents were requested to rank their answers from 1 to 7 scales. The first preferred choice would get 7 points and the last preferred choice would get 1 point.

Table 4.26
Income Tax is not sufficient for economic development and poverty alleviation

S.N.	Major Causes	Group			Total Points	Percent	Rank
		A	B	C			
1.	Growing illegal business activities	7	20	9	36	9.18	6
2.	Increasing habit of tax evasion	17	25	13	55	14.03	3
3.	Lack of economic policy	33	40	19	92	23.47	1
4.	Poor Tax administration	8	27	14	49	12.50	4
5.	Lack of clearly defined programs for poverty alleviation	30	38	20	88	22.45	2
6.	Poor condition of industrialization	18	8	4	30	7.65	7
7.	Ineffective resource mobilization	27	10	5	42	10.71	5
	Total	140	168	84	392		

Source: Opinion Survey

Only the Income Tax is not sufficient for economic development and poverty alleviation. So the respondents were asked the question "Why do you think that only the Income Tax is not enough for economic development and poverty alleviation?" and the major causes are ranked according to the preference of the respondents as follows:

1. Lack of economic policy.
2. Lack of clearly defined programs for poverty alleviation.
3. Increasing habit of tax evasion.

4. Poor tax administration.
5. Ineffective resource mobilization.
6. Growing illegal business activities.
7. Poor condition of industrialization.

Thus according to the response of the respondents the major causes of Income Tax not being sufficient for economic development and poverty alleviation are:

1. Lack of economic policy.
2. Lack of clearly defined programs for poverty alleviation.
3. Increasing habit of tax evasion.

To know whether there is significant relationship or not between the views of tax administrators and tax payers regarding the role of Income Tax in economic development and poverty alleviation, Spearman rank correlation coefficient is used.

Test of Hypothesis 3:

Ho : Ps = O There is no significant relationship between the views of the tax administrators and tax payers regarding the role of tax in economic development and poverty alleviation.

Table 4.27
Calculation of Rank Correlation Coefficient

S. N.	Major Causes	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	Growing illegal business activities	7	7	9	5	2	4
2.	Increasing habit of tax evasion	17	5	13	4	1	1
3.	Lack of economic policy	33	1	19	2	-1	1
4.	Poor tax administration	8	6	14	3	3	9
5.	Lack of clearly defined programs for poverty alleviation	30	2	20	1	1	1
6.	Poor condition of industrialization	18	4	4	7	-3	9
7.	Ineffective resource mobilization	27	3	5	6	-3	9
	n = 7	140		84			$\sum d^2 = 34$

Source: Table 4.26
Note: A refers to tax administrators and C refers to tax payers

Test Statistic: Under Ho, the test statistic is

$$r_s = 1 - \frac{6\sum d^2}{n(n^2-1)} = 1 - \frac{6(34)}{7(49-1)} = 1 - \frac{204}{336} = 0.3929$$

The critical values of r_s at 5 percent level of significance for n = 7 are $\pm$ 0.7450, that is the upper limit of acceptance region is 0.7450 and the lower limit of the acceptance region is
– 0.7450.

Decision:

Since r_s calculated lies in the acceptance region ($\pm$ 0.7450), therefore the null hypothesis is accepted i.e., there is no significant relationship between the views of tax administrators and tax payers regarding the role of Income Tax in economic development and poverty alleviation.

4.23 Attitude towards low Tax/GDP ratio:

The tax/GDP ration of the fiscal year 2061/62 and 2062/63 was 0.11:1 and 0.12:1 respectively according to the annual report 2062/63 of IRD. To know the attitude of the respondents towards this Tax/GDP ratio a question was asked "Do you think that this Tax/GDP ratio is satisfactory?" The responses received from the respondents in this question re tabulated in the table 4.28.

Table 4.28
Satisfaction towards Tax/GDP ratio

Respondents	Code	Yes		No		Total	
		Number	%	Number	%	Number	%
Tax administrators	A	5	33.33	10	66.67	15	100
Tax experts	B	6	40	9	60	15	100
Tax payers	C	10	40	15	60	25	100
Total		21	38.18	34	61.82	55	100

Thus about 61.82 percent of respondents think that the Tax/GDP ratio of fiscal year 2061/62 and 2062/63 is not satisfactory.

Then the respondents were asked the second question "Why do you think that the Tax/GDP ratio is not satisfactory?" The respondents were requested to rank their answers from 1 to 8. The first preferred choice would get 8 points and the last preferred choice would get 1 point.

Table 4.29
Causes of unsatisfactory Tax/GDP ratio

S.N.	Major Causes	Group			Total Points	Percent	Rank
		A	B	C			
1.	Poor tax administration	13	12	50	75	6.13	8
2.	Increasing practice of tax evasion	73	67	25	165	13.48	4
3.	The agricultural income which has significant contribution in GDP is tax free	43	43	55	141	11.52	5
4.	Narrow scope of tax	63	51	115	229	18.71	1
5.	Low tax rate and high exemption limit	33	30	20	83	6.78	7
6.	Lack of appropriate tax assessment procedure	17	41	80	138	11.27	6
7.	Lack of consciousness of tax payers	74	65	85	224	18.30	2
8.	Poor industrialization	44	15	110	169	13.81	3
	Total	360	324	540	1224		

Source: Opinion Survey

The major causes of in satisfactory Tax/GDP ratio are ranked in order of preference of the respondents as follows:

1. Narrow scope of tax.
2. Lack of consciousness of tax payers
3. Poor Industrialization.
4. Increasing practice of Tax evasion.
5. The agricultural income which has significant contribution in GDP is tax free.
6. Lack of appropriate tax assessment procedure
7. Low tax rate and high exemption limit

8. Poor tax administration.

Thus according to the respondents the major causes of unsatisfactory to the respondents the major causes of unsatisfactory tax/GDP ratio are:

1. Narrow scope of tax.
2. Lack of consciousness of tax payers
3. Poor Industrialization.

To know whether there is significant relationship or not between the views of tax administrators and tax payers regarding low Tax/GDP ratio, spearman rank correlation coefficient is used.

Test of Hypothesis 4:

Ho: Ps = 0: There is no significant relationship between the views of tax administrators and tax payers regarding the low Tax/GDP ratio.

Table 4.30
Calculation of Rank Correlation Coefficient

S. N.	Major Causes	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	Poor Tax administration	13	8	50	6	2	4
2.	Increasing practice of tax evasion	73	2	25	7	-5	25
3.	The agricultural income which has significant contribution in GDP is tax free	43	5	55	5	0	0
4.	Narrow scope of tax	63	3	115	1	2	4
5.	Low tax rate and high exemption limit	33	6	20	8	-2	4
6.	Lack of appropriate tax assessment procedure	17	7	80	4	3	9
7.	Lack of consciousness of tax payers	74	1	85	3	-2	4
8.	Poor industrialization	44	4	110	2	2	4
	n = 8	360		540			$\sum d^2 = 54$

Source: Table 4.29
Note: A refers to tax administrator and C refers to tax payers.

Test Statistic: Under Ho, the test statistic is

$$r_s = 1 - \frac{6 \; d^2}{n(n^2 - 1)}$$

Substituting the value

$$r_s = 1 - \frac{6 \times 54}{8(64 - 1)} = 1 - \frac{324}{504} = 0.3571$$

The critical value of r_s at 5 percent level of significance for n = 8 are ± 0.7153, that is the upper limit of acceptance region is 0.7143 and the lower limit of the acceptance region is
– 0.7143

Decision

Since r_s calculated lies in the acceptance region ($<$ 0.7143). Therefore, the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers regarding low Tax/GDP ratio.

4.24 Attitude towards tax avoidance and tax evasion.

Tax avoidance and tax evasion have become a very serious problem of tax administration which has reduced the amount of tax. To know the attitude of respondents in this issue a question was asked to them "Do you think that the tax avoidance and tax evasion are the major problems of tax administration?" The responses received from the respondents in this questions are tabulated in the table 4.31.

Table 4.31
Attitude towards tax avoidance and evasion as major problems

Respondents	Code	Yes		No		Total	
		Number	%	Number	%	Number	%
Tax administrators	A	13	86.67	2	13.33	15	100
Tax experts	B	14	93.33	1	6.67	15	100
Tax payers	C	20	80	5	20	25	100
Total		47	85.45	8	14.55	55	100

About 85.45 percent of the respondents think that the tax avoidance and tax evasion are the major problems of tax administration and only 14.55 percent of the respondents think that its not a big problem.

The respondents were asked the another question "In your opinion, what are the causes of tax avoidance and tax evasion?" The respondents were requested to rank their answers from 1 to 6. The first preferred choice would get 6 points and the last preferred choice would get 1 point.

Table 4.32

Major causes of Tax avoidance and tax evasion

S.N.	Major Causes	Group			Total Points	Percent	Rank
		A	B	C			
1.	Lots of loopholes in tax act	73	51	73	197	19.96	3
2.	Weakness of tax administration	44	19	113	176	17.83	4
3.	Dishonest tax payers	70	75	67	212	21.48	2
4.	Corrupt tax personnel	18	47	33	98	9.93	5
5.	Lack of trained staff	21	23	27	71	7.19	6
6.	Lack of proper check and balance system	47	79	107	233	23.61	1
	Total	273	294	420	987		

Source: Opinion Survey

The major causes of tax avoidance and tax evasion are ranked in order of preference of the respondents as follows:

1. Lack of proper check and balance system.
2. Dishonest tax payers
3. Lots of loopholes in tax act.
4. Weakness of tax administration.
5. Corrupt tax personnel
6. Lack of trained staff

Thus, according to the respondents the major causes of tax avoidance and tax evasion are

1. Lack of proper check and balance system.
2. Dishonest tax payers
3. Lots of loopholes in tax act.
4. Weakness of tax administration.

To know whether there is significant relationship or not between the views of tax administrators and tax payers regarding tax avoidance and tax evasion are the major problems of tax administration in Nepal, Spearman ran correlation coefficient is used.

Test of Hypothesis 5:

Ho: Ps = 0: There is no significant relationship between the views of tax administrators and tax payers regarding tax avoidance and tax evasion are the major problems of tax administration in Nepal.

Table 4.33
Calculation of Rank Correlation Coefficient

S. N.	Major Causes	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	Lots of loopholes in tax act	73	1	73	3	-2	4
2.	Weakness of tax administration	44	4	113	1	3	9
3.	Dishonest tax payers	70	2	67	4	-2	4
4.	Corrupt tax personnel	18	6	33	5	1	1
5.	Lack of trained staff	21	5	27	6	-1	1
6.	Lack of proper check and balance system	47	3	107	2	1	1
		273		420			$\sum d^2 = 20$

Source: Table 4.32
Note: A refers to tax administrators and C refers to tax payers.

Test Statistic: Under Ho, the test statistic is

$$r_s \text{ X}1\text{ Z}\frac{6 \quad d^2}{n(n^2 \text{ Z}1)}$$

$$r_s \text{ X}1\text{ Z}\frac{6(20)}{6(36\text{ Z}1)} \text{ X}1\text{ Z}\frac{120}{210} \text{ X}0.4286$$

The critical value of r_s at 5 percent level of significance for n = 6 are $\pm$ 0.8286, that is the upper limit of acceptance region is 0.8286 and the lower level of acceptance region is -0.8286

Decision

Since r_s calculated lies within the acceptance ($\pm$ 0.8286). Therefore, the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers regarding tax avoidance and tax evasion are the major problems of tax administration in Nepal.

4.25 Attitude towards increasing resource gap problems in Nepal.

Resource gap is the difference between total expenditure and total revenue. There has been a very serous resource gap problem in Nepal. The resource gap was Rs. 22328 millions in F/Y 1998/99 which has increased to Rs. 38607.1 millions in F/Y 2005/06. In this regard, respondents were asked a question “Do you think that the ineffective tax administration is the cause of increasing resource gap problem in Nepal?” The responses from the respondents in this question are tabulated in Table 4.34

Table 4.34
Attitude towards increasing resource gap problems in Nepal

Respondents	Code	Yes		No		Total	
		Number	%	Number	%	Number	%
Tax administrators	A	2	13.33	13	86.67	15	100
Tax experts	B	3	20	12	80	15	100
Tax payers	C	10	40	15	60	25	100
Total		15	27.27	40	72.73	55	

From the above table it is cleared that about 72.73 percent of the respondents think that ineffective tax administration is not the cause of increasing resource gap problem in Nepal and only 27.27 percent of the respondents think that it is the cause.

The respondents were asked the another question “What may be the causes of increasing resource gap problem in Nepal?” The respondents were requested to rank their answers from 1 to 9 scale. The first preferred choice would get 9 points and the last preferred choice would get 1 point.

Table 4.35
Major Causes of resources gap problems.

S.N.	Major Causes	Group			Total Points	Percent	Rank
		A	B	C			
1.	Narrow scope of tax	112	101	100	313	17.39	1
2.	Low income level of tax payers	109	103	69	281	15.61	3
3.	Illegal business activities	44	54	95	193	10.72	5
4.	Increasing expenditure of the government	86	79	125	290	16.11	2
5.	Agricultural income is free from tax liability	59	41	50	150	8.33	7
6.	Low contribution of Non Tax revenue	53	77	25	155	8.61	6
7.	Dishonest Tax payers	18	17	61	96	5.33	8
8.	Defective tax act	21	19	20	60	3.33	9
9.	Defective government expenditure programs	83	49	130	262	14.56	4
	Total	585	540	675	1800		

Source: Opinion Survey

The major causes of increasing resource gap problem in Nepal are ranked in order of preference of the respondents as follows:

1. Narrow scope of tax
2. Increasing expenditure of the government.

3. Low income level of tax payers.
4. Defective government expenditure programs.
5. Illegal business activities.
6. Low contribution of Non-Tax Revenue.
7. Agricultural income is free from tax.
8. Dishonest tax payers.
9. Defective tax act.

Thus according to the responses of the respondents the major causes of increasing resource gap problems are:

1. Narrow scope of tax
2. Increasing expenditure of the government.
3. Low income level of tax payers.

To know whether there is significant relationship or not between the views tax administrators and tax payers regarding ineffective tax administration is the cause of increasing resource gap problem in Nepal, Spearman rank correlation coefficient is used.

Test of Hypothesis 6

Ho : Ps = 0: There is no significant relationship between the views of tax administrators and tax payers regarding ineffective tax administration is the cause of increasing resource gap problem in Nepal.

Table 4.36
Calculation of Rank Correlation Coefficient

S. N.	Major Causes	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	Narrow scope of tax	112	1	100	3	-2	4
2.	Low income level of tax payers	109	2	69	5	-3	9
3.	Illegal business activities	44	7	95	4	3	9
4.	Increasing expenditure of the government	86	3	125	2	1	1
5.	Agricultural income is free from tax liability	59	5	50	7	-2	4
6.	Low contribution of Non-tax revenue	53	6	25	8	-2	4
7.	Dishonest tax payer	18	9	61	6	3	9
8.	Defective tax act	21	8	20	9	-1	1
9.	Defective government expenditure programs	83	4	130	1	3	9
	Total	585		675			$\sum d^2 = 50$

Source: Table 4.35

Note: A refers to tax administrator and C refers to tax payers.

Test Statistic: Under Ho, the test Statistic is

$$r_s = 1 - \frac{6\sum d^2}{n(n^2 - 1)}$$

Substituting the value

$$r_s = 1 - \frac{6(50)}{9(81 - 1)} = 1 - \frac{300}{720} = 0.5833$$

The critical value of r_s at 5 percent level of significance for n = 9 are $\pm$ 0.6833, that is the upper limit of the acceptance region is 0.6833 and the lower limit of the acceptance region is – 0.6833

<u>Decision:</u>

Since the r_s calculated lies within the acceptance region ($\pm$ 0.6833), therefore, the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers regarding ineffective tax administration is the cause of increasing resource gap problem in Nepal.

4.26 Attitude towards bringing the agricultural income within the boundary of tax to increase the contribution of Income Tax

According the economic survey of fiscal year 2006/07, the contribution of agricultural sector in GDP is 36.1 percent but the agricultural income is still out of the tax boundary. To know the attitude of the respondents in this issue a question was asked to them "Do you think that the agricultural income should be taxed to increase the contribution of Income Tax revenue on total government revenue?" The responses received from the respondents in this question are tabulated in the table 4.37

Table 4.37
Attitude towards bringing the agricultural income within the boundary of tax to increase the contribution of Income Tax

Respondents	Code	Yes		No		Total	
		Number	%	Number	%	Number	%
Tax administrators	A	5	33.33	10	66.67	15	100
Tax experts	B	3	20	12	80	15	100
Tax payers	C	5	20	20	80	25	100
Total		13	23.64	42	76.36	55	

From this table it is clear that about 76.36 percent of the respondents do not want the idea of bringing the agricultural income within the boundary of tax to increase the contribution of Income Tax. Only 23.64 percent of the respondents think that agricultural income should be taxed.

Then the respondents were asked the another question “Why do you think that agricultural income should not be taxed?” The respondents were asked to rank their answers from 1 to 5 scale. The first preferred choice would get 5 points and the last preferred choice would get 1 point.

Table 4.38

Causes of not imposing tax on agricultural income

S.N.	Major Causes	Group			Total Points	Percent	Rank
		A	B	C			
1.	Dependents on agriculture are very poor	47	55	87	189	30	1
2.	Traditional agricultural system	23	17	27	67	10.63	5
3.	Dependents on agriculture have no knowledge of tax and its importance’s	43	29	43	115	18.25	3
4.	Lack of agricultural infrastructure	13	26	50	89	14.13	4
5.	Agricultural output fulfill the basic needs of pople	24	53	93	170	26.98	2
	Total	150	180	300	630		

Source: Opinion Survey

The major causes of not imposing tax on agricultural income are ranked in order of preference of the respondents as follows:

1. Dependents on agriculture are very poor.
2. Agricultural output fulfill the basic needs of people.
3. Dependents on agriculture have no knowledge of tax and its importances.
4. Lack of agricultural infrastructure.
5. Traditional Agricultural system.

Thus according to the responses of the respondents the major causes of not imposing tax on agricultural income are:

1. Dependents on agriculture are very poor.
2. Agricultural output fulfills the basic needs of people.
3. Dependents on agriculture have no knowledge of tax and its importances.

Test of hypothesis 7:

Ho : Ps = 0: There is no significant relationship between the views of tax administrators and tax payers regarding agricultural income should be taxed to increase the contribution of Income Tax revenue on total government revenue.

Table 4.39
Calculation of Rank Correlation Coefficient

S. N.	Major Causes	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	Dependents on agriculture are very poor.	47	1	87	2	-1	1
2.	Traditional agricultural system	23	4	27	5	-1	1
3.	Dependents on agriculture have no knowledge of tax and its importance.	43	2	43	4	-2	4
4.	Lack of agricultural infrastructure	13	5	50	3	2	4
5.	Agricultural output fulfill the basic needs of people	24	3	93	1	2	4
	Total	150		300			$\sum d^2 = 14$

Source: Table 4.38
Note: A refers to tax administrator and C refers to tax payers.

Test Statistic: Under Ho, the test statistic is

$$r_s = 1 - \frac{6 \sum d^2}{n(n^2 - 1)}$$

Substituting the value

$$r_s = 1 - \frac{6(14)}{5(25 - 1)} = 1 - \frac{84}{120} = 0.30$$

The critical value of r_s at 5 percent level of significance for n = 5 are ± 0.9000, that is the upper limit of acceptance region is 0.9000 and the lower limit of acceptance region is -0.9000

Decision

Since r_s calculated lies within the acceptance region (± 0.9000), therefore the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers regarding agricultural income should be taxed to increase the contribution of Income Tax revenue on total government revenue.

4.27 Attitude towards Exemption limit provided to Individual and Couple

Income Tax Act 2058 has classified Tax Payers based on marital status as individual and couple. To know the attitude of respondents whether the exemption limit provided to them and tax rate is rational, a question was asked to them "Income Tax Act 2058 has classified Tax payers based on marital status as individual and couple, do you think the exemption limit provided to them and the tax rate is rational?" The responses received from the respondents in these questions are tabulated in the table 4.40.

Table 4.40

Satisfaction towards exemption limit and Tax rate provided to individual and couple

Respondents	Code	Yes		No		Total	
		Number	%	Number	%	Number	%
Tax administrators	A	4	26.67	11	73.33	15	100
Tax experts	B	6	40	9	60	15	100
Tax payers	C	2	8	23	92	25	100
Total		12	21.82	43	78.18	55	100

From this table, it is clear that only about 21.82 percent of the respondents out of 55 think that the exemption limit and tax rate provided to individual and couple is rational and 78.18 percent of the respondents don't think so.

The respondents were asked the another question "Why do you think that the exemption limit and the tax rate provided to individual and couple is not rational?" The respondents were asked to rank their answers from 1 to 5 scales. The first preferred choice would get 5 points and the last preferred choice would get 1 point.

Table 4.41

Causes of the exemption limit and Tax rate provided to Individual and couple not being rational

S.N.	Major Causes	Group			Total Points	Percent	Rank
		A	B	C			
1.	There is no provision to adjust the price level change	51	41	100	192	29.77	1
2.	Number of Dependents upon individuals and couple not considered	18	14	39	71	11.01	5
3.	Certain percentage of educational expenses should be allowed to deduct from total taxable income	40	32	38	110	17.05	3
4.	Whole pension Income should be made Tax exempted	15	13	61	89	13.80	4
5.	Dashain Allowances should be made Tax-exempted	41	35	107	183	28.37	2
	Total	165	135	345	645		

Source: Opinion Survey

The major causes of the exemption limit and tax rate provided to individual and couple not being rational are as follows: -

1. There is no provision to adjust the price level change
2. Dashain Allowances should be made Tax-exempted

3. Certain percentage of educational expenses should be allowed to deduct from total taxable income
4. Whole pension Income should be made Tax exempted
5. Number of Dependents upon individuals and couple not considered

Thus, according to the responses of the respondents the major causes of the exemption limit and tax rate provided to individual and couple not being rational are:

1. There is no provision to adjust the price level change
2. Dashain Allowances should be made Tax-exempted
3. Certain percentage of educational expenses should be allowed to deduct from total taxable income

Test of hypothesis 8:

Ho : Ps = 0: There is no significant relationship between the views of tax administrators and tax payers regarding the exemption limit and tax rate provided to individual and couples by Income Tax Act 2058.

Table 4.42

Calculation of Rank Correlation Coefficient

S. N.	Major Causes	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	There is no provision to adjust the price level change	51	1	100	2	-1	1
2.	Number of Dependents upon individuals and couple not considered	18	4	39	4	0	0
3.	Certain percentage of educational expenses should be allowed to deduct from total taxable income.	40	3	38	5	-2	4
4.	Whole pension Income should be made Tax exempted	15	5	61	3	2	4
5.	Dashain Allowances should be made Tax-exempted	41	2	107	1	1	1
	Total	165		345			$\sum d^2 = 10$

Source: Table 4.41

Note: A refers to tax administrator and C refers to tax payers.

Test Statistic: Under Ho, the test statistic is

$$r_s \ X1Z\frac{6 \quad d^2}{n(n^2 \ Z1)}$$

Substituting the value

$$r_s \ X1Z\frac{6(10)}{5(25Z1)} X1Z\frac{60}{120} X0.50$$

The critical value of r_s at 5 percent level of significance for n = 5 are $\pm$ 0.9000, that is the upper limit of acceptance region is 0.9000 and the lower limit of acceptance region is -0.9000

Decision

Since r_s calculated lies within the acceptance region ($\pm$ 0.9000), therefore the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers regarding the exemption limit and tax rate provided to individual and couples by Income Tax Act 2058.

4.28 Attitude towards the number of Tax Payer registered during the F/Y 2005/06

Total 24856 number of new Tax payers were registered in F/Y 2005/06 which consists of 96 Public Enterprises, 98 Semi-Public Enterprises, 2652 Private Corporate Bodies, 21584 Individuals. "Is this number satisfactory to increase the contribution of income tax in total Government Revenue?" The responses received from the respondents in this question are tabulated in the table 4.43

Table 4.43

Satisfaction towards the number of new Tax Payers Registered

Respondents	Code	Yes		No		Total	
		Number	%	Number	%	Number	%
Tax administrators	A	5	33.33	10	66.67	15	100
Tax experts	B	3	20	12	80	15	100
Tax payers	C	16	64	9	36	25	100
Total		24	43.64	31	56.36	55	100

From this table, it is clear that only about 43.64 percent of the respondents out of 55 think that the number of new tax payers registered in the F/Y 2005/06 is satisfactory to increase the contribution of Income Tax in total Government Revenue and 56.36 percentage of the respondents don' think so.

The respondents were asked the another question "What may be the causes of low number of new tax payers registered in the F/Y 2005/06?" The respondents were asked to rank their answers from 1 to 5 scales. The first preferred choice would get 5 points and the last preferred choice would get 1 point.

Table 4.44

Causes of the low number of new Tax Payers Registered in the F/Y 2005/06

S.N.	Major Causes	Group			Total Points	Percent	Rank
		A	B	C			
1.	Lack of security provision to the industrial sectors	43	53	30	126	27.10	2
2.	Uncertain political situation of the country	24	26	41	91	19.57	3
3.	Lack of infrastructure	47	55	37	139	29.89	1
4.	Poor Supervision and monitoring system	13	17	15	45	9.68	5
5.	Practice of doing the business without registration	23	29	12	64	13.76	4
	Total	150	180	135	465		

Source: Opinion Survey

The major causes of low number of new tax payers registered in the fiscal year 2005/06.

1. Lack of infrastructure
2. Lack of security provision to the industrial sectors
3. Uncertain political situation of the country
4. Practice of doing the business without registration
5. Poor Supervision and monitoring system

Thus, according to the responses of the respondents the major causes of low number of new tax payers registered in the F/Y 2005/06 are:

1. Lack of infrastructure
2. Lack of security provision to the industrial sectors
3. Uncertain political situation of the country

Test of hypothesis 9:

Ho : Ps = 0: There is no significant relationship between the views of tax administrators and tax payers regarding the low number of new tax payers registered in the F/Y 2005/06.

Table 4.45
Calculation of Rank Correlation Coefficient

S. N.	Major Causes	Total Points	Re Rank	Total Points	Re Rank	Difference of Rank	Square of $R_1 - R_2$
		A	R_1	C	R_2	$d = R_1 - R_2$	d^2
1.	Lack of security provision to the industrial sectors	43	2	30	3	-1	1
2.	Uncertain political situation of the country	24	3	41	1	2	4
3.	Lack of infrastructure	47	1	37	2	-1	1
4.	Poor Supervision and monitoring system	13	5	15	4	1	1
5.	Practice of doing the business without registration	23	4	12	5	-1	1
	Total	150		135			$\sum d^2 = 8$

Source: Table 4.44

Note: A refers to tax administrator and C refers to tax payers.

Test Statistic: Under Ho, the test statistic is

$$r_s = 1 - \frac{6\sum d^2}{n(n^2-1)}$$

Substituting the value

$$r_s = 1 - \frac{6(8)}{5(25-1)} = 1 - \frac{48}{120} = 0.60$$

The critical value of r_s at 5 percent level of significance for n = 5 are $\pm$ 0.9000, that is the upper limit of acceptance region is 0.9000 and the lower limit of acceptance region is -0.9000

Decision

Since r_s calculated lies within the acceptance region (< 0.9000), therefore the null hypothesis is accepted i.e. there is no significant relationship between the views of tax administrators and tax payers regarding the low number of new tax payers registered in the F/Y 2005/06.

4.29 Attitude towards the bases of classification of income tax payers.

ITA 2058 has classified the income tax payers based on legal status, marital status, and residential status for the assessment of taxable income. A question “Do you think this bases of classifications are scientific and systematic for the assessment of taxable income?” was asked to know the opinion of respondents towards the classification and the response received from the respondents are tabulated in table 4.46.

Table 4.46
Opinion towards the classification of income tax payers

Respondents	Yes		No		Total	
	Number	%	Number	%	Number	%
Tax administrators	13	86.67	2	13.33	15	100
Tax experts	14	93.33	1	6.67	15	100
Tax payers	20	80	5	20	25	100
	47	85.45	8	14.55	55	

Source: Opinion Survey:

From the above table, it is clear that about 85.45 percent of the respondents approved that the bases of classifications of income tax payers are scientific and systematic for the assessment of taxable income and only 14.55 percentage of respondents did not agree.

So, the conclusion can be drawn out that the bases of classifications are scientific and systematic.

Test of Hypothesis 10:

Table 4.47
Views towards the classification of income tax payers

Respondents	Yes	No	Row Total
Tax administrators	13	2	15
Tax payers	20	5	25
Column Total	33	7	40

Null Hypothesis, H0: There is no significant difference between the views of tax administrators and tax payers regarding the bases of classifications of income tax payers being scientific and systematic for the assessment of taxable income.

Test Statistic: Under H0, the test statistic is

$$\chi^2 = \sum \frac{(fo - fe)^2}{fe}$$

Where,

fo = observed frequency

fe = Expected frequency = $\frac{Rowtotal \times ColumnTotal}{GrandTotal}$

Calculation of χ^2:

(Row, Column)	fo	fe = (RT × CT)/N	fo – fe	$(fo – fe)^2$	$\frac{(fo - fe)^2}{fe}$
(1, 1)	13	(15 × 33)/ 40 = 12.4	0.60	0.36	0.0290
(1, 2)	2	(15 × 7)/ 40 = 2.6	-0.60	0.36	0.1385
(2, 1)	20	(25 × 33)/40 = 20.63	-0.63	0.3969	0.0192
(2, 2)	5	(25 × 7)/40 = 4.4	0.60	0.36	0.0818
					$\chi^2 = \sum \frac{(fo - fe)^2}{fe}$ =0.2685

Calculated $\chi^2 = \sum \frac{(fo - fe)^2}{fe}$ =0.2685

Degree of freedom = (r – 1) (c – 1) = (2 – 1) (2 – 1) = 1 × 1 = 1

Level of significance, α = 5% = 0.05

Tabulated value of χ^2 at 5 % level of significance for 1 degree of freedom is 3.841

Decision:

Since the calculated value of χ^2 is less than the tabulated value, the null hypothesis is accepted i.e. there is no significant difference between the views of tax administrators and tax payers regarding the bases of classifications of income tax payers being scientific and systematic for the assessment of taxable income.

Findings of the study

The major findings of this research study are summarized below.

Government of Nepal is facing very serious resource gap problems. That is because on the one hand the government expenditure is increasing each year due to the expansion in government activities and on the other hand the internal revenue collection is lower than its estimated targets. So government of Nepal is heavily depending up on foreign loan and grants.

Total government revenue of Nepal consists of tax revenue and Non-Tax revenue and tax is revenue is one of the major internal sources of government revenue of Nepal. Tax revenue includes income tax, land revenue and registration tax, customs, excise, sales tax/VAT, tax on property, vehicle tax, tax on interest etc. Among the various tax and non-tax revenue customs, sales tax/VAT, Non-Tax revenue, income tax, excise, land revenue and registration and miscellaneous occupies 1st, 2nd, 3rd, 4th, 5th, 6th & 7th position in the contribution of total government revenue. This study shows that tax revenue contributes more than 77% in total government revenue of Nepal and Non-Tax revenue has a contribution of nearly about 23% contribution in total government revenue. This study also shows that the contribution of tax revenue on total government has been increasing in each fiscal year on the other hand the contribution of non-tax revenue are decreasing in each fiscal year.

Tax revenue of Nepal consists of direct tax and indirect tax. Direct tax includes income tax, land revenue and registration, Urban house and land tax, property tax, vehicle tax, tax on interest etc. and indirect tax includes sales tax, customs, excise, entertainment tax, hotel tax, air flight tax, contact tax, road and bridge maintenance tax etc.

Between the direct tax and indirect tax, the contribution of indirect tax on total tax revenue is higher than direct tax revenue. Direct tax contributes nearly about 27% on total tax revenue whereas the contribution of indirect tax has remained 73% and around.

In the total direct tax revenue, the contribution of income tax is significant. According to the economic survey 2006/07, the contribution of income tax in total direct tax revenue was 74.27% same way the contribution of Land revenue & registration and miscellaneous tax was 15.61 and 10.12 percent respectively.

According to economic survey of F/Y 2006/07, income tax contributes 13.76% on total government revenue, 16.41% on tax revenue and 74.17% on direct tax revenue.

The study has disclosed that tax revenue contributes 1.35% on GDP, same way Non-tax revenue and Income tax revenue contributes 1.99% and 1.70% respectively on GDP.

Structural status of income tax consists of Income Tax from Public Enterprises, Semi-public Enterprises, Private corporate bodies, Income Tax from Individual, Remuneration and Tax on Interest. In structural status of Income Tax of F/Y 2062/63, Income Tax from Public Enterprises contributes 1.89%, Semi-public Enterprises contributes 0%, private Corporate Bodies contributes 32.82%, Individual Income Tax contributes 40.82%, Remuneration contributes 17.01% and Tax on Interest contributes 7.47%.

Through the empirical investigation, it was found out that 90.91% of the respondents think that there are problems in Income Tax system of Nepal and there is no significant relationship between the views of Tax administrators and Tax payers regarding the problems in Income tax system.

Some way 85.45% of the respondents think that tax is a major source of government revenue and there is no significant difference between the views of Tax administrators and tax payers regarding the contribution of tax on total government revenue.

74.55 percent of the respondents think that Income Tax plays an important role in economic development of the country and only 25.45% of the respondents don't think so. It was also found our that there is no significant relationship between the views of tax administrators and tax payers regarding the role of income tax in economic development.

38.18 percent of the respondents think that Tax/GDP ratio is satisfactory and 61.82 percent of the respondents out of 55 think that Tax/GDP ratio is not satisfactory. It was also found out that there is no significant relationship between the views of tax administrators and tax payers regarding low Tax/GDP ratio.

85.45% of the respondents think that tax avoidance and tax evasion are the major problems of tax administration and only 14.55% of the respondents don't think so. More over there is no significant relationship between the views of tax administrators and tax payers regarding tax avoidance and tax evasion are the major problems of tax administration of Nepal.

Only 27.27% of the respondents think that ineffective Tax administration is the cause of increasing resource gap problems and 72.73% of the respondents don't think so. It was also found out that there is no significant relationship between the views of tax administrators and tax payers regarding ineffective tax administration is the cause of increasing resource gap problem in Nepal.

23.64 percent of the respondents think that Agricultural income should be brought within the boundary of tax to increase the contribution of Income Tax and about 76.36% of the respondents don't think so. It was also found out that there is no significant relationship between the views of Tax administrators and Tax payers regarding agricultural income should be taxed to increase the contribution of income tax in total government revenue.

21.82 percent of the respondents out of 55 think that the exemption limit and tax rate provided to Individual and Couple is rational and 78.18 percent of the respondent don’t think so. It was also found out that there is no significant relationship between the views of Tax administrators and Tax payers regarding the exemption limit and tax rate provided to individual and couples by Income Tax Act 2058.

43.64 percent of the respondents out of 55 think that the number of new tax payers registered in the F/Y 2005/06 is satisfactory and 56.36 percentage of the respondents don’t think so. It was also found out that there is no significant relationship between the views of Tax administrators and Tax payers regarding the low number of new tax payers registered in the F/Y 2005/06.

During the study it was found out that about 85.45 percent of the respondents approved that the bases of classifications of income tax payers are scientific and systematic for the assessment of taxable income and only 14.55 percentage of respondents did not agree.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Nepal one of the poor developing countries of the world which confronts with a large number of problems at the present like economic, political, social, etc. Among these the major problems are low economic growth, low per capita income, higher level of poverty, poor social and economic indicators, under-developed physical infrastructure and high-cost economy leading to higher cost of production and so on. While the world economy in general and the emerging and developing economies, India and China at our doorsteps in particular, are moving fast along the trajectory of economic growth, Nepal still finds itself grappled with a host of problems and demand early and effective solutions to ensure and inclusive, just and high economic growth on a sustainable basis. To attain a discernible progress in poverty reduction, economic agenda should be accorded fitting priority coupled with the institutionalization of sustainable peace and democracy in the country.

Nepal's economic growth rate remained below 5 percent in the last six years because of country's precarious economic circumstances. In F/Y 2005/06, Nepal's GDP growth rate stood at a meager 3.3% of which the agricultural sector's growth was 1.1% and the non-agricultural sector's higher at 4.6%. The growth rate further decreased in F/Y 2006/07 to 2.5 percent with the agricultural sector's marginal growth of 0.7% against the non-agricultural sector's 2.5%.

According to the economic survey of F/Y 2006/07, Nepal's economic indicators are very miserable. It has shown that Nepal's economic growth rate is only 1.9% in F/Y 2006 which is smallest figure among the SAARC countries whereas the global economy expanded by 5.4% in 2006. On the other hand the annual percent change in the price of Nepal in F/Y 2006 is 8% which is the third highest percentage of price level change among the SAARC countries According to the human development report 2007 of world Bank, Nepal has the lowest per capita GDP in US$ i.e. 331.1 among SAARC countries.

Lack of sufficient financial resources is the main constraint for economic development of Nepal. Government expenditure is increasing each year due to the expansion of government activities on the other hand the government revenue has not increased enough to meet the increasing expenditure and the resource gap is increasing each year. Government accumulates required fund mainly from internal and external sources to finance regular and development expenditure. The government's internal sources are tax revenue, non-tax revenue and domestic loans and the external sources are foreign loans and grants. Government of Nepal is forces to rely on external sources due to inadequate internal sources.

Government of Nepal has been unable for effective mobilization of internal resources as a result resource gap and the fiscal deficit have been increasing each year. Among the internal resources, tax plays a vital role and has the high contribution on total government revenue. Tax revenue has more that 77% contribution on total government revenue. But the actual collection of tax revenue is lower than its estimated targets. That is all because of lack of proper check and balance system, lots of loopholes in tax act, weakness of tax administration, dishonest tax payers, lack of trained tax personnel and corrupt tax personnel etc.

The main objective of this research was to find out the status of tax payers and study the contribution of tax on total government revenue. As per the nature of the study, secondary as well as primary information were collected, tabulated and analyzed. Descriptive and analytical research designs have been followed in this study. The sources of primary data were from the analysis of respondent's responses, with selected 55 respondents representing tax administrators, Tax experts and Tax payers. Questionnaires were distributed and collected and information obtained from questionnaires has also been tabulated as per the requirement of the study.

Conclusions

The conclusions of this study are mentioned below.

The resource gap is one of the major problems of Nepal. The total expenditure is greater than total revenue. The resource gap is fulfilled through foreign grants, foreign loan and internal borrowings. This resource gap of Nepal can be minimized through effective internal resource mobilization.

Tax is the most important and effective tool for revenue collection. In Nepal about 77% of the total revenue comes from tax revenue and rest 23% from Non-Tax revenue.

Tax revenue consists of direct and indirect tax revenue. Nepalese economy is heavily relied upon indirect tax.

Direct tax includes income tax, Land revenue and registration, urban house and land tax, property tax, vehicle tax, tax on interest etc. Same way indirect tax includes sales tax, customs, excise, entertainment tax, hotel tax, air flight tax, contract tax, road and bridge maintenance tax etc.

The contribution of direct tax revenue in total tax revenue has not been more than 27% and the contribution of indirect tax in total revenue has not fallen down below 75%. This proves that indirect tax plays a vital role in government tax revenue of Nepal. So it is necessary to increase the share of direct tax for the sufficient resource mobilization.

The contribution of income tax revenue is highest in the total direct tax revenue. Income tax revenue is collected form Public Enterprises, Semi Public Enterprises, Private Corporate Bodies, Individual, Remuneration and Tax on interest.

The contribution of Tax Revenue, Non-Tax Revenue and Income Tax Revenue on GDP is not satisfactory. The average contribution of tax revenue on GDP over the seven years period from 2000/01 to 2006/07 is 9.06 percentage. Same way the average contribution of Non-Tax revenue on GDP over the seven years period from F/Y 2000/01 to 2006/07 is 2.44 percentage and the average contribution of Income tax on GDP over the seven years period from 2000/01 to 2006/07 is 1.77 percentage.

After the study, it is concluded that the major problems of Income Tax System are as follows:

1. Inefficient Tax administration
2. Complexities in Income Tax rules and regulations.
3. Lack of uniformity in the explanations of tax act, rules and regulations.
4. Lack of consciousness of Tax payers.
5. Inappropriate rate of tax and exemption limit.

It is also concluded that Tax avoidance and tax evasion have become a very serious problem of tax administration which has reduced the amount of tax.

According to the respondents the major causes of tax avoidance and tax evasion are as follows.

1. Lack of proper check and balance system.
2. Dishonest tax payers

3. Lots of loopholes in tax act.
4. Weakness of tax administration.

The effectiveness of tax system depends upon the existing management and leadership but the developing countries like Nepal are not giving proper attention to the management and administration of tax. So the importance of good administration has been important to minimize the problems of income tax system.

The better understanding between taxpayers, tax administrators and policy maker can solve the major problems of income tax. There must be trust relationship between above three parties.

The success or effectiveness of income tax system entirely depends upon implementation of provision, which is the major responsibility of income tax administration. The taxpayers must be responsible to fulfill their responsibility provided by law. The government must check the discretionary power of tax officers, supervise the tax personnel and must establish legal provision and practice to penalize the corrupt tax officers.

The behavior of tax administrator towards tax payers should be positive and helpful which help to minimize the problems in the income tax system.

5.3 Recommendations

On the basis of the findings mentioned above, the major areas of recommendations are as follows:

1. One of the main causes of increasing resource gap problem is narrow scope of tax. So to increase the scope of tax and government revenue, the excess agricultural income after providing justifiable exemption limit should be taxed.
2. There has been a serious depression in export trade, so to promote the export trade and business; government should reduce the export

duty especially on corrugated sheet, synthetic yarn, galvanized iron pipe, plastic products, rice barn and veritable ghee.

3. Poor industrialization lack of infrastructure is also a cause for narrow scope of tax and low government revenue, so to promote industrialization and increase the scope of tax, government should provide tax rebate and loss carry forward system of one income year up to more income years especially for infrastructure based industry like communication, transportation and Hydropower.
4. Existing bank guarantee or cash deposit system should be removed for the export of excisable goods under self removal system. It minimizes the shortage of current capital in the industries and help to encourage export trade.
5. Excise duty levied on cigarette and liquor can be increased to increase the government revenue.
6. In sales tax/VAT, neither the sellers issue bills nor the buyers bother to take bills after buying goods: This has been a very serious problem of tax administration. So consciousness should be created among the buyers to take bills after buying goods and there should be supervision and monitoring system in the market and guilty sellers who do not issue bill should be strictly punished by the concerned authority.
7. Poor tax administration is also one of the main problem which has reduce the government revenue in some extent. So government and concerned authority should concentrate on administrative reforms. To achieve the effectiveness in tax administration the following recommendation are made.
   - Regular review and analysis are to be undertaken to improve tax policy and system of execution and to increase efficiency in tax administration.

- Proper organizational measures are to be instituted to ensure timely realization of revenue and negligence in it should be avoided at any cost.
- Realized revenue should be timely and accurately credited to the revenue account and accounted properly.
- There should be reasonable degree of uniformity and rationality in tax assessment.
- Revenue should be collected according to the procedure prescribed in legislation and appropriate measures are to be adopted for it.

8. Lack of proper check and balance system in the tax administration is another weakness which has reduced government revenue in some extent. So to maintain a proper check and balance system in tax administration the following recommendation are made.
    - Facts provided by tax payers and information collected by tax authority should be evaluated. They should be complete, accurate and relevant.
    - Evidence collected or documents submitted are to be thoroughly examined and assessed.
    - Exemption, rebate and discount are to be duly allowed.
    - Assessed tax has to be realized in time and accounted properly.
9. To minimize the tax avoidance and evasion problems, the regular tax payers and the tax payers who pay high amount of tax should be awarded. This increases the social prestige of tax payers and encourage them to pay tax.
10. A prescribed format to maintain the books of account should be provided to the tax payers so that assessment will be easy and timely.

11. The income tax rate, exemption limit should be reviewed according to the income level of tax payers and price level in the market.
12. In order to provide information, knowledge and create awareness in tax related matters, there should be one information desk in each district.
13. Many businesses are running without registration and illegal business activities are going on. They all should be brought within the boundary of tax by the concerned authority; If done so, the volume of tax revenue can be increased in some extent.
14. To minimize the problems of running the business without registration and running illegal business activities, tax laws should be strictly enforced and legal loopholes in tax laws should be plugged.
15. There should be provision to adjust price level change while calculating the amount of tax to be paid.
16. Living standard of people would be better if number of dependents upon individuals and couple is considered while determining the exemption limit.
17. it would be better if certain percentage of educational expenses is allowed to deduct from total Taxable income.
18. Dashain allowances should be made Tax-exempted.
19. Generally people who live on pension income are of retired age so it would be better if the whole pension Income is made Tax-exempted.
20. Industrial sector should be provided a security umbrella to increase the contribution of Tax on total government revenue.
21. Market supervision and monitoring system should be made strict to avoid the illegal business activities.

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APPENDIX – A

Dear Sir,

I am a student of Shankar Dev Campus studying in the final year of M.B.S. As you know, the students of this level have to write a dissertation on the subject of their specialization. Being a student of accountancy stream, I have determined to present a dissertation on taxation. The topic approved for me by Tribhuvan University is "Classification of Income Tax Payers and Contribution of Tax to Government Revenue".

I have enclosed a questionnaire with this cover letter. I request you to fill up the questionnaire as per the instruction given on the top of the questionnaire. It would be a matter of great pleasure for me if you kindly respond me back in spite of your busy and valuable time schedule. Your responses will be of great importance of my study.

I assure you that your responses will be kept confidential.

Thank you,

Yours Sincerely,

Ganesh Bista

APPENDIX - B

LIST OF RESPONDENTS

A. Tax Administrators

S.N.	Name	Post	Organization
1.	Nara Sagar Shrestha	Director (Tax Refund)	IRD, Lazimpat
2.	Prem Shanta Manandhar	Director (Non-tax revenue)	IRD, Lazimpat
3.	Bishow Raj Pandey	Director (Investigation)	IRD, Lazimpat
4.	Govinda Bahadur Baniya	Director (Customer service department)	IRD, Lazimpat
5.	Bishnu Prasad Nepal	Director (Excise)	IRD, Lazimpat
6.	Shyam Koirala	Director (Administrative Review)	IRD, Lazimpat
7.	Prem Shanta Manandhar	Director (Financial Department)	IRD, Lazimpat
8.	Devi Das Koirala	Director (Policy and International Tax)	IRD, Lazimpat
9.	Alok Nepal	Tax Officer	IRD, Lazimpat
10.	Gopal Koirala	Tax Officer	IRD, Lazimpat
11.	Keshar Kumar Dhakal	Tax Officer	IRD, Lazimpat
12.	Tanka Pd. Panthi	Tax Officer	IRD, Lazimpat
13.	Mahesh Bhattrai	Tax Officer	IRD, Lazimpat
14.	J.K. Ghimire	Tax Officer	IRD, Lazimpat

B. Tax Experts

S.N.	Name	Post	Organizaion
1.	Mahesh Pd. Lamichane	Registered Auditor	Mahesh & Co.
2.	Yuddha Raj Oli	CA	CIMA Pvt. Ltd.
3.	Ujjwal Kumar Gautam	CA	IRD, Lazimpat
4.	Satish Raj Joshi	CA	Nepal Insurance Company
5.	Madhu Bir Pandey	CA	MB Pandey & Company
6.	Buddhi Acharya	CA	Nepal Telecom
7.	Deepak Sharma	CA	Channel Nepal
8.	Sujan Kafle	CA	IRD, Lazimpat
9.	Krishna Dahal	CA	NCC Bank
10.	Suman Rayamajhi	CA	Rastriya Banijya Bank
11.	Janak Raj Pokharel	CA	NB Bank
12.	Bhava Nath Dahal	CA	Auditor General's Office
13.	Narayan Dhakal	Section Officer	MOF
14.	Ram Joshi	Director	Office of Auditor General

C. Tax Payers

S.N.	Name	Post	Organizaion
1.	Dilip Raj Bhandari	MD	Auto Land
2.	Ashok Baskota	MD, Doctor	BNB Hospital
3.	Dev Raj Paneru	Principal	Valley View School
4.	Surendra Bista	Account Officer	Capital Hospital
5.	Prakash Adhikari	GM	Capital Hospital
6.	Ramesh Kumar Sharma	Personnel Manager	Department of Health
7.	Kishwor Sapkota	Accountand	Food Land
8.	Dilip Poudel	Office Assistant	Machha Puchhre Bank
9.	Netra Prasad Subedi	Office Assistant	Standard Chatered Bank
10.	Sabin Manandhar	MD	Gates Computer Pvt. Ltd.
11.	Nabin Shakya	MD	Bits Computer Pvt.Ltd.
12.	Bala Dev Raut	Superviser	Hotel Shangrila
14.	Shiva Bista	Office Assistant	Hotel Shangrila
15.	Manoj Bista	Office Assistant	Bank of Kathmandu

16.	Dinesh Sharma	Executive Officer	Lumbini Travels & Tours
17.	Ashok Dahal	Office Assistant	Food Land Pvt.Ltd.
18.	Durga Ghimire	Office Assistant	Auto Land Pvt.Ltd.
19.	Sabin Chettri	Supervisor	Auto Land Pvt.Ltd.
20.	Durga Thapa	Finance Officer	Capital Hospital
21.	Sudip Chettri	Personnel Manager	BNB Hospital
22.	Pratibha Poudel	Accountant	Valley View School
23.	Mukunda Bista	Account Officer	Hotel Shangrila
24.	Ram Bahadur Raut	Marketing Manager	Hotel Shangrila
25.	Bimal Shrestha	Account Officer	Buddha Air

QUESTIONNAIRE

Name:

Post:

Experience in years:

Name of office/ organization:

Address of office/ organization:

Please tick (√) the answer of your choice or where ever appropriate put in order of preference from 1 to last number on the basis of number of alternatives.

For example if there are 5 alternatives and while ordering these alternatives give 5 points to first preferred choice and 1 point to last preferred choice and so on.

Q1. Do you think there are problems in Income Tax System?

Yes [ ] No [ ]

If yes, what are the major problems of Income Tax System of Nepal? (Please rank from 1 to 5 scales)

a. Complexities in tax act, rules and regulations. [ ]
b. Inefficient Tax administration. [ ]
c. Lack of uniformity in the explanation of tax act, rules and regulations. [ ]
d. Lack of conscious of tax payers. [ ]
e. Inappropriate rate of tax and exemption limit. [ ]

Q2. Do you think tax is a major source of government revenue?

Yes [ ] No [ ]

Q3. Do you think Income Tax has an important role in economic development and poverty alleviation?

Yes [ ] No [ ]

(if you think no, why do you think so please rank the following alternatives from 1 to 7 scales)

a. Growing illegal business activities. [ ]
b. Increasing habit of tax evasion. [ ]
c. Lack of economic policy. [ ]
d. Poor tax administration. [ ]
e. Lack of clearly defined programs for poverty alleviation. [ ]
f. Poor condition of industrialization. [ ]
g. Ineffective resource mobilization. [ ]

Q4. The Tax/GDP ratio for the F/Y 2061/62 and 2062/63 were 0:11:1 &

0:12:1. Do you think this is a satisfactory Tax/GDP ratio?

Yes [ ] No [ ]

(if you think no, please rank the following alternatives from 1 to 8 scale)

a. Poor Tax administration. [ ]
b. Increasing practice of tax evasion. [ ]
c. The agricultural income which has significant contribution in GDP is tax free. [ ]
d. Narrow scope of tax. [ ]
e. Low tax rate and high exemption limit. [ ]
f. Lack of appropriate tax assessment procedure. [ ]
g. Lack of consciousness of tax payers. [ ]
h. Poor industrialization. [ ]

Q5. Do you think that tax evasion and avoidance are the major problems of tax administration of Nepal?

Yes [ ] No [ ]

If you think yes, what are the causes?

(please, rank the following alternatives from 1 to 6 scales)

a. Lots of loopholes in tax act. [ ]
b. Weakness of tax administration. [ ]
c. Dishonest tax payers. [ ]
d. Corrupt tax personnel. [ ]
e. Lack of trained staff. [ ]
f. Lack of proper check and balance system. [ ]

Q6. Do you think that the ineffective tax administration is the cause of increasing resource gap problem in Nepal?

Yes [ ] No [ ]

If you think No, what are the causes for increasing resource gap problems in Nepal?

(Please, rank the following alternatives from 1 to 9 scales)

a. Narrow scope of tax. [ ]
b. Low income level of tax payers. [ ]
c. Illegal business activities. [ ]
d. Increasing expenditure of the government. [ ]
e. Agricultural income is free from tax liability. [ ]
f. Low contribution of Non-tax revenue. [ ]
g. Dishonest tax payer. [ ]
h. Defective tax act. [ ]
i. Defective government expenditure programs. [ ]

Q7. Do you think that the agricultural income should be taxed to increase the contribution of Income Tax revenue on total government revenue?

Yes [ ] No [ ]

If you think No, why agricultural income should not be taxed?
(Please rank the following alternatives from 1 to 5 scales)

a. Dependents on agriculture are very poor. [ ]
b. Traditional agricultural system. [ ]
c. Dependents on agriculture have no knowledge of tax and its importance.
   [ ]
d. Lack of agricultural infrastructure. [ ]
e. Agricultural output fulfill the basic needs of people. [ ]

Q8. Income Tax Act 2058 has classified tax payers based on marital status as individual and couple. Do you think the exemption limit provided to them and tax rate is rational?

Yes [ ] No [ ]

If you think No, what are the causes of not being rational?
(Please rank the following alternatives from 1 to 5 scales)

a. There is no provision to adjust the price level change. [ ]
b. Number of Dependents upon individuals and couple not considered.[ ]

c. Certain percentage of educational expenses should be allowed to deduct from total taxable income. [ ]
d. Whole pension Income should be made Tax exempted. [ ]
e. Dashain Allowances should be made Tax-exempted. [ ]

Q9. Total 24856 number of new Tax payers were registered in F/Y 2005/06 which consists of 96 Public Enterprises, 98 Semi-Public Enterprises, 2652 Private Corporate Bodies, 21584 Individuals. "Is this number satisfactory to increase the contribution of income tax in total Government Revenue?"

Yes [ ] No [ ]

If you think No, what are the causes of low number of new tax payers registered in the F/Y 2005/06?
(Please rank the following alternatives from 1 to 5 scales)

a. Lack of security provision to the industrial sectors. [ ]
b. Uncertain political situation of the country. [ ]
c. Lack of infrastructure. [ ]
d. Poor Supervision and monitoring system. [ ]
e. Practice of doing the business without registration. [ ]

Q.10 ITA 2058 has classified the income tax payers based on legal status, marital status, and residential status for the assessment of taxable income. "Do you think these bases of classifications are scientific and systematic for the assessment of taxable income?"

Yes [ ] No [ ]

Q11. If any comments and suggestions, please specify.

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(Thanks for you co-operation)