

# CHAPTER - I

## INTRODUCTION

### 1.1 Background of the Study

Income tax may be understood very easily if we first define the term “income”. Income is, generally regarded, as the best measure of the ability in the sense of economic well- being, for income is the primary determinant of level of living, which a family enjoys.

In development countries (DCs), the most important feature of the tax policy has been the rise of the personal income tax to a significant proportion in the revenue structure. The income tax was introduced to finance the war in most of these countries. But it remained in place after the war, primary as relatively modest tax on higher incomes and latter becomes a mass- tax during or soon after the Second World War. Since then, the personal income tax revenue has a trend of unparalleled increase in real and especially in nominal terms (Aryal and Paudel, 2004:25).

The problem, which is the greatest universal concern at present, is ‘development’. Development economics is a distinct yet very important extension of both traditional economics and political economy. Development simply implies the maximization of the welfare of the society and efficient allocation of resources. History reveals that the development of the industrialized countries concentrated their attention on economic growth. By the same token, the economic model at post wartime followed by underdeveloped countries (UDCs) was also growth dominated. But paying attention simply on growth of the economy led to the increment in the gap between haves and have-nots with the failure of “trickle down effect”. So, in 1960s, the concept of sustainable development was dominant and still, it is

the main concern of economists, ecologists and sociologists, reflecting the increasing concern about environment.

After the great depression of 1930's the function of government has been increased considerably for the economic development of an economy. Physical and economic infrastructure are essential. The World Bank emphasizes the need to broaden the forms of policy beyond increasing the quantity of infrastructure facilities to improve the quality and efficiency of infrastructure services. Due to the presence of externalities, long gestation period and low returns, automatic functioning of the market does not lead to the economic efficiency in the case of infrastructure which justifies government's intervention.

Instruments of government to intervene in the public economy are revenue and expenditure policies. These two aspects of the fiscal policy are guided by different philosophy. On the one hand, available budget margin is a hypothetical construct that determines the size of the permissible increase in government expenditure. In contrast to budgetary philosophy in most countries, it is the hypothetical growth of revenue at the trend level of output and not the actual anticipated growth of revenue that guides expenditure planning in a given period (Aryal and Paudel, 2004:42).

The principal components of fiscal policy to mobilize public resources have been government tax policies. The relation between taxation and economic development has long been a matter of concern to policy makers.

The source of government revenue is a conditional source. Duty and fees, penalty, fines and forfeitures, receipt from sale and rent of government property and services, dividends, interests, royalty and sales of government property, principal repayment, donation and miscellaneous income etc are the sources of non tax revenue. Income tax, sales tax, custom duties, hotel tax, revenue from land registration etc are the sources of the tax

revenue. Of them, tax revenue is major sources off the internal revenue as well as the macroeconomic fiscal instrument of the government.

A tax is a compulsory contribution to government made without reference to a particular benefit receives by the taxpayer. It is a personal obligation to pay tax and there is no direct relationship among tax, benefit and taxpayers. The primary purpose of taxation is to direct control of economic resources from the payers to the stare for its own use or transfer to others. Bringing about economic growth, elasticity in the tax structure, control of inflationary and reduction of inequality are the main objectives of a tax policy. For underdeveloped countries to achieve economic growth and equality at the same time is rarely possible task. The imperative of economic growth still overshadows other objectives in these counties (Aryal and Paudel, 2004:57).

Taxes are broadly classified into two groups:

- a. Direct tax
- b. Indirect tax.

**a. Direct tax:**

It is a personal tax. If the impact and incidence of tax is borne by the some person to whom the tax is legally imposed and there is no possibility of shifting then it is called direct tax. Examples include income tax; profit tax, property tax, expenditure tax, gift tax, interest tax, death tax, contract tax, vehicle tax etc.

**b. Indirect tax:**

It 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, entertainment tax, passenger tax, hotel tax, export and import duties, excise duty etc are some of the indirect taxes.

## 1.2 Concept of income tax:

Income tax may be understood very easily if we first define the term 'income tax'. Income is generally regarded as the best measure of ability the sense of economic well-being, for income is the primary determine of the level of living, which a family.

In a broad sense, income refers to the economic gain to a particular person during a particular period of time. It includes the person's consumption during a particular period of time as well as the same period.

Henry Simons defines income tax as the sum of two items, saying "income, as economic gains received by the person during the particular period" of

- I. Personal consumption during the period
- II. Net increase in individual personal wealth during the period.

Symbolically,

$$Y = C + \Delta W$$

Where,  $Y =$  Income

$C =$  Value of consumption

$\Delta W =$  Change in wealth

Therefore, according to above definition income is the sum of consumption and change in wealth during the period. Income tax can consist of three broad items:

- a. The total amount of income received from one person less the expenses directly incurred in gaining this amount.
- b. The value of goods enjoyed by person which are owned by him such as the use value of home owned, hence produced goods such as vegetables, and
- c. The increase in the value of assets held during the period.

Generally, income tax is imposed on net income. Net income comes after deducting the cost of production from gross income. In practice the expense incurred in earning the income and appropriate exemptions are

deducted to find out taxable income. Net income may be real income or money income. Real income is more comprehensive and includes not only money income but also other incidental advantages. Real income should, therefore, be the true index of ability to pay. So income tax should be charged on real net income of an individual and not on his net money income (Agrawal, 1980:104).

### **1.3 Statement of the Problem**

Nepal is one of the least developed and agro-based countries. The agricultural sector provides employment to nearly about 85% of total population. The output per head in the agricultural sector is very low in comparison to that of developed countries. Thus, the role of taxation has increased as the government has promised to provide the infrastructure for the development process and to provide the social services to the poor people, whose volume is dominant in country's demographic structure.

Agriculture sector, which contributes 35.68 % of GDP (WDR 2012), is still free from the income taxation. 25.4% of the populations are below the absolute poverty line. Thus in the course of the fulfilling the development objectives, increase in government expenditure, has outpaced the growth in revenue collection. Nepal is thus facing a problem of scarcity of resources for development activities. Few rich capture major economic sources and they are under-taxed either because of tax evidence or evasion and most of the poor people suffer from commodity tax. There are some inherent problems in the Nepalese tax structure. They are:

#### **A. Increasing the resource gap in each year:**

Nepal is facing a serious and growing resource gap since first budget speech 1951/52. In the first budget, regular expenditure was 42 million and there was no development expenditure. A total of 30.35 million was collected as revenue and the government did not take any foreign loan and grant in that year. Thus resource gap was 11.5 million.

The balance of payments is not favorable. In every year import of goods is higher than export of goods. It has also been commonly known that the gap between expenditure and revenue that is called “resource gap” is increasing in each year.

Therefore, the resource gap has been a serious bottleneck in process of economic development of developing countries like Nepal. Therefore, to raise government revenue it is necessary to raise its sources of revenue.

### **B. Dominant role of indirect tax:**

In the modern era, taxation has been taken as the most effective tool for rising national revenue. The government by mobilizing adequate resources through taxation might invest them in various development programmers. In this way, in the UDCs the government might play in important role in promoting capital formation.

Most of the developing countries, the governments collect  $\frac{3}{4}$  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 direct taxes are more progressive and justifiable on the ground of equity. The indirect tax creates extra burden to the people, especially for poor people by raising prices of commodity. It does not create public consciousness and it has 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.

Therefore, this study has focused on income tax contribution of government revenue in Nepal. It also tries to solve the following research problems:

- What is the structure of revenue collection of income tax?
- What will the ratio of income tax revenue to GDP, total revenue and direct tax revenue?

- What is the composition and trend of income tax revenue in Nepal?

#### **1.4 Objectives of the Study**

The main objective of the study is to analyze the income tax contribution on government in Nepal. The specific objectives of the study are as follows:

- To access the exemption limit of income tax in Nepal,
- To analyze the structure of revenue collection of income tax in Nepal,
- To examine the ratio of income tax revenue to GDP, total revenue and direct tax revenue,
- To make suggestion and recommendation for the improvement in income tax system in Nepal.

#### **1.5 Significance of the Study**

This study concerned with appropriate suggestions for the estimation and correction of income tax evasion. This study would be helpful to the economists, planners, tax officers, tax administrators and government; so that income tax evasion can be controlled and sufficient resources could be mobilized from taxation.

Nepal is Income tax. But income tax evasion decreases the government's revenue collection, which blocks the economic development of Nepal. Hence, the impact of income taxation for the utilization of resources of Nepal has been chosen as a relevant topic for the present study.

#### **1.6 Limitations of the Study**

This study has the following limitations:

- Trend and data have been analyzed from 2058/59 to 2067/68.

- The study has analyses only those data which are available.
- The data are collected and analyzed which are provided by Inland Revenue Department (IRD) and Ministry of Finance (MOF).
- Data, information and findings were based on primary and secondary data.
- Tax planning and tax evasion were taken into consideration in this study.

### **1.7 Organization of the Study**

This study has been organized into five chapters, the title of each chapters are as follows:

Chapter-I: Introduction

Chapter-II: Review of literature

Chapter-III: Research methodology

Chapter-IV: Presentation and analysis of data

Chapter-V: Summary, conclusion and recommendation.

#### **Chapter-I: Introduction**

The first chapter is introduction which includes background of the study, statement of the problems, objectives of the study, importance of the study and limitation of the study along with chapter plan.

#### **Chapter-II: Review of literature**

dome in the related topic in previous days and what is to be done at present or in future. In this chapter which gives the theoretical concept and review of related materials I.e. review of books, review of thesis, review of journals, newspapers, magazine etc.

#### **Chapter-III: Research methodology**

This chapter includes introducing research design, data collection, nature and source of data, data gathering procedure and statistical tools etc.

#### **Chapter-IV: Presentation and analysis of data**

Presentation and analysis of data have been made in the fourth chapter. The data collected from various years annual report of Inland Revenue Department, economy survey etc. have been tabulated in their sequential order and data have been described, analyzed and projected with statistical tool as well as general accounting and taxation principle.

#### **Chapter-V: Summary, conclusion and recommendations**

This chapter is the general idea of the study and it represents all the opinions of the research as far as possible. Summary, conclusion and recommendations are mentioned in the last chapter of the study.

Lastly, essential Bibliography and Appendices have been presented at the end of the study.

## CHAPTER-II

### REVIEW OF LITERATURE

#### 2.1 Conceptual Framework

Taxes have been called the building block of civilization. being the main source of revenue collection, income tax plays huge role in revenue collection. in this chapter I have tried to give clear introduction ,background, evolution, and development of tax and income tax, gradual development of income tax. I have review various other scholar's views as well as. Obviously the principle of income tax may be differ in global context but the major aspect of income tax cover the Nepalese system

##### 2.1.1 Meaning and introduction of income tax

Income tax is a tax on individuals and business entities that taxes their income. The United States uses a progressive income tax system. The income tax has its history in the United States dating back to the Civil War. The income tax is so controversial that the United States needed a Constitutional amendment.

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

$$Y = C + S$$

where,

Y = Income

C = Consumption

S = Saving

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

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

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

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

From the definition given above it can be said that firstly, a tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government. Secondly, taxpayer cannot receive any quid pro quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. Thirdly, the tax is paid to the government for running it. Fourthly, in case of tax, the amount is spent for common interest of the people. The tax is collected from

haves and basically, spent for the interest of have-nots in the society. Fifthly, a natural or an artificial person pays the tax. (Kandel, 2004)

In conclusion, it can be said that tax is a liability to pay an amount to the state. The basis of a minimum amount from certain specified or that they own certain tangible or intangible property or that they carry-on certain activities which have been chosen for taxation. (Kandel, 2001)

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

### **2.1.2 Evolution of Taxation**

The origin of taxation in the United States can be traced to the time when the colonists were heavily taxed by Great Britain on everything from tea to legal and business documents that were required by the Stamp Tax. The colonists' disdain for this taxation without representation (so-called because the colonies had no voice in the establishment of the taxes) gave rise to revolts such as the Boston Tea Party. However, even after the Revolutionary War and the adoption of the U.S. Constitution, the main source of revenue for the newly created states was money received from customs and excise taxes on items such as carriages, sugar, whiskey, and snuff. Income tax first appeared in the United States in 1862, during the Civil War. At that time only about one percent of the population was

required to pay the tax. A flat-rate income tax was imposed in 1867. The income tax was repealed in its entirety in 1872.

Income tax was a rallying point for the Populist party in 1892, and had enough support two years later that Congress passed the Income Tax Act of 1894. The tax at that time was two percent on individual incomes in excess of \$4,000, which meant that it reached only the wealthiest members of the population. The Supreme Court struck down the tax, holding that it violated the constitutional requirement that direct taxes be apportioned among the states by population (*POLLOCK V. FARMERS' LOAN & TRUST*, 158 U.S. 601, 15 S. Ct. 912, 39 L. Ed. 1108 [1895]). After many years of debate and compromise, the Sixteenth Amendment to the Constitution was ratified in 1913, providing Congress with the power to lay and collect taxes on income without apportionment among the states. The objectives of the income tax were the equitable distribution of the tax burden and the raising of revenue.

Since 1913 the U.S. income tax system has become very complex. In 1913 the income tax laws were contained in eighteen pages of legislation; the explanation of the Tax Reform Act of 1986 was more than thirteen hundred pages long (Pub. L. 99-514, Oct. 22, 1986, 100 Stat. 2085). Commerce Clearing House, a publisher of tax information, released a version of the Internal Revenue Code in the early 1990s that was four times thicker than its version in 1953.

Changes to the tax laws often reflect the times. The flat tax of 1913 was later replaced with a graduated tax. After the United States entered World War I, the War Revenue Act of 1917 imposed a maximum tax rate for individuals of 67 percent, compared with a rate of 13 percent in 1916.

In our neighboring country India, the income taxation was started in 1860 by the British government to relief from economic burden created due to first democratic revolution. It was then regularly collected after the publication of Income Tax Act 1886 (Dhakal, 2057).

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

### **2.1.3 Taxation in Ancient Nepal**

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

### **2.1.4 Taxation in Unified Nepal (1768-1846)**

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

King Prithvi Narayan Shah had introduced 'Pota' tax in 1772, which

was regarded as a revolutionary measure in the fiscal system of Nepal. It was based on flat rate system and limited on small Birta owners. There was no taxation of income in the sense of modern income tax.

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

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

### **2.1.5 Taxation in Rana Regime (1846-1950 A.D.)**

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

Land tax, custom and excise duties in the form of lump sum contracts, royalties on felling trees, royalty on supply of porters and soldiers, entertainment taxes were the major source of revenue. There was no direct tax in the country except land tax collected on a contractual basis and

"Salami" which the government employees used to pay out of their salaries at a very small percentage.

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

### **2.1.6 Income Tax in Modern Nepal**

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

## **2.1.7 Gradual Developmental of Income Tax Act and Law**

### **2.1.7.1 Business Profit and Remuneration Tax Act, 1960 (2017 B.S.)**

The finance act 1960, made provisions for the taxation of business profits and remunerations. An ordinance was issued by the king to collect the tax. In 1960, parliament of Nepal, enacted, "Business Profit and Remuneration Tax Act 1960(2017)", which consisted of 22 sections. With the enactment of that act, the salary tax or personnel income tax was levied upon those individuals whose personal income exceeded Rs. 6,000 per year. In the first three years, the exemption was Rs. 7,000. An examination of tax files in the Kathmandu District Office disclosed 577 personal income tax files of individuals who had paid taxes in one or more years.

The following were the salient features of the act.

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

As high discretionary power in assessment of income tax granted to

tax officers, various loopholes, narrow and vague tax base were the major shortcomings of that act which cause the Income Tax Act 1962(2019) came into existence.

#### **2.1.7.2 Income Tax Act, 1962 (2019)**

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

The additional features of this act was as follows:

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

The changing socio- economic environment of the nation had forced to

change the Income Tax Act. As a result Income Tax Act 1974 (2031) came into existence.

### **2.1.7.3 Income Tax Act, 1974 (2031)**

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

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

8. Taxpayer was required to keep accounts and records of the income and to be preserved for six years.
9. Provision was made to make agreement for avoidance of double taxation with foreign government.
10. Provision was made relating to reassessment or additional assessment of tax.

#### **2.1.7.4 Income Tax Act, 2002 (2058)**

To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend and integrate the laws relating to income tax, the parliament of Nepal enacted Income Tax act, 2002 (2058), since First April 2002(19<sup>th</sup> Chaitra, 2058)

This act was brought in Nepal to avoid the following defects of Income Tax Act 2031 (Kandel, 2003)

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

The main objectives of ITA, 2058 are presented below:

1. To levy tax on all income sources and income earning transactions.
2. To impose uniform tax to all people and all sources.
3. To make income tax revenue more productive and elastic.
4. To develop the tax system by means of extended scope, clear-cut, transparent and simple procedure.

5. To make accountable and improve tax administration.
6. To reduce economic cost neutralizing income tax.
7. To emphasize statement based on accounting system.
8. To make responsible to income taxpayers emphasizing procedure of self- assessment system.

**The key features of Income Tax Act, 2058 are:**

1. All income tax related matters are confined within the act by abolishing all tax related concessions, rebates and exemption provided by different acts.
2. The act has broadened the tax base. Unlike previous tax act, tax rates are spelled out in the act. The tax rates and concessions are harmonized on equity grounds.
3. The act has introduced a pool system of charging depreciation. Intangible assets are also depreciated.
4. The act has first introduced taxation on capital gains.
5. The act has provided liberal loss set-off and carry forward/backward provisions, interned adjustments of losses are clearly specified.
6. The act has provided a stringent fine and penalty for the defaulters.
7. The act has introduced a provision for administrative reviews to allow the tax administration to correct mistakes made by tax administrators internally.
8. Global incomes of a resident are made taxable. Non- residents are also taxed on their incomes with source in Nepal.
9. List of expenses is inclusive. All expenses relating to income have been made admissible.
10. The act has made provision of international taxation. Foreign tax credit has been introduced for the first time.
11. The act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.

## **2.1.8 Corporate Tax and Its Development in Nepal**

### **2.1.8.1 Concept of corporate tax**

A corporate body or company is an artificial person created by law. A company is a legal person just as much as individual. It is separate and distinct from its individual members. A company like a natural person can do every thing. It can conduct a lawful business and enter into contacts with others in its own name. A company or corporate body is a legal organization that is voluntarily created, organized or chartered under law. It is 'an artificial person' which can own property, execute contracts, raise debts and generate profits. Corporate tax, therefore, is a tax levied on companies or corporate bodies in contrast to unincorporated enterprise. It is the tax on capital income that occurs in the form of profit and originates in the corporate sector i. e. company. The history of tax was started from 1909 in USA when 1% excise was levied in corporation i. e. companies in the ground of the privilege they enjoy. Since then, corporate tax is contributing a substantial amount of revenue to the state treasury of most of the developed and developing countries. The statutory rate percent, however, was very low in initial period increased vehemently later on after First World War and again started to be turned slow since 1980s (Kandel, 2001)

### **2.1.8.2 Development of Corporate Tax in Nepal**

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

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

The third Income Tax Act was introduced in 1974 with making new changes and provisions than old one. A separate tax system to companies was introduced by the Finance Act, 1976. Finance Act, 1985 made a provision of giving 5% tax rebate from highest marginal rate of 55% to listed public companies and government enterprises. Fiscal year 1986/87 was the year when the corporate tax was really recognized by imposing a flat rate of 40% tax on taxable income of the listed companies. The same Finance Act imposed tax on dividend also to be deducted at source at the rate of 20% which after the filing of return by shareholders was to be reconciled. But the dividend tax system was changed exempting dividend to a level of 85% in 1987/88 and cent percent in 1990/91. Compulsory self-tax assessment system for public and private limited company was enacted from the financial year 1994/95. This change supported to end the discrimination between private company and public company. Another major change carried out in the fiscal year 1998/99 was the inclusion of dividend of non-industrial companies within the tax net.

After enactment of Income Tax Act 2002, the corporate tax levied upon general industries is 25%, 30% for insurance company and financial institutions. Trading companies are levied tax at the rate of 25%, manufacturing industry at 20% and special sector company at 20%. Export profit which was taxed at a level of 8% or 0.5% of sales as per Finance Act 2057 was changed by the Fiscal Act 2058 has recommended, export profit from industry sector and trading sector are taxed at 20% and 25% respectively.

### **2.1.8.3 Corporate Tax Base in Nepal**

There are controversies as regards to the choosing of corporate tax base since there may be various bases of taxation. For instance, these bases may be income, cash flow, turnover, total assets and added value etc. Among these, base-income and cash flow are mostly considered by the tax expert (Kandel, 2006).

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

Tax base may depend on the relation between corporate tax rates and personal tax rates. Different countries of the world have different choice of base for corporate tax. Most of the countries prefer corporate- profits or book profits as the tax base. For, book profit as a tax base is stronger and superior than other types of tax bases. (Khadka, 1994)

If income is taken as the base of taxation, it is called income basis or net profit basis. It means deductions of interest on debt and depreciation of fixed asset from gross profit and adjustment of capital gain, stock appreciation or depreciation etc. Since it is calculating tax base is adding up all the incomes of the company and deducting expenses incurred in earning the income. However, because of its cumbersomeness in finding out taxable income, modern tax experts are in favor of replacing it. The main causes of the cumbersomeness are treatment of revenue and expenses on accrual basis, treatment of depreciation under historical cost, measurement of capital gain

and effect of inflation either interest or valuation of stock. The cash flow tax, on the other hand, is the alternative considered by economists and tax experts to replace income based taxation (Kandel, 2001).

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

### **2.1.9 Concept of Tax Incentives**

Regardless of the fact that an incentive surplus economic activity. Again, many use the term to refer to any relative change in taxation that changes economic behavior. Such pseudo-incentives include tax holidays, tax deductions, or tax abatement. These "Tax incentives" are targeted at both individuals and corporations.

#### **Individual Incentives**

Individual tax incentives are most prominent in the federal income tax code in the United States, and include deductions, exemptions, and credits. Specific examples include the mortgage interest deduction, individual retirement account, and hybrid tax credit.

Corporate tax "incentives" more typically include federal, state, and local governments. The federal tax code provides a wide range of incentives for corporations, totaling \$109 billion in 2011 according to a Tax Foundation Study.

Corporate tax incentives provided by state and local governments are also included in the tax code, but many times are directed at individual companies involved in a corporate site selection project. Site selection consultants negotiate these incentives, which are typically specific to the corporate project the state is recruiting, rather than applicable to a broader industry. Examples include:

- Corporate income tax credit

- Property tax abatement
- Sales tax exemption
- Payroll tax refund

Deduction, exclusion, or exemption from a tax liability, offered as an enticement to engage in a specified activity (such as investment in capital goods) for a certain period.

An income tax is a disincentive to save or invest and therefore, the incentive if to mitigate the disincentive, Tax incentive may imply a partial or complete exemption from one or a variety of taxes and special allowances for a certain period to motivate the behavior of saver or investor (Agrawal, 1978). The main aim of tax incentive is to increase savings and encourage and canalize the investment to desired area or sector. It is supposed that they encourage investment in selected manufacturing activities or improvement of product quality or utilization of domestic resource in manufacturing.

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

#### **2.1.9.1 Present Provisions Related to Tax Incentives in Nepal**

Previously, tax exemption facilities were provided by different acts, in Nepal. More than 18 acts were responsible to provide such facilities, the Industrial Enterprise Acts was the main. Industrial Enterprises Act of 2018, 2031, 2038 and 2049 provided such facilities. The major facilities of such

type were up to 18 years tax holiday to industry; no double taxation on dividend; fixation of tax rate to industry at 20% etc. The other facilities except those were complete exemption of income tax, sales tax and excise to cottage industries, extra depreciation facility of 33.33% of ordinary rate to special industry, deduction facility of 5% of net income as donation and 5% and 10% of gross income for promotion and development of technology respectively; tax rebate of 10% to industry employing 100% of Nepalese labour and more than 80% of Nepalese raw materials. Besides stated above, the other facilities were investment allowance of 40% of capacity is increased by more than 25%, facility or allowing 50% of the pollution control expenditure facility of capitalizing the manpower development expenditure, facility of deducting the expenses incurred for employee or labour residence, life insurance, health, education, training, partial tax holiday to priority industry, tax rebate to the industries in remote areas, no double taxation on raw materials use by the industries etc. As already stated, tax incentives were not the function of Income Tax Act and Industrial Enterprise Act only at that time. Electricity Act, Petroleum Act, Foreign Investment and Technology Transfer Act also provided different types of tax facilities to concerned industries. Facilities provided by these acts were full exemption of income tax to electricity producer of up to 1000 k.w., tax holiday of up to 15 years to electricity related works: only 18% tax rate applicable to electricity related industry; only 10% tax rate to petroleum industry and so forth.(Kandel, 2006)

The Income Tax Act, 2058 has also provided various types of tax incentives such as tax credit, accelerated depreciation, and loss set off and carry forward of losses. An individual may claim medical tax credit (sec. 51) for tax offset of medical expenses incurred for tax offset of medical expenses incurred for him self. Claim to be adjusted in year will be 15% of eligible medical expenses plus any amount carried forward in respect there from the previous year. Maximum amount that can be claimed in an income

year will not exceed Rs. 750 as per rule 17. Likewise a resident person may claim a foreign tax credit as per section 71 for an income year for any foreign income tax paid by the person to the extent to which it is paid with respect to the person's assessable foreign income for the year.

Business loss can be carried forward to 4 years as per sec. 20. In the case of Banking and General insurance, sec 59(2) and sec. 60(2), business loss can be carried back to 5 years. In the case of long term contract, loss can be carried forward as per the notice of Internal Revenue Department sec. 20(4). Similarly, loss of BOT/BOOT can be carried forward up to seven years. Depreciation can be charged only on pool of assets as per sec. 19(2). Accelerated rate of depreciation is available only to manufacturing industry as per sec.3 of Industrial Enterprise Act 1992 and other specific sections 19(2).

## **2.2 Review of Related Materials**

### **2.2.1 REVIEW OF THESIS**

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

His research design was historical and descriptive. He had used only secondary data of 21 years from 1974/75 to 1994/95. Data collection and analysis procedures were; consulting the required governmental and non-governmental offices, and simple arithmetic rule chart and diagrams were applied to analyze data. From that research he had found out and concluded that income tax can be the vital source for internal resource mobilization to

fulfill resource gap. Only 0.35% of total population came under the categories of taxpayers in Nepal during his research period. He found that collection of income tax was gradually growing and the contribution of income tax in total tax revenue and total national revenue were 9.95% and 7.94% respectively. Similarly, he also concluded that individual tax payer had higher contribution in income tax than salaried taxpayer.

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

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

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

Tripathi (1995) had presented a thesis entitled, "Income Tax System in Nepal and Some Potential Areas for Reform." Deficit annual budget and deficit financing of the nation were his main concern of the study where he had tried to show the tax structure in Nepal, role of income tax in Nepalese

economy, income tax administration and tax evasion in Nepal along with reforms.

Tripathi had conducted his research using the 15 years data since 1974/75 to 1989/90. Primary data were also used which were collected through opinion survey within Kathmandu valley. Simple statistical tool such as mean and time series were used to analyze the data Graphs, charts and diagrams were also used as necessary.

From that research, he had concluded that income tax from individual sector had provided maximum contribution in income tax structure and about 80% of total revenue was collected through taxation. Tax evasion had increased due to poor tax administration and delay in tax assessment process. Lastly, he had recommended levying tax on agriculture income, tax holiday should be given to the firms and administration should be sound and efficient.

Shakya (1995) he had presented his thesis entitled, "Income Tax in Tax Structure of Nepal" and had tried to give origin and meaning of income tax with its historical review, structure of government revenue in Nepal, importance of income tax, contribution of income tax to total tax revenue and total revenue.

In his study, he stated that the structure of the government revenue in Nepal is a composition of the tax revenue and non- tax revenue. The tax revenue is the most important sources of government revenue that occupies 80% share in the total government revenue in the year 1993/94. The ratios of income tax to GDP, total revenue, total tax revenue and direct tax revenue had an increasing trend. But the increasing rate was low in comparison to other countries. He further added that the change in tax rate and exemption limit had made the assessment of income tax more complicated, which had given plenty of opportunities to evade income tax, which exist as a major problem.

Lastly, he had recommended many suggestions for the sound and

effective income tax such as honest and effective tax administration scientific method in tax collection and encouragement of self- assessment of tax.

Panta(1996), he had presented a thesis entitled, "A Study on Income Tax Management in Nepal ". His main objectives of research were to find out the share of income tax to government revenue, to review the income tax system and to identify the problem of income tax management. His research was based upon secondary as well as primary data. The primary data were collected within Kathmandu valley through interview, questionnaire etc.

He had concluded that income tax was a major source of internal resource mobilization, the income tax system was not efficient and income tax assessment was not efficient. Evasion of income tax was major constraint for resource mobilization. He also added that corporate tax rate was found high and exemption limit was not sufficient.

Lastly, he had recommended that income tax net should be widened, assessment procedure must be improved and income from agriculture and capital gain should be taxed.

Poudyal 'Kshetry' (1998) he had submitted a Ph. D. thesis entitled, "Corporate Tax Planning in Nepal". This thesis report was aimed to examine the implications of tax factors in strategic planning, project planning and operational planning in Nepalese companies. He had found that the majority (90%) of the companies (sample size of the study) considered tax factors while selecting the lint of business. He also found the positive correlation (+0.8) between tax rate and the debt equity ratio because of interest paid on debt is a tax-deductible item. Similarly, the correlation coefficient between average fixed assets and corporate tax was (0.75) in large companies and (+0.12) in medium size companies. As against this, in large companies, there was a negative correlation (-0.2), which showed that increase in fixed assets in large companies resulted in decrease in the corporate tax. He

addressed that the tax planning should be considered while making corporate planning and so companies should set up separate tax section to get maximum benefit of provisions, provided by tax law. However, tax assessment under the best judgment blocked the application of tax planning in corporate planning. He had recommended that tax incentives should be given to non- industrial companies too, and tax rate should be differentiated for resident and non-resident companies.

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

### **2.2.2 Review of Books**

Khadka (1994); he had written a book entitled, "Nepalese Taxation: A Path for Reform". The book dealt with both national and international taxes. The writer had detailed describe the scenario of Nepalese tax system from

origin of income tax, adoption of quasi-global or a limited scheduler system, segregation of corporate income tax from individual income tax, increasing dependence on the presumptive basis, basic allowance and progressive rate structure, move from joint taxation to individual taxation and shift from itemized to flat system of standard expenses, experiment with an advance tax on impacts and the existing structure, commodity taxes and poverty taxes. He had evaluated the Nepalese tax system base on conventional, theoretical concepts and suggested various measures for its improvement. The book had not been directly focused on corporate tax only but explains the whole Nepalese taxation system and structure for its reform.

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

Aryal and Paudel (2004) had written a book entitled, "Taxation in Nepal" They had explained about the income tax system in Nepal along with house and land tax and value added tax. The book has been designed based on the curriculum of B.B.S. It had been divided into three parts. In the first part of the book introduction and development of income tax, capital and revenue nature expenses and income items, entity and retirement saving,

dividend tax, computation of income from business, remuneration and investment have been explained with numerical and theoretical examples. House and land tax and value added tax have been explained in the second and third part respectively, the book also included proper bibliography and adequate appendix where various income tax, house and land rent and vat related forms, schedules and format had been described.

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

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

Agrawal (1980); he had written a book entitled, "Resource Mobilization in Nepal" published by CEDA. The book had been divided into eight chapters; the first chapter deals with special reference to Nepal. The second chapter deals with fiscal policies in developing nation and Nepal and third chapter looks at income tax in Nepal from the historical perspective, the fourth chapter deals with structure of Nepalese taxation.

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

Agrawal had made an empirical study taking tax policy makers, tax experts, tax administration, tax lawyers and accountants and taxpayers of

different parts of Nepal. From that study he had concluded that Nepalese taxpayers were favorably disposed to income tax. However, the major constraints in the effective functioning of tax system seem to be administrative deficiencies, poor tax paying habits, lack of taxpayer's education, complex procedures and defective tax information system.

### **2.2.3 Review of Research Reports and Articles**

Pant (2004); he had written an article entitled, "Problems in Tax Administration and their Remedies" published in Journal of finance and development 'Rajaswa' April vol. 1. He had comprehensively explained about the problems and their remedies related with tax revenue. The major types of practical problems and challenges, in tax administration. He had mentioned in his article were showing limited amount of transaction showing low selling price, lack of issuing and taking bills, lack of showing the real factory cost, commercial fraud, lack of co-operation in tax auditing, legal ambiguity and complexity in implementation and lack of coordination between Inland Revenue Department and Revenue Investigation Unit. Meanwhile, he had recommended some valuable suggestions to solve the problems and to overcome the challenges. They were: statistical and information system should be properly managed, fixed norms and standards should be used to assess selling price and factory cost, the billing system should be made compulsory, coordination between Inland Revenue Office with various entities of Government, Revenue Investigation Department and its related units should play the important role.

Kandel (2004);he had written an article entitled, "Are Tax Incentives Useful? If so, which one?" published in Journal of Finance and Development, 'Rajaswa', Volume1 2004, April. In that article he had tried to seek the answer from the survey of various empirical studies earlier done in Nepal, India, Pakistan and other western countries. He found that the tax incentives are still the controversial matter whether they promote the

investments or not. But he argued that most of the developing countries need tax incentives.

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

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

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

### **2.3 Research Gap**

All the research studies mentioned above are concerned with study of laws, provisions, administrative aspects and structure of tax. Most of them have indicated the inefficiency of tax administration, widespread tax

evasion. No attention is paid on a particular problem. Many of them have taken various problems as their research objectives and no thoroughly study on a particular subject problems is done except few of the research work.

Nepalese corporate sector is small and stagnant in nature and the performance of public sector, private and government sector is poor. Contribution of income tax from corporate sector plays vital role in Nepalese economy. Regarding the fact that the considerable contribution of corporate sector in the economy of other developing countries, I found no more study done in the contribution of corporate income tax to government revenue of Nepal. So, this study has been undertaken analytically and intensively to analyze the structural composition of income tax, to find about the condition of problem in income tax collection and to analyze corporate income tax contribution to government revenue and fulfilling the resource gap from an internal source.



## **CHAPTER-III RESEARCH METHODOLOGY**

This chapter deals about research methodology which is used for research purpose. Research is a system enquiry for seeking facts and methodology is the method of doing research in well manner. So, research methodology means the analysis of specific topic by using proper method. "The term research methodology refers to the various segmental steps to be adopted by a researcher in studying a problem with certain objectives in a view. It is describes the methods and process applied in the entire aspect of study", (*Kothari, 1994: 19*).

"This process of investigation involves a series of well thought out activities of gathering, recording, analyzing and interpreting the data with the purpose of finding answers to the problem. Thus the entire process by which we attempt to solve problems is called research" *Wolf and Pant (2000:203)*. It is significant to have appropriate choice of research methodology that helps to make this research study meaningful and more scientific. Therefore, appropriate methodology has been followed to meet the purpose objectives of the study. So, the methodologies of this research include the research design, research question, period covered, selection of enterprises, types and sources of data, data processing procedures, presentation of data and method of analysis.

### **3.1 Research Design**

The research topic entitled "Contribution of income tax in government revenue of Nepal," is abstracted from the socio-economic environment of Nepal. As the corporate income tax system and structure is based on various rules regulations and acts which are always setting on different countries own socio-economic infrastructure, descriptive research design is more suitable to analyze Nepalese corporate tax structure. For contribution of corporate income tax, the study needs to analyze its past

performance in different time period with respective indicators. So, historical as well as descriptive research design is used. The data and information of the study are concerned with past phenomena of the performance. An opinion survey has been conducted for an empirical research. The opinion of the various 75 respondents, associated with income tax i.e. income tax administrators, income tax experts and income tax payers, collected through structured questionnaire with reference to income tax system of Nepal. Thus, the research methodology followed in the study can be termed as analytical as well as descriptive research design.

### 3.2 Population and Sampling

The targeted whole area relating to government revenue or national revenue is set for the research population. Income tax, especially, corporate income tax is taken as sample size. To achieve the objectives of the study, 75 sample size from Kathmandu valley has been taken. Persons included in the sample are carefully selected by consultation with the tax experts, professors and lectures of Tribhuvan University and judgment of the researcher. The respondents have been divided into three groups. The following table shows the groups of respondents and the size of samples.

**Table-1**  
**Groups of Respondents and Sample Size**

| S.N.  | Groups of Respondents     | Sample Size | Code |
|-------|---------------------------|-------------|------|
| 1     | Income tax administrators | 25          | A    |
| 2     | Income tax payers         | 25          | B    |
| 3     | Income tax experts        | 25          | C    |
| Total |                           | 75          |      |

### 3.3 Nature and Sources of Data

To find the good and fact results, primary as well as secondary data and information has been collected. But most of the data and information used in the study

Most of the data are collected from secondary sources. The major sources of data are as follows:

- a) Annual report of IRD/N of different years.
- b) Economic survey of various years, published by MOF.
- c) Nepal Rastra Bank's Economic Bulletin of various times.
- d) Central Bureau of Statistics etc.

### **3.4 Data and Information Collection Procedure**

Distribution was done personally through field visits rather than sending by any means to get accurate and actual information in time. The questionnaires were administered in personal meeting with the respondents and additional information was also collected from interview with the respondents. Various numerical data and information are collected as per the objective of the study and research questions. Firstly, laws, rules, regulations and policies related to income tax and corporate tax are studied to get more information about corporate income tax including book related to public finance. Secondly, different libraries such as Chamber of Commerce, FNCCI, NRB are also consulted. Thirdly, the numerical data are collected from the publication of annual reports of IRD/N, economic bulletin of NRB, Economic survey of MOF, publication of security board, CBS, publication of CEDA, T.U., Budget speech etc. Lastly, various journals, national newspapers are also reviewed. Respective parties are consulted while analyzing the research questions.

### 3.5 Data Processing and Analysis Procedures

The collected data and information from different sources of income tax was processed for tabulation and analysis. According to the subject matter and requirement, the data were tabulated into separate tables and format. Then simple statistical tools such as percentage, average, correlation, chi-square test, correlation of coefficient, etc were calculated and used where necessary. They have been presented and analyzed in descriptive way. Graphs, charts and diagrams are also presented to interpret the findings of the study.

### 3.6 Presentation and Analytical Tools

Various tools are applied while conducting this study, which are table, percentage, average, correlation, and regression analysis.

- a. **Table:** Various tables are formulated to tabulate the data. A master table is also presented in the Appendix-II.
- b. **Charts and diagrams:** These tools are used for visually description of the data. Trend line, bar diagrams is used for this purpose.
- c. **Correlation:** Correlation may be defined as the degree of linear relationship existing between two are more variables. Two variables are said to be correlated when the change in the value of one variable is accompanied by the change of another variable. Correlation analysis is defined as the statistical technique which measures the degree and direction of relationship (association) between/among the variables. In other words, it helps in studying the covariance of two or more variables which lies between  $\pm 1$ . If the value of correlation (r) is nearer to +1, this relationship is said to be perfectly positively correlated and vice-versa. We can compute the correlation simply by using direct method:

$$r = \frac{N\sum XY - \sum X \cdot \sum Y}{\sqrt{N\sum X^2 - (\sum X)^2} \sqrt{N\sum Y^2 - (\sum Y)^2}}$$

Determine of correlation coefficient

$$r^2 = \frac{[\sum XY - \frac{\sum X \sum Y}{N}]^2}{[\sum X^2 - \frac{(\sum X)^2}{N}][\sum Y^2 - \frac{(\sum Y)^2}{N}]}$$

- d. **Rank correlation coefficient:** These tools are used for the qualitative characteristics (attributes), cannot be measured quantitatively but can be arranged serially. In such cases, the rank correlation is especially useful. The degree of linear relationship of the correlation between different ranks or grades of two characteristics is called rank correlation. It is also called Spearman's rank correlation coefficient. Spearman's rank correlation coefficient denoted by R is defined by the following formula.

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

$d = R_1 - R_2 =$  difference of rank between paired items.

$R_1 =$  rank of 1<sup>st</sup> characteristics

$R_2 =$  rank of 2<sup>nd</sup> characteristics

$n =$  no. of pairs observation.

- e. **Chi-Square Test:-** It is one of the non-parametric tests where the parametric value such as mean, variance etc are not necessary. However, this test can be used even the knowledge about the parameter is available. By this test hypothesis, we can make a conclusion how the theory is being fit to a given observed data. For this purpose  $\chi^2$  test is defined as –

$$\chi^2 = \sum \left[ \frac{(O - E)^2}{E} \right]$$

Where O = Observed Frequency

E = Expected Frequency worked out under  $H_0$

- f. **Analysis of time series:** A series formed from a set of statistical data arranged in accordance with their time of occurrence is said to be a

time series. A time series shows the relation between two variables one being the time. The size of the population in every decade, the price level of the different in every month the volume of population in every year indicate the relation between the time changes and the changes in the value of other variable. Time series analysis is mostly used in Business and Economics, by which we can predict the value of variable for the future. Mathematically, a time series is defined as the functional relationship  $Y=f(t)$ , where Y is the value of the variable consideration in time. The time 'T' may be yearly, quarterly, monthly, weekly etc. There are various method of analyzing time series, least square method is chosen as the best method in showing trend and prediction in our research.

A widely and most commonly used method to describe the trend line and predication is the method of least square. Under this method, a trend line is fitted to data satisfying  $\sum(Y-Y_2) = 0$ , and  $\sum(Y-Y_c)^2$  is minimum. From that the time obtained by this method is the line of best fit.

$$\text{Trend line } Y = a + bx.$$

Where,

$$a = \frac{N\sum X^2 \sum Y - \sum X \sum XY}{N\sum X^2 - (\sum X)^2}$$

$$b = \frac{N\sum XY - \sum X \sum Y}{N\sum X^2 - (\sum X)^2}$$

Where,

Y = Dependent valuable

X = Independent valuable

a = Y intercept or value of Y when X = 0

b = Slope of the trend line of amount (of) change that comes in Y for a unit change in X.

## **CHAPTER-IV**

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

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

This chapter is related to presentation and analysis of data collected from various primary and secondary sources. The chapter has been divided into main three sections. The first part of the chapter involves the analysis of secondary data while the second part includes the analysis of primary data and the last part of the chapter includes the major findings of the study. In other words this part is devoted to the analysis and presentation of secondary data. The secondary data have been obtained from economic survey, economic bulletin, budget speech and other related newspaper.

##### **4.1.1 Composition of total revenue**

Total revenue in Nepal is composed of both taxes revenue and non-tax revenue when the HMG of Nepal presented first national budget in 1951/52.

Table-2 shows the composition of total revenue of government, which includes tax and non-tax revenue from FY 2059/60 to 2068/69. It seems that the share of tax revenue has always been greater than the share of non-tax revenue. This means the heavy contribution of tax always been increasing per year. However the role of tax revenue is very much important in revenue mobilization of Nepal and to meet the increasing government expenditure. In FY 2068/69, the share of tax revenue and non-tax revenue was 76.89% and 23.36% respectively as the compared with 77.68% and 22.32% in the FY 2059/60. Its percentage contribution has been always fluctuating with in the lower limit of about 75.49 % to the upper limit of about 80.41%. This indicates that the role of tax revenue is very much important in revenue mobilization of Nepal of Nepal and to meet the

increasing government expenditure. Tax revenue has been placed as a major source of government revenue in Nepal.

The composition of tax revenue from the fiscal year 2059/60 to 2068/69 is given below:

**Table-2**  
**Contribution of Tax and Non-tax Revenue in Total Revenue of Nepal**  
**from FY 2059/60 to 2068/69. (Rs. in millions)**

| Fiscal Year | Total Revenue | Tax Revenue | % of Tax revenue on TR | Non tax revenue | % of non tax revenue on TR |
|-------------|---------------|-------------|------------------------|-----------------|----------------------------|
| 2059/60     | 30124.55      | 23401.44    | 77.6822942             | 6723.108        | 22.317706                  |
| 2060/61     | 32802.84      | 26377.7     | 80.4128667             | 6425.136        | 19.587133                  |
| 2061/62     | 35572.93      | 28014.98    | 78.7536546             | 7557.948        | 21.246345                  |
| 2062/63     | 39994.99      | 30817.04    | 77.0522569             | 9177.948        | 22.947743                  |
| 2063/64     | 45896.33      | 35375.72    | 77.0774603             | 10520.928       | 22.923246                  |
| 2064/65     | 52341.55      | 41510.66    | 79.3072853             | 10831.32        | 20.69354                   |
| 2065/66     | 53878.07      | 41873.98    | 77.7198915             | 12004.2         | 22.280309                  |
| 2066/67     | 60124.36      | 45390.02    | 75.493572              | 14734.44        | 24.506608                  |
| 2067/68     | 66562.13      | 51271.49    | 77.0280181             | 15290.64        | 22.971982                  |
| 2068/69     | 74846.48      | 57547.04    | 76.88677               | 17299.44        | 23.11323                   |

*Source: Annual Report (2068/69), IRD.*

The above table reflects that the tax revenue was gradually increasing in every year since 2059/60 amounting Rs. 30124.55 million to Rs 74846.48 million in the year 2068/69. But the percentage contributes of tax revenue on the total government revenue was trend floating in different. The contribution of tax revenue to total revenue was maximum 80.41% in FY 2060/61 and minimum was 75.49% in FY 2066/67 during the study period and the average contribution was 77.50%. The non-tax revenue collection was also in the increasing trend in those 10 yrs i.e. Rs 6723.108 million in 2059/60 to 17299.44 million in 2068/69. The non-tax collection in the 2060/61 was decreased to Rs 6425.136 million as compared with Rs 6723.108 million in the FY 2059/60. Than after, it was in the increasing trend.

The tax revenue collection was seen to be in the gradually increasing trend. The contribution portion of not-tax revenue to total revenue was fluctuating during the study period. It was decreased to 19.59% in FY 2060/61 and was increased up to 24.51% in FY 2066/67. Its contribution was 23.36% in FY 2068/69 and average contribution was 22.50% during the study period. Taking the 2064/65 as base year the projection has been made for five year. It shows that both the tax and non-tax revenue will increase in the future. It is also clear that major portion of government revenue will be covered by tax revenue.

#### **4.1.2 Composition the Tax Revenue**

Tax revenue of composed of direct and indirect tax. The structure of Nepalese tax revenue can be presented in terms of consumption income and capital based tax. Taxes on consumption are known as direct taxes. Custom duties, excise VAT, Entertainment tax, Hotel tax, Air flight tax, Road and bridge maintenance tax, Vehicle tax and contract tax are included in the indirect tax. Similarly, income tax, interest tax, wealth tax and other tax as are included in direct tax. The composition of Nepalese tax revenue is presented in the table 4.1.2 in terms of direct and indirect tax revenue from FY 2059/60 to 2068/69

**Table-3**  
**Contribution of Direct and Indirect Tax on Total Tax Revenue**  
**from Fiscal Year 2059/60 (Rs. In Million)**

| Fiscal Year | Total tax revenue | Total direct tax | % share of direct tax to total tax | Total indirect Tax Revenue | % share of indirect tax to total tax revenue |
|-------------|-------------------|------------------|------------------------------------|----------------------------|--|
| 2059/60     | 23401.44          | 4952.016         | 21.1611593                         | 18449.64                   | 78.8397637                                   |
| 2060/61     | 26377.704         | 5651.964         | 21.4270507                         | 20726.28                   | 78.5749965                                   |
| 2061/62     | 28014.984         | 6494.04          | 23.1805951                         | 21521.16                   | 76.8201759                                   |
| 2062/63     | 30817.044         | 7881.3           | 25.574484                          | 22935.96                   | 74.4262169                                   |
| 2063/64     | 35375.724         | 9239.076         | 26.1169948                         | 26137.08                   | 73.8842264                                   |
| 2064/65     | 41510.664         | 10508.508        | 25.3152009                         | 31002.48                   | 74.6855796                                   |
| 2065/66     | 41873.976         | 10842.228        | 25.8925209                         | 31031.64                   | 74.1072212                                   |
| 2066/67     | 45390.024         | 10310.328        | 22.7149649                         | 35079.48                   | 77.2845593                                   |
| 2067/68     | 51271.488         | 12110.256        | 23.6198645                         | 39160.8                    | 76.3792929                                   |
| 2068/69     | 57547.044         | 13759.05         | 23.9092211                         | 44315.64                   | 77.0076739                                   |

*Source: Annual Report (2068/69), IRD.*

From the above table, we find that there has been simultaneous increase in indirect, direct tax and total tax revenue in absolute terms. The indirect tax of 2059/60 to 2068/69 are respectively 18449.64 and 44315.64. The contribution of direct tax revenue is very low in Nepal, because being an under development country, the people of Nepal live in subsistence level, and all of their income is spent on consumption. As a result direct tax cannot produce more revenue than indirect tax.

Despite of absolute increment of direct tax, its contribution to total tax revenue in 2059/60 was 21.16% amounting to Rs 4952.016 million, which increased up to 26.12% amounting Rs. 9239.076 million in the FY 2063/64. But the direct tax contribution percentage to total tax revenue was decreased down to 22.71%, amounting Rs. 10310.33 million in FY 2066/67 and it slightly increased up to 23.61% amounting Rs. 12110.20 million in the FY 2067/68. The contribution of indirect tax in 2059/60 was 78.84% amounting Rs. 18449.42 million and it was gradually decreased down to 73.88% amounting to Rs. 26136.065 million in FY 2063/64. After that, it was increased to 78.07% amounting to Rs. 44315.64 million in FY 2068/69.

Comparing direct and indirect tax, it reveals that the heavy reliance of economy is on direct taxation. An indirect tax is considered regressive in nature; the tax structure of Nepal is not justifiable on equity ground and progressiveness. So to direct the economy in the channel of development, it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax. Therefore the attention should be paid on the sufficient resource mobilization through internal sources.

#### **4.1.3 Composition of Indirect Tax**

Nepalese tax structure is heavily depends on indirect taxes, which constituted 78.07% of total tax revenue in 2068/69. Nepalese tax revenue is dependent mainly on international trade and sales tax/VAT on goods and services supplemented by taxes on income and properly to some trend.

The major components of indirect tax in Nepalese tax structure constitutes custom duty, excise duty, sales tax/VAT etc. custom duty has been clarified mainly into import duty and export duty. Other components of indirect tax like entertainment tax, hotel tax, air flight tax and other tax contribution normal share zero. Table 4.1.4 shows the composition of indirect tax, given as follows:

**Table-4****Major Sources of Indirect Tax and Their Relative Percentage to Indirect tax from the FY 2059/60 to 2068/69 (Rs. in Million)**

| Fiscal Year | Indirect Tax Revenue | Total % | Custom duties | As % of IDT | Excise duty | As % of IDT | Sales Tax VAT | As % of IDT | Other Tax | As % of IDT |
|-------------|----------------------|---------|---------------|-------------|-------------|-------------|---------------|-------------|-----------|-------------|
| 2059/60     | 18449.6              | 100     | 7913.59       | 42.89293    | 2153.84     | 11.6741     | 7608.276      | 41.2380     | 773.7     | 4.19        |
| 2060/61     | 20726.2              | 100     | 8973.82       | 43.29686    | 2481.94     | 11.9748     | 248367.6      | 40.3720     | 902.3     | 4.35        |
| 2061/62     | 21521.1              | 100     | 9182.37       | 42.66673    | 3116.66     | 14.4818     | 288514.8      | 39.5649     | 707.0     | 3.285       |
| 2062/63     | 22935.9              | 100     | 10279.1       | 44.81659    | 3189.45     | 13.9059     | 729467.1      | 41.2765     | -         | -           |
| 2063/64     | 26137.0              | 100     | 11678.3       | 44.68121    | 3377.80     | 12.9234     | 4711080.      | 42.3937     | -         | -           |
| 2064/65     | 31002.4              | 100     | 13556.2       | 43.7264     | 4072.89     | 13.1373     | 9913372.      | 43.1352     | -         | -           |
| 2065/66     | 31031.6              | 100     | 13671.5       | 44.05666    | 4111.56     | 13.2495     | 6813248.      | 42.6941     | -         | -           |
| 2066/67     | 35079.4              | 100     | 15375.3       | 43.82993    | 5167.90     | 14.732      | 4714536.      | 41.4386     | -         | -           |
| 2067/68     | 39160.8              | 100     | 16799.1       | 42.89796    | 6724.83     | 17.1723     | 2115637.      | 39.9307     | -         | -           |
| 2068/69     | 41033                | 100     | 16957.7       | 41.32705    | 6961.57     | 16.9657     | 2320396.      | 49.7069     | -         | -           |

Source: Annual Report (2068/69), IRD.

Note:

1. Custom duties includes imports + exports + Indian excise refund + others
2. Excise includes industrial production.

Table 4.1.3 reflects that the custom duty and VAT occupies major portion in indirect tax. In FY 2059/60, the contribution of custom duty was 42.89%, which fluctuated between 44% to 42% and it was 38.27% in the

FY 2068/69. The average percentage contribution of custom duty to indirect tax was 42.84% during the study period. The projected data shows that the custom duties will also increase in the future

The sales tax /VAT has become an important source of overall tax revenue with an increasing trend, which contributed 46.03% to indirect tax in FY 2068/69 as compared with 41.23% in FY 2059/60. Its average contribution was 42.10% during the study period, which is not satisfactory and it needs to increase in the future.

The share of excise duty was 11.67% in 2059/60 and it has gradually increased to 15.71% in the FY 2068/69. The total tax amount collected from excise duty was increased continuously during the study period, which was Rs 1994.3 million in FY 2059/60 was raised to Rs 6445.9 million for the FY 2068/69. But its contribution percentage to total indirect revenue was fluctuated. The average contribution of excise duty was 14.24% during the study period.

#### **4.1.4 Composition of Direct Tax**

The major components of direct tax are income tax. Land tax, house and land registration tax. The share of major components of direct tax is given in the following table:

**Table-5**  
**Components of Direct tax and their percent to Direct Tax**  
**(Rs. Million)**

| Fiscal Year | Direct Tax | Total % | Income Tax | IT as % of DT | Land Tax | Land Tax as % of DT | House and Land Regd. | H & L % of DT | Urban House & Land Rent | % of DT |
|-------------|------------|---------|------------|---------------|----------|---------------------|----------------------|---------------|-------------------------|---------|
| 2059/60     | 4952.016   | 100     | 3705.912   | 74.84         | 19.656   | 0.4                 | 1132.272             | 22.86         | 94.176                  | 1.9     |
| 2060/61     | 5651.964   | 100     | 4452.732   | 78.78         | 6.372    | 0.11                | 1090.26              | 19.29         | 102.6                   | 1.82    |
| 2061/62     | 6494.04    | 100     | 5289.948   | 81.46         | 3.888    | 0.06                | 1080.648             | 16.64         | 119.556                 | 1.84    |
| 2062/63     | 7881.3     | 100     | 6664.788   | 84.56         | 1.404    | 0.02                | 1081.944             | 13.73         | 133.164                 | 1.69    |
| 2063/64     | 9239.076   | 100     | 8013.924   | 86.74         | 4.968    | 0.05                | 1092.204             | 11.82         | 127.98                  | 1.39    |
| 2064/65     | 10508.508  | 100     | 9843.444   | 93.67         | 5.508    | 0.05                | 656.424              | 6.25          | 3.132                   | 0.03    |
| 2065/66     | 10842.228  | 100     | 9617.4     | 88.7          | 0.864    | 0.01                | 1221.48              | 11.27         | 2.484                   | 0.02    |
| 2066/67     | 10310.328  | 100     | 8782.884   | 85.19         | 0        | 0                   | 1527.444             | 14.81         | 0                       | 0       |
| 2067/68     | 12110.256  | 100     | 10276.902  | 84.86         | 0        | 0                   | 1833.3               | 15.14         | 0                       | 0       |
| 2068/69     | 37217.232  | 100     | 35274.096  | 85.31         | 0        | 0                   | 1943.136             | 14.69         | 0                       | 0       |

*Source: Annual Report (2068/69), IRD.*

Table 4.1.4 shows that the contribution of income tax to direct was higher than other tax and it occupied the largest share in the direct tax. The percentage share of income to direct tax in FY 2059/60 was 74.84% amounting Rs 3705.912 million which gradually increased into 93.67% amounting Rs 9843.44 million in FY 2064/65. The average share of income tax revenue was 85.44%. It was 85.31% amounting Rs 11288.376 million in the FY 2068/69. So this regular fluctuating in contribution percent of income tax to direct tax is not satisfactory. It needs to increase by widening the tax net. Land tax has contributed 0.40% amounting Rs. 18.20 million in the FY 2059/60, which has decreased gradually and reached to zero percent since 2001/03 and thereafter.

The share of house and land registration tax in the FY 2059/60 was 22.86% amounting Rs. 1132.272 million which gradually decreased to 6.25% amounting Rs. 656.424 million in the FY 2064/65. And then its contribution began to increase and reached to 15.14% amounting Rs. 1833.3 million in the FY 2067/68. In FY 2068/69 amounting Rs 1943.136 million, it was increased but decreased in percent 14.69 % urban house and land rent contribution was 1.9% in FY 2059/60, which was fluctuated over the seven years and decreased to zero percent since 2066/67.

#### 4.1.5 Contribution of Direct tax as percent to GDP total revenue and total tax Revenue

The contribution of direct tax as percent of GDP, total revenue and total tax revenue is shown below.

**Table-6**

#### **Contribution of Direct Tax as Percent to GDP, Total Revenue and Total Tax Revenue. (Rs in million)**

| Fiscal Year | Total Tax | Direct Tax | Direct Tax as % of Total Tax | Total GDP | D.T. as % of GDP | Total Revenue | Direct Tax as % of Total Revenue |
|-------------|-----------|------------|------------------------------|-----------|------------------|---------------|----------------------------------|
| 2059/60     | 23401.44  | 4952.016   | 21.16                        | 258539.04 | 1.92             | 30124.548     | 16.44                            |
| 2060/61     | 26377.7   | 5651.964   | 21.43                        | 291135.6  | 1.94             | 32802.84      | 17.23                            |
| 2061/62     | 28014.98  | 6494.04    | 23.18                        | 312981.84 | 2.07             | 35572.932     | 18.26                            |
| 2062/63     | 30817.04  | 7881.3     | 25.57                        | 356419.44 | 2.21             | 39994.992     | 19.71                            |
| 2063/64     | 35375.72  | 9239.076   | 26.12                        | 395551.08 | 2.34             | 45896.328     | 20.13                            |
| 2064/65     | 41510.66  | 10508.508  | 25.09                        | 425576.16 | 2.47             | 52341.552     | 20.08                            |
| 2065/66     | 41873.98  | 10842.228  | 25.89                        | 438629.04 | 2.47             | 53878.068     | 20.12                            |
| 2066/67     | 45390.02  | 10310.328  | 22.71                        | 472549.68 | 2.18             | 60124.356     | 17.15                            |
| 2067/68     | 51271.49  | 12110.256  | 23.61                        | 512912.52 | 2.36             | 66562.128     | 18.19                            |
| 2068/69     | 57547.04  | 13404.22   | 23.31                        | 549343.08 | 2.41             | 74846.484     | 17.68                            |

*Source: Economic Survey of various year, MOF.*

From the above table, it is clear that the contribution of direct tax on total tax revenue was 21.16%, which was increased to 26.12% in the FY 2063/64. But after that it was decreased to 23.31% in the FY 2068/69. The share of direct tax to GDP seems to be very low. It was 1.81% in the FY 2059/60, which grew up to 2.47% in the FY 2064 and 2065 and decreased to

2.41 % in FY 2067/68. On the other hand, the share of direct tax on total revenue was fluctuated between 15% to 29% during the study period. Its contribution was 16.44% in FY 2059/60 which was increased and remains around 19% since 2062 to 2065 and decreased to 17.68% in FY 2068/69.

#### 4.1.6 Contribution of Various Taxes as Percent to GDP

The contribution of various taxes as percent to GDP is given in the following table.

**Table-7**

**Contribution of Various Taxes as % to GDP**

| Fiscal Year | Total Revenue as % to Revenue | Total Tax Revenue as % to GDP | Direct Tax as % to GDP | Indirect Tax as % to GDP | Income Tax as % to GDP | CITR as % to GDP |
|-------------|-------------------------------|-------------------------------|------------------------|--------------------------|------------------------|------------------|
| 2059/60     | 11.65                         | 9.05                          | 1.92                   | 7.12                     | 1.43                   | 0.95             |
| 2060/61     | 11.27                         | 9.06                          | 1.94                   | 7.12                     | 1.53                   | 1.00             |
| 2061/62     | 11.37                         | 8.95                          | 2.07                   | 6.88                     | 1.69                   | 1.01             |
| 2062/63     | 11.22                         | 8.65                          | 2.21                   | 6.45                     | 1.87                   | 1.05             |
| 2063/64     | 11.60                         | 8.94                          | 2.34                   | 6.61                     | 2.03                   | 1.21             |
| 2064/65     | 12.30                         | 9.75                          | 2.47                   | 7.28                     | 2.32                   | 1.52             |
| 2065/66     | 12.28                         | 9.55                          | 2.47                   | 7.07                     | 2.19                   | 1.07             |
| 2066/67     | 12.72                         | 9.61                          | 2.19                   | 7.42                     | 1.86                   | 0.84             |
| 2067/68     | 12.98                         | 10.00                         | 2.36                   | 7.64                     | 2.00                   | 1.02             |
| 2068/69     | 13.62                         | 10.48                         | 2.41                   | 8.07                     | 2.05                   | 1.05             |

*Source: Annual Report (2068/69), Inland Revenue department.*

From the table 4.1.6, we find that the contribution on GDP was in increasing trend which was 11.65% in the year 2059/60 which was gradually increased and reached to 13.62% in the FY 2068/69. The contribution of total tax on GDP was fluctuating in the past 10 years. It was 9.05 in FY 2059/60, which was slowly decreased to 8.65%, in 2062/63 and thereafter, it was increased to 10.48% in the FY 2068/69. There is significant role of indirect tax in the tax structure of Nepal, which had contributed about three times more than the direct tax. In 2059/60, the contribution of indirect tax and direct tax was 7.12% and 1.92% respectively which was increased to 8.67% and 2.41% in FY 2068/69. The contribution of income tax on GDP was also increasing gradually. Its contribution was 1.43% in FY

2059/60, which was increased to 2.32% in FY 2064/65 at maximum level during the decade. Then after, it was decreased to 1.86% in the FY 2066/67 but it seems some improvement in the FY 2068/69 by increasing up to 2.05%

The contribution of CIT on GDP was very low. It was fluctuating in the past 10 years. It was slowly increased to 1.00 % in FY 2060/61 and reached to 1.52% in the FY 2064/65. Then after, it was decreased to 0.84% in the FY 2066/67 but it seems some improvement in the FY 2068/69 by increasing up to 1.05 %.

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

Nepal has late started practicing of income tax. The idea of introducing income tax in Nepal was originated along with the first budget in 1951. Finally in 1959, Business profit and Remuneration tax Act, 1960 was introduced. At that time income tax was levied only on business profits and salaries. After about three years of experience of income tax, the government replaced the prevailing tax act by income tax Act, 1962, in 1964, income Tax Act, 1974 (2031) was enacted. However, this act is replaced by income Tax Act 2002 (2058). The contribution of income tax on various revenue is given in the following table.

**Table-8**  
**Contribution of Income Tax to GDP, Total Revenue, Total Tax Revenue and Direct Tax Revenue (Rs in million)**

| Fiscal Year | GDP       | Total Revenue | Total Tax Revenue | Direct Tax Revenue | Income Tax Revenue | % of IT on GDP | % of IT on TR | % of IT on TTR | % of IT on Direct Tax |
|-------------|-----------|---------------|-------------------|--------------------|--------------------|----------------|---------------|----------------|-----------------------|
| 2059/60     | 258539.04 | 30124.548     | 23401.44          | 4952.016           | 3705.912           | 1.43           | 12.3          | 15.84          | 74.84                 |
| 2060/61     | 291135.6  | 32802.84      | 26377.704         | 5651.964           | 4452.732           | 1.53           | 13.57         | 16.88          | 78.78                 |
| 2061/62     | 312981.84 | 35572.932     | 28014.984         | 6494.04            | 5289.948           | 1.69           | 14.87         | 18.88          | 81.46                 |
| 2062/63     | 356419.44 | 39994.992     | 30817.044         | 7881.3             | 6664.788           | 1.87           | 16.66         | 21.63          | 84.56                 |
| 2063/64     | 395551.08 | 45896.328     | 35375.724         | 9239.076           | 8013.924           | 2.03           | 17.46         | 22.65          | 86.74                 |
| 2064/65     | 425576.16 | 52341.552     | 41510.664         | 10508.508          | 9843.444           | 2.31           | 18.81         | 23.71          | 93.67                 |
| 2065/66     | 438629.04 | 53878.068     | 41873.976         | 10842.228          | 9617.4             | 2.19           | 17.85         | 22.97          | 88.7                  |
| 2066/67     | 472549.68 | 60124.356     | 45390.024         | 10310.328          | 8782.884           | 1.86           | 14.61         | 19.35          | 85.19                 |
| 2067/68     | 512912.52 | 66562.128     | 51271.488         | 12110.256          | 10276.902          | 2              | 15.44         | 20.04          | 84.86                 |
| 2068/69     | 549343.08 | 74846.484     | 57547.044         | 13200.72           | 11288.376          | 2.05           | 15.08         | 19.62          | 85.31                 |

*Source: Economic Survey of various years, MOF.*

Table-8 reflects that the income tax was increased three folds in 2068/69 as compared with 2059/60. Total income tax was Rs 3705.912 million for the FY 2059/60 and it was increased to Rs 11288.376 million for the FY 2068/69. The share of income tax on GDP of Nepal was very low. It lays 1.43% to 2.05 during the study period. It was 1.43% in 2059/60 which gradually increased up to 2.32% in 2064/65 and slightly decreased to 2.05 in FY 2068/69.

The share of income tax to tax revenue was fluctuated from 12% to 18% during the study period. It was 12.30% in FY 2059/60, in 2064/65. Thereafter, it was decreased to 14.62% in 2066/67 and slightly increased to 15.44 % in 2067/68.

Similarly, contribution of income tax to total tax revenue was 15.34% in 2059/60, which was gradually increased and reached to 23.71% in the year 2064/65 and it was slightly decreased to 9.35% in the FY 2066/67. It is also clear that the contribution of income tax on Direct tax was the maximum, which occupied average 85.44% during the study period. It was 74.84% in year 2059/60, which was gradually increased to 93.67% of

maximum in 2064/65 and was sharply decreased to 84.86% in the year 2067/68. This decreasing trend of contribution of income tax to direct tax is not fruitful for the tax structure of developing country like Nepal.

#### **4.2 Resource Mobilization and Problems of Resource Gap**

The resource mobilization is the main challenge in the economic development of the country. The internal resource plays vital role in economic development of the country. Government collects the resources from different ways. The tax structure is major source of revenue of the government. Government has imposed two types of tax like direct and indirect tax. In the present tax structure, the government revenue comes more from indirect taxes rather than direct tax. Tax policy has to be made a part of the instrument of the development goals.

The resource mobilization has been a major problem in financing of growing government expenses. Since the beginning of planned development of Nepal, there has been tremendous increment in the size of government expenditure. The development works have to be carried out by the government in the initial stage. An increase in government expenditure creates additional demand in the economy through multiplier effects and thereby induces arise in aggregate output. The government resources have been concentrated more on expanding economic overhead in the form of transport, power and communication which will stimulate agricultures, industry and transport in the private sectors.

The government expenditure is the main source of gross national investment and capital formation. Many studies have been attempted to examine the problem of resource gap and prospect of internal resource gap. Domestic resource gap is the amount of excluding net foreign grants and loans. But the overall resource gap includes the contributions made by foreign grants and loans in financing public expenditure.

The problem of research gap has increased from one year to another which has been recovered through massive inflow of external capital. Regular expenditure is fulfilled by internal resources whereas development expenditure is mostly depending on external resources. The dependence on foreign aid and deficit finance has not shown any declining trend. If the resource gap is minimized through the over dependence of foreign loans, it can further create the resource problem in the near future.

The problem of resource mobilization and resource gap is related to the saving and investment. The level of income and the rate of interest influence the saving structure. The low rate of saving is prevailing in the country as a result of low level of income of the people. The low level of income creates the problem of resource mobilization for undertaking investment programmers in a large scale by both government and private sector. The pattern of resource gap is shown in table no. 4.2.

**Table-9**  
**Domestic Resource Gap Pattern of Nepal**

| Fiscal Year | Total govt. expenditure (A) | Total govt. revenue (B) | Resource gap (A-B) | % of resource gap to total expenditure |
|-------------|-----------------------------|-------------------------|--------------------|--|
| 2059/60     | 50267.52                    | 30124.548               | 20142.972          | 40.07                                  |
| 2060/61     | 57697.596                   | 32802.84                | 24894.756          | 43.15                                  |
| 2061/62     | 60607.656                   | 35572.932               | 25034.724          | 41.31                                  |
| 2062/63     | 64345.32                    | 39994.992               | 24350.328          | 37.84                                  |
| 2063/64     | 71574.3                     | 45896.328               | 25677.972          | 35.88                                  |
| 2064/65     | 86221.908                   | 52341.552               | 33880.356          | 39.29                                  |
| 2065/66     | 86477.976                   | 53878.068               | 32599.908          | 37.7                                   |
| 2066/67     | 90726.48                    | 60124.356               | 30602.124          | 33.73                                  |
| 2067/68     | 96598.008                   | 66562.128               | 30035.88           | 31.09                                  |
| 2068/69     | 110765.23                   | 74846.484               | 35918.746          | 32.43                                  |

*Source: Annual Report (2068/69), IRD.*

From the above table , it is found that during the last ten years period there was 31.09% to 43.15% resource gap in Nepal. The amount of resource gap was in increasing trend up to 2064/65 amounting Rs 33880.356 million which amount decreased to Rs 30035.934 million I n 2066/67 and it was Rs

35918.748 million in FY 2068/69. Taking the FY 2064/65 as base year, the forecasted resource gap will also be in the increasing trend.

#### 4.2.1 Revenue-Expenditure

Revenue Expenditure gap is known as resource gap. In this context, three types of gaps are measured and used in the analysis of resource gap.

**Table-10**  
**Overall Resource Gap Pattern of Nepal (Rs. in millions)**

| Fiscal Year | Total govt. expenditure | Total revenue | Resource gap <sup>1</sup> | Foreign grants | Resource gap <sup>2</sup> | Foreign loan | Resource gap <sup>3</sup> |
|-------------|-------------------------|---------------|---------------------------|----------------|---------------------------|--------------|---------------------------|
|             | A                       | B             | A-B                       | C              | A-(B+C)                   | D            | [A-(B+C+D)]               |
| 2059/60     | 50267.52                | 30124.548     | 20142.972                 | 5211.108       | 14931.864                 | 10221.012    | 4710.852                  |
| 2060/61     | 57697.596               | 32802.84      | 24894.756                 | 6467.364       | 18427.392                 | 9767.088     | 8660.304                  |
| 2061/62     | 60607.656               | 35572.932     | 25034.724                 | 5834.808       | 19199.916                 | 11938.86     | 7261.056                  |
| 2062/63     | 64345.32                | 39994.992     | 24350.328                 | 4683.528       | 19666.8                   | 12800.592    | 6866.208                  |
| 2063/64     | 71574.3                 | 45896.328     | 25677.972                 | 6168.636       | 19509.336                 | 12757.176    | 6752.16                   |
| 2064/65     | 86221.908               | 52341.552     | 33880.356                 | 7293.672       | 26586.684                 | 13007.52     | 13579.164                 |
| 2065/66     | 86477.976               | 53878.068     | 32599.908                 | 7220.988       | 25378.92                  | 8314.596     | 17064.324                 |
| 2066/67     | 90726.48                | 60124.356     | 30602.124                 | 12246.228      | 18355.896                 | 4910.112     | 13445.784                 |
| 2067/68     | 96598.008               | 66562.128     | 30035.88                  | 12186.072      | 17849.808                 | 8239.32      | 9610.488                  |
| 2068/69     | 110765.23               | 74846.484     | 35918.748                 | 15542.496      | 20376.252                 | 10007.388    | 10368.864                 |

Source: Annual Report (2068/69), IRD.

##### i) Resource Gap<sup>1</sup> (A-B)

The gap between revenue and expenditure raised from Rs 20142.972 million in FY 2059/60 to Rs 35918.748 million in FY 2068/69, which was about two times more than the FY 2059/60. This figure shows the poor performance of domestic resource mobilization. The forecasted data also reflects the increasing pattern of resource gap.

##### ii) Resource Gap<sup>2</sup> [A-(B+C)]

This type of resource gap was Rs 14985.864 million for the FY 2059/60 which was gradually increased to Rs 26586.684 million of maximum for the FY 2064/65. Then after it was decreased to Rs 18355.896

million for FY 2066/67 which was due to the low proportionate increment in total revenue and foreign grants. This gap was Rs 20376.252 million for the FY 2068/69. This shows that foreign grants should be encouraged to be increased for minimizing the resource gap.

**iii) Resource Gap<sup>3</sup> [A-(B+C+D)]**

This resource gap is taken as the difference between total expenditure and total revenue plus foreign grants plus foreign loan. In FY 2059/60, the gap was Rs 4710.852 million which was increased to Rs 8660.304 million for FY 2060/61 and it started to decrease gradually.

It reached to Rs 6752.16 million of minimum for the FY 2063/64 and increased rapidly to Rs 17064.324 million for the FY 2065/66, which were two folds greater than 2063/64. Then, it was Rs 10368.864 million for 2068/69. It measures the internal indebtedness of the government. Moreover, foreign loan largely depends on the fiscal policy adopted by the nation.

If any government has a resource gap, it has to resort to 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 is rising and the percentage of grants is decreasing. It is not a desirable direction for our country in self-reliance. Moreover, foreign loan creates an extra burden to the economy because debt-servicing charges increase every year. The foreign loan should be taken as a complementary resource to mobilize internal resources properly.

**4.2.2 Problem in Public Expenditure**

Government expenditure is increasing along with its expanding activities in development and social activities. The increasing trend of government expenditure can be fulfilled either by internal resources or through inflow of foreign aid. The increasing rate of growth in government expenditure creates many problems in public expenditure management. As a

result of which deficit financing takes place in the economy. On the one hand, the resource gap problem is increasing and on the other hand it has grown the inflation and price unstablization in the economy. There is two way relationships between resource mobilization and expansion in budgetary size in developing country. Government policy should be reformed for maximum resource mobilization in accordance with the expansion in economy that has taken place through the investment of public sector in development activities.

Development expenditure is mostly prepared in accordance with commitment of the donor agencies. But the disbursement of foreign aid has not been on the commitment. The lack of funding compels to delay the completion of the projects. In the same way, the donor agencies are too much involved in the decision making which creates many problems in implementation and for the completed project by the funding agencies the problem stands to the government on the operation and maintenance of the project.

**Table-11**  
**Share of Government Revenue, Foreign Aid and CITER in Public Expenditure**

**Rs In million**

| Fiscal Year | Total govt. expenditure | Total govt. revenue | Total revenue as % of T.E. | Foreign aid | Foreign aid as % of T.E. | CITER    | CITER as % of T.E. |
|-------------|-------------------------|---------------------|----------------------------|-------------|--------------------------|----------|--------------------|
| 2059/60     | 50267.52                | 30124.548           | 59.93                      | 15432.12    | 30.7                     | 2454.192 | 4.88               |
| 2060/61     | 57697.596               | 32802.84            | 56.85                      | 16234.452   | 28.14                    | 2904.66  | 5.03               |
| 2061/62     | 60607.656               | 35572.932           | 58.69                      | 17773.668   | 29.33                    | 3167.532 | 5.23               |
| 2062/63     | 64345.32                | 39994.992           | 62.16                      | 17484.12    | 27.17                    | 3738.42  | 5.81               |
| 2063/64     | 71574.3                 | 45896.328           | 64.12                      | 18925.812   | 26.44                    | 4793.364 | 6.7                |
| 2064/65     | 86221.908               | 52341.552           | 60.71                      | 20301.192   | 23.55                    | 6460.884 | 7.49               |
| 2065/66     | 86477.976               | 53878.068           | 62.3                       | 15535.584   | 17.96                    | 4700.106 | 5.44               |
| 2066/67     | 90726.48                | 60124.356           | 66.27                      | 17156.34    | 18.91                    | 3947.724 | 4.35               |
| 2067/68     | 96598.008               | 66562.128           | 68.91                      | 20425.392   | 21.14                    | 5225.742 | 5.41               |
| 2068/69     | 110765.23               | 74846.484           | 67.57                      | 25549.884   | 23.07                    | 5753.376 | 5.19               |

*Source: Annual Report (2068/69), IRD.*

Table-11 indicates the contribution of the government revenue in financing public expenditure. Government revenue share was 68.91% of maximum in FY 2067/68 and 56.85% of minimum in FY 2060/61 during the study period. It is also clear from the table that, contribution made by CITER to government expenditure was fluctuating trend between FY 2059/60 to 2068/69 respectively 4.88% to 7.49%. Then after within 3 years period it was decreased to 4.35% of minimum in FY 2066/67. The contribution was 5.19% for the FY 2068/69. CITER had contributed 5.57% on an average to the government expenditure.

### **4.3 Corporate Tax Structure**

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

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

Tax rate is the base of measurement of tax liability. Tax rate should not be so high only for minimum revenue realization but should be activator for the private investment. Developing countries like Nepal needs to boost up their economic conditions by developing industries and trade within the country. For this, corporate tax rate also plays a vital role. Imposition of tax on corporate profit was started with the enactment of Business Profit and Remuneration Tax Act, 1960. The starting corporate tax rate was 25 percent and it was levied on progressive way. The tax amount was calculated on different slabs before FY 1985/86. The corporate tax rate structure was combined with individual tax rate structure. The reason was the number of companies was limited and private companies were generally managed by family. In the year 1985/86 the progressive tax rate structure was abolished in case of government enterprises used to split into different units to take advantages of lower rates. The progressive rate of taxing to private companies was abolished in the fiscal year 2059/60. Thus, flat rate system has been continued for all corporate bodies since the FY 2059/60.

The corporate tax rate structure was increased up to 60 percent the maximum rate in the FY 1975/96 from 25 percent. During 1960/61 to 1975/76, increments of rates were made three times. After FY 1975/76, the tax rate again decreased up to 51 percent and 50 percent. This rate was again increased to 55 percent and remains continued from FY 1982/83 to till 1987/88. In the year, 1987/88, the listed public limited companies were levied 10 percent less than others. This concession was given to such companies by only 5 percent in the year 1985/86. After the FY 1987/88, the tax rate was continuously decreasing. Now, it is 20 percent o industry (except cigarette and alcohol), 25 percent to general companies and 30 percent to banks and finance companies.

Special fee 3 percent of taxable income was levied to all corporate bodies. Now it is decreased to 15 percent.

**Table-12**  
**Corporate Tax Structure in Nepal**

| Fiscal Year     | Maximum marginal tax rate |            | Nature of tax rate |
|-----------------|---------------------------|------------|--------------------|
|                 | Private Co.               | Public Co. | Progressive        |
| 1960/61-1962/63 | 25                        | 25         | „                  |
| 1963/64-1964/65 | 30                        | 30         | „                  |
| 1965/66-1966/67 | 40                        | 40         | „                  |
| 1967/68         | 55                        | 55         | „                  |
| 1968/69-1974/75 | 55                        | 55         | „                  |
| 1975/76         | 60                        | 60         | „                  |
| 1976/77-1978/79 | 51                        | 51         | „                  |
| 1979/80         | 50                        | 50         | „                  |
| 1980/81-1981/82 | 50                        | 50         | „                  |
| 1982/83         | 55                        | 55         | „                  |
| 1983/84-1984/85 | 55                        | 55         | „                  |
| 1985/86         | 55P                       | 55F        | Progressive & Flat |
| 1986/87-1987/88 | 55P                       | 55F        | „                  |
| 1988/89-1989/90 | 50P                       | 50F        | „                  |
| 1990/91-1991/92 | 40P                       | 40F        | „                  |
| 1992/93-1294/95 | 33P                       | 33F        | „                  |
| 2059/60         | 33                        | 33         | Flat               |
| 2060/61         | 30                        | 30         | ..                 |
| 2062/63-2068/69 | 20-25 & 30                | 20-25 & 30 | ..                 |

*Source: Annual Report (2068/69), IRD.*

Note: 20% tax rate for special industries

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

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

### **4.3.2 Corporate Tax Base in Nepal**

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

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

#### 4.4 Contribution of Corporate Income Tax

Contribution of corporate income tax on total revenue, tax revenue, direct tax revenue, income tax revenue, its composition and its trend line for 15 yrs. Has been drawn in this sub-chapter. Taking the FY 2064/65 as the base year, projections have been made for next five years. The relationship of CITR with other taxes and total revenue and its coverage portion has been examined.

##### 4.4.1 Contribution of Corporate Income Tax on Total Government Revenue

Corporate income tax plays an important role in Nepalese government revenue. The composition of national revenue/government revenue has been shown in master table in appendix-II and the composition of corporate tax revenue as well. As per the master table, the following table has been drawn to show the contribution portion of CITR in different time periods in percentage and amounts also.

**Table-13**  
**Contribution of CITR on Total Government Revenue (Rs. in millions)**

| Fiscal Year | Total revenue | %  | CORPORATE INCOME TAX |     |               |     |                |          | Total CITR | %    |
|-------------|---------------|----|----------------------|-----|---------------|-----|----------------|----------|------------|------|
|             |               |    | Government sector    | %   | Public sector | %   | Private Sector | %        |            |      |
| 2059/60     | 30124.58      | 10 | 1236.06              | 4.1 | 609.012       | 2.0 | 609.12         | 2.022005 | 2454.192   | 8.15 |
| 2060/61     | 32802.84      | 10 | 1329.588             | 4.0 | 927.072       | 2.8 | 648            | 1.975439 | 2904.66    | 8.85 |
| 2061/62     | 35572.93      | 10 | 1423.224             | 4   | 999.108       | 2.8 | 745.2          | 2.094851 | 3167.532   | 8.9  |
| 2062/63     | 39994.99      | 10 | 1648.62              | 4.1 | 1247.4        | 3.1 | 842.4          | 2.106264 | 3738.42    | 9.35 |
| 2063/64     | 45896.38      | 10 | 2374.704             | 5.1 | 1446.66       | 3.1 | 972            | 2.117816 | 4793.364   | 10.4 |
| 2064/65     | 52341.55      | 10 | 3162.24              | 6.0 | 2078.24       | 3.9 | 1220.4         | 2.331608 | 6460.884   | 12.3 |
| 2065/66     | 53878.06      | 10 | 1910.844             | 3.5 | 1524.96       | 2.8 | 1264.30        | 2.346599 | 4700.106   | 8.72 |
| 2066/67     | 60124.35      | 10 | 1351.08              | 2.2 | 1335.20       | 2.2 | 1261.44        | 2.098059 | 3947.724   | 6.57 |
| 2067/68     | 66562.18      | 10 | 2221.128             | 3.3 | 1653.77       | 2.4 | 1350.84        | 2.029448 | 5225.742   | 7.85 |
| 2068/69     | 74846.48      | 10 | 1438.128             | 1.9 | 2665.22       | 3.5 | 1650.24        | 2.204833 | 5753.376   | 7.69 |

*Source: Annual Report (2068/69), IRD.*

Table-13 reflects that the contribution percentage of corporate income tax to total revenue during the study period was fluctuating from 6.57% to 12.34%. The share of corporate income tax revenue was 8.15% amounting Rs 2454.192 million. In the FY 2059/60 in 4.10% of total of revenue was covered only by government sector. Later on the share of CITR to total revenue was slowly increased up to 12.34 % of maximum in the FY 2064/65 amounting Rs 6460.884 million where intra-structural composition of corporate sector was also dominated by government sector contributing 6.04% of maximum percentage of amounting Rs 3162.24 million during the study period. But that situation did not continue later on. Political imbroglio unfriendly environment of smooth operation of business were some or the main reasons for Nepalese corporate sector unable in improving its competency. As a result, contribution of CITR to total revenue was sharply decreased from 12.34% amounting Rs 6460.884 million in 2064/65 to 6.57% in 2066/67 amounting Rs 3947.724 million which was 7.69% amounting Rs 5753.376 million in 2068/69.

Total revenue national revenue was also in increasing trend which was not only the cause of better implementation of fiscal policy and positive macro-economic indicator but it was also due to expansion of taxation and revenue net. This table also shows that the private sector's tax collection was in increasing trend except in 2066/67, but private sector contribution percent to total revenue was only around 202% since last 7 years although Nepal has liberalized the economy and privatized about 24 public enterprises and companies during the last decade. Likewise, tax collection from public enterprises seem to the increasing up to 2064/65 which contribution portion was 3.97% but later on it was slightly decreased to 3.56% in 2068/69

Nevertheless, Nepalese corporate sector is contribution to total revenue about 9% which seems to be very small portion comparing to other developing countries.

#### 4.4.2 Contribution of corporate Income Tax on Total Tax Revenue.

Total tax revenue is composed of direct tax and indirect tax which has been shown in the master table Appendix-II. Total tax revenue is mostly affected by CITR and its enhancement by the country. The following table has been drawn to know the Nepalese CITR's contribution portion to total tax

**Table-14**  
**Contribution of CITR on Total Tax Revenue (Rs in million)**

| Fiscal Year | Total Tax revenue | %    | CORPORATE INCOME TAX |      |               |      |                |            | Total CITR | %     |
|-------------|-------------------|------|----------------------|------|---------------|------|----------------|------------|------------|-------|
|             |                   |      | Government sector    | %    | Public sector | %    | Private Sector | %          |            |       |
| 2059/60     | 23401.44          | 10.0 | 1236.06              | 5.28 | 609.012       | 2.6  | 609.12         | 2.60291674 | 2454.192   | 10.49 |
| 2060/61     | 26377.704         | 10.0 | 1329.588             | 5.04 | 927.072       | 3.51 | 648            | 2.45662018 | 2904.66    | 11.01 |
| 2061/62     | 28014.984         | 10.0 | 1423.224             | 5.08 | 999.108       | 3.57 | 745.2          | 2.66000509 | 3167.532   | 11.31 |
| 2062/63     | 30817.044         | 10.0 | 1648.62              | 5.35 | 1247.4        | 4.05 | 842.4          | 2.73355225 | 3738.42    | 12.13 |
| 2063/64     | 35375.724         | 10.0 | 2374.704             | 6.71 | 1446.66       | 4.09 | 972            | 2.74764695 | 4793.364   | 13.55 |
| 2064/65     | 41510.664         | 10.0 | 3162.24              | 7.62 | 2078.24       | 5.01 | 1220.4         | 2.93996743 | 6460.884   | 15.56 |
| 2065/66     | 41873.976         | 10.0 | 1910.844             | 4.56 | 1524.96       | 3.64 | 1264.302       | 3.01930249 | 4700.106   | 11.22 |
| 2066/67     | 45390.024         | 10.0 | 1351.08              | 2.98 | 1335.204      | 2.94 | 1261.44        | 2.77911287 | 3947.724   | 8.7   |
| 2067/68     | 51271.488         | 10.0 | 2221.128             | 4.33 | 1653.77       | 3.23 | 1350.8424      | 2.63468538 | 5225.742   | 10.19 |
| 2068/69     | 57547.044         | 10.0 | 1438.128             | 2.5  | 2665.224      | 4.63 | 1650.24        | 2.86763643 | 5753.376   | 10    |

*Source: Annual Report (2068/69), MOF.*

The above table shows that the CITR's contribution to total tax revenue was fluctuated during the study period. It was 10.49% in the FY 2059/60, which was gradually increased and reached to 15.56% of maximum contribution in the FY 2064/65. But this contribution was decreased sharply within two years and reached to 8.7% in the year 2066/67, which was the lowest contribution during the 10 years period. CITR's contribution was 10% in the FY2068/69. Such kind of lower contribution was due to the lower collection of corporate income tax which might be the

result of political instability, unfriendly environment for operating industry, trade and business. Moreover, CITR has been contributing 11.31% on average to total tax revenue, which regards the small but important portion contributing on total tax.

The structural composition of corporate income tax seems to be changed during the study period. In FY 2059/60 about half portion of CITR was covered only by government sector and rest of the half was covered equally by private and public sector. Within 10 years, in the FY 2067/68 the tax contribution from public sector was improved and reached to 4.69% but the private sector had gradual decrease. The tax contribution percentage from private sector seems to be neutral during the study period around 3% only. The tax contribution to total tax revenue from government sector was the most fluctuated one. It was 5.28% in FY 2059/60, which was gradually increased to 7.62% in FY 2064/65. But it was sharply decreased to 2.5% in the FY 2068/69. That sort of fluctuation is not good for the Nepalese economy. The lower contribution of private sector since last 10 years was due to the poor performance of private sectors.

#### **4.4.3 Contribution of corporate Income Tax on Direct tax Revenue**

Direct tax comprises of income tax, house and land registration tax, land tax revenue which is shown in detail in master table Appendix-II. From that master table following data have been presented projecting three years position of direct tax revenue, CITR and its contribution in Direct tax revenue.

**Table-15**  
**Contribution of CITR on Direct Tax Revenue (Rs in million)**

| Fiscal Year | Direct Tax | %   | CORPORATE INCOME TAX |        |               |       |                |       | Total CITR | %     |
|-------------|------------|-----|----------------------|--------|---------------|-------|----------------|-------|------------|-------|
|             |            |     | Government sector    | %      | Public sector | %     | Private Sector | %     |            |       |
| 2059/60     | 4952.016   | 100 | 1236.06              | 24.96  | 609.012       | 12.3  | 609.12         | 12.3  | 2454.192   | 49.56 |
| 2060/61     | 5651.964   | 100 | 1329.588             | 23.52  | 927.072       | 16.4  | 648            | 11.47 | 2904.66    | 51.39 |
| 2061/62     | 6494.04    | 100 | 1423.224             | 21.91  | 999.108       | 15.39 | 745.2          | 11.48 | 3167.532   | 48.78 |
| 2062/63     | 7881.3     | 100 | 1648.62              | 20.92  | 1247.4        | 15.83 | 842.4          | 10.69 | 3738.42    | 47.43 |
| 2063/64     | 9239.076   | 100 | 2374.704             | 25.7   | 1446.66       | 15.66 | 972            | 10.52 | 4793.364   | 51.88 |
| 2064/65     | 10508.508  | 100 | 3162.24              | 30.092 | 2078.244      | 19.78 | 1220.4         | 11.61 | 6460.884   | 61.48 |
| 2065/66     | 10842.28   | 100 | 1910.844             | 17.62  | 1524.967      | 14.07 | 1264.302       | 11.66 | 4700.106   | 43.35 |
| 2066/67     | 10310.328  | 100 | 1351.08              | 13.15  | 1335.204      | 12.95 | 1261.44        | 12.24 | 3947.724   | 38.29 |
| 2067/68     | 12110.256  | 100 | 2221.128             | 18.34  | 1653.776      | 13.66 | 1350.8424      | 11.16 | 5225.742   | 43.15 |
| 2068/69     | 37217.232  | 100 | 1438.128             | 10.87  | 2665.224      | 20.14 | 1650.247       | 12.47 | 5753.376   | 43.48 |

*Source: Annual Report (2068/69), IRD.*

From the above table, we can see that the contribution of CITR to direct tax revenue was fluctuated between 38.29% to 61.48% during the decade. Its contribution percentage was 49.56% amounting Rs.2454.192 million in FY2059/60 which increased to 51.39% in FY 2060/61. But later on it was decreased to 47.43% amounting Rs 3738.42 million in FY 2062/63. Then after, its contribution grew up drastically to the apex of 61.48% amounting Rs 6460.884 million in FY 2064/65. That was possible due to the business friendly environment and side's fire in the country. Unfortunately, that situation did not long last. The CITR's contribution to direct tax revenue was sharply decreased within 2 years to 38.79 % amounting Rs 3947.724 million in 2066/67, This contribution was 43.15% amounting Rs 5225.742 million in 2067/68. The CITR had contributed 53.58% on an average during the study period.

This table has also shown the structural composition of corporate tax. Nearly, half portion of CITR was covered by government sector. But it has been slightly changed in the past few years. Still government sector covers the maximum portion but public and private sector have also improved their position.

#### 4.4.4 Contribution of corporate Income Tax Revenue on Income Tax Revenue

Income tax revenue is comprises of corporate income tax, individual income tax, interest tax and house and land tax. The size of the income tax revenue largely depends upon the size of corporate sector. Higher the size of corporate sector higher will be the CITR and total income tax revenue and vice-versa. So CITR in Nepal has played a vital role in income tax revenue which has been presented in the following table projecting for three subsequent years.

**Table-16**  
**Contribution of CITR in Income Tax Revenue(Rs. in million)**

| Fiscal Year | Income Tax | %   | CORPORATE INCOME TAX |       |               |       |                |       | Total CITR | %     |
|-------------|------------|-----|----------------------|-------|---------------|-------|----------------|-------|------------|-------|
|             |            |     | Government sector    | %     | Public sector | %     | Private Sector | %     |            |       |
| 2059/60     | 3705.912   | 100 | 1236.06              | 33.35 | 609.012       | 16.43 | 609.12         | 16.44 | 2454.192   | 66.22 |
| 2060/61     | 4452.732   | 100 | 1329.588             | 29.86 | 927.072       | 20.82 | 648            | 14.55 | 2904.66    | 65.23 |
| 2061/62     | 5289.948   | 100 | 1423.224             | 26.9  | 999.108       | 18.89 | 745.2          | 14.09 | 3167.532   | 59.88 |
| 2062/63     | 6664.788   | 100 | 1648.62              | 24.74 | 1247.4        | 18.72 | 842.4          | 12.64 | 3738.42    | 56.09 |
| 2063/64     | 8013.924   | 100 | 2374.704             | 29.63 | 1446.66       | 18.05 | 972            | 12.13 | 4793.364   | 59.81 |
| 2064/65     | 9843.444   | 100 | 3162.24              | 32.13 | 2078.24       | 21.11 | 1220.4         | 12.4  | 6460.884   | 65.64 |
| 2065/66     | 9617.4     | 100 | 1910.844             | 19.87 | 1524.96       | 15.86 | 1264.302       | 13.15 | 4700.106   | 48.87 |
| 2066/67     | 8782.884   | 100 | 1351.08              | 15.38 | 1335.204      | 15.2  | 1261.44        | 14.36 | 3947.724   | 44.95 |
| 2067/68     | 10276.902  | 100 | 2221.128             | 21.61 | 1653.7716     | 16.09 | 1350.8424      | 13.14 | 5225.742   | 50.85 |
| 2068/69     | 11288.376  | 100 | 1438.128             | 12.74 | 2665.224      | 23.61 | 1650.24        | 14.62 | 5753.376   | 50.97 |

Source: Annual Report (2068/69), IRD.

Table-16 reflects that the contribution of CITR to income tax revenue seems to be in decreasing trend during the study period. It was 66.22% amounting Rs 2454.192 million in the FY 2059/60, which was increased in amounting. But its contribution was started to decrease and reached to 56.09 amounting Rs 3738.42 million in 2062/63. The fluctuation of contribution of CITR to income tax revenue was maximum on the later year. It was maximum at 65.64% in FY 2064/65 amounting Rs 6466.284, which was sharply decreased to 44.95% within 2 years amounting Rs 3947.724 million in 2066/67. Its percentage seemed to be slightly increased to 50.97% amounting Rs 5753.376 million in FY 2067/68. The CITR has been contributing 55.36% on an average to the income tax revenue.

The structural composition of corporate sector seems to be changed during the study period. In 2059/60, 33.35%, 16.43%, and 16.44% contribution were made by government, public and private sector respectively which were 12.74%, 23.61% and 14.62% in the year 2068/69. IT seems that though tax collection from private sector was increasing except 2066/67, its contribution to income tax revenue was increasing trend. That was due to the proportionate increment of income tax collection from private sector was lower than that of public and government sector, which was the result of volatile situation of trade and economy of the country.

#### **4.4.5 Structural Composition of Corporate Income Tax**

The corporate income tax structures comprises of government sector, public and private sector. Corporation taxable income is calculated by adding all the taxable income and deducting all the allowable expenses. The corporate tax base is explained and presented in the preceding subchapter 4.3.2. After the enactment of Income tax act, 2058, the books of account of corporate sector have been kept a little bit differently. From the FY 2066/67, the total corporate sector income tax is computed by adding government, public and private sector including individual and sole trading firm and

income from other institutions too. The following table has been drawn to show the structural composition of corporate income tax from the FY 2059/60 to 2068/69.

**Table-17**  
**Structural Composition of Corporate Income Tax**  
(Rs. in million)

| Year    | CITR     | %   | Government Sector | %     | Public sector | %     | Private Sector | %     |
|---------|----------|-----|-------------------|-------|---------------|-------|----------------|-------|
| 2059/60 | 2454.192 | 100 | 1236.06           | 50.37 | 609.012       | 24.82 | 609.12         | 24.82 |
| 2060/61 | 2904.66  | 100 | 1329.588          | 45.77 | 927.072       | 31.92 | 648            | 22.31 |
| 2061/62 | 3167.532 | 100 | 1423.224          | 44.93 | 999.108       | 31.54 | 745.2          | 23.53 |
| 2062/63 | 3738.42  | 100 | 1648.62           | 44.1  | 1247.4        | 33.37 | 842.4          | 22.53 |
| 2063/64 | 4793.364 | 100 | 2374.704          | 49.54 | 1446.66       | 30.18 | 972            | 20.28 |
| 2064/65 | 6460.884 | 100 | 3162.24           | 48.94 | 2078.244      | 32.17 | 1220.4         | 18.89 |
| 2065/66 | 4700.106 | 100 | 1910.844          | 40.66 | 1524.96       | 32.45 | 1264.302       | 26.9  |
| 2066/67 | 3947.724 | 100 | 1351.08           | 34.22 | 1335.204      | 33.82 | 1261.44        | 31.95 |
| 2067/68 | 5225.742 | 100 | 2221.128          | 42.5  | 1653.7716     | 31.65 | 1350.8424      | 25.85 |
| 2068/69 | 5753.376 | 100 | 1438.128          | 25    | 2665.224      | 46.32 | 1650.24        | 28.68 |

Source: Annual Report (2068/69), IRD.

The above structural composition of corporate tax shows that major portion was covered by government sector. It was 50.37% in the FY 2059/60 while the public and private sector contributed 24.82% and 24.82% respectively. The share of government sector was started to decrease and reached to 44.10% in the FY 2062/63. However, it was increased considerably to 49.54% contribution out of Rs 4793.364 million CITR in the FY 2063/64. But later on it was sharply decreased to 25% out of 5753.376 million CITR in FY 2068/69. The contribution of public sector was ultimately seemed to be increase during the 9 years period from 24.82% to 31.65% with some fluctuation. In the FY 2068/69, it was sharply increased to 46.32% amounting Rs 2665.224 million. The private sector contribution was fluctuated from 28% to 31% during the period. Private sector was contributing 24.82% amounting Rs 609.12 million to CITR in the FY 2059/60, which was gradually decreased to 18.89% amounting Rs 1220.4 million in FY 2064/65. But it was increased considerably in the FY 2066/67. The drastic increment in percentage contribution was due to the

retrospective effect of reduced in tax collection from government and public sector rather than the improvement of tax collection from private sector. The private sectors contribution was 68% amounting Rs 1650.24 million in the FY 2068/69. The average contribution by government sector, public sector and private sector to CITR were 41.94%, 33.58% and 24.48% respectively during the study period.

## **4.5 Empirical Investigation:**

### **4.5.1 Introduction**

When a researcher collects data possession original character himself or through agent for the first time from related field, such data are called as primary data (source). And when such primary data are reused by anybody else they are called secondary data. Once primary data have been used, it loses its originality or primary characteristics and becomes secondary. In this study, this part is entirely related with primary source of data.

An empirical investigation has been conducted in order to find out various aspects of problems for the administration of Income Tax Act, 2058 in Nepal from the real life experience. For this purpose, questionnaire was developed and responses were collected from the respondents. A set of 80 questionnaires was received out of 100 questionnaires distributed to the respondents. Respondents were classified into two groups - tax experts and taxpayers. The responses received from various respondents have been arranged, tabulated and analyzed in order to facilitate the descriptive analysis of the study. (See the format of questionnaire and the list of the respondents in appendix A and B respectively.

The questionnaire was asked for a yes/no response or asked for ranking of the choices according to the number of alternatives where first choice was the most important and the last choice was the least important. For analysis purpose, choices were assigned weight according to number of alternatives. If the number of alternatives were 8 then the first preferred choice got eight points and the last preferred choice got one point. Any alternative, which was

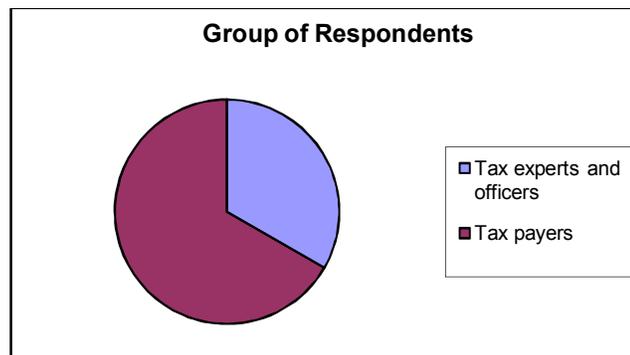
not ranked, didn't get any point. The total points available to each choice were converted into percentage in reference to the total points available for all choices. The choice with the highest score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as last choice. The following table 18 shows the group of respondents.

**Table-18**  
**Groups of Respondents and Code Used**

| Respondent Groups        | Sample Size | Codes Used |
|--------------------------|-------------|------------|
| Tax experts and officers | 20          | Y          |
| Tax payers               | 40          | Z          |
|                          | 60          |            |

*Source: Opinion Survey*

**Figure-1**



#### **4.5.2 Opinion towards Tax Paying Habit of Nepalese People**

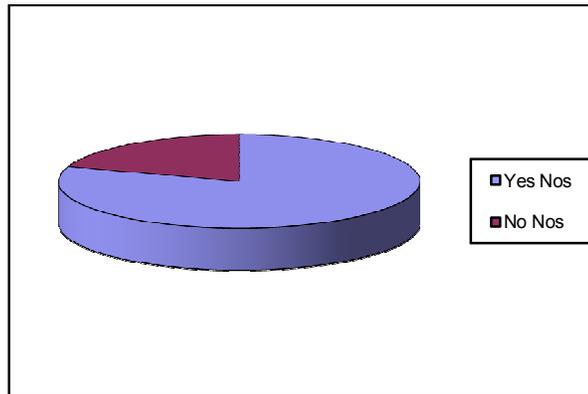
To know the respondents opinion about the taxpaying habit of Nepalese people, the first question, "Do you think there is poor taxpaying habit of Nepalese people?" was asked. The responses received from respondents are tabulated as under:

**Table-19**  
**Opinion towards taxpaying habit of Nepalese people**

| Respondent Groups            | Yes |       | No  |       | Total |       |
|------------------------------|-----|-------|-----|-------|-------|-------|
|                              | Nos | % age | Nos | % age | Nos   | % age |
| Y (Tax experts and officers) | 16  | 80    | 4   | 20    | 20    | 100   |
| Z (Tax payers)               | 34  | 85    | 6   | 15    | 40    | 100   |
| Total                        | 50  | 83.33 | 10  | 16.67 | 60    | 100   |

*Source: Opinion Survey*

**Figure-2**



From the above table, 80% of tax experts and 85% of tax payers approved there is poor taxpaying habit of Nepalese people and 20% of tax experts and 15% of tax payers approved there is not poor taxpaying habit of Nepalese people. Out of 60 respondents, 50 respondents, i.e. 83.33% voted for poor taxpaying habit of Nepalese people and 10 respondents i.e. 16.67% voted for there is not poor taxpaying habit of Nepalese people.

From the above table, it has been clear that there is poor taxpaying habit of Nepalese people.

**Test of Hypothesis**

Hypothesis: 1

We have 2x2 contingency table with cell frequency less than 5 as follows:

**Table-20**

| Respondent Groups            | Yes    | No    | Total      |
|------------------------------|--------|-------|------------|
| Y (Tax experts and officers) | a = 16 | b = 4 | (a+b) = 20 |
| Z (Tax payers)               | c = 34 | d = 6 | (c+d) = 40 |
| Total                        | 50     | 10    | N = 60     |

*Source: Opinion Survey*

Null Hypothesis  $H_0$ : There is no significant relationship between the views of tax experts and taxpayers with respect to there are poor taxpaying habit of Nepalese people.

Alternative Hypothesis  $H_1$ : There is significant relationship between the views of tax experts and taxpayers with respect to there is poor taxpaying habit of Nepalese people.

Applying Yates Correlation

$$\begin{aligned}\chi^2 &= \frac{N[(ad-bc)-N/2]^2}{(a+b)(c+d)(a+c)(b+d)} \\ &= \frac{60[(16 \times 6 - 4 \times 34) - 60/2]^2}{20 \times 40 \times 50 \times 10} \\ &= 0.01\end{aligned}$$

$\therefore$  Calculated value of  $\chi^2 = 0.01$

Level of Significance,  $\alpha = 5\% = 0.05$  (Suppose)

Degree of freedom =  $(r-1)(c-1) = (2-1) \times (2-1) = 1 \times 1 = 1$ .

From the table, tabulated  $\chi^2_{(0.05, 1)} = 3.84$

Decision: Since, calculated  $\chi^2$  is less than tabulated  $\chi^2_{(0.05, 1)}$  i.e.  $0.01 < 3.84$ , we accept null hypothesis ( $H_0$ ) at 5% level of significance. It means there is no significant relationship between the views of tax experts and taxpayers with respect to there is poor tax paying habit of Nepalese people i.e. both tax experts and taxpayers have approved there is poor tax paying habit of Nepalese people.

### 4.5.2.1 Reasons behind Poor Tax Paying Habit of Nepalese People

Most of the respondents voted that there is poor taxpaying habit of Nepalese people. To know the causes of poor taxpaying habit of Nepalese people, the question was asked, "If Yes, what are the major causes of poor tax paying habit of Nepalese people?" The respondents were requested to rank their answer from 1 (most important) to 7 (least important). The responses received from the respondents are tabulated below:

**Table-21**  
**Major causes of poor tax paying habit of Nepalese people**

| SN | Major causes                                       | Group |     | Total Points | % age  | Rank |
|----|--|-------|-----|--------------|--------|------|
|    |  | Y     | Z   |              |        |      |
| 1  | Poverty ness of tax payer                          | 40    | 88  | 128          | 6.00   | 7    |
| 2  | Little knowledge of tax and its importance         | 120   | 231 | 351          | 16.45  | 2    |
| 3  | Widespread practices of illegal business           | 110   | 228 | 338          | 15.84  | 3    |
| 4  | Lack of incentives for regular tax payers          | 136   | 260 | 396          | 18.56  | 1    |
| 5  | Defective tax administration system                | 112   | 219 | 331          | 15.51  | 4    |
| 6  | Complexity of tax laws and policies                | 85    | 198 | 283          | 13.26  | 6    |
| 7  | Poor public relation by tax office and authorities | 98    | 209 | 307          | 14.39  | 5    |
|    | Total  |       |     | 2134         | 100.00 |      |

*Source: Opinion Survey*

The major causes of poor taxpaying habit of Nepalese people were ranked in order of the preference of the respondents as follows. (Please refer table 5.2.3 for details)

1. Lack of incentives for regular taxpayers
2. Little knowledge of tax and its importance
3. Widespread practices of illegal business
4. Defective tax administration system
5. Poor public relation by tax office and authorities
6. Complexity of tax laws and policies
7. Poverties of taxpayers

To know whether there is positive or negative correlation between the above views of tax experts and taxpayers, it is tested by Spearman's rank correlation coefficient.

**Test of Spearman's Rank Correlation:**

Rank correlation: 1

We have;

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

Where;

$r_s$  = Spearman's rank correlation coefficient

$d$  = difference of the corresponding ranks

$n$  = number of pairs of observations

The value lies between -1 and +1.

**Table-22**

**Calculation of Spearman's Rank Correlation Coefficient**

| SN | Major causes                                       | Total Points | Re-rank | Total Points | Re-rank | Diff. Of Rank | % age |
|----|--|--------------|---------|--------------|---------|---------------|-------|
|    |  | Y            | R1      | Z            | R2      | d=R1-R2       | d2    |
| 1  | Poverties of tax payer                             | 40           | 7       | 88           | 7       | 0             | 0.00  |
| 2  | Little knowledge of tax and its importance         | 120          | 2       | 231          | 2       | 0             | 0.00  |
| 3  | Widespread practices of illegal business           | 110          | 4       | 228          | 3       | 1             | 1.00  |
| 4  | Lack of incentives for regular tax payers          | 136          | 1       | 260          | 1       | 0             | 0.00  |
| 5  | Defective tax administration system                | 112          | 3       | 219          | 4       | -1            | 1.00  |
| 6  | Complexity of tax laws and policies                | 85           | 6       | 198          | 6       | 0             | 0.00  |
| 7  | Poor public relation by tax office and authorities | 98           | 5       | 209          | 5       | 0             | 0.00  |
|    | Total  |              |         |              |         |               | 2.00  |

Source: *Opinion Survey*

Note: Y refers to tax experts and Z refers to taxpayers.

The above table gives  $\sum d^2 = 2$  and  $n = 7$  to compute rank correlation coefficient as:

$$\begin{aligned}
 r_s &= 1 - \frac{6\sum d^2}{n(n^2-1)} \\
 &= 1 - \frac{6(2)}{7(49-1)} \\
 &= 1 - \frac{12}{336} = +0.96
 \end{aligned}$$

Decision: The correlation coefficient i.e. +0.96 indicates that there is highly positive correlation between the tax experts and tax payers ranking regarding the major causes of poor tax paying habit of Nepalese people.

#### 4.5.3 Opinion towards Effectiveness of Income Tax to Reduce the Gap between Rich and Poor People in Nepal

Income tax is levied on the income of the person or organization after allowing deductions of genuine expenses incurred to generate such income. And collected income tax is spent in public expenditures for everyone's benefit. The person or organization, which doesn't generate income, doesn't pay tax. So, income tax is supposed to be an effective tool to reduce the gap between rich and poor people. In this context, the respondents were asked the question, "Do you think income tax is an effective tool to reduce the gap between rich and poor people in Nepal?" and the responses received from them are tabulated below:

**Table-23**

**Opinion towards effectiveness of Income Tax to reduce the gap between rich and poor people**

| Respondent Group | Yes |       | No  |       | Total |        |
|------------------|-----|-------|-----|-------|-------|--------|
|                  | Nos | % age | Nos | % age | Nos   | % age  |
| Y (Tax experts)  | 14  | 70    | 6   | 30    | 20    | 100.00 |
| Z (Tax payers)   | 32  | 80    | 8   | 20    | 40    | 100.00 |
|                  | 46  | 76.67 | 14  | 23.33 | 60    | 100.00 |

*Source: Opinion Survey*

From the above table, it is clear that income tax is an effective tool to reduce the gap between rich and poor people. About 76.67% of the respondents responded that income tax is an effective tool to reduce the gap between rich and poor people and only 23.33% of respondents accepted that income tax is not effective tool to reduce the gap between rich and poor people in Nepal.

In conclusion, it can be said that most of the respondents opined that income tax is an effective tool to reduce the gap between rich and poor people.

### Test of Hypothesis

Hypothesis: 2

We have 2x2 contingency table with cell frequency less than 5 as follows:

**Table-24**

| Respondent Groups            | Yes    | No    | Total      |
|------------------------------|--------|-------|------------|
| Y (Tax experts and officers) | a = 14 | b = 6 | (a+b) = 20 |
| Z (Tax payers)               | c = 32 | d = 8 | (c+d) = 40 |
| Total                        | 46     | 14    | N = 60     |

Null Hypothesis  $H_0$ : There is no significant relationship between the views of tax experts and taxpayers with respect to income tax is effective tool to reduce the gap between rich and poor people.

Alternative Hypothesis  $H_1$ : There is significant relationship between the views of tax experts and taxpayers with respect to income tax is effective tool to reduce the gap between rich and poor people.

For 2x2 contingency table, the value of  $\chi^2$  can be calculated by using following formula;

$$\begin{aligned} \chi^2 &= \frac{N(ad-bc)^2}{(a+b)(c+d)(a+c)(b+d)} \\ &= \frac{60(14 \times 8 - 6 \times 32)^2}{20 \times 40 \times 46 \times 14} \\ &= 0.74 \end{aligned}$$

$\therefore$  Calculated value of  $\chi^2 = 0.74$

Level of Significance,  $\alpha = 5\% = 0.05$  (Suppose)

Degree of freedom = (r-1) (c-1) = (2-1)x(2-1)= 1x1=1.

From the table, tabulated  $\chi^2_{(0.05, 1)} = 3.84$

Decision: Since, calculated  $\chi^2$  is less than tabulated  $\chi^2_{(0.05, 1)}$  i.e.  $0.74 < 3.84$ , we accept null hypothesis ( $H_0$ ) at 5% level of significance. It means there is no significant relationship between the views of tax experts and taxpayers with respect to income tax is effective tool to reduce the gap between rich and poor people in Nepal.

#### 4.5.4 Opinion towards Modern's and Effectiveness of Income Tax Act 2058

To measure the modern ness and effectiveness of Income Tax Act, 2058 in comparison to the previous Income Tax Act 2031, a question, "In you opinion is the Income Tax Act 2058 a modern and more effective Tax Act than Income Tax Act 2031?" was asked. The responses received from the respondents are tabulated as below:

**Table-25**

**Opinion towards modernism and effectiveness of Income Tax Act 2058**

| Respondent Group | Yes |       | No  |       | Total |        |
|------------------|-----|-------|-----|-------|-------|--------|
|                  | Nos | % age | Nos | % age | Nos   | % age  |
| Y (Tax experts)  | 19  | 95    | 1   | 5     | 20    | 100.00 |
| Z (Tax payers)   | 37  | 92.5  | 3   | 7.5   | 40    | 100.00 |
| Total            | 56  | 93.33 | 4   | 6.67  | 60    | 100.00 |

Source: Opinion Survey

From the above table, it is clear that 93.33% of the respondents approved Income Tax Act 258 is a modern and more effective than Income Tax Act 2031 and only 6.67% of the respondents don't recognize Income Tax Act 2058 as a modern and more effective than Income Tax Act 2031.

Hence, it can be concluded that Income Tax Act 258 is a modern and more effective than Income Tax Act 2031.

### Test of Hypothesis

Hypothesis: 3

We have 2x2 contingency table with cell frequency less than 5 as follows:

**Table-26**

| Respondent Groups            | Yes    | No    | Total      |
|------------------------------|--------|-------|------------|
| Y (Tax experts and officers) | a = 19 | b = 1 | (a+b) = 20 |
| Z (Tax payers)               | c = 37 | d = 3 | (c+d) = 40 |
| Total                        | 56     | 4     | N = 60     |

Null Hypothesis  $H_0$ : There is no significant relationship between the views of tax experts and taxpayers with respect to Income Tax Act 2058 is modern and more effective than Income Tax Act 2031.

Alternative Hypothesis  $H_1$ : There is significant relationship between the views of tax experts and taxpayers with respect to Income Tax Act 2058 is modern and more effective than Income Tax Act 2031.

For 2x2 contingency table, the value of  $\chi^2$  can be calculated by using following formula;

$$\begin{aligned} \chi^2 &= \frac{N(ad-bc)^2}{(a+b)(c+d)(a+c)(b+d)} \\ &= \frac{60(19 \times 3 - 1 \times 37)^2}{20 \times 40 \times 56 \times 4} \\ &= 0.13 \end{aligned}$$

$\therefore$  Calculated value of  $\chi^2 = 0.13$

Level of Significance,  $\alpha = 5\% = 0.05$  (Suppose)

Degree of freedom =  $(r-1)(c-1) = (2-1) \times (2-1) = 1 \times 1 = 1$ .

From the table, tabulated  $\chi^2_{(0.05, 1)} = 3.84$

Decision: Since, calculated  $\chi^2$  is less than tabulated  $\chi^2_{(0.05, 1)}$  i.e.  $0.13 < 3.84$ , we accept null hypothesis  $H_0$ ) at 5% level of significance. It means there is no significant relationship between the views of tax experts and taxpayers with respect to income tax is effective tool to reduce the gap between rich and poor people in Nepal.

#### 4.5.5 Opinion towards Contribution of Income Tax on National Revenue

Income taxes are most essential for the development of a country especially underdeveloped and developing countries. Nepal is underdeveloped country requiring development on various sectors to export the resources of the country. It is blamed that the contribution of income tax on national revenue is not satisfactory through Income Tax Act 2058. To know the fact a question was asked, "Do you think that contribution of income tax on national revenue is not satisfactory through Income Tax Act 2058?" The responses received from the respondents are tabulated below:

**Table-27**

**Opinion towards contribution of Income Tax on National Revenue**

| Respondent Group | Yes |       | No  |       | Total |        |
|------------------|-----|-------|-----|-------|-------|--------|
|                  | Nos | % age | Nos | % age | Nos   | % age  |
| Y (Tax experts)  | 7   | 35    | 13  | 65    | 20    | 100.00 |
| Z (Tax payers)   | 10  | 25    | 30  | 75    | 40    | 100.00 |
|                  | 17  | 28.33 | 43  | 71.67 | 60    | 100.00 |

*Source: Opinion Survey*

From the above table, it is clear that the contribution of income tax on national revenue is not satisfactory through Income Tax Act 2058. 71.67% of the respondents approved contribution of income tax on national revenue not satisfactory and only 28.33% of the respondents recognize that contribution of income tax on national revenue is satisfactory through Income Tax Act 2058.

Hence, it can be concluded that the contribution of income tax on national revenue is not satisfactory through Income Tax Act 258.

### Test of Hypothesis

Hypothesis: 4

We have 2x2 contingency table with cell frequency less than 5 as follows:

**Table-28**

| Respondent Groups            | Yes    | No     | Total      |
|------------------------------|--------|--------|------------|
| Y (Tax experts and officers) | a = 7  | b = 13 | (a+b) = 20 |
| Z (Tax payers)               | c = 10 | d = 30 | (c+d) = 40 |
| Total                        | 13     | 43     | N = 60     |

*Source: Opinion Survey*

Null Hypothesis  $H_0$ : There is no significant relationship between the views of tax experts and taxpayers with respect to the contribution of income tax is not satisfactory through Income Tax Act 2058.

Alternative Hypothesis  $H_1$ : There is significant relationship between the views of tax experts and taxpayers with respect to the contribution of income tax is not satisfactory through Income Tax Act 2058.

For 2x2 contingency table, the value of  $\chi^2$  can be calculated by using following formula;

$$\begin{aligned} \chi^2 &= \frac{N(ad-bc)^2}{(a+b)(c+d)(a+c)(b+d)} \\ &= \frac{60(7 \times 30 - 13 \times 10)^2}{20 \times 40 \times 17 \times 43} \\ &= 0.66 \end{aligned}$$

$\therefore$  Calculated value of  $\chi^2 = 0.66$

Level of Significance,  $\alpha = 5\% = 0.05$  (Suppose)

Degree of freedom =  $(r-1)(c-1) = (2-1) \times (2-1) = 1 \times 1 = 1$ .

From the table, tabulated  $\chi^2_{(0.05, 1)} = 3.84$

Decision: Since, calculated  $\chi^2$  is less than tabulated  $\chi^2_{(0.05, 1)}$  i.e.  $0.66 < 3.84$ , we accept null hypothesis  $H_0$  at 5% level of significance. It means there is no

significant relationship between the views of tax experts and taxpayers with respect to the contribution of income tax is not satisfactory through Income Tax Act 2058.

#### **4.5.6 Opinion towards Effectiveness of Revenue Administrative and Revenue Tribunal**

A taxpayer may not be satisfied with the decision made by tax officials. In such case, he may lodge an objection against the assessment with the Director General (DG) or revenue tribunal. In order to ensure justice or impartiality, it is necessary to establish a sound appeal system. Income Tax Act, 2058 has made provision for two types of appeal system: first to the Inland Revenue Department (IRD) for and administrative review and second to review tribunal. The Act has made it mandatory for the taxpayers to file an objection with IRD for an administrative review before appealing the revenue tribunal.

In order to know the effectiveness of the revenue administrative and revenue tribunal to give the correct decision to the taxpayer, a question was asked, "Are the revenue administrative and revenue tribunal offices effective to give the correct decision to the taxpayer?" The responses received from the respondents are tabulated below:

**Table-29**

#### **Opinion towards Effectiveness of Revenue Administrative and Revenue Tribunal Offices**

| Respondent Group | Yes |       | No  |       | Total |        |
|------------------|-----|-------|-----|-------|-------|--------|
|                  | Nos | % age | Nos | % age | Nos   | % age  |
| Y (Tax experts)  | 9   | 45    | 11  | 55    | 20    | 100.00 |
| Z (Tax payers)   | 10  | 25    | 30  | 75    | 40    | 100.00 |
|                  | 19  | 31.67 | 41  | 68.33 | 60    | 100.00 |

*Source: opinion survey*

From the above table, it is clear that the revenue administrative and revenue tribunal offices are not effective to give the correct decision to the taxpayers. Out of the 60 respondents 41 respondents i.e. 68.33% voted against the effectiveness of revenue administrative and revenue tribunal office and 19 respondents i.e. 13.67% voted for the effectiveness of revenue administrative and revenue tribunal offices.

In conclusion, on the basis of the above survey, it can be said that the revenue administrative and revenue tribunal offices are not effective to satisfy the taxpayers in their cases.

**Test of Hypothesis:**

Hypothesis: 5

We have 2x2 contingency table with cell frequency less than 5 as follows:

**Table-30**

| Respondent Groups            | Yes    | No     | Total      |
|------------------------------|--------|--------|------------|
| Y (Tax experts and officers) | a = 9  | b = 11 | (a+b) = 20 |
| Z (Tax payers)               | c = 10 | d = 30 | (c+d) = 40 |
| Total                        | 19     | 41     | N = 60     |

Null Hypothesis H<sub>0</sub>: There is no significant relationship between the views of tax experts and taxpayers with respect to the effectiveness of revenue administrative and revenue tribunal offices to give the correct decision to the taxpayers.

Alternative Hypothesis H<sub>1</sub>: There is significant relationship between the views of tax experts and taxpayers with respect to the to the effectiveness of revenue administrative and revenue tribunal offices to give the correct decision to the taxpayers

For 2x2 contingency table, the value of  $\chi^2$  can be calculated by using following formula;

$$\begin{aligned} \chi^2 &= \frac{N(ad-bc)^2}{(a+b)(c+d)(a+c)(b+d)} \\ &= \frac{60(9 \times 30 - 11 \times 10)^2}{\dots} \end{aligned}$$

$$20 \times 40 \times 19 \times 41$$

$$= 2.52$$

∴ Calculated value of  $\chi^2 = 2.52$

Level of Significance,  $\alpha = 5\% = 0.05$  (Suppose)

Degree of freedom =  $(r-1)(c-1) = (2-1) \times (2-1) = 1 \times 1 = 1$ .

From the table, tabulated  $\chi^2_{(0.05, 1)} = 3.84$

Decision: Since, calculated  $\chi^2$  is less than tabulated  $\chi^2_{(0.05, 1)}$  i.e.  $2.52 < 3.84$ , we accept null hypothesis ( $H_0$ ) at 5% level of significance. It means there is no significant relationship between the views of tax experts and taxpayers with respect to the to the effectiveness of revenue administrative and revenue tribunal offices to give the correct decision to the taxpayers.

#### 4.5.7 Opinion towards Effectiveness of Income Tax Act 2058 in the Coming Years

In order to know the effectiveness of Income Tax Act 2058 in the coming years, a question was asked, "Will the Income Tax Art 2058 be more effective in the coming years?" The responses received from the respondents are tabulated below:

**Table-31**

**Opinion towards Effectiveness of ITA 2058 in the coming years**

| Respondent Group | Yes |       | No  |       | Total |        |
|------------------|-----|-------|-----|-------|-------|--------|
|                  | Nos | % age | Nos | % age | Nos   | % age  |
| Y (Tax experts)  | 15  | 75    | 5   | 25    | 20    | 100.00 |
| Z (Tax payers)   | 28  | 70    | 12  | 30    | 40    | 100.00 |
|                  | 43  | 71.67 | 17  | 28.33 | 60    | 100.00 |

From the above table, it is clear that Income Tax Act 2058 will be more effective in the coming years. Out of the 60 respondents 43 respondents i.e. 71.67% voted for the effectiveness of Income Tax 2058 in the coming years and 17 respondents i.e. 28.33% voted against the effectiveness Income Tax 2058 in the coming years.

In conclusion, on the basis of the above survey, it can be said that Income Tax 2058 will be more effective and productive in the coming years.

### Test of Hypothesis

Hypothesis: 6

We have 2x2 contingency table with cell frequency less than 5 as follows:

**Table-32**

| Respondent Groups            | Yes    | No     | Total      |
|------------------------------|--------|--------|------------|
| Y (Tax experts and officers) | a = 15 | b = 5  | (a+b) = 20 |
| Z (Tax payers)               | c = 28 | d = 12 | (c+d) = 40 |
| Total                        | 43     | 17     | N = 60     |

Null Hypothesis  $H_0$ : There is no significant relationship between the views of tax experts and taxpayers with respect to the effectiveness of Income Tax 2058 in the coming years.

Alternative Hypothesis  $H_1$ : There is significant relationship between the views of tax experts and taxpayers with respect to the to the effectiveness of Income Tax 2058 in the coming years.

For 2x2 contingency table, the value of  $\chi^2$  can be calculated by using following formula;

$$\begin{aligned} \chi^2 &= \frac{N(ad-bc)^2}{(a+b)(c+d)(a+c)(b+d)} \\ &= \frac{60(15 \times 12 - 5 \times 28)^2}{20 \times 40 \times 43 \times 17} \\ &= 0.16 \end{aligned}$$

$\therefore$  Calculated value of  $\chi^2 = 0.16$

Level of Significance,  $\alpha = 5\% = 0.05$  (Suppose)

Degree of freedom =  $(r-1)(c-1) = (2-1) \times (2-1) = 1 \times 1 = 1$ .

From the table, tabulated  $\chi^2_{(0.05, 1)} = 3.84$

Decision: Since, calculated  $\chi^2$  is less than tabulated  $\chi^2_{(0.05, 1)}$  i.e.  $0.16 < 3.84$ , we accept null hypothesis ( $H_0$ ) at 5% level of significance. It means there is no

significant relationship between the views of tax experts and taxpayers with respect to Income Tax 2058 will be more effective in the coming years.

#### **4.5.8 Opinion towards Existence of Corrupt Practices in Income Tax Administration**

Administration is the design of implementation of government policies. Tax administration is regarded as having the responsibility for determining the policies & programmes of government related to tax. Specially, it is the planning, organizing, directing, coordinating and controlling of government organizations related to taxation. Income Tax Act 2058 has made a provision regarding the design of tax administration also. However, Income Tax Administration of Nepal has got blame as a corruption center and administrator as the member of the center. In order to find out whether the corruption is existed in Nepalese income tax administration or not, a question, "Do you think corrupt practice exists in Income Tax Administration of Nepal?" was asked. The responses received from the respondents are tabulated below:

**Table-33**

**Opinion towards Existence of corrupt practices in income tax administration**

| Respondent Group | Yes |       | No  |       | Total |        |
|------------------|-----|-------|-----|-------|-------|--------|
|                  | Nos | % age | Nos | % age | Nos   | % age  |
| Y (Tax experts)  | 10  | 50    | 10  | 50    | 20    | 100.00 |
| Z (Tax payers)   | 40  | 100   | 0   | 0     | 40    | 100.00 |
|                  | 50  | 83.33 | 10  | 16.67 | 60    | 100.00 |

Source: Opinion Survey

From the above table, it is clear in the view of taxpayers there is corrupt practice in the income tax administration i.e. 100% of the taxpayers accepted that there is corrupt practice. However, according to the opinion of tax experts/officers, they have opined differently. 50% of the respondents have voted for there is corrupt practice and 50% have voted against the corrupt practice i.e. out of 20 respondents of tax officers/experts only 10 respondents opined that there is corrupt practice in the income tax administration of Nepal.

In aggregate, 50 respondents out of 60 i.e. 83.33% voted that there is corrupt practice in the income tax administration of Nepal. We can also believe the same.

### Test of Hypothesis

Hypothesis: 7

We have 2x2 contingency table with cell frequency less than 5 as follows:

**Table-34**

| Respondent Groups            | Yes    | No     | Total      |
|------------------------------|--------|--------|------------|
| Y (Tax experts and officers) | a = 10 | b = 10 | (a+b) = 20 |
| Z (Tax payers)               | c = 40 | d = 0  | (c+d) = 40 |
| Total                        | 50     | 10     | N = 60     |

Null Hypothesis  $H_0$ : There is no significant relationship between the views of tax experts and taxpayers with respect to there is corrupt practice in the income tax administration of Nepal.

Alternative Hypothesis  $H_1$ : There is significant relationship between the views of tax experts and taxpayers with respect to there is corrupt practice in the income tax administration of Nepal.

For 2x2 contingency table, the value of  $\chi^2$  can be calculated by using following formula;

$$\begin{aligned}\chi^2 &= \frac{N(ad-bc)^2}{(a+b)(c+d)(a+c)(b+d)} \\ &= \frac{60(10 \times 0 - 10 \times 40)^2}{20 \times 40 \times 50 \times 10} \\ &= 24\end{aligned}$$

$\therefore$  Calculated value of  $\chi^2 = 24$

Level of Significance,  $\alpha = 5\% = 0.05$  (Suppose)

Degree of freedom =  $(r-1)(c-1) = (2-1)(2-1) = 1 \times 1 = 1$ .

From the table, tabulated  $\chi^2_{(0.05, 1)} = 3.84$

Decision: Since, calculated  $\chi^2$  is greater than tabulated  $\chi^2_{(0.05, 1)}$  i.e.  $24 > 3.84$ , we accept alternative hypothesis ( $H_1$ ) at 5% level of significance. It means there is significant relationship between the views of tax experts and taxpayers with respect to there is corrupt practice in the income tax administration of Nepal.

### 4.5.8.1 Causes behind the Existence of Corrupt Practices in the Income Tax Administration of Nepal.

In order to know the causes of corrupt practices existed in the income tax administration of Nepal the next question was asked, "If yes, what are the major causes of corruption in the income tax administration of Nepal?" The respondents were requested to rank their answers from 1 to 5 scales. Table 5.2.16 gives a breakdown of the responses.

**Table-35**

**Major causes of corrupt practices in income tax administration of Nepal**

| SN | Major causes                              | Group |     | Total Points | % age | Rank |
|----|---|-------|-----|--------------|-------|------|
|    |   | Y     | Z   |              |       |      |
| 1  | Dishonest taxpayers                       | 40    | 23  | 63           | 8.95  | 5    |
| 2  | Dishonest tax personnel                   | 8     | 186 | 194          | 27.56 | 1    |
| 3  | Political uncertainty                     | 35    | 148 | 183          | 25.99 | 2    |
| 4  | Lower remuneration of tax personnel       | 28    | 118 | 146          | 20.74 | 3    |
| 5  | Weaknesses of acts, rules and regulations | 15    | 103 | 118          | 16.76 | 4    |
|    | Total                                     |       |     | 704          | 100   |      |

Source: Opinion Survey

Note: Y: Tax experts/Officers

Z: Taxpayers

The major causes of corrupt practice existed in income tax administration of Nepal were ranked in order of preference of the respondents as follows. (See Table 5.2.16 for detail)

1. Dishonest tax personnel
2. Political uncertainty
3. Lower remuneration of tax personnel
4. Weaknesses of acts, rules and regulations
5. Dishonest taxpayers

To know whether there is positive or negative correlation between views of tax experts and taxpayers, it is tested by Spearman's rank correlation coefficient.

### Test of Spearman's Rank Correlation

Rank correlation: 2

We have;

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

Where;

$r_s$  = Spearman's rank correlation coefficient

$d$  = difference of the corresponding ranks

$n$  = number of pairs of observations

The value lies between -1 and +1.

**Table-36**

**Calculation of Spearman's Rank Correlation Coefficient**

| SN | Major causes                              | Total Points | Re-rank | Total Points | Re-rank | Diff. Of Rank |                |
|----|---|--------------|---------|--------------|---------|---------------|----------------|
|    |   | Y            | R1      | Z            | R2      | d=R1-R2       | d <sup>2</sup> |
| 1  | Dishonest taxpayers                       | 40           | 1       | 23           | 5       | -4            | 16.00          |
| 2  | Dishonest tax personnel                   | 8            | 5       | 186          | 1       | 4             | 16.00          |
| 3  | Political uncertainty                     | 35           | 2       | 148          | 2       | 0             | 0.00           |
| 4  | Lower remuneration of tax personnel       | 28           | 3       | 118          | 3       | 0             | 0.00           |
| 5  | Weaknesses of acts, rules and regulations | 15           | 4       | 103          | 4       | 0             | 0.00           |
|    | Total                                     |              |         |              |         |               | 32.00          |

Source: Opinion Survey

Note: Y refers to tax experts and Z refers to taxpayers.

The above table gives  $\sum d^2 = 32$  and  $n = 5$  to compute rank correlation coefficient as:

$$\begin{aligned} r_s &= 1 - \frac{6\sum d^2}{n(n^2-1)} \\ &= 1 - \frac{6(32)}{5(25-1)} \\ &= 1 - \frac{192}{120} = -0.6 \end{aligned}$$

Decision: The correlation coefficient i.e. -0.6 indicates that there is moderate negative correlation between the tax experts and tax payers ranking regarding the major causes of corrupt practice existed in the income tax administration of Nepal.

#### **4.6 Major Findings of the Study**

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

- The study shows that the contribution of tax revenue to total revenue was 76.89% and that of non- tax revenue was 23.36% in FY 2068/69. It shows that taxation has been a major source of government revenue. But the contribution of tax revenue was in the decreasing trend. Its contribution was 77.68% in FY 2059/60 on total revenue, which was slightly decreased to 76.89% in FY 2068/69.
- Nepalese tax revenue is composed of both direct and indirect tax revenue. There is dominant role of indirect tax revenue in Nepalese tax revenue. The contribution of direct tax and indirect tax to total tax revenue was 21.16% and 78.84% respectively in FY 2059/60 which became 22.99% and 77.01% respectively in 2068/69. IT reveals that tax structure of Nepal is not justifiable on equity ground and progressiveness because indirect tax is considered regressive in nature.
- the contribution of custom duty, excise duty sales tax/ VAT and other tax on indirect tax were 42.89% 11.89%, 41.23% and 4.19% respectively in FY 2059/60 and the contribution of each taxes were reached to 38.20%, 15.71%, 46.03% and 0% respectively in FY 2068/69. It shows that custom duties and other tax were in decreasing trend and excise duty and sales tax/VAT were in increasing trend.
- The contribution of income tax, land tax house and land registration tax and urban house and land rent to direct revenue in FY 2059/60

were 74.84%, 0.40% 22.86% and 1.9% respectively which were reached to 85.31%, 0%, 14.69% and 0% respectively in FY 2068/69. In the composition of direct tax, income tax was the giant one which contribution seems to be increasing every years. The percentage contribution of house and land registration tax was in decreasing trend and the other remaining taxes portions came to nil in the succeeding years. Income tax has occupied third position at present on the basis of mean contribution to GDP. Its contribution to government's revenue is in increasing trend. So the income tax in future will also contribute very well.

- Income tax has been considered as suitable source for the mobilizing internal resources. It can be used as a positive instrument to boost government revenue collection, to develop the economic conditions of Nepalese people and promote distribute justice and to cure resource gap problem.
- The direct tax/GDP ratio, contribution of direct tax total tax revenue and total revenue in FY 2059/60 were 1.92%, 21.16% and 16.44% respectively which were increased to 2.41%, 22.99% and 17.68% respectively for the 2068/69, which is not satisfactory increment for the developing country like Nepal.
- The total tax revenue/GDP ratio in FY 2059/60 was 9.05% which increased to 10.48% in the FY 2068/69. But this ration is not regarded as satisfactory increment.
- The indirect tax/ GDP ratio. Total revenue/GDP, income tax/GDP income tax/GDP and CITR/GDP in 2059/60 were 7.12%, 11.65%, 1.43% and 0.95 respectively which were slightly increased to 8.07%, 13.62%, 2.05% and 1.05% respectively for the FY 2068/69, which is not satisfactory increment for the developing country like Nepal.

- The resource gap has been increasing every year. It was Rs 18650.9 million in FY 2059/60 which was increased to Rs 33258.1 million in the FY 2068/69 and average percentage of resource gap to total expenditure was 36.52%. It is also found from the projected data that the resource gap will also further increase in the future, which is not desirable for the economy.
- On an average, contribution of the government revenue in financing public expenditure was 63.48% during the study period. Government revenue was 68.91% in FY 2067/68 at maximum level and it was 56.85% at lowest level in FY 2060/61. Similarly, the contribution made by foreign aid comprising both grants and loans was 23.84% on an average. This indicates the internal indebtedness of the country.
- The contribution made by CITR to total expenditure was 5.57% on an average. Its contribution was 7.49% of maximum in FY 2064/65 and 4.35% minimum in FY 2066/67. The drastic reduction in contribution percentage of corporate sector was mainly due to the unfriendly business environment created by unstable political and economic situation of the country.
- The corporate tax rate have been revised for several times in the history of corporate tax. Nowadays private and public companies are taxed at a flat rate of 20, 25 and 30 percent respectively which are the lowest rate in the history of more than one decade.
- Nepal has been practicing book profit or corporate profit as tax base for corporate taxation ITA, 2058, has clarify about the format for calculating different head of incomes.
- The contribution of CITR to total revenue was 12.34% of maximum in FY 2064/65 and 6.57% of minimum in FY 2066/67. The average contribution was 8.77% during the study period. This contribution is important but not satisfactory for developing country like Nepal.

- On an average, CITR had contributed 11.31% to total tax revenue. The contribution trend was fluctuating from 15.56% of maximum in FY 2064/65, to 8.7% of minimum in 2066/67. Similarly, CITR's contribution in direct tax revenue was also found in increasing trend up to 61.48% in 2064/65 which was sharply decreased to 38.29% in FY 2066/67 at the lowest level. This indicate the low portion of resource mobilization from domestic source.
- CITR portion in income tax revenue was 66.22% of maximum in 2059/60 which was gradually decreased to 44.95% of lowest in FY 2066/67 and it was 50.97% in FY 2068/69. On average, CITR had contributed 55.36% to income tax revenue. This shows that CITR occupied major portion in income tax. But the massive fluctuation in CITR collection and its percentage contribution was due to the effect of unfriendly political and economic environment and lack of developing competency by public and private sector.
- In the structural composition of CITR government sector has dominated the structure. The average portion converted by government, public and private sector was 41.94%, 33.58% and 24.48% respectively. The forecasted data shows that, though the increment in CITR, its contribution percent to total revenue, direct tax revenue and total tax revenue will be in decreasing trend except the contribution percentage to income tax.
- From the opinion survey with various respondents i.e. Income Tax administrators, income tax experts, and income taxpayers, the following finding have been drawn:
  - Income tax is suitable means of raising government revenue of Nepal
  - The taxpaying habits of Nepalese people are poor.
  - The specific objective of income taxation of Nepal is to increase the government revenue.

- The contribution of corporate income tax is significantly on government revenue of Nepal.
- Income tax system of Nepal is not efficient to fulfill the needs of 21<sup>st</sup> country.
- Inefficiently income tax administrator lack of consciousness of tax payers complexity income tax act, rules and regulation, increasing habit of tax evasion etc are the major problems of income tax system of Nepal.
- Lack of trained and competent tax personnel complicated tax laws, under delay is making assessment is the major causes of ineffectiveness of income tax administration of Nepal.
- Clear act, rules and regulation are the most important instrument for effectiveness of income taxation in Nepal.
- Newly enacted “ Income Tax Act 2058” more effective in comparison to previous Income Tax Act 2031”
- Provision of international taxation, taxing capital gain and dividend, provision of stringent fine and penalties etc. are the major reasons of the effectiveness of new Income Tax Act 2058.

## **CHAPTER-V**

### **SUMMARY CONCLUSION AND RECOMMENDATION**

#### **5.1 Summary**

Tax is compulsory burden of country, government operates its activities through the revenue collection income tax is the main source of revenue collection tax is imposed on person's income or wealth. The modern income tax act was started in 1959 year. Income tax collected from corporate income tax and remuneration income tax which is collected through direct tax and indirect tax.

The study has been divided into five chapters. prior to the body of the thesis, several pages of preliminary materials such as title page, viva-voce sheet, recommendation, declaration of the researcher, acknowledgements, table of contents, list of table and figures and abbreviation used have been included.

The first chapter is about the introduction which included the general background of the case study, brief description of study about income tax, statement of problems, objectives of study, importance of study, limitation of study, organization of study.

The second chapter is literature review which gives the details concept of study. It includes the related review of literature, which includes conceptual framework of study, evolution of tax, gradual developments of income tax act and laws, review of materials, research gap.

The third chapter is related with facts like type of research consulted, research design, data processing and analysis is done.

The fourth chapter is related with data presentation and analysis of data. In this chapter primary and secondary data collected from various sources been have presented in the systematic format such as table, chart, and figures

The fifth and the last chapter are about the facts. Which are found through the study and conclusion .In this chapter consists of summary of the major findings of the study, it with major recommendation and suggestion about the income tax structure in Nepal.

## **5.2 Conclusion**

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

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

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

Corporate sector is in initial stage of development in Nepal which is small and stagnant in nature comparing to other developing country. The performance of corporate sector, especially the industry is very poor. Their number, profitability, investment in fixed assets, share of market transaction is all in weak position. Nevertheless, the important and contribution of

corporate income tax to government revenue is equally important to Nepal like developing country.

The contribution of CITR to government revenue, total tax revenue, total direct tax revenue during the study period seemed to be increasing. But it was found in decreasing trend since 2066/67 which may be serious setback for our nation in generating revenue from internal sources and smooth growth of economy.

The resource gap seems to be increasing every years. CITR has been contribution on an average 5.57 percent to total government expenditure which looks small in percentage but it is important to agro-based economy country like Nepal.

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

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

Unclear vision of government to corporate sector, frequent changes of rule and regulations and unstable political-economic environment of Nepal has sharply damaged the corporate sector. is the compulsory burden of country, there is no possibility of getting specific rewards and taxpayer cannot know where the tax is being properly used. The public dislike taxation as a first principle for obvious reasons. The public's first wish for the tax system becomes "reduce my tax liability and raise others". No residents want to pay tax until government assures the proper utilization of the government revenue. Out of the total tax, the share of the indirect tax is 2/3 of the total tax while that of direct tax is nearly 1/3 only. Among the indirect taxes, custom and VAT are

the two major sources while income tax is one of the major sources for direct tax.

Due to some problems like narrow coverage, unscientific tax assessment, deviation from the basic principal in income taxation, long time lag, defective system for the perspective of international taxation, weak tax administration etc. tax revenue collection has not been implemented to the optimum level.

### **5.3 Recommendation**

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

- Total tax consists of direct tax revenue and indirect tax revenue. Nepalese tax revenue is having dominated by indirect tax revenue. So to direct the economy in the path of direct tax revenue. Because of the direct tax revenue plays more significant role in the economic development of the country than indirect tax. Resource mobilization through direct taxation should be focused.
- Out of total tax revenue, the contribution of income tax revenue is very low. So the contribution of income tax revenue to tax revenue and direct tax revenue should be increased by checking income tax evasion, bringing new tax payers into tax brackets, tax incentives programs with the help of sound tax planning.
- Formally 15 to 18 percent tax/GDP ratio is regarded as moderate standard. But Nepalese tax/GDP ratio is contribution 9.40 percent only on an average. So the government should use appropriate measure to meet the standard. For that it can increase the portion of direct tax by bringing the education, public transportation etc. into tax net.
- The target of government to increase tax collection from VAT, income tax and excise duty within 3 years from FY 2059/60 to 4, 3

and 1 percent of GDP respectively are in the positive direction of progress. But unless and until the political and economic scenario is changed, it will be quite hard to achieve the target. So, the government should encourage the entrepreneur, to join in VAT, taking PAN by offering different benefits and it should systematize the customs and boarder etc.

- Structural composition of corporate tax was found to be dominated by government sector. In spite of increment in tax collection from private sector, its contribution percentage to CITR was fluctuated. So the performance of private sector is not satisfactory in overall. Government should do proper homework before privatizing the enterprises and company and a research should be undertaken, why the performance of private sector is poor even then government giving more emphasis to it.
- Government should make a clear cut distinction between the role of public and private sector. It should take an endeavor to motivate, facilitate and regular to accelerate the private sector.
- Government should reduce resource gap by increasing internal revenue and subsidies. Likewise government should only take the foreign loan for productive sector or purposes which has high revenue generating possibility.
- As per the Income Tax Act, 2058, the same flat rate is levied both to resident and non-resident companies in Nepal. In many countries like, India, Belgium, Germany, Indonesia and New Zealand, foreign companies are taxed at the higher rate than domestic companies. It feels that in Nepal also, tax rate should be higher, say 40 percent in case of foreign companies as against 20 to 25 percent in case of domestic company.

- Proper tax incentives should be given for revival of sick industrial unit. Provisions should be made under the Income Tax Act for carry forward and set off of accumulated losses and unabsorbed depreciation of sick units if it is amalgamated with another company.
- Corporate tax base should be based on generally accepted accounting principle.
- Recent decreasing trend of CITR indicates that it is necessary to protect corporate sector from different external security threaten. So, priority should be given to maintain its existence.

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