

CHAPTER – ONE

INTRODUCTION

1.1 General Background

Nepal, with an area of 147,181 sq. km. and around 27.2 million populations, lies in the lap of the Himalayas between the two giant neighbors, China and India. These two countries have been linked with Nepal from the time immemorial by geographical, cultural, economic and social ties.

The Nepalese economy is quite dynamic with favorable economic indicators, viz., stable prices, strong balance of payments position and average annual economic growth of more than 4 percent during the decade of the 1990's. These descriptions, however, hide the fact that Nepal is in LDC with widespread poverty and a gross national per capita income of US\$ 473 in fiscal year 2008/09, with the country ranking 144 out of 182 countries in the United Nation Development Program's human development index. (NRB, 2009:1-2).

Now a day, prime concern of every nation of the world is rapid economic development and Nepal is no exception to this ever-continuing process. Nepal aims for self-reliant economic system to upgrade its living standard of people. Thus a lot of money has to be spent to achieve maximum national objectives.

Either to pay regular expenditure or to do development works, Governments collect revenue. The source of government revenue can be classified into external and internal. External source of government revenue are foreign loans, grants, external borrowings etc. External source are uncertain, inconvenient, and not good for healthy development of nation because they have to pay after a certain time. So it is better to mobilize internal sources rather than external source.

Another source of government revenue is internal which constitute tax and non-tax revenue. The examples of non-tax revenue are fees, fines, royalty, administrative and business income etc. Administrative income denotes the amount charged by government for providing administrative service. Business income means the return received by government for providing various goods and services to the people.

Taxes are the main source of revenue for many governments. The source of tax revenue and the relative contributions of these sources are determined by government policy choices about where and how to impose taxes and by change in the structure of the economy. Taxes influence the incentives and thus the behavior of economic actors and the economy's competitiveness. (World Development, 2005:293)

Tax revenue is the important source of government revenue. Taxation is regarded as an effective instrument, it monitor various economic activities in a country. Customs excise, value added tax, corporate and personnel income tax are the examples of the sources of tax revenue. Government collects revenue through taxation with major objectives of economic development and economic stability. Taxation is the main source of government revenue since it occupies the most important place in the government treasury. The contribution of tax revenue to total revenue is 81.82 percent in fiscal year 2008/09. (Economic survey).

According to Seligman, "Taxation is the compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred."

It is clear that a tax is a compulsory levy and those who are taxed has to pay it without getting corresponding benefit of services or goods from the government. The taxpayer does not have any right to receive direct benefit from the tax paid. The taxpayer cannot receive equivalent benefit from the government. Government need funds for its running, therefore tax is paid to the

government. Amount collected through taxation is spent for common interest of the people and it is collected from natural and artificial person.

Taxes are classified into direct and indirect tax. According to Dalton, “A direct tax is one which is really paid by the person on whom it is legally imposed while an indirect tax is imposed on one person, but paid partly or wholly by another, owing to consequential change in terms of some contract or bargaining between them” (Lekhi, 2000:190). Taxpayer cannot collect direct tax from other persons. Income tax, Interest tax, Contract tax, Vehicle tax are some examples of direct tax. Direct tax is paid according to the income or property earned by a person. Taxpayer can collect indirect tax from other persons. So, impact and the incidence of tax are on different person. In Nepalese tax structure, indirect tax includes customs, excise duties, VAT etc.

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

Income tax is the tax of equity. It is imposed on the basis of paying capacity of taxpayers. So, it will be possible to reduce the gap in income by imposing higher rate to those who are having income and from that collected amount, providing necessary assistance to the people with very poor economic condition.

1.2 Statement of Problem

Like other developing countries in the world, Nepal has been suffering from resources constraints, massive poverty, rapid growth of population, increasing

frictional and seasonal unemployment, diseases, aggressive dependent on the agriculture, subsistence living standard and poor infrastructure despite over five decades planned development efforts.

A government needs development with higher economic growth to overcome from such serious problem for which government should have adequate financial resource. In Nepal, resource mobilization is still poor that does not cover the requirements. Nepal has facing serious problem of resources gap and high dependency on foreign loan. Resource gap has incurred in Nepalese finance because the expenditure of Nepal Government has been increasing at a faster rate than the increase in revenue. The resource gap is widening continuously with the increment of total expenditure in respect to total revenue collection. The resource gap was Rs. 14,484.8 million in FY 1994/95, which further widened to Rs. 71,367.04 million in FY 2008/09 (Economic Survey, various years) (Resource Gap = Expenditure - Revenue). To meet the growing national expenditure, government managed its funds from internal and external source. Such external sources are an uncertain, inconvenient and not good for healthy development in case of high dependency. It is better to mobilize internal source rather than expecting with beggars eye to donors.

Therefore, to raise government revenue it is necessary to raise its internal sources of revenue. Internal source of revenue constitute tax and non-tax revenue. The contribution of tax revenue in the national revenue is 81.82 in FY 2008/09 which was 79.90 percent in the FY 1994/95. Government revenue is totally based in taxation revenue and it has increased in fiscal year 2008/09. Government has adopted various policies to strengthen the revenue structure of Nepal. Government implemented self-tax assessment system to enhance the government revenue, although, there is higher tendency of income tax evasion.

In Nepal, the contribution of income tax to total revenue is only about 18.88 percent in fiscal year 2008/09, which is very low contribution compared to developed countries. The contribution of income tax to GDP (at current producers' price) is only about 3.86 percent in fiscal year 2008/09. There are

many problems in Nepalese income tax system, inefficient tax administrative system, widespread income tax evasion, complicated and frequent change in tax rate and in policies are appearing a major factor for low contribution income tax revenue to national revenue.

Nepal depends upon the external sources more than on the internal sources. The available resources do not meet the estimated budget fulfilling the aspiration of the people and constructing the social welfare state. Therefore, there is need of improvement of income tax collection system to mobilize internal sources, which is also considered as the optimal solution of resources gap and high dependency on foreign loan. Nepalese tax system to mobilize the internal resource in optimal level is fundamental need of the country but appears very poor and inefficient picture.

1.3 Objectives of the Study

The main objectives of present study are as following

1. To analyze the contribution of income tax to national revenue of Nepal.
2. To analyze volume of indirect tax and direct tax in total tax revenue.
3. To examine the effectiveness of income tax revenue collection in Nepal
4. To know views of the taxpayer, tax experts and tax Officers about various aspect of present income tax.
5. To recommend possible measure.

1.4 Scope of the Study

Present study aims to find out the effectiveness of income tax collection in Nepal. The major areas covered by this study are as follows:

1. Nepalese tax structure
2. Role of income tax in Nepal
3. Government revenue from direct tax and indirect tax
4. Existing position of income tax in Nepal.

1.5 Research Methodology

This study includes three types of research viz. descriptive analytical as well as empirical. For empirical research the opening of 75 respondents associated with distinct denomination i.e., tax experts, tax administrators and taxpayers were collected through structured questionnaire. Similarly for descriptive and analytical research, data are collected from various sources such as economic survey, IRD website etc.

1.6 Limitation of Study

The present study is not free from the limitations. The limitations of this study are as follows:

1. Due to the small sample size, it may not fully represent Nepal as a whole.
2. Sample size is selected only from Kathmandu Valley.
3. Basically, secondary data is used in this study.
4. The study has covered data only fiscal year 1994/95 to 2008/09
5. Absence of required data concerned with income tax of various countries limits to details study.

1.7 Scheme of Study

This scheme has organized in seven chapters. The first chapter is introduction chapter, which includes General Background, Statement of problem, Objectives, Scope and Limitation of Study.

Second chapter is about the conceptual framework and Review of Literature through different relevant books, journals, and unpublished dissertations. This chapter content concept of tax, concept and meaning of income tax, income tax in international context, legal provision of income tax in Nepal etc.

The third chapter is Research Methodology, which includes Types of Research, Research Design, Population and Samples, Nature and Source of Data, Data Collection Procedure and Data Processing and Analysis Procedure.

The fourth chapter is the main body of research, which is data presentation and analysis and the result of opinion survey. The content of this chapter are Resource gap in Nepal, Tax –GDP ratio, Nepalese government Revenue Structure, Composition of Tax Revenue in Nepal, Composition of Indirect Tax Revenue, Composition of Direct Tax Revenue, Composition of Income Tax, Contribution of Income Tax on Direct Tax Revenue, Tax Revenue, Total Revenue and GDP. Income Tax Collection Performance in Nepal, Exemption Limit, Personal and Corporate tax rate, Registration of taxpayers and returns of income, assessment of tax and appeals for FY 2008/09.

Result of the opinion survey is also presented in the fourth chapter.

Summary, conclusion and recommendations are presented in the fifth or last chapter.

CHAPTER – TWO

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

CONCEPTUAL FRAMEWORK

2.1 Background

The launching of all programs depends first and foremost on the treasury. Whether to pay salary to government employees or to do the developmental works, it needs huge amount of money called revenue. The government collects the revenue from different sources such as tax, remittance from public enterprises, fees, fines, grants and deficit financing. However, across all these sources of collecting the public revenue, taxation is the main source since it occupies the most important part of government treasury. Because of this importance of this source in revenue mobilization of a country, some people like to say tax as the sinews of the state.

2.2 Meaning of Taxation

Different person have defined taxation in different ways. In this respect, it would be better to take the definition given by Prof. Seligman. In his words, 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. The taxpayers do not have any right to receive the direct benefits from the tax paid. Due to this compulsory nature, people have expressed different views in satirical way about taxation. In this respect, some say “nothing is certain in this world but death and

taxes”; some say “death and taxes are both certain, but death is not annual”; while others say “death means stopping to pay tax”. Here it should be noted that all compulsory payments are not taxes. For example, fines and fees are also compulsory payment without getting benefits but it is not tax because its objective is not to collect revenue but to curb certain types of offences. Secondly, taxpayer cannot receive any quid pro quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. In case of tax, it is not a price paid by one for which he can claim for goods and services. The charge of price for goods and services by public authority is not a tax. 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.

In conclusion, it can be said that a tax is a liability to pay an amount to the state on account of the fact that the assessor have income of a minimum amount from certain specified sources or that they own certain tangible or intangible property or that they carry on certain economic activities which have been chosen for taxation.

2.3 Objective of Taxation

Taxation has been a very essential element of the government from the very beginning of the state system. However, the objective of taxation has been different for different epochs. In ancient times, the objective of taxation was strengthening the muscle of the state by providing the resources. Till the time of Adam Smith, the objective of the revenue was to provide resources to the government for providing security to an individual and society from violence, invasion, injustice and maintaining public institutions which can never be for the interest of an individual. In modern days, the objective of taxation has been shifted from security perception to the economic development. The modern objectives of taxation is raising revenue to have resource mobilization, equal distribution of wealth and income in the society; encouragement in production

of certain products; encouragement in employment, saving and investment; removal of regional imbalances and enforcement of government policy.

CANNONS OF TAXATION

There are different views regarding the requirement in a good tax system. Adam Smith's view in this respect is generally accepted as the characteristics of a good tax system. The cannons that are given by Adam Smith are as follows:

1. *Cannon of Equality:* Cannon of equality says that the people should contribute to the government as per the benefits that they get from the government.
2. *Cannon of Certainty:* Certainty, in word of Smith is related to the time, method, manner and quantity of paying the tax.
3. *Cannon of simplicity:* Cannon of simplicity says that the tax system should be of such type that can be understood and followed by ordinary people in the society.
4. *Cannon of Economy:* Cannon of Economy says that the cost of collecting the tax should be very small. There should be minimum difference between the amount that people take out of their pocket to pay tax and the amount that actually goes to the state treasury.

2.4 Types of Taxes

There are two types of taxes named direct tax and indirect tax.

If the person paying and bearing the tax is same, it is called direct tax. A direct tax is really paid by the same person on whom it is legally imposed. The characteristics of a direct tax are equitable as per the property or income, certainty as per the process of payment, amount to be paid, time of payment, elastic in nature etc.

In contrast to direct tax, an indirect tax is that tax system where the person paying the tax and the person bearing the tax is different. An indirect tax is

imposed on one person but paid partly or wholly by another. The main features of indirect tax are convenience to pay, mass participation, limited evasion etc.

2.5 Concept and Sources of Income

It is very difficult to define income precisely and clearly. Different imputed and accrued incomes create such difficulties in measurement. Different economists define the term income differently. Musgrave and Musgrave have taken the income as the accretion in the net wealth. R.M. Haig and Henry Simon who are renowned for defining the term income most acceptably view that income consists the total of the increase in net wealth and consumption. However, it is very difficult to use the concept of income given by Haig and Simon for the use in actual life since all the incomes generated by any means should be summed up for the measurement for taxable income. Because of these difficulties, income is exemplified rather than defined in income tax laws of various countries. For example, Sec.2 of the Indian Income Tax Act, 1961 keeps profit and gains, dividends, voluntary contributions received by charitable trust, value of any perquisite or profit in lieu of salary, any capital gains, winning from lotteries, cross word puzzles etc. under the head of income instead of defining it vaguely. Sec. 2(a) of Income Tax Act, 2031 of Nepal defined the income just like the Indian Income Tax Act. It defines income as the cash or in kind which are received from agriculture; industry, business, profession or vocation; remuneration; house and land rent and other sources.

Income Tax Act, 2058 is also not different in respect of defining the income. Although, it has reduced the sources of income from five to three, it defines income in terms of sources only. The Act defines income as “a person’s income from any employment, business or investment and the total of that income as calculated in accordance with this act”. As per the act, the first source of income is employment. Under this head, all payments and benefits received by the employee including past or future employment are taxable. The examples of employment benefits are salary, house rent, pension, gratuity, dearness allowance, medical allowance etc. It also includes payments relating to the

change of terms of employment, fringe benefits, various types of allowances, payments received through third parties etc. The second source of income is investment which includes dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from an unapproved retirement fund interest, or retirement payment made by an approved retirement fund derived in respect of the investment; net gains from the disposal of assets, gifts, retirement contributions etc.

2.6 Income Tax in International Context

Income tax was first introduced in Great Britain in 1799 in order to finance wars with France. Only after 1980, it was accepted as a permanent tax. In United State of America, first federal income tax was imposed in 1862 to finance civil war expenditure. However it became a permanent feature only in 1913 after 16th amendment to U.S. constitution. In neighbor country India, at first income tax was introduced in 1860. After introducing ‘Income Tax Act 1886’ in 1886, it was imposed as a permanent. Italy adopted income tax in 1864, Newzeland in 1891, Australia in 1915 and Canada in 1917. After First World War, the income tax became an important source of tax revenue in many developed countries. By 1939, it has become the most important source of revenue in most developed countries and had made appearance in a number of developing nations. (Agrawal, 1978:113)

From the First World War decade, income tax has shown as an important source of revenue in developed country. In the beginning of introducing time, it was generally levied at flat rate. Only after 1909, the principle of progression was introduced from the UK and Newzeland.

2.7 The History of Income Tax in Nepal

Nepalese tax system was based on Vedas, Smritis, and Puranas. Directives propounded by Manu, Yagnabalka, Chanakya etc. guided the taxation system. At that time, the principle of collecting tax from the people was imposition of tax without harming the activities of people.

Although there was tax system in Nepal in ancient time also, the concept of income tax was brought only by the first budget. The budget introduced in 2008 B.S. (1951 A.D.) stated about the introduction of income tax system in Nepal. However, it was actually introduced only in 2017 B.S. (1960 A.D.) when the Finance Act, 2016 and Business Profit and Remuneration Tax Act, 2017 were enacted. The marginal rate of taxation prescribed by these acts was 25 percent. Since, the income tax was imposed only on income from business profit and remuneration; the tax act could not cover all the sources of income and so was replaced by the Income Tax Act, 2019 in 2019 B.S. (1962 A.D.). Income Tax Act, 2019 with 29 sections divided the heads of income into 9 parts covering business, profession and occupation, remuneration, house and land rent, cash or kind investment, agriculture, insurance business, agency business and other sources. The act was amended in 2029 extensively. However, considering this act incapable of fulfilling the needs of the time was replaced in 2031 B.S. (1974 A.D.) by another act.

As already stated, Income Tax Act, 2031 replaced Income Tax Act, 2019 in 2031 B.S. (1974 A.D.). This act having 66 sections classified the sources of income into 5 heads namely (1) Agriculture, (2) Industry, business, Profession or Vocation, (3) Remuneration, (4) House and land rent and (5) Other sources. However, agriculture income was kept outside the tax net except few years through the Finance Acts. This Act was amended for eight times and existed for a period of 28 years.

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, 2058 (2002 A.D.). This Act became effective since Chaitra 19, 2058 (01, April 2002). The Act governs all income tax matters. Likewise, this act is applicable throughout the kingdom of Nepal. It is also applicable to residents residing wherever outside Nepal.

2.8 The features of Income Tax Act, 2058 (2002 A.D.)

1. All tax related matters within one Act

Before the introduction of Income Tax Act, 2058; there were almost one and half dozen acts related to income taxation. Income Tax Act, 2058 has abolished all tax-related laws given in other acts and embraced all income tax related matters within it.

2. Specification of tax rates

Earlier, the tax act had not dealt with tax rates. Finance Act of each year used to deal with the tax rates. However, Income Tax Act, 2058 has embraced the tax rates applicable to all the sources of income.

3. Abolishing of various tax related concessions, rebates and exemptions

Most of the facilities provided by the government in past to taxpayers were used for tax evasion. Income Tax Act, 2058 has abolished most of the facilities given by earlier Acts and introduced a fair system of taxation.

4. Specification of stock valuation methods

Income Tax Act, 2031 was silent about the method of stock valuation for taxation purpose. However, Income Tax Act, 2058 has made a provision of valuing the stocks of goods for tax propose.

5. Simplification of depreciation related provisions

Income Tax Act, 2031 had complicated provisions related to depreciations. The types of assets categorized for depreciation purpose were around 3 dozens. Different rates were allocated to different types of assets. However, Income Tax Act, 2058 has specified diminishing balance method based on pool system with only 5 categories of assets.

6. Taxing capital gains and dividends

Income Tax Act, 2031 had not the provisions of taxing capital gains and dividends. But Income Tax Act, 2058 in contrast has made legal

provision of taxing these items. A rate of taxes for dividend is laid as 10 percent whereas the capital gain is taxed as ordinary income of business.

7. Liberal loss setoff and carry-forward provision

Income Tax Act, 2031 had made the provision of setting off and carry forwarding of business losses only for three years from the same source of income. That is intra- head provision only. But Income Tax Act, 2058 has made provision of inter-head adjustment for one year and intra-head adjustment for four years. For financial sector and long-term contract, the provision is more liberal providing the facility of recovering the losses form previous profit also.

8. Provision of international taxation

Due to closed economy concept, international taxation was not felt necessary and hence there was not such tax provision in Income Tax Act, 2031. But now this concept is introduced in the tax law. The provisions introduced are transfer pricing, foreign tax credit, double taxation agreement etc.

9. Strict fine and penalty provision

The fine and penalties for the defaulter in old tax Act were not so severe as in new tax Act. But Income Tax Act, 2058 has made the provision of fine and penalty more stringent.

10. Submission of income statement

This Act has made a provision of relaxing the submission of income statement by a person who does not have taxable income or who has the income only from remuneration.

2.9 Legal Provision of Income Taxation

The function of revenue collection has remained one of the key activities of the government from ancient time in Nepal. During that time, very few economic activities were operated on the country. Hence, government could not collect

huge amount of money in the form of taxation. At that time, taxes were levied to the merchant, travelers and farmers in the form of cash, kind or labour. In some occasion, gold and agricultural products were also paid as taxes but the nature of these taxes were temporary and taxes were raised for special purposes (Regmi, 1971:55)

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

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

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

There was no direct tax in the country except land tax collected on a contractual basis and “Salami” which the government employees used to pay out of their salaries at a very small percentage. The Salami was abolished in 1951. The Rana rulers did not think of development of effective revenue administrative system. After the advent of democracy in country in 1951, no taxes are levied and collected in Nepal except in according with law.

2.10 Sources of Income

Income is the accretion of wealth or purchasing capacity of a person or entity. According to Income Tax Act, 2058 it is the term used to define income derived from employment, business and investment. It is the gross income less deduction allowed under the Act. This means, Income Tax Act, 2058 has specified sources of income into three heads named

1. Income from a business [Section 7]
2. Income from an employment [Section 8]
3. Income from an investment [Section 9]

Section 6 of the Act specifies that the assessable income includes income earned from any country of the world in case of resident and income earned in Nepal in case of non-resident.

2.10.1 Income from a Business

These are the receipts which are included in computation of income from business:

- a. Service fees;
- b. Amount received from disposal of trading stocks;
- c. Net profit from disposal of business assets or business liability calculated as per chapter 8;
- d. Amount treated as net profit from disposal of depreciable assets calculated as per schedule 2;
- e. Gifts received in respect of business;

- f. Amount received in lieu of restriction accepted in relation to the business operation;
- g. Amounts derived are directly connected with the business and that would otherwise be included in calculating the income from investment;
- h. According to Sec.25:
 - 1. bad debts written off but subsequently recovered;
 - 2. any liability which is not payable now; and
 - 3. any expenses claimed but not now payable.
- i. According to Sec.26 any income derived proportionately from a long term contract;
- j. According to chapter 7:
 - 1. interest charged on loans and advances at the rate lower than the prevailing market rate, the difference amount; [Sec.27 4&3]
 - 2. income deemed to be derived from transfer pricing and other arrangement between associates as per Sec. 33.
- k. Amounts distributed as dividend otherwise than from income; [Sec. 56 (3)]; and
 - l. Income of general insurance as per Sec.60.

2.10.2 Income from an Employment

These are the receipts which are to be included in computation of income from employment:

- a. Wages, salary, leave pay, overtime pay, fees, commissions, prizes, gifts, bonus and other facilities;
- b. Dearness allowance, cost of living expenses, rent, entertainment and transportation allowance and like personal allowances or expenses;
- c. Amount received in reimbursement of personal expenses of the employee or related person;

- d. Amount received in lieu of acceptance of any condition with regard to the terms of employment;
- e. Payments received for redundancy or loss or termination of the employment;
- f. Amount received from retirement fund;
- g. Contribution of employer to a retirement fund;
- h. Other payments made in respect of the employment;
- i. Amount received or deemed to be received as per sub point nos. (h), (i) & (j) of point no. 4.10.1

These receipts are not included in the taxable income of the employee:

- a) Meals or refreshment provided in premises by the employer and that is available to all the employees of the employer in similar terms;
- b) Reimbursement of expenses incurred for the employer;
- c) Payment of an amount up to Rs. 500 for such a purpose which is unreasonable or administratively impracticable to make accounting for them.

2.10.3 Income from an Investment

These are the receipts which are to be included in computation of income from investment:

- a. Any dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from an unapproved retirement fund and amount received from an approved retirement fund;
- b. Net gain from disposal of the person's non-business chargeable assets of the investment as calculated under Chapter 8;
- c. The excess amounts of incoming over the depreciation basis including outgoings, on the disposal of depreciable assets of the investment of the person as per paragraph 4(2)(a) of Schedule 2;

- d. Gifts received by the person in respect of the investment;
- e. Retirement contribution, including those paid to a retirement fund in respect of the person, and retirement payments in respect of the investment;
- f. Amount received in lieu of restriction accepted in relation to the investment;
- g. Amounts received or deemed to be received as per sub point no. (h), (i), (j) and (k) of the point no. 4.10.1.

Note: Amounts those are included in calculating the person's income from any employment or business that should be excluded in calculating a person's profit from investment.

2.11 Exemption in Income Tax Act, 2058

2.11.1 Ordinary Exemptions (Sec. 10)

An amount of income allowed by law as tax-free is exempt amount of income. Such amount of income is not included in total income while calculating the net income of a person. The expenditure related to such income is also not deducted while calculating the assessable income of a person [Sec. 21(1) (c)]. Accordingly, no amount is deducted at source while making the payment of such amount.

The following amounts are exempt from tax (Sec.10)

- a) Amounts derived by a person entitled to privileges under a bilateral or multilateral treaty concluded between HMG Nepal with any foreign country or international agencies;
- b) Amounts derived by an individual from employment in the public service of the government of a foreign county provided that:
 - 1. the individual is a resident person solely by reason of performing the employment or is a non-resident person; and
 - 2. the amounts are payable from the public funds of the country;

- c) Amounts derived from foreign sources by an individual or member of his immediately who is not a citizen of Nepal;
- d) Amounts derived by an individual who is not a citizen of Nepal who is employed by His Majesty's Government of Nepal on terms of a tax exemption;
- e) Allowances paid by His Majesty's Government to widows, elder citizens, or disabled individuals;
- f) Amounts derived by way of gifts, bequest, inheritance, or scholarship except as required to be included in calculating income under Section 7, 8, or 9;
- g) Amounts derived by an exempt organization by way of gift; or other contributions whether or not the contribution is made in return for consideration provided by the organization or amount received by Nepal Rastra Bank as per its objective.
- h) Amount received as pension from foreign government treasury by Nepalese citizen as a retired army or policeman.

2.11.2 Business Exemption and Facilities (Sec 11)

The following incomes are exempt from tax of a business firm:

- a) Incomes derived from sources in Nepal during an income-year by a person from agriculture other than those by a firm, company, partnership and organized entity or those stated in Sec. 12 (d and e) of Land Act 2021 are exempt from income tax.
- b) Incomes of co-operative registered under Co-operative Act, 2048 related to agriculture and forestry and saving and co-operative based on rural community. The dividends distributed by such organization are also tax exempt.

2.12 Methods of Income Tax Assessment

Income Tax Act, 2058 has specified three types of assessments. They are as follows:

1. Self assessment (Sec. 99)
2. Jeopardy assessment (Sec.100)
3. Amended assessment (Sec. 101)

Self assessment is done by the assesee himself whereas jeopardy and amended assessments are the assessments based on judgment of the Department

2.13 Installment Payment

There is a provision of payment of income tax of the current year by three installments that is 40%, 70% and 100% by the end of Poush, Chaitra and Ashad respectively.

2.14 Appeal

A tax payer may not be satisfied with the assessment made by tax officials. In such case, he may lodge an objection against the assessment with the Director General (DG) of Inland Revenue Department or go to Revenue Tribunal. The Act has made it mandatory for the taxpayers first to file an objection with the Inland Revenue Department for an administrative review and then if unsatisfied with the decision of Director General, he/ she can go to Revenue Tribunal.

2.15 Offences

Offences are dealt within the Act in a sense of criminal offences of taxpayers as well as tax administrators. They lead to punishable in the form of fines and imprisonment on conviction. The offences attracting both a fine and the imprisonment include failures to comply with the Act, failures to pay tax, maintaining documentation or filing income returns and statements of estimated tax, making false or misleading statements, impeding or coercing the tax administration, offences by the authorized and unauthorized persons, offences of aiding or abetting, etc. In case if the Tax Return File is not submitted within

the period prescribed by the Act, the late fee and interest amount will be charged at the rate of 0.1% per year of the assessable income.

2.16 The Super Act

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

REVIEW OF LITERATURE

Income tax was imposed in Nepal by the first Parliamentary Government in 1959. Then after, various studies were made and researches conducted by different individuals and institutions concerning with various aspects of this act such as the structure, role, productivity, legal and administrative framework etc. Some of the books, reports and dissertations that are reviewed during this study are as follows:

REVIEW OF BOOKS AND REPORTS

At the earliest in 1965, Mr. Kedar Bahadur Amatya, published a book “Nepal Ma Aayakar ko Bebastha“in 1965. He has tried to describe about income tax and provision regarding income tax. His contribution was first in the field. Basically, he analyzed legal aspect of income tax in Nepal at that period. (Amatya, 1965)

Lent (1968), has presented a report entitled, “Survey of Nepalese tax Structure” under the request of IMF, Fiscal Affairs Department. He has critically analyzed the scope of income tax in Nepal, tax structure, taxable income exemption and allowances given at that time. He has suggested reforming both the income law and administration to increase government revenue through income tax. (Lent, 1968)

The book published in 1976 by Nirmal Bhattarai and Ratna Shrestha, gave information about the legal aspects of income taxation in Nepal of that period.

This book is theoretically based rather than analytical. (Bhattarai and Shrestha, 1976)

In 1976 the three-team researchers Mr. Bhavani Dhungana, Mr. Narendra Lal Kayastha and Mr. Bal Prasad Rai , published a report entitled “An analysis of tax Structure of Nepal” dealing the tax structure of Nepal in 1976. Their report has examined the problems and possibility of mobilizing additional resources and has also provided some recommendations for the reform of income tax. But their report was not analytical. (Dhungana, Kayastha and Rai, 1976)

Dr. Agrawal (1978), presented a nine chaptered research report .The picture of resource gap in Nepalese Finance has been indicated in the first chapter of the report. The main reason for this resource gap has been the lop sided growth of government expenditure as compared to revenue generation from domestic sources. He has also discussed about the historical background of income tax, legal and administrative aspects, and role of income tax in Nepal. He has also calculated the elasticity and buoyancy of major Nepalese taxes using the double log linear model. Projection of income tax and resource gap has been made using similar linear model. Though his study has been first comprehensive scientific study on the income taxation of Nepal and has been useful for the research purpose but many things mentioned in it are not fully relevant today. (Agrawal, 1978)

On 27th Jestha 2036 (1979), an economic commission was established by HMG to make scientific, justice and simple tax system of Nepal. This commission was ordered to conduct some research and to reform on the existing tax system of Nepal. It has published its preliminary report named “Arthik Aayog Ko Pratham Charan Ko Pratibedan” in 1979. This report deals the development of the tax system in Nepal and suggests reforms for the different taxes in Nepal. Though this report was useful but in the present context the report is irrelevant. (Pratibedan, 1979)

In 1980, Dr. Govinda Ram Agrawal gave his second contribution towards income taxation. He has explained in detail about resource mobilization through

income tax in Nepal, role of income tax, administrative and legal aspect of income tax in Nepal. His study is useful to find out facts and figures about the income tax in Nepal at that time. (Agrawal, 1984)

Poudyal and Timsina (1990), presented a book based on *B.Com.* Syllabus. This book is designed to give theoretical as well as practical ideas of income tax in Nepal. Provisions and methods of assessment have been described with numerical examples but the major problems and defects of income tax system of Nepal have not been analyzed. (Poudyal and Timsina, 1990)

Khadka (1994), had discussed the economic policy of Nepal, VAT as a long term tax for Nepal, Income tax, improving tax administration, tax reform strategy. He had analytically described about development, existing structure, main problems and possible direction of reform of income tax .He had identified the major problems of income tax as narrow coverage, unscientific tax assessment and collection, defective system form the perspective of international taxation. Weak tax administration, imbalance and inadequate tax training, predominance of low level non technical posts, debatable scope of revenue investigation department, and lack of information system were the major problems of tax administration identified by him.

He had suggested some suggestions to overcome from the problems of income tax which were extension of tax coverage, scientific method of tax assessment, extension of withholding tax, inflation adjustment etc. He had also identified some possible direction for administrative reform. They were reorganization and expansion, applying integrated information system; research unit on taxation, strengthening the revenue service .His book was analytical and very useful to obtain the various aspects of income tax. (Khadka, 2001)

In 2003, Adhikari has published a book which is mainly based on the T.U. syllable of B.B.S. third year. Apart from the theoretical concept on taxation, he has also presented the historical background, income tax laws and its implementations, assessment of tax and tax authorities, rights and duties. He has also described the management of VAT, Property Tax and Sales Tax. The

book includes precedents of Supreme Courts about Income Tax, classification and interpretation of revenue code, tax planning and income tax management in Nepal. (Adhikari, 2003)

Tiwari (1999), presented a book about income tax system in Nepal. This book is published mainly for the students of Tribhuvan University but is equally useful to the tax payers, tax administrators and those who desire to get theoretical as well as practical knowledge about income tax. He has described the provisions under Income Tax Act 1974, income tax rules, information and acts related to income tax etc. He has not analyzed the major problems of income tax system. (Tiwari, 1999)

Khadka (2001), published a book on income taxation of Nepal .The book contains many interesting articles on various aspects of income tax. It first traces out the evolution of income tax around the world. It then analyzes relative importance of income tax in the tax system of some selected countries. It also defines various concepts, which are widely used in the modern income tax literature. The book also reviews major changes introduced in the field of the Nepalese income tax system since its inception in 1959 AD and examines its existing structure and operation. It also analyzes the current problems and makes recommendations for the rationalization of the structure and modernization of operation of the income tax system. The book also includes income tax acts of 1959, 1962 and 1974 A.D. (Khadka, 2001)

In 2001, Revenue Consultation Committee Report has studied the overall taxation situation in depth. It highly emphasized to simplify the tax policy to increase voluntary compliance. This report recommended for written communication between taxpayer and tax administration rather than the informal relation. This report suggested widening the income tax bases by including all kinds of taxpayer of new sector. For this, the report suggested to make the act more transparent and clear in order to attract foreign and domestic investors. It was further suggested to increase income tax exemption limit with

considering purchasing power and inflation rate. (Revenue Consultation committee, 2001)

Adhikari (2003), has discussed the legal provision of new Income Tax Act, 2002. His book is analytical rather than informative. Writer has not included administrative aspect, role and structure of income tax in his book .The book has only focused on the legal aspect of income tax. Agreement and protocol relating to avoidance of double taxation and the prevention of fiscal evasions with respect to taxes on income between different countries had also included in his book. (Adhikari, 2003)

Mallik (2003), has published book named “Nepalese Modern Income Tax System”. He had described historical aspects of income tax and legal provisions relating to income tax with numerical examples. This book is very useful to know the general information and legal provision of Income Tax Act, 2002. His book was informative rather than analytical. He had not analyzed the role of income tax, structure of income tax in Nepal. (Mallik, 2003)

Amtya, Pokhrel and Dahal (2004), have published book named ‘Taxation in Nepal’ specially designed for LLM, MPA, MBS and MBA. They have given in-depth approach to the study of Income tax in Nepal in order to meet the specific requirements. The book is very useful to elaborate the concept of taxation in Nepal. (Amtya, Pokhrel and Dahal, 2004)

Agrawal (2005), has published book named ‘Income Tax Theory and Practice’ specially to fulfill the understanding the history of income tax in Nepal, objectives of the Income Tax Act, Characteristics of the Act and enhancement of practical exposure in income tax. He criticizes on the lack of decisions from any courts with regard to the provisions of Income Tax Act. (Agrawal, 2005)

Kadel (2005), had criticized the income tax act 2002 on several grounds. Exemption of agriculture income from income tax, export duties levied on export, inequality between different capital earned income (i.e. tax on interest, dividend, and capital gain), withdrawal of the provisions of exemption suddenly and no adjustment for inflation are the major issue he raised in his article. He

further criticized the Act for the provision of income tax from export as 0.5 percent of total export because it is not good choice of income tax base. (Kadel, 2005)

Kadel (2006), has published a book named 'Tax Laws & Tax Planning in Nepal' to give clear cut view to regarding income tax and its effect in economic environment. The main objective of the book is that every individual relating to tax administration should know the provisions laid down in the Act clearly to function properly. (Kadel, 2006)

Bhattarai and Koirala (2009), have published a book named 'Taxation in Nepal' to elaborate the practical aspect of the Income Tax Act 2058. So that the readers with basic knowledge of general principles and practices of tax laws in Nepal and to develop in them basic skills to handle the tax matters independently. (Bhattarai and Koirala 2009)

REVIEW OF DISSERTATION

Shrestha (1967), has prepared a master degree thesis entitled "Income Tax in Nepal ". He has described about historical background, income tax act, rules and administrative aspect of income tax. All things mentioned in it are not fully relevant at present. (Shrestha, 1967)

Kayastha (1974), has tried to analyze the contribution of income tax and property taxes to overall revenue generation in Nepal. He has studied on legal and administrative aspect income tax system of Nepal and pointed out some drawback. According to him before 1951, Nepal didn't have scientific economic policy, which could facilitate the economic development of the country. According to him, the major problems of income tax system of Nepal are income tax evasion at high level and greater role of indirect tax in tax revenue. These problems have not solved yet effectively. (Kayastha, 1974)

Pandey (1978), in his study has discussed various aspect of income tax such as legal aspects, structure of income tax role of income tax, problems of income taxation, economic effect of income tax in Nepal. He had highlighted on tax

structure of Nepal. According to him, income tax played a significant role in the economic development of Nepal. He found the capital burden of income tax was Rs.0.2 in 1962/63 and it had increased to Rs.7 in 1975/76. He had stated that indirect tax had a dominated role in the total tax revenue. Lack of scientific record keeping, Lack of maintaining accounts by tax payers, lack of coordination, lack of scientific method of income tax assessment and collection procedure, lack of honest tax officers are the major problems identified by him. His suggestions about income tax were capital gain should bring in tax net, income tax accounting assessment and collection method must be scientific etc. His study was done with objectives of examining the economic effects of income tax but he had not described it with numerical examples and empirical investigation. (Pandey, 1978).

Subedi (1982), has analyzed about the role of income tax on national revenue of Nepal. He has examined the growth of income tax collection, its ratio to GDP, cost of income tax collection and elasticity. He has also included historical perspective and legal aspect of income tax in his study. He has pointed out that tax evasion, inefficient tax administration and dominated role of indirect tax are the major problems in Nepalese tax system. He has suggested that tax administrative reform is the major necessity in development of income tax system. (Subedi, 1982)

Nepal (2002), has critically examined the income tax system of Nepal in that time. Her study has been conducted with purpose of examining the role of income tax in overall tax structure, analyzing the problems and prospects of income tax in Nepal and highlights the future prospective of the Nepalese income tax. (Nepal, 2002)

Regmi (1986), has prepared a dissertation with the main objective of examining the trend of income tax in Nepal, ascertaining the share of income tax to total tax revenue and its ratio to gross domestic product. He has also stated as a great problem in income tax in Nepal. To increase the revenue of government, he has recommended that income tax law should be clear and precise, scientific

method for accounting assessment and collection of income tax, widening tax coverage, easy and simple procedure of tax payment ,public awareness. (Regmi,1986)

Siwakoty (1987), has explained the various aspect of income tax. HIS study emphasized on drawing a clear sketch of role of income tax, structure of income tax, projection of income tax, legal aspect of income tax act and problems of income tax. Major problems existing in Nepalese income tax system, stated by him are narrow coverage, unscientific and time consuming assessment and collection procedure, complicated act and defective income tax act. (Siwakoty, 1987)

Baral (1998), has tried to shown the contribution of income tax on the structure of government revenue in Nepal .She stated that the composition of tax and non tax revenue is still less satisfactory in Nepal .she found that total revenue, total tax revenue and direct tax revenue have an increasing trend in Nepal but in low rate. She has mentioned that tax evasion as the major problem of income tax system in Nepal .In her study, inefficient tax administration, unconsciousness of tax payer, lack of scientific method of tax assessment and collection have identified as the major reasons for tax evasion at high level. (Baral, 1998)

Bhandari (1994), has tried to examine historical background, tax structure in Nepal and contribution of income tax to economic development of Nepal .He has stated that actual collection of revenue through income tax was lower than its estimated targets because the poor tax paying habit of Nepalese tax payer, poor tax administration system, wide spread evasion of income tax. He has suggested to make effective personnel management, increasing habit of tax paying of Nepalese tax payer through proper tax education and better public communication system, minimize tax evasion, reduce tax collection cost. (Bhandari, 1994)

Shahu (1995) has found that 0.35 percent of total population came under the categorizes of taxpayer during his study period. Main objective of his study was to study Nepalese structure, role and contribution of income tax on national

revenue .He has identified that income tax has been gradually increasing and was in the fourth place in the tax structure of Nepal .He has not discussed the major aspects of income tax clearly and analytically so it is incomplete study and all things mentioned in it are not also fully relevant today because it was made 9 yrs ago. (Shahu, 1995)

Shakya (1995), presented a dissertation named “Income Tax System in Tax Structure of Nepal.”His study was done with basic objective of analyzing the causes of heavy reliance of indirect taxes, analyzing the volume of indirect tax revenue and direct tax revenue in total tax structure, highlighting the revenue assessment procedure from different sources and suggesting to improve on them. In his study, he has identified the income tax has occupied fourth position among tax revenue of Nepal. Custom duty, sales tax and excise duty has occupied first, second and third position respectively in Nepalese tax revenue. He has mentioned Nepalese taxable capacity is limited by various factor such as low per capita income, extensive subsistence economy, relatively “closed”(India) economy, weak export position etc

He found the ratio of income tax to GDP total revenue; total tax revenue and direct tax revenue have been on increasing trend in Nepal. But increasing trend rate is very low in comparison to other countries. Tax evasion is the main reason behind it. Lack of clear and comprehensive definition of income, lack of punishment to the evaders, low tax paying capacity and non conscious of tax payers, lack of inefficient tax administration, lack of scientific method of tax collection and lack of trained tax collectors were the main reasons of income tax evasion identified by him. (Shakya, 1995)

Shrestha’s (2004), study had covered the historical background, legal provisions, structure of income tax, income tax administration in Nepal and empirical investigation. Her findings about tax structure were: there was dominant share of tax revenue in Nepalese government revenue. But the contribution of tax revenue showed the decreasing trend. The tax/GDP ratio was not found satisfactory with compare to other SAARC countries. It was 6.81

percent for the period of 1984/85 and 9.36 percent in 1998/99. There was serious and growing financial resource gap in Nepal seems to be never ending problem for Nepalese economy. There was dominant role of indirect tax revenue in Nepalese tax revenue. The contribution of direct and indirect on tax revenue were 17.76 percent and 82.24 percent respectively in 1984/85 which becomes 26.14 and 73.86 percent in 1998/99. The contribution from individuals to income tax revenue was greatest in every fiscal year and it was in increasing trend. Income tax revenue was playing a significant role in direct tax revenue because the share of income tax in direct tax was increasing rapidly.

She had found various problems of income tax system in Nepal. They were Narrow tax coverage, mass poverty of Nepalese people, lack of conscious of taxpayer, widespread evasion and avoidance of income tax, unscientific tax assessment procedure, inefficient tax administration, complicated tax laws and procedures, instability in government policy. She had also identified the major weak points of income tax administration in Nepal. They were failure to locate new taxpayers, failure to maintain proper accounts and records, defective selection of personnel, undue delay in making assessment, lack of motivation in tax personnel, existence of corruption.

She had suggested to broaden the Nepalese income tax base by bringing agriculture income and capital gain under income tax net. She had suggested to make consciousness to people, reform of income tax assessment, reform the tax administration and minimizing the tax evasion. For the improvement of income tax administration, she has suggested computerization and effective exchange of information, tax education to tax payers, tax inspectors and officials, effective personnel management. Her suggestion for minimizing tax evasion were control illegal business activities, enforce proper auditing and investigation, enforce heavy fines and penalties and maintain proper records and accounts. (Shrestha, 2004)

Acharya (2004), has mentioned the main objectives of income tax as to achieve social justice, to check inflation and to collect more government revenue. He

has identified the contribution of individuals in total income tax revenue seems to be greatest during his study period followed by public enterprises, enumeration, house rent, and interest taxes, semi public enterprises and private corporate bodies respectively .He has also analyzed the administrative and legal aspects of income tax .He has recommended simplifying the tax structure ,legal and administrative aspect, and understanding with the consent of tax payer to raise income tax revenue. (Acharya, 2004)

Sherchan's (2006), study had covered tax structure, role of income tax and legal provision of income tax. But specially, his study had focused on provision of fines and penalties. He had found that there was dominated share of tax revenue in Nepalese government structure. Income tax had occupied third position in his study period and it was increasing trend. The tax/GDP ratio was not found satisfactory. With the income tax, there was the dominated role of corporate income tax but it was in decreasing trend and contribution of individual income tax was second position and it was in increasing trend.

He had suggested revising the position of fees and penalties, introducing reward, prize, incentives position, clear income tax, rules and regulation, clear right and duties of tax officers. Further, his suggestions were: timely revision in income tax policy, computerized system for payment of income tax. This study was done with main objectives of analyzing tax structure of Nepal, analyzing the position of fines and penalties under income tax law, know the taxpayers knowledge and tax officers view about fines and penalties. His study had focused only on study on provision of fines and penalties. So, this study is incomplete study. (Sherchan, 2006)

Pradhan's (2007), study is basically concerned with historical background, contribution of income tax to the public revenue, contribution of Nepal Telecommunication Corporation (NTC) to income tax, effectiveness of income tax collection .She had found the contribution of income tax from public enterprises in Nepal was not significant due to poor achievement, weakness in government's economic policy and deficiency in legislation .NTC has been

contributing effectively to total income tax revenue. Contribution of tax revenue on GDP of Nepal was lower than other SAARC countries except Bangladesh. Average contribution of income tax from NTC to total tax revenue, total income tax revenue and total government revenue was 2.37 percent, 15.60 percent and 1.93 percent in her study period.

Her suggestion about income tax system were clear cut provision, discretionary power of tax officers should curtailed, assessment and collection provision should be made clear and simple, provision of reward, prize, incentive should introduce to encourage the taxpayers to pay voluntarily, compulsorily provision of auditing, etc. For the improvement income tax administration in Nepal, she had suggested promotion and rewards to active, efficient and honest tax personnel, tax education to tax payers, strict actions against corruption, and reduction of delays in tax assessment. Specially, her study had focused on the study on Nepal Telecommunication Corporation. (Pradhan, 2007)

Sapkota (2008) To find out the parts of national revenue occupied by income tax and its trend, to analysis the composition of income tax revenue in national economy and to find out the impact of income tax before and after implementation of Income Tax Act 2058. He concluded that the new act is very strong and practicable to the taxpayers and tax authority. The act is helping to generated more revenue than previous tax law. So the impact of the Income Tax Act 2058 is very useful. Further, he recommended that the Act need to be modify as per the changing tax environment. (Sapkota, 2008)

Bhattarai (2010), prepared a thesis on 'A study on Income Tax 2058; problems and Difficulties'. Main objectives of the study are to find out the problems and difficulties in the income tax act and the rules, to find out necessary reform for income tax system and to find out the contribution of income tax to our national economy. He concluded that taxes are backbone of the nation without strong backbone government of the nation cannot stand properly. So, tax system should be proper and friendly to taxpayer. He recommended that tax system is not free from problems many challenges has been coming in its way but also

the good sign of prospects has been seen after Income Tax Act reform in 2058. (Bhattarai 2010).

Besides these reports, books and master level dissertations, some articles about income tax published in Rajaswa, Rising Nepal, Ghorkhapatra, The Kantipur, The Kathmandu Post etc. and publication of Ministry of Finance such as Budget Speech, Economic Survey were reviewed in the study period.

RESEARCH GAP

The role of revenue is crucial for the overall development of the country. Therefore, inspite many times the research have been conducted on this topic, once again the researcher chooses the same, “The contribution of income tax on Government Revenue of Nepal”. Since, more than 80 percent of the total revenue it collected from the tax source, efficient tax system has to be developed and strengthened. In recent years, the government has taken several measures to reduce tax-induced distortions, strengthening tax administration, simplifying tax laws and procedures to make them more transparent. So, since the government main concentration is always to increase revenue, its very important for us to talk about revenue and the pros and cons of activities taken by the government as we all are directly or indirectly participated in this subject matter.

CHAPTER – THREE

RESEARCH METHODOLOGY

3.1 Types of Research

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

3.2 Research Design

The study of Income Tax Act; the role of income tax, indirect tax and direct tax in total tax revenue etc. is done as a part of descriptive research. Analytical research is conducted to analyze the trend and contribution of income tax in government revenue of Nepal, the effectiveness of income tax administration, effectiveness of income tax revenue collection in Nepal etc. It is mainly done through the secondary source of data. For empirical research, the opinion of the various 75 respondents associated with distinct denomination i.e., tax experts, tax administrators and taxpayers were collected through structured questionnaire. The questionnaire included the role of income tax to national revenue, provision of fine and penalty, soundness and effectiveness of income tax system, the most important factors for the effectiveness of income tax system including necessary suggestion for achieving effectiveness of income tax in Nepal etc. In this way, the research design of this research design of this research is descriptive, analytical and empirical.

3.3 Population and Sample

The population of the study comprises the persons belonging to income tax of Nepal. In order to fulfill the objectives of the study, the 74-sample size from Kathmandu is selected. The total number of questionnaire distributed were 100 among which only 82 were received back with view and among them only 74

were usable. Persons included in the sample are carefully selected by consultation with lectures and best judgment of the researcher. The respondents have been divided into three groups. The following table shows the groups of respondents and the size of samples.

Table 3.1

Group of Respondents and Size of Samples

S. No.	Groups of Respondents	Sample size
1	Income Tax Administrators	25
2	Income tax Experts	25
3	Income Tax Payers	25
Total		75

3.4 Nature and Source of Data

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

A. Primary Data:

Primary data and information have been collected through administering structured questionnaire to sample population. The same questionnaire was distributed to all respondents. Tax administrators are selected from tax department and various sectors of tax offices. Tax administrators are selected from tax department and various sectors of tax offices. Tax experts are the Chartered Accountant, auditors, high post officials etc. Taxpayers are selected representing various sectors i.e., manufacturing company, trading company, industries, private banks, finance company, travel & tours, school, consultancy firm etc.

B. Secondary Data:

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

1. Official website of Inland Revenue Department: www.ird.gov.np
2. Official website of Ministry of Finance: www.mof.gov.np
3. Reports and records of Inland Revenue Department, Ministry of Finance, GON
4. Budget speech of various years, Ministry of Finance, GON.
5. Economic survey of various years Ministry of Finance, GON.
6. Books related to income tax and public finance.
7. Dissertation related to income tax.
8. National and international newspaper, journals, souvenir, and news magazines.
9. Other relevant records and data.

Secondary data from fiscal year 1994/95 to fiscal year 2008/09 is used in this study.

3.5 Data Collection Procedure

Data and information used in this study is collected from primary and secondary sources. To get accurate and actual information in time, all questionnaires were distributed and collected personally through field visits.

3.6 Data Processing and Analysis Procedure

For the analysis, all collected data and information of various aspects of income tax was arranged in order and processed. Then, the descriptive tools and statistical tools such as simple percentage, simple average, graphs, charts and diagrams etc. have been applied in the way of analysis so that the findings could be presented and interpreted properly in order and clear.

CHAPTER-FOUR

PRESENTATION AND ANALYSIS OF DATA

ANALYSIS OF SECONDARY DATA

4.1 Resource Gap in Nepal

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

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

As shown in the table, resource gap^a (before considering foreign grants) of Rs. 14484.8 million in fiscal year 1994/95 reached to Rs. 27111.6 million in F.Y. 2003/04 and again decreased to Rs. 56276.9 million in F.Y. 2008/09. Since 2004/05 resource gap^a is in increasing trend.

Resource gap^b (after considering foreign grants) was Rs. 10547.7 million in the F.Y. 1994/95 which reached to Rs. 15828.2 million in the F.Y. 2003/04 and then declined to Rs. 21706.5 million in the F.Y. 2008/09. It was highest in F.Y. 2000/01. Since then it is in decreasing trend till FY 2004/05 and then in increasing trend.

The government takes internal and external loan to meet deficit finance. Foreign loan taken in F.Y. 2001/02 was Rs. 12044.0 million, which declined to Rs. 10405.4 in F.Y. 2008/09. After foreign loan financing, resource gap^c was

Rs.3235.4 million in F.Y. 1994/95 and increased to Rs. 11301.1 million in F.Y. 2008/09.

Table 4.1
Resource Gap in Nepal

Rs. In Million

Fiscal Year	Total Expenditure (A)	Total Revenue (B)	Resource Gap ^a (A-B)	Foreign Grants (C)	Resource Gap ^b {A-(B+C)}	Foreign Loan (D)	Resource Gap ^c {A-(B+C+D)}
1994/95	39060.0	24575.2	14484.8	3937.1	10547.7	7312.3	3235.4
1995/96	46542.4	27893.1	18649.3	4825.1	13824.2	9463.9	4360.3
1996/97	50723.7	30373.5	20350.2	5988.3	14361.9	9043.6	5318.3
1997/98	56118.3	32937.9	23180.4	5402.6	17777.8	11054.5	6723.3
1998/99	59579.0	37251.0	22328.0	4336.6	17991.4	11852.4	6139.0
1999/00	66272.5	42893.8	23378.7	5711.7	17667.0	11812.2	5854.8
2000/01	79835.1	48893.6	30941.5	6753.4	24188.1	12044.0	12144.1
2001/02	80072.3	50445.5	29626.8	6686.1	22940.7	7698.7	15242.0
2002/03	84006.1	56229.8	27776.3	11339.1	16437.2	4546.4	11890.8
2003/04	89442.6	62331.0	27111.6	11283.4	15828.2	7629.0	8199.2
2004/05	89027.1	68875.1	20152.0	14391.2	5760.8	9266.1	(3505.3)
2005/06	95127.0	70768.5	24358.5	13827.5	10531.0	8214.3	2316.70
2006/07	116832.3	86686.0	30146.3	15800.8	14345.5	10053.5	4292.0

2007/08	138059.6	104939.3	33120.3	20320.7	12799.6	8979.9	3819.7
2008/09	194648.9	138372.0	56276.9	34570.4	21706.5	10405.4	11301.1

Source: Various years Economic Survey, Ministry of Finance

The internal loan taken in the F.Y. 2001/02 was Rs.8000 million which was Rs. 25000 million in the F.Y. 2008/09. Even after loan financing, there was Rs. 7242 million deficit finance in F.Y. 2001/02, and Rs. 2590 million in F.Y. 2008/09.

Fiscal deficit (resource gap) is continuously increasing due to lack of proper income management to meet the increasing trend of government expenditure (Economic Survey, 2005:39). Thus this increasing resource gap indicates that it is necessary to mobilize additional domestic resources. Ultimate and best measure to fill up the resource gap is to increase public revenue through effective tax system.

4.2 Tax-GDP Ratio of some Countries

The level of taxation is typically measured by tax revenue as a share of gross domestic product (GDP). Comparing levels of taxation across countries provides a quick overview of the fiscal obligations and incentives facing the private sectors. The table shows only central government data, which may significantly understate the total tax burden.

Low ratios of tax revenue to GDP may reflect weak administration and large-scale tax avoidance or evasion. Low ratios may also reflect the presence of a sizable parallel economy with unrecorded and undisclosed incomes. Tax revenue ratios tend to rise with income, with higher income countries relying on taxes to finance a much broader range of social services and social security than lower income countries are able to provide. (World Development Indicators, 2005:293)

The tax revenue as percentage of GDP of some countries is shown in the table 4.2 so that the tax performance of Nepal can be compared with those countries.

Nepal falls under low income economics. Nepal's tax- GDP ratio is 9.4 percent which is less than that of Pakistan and Sri Lanka but it is more than that of Bangladesh, India and Myanmar. In case of low and middle income economics, the ratio of tax-GDP is below 20 percent and in the case of high income economics the ratio is above 20 percent except that of U.S.A. It is clear from this table that Nepal's tax performance is not in satisfactory level.

Table 4.2

Tax Revenue-GDP Ratio of Some Selected Countries

Countries	Year 1990	Year 1998	Year 2001	Year 2003	Year 2008
<u>Low Income Economics</u>					
Myanmar	6.2	4.5	3.0	2.3	4.3
Bangladesh	7.0	8.1	8.5
India	9.9	8.6	10.0	9.1	17.7
Nepal	7.0	8.8	9.5	9.4	10.9
Pakistan	13.3	12.6	12.4	10.9	10.2
Sri Lanka	19.0	14.5	14.6	14.0	15.3
<u>Middle Income Economics</u>					
Panama	17.7	18.4	16.8	9.3	10.6
Argentina	9.4	12.4	12.5	9.4	22.9
Philippines	14.1	17.0	13.4	12.3	14.4
Peru	9.4	13.7	13.5	12.9	15.1
Indonesia	17.8	15.6	13.2	13.0	11.0
Thailand	17.1	14.4	14.5	15.4	17.0
<u>High Income Economics</u>					
USA	18.0	20.4	19.4	9.9	28.2
Austria	31.4	34.8	35.1	21.0	43.8
Hungary	44.7	31.4	32.1	22.2	37.3

Australia	23.8	22.9	22.0	24.1	30.5
United Kingdom	33.3	36.3	34.3	27.2	39.0
Norway	32.3	34.1	33.2	27.5	43.6
Denmark	32.3	..	31.9	30.1	50.0

Source: World Development Indicators, 2003, World Bank (For Year 2001)

World Development Indicators, 2005, World Bank (For Year 2003)

World Development Report, 2001/2002 (For Years 1990, 1998)

World Development Indicators, 2009, World Bank (For Year 2008)

4.3 Revenue-GDP Ratio in Nepal

Total Revenue-GDP, Tax Revenue-GDP and Non-tax Revenue-GDP ratio in Nepal from Fiscal Year 1994/95 to 2008/09 is presented in table 4.3 along with their average ratios 11.9, 9.79 and 2.7 respectively. From table we can see that ratio of total revenue and tax revenue with GDP is rising.

Table 4.3

Revenue-GDP Ratio

Fiscal Year	Total revenue- GDP Ratio	Tax Revenue- GDP Ratio	Non-tax Revenue- GDP Ratio
1994/95	11.2	9.0	2.2
1995/96	11.2	8.7	2.5
1996/97	10.8	8.7	2.1
1997/98	10.9	8.6	2.3
1998/99	10.9	8.4	2.5
1999/00	11.3	8.7	2.6
2000/01	11.9	9.5	2.4
2001/02	11.9	9.3	2.6
2002/03	12.3	9.3	3.0
2003/04	12.6	9.7	2.9
2004/05	12.8	9.9	2.9
2005/06	13.5	10.4	3.1
2006/07	13.7	10.3	3.4
2007/08	14	10.7	3.3

2008/09	14.1	10.9	3.2
Average	11.9	9.79	2.7

Note: GDP is taken in current producers' price

Source: *Economic Survey 2008/2009, Ministry of Finance, 2009*

4.4 Nepalese Government Revenue Structure

Government collects revenue from different sources. Basic source of the government revenue are classified into tax and non-tax revenue. Nepalese economy is characterized by a low revenue performance in contrast to growing public expenditure, the composition of government revenue from Fiscal Year 1994/95 to 2008/09 is presented in the table 4.4.

In 1994/95, the government revenue mobilization stood at Rs. 24605.1 million, amongst which Rs. 19660.0 million (79.9 percentage) was mobilized from tax revenue sources. The remaining Rs. 4945.1 million (20.1 percent) were collected from non-tax sources such as fees, fines, interest, dividends and principal repayments. In FY 2003/04 government revenue increased to Rs. 62331.0 million, with the contribution of tax revenue being 77.29 percent. The share of revenue from non-tax sources increased to 22.71 percent. This indicates that the role of tax revenue is very important in revenue mobilization of Nepal to meet the government expenditure. The highest contribution of tax revenue to total revenue was 80.41 during the study period.

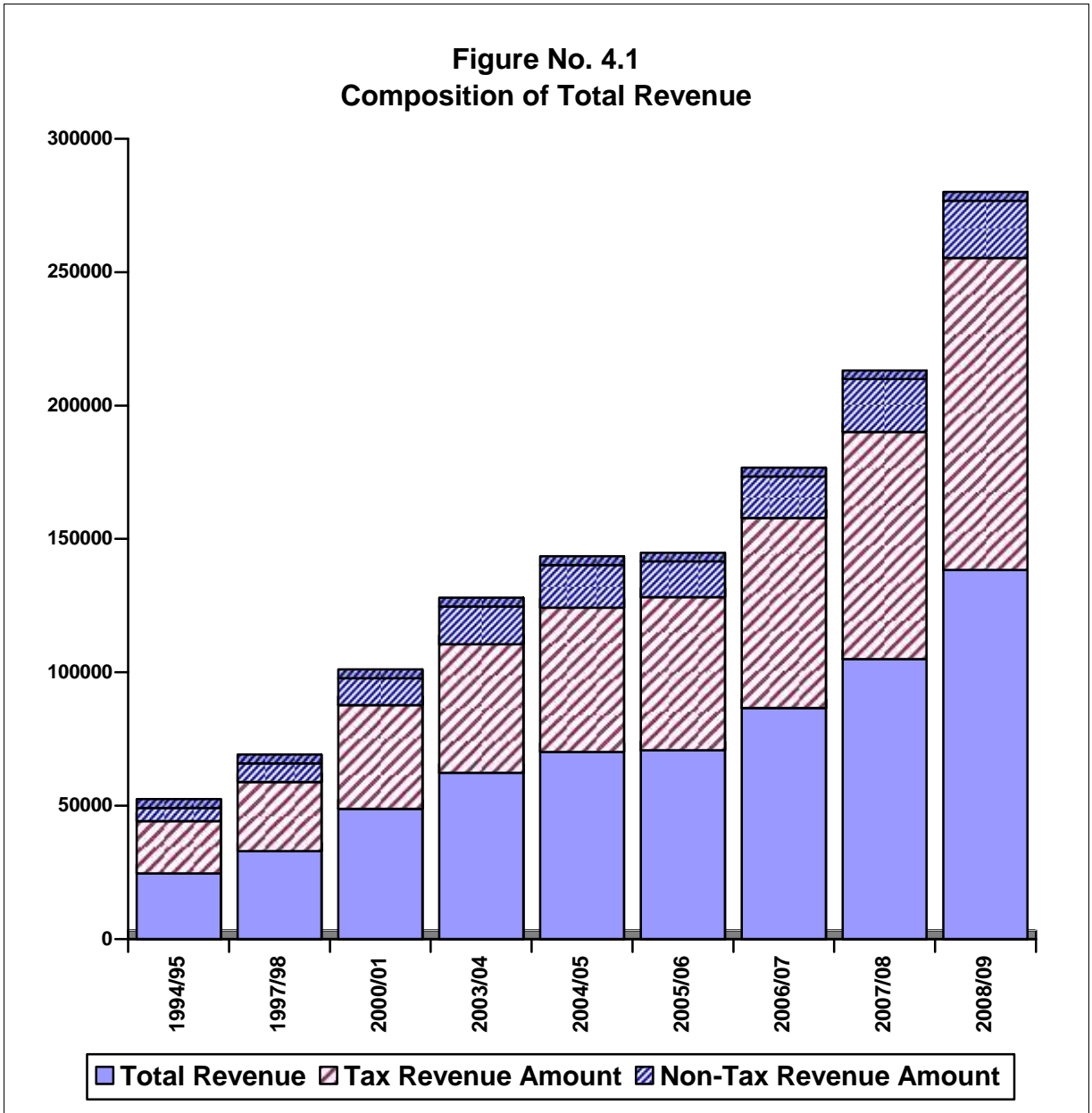
Table 4.4
Composition of Total Revenue

Rs. In Million

Fiscal Year	Total Revenue	Tax Revenue		Non-Tax Revenue	
		Amount	Percentage as Total Revenue	Amount	Percentage as Total Revenue
1994/95	24605.1	19660	79.90	4945.1	20.10
1995/96	27893.1	21668	77.68	6225.1	22.32
1996/97	30373.5	24424.3	80.41	5949.2	19.59

1997/98	32937.9	25939.8	78.75	6998.1	21.25
1998/99	37251	28752.9	77.19	8498.1	22.81
1999/00	42893.8	33152.1	77.29	9741.7	22.71
2000/01	48893.6	38865.1	79.49	10028.5	20.51
2001/02	50445.5	39330.6	77.97	11114.9	22.03
2002/03	56229.8	42587.0	75.74	13642.8	24.26
2003/04	62331.0	48173.0	77.29	14158.0	22.71
2004/05	70122.7	54104.8	77.16	16017.9	22.84
2005/06	70768.5	57427.0	81.15	13341.5	18.85
2006/07	86686.0	71126.7	82.05	15559.3	17.95
2007/08	104939.3	85155.5	81.14	19783.8	18.84
2008/09	138372.0	116996.7	84.55	21375.3	15.45

Source: Various years Economic Survey, MOF



Source: Table 4.4

4.5 Composition of Tax Revenue in Nepal

In Nepal the major source of government revenue is the tax revenue, as it contributes around 77 percent of total revenue mobilization. The remaining 23 percent is mobilized from non-tax revenue sources such as fees, fines, royalties and others. On the tax revenue, almost 75 percent comes from the sources of indirect tax and remaining 25 percent from direct tax sources.

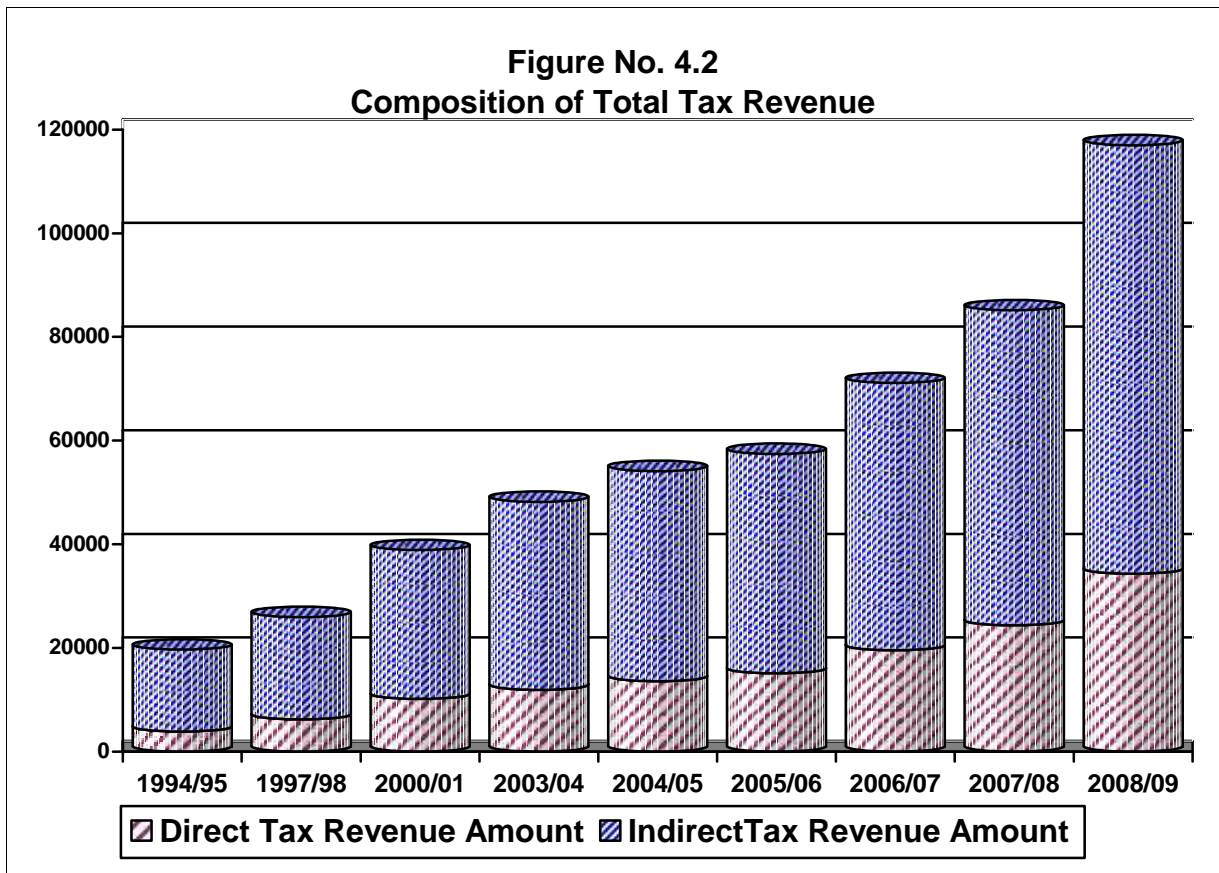
The figure of direct tax and indirect tax revenue from Fiscal Year 1994/95 to FY 2008/09 is presented in the table 4.5 and figure no. 4.2

Table 4.5
Composition of Total Tax Revenue

Rs. in Million

Fiscal Year	Total Tax Revenue	Direct Tax Revenue		Indirect Tax Revenue	
		Amount	Percentage of Tax Revenue	Amount	Percentage of Tax Revenue
1994/95	19660.0	3849.3	19.6	15810.7	80.4
1995/96	21668.0	4655.9	21.5	17012.1	78.5
1996/97	24424.3	5340.0	21.9	19084.3	78.1
1997/98	25939.8	6187.9	23.9	19751.9	76.1
1998/99	28752.9	7516.1	26.1	21236.8	73.9
1999/00	33152.1	8951.5	27.0	24200.6	73.0
2000/01	38865.1	10159.4	26.1	28705.7	73.9
2001/02	39330.6	10597.5	26.9	28733.1	73.1
2002/03	42587.0	10105.8	23.7	32481.2	76.3
2003/04	48173.0	11912.6	24.7	36260.4	75.3
2004/05	54104.8	13580.3	25.1	40524.5	74.9
2005/06	57427.0	15103.4	26.3	42323.6	73.7
2006/07	71126.7	19559.8	27.5	51566.9	72.5
2007/08	85155.5	24354.5	28.6	60801.0	71.4
2008/09	116996.7	34320.7	29.3	82676.0	70.7

Source: Economic Survey, Ministry of Finance, various years



Source: Table 4.5

Total tax revenue, direct tax and indirect tax are in increasing trend. The main share of direct tax revenue was Rs. 7927.6 million and that of indirect tax revenue was Rs. 24327.7 million. The amount of direct tax was Rs. 3849.3 million in the FY1994/95. It is increasing each year and has reached to Rs. 34320.7 million in FY 2008/09. Percentage contribution of direct tax to total tax revenue is fluctuating over the study period from 19.6 percent to 29.3 percent.

Similarly, the amount of indirect tax was Rs. 15810.7 in the FY 1994/95. It is increasing each year and has reached to Rs. 82676.0 million in FY 2008/09. Percentage contribution of indirect tax to total tax revenue is fluctuating over the study period from 70.7 percent to 80.4 percent.

4.6 Composition of Indirect Tax Revenue

Indirect tax is that tax system where the person paying the tax and the person bearing the tax is different. An indirect tax is imposed on one person but paid partly or wholly by another. The main features of indirect tax are convenience

to pay, mass participation, limited evasion etc. Indirect tax provides two third or more of tax revenue in most of the UDCs with tax on foreign trade (custom duties) more important in poorest countries and domestic taxes on goods and services (sales and excise) more important in the other.

The components of indirect tax are custom duty, VAT (sales tax) and the excise duty. Custom duties are composed of import duties, export duties and export service charge and Indian excise refund. VAT (sales tax) has a wider coverage since it covers, most of the goods either imported or domestically produced. In 1997, the government introduced VAT aiming to develop it as the backbone of Nepalese Revenue.

The composition of indirect tax revenue from FY 1994/95 to FY 2008/09 is presented in the table 4.6.

Table 4.6

Composition of Indirect Tax Revenue

Rs. in Million

Fiscal Year	Total Indirect Tax	Custom Duties		VAT and other taxes*		Excise Duties	
		Amount	%	Amount	%	Amount	%
1994/95	15810.7	7018.1	44.4	7135.3	45.1	1657.3	10.5
1995/96	17012.1	7327.4	43.1	7740.4	45.5	1944.3	11.4
1996/97	19084.3	8309.1	43.5	8477.1	44.4	2298.1	12.0
1997/98	19751.9	8502.2	43.0	8363.9	42.3	2885.8	14.6
1998/99	21236.8	9517.7	44.8	8765.9	41.3	2953.2	13.9
1999/00	24200.6	10813.3	44.7	10259.7	42.4	3127.6	12.9
2000/01	28705.7	12552.1	43.7	12382.4	43.1	3771.2	13.1
2001/02	28733.1	12658.8	44.1	12267.3	42.7	3807.0	13.2
2002/03	32481.2	14236.4	43.8	13459.7	41.4	4785.1	14.7
2003/04	36260.4	15554.8	42.9	14478.9	39.9	6226.7	17.2
2004/05	40524.5	15183.4	37.5	18894.6	46.6	6446.5	15.9
2005/06	42323.6	13865.4	32.8	21946.0	51.8	6512.2	15.4
2006/07	51566.9	16328.9	31.7	26704.2	51.8	8533.8	16.5
2007/08	60801.0	19173.2	31.5	31154.6	51.2	10473.2	17.3
2008/09	82676.0	25117.9	30.4	43225.4	52.3	14332.7	17.3

- * Other Tax includes Sales Tax, Entertainment Tax, Hotel Tax, Air Flight Tax and Contract Tax etc.

Source: Economic Survey, Ministry of Finance, various years

Customs and VAT are the two major sources of tax revenue in Nepal. Of the total revenue mobilization in the last six years, the revenue from customs duty and VAT each constituted about 32.0 percent of the total tax revenue. Average share of custom duty to indirect tax is 43.8 percent. Its share in the FY 2008/09 is 30.4 percent amounting Rs. 25117.9 million, which was 44.4 percent in FY 1994/95.

Similarly, average share of VAT and other taxes to indirect tax is 42.8 percent. Amount of VAT and other tax in the FY 1994/95 was Rs. 7135.3 million and had reached to Rs. 43225.4 million in FY 2008/09. VAT has occupied second position on indirect tax revenue.

Average share of excise duties to indirect tax is 13.4 percent. Amount of excise duties is increasing every year but in percentage it is fluctuating. In FY 2008/09, the portion of excise duty is 17.3 percent.

4.7 Composition of Direct Tax Revenue

If the person paying and bearing the tax is same, it is called direct tax. A direct tax is really paid by the same person on whom it is legally imposed. The characteristics of a direct tax are equitable as per the property or income, certainty as per the process of payment, amount to be paid, time of payment, elastic in nature etc. Direct tax in Nepalese economy is composed of different taxes namely: income tax, land tax, property and wealth tax, tax on registration.

In Nepalese tax revenue structure, the contribution of direct tax and share of its components are shown in the table 4.7 and figure no. 4.3.

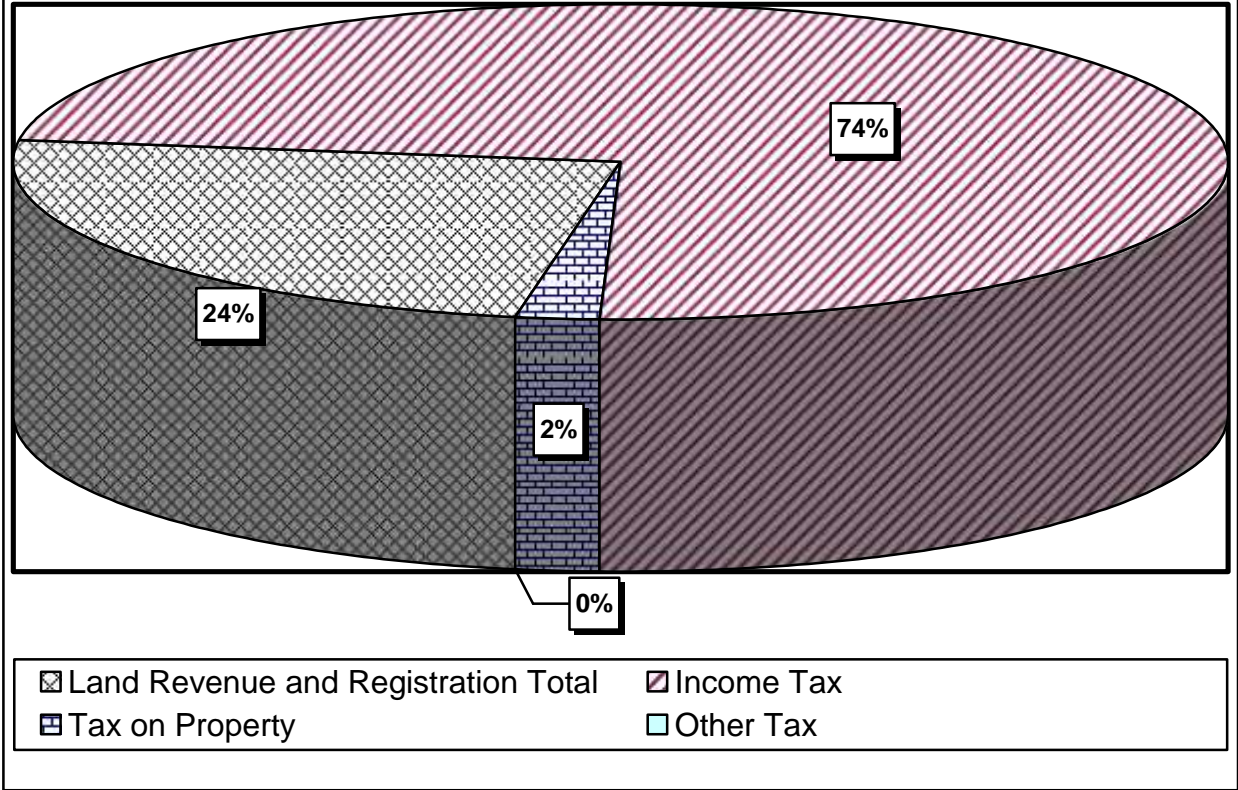
Table 4.7
Composition of Direct Tax

Rs. in Million

Fiscal Year	Total Direct Tax	Land Revenue and Registration				Tax on Property, Profit and Income				
		Land Tax	House, Land Registration	Total	% of Total Direct Tax	Income Tax	Tax on Property	Other Tax	Total	% of Total Direct Tax
1994/95	3849.3	34.9	902.8	937.7	24.4	2823.4	88.2	0.0	2911.6	75.6
1997/98	6187.9	3.6	1000.6	1004.2	16.2	4898.1	285.6	0.0	5183.7	83.8
2000/01	10159.4	5.1	607.8	612.9	6.0	9114.0	432.5	0.0	9546.5	94.0
2003/04	11912.6	0.0	1697.5	1697.5	14.2	9245.9	700.6	268.6	10215.1	85.8
2004/05	13580.3	0.0	1799.2	1799.2	13.24	10466.2	0.0	1314.9	11781.1	86.76
2005/06	15103.4	0.0	2181.1	2181.1	14.44	10933.5	0.0	1988.8	12922.3	85.86
2006/07	19559.8	0.0	2253.5	2253.5	11.52	15731.8	0.0	1574.5	17306.3	88.48
2007/08	24354.5	0.0	2940.7	2940.7	12.07	19077.8	0.0	2336.0	21413.8	87.93
2008/09	34320.7	0.0	5223.4	5223.4	15.22	27247.4	0.0	1849.9	29097.3	84.78

Source: Economic Survey, Ministry of Finance, various years

**Figure No. 4.3
Composition of Direct Tax**



Source: Table 4.7

Direct tax is classified into land revenue and registration and tax on property, profit and income. Of the total revenue in FY 2003/04, the share of land revenue and registration fee was 3.5 percent. Land revenue and registration is further classified into land tax and house and land registration. House and land revenue registration is higher than land revenue each year. The share of land revenue and registration is in increasing trend as the real estate activities are increasing in reporting years. Its share was Rs. 937.7 million in FY 1994/95 and increased to Rs. 5223.4 million in FY 2008/09.

The other source of direct tax revenue is tax on property, profit and income. Of the total tax revenue, in FY 2008/09, the share of income, profit and property tax was

84.78 percent of direct tax revenue. Over the study period, its share is not less than 75.6 percent and not more than 94.0 percent of direct tax revenue. Total amount of it was Rs. 2911.6 million in the initial period of the study and increasing each year and had reached to Rs. 29097.3 million in FY 2008/09.

4.8 Composition of Income Tax Revenue

Income tax is an important source of direct tax. In the present situation, Nepal is levying three different types of income tax. They are individual income, corporate income tax and interest tax. Base of the individual income tax covers all individuals having income of taxable capacity. Corporate income tax is levied on the profit of corporation. A corporation is a separate entity from its shareholders in both legal and economic grounds. The interest tax is levied on the interest received.

The composition of income tax revenue for the recent 10 years is presented in the table 4.8 and table 4.9 and figure no. 4.4.

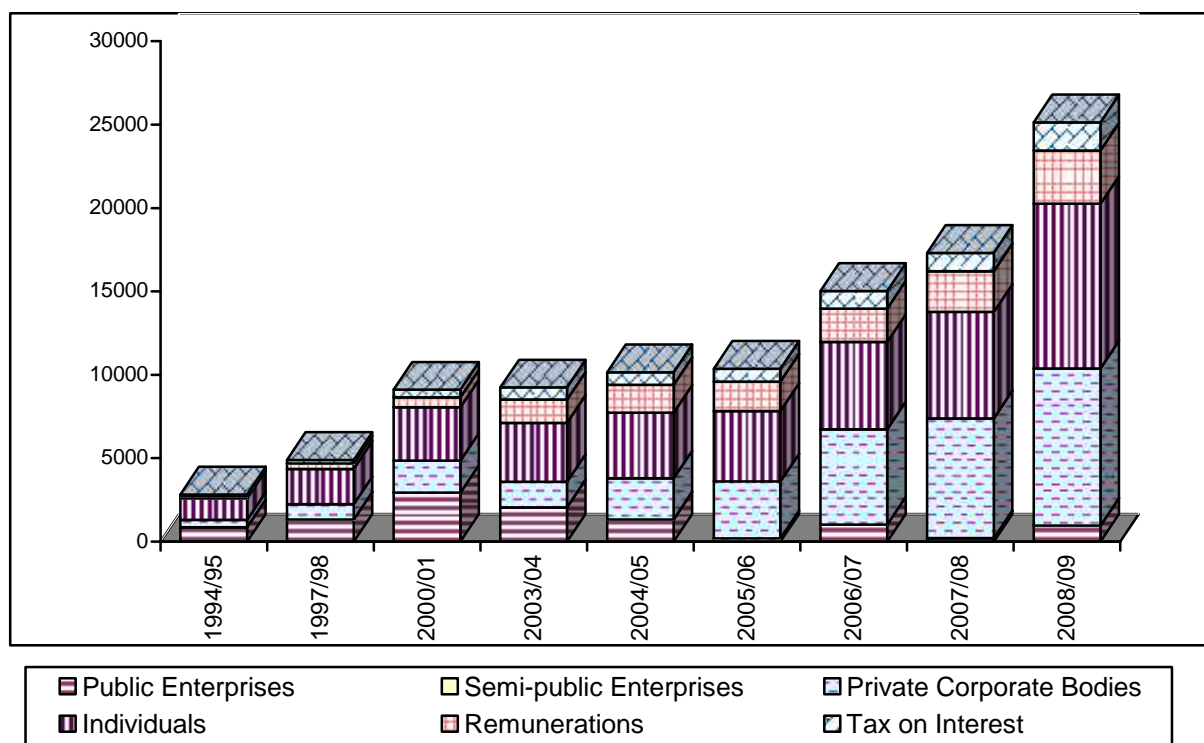
Table 4.8
Structure of Income Tax Revenue

Rs. In Million

Fiscal Year	Total Income Tax Revenue	Public Enterprises	Semi-public Enterprises	Private Corporate Bodies	Individuals	Remunerations	Tax on Interest
1994/95	2823.4	860.2	0.0	440.1	1293.1	118.4	111.6
1997/98	4898.1	1317.8	0.0	925.1	2120.8	322.2	212.2
2000/01	9114.0	2928.0	0.0	1924.3	3200.5	597.3	463.9
2003/04	9245.9	2056.6	0.0	1531.3	3533.4	1391.2	733.4
2004/05	10466.2	1332.4	0.0	2467.8	3926.3	1675.9	757.0
2005/06	10933.5	195.7	0.0	3404.3	4234.7	1764.1	774.9
2006/07	15731.8	1019.7	0.0	5717.1	5234.4	2007.9	1054.9
2007/08	19077.8	204.6	0.0	7186.5	6381.2	2451.0	1087.9
2008/09	27247.4	959.1	0.0	9425.1	9877.5	3195.6	1685.1

Source: Economic Survey, Ministry of Finance, various years

Figure No. 4.4
Structure of Income Tax Revenue



Source: Table 4.8

Table 4.9
Structure of Income Tax Revenue

In Percentage

Fiscal Year	Total Income Tax Revenue	Public Enterprises	Semi-public Enterprises	Private Corporate Bodies	Individuals	Remunerations	Tax on Interest
1994/95	100.00	30.47	0.00	15.59	45.80	4.19	3.95
1997/98	100.00	26.90	0.00	18.89	43.30	6.58	4.33
2000/01	100.00	32.13	0.00	21.11	35.12	6.55	5.09
2003/04	100.00	22.24	0.00	16.56	38.22	15.05	7.93
2004/05	100.00	12.73	0.00	23.57	37.51	15.28	10.91
2005/06	100.00	1.78	0.00	31.13	38.73	19.13	9.63
2006/07	100.00	6.48	0.00	36.34	39.63	12.76	4.79
2007/08	100.00	1.07	0.00	37.67	32.80	22.35	6.11
2008/09	100.00	3.52	0.00	36.59	39.25	13.73	6.93

Source: Table 4.8

When income tax was introduced in Nepal as business profit and remuneration tax in 1959/60, it had contributed Rs. 203 thousand as revenue. Income tax is increasing each year. Total income tax was Rs.2823.4 million in the FY 1994/95 and had reached to 27247.4 million in the FY 2008/09. This amount is the total of income tax from public enterprises, semi-public enterprises, private corporate bodies, individuals, remuneration and tax on interest.

Contribution of income tax to total income tax from public enterprises is 26.49 percent in average till FY 2003/04 but it is decreasing rapidly in current years. Total amount contribution from public enterprises has fluctuated from Rs. 195.7 million to Rs. 2928.0 million. The contribution of income tax to public revenue from public enterprises is not satisfactory. The main reasons for unsatisfactory contribution of income tax were poor performance of public enterprises, weakness in government's economic policy, defective income tax etc.

Contribution from semi-public enterprises is lowest than other. It has not contributed even a single percent to income tax in any year during the study period. Average contribution of private corporate bodies is 4338.6 million from FY 1994/95 to 2008/09. Contribution of individuals to total income tax is highest in each year. Share of individual was Rs. 1293.1million in the FY 1994/95 and increased to Rs. 9877.5 million in the last year of the study. In amount it is increasing each year. The percentage contribution was highest in the FY 2006/07 that was 39.63

Average contribution from remuneration and tax on interest is 17.79 and 5.54 percent respectively. Tax revenue from remuneration is increasing each year. It was Rs. 118.4 million in the FY 1994/95 and reached to Rs. 3195.6 million in the FY 2008/09. Tax on interest was also in an increasing trend.

There is growth of 865.18% in income tax collection as compared to FY 1994/95 to FY 2008/09.

4.9 Contribution of Income Tax

Contribution of income tax to Direct Tax Revenue, Total Tax Revenue, Total Revenue and GDP in Nepal is shown in table 4.10.

Contribution of Income Tax to the Direct Tax Revenue:

There is the dominated role of income tax in the direct tax revenue. Average share of income tax to direct tax is 79.86 percent over the study period. In the beginning of the study, it was 73.35 percent and had reached maximum up to 89.71 percent and was 79.37 percent in the FY 2008/09. The contribution of income tax is not less than 73.35 percent in any year.

Contribution of Income Tax to the Total Tax Revenue:

Total tax revenue constitutes direct and indirect tax revenue. There is dominant role of indirect tax in the Nepalese tax revenue structure. The contribution of income tax on total tax revenue was 14.36 percent in the initial period of the study. The highest contribution of income tax was 23.45 percent in the FY 2000/01 but average contribution is 19.38 percent over the study period. The share of income tax as a percentage of total tax revenue was 14.36 in FY 1994/95, which was the lowest contribution over the study period.

Contribution of Income Tax to Total Revenue:

Total revenue constitutes tax and non-tax revenue. In Nepalese government revenue structure, tax revenue has occupied the most part of public revenue i.e., about two third part in total revenue. The share of income tax as a percentage of total revenue has fluctuated from 11.49 percent to 18.64 percent. Average contribution is 15.14 percent over the study period. Contribution in total revenue is increasing year after year. In FY 2008/09, it came to 18.98%.

Contribution of Income Tax to Gross Domestic Product (GDP):

Contribution of income tax in GDP was 1.29 percent in the FY 1994/95. Maximum contribution of income tax revenue as a percentage of GDP is 2.23 in the FY

2000/01 it is in increasing trend except for fiscal year 2001/02 and 2002/03. In FY 2008/09 the contribution of income tax in total GDP is 2.83%.

Table 4.10

Contribution of Income Tax on Direct Tax Revenue, Tax Revenue, Total Revenue and GDP in Nepal

Rs. in Million

Fiscal year	Total Income tax	Percentage of Income Tax on Direct Tax Revenue	Percentage of Income Tax on Total Tax Revenue	Percentage of Income Tax on Total Revenue	Percentage of Income Tax on GDP
1994/95	2823.4	73.35	14.36	11.49	1.29
1995/96	3431.4	73.70	15.84	12.30	1.38
1996/97	4123.4	77.22	16.88	13.58	1.47
1997/98	4898.1	79.16	18.88	14.87	1.62
1998/99	6170.2	82.09	21.46	16.56	1.80
1999/00	7420.6	82.90	22.38	17.30	1.95
2000/01	9114.0	89.71	23.45	18.64	2.23
2001/02	8903.7	84.02	22.64	17.65	2.11
2002/03	7966.2	78.83	18.71	14.17	1.74
2003/04	9245.9	77.61	19.19	14.83	1.87
2004/05	1046.6	77.52	19.33	14.91	2.07
2005/06	1093.3	78.11	19.03	15.23	1.87
2006/07	1573.1	77.79	22.11	17.93	2.34
2007/08	1907.7	79.02	22.39	17.72	2.32
2008/09	2724.6	79.37	23.27	18.98	2.83

Source: *Economic Survey, Ministry of Finance, various years*

4.10 Income Tax Collection Performance in Nepal

Revenue from income tax is in increasing trend but the performance of income tax collection is not satisfactory. Income tax collection performance in Nepal is presented in the table 4.11. The collection was only 86.61 percent of estimate in the FY 1994/95. Tax was collected excess than the target in the fiscal year 1997/98, 1998/99, 1999/00 and 2003/04 and the highest percentage of collection over the estimate was in the FY 1998/99. The lowest percentage of collection was 80.07 percent in the FY 2001/02.

Table 4.11
Collection Performance of Income Tax Revenue
from FY 1994/95 to 2008/09

Rs. in Million

Fiscal Year	Estimates	Collections	Difference	Collection as the % of Estimates
1994/95	3260.0	2823.5	(436.5)	86.61
1995/96	4000.0	3431.4	(568.6)	85.78
1996/97	4595.0	4123.4	(471.6)	89.74
1997/98	4750.0	4898.1	148.1	103.12
1998/99	5780.0	6170.2	390.2	106.75
1999/00	7380.0	7420.0	40.0	100.54
2000/01	9980.0	9110.0	(870.0)	91.28
2001/02	11140.0	8919.6	(2220.4)	80.07
2002/03	9862.5	9766.2	(96.3)	99.02
2003/04	8697.5	9245.9	48.4	106.31
2004/05	1050.0	1046.6	3.40	99.61
2005/06	1180.0	1093.3	86.7	92.62
2006/07	1271.0	1573.1	302.1	123.76
2007/08	1938.0	1907.7	30.3	98.40
2008/09	3150.0	2724.6	425.4	86.47

Source: Various years Budget Speech and Economic Survey, MOF

Note: Figure in bracket indicates negative value.

4.11 Exemption Limit in Nepal

Exemption limit directly influence income tax revenue collection. Taxpayer having low tax paying capacity should exclude from the tax net for the social justice and economic balance between rich and poor. The exemption limit provided in the various years is presented in the table 4.12. In the earlier time, there was equal amount of exemption to all the taxpayers i.e. individual, couple, family and corporate bodies. Exemption limit to all taxpayers was Rs. 7000 in the FY 1959/60 to FY 1962/63. The exemption limit to the corporate taxpayer was curtailed from the FY 1965/66. The exemption limit to the couple and family was equal each year except FY 1967/68 to FY 1973/74 and FY 1975/76 to FY 1978/79. The exemption limit to the family was Rs. 6000 in the FY 1967/67 to FY 1973/74 whereas it was Rs.4500 to the couple. The exemption limit to couple and family was Rs.6500 and 7500 respectively in the FY 1974/75 and it was further extended by Rs. 1000/ 1000 for the fiscal year 1976/77 to1978/79. From the table, it is clear that exemption limit is extended according to need of time and income condition. At present time, individual having the taxable income up to Rs. 160,000 are exempted from tax and that for couple is Rs. 200,000.

Note that if it is pension income of a resident person, the exemption limit would be to, exemption amount plus 25 percent of exemption amount.

Table 4.12

Exemption Limit in Nepal

From fiscal year 1959/60-2005/06

Fiscal Year	Individual	Couple	All taxpayers
1959/60-1962/63	-	-	7000
1963/64-1964/65	-	-	6000
1965/66-1966/67	-	-	5000
1967/68-1973/74	3000	4500	-
1974/75	4500	6000	-
1975/76	5500	6500	-
1976/77-1978/79	6500	7500	-

1979/80-1980/81	7500	10000	-
1981/82-1982/83	10000	15000	-
1983/84-1989/90	15000	20000	-
1990/91-1991/92	20000	30000	-
1992/93-1996/97	25000	35000	-
1997/98	30000	40000	-
1998/99	40000	50000	-
1999/00	55000	75000	-
2000/01	55000	75000	-
2002/03	65000	85000	-
2003/04	80000	100000	-
2004/05	80000	100000	-
2005/06	100000	125000	-
2006/07	115,000	140,000	
2007/08	160,000	200,000	
2008/09	160,000	200,000	

Source: Finance Acts of Various Year, Ministry of finance

4.12 Income tax rate in Nepal

Tax rates are a function of the size of government and the way the burden is allocated among alternative sources. While views on the appropriate size of government's differ, government share of GDP in many developing countries is much larger than in today's developed countries when they were at similar stages of development. (World, 2005:107)

Income tax rate in Nepal for the various years is presented in the table 4.13 and 4.14. At the introduction time of income tax, there was narrow coverage and high tax rate but at present it is taken the principle of "low rate, wide coverage". In the history of Nepal, the highest tax rate for personal income was 60 percent in the FY 1975/76. In FY 1980/81, the tax rate for personal income was 5 percent to 50 percent for different seven slabs. The tax rate and also number of slabs increased to 55 percent and eight slabs in FY 1985/86. But after that, rate and slabs is decreased. At present, there is only 15 and 25 percent tax rate for personal income with two slabs. But, tax is levied at flat rate to corporation at the present.

Table 4.13
Income Tax Rate in Nepal for Personal Income

Slabs Fiscal year	1	2	3	4	5	6	7	8
1980/81	5000 5%	5000 10%	10000 15%	20000 20%	20000 30%	30000 40%	Balance 50%	-
1985/86	5000 10%	5000 15%	10000 20%	15000 25%	15000 30%	30000 40%	200000 50%	Balance 55%
1990/91	10000 15%	15000 20%	20000 35%	25000 40%	30000 15%	Balance 50%	-	-
1995/96	40000 10%	25000 20%	Balance a) 25% b) 33%	-	-	-	-	-
2000/01 to 2008/09	200,000 1%	100,000 15%	Balance 25%	-	-	-	-	-

Source: Finance Acts of various years, MOF, Nepal Government

Table 4.14

Income Tax Rate for Partnership Firms, Corporation and Non-Residence
From 1983/84 to 2005/06

Fiscal Year	1	2	3	4	5	6	7	8
1983/84-1988/89	5000 10%	5000 15%	10000 20%	15000 25%	15000 30%	30000 40%	200000 50%	Balance 55%
1989/90-1990/91	5000 10%	5000 15%	10000 20%	15000 25%	15000 30%	30000 40%	Balance 50%	-
1991/92	10000 15%	15000 25%	20000 35%	25000 40%	30000 45%	Balance 50%	-	-
1992/93	10000 15%	20000 20%	20000 30%	20000 40%	Balance 50%	-	-	-
1993/94	25000 15%	40000 25%	Balance 40%	-	-	-	-	-
1994/95-1995/96	35% in total	-	-	-	-	-	-	-
1996/97-1997/98	33% in total	-	-	-	-	-	-	-
1998/99-2008/09	(a) 30% (b) 25%	-	-	-	-	-	-	-

(a) For Bank, finance com. etc.

(b) Other

Source: Finance Acts of various year, MOF, HMG/Nepal

4.13 Taxpayers and Returns of Income of the Fiscal Year 2004/05

The details of registered taxpayers and returns of income for the FY 2008/09 are shown in the table no.4.15. The total number of registered taxpayers has reached 195498 by the FY 2008/09 whereas it was 166699 in the FY 2007/08. It shows that the number of taxpayers has increased by 28,799 i.e. 17.28 percent. Though 29308 new taxpayers are registered in the year 2008/09, there is 509 numbers of taxpayers deducted in this year.

During the FY 2008/09, the total number of returns of income filed has reached 113202 while it was only 56840 at the end of the last year. The number of new returns filed in the FY 2008/09 is 56352.

Table 4.15

Registration of Taxpayers and Returns of Income

For the Fiscal Year 2008/09

Tax Headings	No. of Taxpayers				Registration of Returns of Income		
	No. of registration upto last year	This year addition	Deducted number in this year	Total No. of Registered Taxpayers	Brought down from last year	Number of Submission in this year	Total
Income Tax	166699	29308	509	195498	56850	56352	113202
Corporate Income Tax	163507	27546	507	190546	56100	56307	112407
Public Enterprises	26963	30	2	26991	128	22	150
Public Limited Co.	474	54	30	498	600	271	871
Private Limited Co.	6944	4562	30	11476	2976	3687	6663
Individual Firm	128517	22618	443	150692	48464	51912	100306
Other Entity	609	282	2	889	3932	415	4347
Remuneration	1064	1762	2	2824	232	45	277
Income Tax in Investment	2128	0	0	2128	518	0	518
Rent	2128	0	0	2128	518	0	518
Interest	0	0	0	0	0	0	0
Capital Gain	0	0	0	0	0	0	0
Dividend	0	0	0	0	0	0	0
Other Investment	0	0	0	0	0	0	0
Special Fees	0	0	0	0	0	0	0
Total	166699	29308	509	195498	56850	56352	113202

Source: Annual Report 2008/09, Inland Revenue Department, Ministry of Finance, Nepal Government.

4.14 Assessment for the Fiscal Year 2008/09

The detail of the assessment for the FY 2008/09 is shown in the table no. 4.16. The table shows that the total of the brought down and the filed returns of income is 125988. The total assessments of 4121 are done in the FY 2008/09 out of which 3412 are from dues of the previous years and 709 are from the current fiscal year. The total amount for which the assessment has been done in the FY 2008/09 is Rs. 2330765 thousand, which consists of Rs. 2037269 thousand from among the dues and Rs. 293496 thousand from the current fiscal year. The number of returns, which are remained for assessment and carried forward to the next year, is 121867.

Table 4.16
Detail of Assessment
For the Fiscal Year 2008/09

Rs. in Thousand

Tax Headings	Total Brought down and filed this year	Assessment						Carried forward to the next year
		Among the dues		Among the Current FY		Total		
		Number	Amount	Number	Amount	Number	Amount	
Income Tax.	125988	3412	1964396	709	289366	4121	2253762	121867
Corporate Income tax	125235	3411	1964350	708	289365	4119	2253715	121116
Public Enterprises	155	20	96722	0	0	20	96722	135
Public Limited Co.	869	154	1189364	7	54134	161	1243498	708
Private Limited Co.	6793	846	489985	164	115526	1010	605511	5783
Individual Firm	113326	2364	167082	527	117260	2891	284342	110435
Other Entity	4092	27	21197	10	2445	37	23642	4055
Remuneration	235	0	0	1	1	1	1	234
Income Tax in Investment	518	1	46	0	0	1	46	517
Rent	518	1	46	0	0	1	46	517
Interest	0	0	0	0	0	0	0	0
Capital Gain	0	0	0	0	0	0	0	0
Dividend	0	0	0	0	0	0	0	0
Other Investment	0	0	0	0	0	0	0	0
Special Fees	0	0	72873	0	4130	0	77003	0
Total	377729	10236	2037269	709	293496	4121	2330765	121867

Source: Annual Report 2008/09, Inland Revenue Department, Ministry of Finance, Nepal Government

4.15 Appeals for the Fiscal Year 2008/09

The number of appeals and the amount involved in it are shown in the table no. 4.17. The number of appeals against the assessment orders of the various Inland Revenue Offices at the end of the FY 2007/08 was 2618. During the FY 2008/09, 331 more appeals were made totaling the number of appeals at 2949. The number of appeals yet to be listened or the arrears for the next fiscal year 2009/10 is 2434.

The number of appeal is maximum for individual firms. The minimum number of appeals is from remuneration. The amount involved in appeal against the assessment orders of the various Inland Revenue Offices at the end of the fiscal year 2007/08 was Rs. 2438525 thousand. In the year 2008/09, the amount of Rs. 1350423 thousand is added more. Out of these, Rs. 771134 thousand has been settled in the year 2008/09 and the amount carried forward for the next fiscal year 2009/10 is Rs. 4,695,990 thousand.

Table 4.17
Appeals
For the Fiscal Year 2008/09

Rs. in Thousand

Tax Headings	No. of Appeal				Amount involved in appeal			
	Brought down from last year	This year addition	Settlement on this year	Carried forward for next year	Amount brought down from last year	This year addition in amount	Settlement amount on this year	Amount carried forward for next year
Income Tax	33	267	312	(12)	8104384	2615532	3102530	3773599
Corporate Income Tax	30	267	312	(15)	4062697	2615532	3102530	3770786
Public Enterprises	13	5	8	10	687868	545865	800894	432839
Public Limited Co.	233	49	81	201	2346204	1077725	1142784	2334471
Private Limited Co.	518	163	170	511	855813	407024	572447	769747
Individual Firm	551	38	47	521	151802	9300	16866	147199
Other Entity	28	12	6	19	21012	575618	569539	86530
Remuneration	1	0	0	1	0	0	0	0
Income Tax in Investment	0	0	0	0	0	0	0	0
Rent	0	0	0	0	0	0	0	0
Interest	0	0	0	0	0	0	0	0
Capital Gain	0	0	0	0	0	0	0	0
Dividend	0	0	0	0	0	0	0	0
Other Investment	2	0	0	2	2813	0	0	2813
Special Fees	15	0	0	15	1392	0	0	1392
Total	154	299	347	106	8860036	2768125	3126176	4695990

Source: Annual Report 2008/09, Inland Revenue Department, Ministry of Finance, Nepal Government.

ANALYSIS OF PRIMARY DATA

INTRODUCTION

The survey result has been conducted to find out the various aspects of income tax in Nepal. The structured questionnaire was prepared and distributed for this purpose. The opinion of the various 75 respondents associated with distinct denominations i.e. tax administration, tax expert and tax payers were collected. The questionnaire has covered role of income tax, major problem of income tax system, problems facing by tax payer, the most important factors for the effectiveness of income tax system in Nepal (see the format of questionnaire in a appendix 1). The respondents were asked either to response yes/no or for ranking of choices according to no of alternatives where first choice was the most important and last choice was least important. Number of respondents in each denomination is equal 25. Information received from the respondents are tabulated and analyzed in the proper way. Table 4.18 the groups and number of respondents.

Table 4.18

Group of Respondents and NO From each Group

S.No.	Groups of Respondents	No.
1	Income Tax Administrators	25
2	Income Tax Experts	25
3	Income Tax Payers	25
Total		75

RESULT OF EMPIRICAL INVESTIGATION:

4.16 Income Tax as Suitable Means of Raising Government revenue:

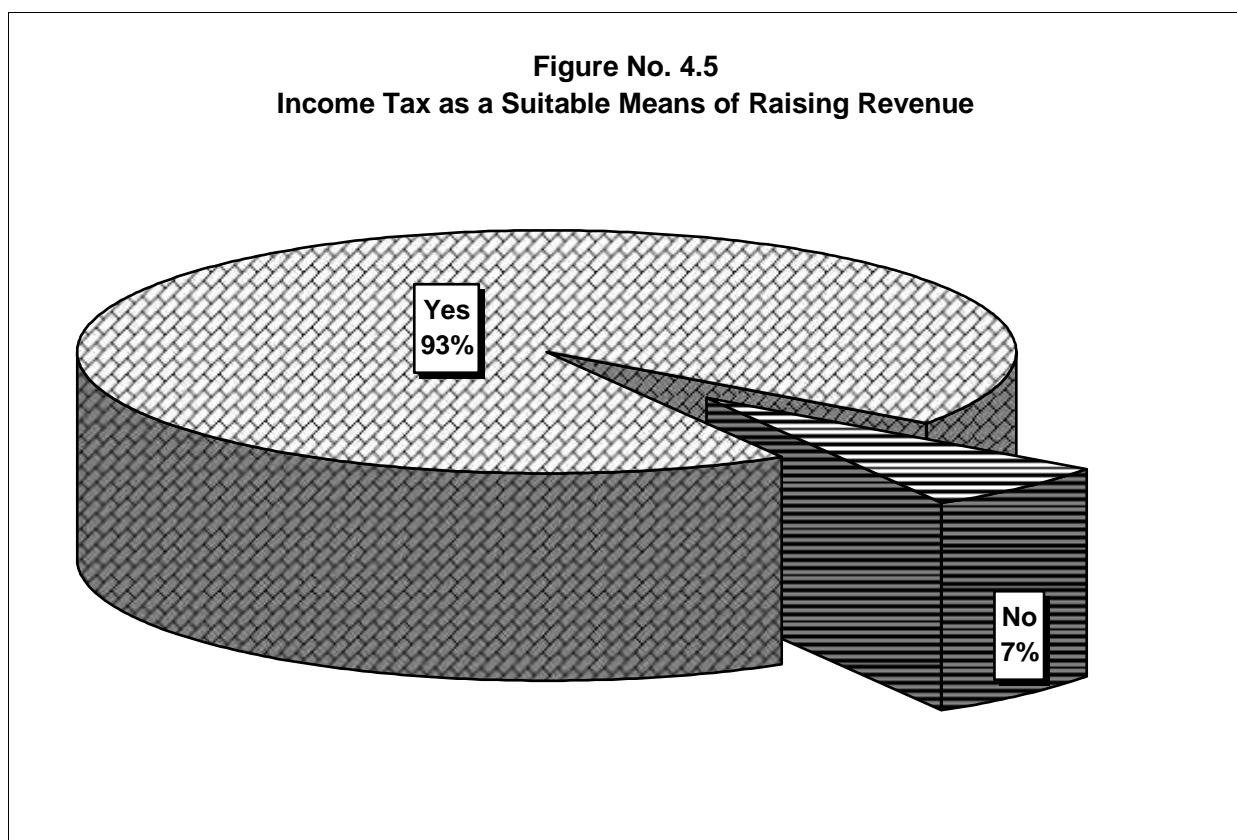
To know whether income tax as a suitable means of raising government revenue in Nepal, a question was asked “Do you consider that income tax is the suitable means of raising government revenue in Nepal?” The respondent’s responses are tabulated in the table 4.19 and figure 4.5.

Table 4.19

Income Tax as a suitable means of raising revenue

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	24	96	1	4	25	100
Tax Expert	24	96	1	4	25	100
Tax payer	22	88	3	12	25	100
Total	70	93.3	5	6.6	75	100

Source: Opinion Survey, 2010



Source: Table 4.19

From the opinion survey, it is found that 96 percent of tax administrators and tax experts and 88 percent of taxpayers recognize income Tax as a suitable means of raising government revenue. Only 4 percent tax administrators and tax expert and 12 percent tax payer does not recognize. In aggregate, 93.3 percent respondent recognized and 6.6 percent does not recognized income tax as a suitable means of raising government revenue in Nepal. Thus, it is concluded that income tax is a suitable means of raising government revenue in Nepal.

4.17 Need of Public Awareness Program

To know the respondents' view towards public awareness program the questions was put "Do you think that public awareness program is necessary in Nepal for raising the government revenue?" opinion result summarized in the table 4.20.

Table 4.20

Need of Public Awareness Program

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	25	100	-	-	25	100
Tax Expert	25	100	-	-	25	100
Tax payer	25	100	-	-	25	100
Total	75	100	-	-	75	100

Source: *Opinion Survey, 2010*

All of the samples of tax administration, tax experts and tax payer approved that public awareness program are necessary in Nepal for raising government revenue. Thus, it can be concluded that public awareness program is very much necessary for raising Nepalese government revenue.

4.18 Contribution of Income Tax Revenue:

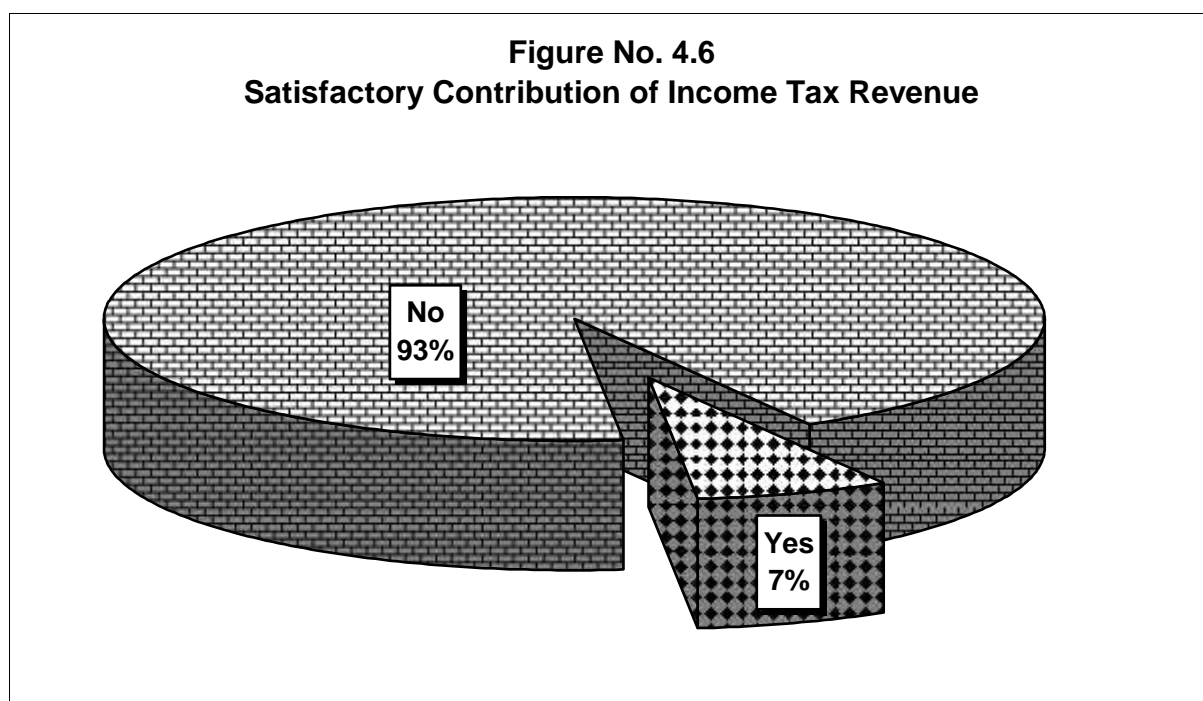
Income tax has contributed about 20 percent to public revenue in Nepal .it is blamed that contribution of income tax to national revenue is not satisfactory. To know the fact, the question was asked to respondent “In your opinion, is contribution of income tax to national revenue of Nepal satisfactory?” Opinion result is presented in the table 4.21 and figure no. 4.6.

Table 4.21

Satisfactory Contribution of Income Tax Revenue

Response	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	2	8	23	92	25	100
Tax Expert	3	12	22	88	25	100
Tax payer	-	-	25	100	25	100
Total	5	6.7	70	93.3	75	100

Source: Opinion Survey, 2010



Only 8 percent of tax administrators and 12 percent of taxpayers approve that income tax contribution to public revenue is satisfactory. But cent percent tax payers argue that contribution of income tax to national revenue in Nepal is unsatisfactory. In aggregate, 6.7 percent respondents argue that Nepalese income tax contribution is satisfactory.

Reasons for low contribution of Income Tax

In order to know the major reasons for lower contribution of income tax, next question was asked, “If no, what are the major reasons.” The respondents were requested to rank their choice from 1 to 5 according to preference.

Table 4.22

Reasons for Low Contribution of Income Tax to National Revenue

S. No.	Method	Total Points Received				Percentage	Rank
		Tax Administrator	Tax Expert	Tax Payer	Total		
1	Defective of Income Tax Act	90	73	99	262	24.95	4
2	Mass poverty and low income level	43	80	49	172	16.38	2
3	Increasing habit of tax evasion	45	34	77	156	14.86	1
4	Inefficient income tax administrator	99	52	42	193	18.38	3
5	Inappropriate rate and exemption limit	68	91	108	267	25.43	5
Total					1050	100	

Source: Opinion Survey, 2010

In table No. 4.22, Rank 1 is given to the lowest percentage and 5 to the highest. Here lowest percentage is obtained by the method which is regarded highly appropriate by the respondents. In the questionnaire, the respondents were

requested to give number 1 to the most appropriate of last to the least appropriate.

From the above table, the major reasons for low contribution of income tax to national revenue ranked in order of preference of the respondents are as follows:

1. Increasing habit of tax evasion
2. Mass poverty and low income level
3. Inefficient income tax administration
4. Defective income tax act
5. Inappropriate rate and exemption limit

4.19 Contribution of Direct Tax

Direct tax includes tax on poverty, tax on income, tax in interest and other taxes. The contribution of direct tax to nation revenue is about 21 percent in average.

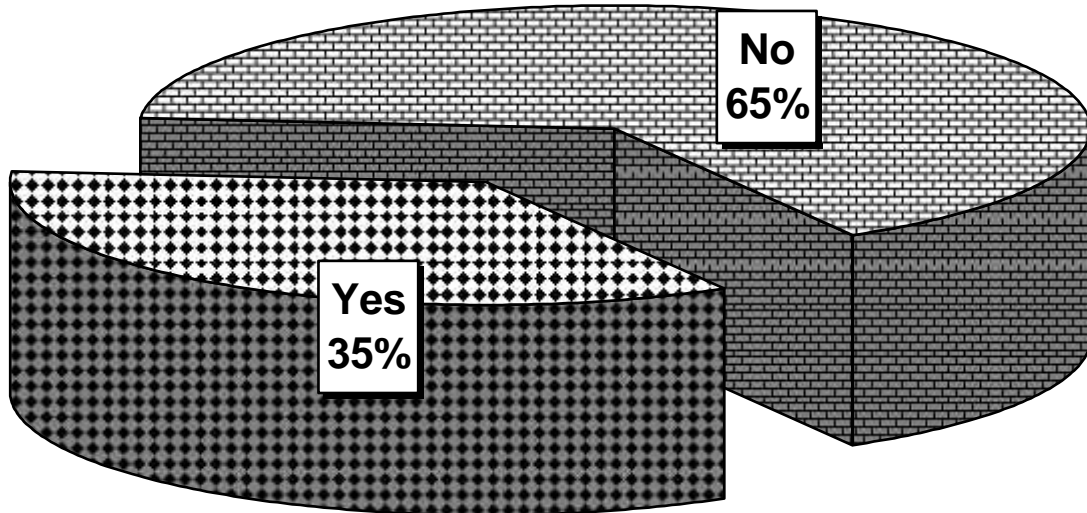
To know whether the contribution of direct tax to national revenue is effective or not, a question was asked, “DO you think that contribution of direct tax to total revenue is effective?” The responses are tabulated in Table 4.23:

Table 4.23
View Towards Effective Contribution of Direct Tax

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	6	24	19	76	25	100
Tax Expert	12	48	13	52	25	100
Tax payer	8	32	17	68	25	100
Total	26	34.6	49	65.3	75	100

Source: *Opinion Survey, 2010*

Figure No. 4.7
Views Towards Effective Contribution of Direct Tax



Source: Table 4.23

Only 24 percent of tax administrator 48 percent of tax expert and 32 percent of taxpayer recognized the contribution of direct tax to total revenue is effective. 65.3 percent respondent did not approve that contribution of direct tax to total revenue is effective. From this opinion, it can be concluded that the contribution of direct tax to total revenue is not effective.

4.20 Appropriateness of Exemption and Deduction

Adequate exemption and deduction is necessary to promote the business enterprises. Many exemption and deduction are provided by “Industrial Enterprises Act, 2049” and “Income Tax Act, 2058”. The question “Are exemption and deduction provided by Act appropriate?” was asked to find out the opinion of the respondent regarding the exemption and deduction. Opinion result is summarized in the table 4.24.

Table 4.24
Appropriateness of Exemption and Deduction

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	3	12	22	88	25	100
Tax Expert	5	20	20	80	25	100
Tax payer	2	8	23	92	25	100
Total	10	13.3	69	86.6	75	100

Source: Opinion Survey, 2010

Only 13.3 percent of respondent agree with present exemption and deduction. But large figure i.e., 86.6 percent respondents disagree with the present exemption and deduction.

4.21 Appropriate Method of Income Tax Assessment

Revenue collection from income tax also depends on the income tax assessment procedures. Therefore, assessment procedure should be appropriate and effective. A question, “Which income tax assessment method is more appropriate in Nepal?” was asked to know the respondents’ opinion about appropriate method of income tax assessment .The response is presented in the table 4.25 as below.

Table 4.25
Appropriate Method of Income Tax Assessment

S. No.	Methods	Tax Administrator	Tax Expert	Tax Payer	Total	Percent
1	Self Assessment	18	23	25	66	88
2	Jeopardy Assessment	-	2	-	2	2.6
3	Amended Assessment	7	-	-	7	9.3
	Total	25	25	25	75	

Source: Opinion Survey, 2010

88 percent respondents approved self-tax assessment method is more appropriate to assess income tax. 2.6 percent respondents are in favor of jeopardy assessment and 9.3 percent in favor of amended assessment. The respondent category that is most in favors of self-assessment is taxpayers. From the above opinion, it can be concluded that self-tax assessment method is more appropriate while assessing income tax to collect large amount of revenue through income tax. But during the survey, the opinion of one of the respondent was that, these are not mutually related. So they all are equally important.

4.22 Attitude toward Problems in Paying Income Tax

To know the problems facing by the taxpayers while paying income tax, the respondents were requested to rank their choice from 1 to 5 according to their preference. The question was, “In your thinking, what types of problems are facing by the tax payer while paying income tax.” Responses received from respondents are tabulated in the Table 4.26.

Table 4.26

Problems in Tax Paying

S. No.	Problems	Points Received				Percent	Rank
		Tax Administrator	Tax Expert	Tax Payer	Total		
1	Consuming unnecessary time	76	92	113	281	24.98	5
2	Expectation of illegal incentives by tax personnel	80	81	61	222	19.73	2
3	Vague provision in income tax laws	58	37	51	146	12.98	1
4	Lengthy process	70	88	94	252	22.50	4
5	Lack of cooperation by tax administrator	91	77	56	224	19.90	3
Total					1125	100.00	

Source: *Opinion Survey, 2010*

In table No. 4.26, Rank 1 is given to the lowest percentage and 5 to the highest. Here lowest percentage is obtained by the problem which is treated as the important problem by the respondents. In the questionnaire, the respondents were requested to give number 1 to the most appropriate of last to the least appropriate.

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

1. Vague provision in income tax laws
2. Expectations illegal incentives to the personnel
3. Lack of co-operation by tax administrator
4. Lengthy process
5. Consuming unnecessary time

4.23 Reasonableness of Existing Provision of Fines and Penalty

Fines and penalty also play significant role to reduce the tax evasion and illegal activities and make morality to the tax payer. To know the views of respondents about the fine and penalty, the respondents were requested to tick yes /no option . The question was, “Are the provisions of fines and penalty under the Nepalese tax system reasonable?” The opinion of respondents tabulated in the Table 4.27.

Table 4.27

Reasonableness of Existing Provision of Fines and Penalty

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	19	76	6	24	25	100
Tax Expert	18	72	7	28	25	100
Tax payer	4	16	21	84	25	100
Total	41	54.6	34	45.3	75	100

Source: Opinion Survey, 2010

54.6 percent respondents are in favor of present provisions of fines and penalty but 45.3 percent respondent is against the present provisions of fines and penalty. Out of totals taxpayer respondent, the highest 84 percent are against the present fine and penalty.

In order to know reasons of unreasonable fine and penalty provisions, the next question was asked, “If no, how should it be made reasonable?” Views of respondents are tabulated in the Table 4.28.

Table 4.28
Reasonable Fine and Penalty Rate

Respondents	By Increasing		By Decreasing		Total	
Tax Administrator	6	100	-	-	6	100
Tax Expert	7	100	-	-	7	100
Tax payer	4	19	17	81	21	100
Total	17	73	17	27	34	100

Source : Opinion Survey, 2010

73 percent of the respondents, who were against present fines and penalty, gave their view for increasing fine and penalty and 27 percent gave view in the favor of decreasing rate. The unsatisfied tax administrators and tax experts are totally in favors of increasing fines and penalty.

4.24 Soundness of Income Tax System in Nepal

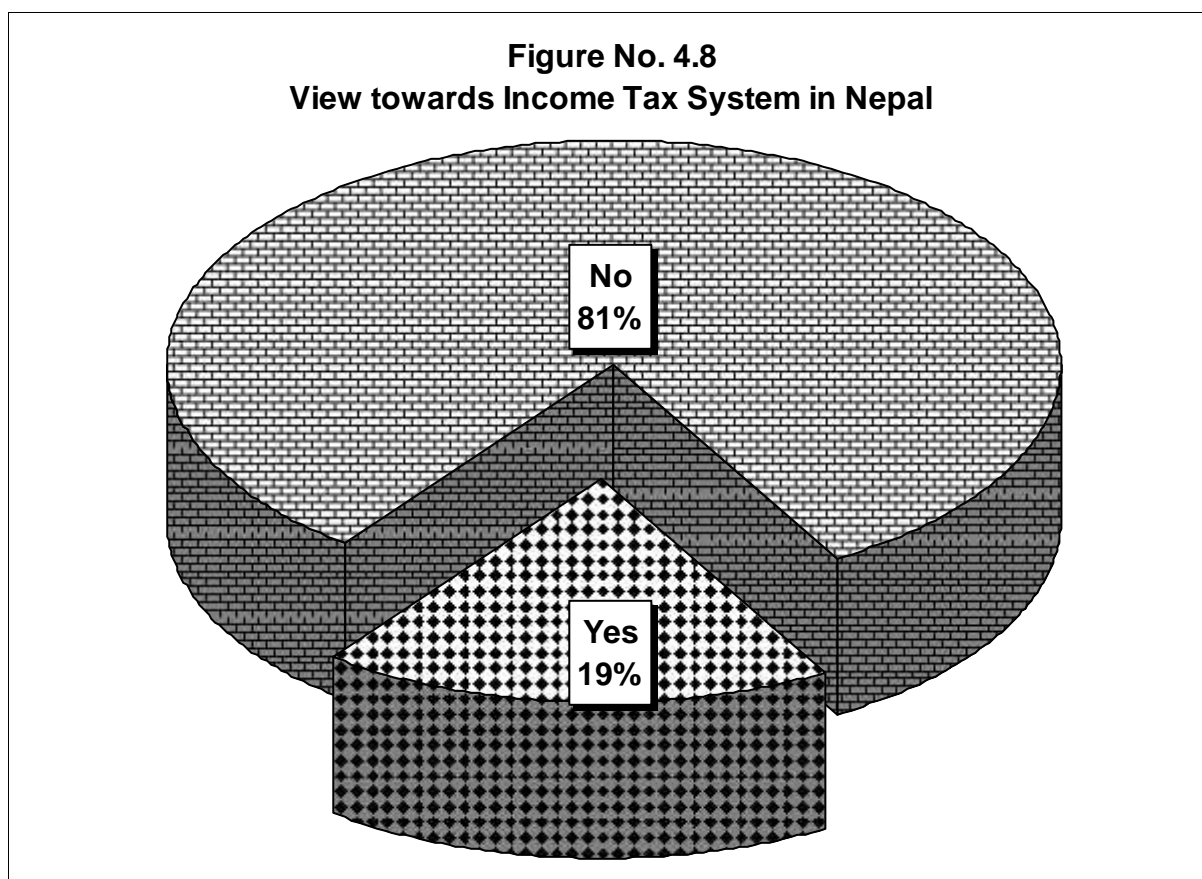
To know the respondents view regarding soundness and efficient of income tax system in Nepal, a question, “In your opinion is income tax system of Nepal sound and efficient?” was asked The responses are tabulated in the Table 4.29.

Table 4.29

Soundness of Income Tax System in Nepal

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	11	44	14	56	25	100
Tax Expert	3	12	22	88	25	100
Tax payer	-	-	25	100	25	100
Total	14	18.6	61	81.3	75	100

Source : *Opinion Survey, 2010*



Source: *Table 4.29*

81.3 percent respondent approve that income tax system of Nepal is not sound and efficient. Only 18.6 percent respondents approve soundness and efficient tax system of Nepal.

4.25 Effectiveness of Income Tax Administration

To know the respondents view regarding effectiveness of income tax administration in Nepal a question, “Do you agree that Nepalese income tax administration is effective?” was asked. The responses are tabulated in the table 4.30.

Table 4.30

Effectiveness of Income Tax administration in Nepal

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	17	68	8	32	25	100
Tax Expert	3	12	22	88	25	100
Tax payer	-	-	25	100	25	100
Total	20	26.6	55	73.3	75	100

Source: *Opinion Survey, 2010*

From the table 4.30 it has been clear that Nepalese income tax administration is not effective. Most of the respondents i.e. 73.3 percent of respondents recognize it ineffective. The high percentage of respondent who are in favors of Nepalese tax administration is the tax administrators themselves.

4.26 Suitable Tax Rate in Nepal

In order to find out the suitable income tax rate system in Nepal, respondents were requested to select any one among the three alternatives. The question was “In your opinion, which income tax rate is suitable for Nepal?” The responses are tabulated in the table 4.31.

Table 4.31

Suitable Tax Rate in Nepal

S. No.	Methods	Tax Administrator	Tax Expert	Tax Payer	Total	Percent
1	Progressive	20	25	15	60	80
2	Proportional	5	-	10	15	20
3	Regressive	-	-	-	-	-
	Total	25	25	25	75	

Source: *Opinion Survey, 2010*

From the table 4.31 it is clear that, 80 percent of respondents prefer progressive income tax rate in Nepal. So, it can be concluded that progressive tax rate is most suitable means of tax rate in Nepal.

4.27 Most important factors for effectiveness of Income Tax

The respondents were requested to rank their choice from 1 to 5 according to their preference to know the opinion of the respondents' view regarding to important factors for effectiveness of income tax in Nepal. A question, "In your opinion, what is the most important factor for effectiveness of income tax in Nepal to raise government revenue?" was asked. Responses are summarized in the table 4.32.

Table 4.32

Most important factors for effectiveness of Income Tax

S. No.	Factors	Points Received				Percent	Rank
		Tax Administrator	Tax Expert	Tax Payer	Total		
1	Clear Act, Rules and Regulations	79	70	90	239	21.24	4
2	Conscious and honest tax payers	31	65	55	151	13.42	1
3	Moral and honest tax officers	60	75	45	180	16.00	2
4	Effective tax administration	98	60	70	228	20.27	3
5	Political non interruption	107	105	115	327	29.10	5
Total					1125	100.00	

Source: *Opinion Survey, 2010*

In table no. 4.32, Rank 1 is given to the lowest percentage and 5 to the highest. Here lowest percentage is obtained by the factor which is regarded highly appropriate by the respondents. In the questionnaire, the respondents were requested to give number 1 to the most appropriate of last to the least appropriate.

The important factors for effectiveness of income tax in Nepal according to the preference of the respondents were as follows:

1. Conscious and honest tax payers
2. Moral and honest tax officers
3. Effective tax administration

4. Clear act, rules and regulation
5. Political non interruption

FINDINGS

FINDINGS FROM THE STUDY OF SECONDARY DATA

1. Taxes are the main source of revenue for many governments. The source of tax revenue and the relative contributions of these sources are determined by government policy, choices about where and how to impose taxes and by changes in the structure in the economy.
2. Income tax is a suitable source for collection of government revenue. It may enhance the revenue of the government, promote distribute justice and encourage private sector investment.
3. Nepalese government expenditure is increasing at the faster rate than the increase in revenue. Therefore, resource gap has existed in Nepalese economy and it is in increasing trend. Resource gap in the FY 2008/09 was Rs 11301.1 million, had extended from Rs.3235.4 million in FY 1994/95.
4. The Tax/GDP ratio of Nepal is very poor as it has not yet exceeded beyond 10 percent. This shows a disappointing picture of Nepalese economy.
5. The Tax-GDP ratio of Nepal is not found satisfactory compare to other developing countries. Tax-GDP ratio in FY 1994/95 was only 9.0 percent and has gradually increased and reached to 10.9 percent in FY 2008/09.
6. Nepalese Government revenue is the composition of tax revenue and non-tax revenue. There is dominant share of tax revenue in Nepalese government revenue. But contribution of tax revenue shows the decreasing trend as it had contributed by 79.9 percent in FY 1994/95 on the total but it was decreased to 84.55 percent in FY 2008/09.
7. Nepalese tax revenue is the composition of direct and indirect tax. There is dominant role of indirect tax revenue in Nepalese tax revenue. Average

contribution of direct and indirect tax revenue to total tax revenue is 29.3 percent and 70.7 percent over the study period.

8. Indirect tax revenue is the composition of custom duty, VAT and other taxes, and excise duty. The contribution of custom duty, VAT and excise duty to indirect tax were 44.4, 45.1 and 10.5 percent respectively in FY 1994/95 and were 42.9, 39.9 and 17.2 percent in FY 2008/09 respectively. Out of the various indirect taxes, the custom duty has occupied the first position and VAT has occupied second position and its contribution is in increasing trend.
9. Direct tax revenue is the composition of tax on property, profit and income and land revenue & registration. Contribution of tax on property, profit and income to direct tax was 75.64 percent in FY1994/95 and that for FY 2008/09 was 85.8 percent.
10. Nepalese income tax revenue is the composition of income tax from public enterprises, semi public enterprises, private corporate bodies, individuals, remuneration and tax on interest. Income tax of Rs.9245.9 million was collected in FY 2008/09. Share of individuals to income tax revenue is the highest.
11. Within income tax, there is dominant role of individuals and it is in decreasing trend, which was 45.8 percent of income tax revenue in FY 1994/95 but decreased to 38.22 percent of income tax revenue in FY 2008/09. The contribution of individual income tax is in first position.
12. Income tax is the important source of internal revenue of government. Contribution of income tax on direct tax revenue, tax revenue, total revenue and GDP were 73.35, 14.36, 11.49 and 1.29 percent respectively in FY 1994/95 and became to 77.61, 19.19, 14.83 and 1.87 percent in FY 2008/09 respectively.
13. Collection performance of income tax in Nepal is not so satisfactory. In FY 1994/95, total collection of income tax was Rs. 2823.5 million which was 86.61 percent of estimates. Income tax was collected 106.31 percent of estimates in the fiscal year FY 2008/09.

14. Income tax exemption limit in Nepal was Rs.7000 for all taxpayer in FY 1959/60 but at present income tax exemption limit is Rs. 160000 for individuals and Rs. 200000 for couple and family in FY 2008/09. The exemption limit is not provided for partnership firms, corporation and non-residents. It is found that exemption limit has been changed on the need of time and income.
15. Personal income tax rate was 5 to 50 percent with 7 slabs in FY 1980/81 but at present (i.e. for FY 2008/09) it is reduced to 3 slabs. In the same way, corporate tax rate was 10 to 55 percent with 8 slabs in FY 1980/81 but at present corporate taxpayers are taxed at flat rate. Income tax rate is 15 percent and 25 percent for personal income, 30 percent for bank, finance companies and 25 percent for other corporate taxpayers.
16. Increment in the number of taxpayers is very much essential in order to broaden the tax base. Number of registered income taxpayers in Nepal for the FY 2008/09 has reached 195498 while it was 166699 in the previous year.
17. If we consider the registration of returns of income for the FY 2008/09, it is in total 113202 out of which 56850 is brought down from the previous year and 56352 is submitted in this year.
18. Assessment of the returns of income is one of the important parts of income tax administration. Out of 125988 returns filed 4121 is made for assessment in the FY 2008/09 and 121867 is carried forward to the next year.
19. Taxpayers may not be satisfied with the assessment of the Inland Revenue Offices. So, they can make appeal against it. The number of appeal added in the FY 2008/09 is 331 whereas 2618 appeals are brought down from the last year. Out of these, 395 appeals are settled this year and 2554 appeals are carried forward for the next year.

FINDINGS FROM THE STUDY OF PRIMARY DATA

An opinion survey has been conducted in order to find out the role of income tax in Nepal and some other aspects of income tax. From the opinion survey with tax administrators, tax experts and taxpayers, the following findings have been drawn.

- i. Income tax is the suitable means of raising government revenue.
- ii. Public awareness program is necessary to increase tax consciousness and raising the government revenue.
- iii. Mass poverty and low income level, increasing habit of tax evasion, inefficient income tax administration etc are the major reasons for the Low contribution of income tax to national revenue.
- iv. Contribution of direct tax to total revenue is not effective.
- v. Exemption and deduction should be increased to promote the special industry and export.
- vi. To increase the voluntary compliance by taxpayer, self-assessment method is the appropriate method while assessing the income tax.
- vii. Lengthy process, vague provision in income tax laws, consuming unnecessary time etc are the major problems facing by the taxpayer while paying the tax.
- viii. The fines and penalty under the Nepalese tax system are not reasonable and it should be increase to discourage tax evader and illegal activities.
- ix. Income tax system of Nepal has not reached at the satisfactory level yet.
- x. The current income tax administration is not running satisfactorily and is not efficient.
- xi. Progressive income tax rate is considered as the suitable means of tax in Nepal.
- xii. Clear act, rules and regulation, effective tax administration are the most important instruments for effectiveness of income taxation in Nepal.

CHAPTER- FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

SUMMARY AND CONCLUSION

The Nepalese economy is quite dynamic with favorable economic indicators, viz., stable prices, strong balance of payments position and average annual economic growth of more than 4 percent during the decade of the 1990's. These descriptions, however, hide the fact that Nepal is in LDC with widespread poverty and a gross national per capita income of US\$ 473 in fiscal year 2008/09, with the country ranking 144 out of 182 countries in the United Nation Development Program's human development index. (NRB, 2006:1-2).

The government need huge amount to achieve the maximum objectives of nation. In developing countries like Nepal, lack of sufficient financial resource is the main constraint for the national economic development. Nepal has facing serious problem of resource gap and high dependency on foreign loan. Resource gap has been increasing at a faster rate than the increase in revenue. The resource gap is widening continuously with the increment of total expenditure in respect to total revenue collection. To solve such serious problem of deficit fiscal, income tax should play important role. But, resource mobilization in Nepal is still poor.

Developing countries such as Nepal utilize external borrowing as a technique to address the gap between the government revenue and investment as well as to meet the export-import gap. This kind of borrowing adds to the total resources available to the government over a given period and enables the government to incur higher expenditure than would be otherwise possible. These resources can contribute to poverty alleviation and economic growth if properly employed.

The government of Nepal introduced a formal tax for the first time in Nepal in 1959 (2017 B.S.) in the form of "Business Profits and Remuneration Tax." According to this

Act, incomes only from Business profits and remuneration were subjected to tax. At present, in Income Tax Act, 2002 which became effective since April 1st 2002, sources of Nepalese income are classified into Business income, investment income and employment income for the tax purpose. The percentage share of income tax to government revenue is not satisfactory in comparison to other developing countries like India, Pakistan, Bangladesh, and Sri Lanka etc. There are three major income tax assessment methods in the Nepal.

Currently, income tax revenue in Nepal is collected through four sector i.e. corporate income tax, individual income tax, house and land rent tax and interest tax. Among them, share of the individuals' income tax is the highest. Exemption limit and tax rate of the income tax is determined according to the income level and sector wise but is not adjusted according to the inflationary situation of the country and number of dependents. Exemption limit is not provided to the corporate bodies.

The success or effectiveness of income tax system entirely depends upon implementation of provisions, which is the major responsibility of income tax administration. Income tax system of Nepal has blamed as not efficient enough. Various problems existed in the income tax such as increasing habit of tax evasion, inefficient income tax administration, defective income tax law are the reasons of lower contribution of income tax. But if we analyze the data relating to it then we can find out that revenue collection from income tax is increasing continuously. Provisions in Act and language have to be made clear. Some reforms in income tax administration are needed to raise the income tax revenue.

Due to reform, the corruption in income tax administration can be decreased, the efficiency and transparency can be improved and the tax administrators will treat the taxpayers as a responsible citizen to a considerable extent. The cost of tax collection to taxpayer, government and economy as a whole can be reduced to some extent.

To revise the revenue-to-GDP ratio, Nepal Government is improving administration of VAT, simplifying the income tax law and implementing customs reforms and modernization programme. It also announced 3-percentage point increase in the VAT to 13 percent during the mid-term review of the FY 2008/09 budget.

The role of revenue is crucial for the overall development of the country. In this context, the Nepalese government needs to develop a sustainable broad based source of revenue. Since more than 80 percent of the total revenue is collected from the tax source, efficient tax system has to be developed and strengthened. In recent years, the government has taken several measures to reduce tax-induced distortions, strengthening tax administration, simplifying tax laws and procedures to make them more transparent. With an aim to broaden the tax base the government enacted new Income Tax Act in 2002. This Tax Act brought all sources of income - from employment, business and investment - under the tax net and helped maintain neutrality of taxation in various income generating activities. The Customs Act was amended to make the Nepalese system compatible with the WTO valuation system, broaden the tax base and mobilize additional revenues by curtailing wide range of exemptions. In 1997, the government introduced VAT aiming to develop it as the backbone of Nepalese Revenue.

RECOMMENDATIONS:

On the basis of this study, the following recommendations are made in order to increase the contribution of income tax on government revenue of Nepal.

1. Income tax policy should be formulated according to the economic policy of the country. Income tax policy should be revised timely.
2. Tax ratio should be increased gradually on long run basis to meet the deficit in budget. For this, the tax base should be widened.
3. The members involved in formulating income tax policies must have depth knowledge about income tax.
4. The provisions of rewards, prize, incentives should be introduced in the act to encourage the taxpayers to pay tax voluntarily rather through coercive measures.
5. Tax personnel should be encouraged, punished and transferred on the basis of their work and experience. Regular and effective training system; reward, prize

and punishment system should be established for the effective personnel management.

6. The provisions of fines, penalties and punishments should be made at higher rate for income tax evaders.
7. Income tax, rules and regulation should be clear and simple for all the taxpayers as well as for tax administrators.
8. The definition made in Income Tax Act should be further clarified and well defined in simple language.
9. Clear provisions should be made in case of deduction. All the items of deductions should be clearly defined in the act.
10. To promote export, more deduction should be provided.
11. A research and intelligence center should be established in each tax office for proper planning and to collect the information in regard to income tax evaders, potential new taxpayers and non-residents who have conducted business without registration.
12. Separate income tax Department should be established so that the specialization could be achieved in matter of income tax.
13. Effectiveness of income tax system depends upon the income tax administration. In Nepal, one of the most important reasons for unsound income tax system is inefficient and unscientific income tax administration. Following recommendations are made for improvement of income tax administration.
 - ❖ Delays in assessment should be reduced as possible.
 - ❖ Computerized information system is necessary to keep up to date records of income tax.
 - ❖ Proper tax education should be provided to tax officials as well as tax inspectors and taxpayers regularly.
 - ❖ Unnecessary outside pressure should be avoided.

- ❖ Income tax experts/profession should be increased in tax administration.
14. The administration should pay great attention to bring the income from house and land rent; doctor's clinic; consultancy service; tuition; research works into income tax net. In these sectors, income tax has been highly evaded.
 15. With a large and growing population of taxpayers it is simply not possible to check the returns filed by every assessee. It is better to proceed on the basis of "self-assessment", subject to random checks. Every taxpayer should be under a credible threat of getting caught for any misstatement.
 16. The habit in business sector of not keeping the complete accounts of the transactions or not submitting the real account for tax assessment must be abolished.
 17. There must be coordination between the departments of tax.
 18. There must be good faith between the taxpayers and the tax collectors.
 19. Effective public participation is necessary to minimize the income tax evasion. Tax authority should do continuous effort in order to develop the taxpayers' positive attitude towards taxation.
 20. There must be partnership between the government and the private sector leadership like FNCCI, CNI etc. in respect of making the taxpayers aware of the taxation.
 21. There are insufficient numbers of tax offices within and outside the Kathmandu valley. Therefore the numbers must be increased to provide the services conveniently.

There has been the problem of collection of income tax revenue from a long time in Nepal. The problem can be minimized and income tax will follow a substantial increment in revenue structure of Nepal if the above-mentioned recommendations are managed timely and effectively.

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