INCOME TAX SYSTEM IN NEPAL AND ITS CONTRIBUTION TO REVENUE COLLECTION

A PROJECT WORK

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RECOMMENDATION

This is to certify that the project work

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INCOME TAX SYSTEM IN NEPAL AND ITS CONTRIBUTION TO REVENUE COLLECTION

has been prepared as approved by this Department in the prescribed format of Faculty of Management. This project work is forwarded for examination.

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DECLARATION

I hereby declare that the work reported in this Project entitled, **"Income Tax System in Nepal and its Contribution to Revenue Collection"** has submitted to Faculty of Management, Tribhuvan University is my Original work. It is done in the form of partial fulfillment for the Master of Business Studies (M.B.S) under the supervision and guidance of Prof. Dr. Bihari Binod Pokharel, Head of Research Department, Nepal Commerce Campus

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ABBREVIATION

A.D.	=	Anno Domini
B.S.	=	Bikram Sambat
CBS	=	Central Bureau of Statistics
CITR	=	Corporate Income Tax Revenue
DT	=	Direct Tax
DTR	=	Direct Tax Revenue
Fig.	=	Figure
FNCCI	=	`Federation of Nepal Chamber of Commerce and Industries
FY	=	Fiscal Year

GDP	=	Gross Domestic Product
Govt.	=	Government
i.e.	=	That is
IDT	=	Indirect Tax
IRD	=	Inland Revenue Department
ITA	=	Income Tax Act
Ltd.	=	Limited
MOF	=	Ministry of Finance
No.	=	Number
NRB	=	Nepal Rastra Bank
PAN	=	Permanent Account Number
Pvt.	=	Private
R & D	=	Research and Development
Rs.	=	Rupees
Sec.	=	Section
S.N.	=	Serial Number
T.U.	=	Tribhuvan University
VAT	=	Value Added Tax
W.T.O.	=	World Trade Organization

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CHAPTER- I
INTRODUCTION

1.1 General Background

As Kautilya says “The launching of all programmes depends first and foremost on the treasury”, so every state needs resources. Whether to pay salary to the government employers or to do the developmental works, it needs huge amount of money called revenue.

The government of a country requires sufficient revenue to carry out development plans to handle day to day administration, to maintain peace and security and to launch various public welfare activities. The government revenue comes from different sources like tax revenues from public enterprises, special assessment, fees, fines, grants. Among them, tax is the main source of government revenue. Custom, excise duty, sales tax, value added tax, income tax are the examples of the sources of tax revenue. Government passes the acts for getting tax revenues and collects the taxes as per the act.

Nepal has a predominantly agriculture base economy. The major portion of population of Nepal is in village area and most of them live below the poverty line. Wide spread poverty, rapid population growth, low income level, extreme disparity in the distribution of wealth and income, heavy dependence on agriculture, lack of industrialization, lack of needed saving and capital, dependence on foreign aid, unemployment, unexploited resources, lack of infrastructure, adverse balance are the main characteristics of Nepalese economy and it shows poor performance of economy.

Now days, the prime concern of every country is rapid economic development and Nepal is no exception to this ever continuing process, aimed at the betterment of its people. Capital plays a vital role in the rapid economic development programme to solve the various socio-economic problems.

The constitution of Nepal has clearly directed Nepalese government for a self reliant economic system, encouragement to national enterprises, prevention of economic exploitation as well as upgrading the standard of the people. For self reliant economic system and sound infrastructure for the development, the government should generate sufficient generate sufficient government revenue. Government revenue is the most important source of financing government expenditure. To achieve the national objectives, the government is required to make and implement various policies and planning, acts and procedure. Besides these functions revenue mobilization is one of the most important functions of the government. (Bhattarai, 1997)

The income of the government is called public or government revenue. Government revenue constitutes internal and external sources. Internal sources constitutes tax and non- tax revenue. Taxation is regarded as an effective instrument to monitor various economic activities in a country. The major objective of taxation is to make fund available for the economic development and economic stability. For the economic development of the country internal resource mobilization is much better than external resource mobilization because internal source are safer than external. It is better for developing countries to maximize the mobilization of domestic resources. Heavy dependence on foreign assistance and loan to strengthen the revenue structure is not favorable sign for developing countries. (Pant & Pant, 1999)

The dependency on foreign assistance or loan can be minimized if the country can maximize the mobilization of the domestic resources. There are lots of ways to strengthen the economy of the country by properly mobilizing the internal resources. Taxation may be very useful and major internal sources for government revenue as it is considered as safest means of capital formation.

The effectiveness of any government depends on the willingness of the people governed to surrender or exchange a measure of control over their person and property in return for protection and other services. Taxation is one form of this exchange. (Encyclopedia, 1971)

In the context of developing countries like Nepal, the prospect of mobilizing resources other than taxation has not been so encouraging. Taxation not only contributes in capital formation but also in equal distribution of national income of the country. It helps to reduce extreme disparity in the distribution of wealth and income.

Tax is, in simple terminology, a liability to pay an amount to the government. It is a compulsory contribution to the national revenue from the taxpayers according to law.

Prof. Seligman defined tax as a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit 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.

Tax can be classified into two categories Direct tax and Indirect tax. A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is the same. Examples of direct taxes are Income Tax, Property Tax, Vehicle Tax, Interest Tax.

An indirect tax is a tax imposed on one person but partly or wholly paid by another. In indirect tax, the person paying and bearing the tax is different. Examples of indirect taxes are Value Added Tax, Excise Duty, Import and Export Duty.

Revenue collection from income tax is one of the major parts of taxation. Income tax is a direct tax, which enjoys a major place in the revenues of government all over the world. It is a tax levied by the government on the income of individuals and business firms. (Prasad, 1999)

1.2 Statement of Problem

Nepal is one of the least developed countries among the developing countries in the world. It is facing serious financial problem from the beginning of its development process.

Despite the various measures adopted by the government to boost revenue collections, there is still a substantial resource gap between expenditure and revenue. Resource constraint is appearing as a limiting factor from the beginning of development phase to present time due to increasing resource gap. Even if foreign aids are also taken into consideration the resource gap is not negligible.

There is improper internal resources mobilization, heavy foreign aid dependence, low aid absorptive capacity and misutilization of available resources in Nepal. There are not adequate internal financial resources to spend and invest on economic development activities of the country. Even after the introduction of various taxes after the advent of the democracy in Nepal in 1951 to create internal resources for economic development, the first five year economic plan (1956-1961) was implemented under cent percent foreign assistance. Considering this background, the main problem of Nepal is the lack of creation and mobilization of internal financial resources. (Guru Gharana, 1995)

The development of the country will be possible only when the government can collect its own internal revenue which constitutes tax and non tax revenue. Tax revenue constitutes a significant portion in government revenue. Of the total revenue collected in fiscal year 2006/07, tax revenue and non tax revenue account for 79.45 percent and 20.55 percent respectively. In fiscal year 2005/06, their contribution was 77.2 percent and 22.8 percent respectively. (Economic Survey, 2008)

Government has adopted various policies to strengthen the revenue structure of Nepal. Broad tax base is necessary to enhance the government revenue and for this purpose income tax revenue is most reliable among the different sources of revenue.

There is low collection of income tax even after the implementation of self tax assessment system, and higher tendency of income tax evasion. The revenue administration is not effective in Nepal. There is no willingness to pay tax on the part of the taxpayers of the country. Frequent changes in tax rates and in policies would not be favorable to strengthen the revenue mobilization and economic development and this fact is to be taken into consideration by the government of Nepal. (Auditor General’s Report 2053/54, Nepal, 12)

In developed countries income tax revenue is very important and it contributes more than 40 to 50 percent of total revenue of government but in developing countries income tax contributes low per capita. In Nepal, the contribution of income tax to total revenue is only 18.2 percent in the fiscal year 2006/07.

Although the trend of income tax revenue has displayed a healthy growth rate in the more recent years it still does not constitute a significant percentage of the country's gross domestic product (GDP). In fiscal year 2006/07 total contribution of government revenue to GDP is 11.2 percent; however the contribution of income tax to total government revenue is only 18.2 percent in the same fiscal year. Above figure clarifies a very little contribution of income tax to GDP. There are many problems in Nepalese income tax collection system. The causes of low coverage of income tax in government revenue are low per capita income of the Nepalese people, inefficient income tax administrative system, Lack of consciousness about income tax in part of public, widespread income tax evasion. (Economic Survey, July 2008).

As the investments and expenditures of the country on economic activities are increasingly yearly, the internal resources mobilization is not increasing at the same ratio which is not a good sign for national economy and it causes heavy burden of foreign loans and assistance and the country is suffering from mass poverty.

A good tax system should be structured so that it can be administered effectively and economically. Taxes that are costly or difficult to administer divert resources o non productive uses and diminish confidence in both levy and the government. (Encyclopedia)

If the government had been effective in its revenue collection by income tax and other internal resources, the amount of foreign loan would have been increased less rapidly. So, in order to create the huge internal resources, the revenue administration of the country must be systematic and the people of the country must have knowledge of income tax rules and regulations and willingness to pay income tax. Only after that, the prospect of revenue collection from income tax will be higher for internal resource mobilization.

Therefore, for the government of Nepal it is better to depend on its own revenue than foreign assistance. Among the various sources of government revenue, income tax revenue can play a significant role if the problems of Nepalese income tax collection system can be improved. The study deals with the following issues:

1. Is income tax system in Nepal effective?
2. What is the contribution made by of income tax in national revenue?
3. What are the problems and challenges of revenue collection from income tax?

1.3 Objectives of the Study

The specific objectives of the study are as follows:

1. To analyze the effectiveness of Income Tax System in Nepal.
2. To evaluate the contribution of Income Tax in National Revenue.
3. To examine the problems and challenges of revenue collection from income tax.

1.4 Scope of the Study

Present study will attempt to cover the major constituents of income tax collection system in Nepal as a major source of direct tax revenue. It aims to find out the major problems in revenue collection system of income tax in Nepal and prospect for its effectiveness. The major areas of this study are as follows:

1. Structure of government revenue in Nepal.
2. Contribution of income tax to government revenue and GDP.
3. Administrative aspects of income tax in Nepal.
4. Income tax assessment procedures in Nepal.
5. Existing position of income tax in Nepal.
6. Tax laws and procedures, income tax rate, exemption limit in income tax.

1.5 Limitations of the Study

There are some limitations in this study which are as follows:

1. The extent of this study is based on the availability of reliable data and sufficient literature.
2. Data used in this study is secondary data.

3. Limited time to collect data.
4. This study is confined to Nepalese laws, acts, rules and regulations to the income tax.

1.6 Organization of the Study

The report will be presented in three chapters, Introduction, Data Presentation and Analysis, Conclusion and Recommendations.

1.7 Research Methodology

This chapter is concerned with detail discussion of the methodology used in this study by covering the procedure of getting research problems answers as per the objectives. There are four parts as Research Design, Nature and source of data, Data collection procedure and Data processing and Analysis procedures.

1.7.1 Research Design

This study includes three types of research as descriptive and analytical. The study of income tax act, the role of income tax, indirect tax and direct tax in total tax revenue are 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. It is mainly done through the secondary source of data. In this way, research design of this research is descriptive and analytical.

1.7.2 Nature and Source of Data

Necessary data and information to describe this study has been collected from secondary sources.

1. Budget speech of various years, Ministry of Finance, Government of Nepal.
2. Economic survey of various years, Ministry of Finance, Government of Nepal.
3. Books related to income tax and public finance.
4. Dissertation related to income tax.
5. National and international news papers, journals and news magazines.
6. Official website of Inland Revenue Department: www.ird.gov.np

7. Official website of Ministry of Finance: www.mof.gov.np
8. Reports and records of Inland Revenue Department,
9. Other relevant records and data.

1.7.3 Data and Information Collection Procedure

Data and information used in this study is collected from secondary sources. The numerical data or secondary data are collected from the annual reports of IRD/N (Inland Revenue Dept, Nepal) economic survey of ministry of finance, publication of CEDA/TU, budget speeches.

1.7.4 Data Processing and Analysis Procedures

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, diagrams, Table time series analysis, have been applied in the way of analysis so that the findings could be presented and interpreted precisely and properly in order.

1.8 Review of Literature

1.8.1 Conceptual Framework

Different persons have defined taxation in different ways. In this respect, it would be better to take the definition given by 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 references 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 taxpayer does not have any right to receive direct benefit from the tax paid. Due to this compulsory nature, people have expressed different views in satirical ways about the taxation. 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 payments without having direct benefit to the payer 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. A tax is not a price paid by one, for which he can claim 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 as 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. The basis for the payment is that the assesses 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.

Taxation has been a very essential element of a government from the very beginning of the state system. However, the main objective of taxation has been different for different epochs. In ancient times, the major objective of taxation was strengthening the muscle of the state by providing resources. Till to the time of Adam smith, the chief motive of collecting the revenue was to provide resources to the government for providing security to an individual and society against violence, invasion, and injustice and maintaining public institutions.

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

a. To increase the revenue for a welfare state.
b. To have equitable distribution of income and property.
c. To increase the production of particular goods.
d. To increase the employment, saving and investment.
e. To minimize regional disparity.

f. To implement government policy, and
g. To control the production of certain goods.

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

1.8.1.1 Concept and Meaning of Income Tax

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

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

$y = c + s$

Where,

y = income

c = consumption

s = saving

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

1. Agriculture
2. Industry, Business, Profession or vocation.
3. Remuneration
4. House and land rent.

5. Other sources.

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

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

1.8.1.2 Income Tax in Modern Nepal

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

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

To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend and integrate the laws relating to income tax, the parliament of Nepal enacted Income Tax Act, 2002 (2058), since first April 2002. (19th chaitra, 2058).

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

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

The main objectives of ITA, 2058 are presented below:

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

The key Features of Income Tax Act, 2058 are:

1. All income tax related matters are confined within the act by abolishing all tax related concessions, rebates and exemption provided by different acts.
2. The act has broadened the tax base. Unlike previous tax act, tax rates are spelled out in the act. The tax rates and concessions are harmonized on equity ground.
3. The act has introduced a pool system of charging depreciation. Intangible assets are also depreciated.
4. The act has firstly introduced taxation on capital gains.
5. The act has provided liberal set-off and carry forward/backward provisions and inter head adjustments of losses are Cleary specified.
6. The act has provided a stringent fine and penalty for the defaulters.
7. The act has introduced a provision for administrative reviews to allow the tax administration to correct mistakes made by tax administration internally.
8. Global income of a resident are made taxable. Non-resident are also taxed on their income with source in Nepal.
9. List of expenses is inclusive. All expenses relating to income have been made admissible.
10. The act has made provision of international taxation. Foreign tax credit has been introduced for the first time.
11. The act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities (Bhattarai and Koirala, 2061).

1.8.1.3 Legal Provisions of Income Taxation in Nepal

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 in 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 of labor. 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).

In the Lichhavis regime, income taxes from agriculture income and business were introduced as a direct tax for the first time in Nepal. Tax on agriculture income was called 'Bhaga' and tax an business was called "Kara". Irrigation tax and religious monuments preservation taxes also existed at the time of king Ansubarma of Nepal. During the period of 1768-1846 A.D., different types of taxes were levied to generate maximum revenue. The major sources of revenue were : Birta and Kipat, taxes an land, monopoles 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 an occupations and economic activities, not in income or property. There was no taxation of income in the modern sense of income tax.

During the period of Rana regime, there was not formal provision for imposition and collection of taxes. Taxes were imposed according to the objectives, needs and whims of the ruling 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 as the personal income of the Rana prime minister.

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

There was no direct tax in the country except land tax collected 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 the country in 1951, no taxes are levied and collected in Nepal except in accordance with law.

1.8.1.4 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.

1. Income from a business (Section 7)
2. Income from employment (Section 8)
3. Income from 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.

1.8.1.5 Corporate Tax and its Development in Nepal

Concept of Corporate Tax

A corporate body or company is an artificial person created by law. A company is a legal person just as much as individual. It is separate and distinct from its individual members. A company like a natural person can do everything. It can conduct a lawful business and enter into contracts with others in its own name. A company or corporate body is legal organization that is voluntarily created, organized or chartered under law. It is artificial people which can own property execute contracts, raise debts and generate profits. Corporate tax, therefore, is a tax. Levied on companies or corporate bodies in contrast to unincorporated enterprise. It is the tax on capital income that occurs in the form of profit and originates in the corporate sector i.e. company. The history of tax was started from 1909 in USA when 1percentage excise was levied on corporation i.e. companies in the ground of the privilege they enjoy. Since then, corporate tax is contributing a substantial amount of revenue to the state treasury of the most of the developed and developing countries. The statutory rate percent, however, was very low in initial period, increased vehemently later on after First World War and again started to be sown turned since 1980's (Kandel, 2000).

Development of Corporate Tax in Nepal

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

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

Nepal originally combined corporate income tax with individual income tax. The same rate structure was designed for corporate income and other income for many years. In 1986/87, a flat rate corporate tax was introduced for government corporations and public limited corporations listed with security exchange center. Corporate tax was extended to private limited companies in 1993/94 and partnership firms in 1995/96 (Khadka, 1997)

After enactment of Income Tax Act 2002, the corporate tax levied upon general industries is 25 percentages, 30 percentages for insurance company and financial institutions. Trading companies are levied tax at the rate at 25 percentages, manufacturing industry at 20 percentage and specials Sector Company at 20 percentages. Export profit was taxed at a level of 8 percentage or 0.5 percentage of sales as per finance Act, 2057 was changed by the fiscal Act, 2058 has recommend, export profit from industry sector and trading sector are taxed at 20 percentage and 25 percentage respectively.

Corporate Tax Base in Nepal

There are controversies as regards to the choosing of corporate tax base since there may be various bases of taxation. For instance, these bases may be income, cash flow, turnover, total assets and added value. Among there, two base income and cash flow are mostly considered by the tax expert (Kandel, 2005)

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

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

If income is taken as the base of taxation, it is called income basis or net profit basis. It means deduction of interest on debt and depreciation of fixed assets from gross profit and adjustment of capital gain, stock appreciation or depreciation. Since, calculating tax base is adding up all the incomes of the company and deducting expenses incurred in earning the income.

However, because of its cumbersomeness in finding out taxable income, modern tax experts are in favor of replacing it. The main causes of cumbersomeness are treatment of revenue and expenses on accrual basis, treatment of depreciation under historical cost, measurement of capital gain and effect of inflation either interest or valuation of stock. The cash flow tax, on the other hand, is the alternative, considered by economists and tax experts to replace income based taxation. (Kandel, 2000)

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

1.8.2 Review of Related Study

1.8.2.1 Review of Thesis

Serchan (2003) had covered tax structure, role of income tax and legal provision of income tax in his thesis. Serchan had specially focused on provision of fines and penalties of income tax Act. He found the dominating role of tax revenue to the total government revenue. Income tax had occupied third position during his study period and it was in increasing trend. The tax/GPP ratio was not found satisfactory. There was dominating role of corporate income tax but it was in decreasing trend and contribution of individual income tax was in second position with increasing trend.

He had recommended measures for revising the provision of fees and penalties, introduction of reward, prize to the tax payer, clear act, rules and regulation regarding Income tax, timely revision of income tax policy, and computerized system for payment of income tax. This study was done with the objective of analyzing tax structure of Nepal, analyzing the provision of fines and penalties under income tax law, Awareness of taxpayer towards fines and penalties.

Paudel (2006), conducted a research entitled “Role of Income Tax in National Revenue of Nepal” in order to fulfill partial requirement of Masters of Public Administration (MPA). The major objectives of his study were to study role of income tax in revenue of Nepal, evaluate prevailing income tax system, and examine issues relating to income tax. The major findings of study were as follows:

●There was dominant contribution of tax revenue over non tax revenue to the total revenue of Nepal. Contribution of tax revenue was in increasing trend.

●The Tax- GDP ratio of Nepal was not found satisfactory compare to other developing countries.

●Nepalese income tax system is facing problems during tax collection such as: lengthy assessment process, lack of sufficient incentives to employees, inadequate power to income tax administrators, and lack of experts in the tax management, more tax evasion.

●Tax payers were facing problems while paying tax because of misconduct of tax personnel, administrative harassment and complex tax laws and rules.

● Reforming and controlling present taxation system, controlling open boarder with India, preventing illegal business, making effective administration, increasing tax coverage can contribute positively to the present tax system of Nepal.

Pokhrel (2007), in his thesis “Contribution of Income Tax on Tax Structure of Nepal” has conducted an empirical investigation. According to his investigation, income tax is a suitable means of raising government and tax education is necessary in Nepal for which 91.67 percentage and 98.33 percentage respondents have supported respectively. He found that inefficient tax administration, tax evasion and inappropriate objectives of income tax were the main causes of low collection of income tax in Nepal. Self assessment method of assessing income tax is most appropriate in Nepal. 70 percentages of the respondents were in favor of fees, fines and penalties whereas remaining 30 percentages were against it. The recommended measures of the respondents are effective tax management, training and development programs to tax personnel, development of check and balance system can bring efficiency in income tax system in Nepal.

1.8.3 Review of Books

Agrawal (1980) had written a book entitled "Resource Mobilization in Nepal" Published by CEDA. The books had been divided into eight chapters; the first chapter deals with special reference to Nepal. The second chapter deals with fiscal policies in developing nation and Nepal and third chapter looks at income tax in Nepal from the historical perspective, the fourth chapter deals with structure of Nepalese taxation. In this chapter, writer had concluded the predominant role of indirect taxes in Nepalese tax structure. More than 60percentage of tax revenue was derived from foreign trade alone. However, the role of income tax had been increasing since 1974/75.

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

Aryal and Poudel (2004) had written a book entitled, "Taxation in Nepal". They had explained about the income tax system in Nepal along with house and land tax and value added tax. This book has been designed on the basis of the curriculum of B.B.S. It has been divided into three parts. In the first part of the book introduction and development of income tax, capital and revenue nature expenses and income items, entity and retirements saving, dividend tax, computation of income from business, remuneration and investment have been explained in the second and third part respectively. The book also included proper bibliography and adequate appendix where various income tax, house and land rent and VAT related forms, schedules and format had been described. Lastly, he had recommended mobilizing additional domestic resources through taxation, redesigning the tax structure in order to increase the role of direct tax and reformation of income tax in Nepal.

1.8.4 Review of Research Reports and Articles

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

Pant (2004) explained about the problems and their remedies related with tax revenue and major types of practical problems and challenges, in tax administration. He had highlighted on the major problems like showing limited amount of transaction at low selling price, low practice of issuing and taking bills, Hiding the real factory cost, Commercial fraud, lack of co-operation in tax auditing, legal ambiguity and complexity in implementation and lock of co-operation between Inland Revenue Department and Revenue Investigation unit. Meanwhile, he had recommended some valuable suggestions to solve the problems and to overcome the challenges. Such as managing statistical and information system, Using of fixed norms and standards for assessing selling price and factory costs, compulsory use of billing system, proper co-ordination of Inland Revenue office with various entities of HMG, Revenue Investigation Department and its related units.

Kandel (2004) had written an article entitled, "Are Tax Incentives Useful? If so, which one?" Published in journal of Finance and Development, 'Rajaswa', Volume. 1, 2004, April. In that article, he had tried to seek the answer from the survey of various empirical studies done in Nepal, India, Pakistan and Other western countries. He found that the tax incentives are still the controversial matter whether they promote the investments or not but he argued that most of the developing countries need tax incentives. The empirical study concluded that among different types of tax incentives, investment allowance or investment tax credit and accelerated depreciation is superior to other types of tax incentives. Tax holiday is the most inferior type of tax incentive which causes revenue loss without enhancing the investment environment. Meanwhile, most of the researchers have opposed the tax holiday system both within Nepal and outside Nepal.

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

The Institute of Chartered Accountants of Nepal (ICAN) published a monthly journal on December 2005. Sinha presented an article named “Taxation-legal illegality”? He had described the taxpayer have been encouraged by the tax officials themselves to go courts over the complaints of their wrong doing because the authority is totally convinced that no immediately solution can be expected from the court of tribunal on short-span of time as long as they are in position. The Tribunal court reviews the decision of Inland Revenue department’s director.

In 2005, The Kantipur daily published news about Income tax and VAT. The news presented the terms used in Income tax and VAT which is not clear. There is not friendly business environment between taxpayers and government. Similarly, the vocabularies used in tax act are very ambiguous and difficult.

In 2007, Mr. Neupane has published an article in economic bulletin ‘Rajaswa’, which shows the contribution of income tax to total tax revenue, has decreased from 23.93percentage to 20.83percentage in the FY056/057 to 061/62. It may be due to the collection of the property tax by municipalities. But it is not only the cause; emphasis should be given to the income tax collection. To facilitate tax collection, Inland Revenue Department has implemented e-tds, e-pan, and e-filing for the better tax compliance. There is provision of tax plate also. But the frequent change in the act decreases tax compliance which is a major drawback of instable political condition.

In 2007, The Kantipur daily has published news about tax paying behaviors in Nepal and European countries. The news presented that 95percentage of taxpayer in European countries were willing to pay tax but in Nepal 95percentage taxpayer want to hide the income and they did not pay tax as per rules and regulation.

CHAPTER II
PRESENTATION AND ANALYSIS OF DATA

2.1 Tax Structure of Nepal

Modern economic planning of Nepal had started with the initiation of first economic planning in 1956. Since then, taxes have been used for the achievement of national economic goals. So, taxes play vital role to the economic development of Nepal. Tax structure of any country comprises both direct and indirect taxes.

2.1.1 Composition of Total Revenue

Total Revenue of Nepal is composed of both tax and non-tax revenue since the presentation of first national budget in 1951/52 by HMG.

Table 4.1 shows the composition of total revenue of government, which includes tax and non-tax revenue from FY 2000/01 to 2007/08. It seems that the share of tax revenue has always been greater than the share of non-tax revenue. In FY 2000/01 share of tax and non-tax revenue is 77.19 percentages and 22.81 percentages respectively, however it is 79.45 percentage and 20.55 percentage in FY 2007/08. It indicates that tax revenue plays the significant role in financing government expenditure. Tax revenue has been placed as a major source of government revenue in Nepal.

Table 2.1 presents the composition of revenue from fiscal year 2000/01 to 2007/08

Table 2.1
Composition of Total Revenue

(Rs. in Million)

Fiscal Year	Total Revenue	Tax Revenue	Percentage of Tax Revenue	Non-Tax Revenue	Percentage of NTR on TR
2000/01	37251	28752.90	77.19	8498.10	22.81
2001/02	42893.70	33152.10	77.29	9741.60	22.71
2002/03	48893.90	38865.10	79.49	10028.80	20.51
2003/04	50445.60	39330.60	77.97	11115	22.03
2004/05	56229.70	42587	75.74	13642.70	24.26
2005/06	62331	48173	77.29	14158	22.71
2006/07	70122.70	54104.70	77.16	16018	22.84
2007/08	72282.10	57430.40	79.45	14851.70	20.55

Source: Economic Survey

The table 2.1 reflects the increasing trend of tax revenue from the fiscal year 2000/01to 2006/07. It was Rs. 28752.90 million in FY 2000/01 and increased to Rs. 57430.40 million in FY 2007/08. But the percentage contribution of tax revenue seems to be fluctuating in different years. The contribution of tax revenue to total revenue was maximum i.e. 79.49percentage in FY 2001/02 and minimum 75.74 percentage in FY 2004/05 during the study period. The non-tax revenue is also in increasing trend for the first 7 years but it is decreased from Rs. 16018 million to Rs. 1485.70 in last year i.e. FY 2007/08.

The percentage contribution of non-tax revenue to total revenue is also fluctuating during the study period. It was decreased to 20.51 percentages in FY 2002/03 and increased up to 24.26 percentages in FY 2004/05. During the FY 2007/08 the contribution of non-tax revenue to total revenue is only 20.55 percentage however the contribution of tax-revenue to total revenue is 79.45 percentage in the same year from the above figure it is clear that the tax-revenue has covered the major portion of government revenue.

2.1.2 Composition of Tax Revenue

Tax revenue is composed of direct tax and indirect tax. Income Tax, property tax, Tax and interest are included in direct tax. Indirect tax includes customs, Excise duty, VAT. The composition of Nepalese tax revenue is presented in Table 2.2 in terms of direct and indirect tax revenue from FY 2000/01to 2007/08.

Table 2.2
Contribution of Direct and Indirect Tax on Total Tax Revenue

Rs. in Million

Fiscal Year	Total tax Revenue	Total direct tax	percentage share of direct tax	Total Indirect tax	Percentage share of Indirect tax
2000/01	28752.90	7516.10	26.14	21236.8	73.86
2001/02	33152.10	8951.5	27	24200.6	73
2002/03	38865.10	10159.4	26.14	28705.7	73.86
2003/04	39330.60	10597.5	26.94	28733.1	73.06
2004/05	42587	10105.8	23.73	32481.2	76.27
2005/06	48173	11912.6	24.73	36260.4	75.27
2006/07	54104.70	13071.8	24.16	41032.9	75.84
2007/08	57430.40	13968.10	24.32	43462.3	75.68

Source: Economic Survey

The table 2.2 shows the increasing trend of total tax revenue thereby increasing its contributing factor i.e. direct and indirect tax. In FY 2000/01 the amount of direct and indirect tax is Rs. 7516.10 million and 21236.8 million respectively. The indirect tax is in sharp increasing trend however the direct tax is decreased in FY 2004/05 from Rs. 10597.5 in FY 2003/04 to Rs. 10105.8, in spite of its increasing trend. The share of direct and indirect tax in FY 2007/08 is Rs. 13968.10 and Rs. 43462.3 respectively.

The percentage share of direct and indirect tax to total tax revenue is 26.14percentage and 73.86percentage respectively in FY 2000/01. But in FY 2007/08 this portion is changed into 24.32 percentages and 75.68 percentages respectively. The contribution of direct tax to total tax revenue is decreased to 23.73 percentages in FY 2004/05 which is lowest among other years. But it increased gradually and covered 24.73 percentages in FY 2005/06. Similarly, the share of indirect tax also decreased to 73percentage of total tax revenue. And gradually increases to 73.86 percentages in FY 2002/03. The share of indirect tax is maximum i.e. 76.27 percentage in FY 2004/05. This means that the share of direct tax is minimum and share of indirect tax is maximum in the same fiscal year i.e. 2004/05. It may be due to unfavorable economic environment in the country.

Table 2.2 makes us clear that major portion of tax revenue is covered by indirect tax. And it is also in increasing trend. The share of indirect tax has increased from 73.86 percentages in FY 2000/01 to 75.68 percentages in FY 2007/08. But direct tax is 26.14percentage in 2000/01 and decreased to 24.32 percentage of total tax revenue in FY 2007/08. It indicates that the income level of people is in decreasing trend in one hand and promotion of importing goods from other countries on the other. To direct the economy in the channel of development, it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax. Therefore attention should be paid on the sufficient resource mobilization through internal sources.

2.1.3 Composition of Indirect Tax

Nepalese tax structure is heavily dependent on indirect taxes which constitutes the major portion of total tax revenue. Nepalese tax revenue is dependent mainly on international trade and VAT on goods and services supplemented by taxes on income and property to some extent. The major components of indirect tax in Nepalese tax structure constitutes custom duty, excise duty and VAT. Custom duty has been classified mainly into import duty and export duty. Table 2.3 shows the composition of indirect tax:

Table 2.3
Major Sources of Indirect Tax and Their Relative Percentage to Indirect Tax

Rs. in Million

Fiscal Year	Indirect tax revenue	Customs	As Percentage of IDT	Excise Duties	As Percentage of IDT	VAT	AS Percentage of IDT
2000/01	21236.8	9517.7	44.82	2953.2	14	8765.9	41.28
2001/02	24200.6	10813.3	44.68	3127.6	13	10259.7	42.41
2002/03	28705.7	12552.1	43.73	3771.2	13.14	12382.4	43.13
2003/04	28733.1	12658.8	44.06	3807	13.25	12267.3	42.7
2004/05	32481.2	14236.4	43.83	4785.1	14.73	13459.7	41.44
2005/06	36260.4	15554.8	42.9	6226.7	17.17	14478.9	39.93
2006/07	41032.9	15701.6	38.27	6445.9	15.71	18885.4	46.02
2007/08	43462.3	15344	35.30	6507.6	14.97	21610.7	49.72

Source: Economic Survey

Note:

- Value Added Tax includes sales Tax, Entertainment Tax, Hotel Tax, Air Flight Tax and contract Tax.
- Customs includes Imports, Exports, Indian Excise Refund, others.

The table 2.4 reflects that the custom duty and VAT occupies major portion in Indirect tax. The total indirect tax revenue collected in FY 2000/01 is Rs. 21236.8 million of which Rs. 9517.7 million i.e. 44.82 percent is contributed by customs, 41.28 percentage i.e. Rs. 6765.9 is covered by VAT and Rs. 2953.2 i.e. 14percentage is covered by Excise duty. The share of customs is continuously increasing from FY 2000/01 to FY 2006/07. But it is decreased in FY 2007/08. In this year customs amounted to Rs 15344 million which is only 35.30percentage of indirect tax revenue. The collection of VAT is decreased in FY 2003/04 from Rs. 12382.4 to Rs. 12267.3 million and their respective share is 43.13percentage to 42.7percentage. After that there is improvement in collection from VAT. In FY 2007/08 the total collection from VAT amounted to Rs. 21610.7 million representing 49.72 percentage of total indirect tax revenue which is the highest collection from VAT during the study period. Such significant increase in VAT shows the improving consumption pattern of Nepalese market. The share of excise duty is also continuously increasing from FY 2000/01 to 2007/08. However, its percentage share in indirect tax is fluctuating during the study period. In FY 2000/01 its percentage contribution is 14percentage and increased to 14.97percentage in FY 2007/08. The highest contribution of excise duty is 17.17 percentages in FY 2005/06 representing Rs. 6226.7 million. From the above table we can clearly see that the percentage contribution of excise duty to indirect tax revenue is not significantly changed although total collection from excise duty is increased.

2.1.4 Composition of Direct Tax

The major components of direct tax are income tax, land Revenue and Registration, Urban house and Land tax, vehicle tax and others.

Table 4.4 shows that contribution of income tax to direct tax is higher than other tax and it occupies the largest share in the direct tax. The percent share of income tax to direct tax in FY 2000/01 is 82.09 percent amounting Rs. 6170.2 million. This gradually increases to 89.71 percentages in FY 2002/03 amounting Rs. 9114 million. After the FY 2002/03 the percentage contribution of income tax is continuously decreased in FY 2003/04. its contribution to direct tax is 84.01 percent and in FY 2007/08 this share is decreased to 74.27 percent amounting Rs. 10373.7 million, so, this regular decrease in contribution percent of income tax to direct tax is not satisfactory. It needs to increase by widening the tax net.

Table 2.4
Components of Direct Tax and Their Percent to Direct Tax

Rs. in Million

Fiscal Year	Direct Tax	Income Tax	IT as percentage of DT	Land Revenue & Registration tax	As % of DT	Urban house & land Tax	As % of DT	Vehicle tax	As % of DT	Others	As % of DT
2000/01	7516.10	6170.2	82.09	1003.1	13.35	123.3	1.64	219.4	3	0	-
2001/02	8951.5	7420.6	82.9	1015.9	11.35	118.5	1.32	396.5	4.43	0	-
2002/03	10159.4	9114	89.71	612.9	6.03	2.9	0.03	429.6	4.23	0	-
2003/04	10597.5	8903.7	84.01	1131.8	10.68	2.3	0.02	559.7	5.28	0	-
2004/05	10105.8	7966.2	78.84	1414.3	14	0	-	559.5	5.54	165.8	1.64
2005/06	11912.6	9245.9	77.62	1697.5	14.25	0	-	700.6	5.88	268.6	2.25
2006/07	13071.8	10159.4	77.72	1799.2	13.76	0	-	806.5	6.17	306.7	2.35
2007/08	13968.1	10373.7	74.27	2181.1	15.61	0	-	847.6	6.07	565.7	4.05

Source: Economic Survey

The land revenue and registration has covered 13.35 percentage of direct tax in FY 2000/01 amounting Rs. 1003.10 million. But in FY 2002/03 its share is decreased to 6.03 percent only. Afterwards it started to increase and its maximum contribution is 15.61percentage in FY 2007/08. The urban house and land tax has contributed 1.64 percent of direct tax in FY 2000/01 amounting Rs. 123.3 million, which has decreased gradually and reached to Zero percent since 2004/05 and thereafter.

Another major component of direct tax is vehicle tax which has covered 3percentage of direct tax in FY 2000/01 amounting Rs. 219.4 million. Its share to direct tax is continuously increasing thereafter. Its maximum share is Rs. 806.5 million which is 6.17percentage of direct tax. In FY 2007/08 the percent share of vehicle tax to direct tax is 6.07 percentage amounting Rs. 847.6 million.

The contribution of other sources to direct tax is also in increasing trend from FY 2004/05 and 2007/08 respectively.

2.1.5 Contribution of Direct Tax as Percent to GDP, Total Revenue and Total Tax Revenue

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

Table 2.5
Contribution of Direct Tax as Percent to GDP, Total Revenue and Total Tax Revenue
Rs. in million

Fiscal Year	Direct Tax	Direct Tax as percentage of Total Tax	Direct Tax as percentage of GDP	Direct Tax as percentage of Total Revenue
2000/01	7516.10	26.14	2.28	20.18
2001/02	8951.5	27	2.44	20.87
2002/03	10159.4	26.14	2.58	20.78
2003/04	10597.5	26.94	2.61	21
2004/05	10105.8	23.73	2.31	17.97
2005/06	11912.6	24.73	2.51	19.11
2006/07	13071.8	24.16	2.38	18.64
2007/08	13968.10	24.32	2.31	19.32

Source: Economic Survey

From the table, it is clear that percentage share of direct tax to total tax revenue is 26.14 percent in FY 2000/01. Then it has increased to 27 percentages in FY 2001/02 which is maximum contribution during the study period. In FY 2004/05 direct tax share to total tax revenue has decreased to 23.73 percent which is its lowest contribution. Afterwards its share is 24.73 percentages, 24.16 percentages and 24.32 percentages in FY 2005/06, 2006/07 and 2007/08 respectively. The share of direct tax to GDP seems to be very low. It is only 2.28 percentages in FY 2000/01 which is gradually increased to 2.61 percentage in 2003/04. But the share is only 2.31percentage in FY 2007/08. From the above figures, we can conclude that there is not any significant improvement in contribution of direct tax to GDP in the last 8 years. In the other hand, the share of direct tax on total revenue was fluctuated. Its contribution is 20.18 percentages in FY 2000/01 and its share is increased to 21percentage in FY 2003/04 and decreased to 17.97 percentages in FY 2004/05. In FY 2007/08 its share is only 19.32 percentages which is 1.32 percentages higher than FY 2006/07.

2.1.6 Contribution of Various Taxes as percentage to GDP

The contribution of various taxes as percentage to GDP is given in the following table:

Table 2.6

Contribution of Various Taxes as percentage to GDP

Rs. in million

Fiscal Year	Total Revenue as percentage of GDP	Total Tax Revenue as percentage of GDP	Direct Tax as percentage of GDP	Indirect tax as percentage of GDP	Income tax as percentage of GDP	Custom duty as percentage of GDP	Excise duty as percentage of GDP	VAT as percentage of GDP	Land Revenue & Reg. as percentage of GDP
2000/01	11.29	8.71	2.28	6.43	1.87	2.88	0.89	2.66	0.30
2001/02	11.71	9.05	2.44	6.61	2.02	2.95	0.85	2.80	0.28
2002/03	12.41	9.86	2.58	7.28	2.31	3.18	0.95	3.14	0.15
2003/04	12.42	9.68	2.61	7.07	2.19	3.12	0.94	3.02	0.28
2004/05	12.85	9.73	2.31	7.42	1.82	3.25	1.09	3.08	0.32
2005/06	13.12	10.14	2.51	7.63	1.95	3.27	1.31	3.05	0.36
2006/07	12.78	9.86	2.38	7.48	1.85	2.86	1.17	3.44	0.33
2007/08	11.97	9.51	2.31	7.20	1.72	2.54	1.08	3.58	0.36

Source: Economic Survey

From the table 2.6, we can find out that the contribution of total revenue on GDP is in increasing trend up to FY 2005/06. In FY 2000/01 it is 11.29 percentages which is gradually increased and reached to 13.12 percentages in FY 2005/06. But after that, it is decreased to 12.78 percentage and 11.97 percentages in FY 2005/06 and 2007/08 respectively. The contribution of total tax revenue on GDP is fluctuating in past 8 years. It is 8.71percentage in FY 2000/01, and increased to 10.14percentage in FY 2005/06. In FY 2006/07 its share to GDP is decreased to 9.86 percentages and it further decreased to 9.51 percentages in FY 2007/08. There is significant role of indirect tax in the tax structure of Nepal, which has contributed about three times more than direct tax. In FY 2000/01, the contribution of indirect tax and direct tax 6.43percentage and 2.23 percentages respectively, this is increased to 7.20percentage and 2.31percentage in FY 2007/08. The contribution of income tax on GDP is also increasing gradually in the beginning years. Its contribution is 1.87percentage in FY 2000/01 which is increased to 2.31percentage in FY 2002/03 at maximum level during the period of 8 years. Then after, it is decrease to 2.19 percentages in FY 2003/04 and further decreased to 1.82 percentages in FY 2004/05 but it seems same improvement in FY 2003/04 by increasing up to 1.95 percentages. In FY 2007/08 the share of income tax to GDP is only 1.72percentage. The contribution of land revenue and Registration tax is 0.30 percentages in FY 2000/01. And it is slightly increased to 0.36 percentages in FY 2007/08 within the direct tax; the contribution from income tax on GDP is higher than other tax.

The custom duty, which is composed of import and export duty, has contributed the largest part in GDP within the indirect tax. It has contributed 2.88 percentages on GDP in FY 2000/01. After that, it is gradually increased and covered the share of 3.27 percentages in FY 2005/06. But it is again decreased to 2.86 percentage and 2.54percentage in FY 2006/07 and 2007/08 respectively. The contribution of VAT in GDP is increased to 3.58percentage in 2007/08 as compared with 2.66 percentages in FY 2000/01. The contribution of VAT to GDP is maximum in FY 2007/08. The contribution of excise duty is maximum i.e. 1.17percentage in FY 2006/07. But it is decreased to 1.08 percentages in FY 2007/08. The government has target to increase the VAT at 4 percentage of GDP. But it will not be fulfilled unless the VAT is implemented properly. For that government should stimulate the consumer's awareness program for taking bills and control the practice of evading VAT.

2.1.7 Contribution of Income Tax in Nepal

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

Table 2.7 reflects that the income tax is increased in 2007/08 as compared with 2000/01. Total income Tax is Rs. 6170.2 million for the FY 2000/01 and it is increased to Rs. 10373.7 million for the FY 2007/08. The share of income tax on GDP of Nepal is very low. It lied between 1.87 percentages to 1.72percentage during the study period. It is 1.87 percentages in FY 2000/01 and decreased to 1.72percentage in FY 2007/08. In FY 2002/03 the share of income tax on GDP is maximum i.e. 2.31percentage.

Table 2.7
Contributions of Income Tax to GDP, Total Revenue, Total Tax Revenue and Direct Tax Revenue

Rs. in million

Fiscal Year	GDP	Total Revenue	Total Tax Revenue	Direct Tax Revenue	Income Tax	percentage of IT on GDP	percentage of IT on TTR	percentage of IT on TR	percentage of IT on Direct tax
2000/01	330018	37251	28752.90	7516.10	6170.2	1.87	21.46	16.56	82.09
2001/02	366251	42893.70	33152.10	8951.5	7420.6	2.02	22.38	17.30	82.89
2002/03	394052	48893.90	38865.10	10159.4	9114	2.31	23.45	18.64	89.71
2003/04	406138	50445.60	39330.60	10597.5	8903.7	2.19	22.64	17.65	84.02
2004/05	437546	56229.70	42587	10105.8	7966.2	1.82	18.70	14.17	78.83
2005/06	474919	62331	48173	11912.6	9245.9	1.95	19.19	14.83	77.61
2006/07	548485	70122.70	54104.70	13071.8	10159.4	1.85	18.77	14.49	77.72
2007/08	603673	72282.10	57430.40	13968.10	10373.7	1.72	18.06	14.35	74.27

Source: Economic Survey

The share of income tax to total tax revenue is fluctuated from 21.46 percentages to 18.06percentage. It is 21.46 percentages in FY 2000/01, increased to 23.45 in FY 2002/03. Thereafter, it is decreased to 18.77 in FY 2006/07 and further decreased to 18.06 in FY 2007/08. Similarly, contribution of income tax to total revenue is 16.56percentage in FY 2000/01. And it is decreased to 14.35 percentages in FY 2007/08. Its contribution is highest in FY 2002/03 which is 18.64 percentage of total revenue. The contribution of income tax on direct tax is maximum; it is 82.09 percentages in FY 2000/01. It reached to the maximum contribution of 89.71 percentages in FY 2002/03. But its contribution is sharply decreased to 74.27 percentages in FY 2007/08. Such decreasing trend of contribution of income tax to direct tax structure is not fruitful for the tax structure of developing country like Nepal.

2.1.8 Structure of Income Tax in Nepal

Income tax revenue is divided into corporate tax, individual income tax and remuneration tax until 1993/94. After that, the income tax revenue is divided into four group i.e. corporate income tax, individual income tax, house and land rent tax and interest tax. Corporate tax is collected from government, public and private limited companies and partnership firms, and individual income tax is collected from remuneration and industry, business profession or vocation, Interest tax is paid from banks and financial institution that pay interest for all types of deposits and the house rent tax is levied on income obtained from renting house and land in urban areas. The structural composition of income tax is presented below.

Table 2.8
Composition of Income Tax

Rs. in million

Fiscal Year	Total Income tax	Corporate income Tax	percentage of Corporate tax	Individual Income	percentage of individual Income	Remuneration	percentage of Remuneration	Tax on Interest	percentage of tax on interest
2000/01	6170.2	2681.5	43.46	2772.7	44.94	396.5	6.45	319.5	5.18
2001/02	7420.6	3538.3	47.68	3016.4	40.65	451.5	6.08	414.4	5.58
2002/03	9114	4852.3	53.24	3200.5	35.17	597.3	6.55	463.9	5.09
2003/04	8903.7	3181.3	35.73	4419.1	49.63	835.6	9.38	467.7	5.25
2004/05	7966.2	2487.3	31.22	3362.3	42.2	1252.6	15.72	864	10.84
2005/06	9245.9	3587.9	38.80	3533.4	38.22	1391.2	15.05	733.4	7.93
2006/07	10159.4	3800.2	37.4	3926.3	38.65	1675.9	16.49	757	7.45
2007/08	10373.7	3600	34.7	4234.7	40.82	1764.1	17	774.9	7.47

Source: Economic Survey

The table 2.8 shows that the share of corporate income tax was 43.46 percentages in FY 2000/01, which was increased to 47.68 percentages in FY 2001/02. And it gradually increased to 53.24 percentages in FY 2002/03. But it sharply decreased to 35.73percentage in FY 2003/04. Among these ups and downs the share of corporate income tax is decreased to 34.7 percentages in FY 2007/08. Tax collection from corporate sector is found to be highly fluctuated during the study period, which is the red signal for the corporate sector.

Contribution of individual income seem to be gradually increasing from Rs. 2772.7 million to Rs. 3016.4 million in FY 2000/01 and 2007/08 respectively, but in percentage the figure is in diminishing trend i.e. 44.94 percentage and 40.82 percentage in FY 2000/01 and 2007/08 respectively. Individual income tax collection is highest in FY 2003/04 which is 49.63percentage of total income tax amounting to Rs. 4419.10 million.

Contribution from Remuneration and tax an interest is Rs. 396.5 million and Rs. 319.5 million which is 6.45 percentages and 5.18 percentage of total income tax respectively in FY 2000/01. The share of remuneration is continuously increasing during the study period. Its share is 6.45percentage in 2000/01 and reached to 17 percentages in FY 2007/08 amounting Rs. 1764 percentage million. Tax an interest is also in increasing trend during the first five years. It is Rs. 864 million in FY 2004/05, but decreased to Rs. 733.4, 757 and 774.9 million in FY 2005/06, 2006/07 and 2007/08 respectively.

2.2 Problem of Resource Gap in Nepal

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

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

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

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

The problem of resource mobilization and resource gap is related to the saving and investment. The level of income and the rate of interest influence the saving structure. The low rate of saving is prevailing in the country as a result of low level of income of the people. The low level of income creates the problem of resource mobilization for undertaking investment programmes in a large scale by both government and private sector.

From the table 4.9, the Resource Gap is increasing every year. It was Rs. 22328 million in FY 2000/01 and reached to Rs. 38067.10 million in FY 2007/08. This amount of resource gap is decreased in year 2003/04, 2004/05 and 2005/06 respectively. But it sharply increased from Rs. 27111.6 million to Rs. 32437.7 million in FY 2006/07. Percentage of resource of gap on total expenditure is maximum i.e. 38percentage in FY 2002/03 amounting to Rs. 30941.50 million. Total Government revenue and expenditure is increasing every year. But the rate of increase in expenditure is higher than increasing revenue which leads to the rising resource gap.

Table 2.9
Domestic Resource Gap Pattern in Nepal

Rs. in million

Fiscal Year	Total Govt. Expenditure (A)	Total Govt. Revenue (B)	Resource Gap (A-B)	Resource gap as percentage of Total Expenditure
2000/01	59579	37251	22328	37
2001/02	66272.5	42893.8	23378.7	35
2002/03	79835.1	48893.6	30941.5	38
2003/04	80072.2	50445.5	29626.7	37
2004/05	84006.1	56229.8	27776.3	33
2005/06	89442.6	62331	27111.6	30
2006/07	102560.4	70122.7	32437.7	31
2007/08	110889.2	72282.1	38607.1	35

Source: Economic Survey

2.2.1 Revenue Expenditure

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

Table 2.10
Overall Resource Gap pattern of Nepal

Rs. in million

Fiscal Year	Total Govt. Expenditure (A)	Total Govt. Revenue (B)	Resource Gap (A-B)	Foreign Grants (C)	Resource Gap 2 A-(B+C)	Foreign Loan (D)	Resource Gap 3 A-(B+C+D)
2000/01	59579	37251	22328	4336.6	17991.4	11852.4	6139
2001/02	66272.5	42893.8	23378.7	5711.7	17667	11812.2	5854.8
2002/03	79835.1	48893.6	30941.5	6753.4	24188.1	12044	12144.10
2003/04	80072.2	50445.5	29626.7	6686.1	22940.6	7698.7	15241.9
2004/05	84006.1	56229.8	27776.3	11339.1	16437.2	4546.4	11890.8
2005/06	89442.6	62331	27111.6	11283.4	15828.2	7629	8199.2
2006/07	102560.4	70122.7	32437.7	14391.2	18046.5	9266.1	8780.4
2007/08	110889.2	72282.1	38607.1	13827.5	24779.6	8214.3	16565.3

Source: Economic Survey

- **Resource Gap[1] (A-B)**

The gap between government revenue and expenditure has risen from Rs. 22328 million to Rs. 38607.10 million in FY 2000/01 and 2007/08 respectively. This figure shows the poor performance of domestic resource mobilization.

- **Resource Gap[2] A – (B + C)**

This type of resource gap is Rs. 17991.4 million in FY 2000/01, which is gradually increased to Rs. 24188.10 million in FY 2002/03. And decreased to 22940.60 million in FY 2003/04. It further decreased to Rs. 16737.2 million and 15828.2 million in FY, 2004/05 and 2005/06 respectively. However, this figure is Rs. 24779.6 million in FY 2006/07. The above data suggests that foreign grants should be encouraged to minimize the resource gap.

- **Resource Gap[3] A – (B + C + D)**

This resource gap is taken as the difference between total expenditure and total revenue plus foreign grants plus foreign loan. In FY 2000/01 the gap was Rs. 6139 million which was increased to Rs. 12144.10 million and 15241.90 million in FY, 2002/03 and 2003/04 respectively. And it was started to decrease gradually. It was Rs. 8199.2 million and 8780.4 million in FY 2005/06 and 2006/07 respectively. Then it was rapidly increased and reached to Rs. 16565.3 million in FY 2007/08 which is nearly two times higher than previous year. It measures the internal indebtedness of the government. The above data reflects the decreasing resource gap when foreign loan is increased and vice versa. As the loan taken amount will decrease simultaneously, the resource gap will increase consequently. Moreover, foreign loan largely depends on the fiscal policy adopted by the nation.

Fiscal deficit (resource gap) is continuously increasing due to lack of proper income management to meet the increasing trend of government expenditure (Economic Survey). 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.

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

2.2.2 Problems in Public Expenditure

Government expenditure is increasing along with its expanding activities in development and social activities. The increasing trend of government expenditure can be fulfilled either by internal resources or through inflow of foreign aid. The increasing rate of growth in government expenditure creates many problems in public expenditure management. As a result, deficit financing takes place in the economy. On the one hand, the resource gap problem is increasing and on the other hand it has grown the inflation and price unstabilization in the economy. There are two way relationships between resource mobilization and expansion in budgetary size in developing country. Government policy should be reformed for maximum resource mobilization in accordance with the expansion in economy that has taken place through the investment of public sector in development activities.

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

Table 2.11
Share of Government Revenue, Foreign Aid and CITR in Public Expenditure

Rs. in million

Fiscal Year	**Total Govt. Expenditure**	**Total Govt. Revenue**	**TR as percentage of TE**	**Foreign Aid**	**Foreign Aid as percentage of TE**	**CITR**	**CITR as percentage of TE**
2000/01	59579	37251	62.52	16189	27.17	2681.5	4.5
2001/02	66272.5	42893.8	64.72	17523.9	26.44	3538.3	5.34
2002/03	79835.1	48893.6	61.24	18797.4	23.54	4852.3	6.08
2003/04	80072.2	50445.5	63	14384.8	17.96	3181.3	3.97
2004/05	84006.1	56229.8	66.93	15885.5	18.91	2487.3	2.96
2005/06	89442.6	62331	69.69	18912.4	21.14	3587.9	4.01
2006/07	102560.4	70122.7	68.37	23657.3	23.07	3800.2	3.70
2007/08	110889.2	72282.1	65.18	22041.8	19.88	3600	3.25

Source: Economic Survey

The table 2.11 shows the total government expenditure, government revenue, foreign aid and CITR. The contribution of government revenue is only 62.52percentage of government expenditure in FY 2000/01. This share has increased to 64.72 percentages in FY 2001/02 amounting to Rs. 42893.8 million. And it decreased to 61.24 percentages in FY 2002/03. The share of government revenue is maximum in FY 2005/06 contributing 69.69 percentage of government expenditure. This share is only 65.18percentage in FY 2007/08.

The share of CITR is 4.5 percentages in FY 2000/01. This share is maximum in FY 2002/03 which represents 6.08 percentage of total government expenditure. This share is 4.5percentage in FY 2000/01. The share of CITR is only 2.96percentage in FY 2004/05. However it is increased to 4.01percentage in FY 2005/06. And decreased to 3.25percentage in FY 2007/08 amounting to Rs. 3600 million.

Similarly, the contribution made by foreign aid comprising both foreign grants and loans is 27.17percentage in FY 2000/01 amounting Rs. 16189 million. After this year, its share is on decreasing trend. Its contribution is minimum in FY 2002/03 i.e. 17.96 amounting Rs. 14384.8 million. In FY 2006/07 it has contributed 19.88percentage of government expenditure amounting to Rs. 22041.8 million.

Conclusion from the above analysis is that government dissaving is increasing every year. Government's expenditure is increasing at a higher rate than the growth of government revenue. The growth rate of domestic saving has not increased substantially even the external capital inflow has been increasing with higher rate. As a consequence of which the resource gap is highly increasing instead of diminishing. In this context, the certain percentage increase in the share of CITR will play a significant role to fulfill resource gap from the internal sources. So, more emphasis should be given on raising revenue through corporate sectors.

2.3 Corporate Tax Structure

This deals with the corporate tax rate and tax base. It has divided into two section first section presents structure of corporate income tax while the second reveals the present corporate tax base followed by corporate sector.

2.3.1 Corporate Tax Rate Structure in Nepal

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

The corporate tax rate structure was increased up to 60 percentages the maximum rate in the FY 1995/96 from 25 percentages. During 1960/61 to 1975/76, the tax rate again decreased up to 51 percentage and 50percentage. This rate was again increased to 55percentage and remains continued from FY 1982/83 till 1987/88. In the year 1987/88, the listed public limited companies were levied 10percentage less than others. This concession was given to such companies by only 5percentage in the year 1985/86. After the FY 1987/88, the tax rate was continuously decreasing. Now it is 20percentage to industry (except cigarette and alcohol), 25 percentages to general companies and 30percentage to banks and finance companies. Special fee of 3percentage of taxable income was levied to all corporate bodies. The corporate tax rate structure of different years is presented as below:

Table 2.12
Corporate Tax Rate Structure in Nepal

Fiscal Year	Maximum Marginal Tax Rate		Nature of tax rate
	Private Co.	Public Co.	Progressive
1960/61-1962/63	25	25	"
1963/64-1964/65	30	30	"
1965/66-1966/67	40	40	"
1967/68	55	55	"
1968/69-1974/75	55	55	"
1975/76	60	60	"
1976/77-1978/79	51	51	"
1979/80	50	50	"
1980/81-1981/82	50	50	"
1982/83	55	55	"
1983/84-1984/85	55	55	"
1985/86	55p	55f	Progressive(P) & Flat(F)
1986/87-1987/88	55p	50f	"
1988/89-1989/90	50p	50f	"
1990/91-1991/92	40p	40f	"
1992/93-1994/95	35p	35f	"
1995/96	33	33	Flat
1996/97	30	33	"
1997/98-2006/07	20,25 & 30	20,25 & 30	"

Source:

1. Kandel, P. R. (2000), Corporate Tax System & Investment Behavior in Nepal
2. Budget Speech, 2005/06 & 2006/07
3. Finance Acts

Notes:

- 20percentage tax rate for special industries.
- 25percentage tax rate for general industries producing cigarette, bidi, liquor and industries uses as raw material.
- 30percentage tax rate for non industries for banking and insurance business.

2.3.2 Corporate Tax Base in Nepal

Under the Income Tax Act, 2058 of Nepal, corporate tax is levied on the total taxable income of the previous year. It has assumed the global or total as well as scheduler income tax. This act has divided the source of income into three major heads they are: income from business, income from investment and income from employment. The third amendment of Income Tax

Act, 2058 has further clarified about calculating the adjusted taxable income and net taxable income from business, investment and employment. All the taxable income are added as per law and deduction allowable expenses such as general deduction, cost of trading stock, interest expenses, repair and maintenance expenses, depreciation, reserve and rise-bearing fund and expenses related with business and investment were deducted as per the law, which occurs adjusted taxable income. Then, incase of business income, pollution control and R & D expenses should be deducted taking the adjusted taxable income as base, after that we get assessable income from business before loss adjustment. Then, loss from business in current year and previous year are deducted to get the net assessable income from business. Likewise, loss in business and investment of current year and business loss of previous year are deducted to get the net assessable income from investment.

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

2.3.3 Contribution of Corporate Income Tax

Contribution of corporate income tax on Income Tax revenue, total government revenue, its composition and trend line for 8 years has been drawn in this sub-chapter. The relationship of CITR with other taxes and total revenue and its coverage portion has been examined.

2.3.3.1 Structural Composition of Corporate Income Tax

The corporate income tax structure comprises of government sector, public and private sector. Corporate taxable income is calculated by adding all the taxable income and deducting all the allowable expenses. After the enactment of Income Tax Act 2058, the books of account of corporate sector have been kept a little bit differently. From the FY 2003/04, the total corporate sector income tax is computed by adding public and private sector including individual and sole trading concern. The, following table has been drawn to show the structural composition of corporate income tax from the FY 2000/01 to 2007/08.

Table 2.13
Structural Composition of Corporate Income Tax

Rs. in million

Fiscal Year	**CITR**	**Public Sector**	**percentage share of CITR**	**Private Sector**	**percentage share of CITR**
2000/01	2681.5	1526.5	56.93	1155	43.07
2001/02	3538.3	2198.8	62.14	1339.5	37.86
2002/03	4852.3	2928	60.34	1924.3	39.66
2003/04	3181.3	1769.3	55.61	1412	44.39
2004/05	2487.3	1251	50.30	1236.3	49.70
2005/06	3587.9	2056.6	57.32	1531.3	42.68
2006/07	3800.2	1332.4	35.06	2467.8	64.94
2007/08	3600	195.7	5.43	3404.3	94.57

Source: Economic Survey

The table 2.13 structural composition of corporate tax shows that major portion is covered by public sector in the beginning. It is 56.93 percentages in FY 2000/01 while the private sector contributed only 43.07 percentages. The share of public sector increased to 62.14 percentages in FY 2001/02 where as the private sector contribution is decreased to 37.86percentage. From the FY 2002/03, the share of public sector is gradually decreasing and the share of private sector is increasing. In FY 2004/04 the public sector contribution is 50.30 percentages where as the share of private sector is 49.70 percentages. There is a huge decrease in share of public sector is FY 2007/08 in comparison to FY 2006/07. Its share is decreased from 35.06percentage to 5.43 percentages in FY 2007/08. On the other side, the share of private sector is highly increased in FY 2007/08 in comparison to previous fiscal year. It has increased to 94.57 percentages in FY 2007/08 from 64.94 percentages in FY 2006/07. The above figure shows the growth and diversification of private sectors in the country. The structural composition of CITR can be presented in bar graph and chart as follows:

2.3.3.2 Contribution of Corporate Income Tax Revenue on Income Tax Revenue

Income tax revenue comprises of corporate income tax, individual income tax, remuneration tax and interest tax. The size of income tax revenue largely depends upon the size of corporate sector. Greater the size of corporate sector, higher will be the CITR and total tax revenue and vice versa. So CITR in Nepal has played a crucial role in income tax revenue which has been presented in the following table:

Table 2.14
Contribution of CITR on Income Tax Revenue

Rs. in million

Fiscal Year	Income Tax	Corporate Income Tax				Total CITR	percentage
		Public Sector	percentage	Private Sector	percentage		
2000/01	6170.2	1526.5	24.73	1155	18.72	2681.5	43.45
2001/02	7420.6	2198.8	29.63	1339.5	18.05	3538.3	47.68
2002/03	9114	2928	32.13	1924.3	20.11	4852.3	53.24
2003/04	8903.7	1769.3	19.87	1412	15.86	3181.3	35.73
2004/05	7966.2	1251	15.70	1236.3	15.52	2487.9	31.22
2005/06	9245.9	2056.6	22.24	1531.3	15.56	3587.9	37.40
2006/07	10159.4	1332.4	13.11	2467.8	24.29	3800.2	37.40
2007/08	10373.7	195.7	1.88	3404.3	32.81	3600	34.69

Source: Economic Survey

Table 2.14 reflects that the contribution of CITR to income tax seems to be in decreasing trend during the study period. It is 43.45 percentage amounting Rs. 2681.5 million in The FY 2000/01, which is increased to 47.68percentage amounting Rs. 3538.3 million. In FY 2002/03 it is increased to 53.24 percentages amounting 4852.3 million. But its contribution is started to decrease and reached to 31.22 percentages in FY 2004/05 amounting Rs. 2487.30 million. After that it is increased to 37.80 percentages and decreased to 37.40 percentages in FY 2005/06 and 2006/07 amounting Rs. 3587.9 million and 3800.2 million respectively. In FY 2007/08 the contribution of CITR is only 34.69 percentage amounting Rs. 3600 million.

The Structural composition of corporate sector seemed to be changed during the study period. In FY 2000/01, 24.73percentage and 18.72 percentages contribution is made by public and private sectors. This figure is 15.70 percentages and 15.52 percentages respectively in FY 2004/05. And this figure is changed to 1.88 percentage and 32.81 percentages in FY 2007/08. The above figure clarifies that the contribution of public sector is decreasing and private sector is in increasing trend.

The CITR and income tax revenue position has been shown in the following bar diagram and chart

2.3.3.3 Contribution of Corporate Income Tax on Total Revenue

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

Table 2.15
Contribution of Corporate Income Tax on Total Revenue

Rs. in million

Fiscal Year	Total revenue	Corporate Income Tax				Total CITR	percentage
		Public Sector	percentage	Private Sector	percentage		
2000/01	37251	1526.5	4.10	1155	3.10	2681.5	7.20
2001/02	42893.7	2198.8	5.13	1339.5	3.12	3538.3	8.25
2002/03	48893.9	2928	5.98	1924.3	3.93	4852.3	9.91
2003/04	50445.6	1769.3	3.51	1412	2.80	3181.3	6.31
2004/05	56229.9	1251	2.22	1236.3	2.20	2487.3	4.42
2005/06	62331	2056.6	3.30	1531.3	2.46	3587.9	5.76
2006/07	70122.7	1332.4	1.90	2467.8	3.52	3800.2	5.42
2007/08	72282.1	195.7	0.27	3404.3	4.71	3600	4.98

Source: Economic Survey

Table 2.15 reflects the contribution percentage of corporate income tax to total government revenue during the study period is fluctuating from 4percentage to 7 percentage. The share of corporate income tax revenue is 7.2 percentage amounting Rs. 2681.5 million in the FY 2000/01, in which 4.10percentage is covered by public sector and rest by private sector. Later on, the share of CITR to total revenue has slowly increased up to 9.91percentage of maximum in FY 2002/03 amounting Rs. 4852.3 million. Where intra-structural composition of corporate sector is dominated by government sector contributing 5.98 percentage of maximum percentage of amounting Rs. 2928 million during the study period. But these situations continue no longer. Political instability, unfriendly economic environment for smooth operation of business is some of the main reason for Nepalese corporate sector unable in improving its competency. As a result, contribution of CITR on total revenue is sharply decreased from 9.91percentage amounting Rs. 4852.3 million in 2002/03 to 5.42percentage in 2006/07 amounting Rs. 3800.2 million which is 4.98percentage amounting Rs. 3600 million in FY 2007/08.

Total revenue is also in increasing trend which is not only the cause of better implementation of fiscal policy and positive macro-economic indicator but it was also due to the expansion of taxation and revenue net. This table also shows that the private sector's tax collection is fluctuating but it is around 2percentage to 4percentage since last 8 years although Nepal has liberalized the economy and privatized about 24 public enterprises and companies during the last decade. Likewise, tax collection from public enterprises seemed to be increasing up to 2002/03 but later on it was decreased to 0.27percentage in FY 2007/08. We can find out from the above table that, the contribution from public sector is decreasing gradually and from private sector is in increasing trend.

Nevertheless, Nepalese corporate sector is contributing to total revenue only about 6percentage on average which seems to be very small portion comparing to other developing countries.

2.5 Major Findings of the Study

On the basis of data presentation and the analysis, findings of the study are summarized below:

1. The study shows that the contribution of tax revenue to total revenue is 79.45percentage and of non-tax revenue to total revenue is 20.55percentage in FY 2007/08. The share of tax revenue is in increasing trend.
2. Nepalese tax revenue is composed of both direct and indirect tax revenue. There is a dominant role of indirect tax revenue in Nepalese tax structure. The contribution of direct tax and indirect tax to total tax revenue was 26.14 percentage and 73.86 percentages in FY 2000/01 which become 24.32 percentages and 75.68 percentages in FY 2007/08. Although the total amount of both taxes is increasing, there is not satisfactory growth in collection of both taxes.
3. The contributions of customs, excise duty and VAT on indirect tax revenue were 44.82 percentages, 14 percentages and 41.28 percentages respectively in FY 2000/01 and contribution of each tax were reached to 35.30 percentages, 14.97 percentages and 49.72 percentages respectively in FY 2007/08. It shows that the custom duty is in decreasing trend where as excise duties and VAT is in increasing trend.
4. The contribution of income tax, land revenue and registration, urban house and land tax, vehicle tax an direct tax revenue were 82.09 percentage, 13.35percentage,

1.64percentage and 3percentage respectively in FY 2000/01. The contribution from other taxes was nil during that period. This was reached to 74.27percentage, 15.61 percentages, 0 percentages, and 6.07 percentages in FY 2007/08. The contribution from other taxes was 4.05 percentages during this year. In the composition of direct tax, income tax was the giant one which contribution seems to be fluctuating every year. The percentage contribution from land revenue and registration is in increasing trends and from urban souse and land tax come to nil in the proceeding years.

5. Income Tax has been considered as suitable source for mobilizing internal resources. It can be used as a positive instrument to boost up government revenue collection, to develop the economic condition of Nepalese people, to promote distributive justice and to eliminate the resource gap problem.
6. Total tax revenue covered only 8.71 percentage of GDP in FY 2000/01. This increased to 10.14 percentages in FY 2005/06. In FY 2007/08 this ratio was only 9.51 percentages. There is no significant increment in total tax revenue/GDP ratio in last eight fiscal years.
7. The indirect tax /GDP ratio, custom duty/GDP ratio, excise duty/ GDP ratio and VAT /GDP ratio was 6.43 percentage, 2.88 percentage, 0.89 percentage and 2.66 percentage respectively. These were reached to 7.20 percentages, 2.54 percentages, 1.08 percentages and 3.58 percentages respectively in FY 2007/08. It shows that the contribution of indirect tax to GDP is not satisfactory in last 8 years however the ratio is in increasing trend.
8. The direct tax/GDP ratio, contribution of direct tax to total tax revenue and total revenue in FY 2000/01 was 2.28 percentages, 26.14 percentages and 20.18 percentage respectively, which were 2.31 percentage, 24.32 percentage and 19.32percentage respectively in FY 2007/08. It means there is not substantial growth in the collection of direct tax.
9. The income tax/GDP, income tax/total revenue, income tax/total tax revenue and income tax/direct tax revenue ratio were 1.87 percentage, 16.56 percentage, 21.46 percentage and 82.09 percentage respectively in FY 2000/01 which had been changed to 1.72 percentage, 14.35 percentage, 18.06 percentage and 74.27 percentage

respectively in FY 2007/08. It shows that there is decrease in every ratio for the last eight years.

10. Total income tax is the composition of corporate income tax, individual income tax, remuneration tax and tax on interest. Corporate tax and individual income tax which are the major components of income tax is in decreasing trend. But the remuneration tax and interest tax is in increasing trend. The contribution of remuneration tax has doubled in last eight years.
11. The resource gap is increasing every year. It was Rs. 22328 million in FY 2000/01 and increased to Rs. 38607.10 million in FY 2006/07. It shows the poor performance of domestic resource mobilization. The amount of foreign grants is slightly increasing and amount of foreign loan is in decreasing trend. The resource gap as percentage of total expenditure was 37 percentages in FY 2000/01 and 35 percentages in FY 2006/07.
12. Total government revenue has contributed 62.52 percentages in financing govt. expenditure in FY 2000/01. Similarly foreign aid and CITR had contributed 27.17 percentages and 4.5 percentages respectively. In FY 2007/08 the contribution of government revenue, foreign aid and CITR to total govt. expenditure is 65.18percentage, 19.88 percentages and 3.25 percentages respectively. There is a drastic reduction in the contribution made by foreign aid and CITR. Foreign aid is declined due to the lack of funding by donor agencies. Similarly, the contribution percentage of corporate sector is declined mainly because of the unfriendly business environment created by unstable political and economic situation of the country.
13. The corporate tax rates have been revised for several times. Now days, special industries, general industries and non-industries banking and insurance business are taxed at a flat rate of 20 percentages, 25 percentages and 30 percentages respectively in spite of the progressive, progressive & flat tax rate in previous years.
14. The contribution of CITR on income tax revenue was 43.45 percentages in FY 2000/01, of which public sector and private sector contributed 24.73 percentages and 18.72 percentages respectively. In FY 2007/08 CITR has contributed 34.69 percentage of which public and private sector share was 1.88percentage and 32.81 percentages respectively. CITR has decreased due to the unfavorable business environment. The

CITR from public sector has drastically reduced in last eight year. This may be due to the inefficiency of public enterprises. Most of the public enterprises are suffering from heavy losses due to their inefficient operation. But private sector is flourishing day by day so their share in CITR is also increasing, this may be due to the globalization and economic liberalization in the country.

15. Contribution of CITR on total government revenue was 7.20 percentages in FY 2000/01. In which public and private sector contributed 4.10percentage and 3.10 percentages respectively. The share of CITR to total revenue was maximum i.e. 9.91percentage in FY 2002/03. After that it is in diminishing trend. In FY 2007/08, the share of CITR is only 4.98 percentage of total government revenue in which the share of public and private sector is only 0.27 percentages and 4.71 percentages respectively.
16. In the structural composition of corporate income tax, public sector had played a dominating role in the initial years. In FY 2000/01 share of public and private sector was 56.93 percentages and 43.07 percentages respectively. But in FY 2007/08 the share of public sector has decreased to 5.43percentage and that of private sector has increased to 94.57 percentages. It shows the flourishing trend of private sector in the economy.

CHAPTER III
CONCLUSION & RECOMMENDATIONS

3.1 Conclusion

The economy of a nation largely depends on the well developed private sector. The private sector can be developed through corporate friendly laws, rules and regulations as well as the process of industrialization. A good corporate culture is very important to develop corporate sector.

As Nepal is adopting the mixed economy for last five decades and have been liberalized from 1990's. By constitution, Nepal has encouraged the foreign investments. Various corporate friendly, laws rules has been formulated. Many public enterprises has been privatized and liquidated, some are in the process of privatization. Nepal has entered to WTO from 23rd April 2004 and has given emphasis to foreign trade and foreign direct investments. Also the rate of custom duties has been lowered and relief in other trade barriers. Due to liberalized economy number of multinational companies has been established. Though there is establishment of multinational companies, they are facing various challenges. The challenges are open boarder, smuggling of goods and services, improper billing, tax evasion, political instability, strike, insecurity and unhealthy relation between labor union and the management.

The resource gap has been increasing every year. The internal source of revenue cannot meet the regular expenditure so for the development activities depend on the foreign grants and loan. There is always trade loss in foreign trade. The trade deficits have been increasing every year.

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

In order to increase the contribution from income tax, Nepal has adopted the new income tax act 2058 from 19th chaitra 2058 B.S. This act has been formulated so as to encourage the foreign investors. This act has the feature of self assessment system with broad tax base.

The corporate sectors are in the initial stage of development. The role of industrial sector is very poor. We have to depend on the foreign countries for raw materials as well as technologies. Due to land locked nature the carriage cost of the industrial raw materials is very high. Also our economy is more or loss depended on the Indian economy. So most of the profits are diverted to foreign countries.

These days after the restoration of democracy in 2063 B.S., due to the peaceful nature and feeling of security there is chances for good business environment. The hotel and tourism sector are progressing these days and is the future for Nepalese economy.

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

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

3.2 Recommendations

On the basis of this research, following recommendations are recommended by researcher in order to increase the contribution of income tax in revenue collection as well as for the effectiveness of the income tax act in Nepal.

1. The rate of total tax to GDP is 9.51 percentages which is very low. The ratio can be increased by levying tax on education, public transport and broadening the tax net.
2. The VAT is regarded as good source of indirect tax. The government should encourage the entrepreneur to join VAT, take PAN and systematize the custom.
3. Consumer awareness lottery is good method for proper billing in VAT. So this type of awareness programme should be continued and simplified.
4. There should be good policy so as to control under invoicing. This can be controlled only through application of ASYCUDA, proper declaration of goods value in custom point and proper billing in manufacturing level.
5. The under invoiced goods should be bought by the government.
6. The transaction record between tax payers more than one lakh should be exchanged among Inland Revenue offices.
7. Proper tax incentives should be given to sick industrial units like Hotel and Tourism.
8. The foreign grants and loans should be invested on the projects with high return ratio.
9. The sick public enterprises should be privatized and the sectors which are interested by private sectors should be handed to the private sectors.
10. There should be tax facilities to attract the foreign investment. Different tax facilities should be given to multinational companies and export based industries.
11. There should be good monitoring policy. The tax officers should have access to the taxpayer’s premises which can be met by reorganizing the existing Inland Revenue offices.
12. The service sectors should be properly defined and they should be covered in tax net.
13. Tax education should be given to general public. For this purpose, tax education should be included in the syllabus of the secondary education.

14. Highest tax paying person should be motivated by giving different facilities and by honoring him.
15. The income tax act should be very simple. Tax laws, rules and regulations should be consistent.
16. Heavy fines and penalties should be strictly levied so as to harass the tax evaders.
17. There should be effective coordination among the different tax related departments.
18. Tax deduction at source should be simplified by use of IT. The new programme E-tds should be encouraged to tax payers.
19. The services given by revenue offices should be simplified and all the tasks should not be paper based but IT based.
20. Provision of reward, prize and incentives should be introduced to encourage the tax payers to pay tax voluntarily rather than through coercive measures.

EXECUTIVE SUMMARY

There is lack of the financial resources and a lot funds are required to do the development activities. Nepal has been suffering from the shortage of capital to accelerate the economic growth. There is so much resource gap so in order to fulfill the shortage, government is depending on the foreign grants and loans. So to fulfill the resource gap income tax, a direct tax is most important sources of internal revenue. Due to the low economic activities and lesser development of the corporate sector, the contribution of income tax to the total revenue is very low.

The study shows that the percentage of tax revenue and non tax revenue to total revenue was 79.45 percentages and 20.55 percentages respectively in fiscal year 2007/08, the ratio of total tax revenue to GDP was only 9.51 percentage in the fiscal year 2007/08. The total tax revenue was very few. This may be because of the low economic activities, mass poverty and low income level of people. The percentage of total tax revenue to GDP of about 13percentage is regarded satisfactory in case of the developing country.

In Nepalese economy, the percentage of indirect tax to total tax revenue is 75.68 percentages and direct tax to total tax revenue is 24.32 percentages in the FY 2007/08. So the direct tax revenue portion to tax revenue is low which may be due to the low income level and loss improvements of the private sectors as well as public enterprises.

The composition of the corporate income tax seems to be dominated by private sector in the FY 2007/08. The average contribution of Public sector and private sector are 5.42 and 94.58 percentage respectively. Similarly the percentage of corporate income tax to income tax revenue was 34.69 percentages.

During the study period, the resource gap has been increasing every year. It was Rs. 22328 million in the FY 2000/01 and increased to 38607.1 millions in the FY 2007/08. This shows the poor performance of the domestic resource mobilization. It was found that the contribution of government revenue, foreign aid and corporate income tax to total government expenditure was 65.18percentage, 19.88 percentages and 3.25 percentages respectively in FY 2007/08.

In order to find out the problems in the income tax administration, a set of questionnaires were distributed among tax administrators, tax experts and tax payers .On the opinion survey empirical investigation has found the weaknesses of the income tax act as well as the income tax administration which follows as below.

According to survey 96 percentage of the total respondents believed that taxpayers were not well informed about the income tax system in Nepal .So awareness programmes and tax education were to be given to the tax payers. 56 percentages of the total respondents were in favor that the present income tax rate appropriate in Nepal. 44 percentages preferred that the rate was high and among them 36.36 percentage recommended the 15percentage tax rate was appropriate to increase the income tax collection.

53.33 percentage of total respondents believed that the contribution from income tax was not satisfactory because of the income tax act 2058 in which assessment system is not based on the best judgment.

57.33 percentage of total respondents believed that after merging VAT and income tax administration the administration was not sound and lot of tax evasion were recorded after a taxpayer registered on VAT.

56 percentage of total respondents believed that the income tax administration was satisfactory. 41.33percentage of the total respondents believed that the vague provision in income tax laws was the main problem facing by tax payers while paying income tax.

72 percentage of the total respondents believed that the few submission of income tax returns was the main cause for low collection from income tax and awareness should be given through mass media to increase the returns rather than levying the fines and penalties. The main loopholes of the income tax act 2058 were found to be the complicated income tax acts, rules and regulations. So the provisions like installment returns, installment payment, and submission process of the income tax returns should be simplified.

In order to motivate the highest tax paying firm and person 56 percentage of total respondents believed that the highest payers should be motivated by providing the services like free health service, free education facilities as provided by developed countries.

The appropriate method of assessment system was found to be the self assessment system as 50.66 percentages of total respondents supported because a genuine taxpayer knows his transactions and expenses if recorded properly. So, clear acts rules and regulation is necessary for the effectiveness of the income tax administration and income tax laws should be simplified because it is vague.

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