

# **CHAPTER: ONE**

## **INTRODUCTION**

### **1.1 Background of the Study**

A nation requires sufficient funds to carry out development plans, handle day-to-day administration, maintain peace and security and launch other public welfare activities. The funds required by the government are normally collected from two sources: debt and revenues. The debt can be collected either from internal sources or from external sources. The debt collected within the country is known as internal debt while the debt collected from outside the country is called external debt. The debt financing of the government is also known as deficit financing. The revenues of the government come basically from two sources: tax and non- tax. Non- tax sources include different revenues like gifts, grants, revenues from public enterprises, administrative revenues such as registration fees fines and penalties. Tax sources include customs, excise duty, VAT, income tax. In Nepal around eighty percent of the government revenues come from taxation. Hence, the tax is the major source of government revenue.

Tax is a compulsory levy, paid by individuals and organizations to local and central government, Tax can be defined as the contribution of individual's customs to the government to maintain peace security and development of the country. The economic strength depends upon the collection of tax.

First of all, income tax was imposed in Nepal in fiscal year 2008/09 under the " Business profit Remuneration Tax Act 2058' Then after, various

studies were made concerning with various aspects of this act such as the structure, role, productivity, legal and administrative framework etc. Either to pay regular expenditure or to do developmental works, The Government collects revenue. The sources of government revenue can be classified into external and internal. External sources of government revenue are foreign loans and grants, external sources etc. External source are uncertain, inconvenient and not good for healthy development of nation because they are to be paid after a certain time. So, it is better to mobilize internal sources rather than external sources. Another source of government revenue is internal which constitutes tax and non tax revenue. The examples of non tax revenue are fees, fines, royalty, administrative and business income. Administrative income denotes the amount charged by the government for providing administrative service. In Nepal, the contribution of non tax revenue on national revenue is 78.2% the fiscal year 2008/09. (Economic Survey, 2008/09.)

The income tax act is imposed on income or wealth created by a person in the course of an earning. There are basically three sources that generate income: labour, capital, and labour plus capital. Correspondingly, the act imposes tax on income from employment - which is labor, income from investment - which is capital, and income from business - which is labour plus capital.

### **Objectives of tax**

Tax is a permanent instrument for collecting revenues. It is a major source of revenue in the developed world and has been appearing as an important source of revenue in the developing world as well. It has been

an instrument of social and economic policy for the government .The main objectives of tax are:

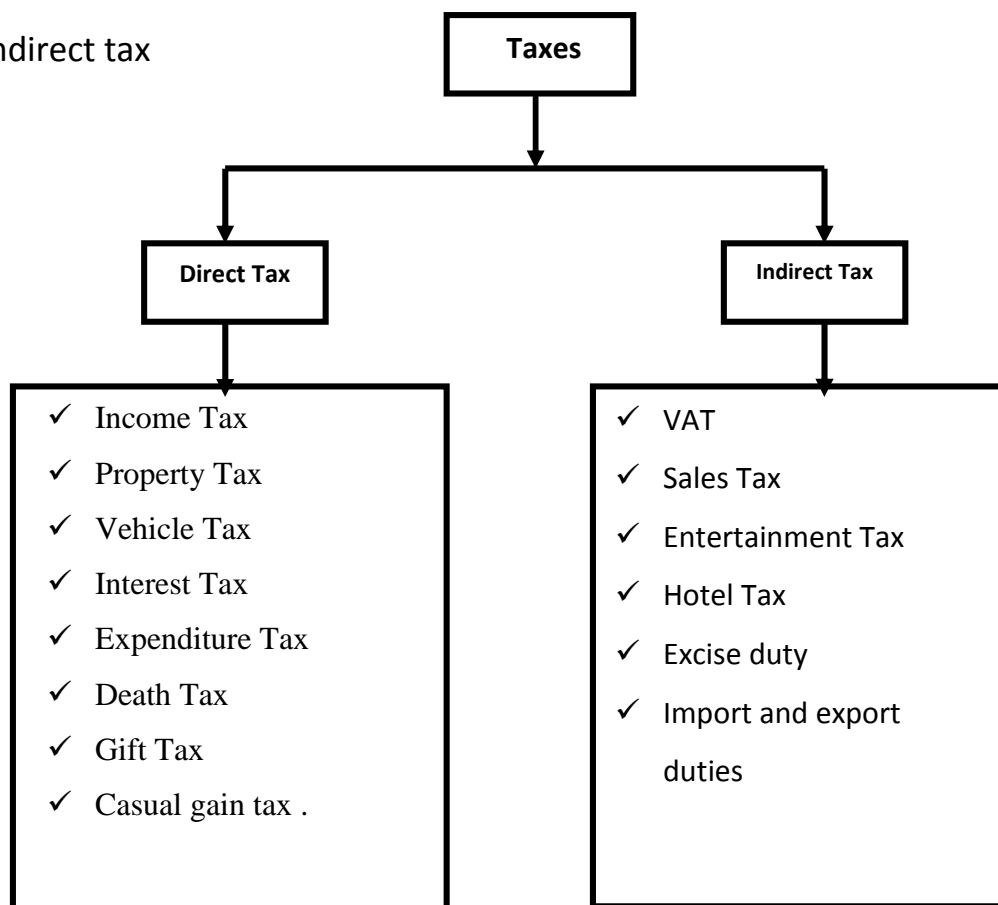
To raise more revenue.

- ) To prevent concentration of wealth in a few hands.
- ) To redistribute wealth for the common good.
- ) To boost up the economy.
- ) To reduce unemployment.
- ) To remove regional disparities.

### Classifications of Taxes

Basically, tax can be classified into two broad categories:

- ) Direct tax
- ) Indirect tax



## **Historical Background of Taxation**

Great Britain is the first country to introduce income tax in the world. The British Government introduced income tax in 1799 in order to generate revenues to finance the war against France. The United Kingdom imposed the income tax regularly from 1860. Income tax was introduced in Switzerland in 1840, Austria in 1849, India in 1860, USA in 1862, Italy in 1864 and Nepal in 1959. Historical background of evolution of income tax in Nepal is not long. Tax has been one of the primary sources of government's revenue from the ancient time in Nepal. During this period taxes were levied on farmers, merchants and travelers in the form of cash or kind. Labour and goods were a type of taxes. The fiscal administration during Lichchavi and Malla regime was of remarkable importance. In Lichchavi regime; direct taxes were introduced for the first time in Nepal. At that time Direct taxes were imposed on income from agriculture and business. These direct taxes were copied from 'Kautilya-The Arthashastra'. Thus, taxes on income from agriculture were called Bhaga (Share of production). According to the quality of land owned by farmers, so called Bhaga was prescribed  $\frac{1}{6}$ ,  $\frac{1}{8}$  and  $\frac{1}{12}$  of their total production. It shows the meaning of taxes on income not on profit. Taxes on income from business were called Kara (tax). It was a tax in cash. It was also copied from 'Kautilya-The Arthashastra'. During the regime of King Anshubarma, irrigation and religious taxes were levied. (S.K. Amatya-2004, Page-13)

After the national unification (1768 A.D) and after the B.S regime (1768 A.D) Nepal experienced a variety of taxes to be levied on land, transit, market duties, forest product and mine. Taxes were both cash and kind, imposed and collected from; three levels such royal palace,

government bodies and local government bodies. They imposed and collected taxes without special acts and rules. Taxes were collected only for maximum government revenue by coercion in earlier years, during that time taxes were levied on customs and transit, jewelry, blankets, copper, iron, papers, textiles, yak-tails, drugs, herbs, cotton, cloths, sheep, goats etc. However, direct taxes on land business were prominent sources.

After democracy, the idea of introducing income taxation originated in Nepal. The first democratic government of Nepal submitted annual budget in 1952 A.D (2008 B.S) with a proposal to levy an income tax.

But, actual income tax was started through the Finance Act of 1959 A.D. (2016 B.S). In 1950, new regime began in Nepal. It started with multiparty democracy in February 18, 1951. This act made a provision of tax on remuneration and business profit at the rate of 5 to 25 percent rating taxes into 10 types. This Act also made a provision of concession to big and small scale industries. Big and small scale industries were given concession by 25 percent and 50 percent respectively on their tax liability. In 1960 A.D. (2017 B.S), Business profits and Remuneration tax Act, 1960 (BPRTA, 1960) a formal income tax Act was enacted in accordance to the provisions of finance Act, 1959 (2016) for the first time in Nepal it had altogether 22 sections. The BPRTA, 1960 defined the terms business, profit, remuneration, company, firm, assessment, tax realization, tax exempt person, tax exempt area, taxable income, tax deduction at source, submission of income statement, rights of the tax officer method of assessment, payment of tax, fine and penalties, tax officials, secrecy etc. The BPRTA, 1960 was considered as unclear and narrow and it was replaced by Nepal income tax Act, 1962(2019). This

act had altogether 29 sections. It had defined nine headings of incomes. They were: (1) Business; (2) Remuneration; (3) Profession and Vocation; (4) House Land Rent; (5) Cash or kind investment; (6) Agriculture; (7) Insurance Business; (8) Agency Business; and (9) Other sources.

The ITA 1974 was replaced by income tax Act 2002(2058). It came onto effect on April 1, 2002(Chaitra 19, 2058). The Government of Nepal enacted income tax rules 2002 (2059) in 2002 in accordance to the authority given under the ITA 2002. It seeks its objectives in the its preamble- “ in order to enhance revenue mobilization through effective revenue collection process for the economic development of the nation, it was imperative to make the laws on income tax in order to update, amend an integrate them”. It is an integrated Income Tax Act of Nepal. Thus, the objectives of this tax law are

- (1) To tax all sources of income.
- (2) To tax according to equity (Horizontal and vertical).
- (3) To make elastic and productive tax system.
- (4) To develop to extensive clear, transparent, simile and efficient tax system.
- (5) To make responsible to tax officials.
- (6) To develop tax system as a neutral task and.
- (7) To stress accounting process and self assessment.

## **1.2 Statement of the Problem**

The contribution of income tax to the nation budget must be increased to achieve the goal of nation development and equal economic distribution. The goal can be achieved only if the government of Nepal takes steps for making the increased by bringing the new tax payers into tax net and implementing the tax laws effectively so as to discourage the

tax evasion practice. Loopholes must be traced by monitoring and implementing rules and regulation to bridge the gap between total resources required and supply of the resources, income tax plays a vital role in government revenue. Economic development is the prime concern of every nation of the world.

Underdeveloped countries are facing serious problem in the process of economic development Nepal is also not an exception to this condition. The majority of people have been able to get even basic facilities. The government wants to fulfill the basic needs of the people and accelerate development activities one at a time thus; every nation of the world is accomplishing various activities to fulfill these objectives. It needs huge amount of capital. Despite the various measures adopted by the government to boost revenue collection there is still a subset entail resource gap between expenditure and revenue. The rate of government expenditure is exceeding the rate of growth revenue almost every year. In other words Nepal has been facing persistent budget deficit from the beginning of her development phase. External deficit, Currency depreciation, inflationary pressure, rising interest rates which may cause crowding out effect and reduction in economic growth are the consequences of the budget deficits. The mobilization of revenue has not increase to level in which level and speed at our expenditure is rising. Raising the government revenue helps to overcome from the serious bottleneck of resource gap in the process of economic development programs by mobilization additional resources from domestic sources. Income tax is one of the component of taxation and major sources of government revenue. Income tax is developing nations has been regarded as an instrument of growth and social justice. But

Nepal Government is being unable to mobilize the expected income tax from personal as well as corporation. Most of the personal tax payers do not reveal the income sources even they earn significant amount. They hardly keep and show their proper accounts. Similarly, many research reports have addressed that tax evasion has become a serious problem as a result the actual collection of income tax is being very low. So, the role of corporate income tax revenue is justifiable. Corporations are easily identifiable, keep their account and cannot escape tax liabilities. But corporate sectors in initial state of development in Nepal. The performance of corporate sector, specially the industry is very poor. Their number, profitability investment in fixed assets share in market transaction is all in weak position. There is no agreement as regards to various issues in corporate tax area. The debate is going on as regards to base of tax, method of taxing corporation, method and rate of depreciation, use of appropriate type of tax incentive, treatment of tax inflation. Such problems are developing countries generate more direct tax and less indirect but in developing countries generates more indirect tax and less direct tax etc.

### **1.3 Objectives of the Study**

The main objective also of this study is to know the effectiveness of income tax system in Nepal. This study also includes the following special objectives.

- 1.** To study and analyze the contribution of income tax to public Revenue.
- 2.** To study and analyze the income tax structure of Nepal.
- 3.** To identify the problems while collecting the income tax.



4. To examine the targets and realizations of income tax and see its position in total revenue.
5. To provide the suggestions for the effective collection of income tax on the basis of study findings

#### **1.4 Significance of the Study**

Nepal is least developed country of the world. The resources collected internally are sufficient to run day- to-day administration of the country but the revenue surplus is not adequate to undertake adequate developmental activities. So, the country is heavily dependent on the foreign aids and grants to undertake its developmental Activities.

Out of various incomes, income tax is an important source for Inland Revenue. It is a regular source of tax revenue too. Income Tax has been contributing to the tax revenue of Nepal. There is lots of this about Inland Revenue like as VAT, excise duty, but no one has studied in details on the contribution of Income Tax. So, the project work is directed acquiring information about income tax revenue collection from Income Tax to Inland Revenue. This study might be fruitful for all researchers, tax officers, tax experts, Inland Revenue department.

#### **1.5 Limitations of the Study**

The main objective of this study is to fulfill the partial requirement of MBS course of Tribhuvan University So, the study cannot cover all the dimensions of the subject and cannot penetrate the extreme depth there for the limitations of this study are as follow:

Limitations of the study were based on the availability of reliable data and sufficient literature.

Due to the lack of time and other difficulties, the field study has limited to Kathmandu Valley for primary data purposes.

Primary data were collected from opinion survey.

The study confined to Nepalese Law, Acts, Ordinance, Regulations, and Circular to income tax.

### **1.6 Organization of the Study**

The study has been organized into three chapters. They are as follows:

**Chapter I:** This is about introduction that includes the general background, statement of the problem, objectives of the study, significant of study, organization of the study, limitations of the study.

**Chapter II:** This is about review of literature that includes the theoretical review, historical background of evaluation of income tax in Nepal, heads of Income, meaning of tax, classification of tax, canon of taxation, final withholdings payment, tax exemption organization, review of books, review of thesis, journals, articles and annual report of Inland Revenue Department.

**Chapter III:** This chapter is about research methodology that includes research design, population and sample, sources of data, data collection techniques, data analysis tools and research gap.

**Chapter IV:** This chapter is about presentation and analysis of data That includes of have been presented in the second chapter. This is one of the most important chapters and includes the data related to the topic extracted from economic survey and annual reports published by ministry of finance and Annual Report of Inland Revenue department. The data have been presented in tables, figures and charts. Similarly, opinion survey has been placed under this chapter.

**Chapter-V:** This is final chapter of the study is related to conclusions and possible recommendations regarding improvement of Income tax to Inland Revenue & related issue.

## **CHAPTER: TWO**

### **REVIEW OF LITERATURE**

#### **2.1 Introduction**

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the structure, role, productivity, legal and administrative framework etc. Either to pay regular expenditure or to do developmental works, The Government collects revenue. The sources of government revenue can be classified into external and internal. External sources of government revenue are foreign loans and grants, external sources etc. External source are uncertain, inconvenient and not good for healthy development of nation because they are to be paid after a certain time. So, it is better to mobilize internal sources rather than external sources. Another source of government revenue is internal which constitutes tax and non tax revenue. The examples of non tax revenue are fees, fines, royalty, administrative and business income. Administrative income denotes the amount charged by the government for providing administrative service. In Nepal, the contribution of non tax revenue on national revenue is 78.2% the fiscal year 2008/09. (Economic Survey, 2008/09.)

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### **2.1.2 Review of Income Tax Act 2058:**

The introduction of income tax system was brought only in the first budget in 2008 BS .However, it was actually introduce only in 2017 BS when the Finance Act, 2016 and business profit and Remuneration Act, 2017 were enacted. At the beginning, equivalent tax rate with progressing and exemption limit were prescribed by the Finance Act of

2017 and after wards to all companies, private firms, individuals and families. The marginal rate of taxation prescribed by these act 25 percent. Since the income tax was imposed only on business profit and remuneration; the tax act could not cover all the sources of income and so was replaced by the Income Tax Act 2019. Income Tax Act 2019 with 29 sections divided the heads of income to 9 parts covering business, profession and occupation, remuneration, house and land rent, cash or kind investment, agriculture, insurance, business, agency business and other sources. The act was amended in 2029 extensively. However, considering this incapable of fulfilling the need of the time, it was replaced in 2031 by another act. The act having 66 section, classified the source of income into 5, namely-(1)Agriculture,(2) Industry, business, profession or vocation(3) Remuneration (4) House and land rent and (5) other sources. Income Tax Act 2031 was revised for 8 times in 1977, 1979, 1980, 1984, 1985, 1986,1989 and 1992. Since 19th chaitra, 2058, INCOME TAX ACT 2058 has been introduced in Nepal. The act was brought in Nepal to avoid the following defects of Income Tax Act 2031:

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

The new Income Tax Act has 143 sections. Income tax rules, 2059 is also implemented under the provision of this act. The new act has many new provisions in comparisons to income tax 2031. Income tax rules 2059 was formed by government of Nepal to clarify some provisions of the act. Finance ordinances have been making slight amendments in the act every year.

### **2.1.3 Provisions under Income Tax Act 2058**

### **2.1.4 Definition of related terms under Income Tax Act 2056**

#### **1. Income (section 2 Ja)**

Income means a “person’s income from any employment, business or investment and the total of that income as calculated in accordance with this act “. It includes all shorts of income received for the provision of labour or capital or both of whether from or nature in the taxable income.

#### **2. Income year (section 2 Jha)**

Income year means period from the start of shrawan of a year to the end of Ashad of the following year. Income Tax Act 2058 has regarded Nepalese fiscal year as an income year.

#### **3. Company (section 2 Da)**

Company means a company established under the company laws for the time being in force. Besides, the following institutions are also treated as company for tax purpose.

- a. Corporate body established under the laws for the time being in force.

**b.** Any unincorporated association, committee, institution, society or group of persons other than a partnership or a proprietorship firm (whether or not registered) or a trust.

**c.** A partnership firm (whether or not registered under the laws for the time being in force) that has 20 or more partners, a retirement fund, a co-operative, a unit trust, or a joint venture.

**d.** Foreign company; and

**e.** Any foreign institution prescribed by the director-general.

#### **4. Individual (section 2 wa)**

Individual means a natural person and a proprietorship firm whether registered or unregistered owned by the person under section 50.

#### **5. Entity (section 2 Bha)**

Entity means the following institutions or organizations:

**a.** A partnership, trust, or company.

**b.** A V.D.C, municipality or D.D.C

**c.** Nepal government

**d.** A foreign government or a political sub- division of the foreign government or a public international organization established under treaty; and

**e.** A permanent establishment of an individual or an entity that is not situated in the country in which the individual of entity is resident.

#### **6. Resident person (section 2 Ka Nga)**

Resident person with respect to an income year means –

**a.** In the case of an individual, an individual-

- Whose normal place of abode is in Nepal?
- Who is present in Nepal for 183 days or more in any period of 365 consecutive days; or - Who is an employee or an official of Nepal government posted abroad at any time during the income year?

**b.** Any partnership

**c.** In the case of trust, a trust that:

- Is established in Nepal
- Has trustee that is a resident person for the income year; or
- Is controlled directly or through one or more interpose entities by a person for the income year.

**d.** In case of a company, a company that: - Is incorporated or formed under the law of Nepal: or- Has its effective management in Nepal during the income year.

**e.** V.D.C, municipality or D.D.C

**f.** In case of a foreign government or a political sub division of the foreign

Government, such an entity: - If it is established under the laws of Nepal; or

- Has its effective management in Nepal during the income year.

**g.** Any institution or entity established under treaty; and

**h.** A foreign permanent establishment of a non- resident person situated in Nepal.

A person who is not a resident person is considered as a non- resident.



## **7. Partnership (section 2 Ka pa )**

Partnership means a firm (whether or not registered) that has fewer than 20 partners. However, the term does not include a proprietorship firm (whether or not registered) or a joint venture.

## **8. Exempt organization (section 2 Dha)**

Exempt organization means the following entities.

a. following entities registered with Inland revenue department as tax exempt entity:- A social, religious, educational, or charitable organization of public character registered without having a profit motive:- A amateur sporting association formed for the purpose of promoting social or sporting amenities not involving acquisition of gain.

b. A political party registered with election commission.

c. A V.D.C municipality or D.D.C

d. Nepal Rastra Bank

e. Nepal government. However, any benefit acquired by any person out of the assets of and amount driven by the entity except in pursuit of the entity's functions or as payment for assets or services rendered to the entity by the person is not exempt for tax.

## **9. Retirement fund (section 2 Gha)**

Retirement fund means any entity established and maintained solely for the purpose of accepting and investing retirement fund contributions in order to provide retirement fund payment to individuals who are beneficiaries of the entity of a dependent of such an individual.

## **10. Retirement payment (section 2 Nga)**

Retirement payment means a payment to:- An individual in the event of the individual's retirement, or - A dependent of an individual in the event of the individual's death.

#### **11. Retirement contribution (section 2cha)**

Retirement contribution means a payment made to a retirement fund for the provision or future provision of retirement payment.

#### **12. Business (section 2 Ka Ja)**

Business means an industry, a trade, a profession, or the like isolated transaction with a business character and includes a past, present, or prospective business. However, the term does not include employment.

#### **13. Investment (section 2 Ka Kha)**

Investment means an act of possessing or investing one or more assets. But the term excludes act of holding assets for personal use by the person owning the assets and employment and business. However, the act of holding non-business chargeable assess is considered as investment.

#### **14. Employment (section 2 Jha)**

Employment includes a past, present, or prospective employment. It is the return for the provision of labour.

#### **15. Assets (section 2 Ka Dha)**

An asset means tangible or intangible assets. It includes currency, goodwill, knowhow property, and an owner's interest or ownership in foreign branch, a right to receive income whether present or future and part of such assets.

## **16. Tax (section 2 Dha)**

Tax means income tax imposed under this act and includes following payments:

- Expenses incurred in the process of creating charge and performing auction of the property of tax creditor by the department.
- Amount payable by a withholding agent or with holdee or amount payable by an installment payer and an assessment.
- Amount payable to the department in respect of a tax liability of a third party.
- Amount payable by way of interest and penalties.
- Amount payable by way of fine in order of the department.

## **17. Trading stock (section 2 Ka Yna)**

Trading stock means assets owned by a person that are intended to be sold in the ordinary course of a business conducted by a person, work-in-progress on such assets, and inventories of materials to be incorporated into such assets. However, the term does not include foreign currency assets. Motor cars of an automobile dealer are trading stock, for example.

## **18. Business Assets (section 2Ka Ta)**

Business assets mean an assets to the extent to which it is used in a business. However, it includes trading stock and depreciable assets of business. A piece of land used in business is an example of a business asset.

### **19. Non –business chargeable assets (section 2 Da)**

Non- business chargeable assets means securities or an interest in an entity as well as land and building. However, it excludes the following assets.

- Business assets, depreciable assets or trading stock,
- A private residential house of an individual that has been owned continuously for at least three years and resided for a total period of at least three years either continuously or intermittently.
- Interest in a retirement fund of a beneficiary.
- A private residential house and land of an individual that is disposed in less than one crore rupees; or
- Non- business assets of an individual that is disposed of by way of any type purchase made within three generations.

### **20. Depreciable assets (section 12 Ka Ra)**

Depreciable assets means an assets to the extent to which it is used in the production of income from a business or investment and that is likely to lose value because of wear and tear, obsolescence, or the passing of time. However, the term does not include trading stock.

### **21. Associated persons (section 2 Ka Na )**

Associated person means two or more persons where one may reasonably be expected to act in accordance with the intentions of the other. It includes:

- An individual and relative of the individual or an individual and a partner of the Individual.

- A foreign permanent establishment and its owner and
- An entity and a person who, either alone or together with an associate or associates control's or may benefit from so percent or more of the rights to income, capital , or voting power of the entity, as the case required , either directly or through one or more interposed entities or a person who is an associated of such person . However, the term does not include employee and persons prescribed by the department as not being associated persons.

## **22. Long term contract (section 2 pha)**

Long term contract means such contract, the term of which exceeds 12 months.

### **2.1.5 Income Heads**

For tax assessment, Income Tax Act 2058 (section 5) has classified the heads of income into three main groups.

- a. Income from business
- b. Income from Employment; and
- c. Income from Investment

#### **Income from business**

If any natural person or corporate body earns income by running any business, industry or trade within an income year. Such income included while computing taxable income from business. Section 7(2) of Income Tax Act 2058 specifies certain income included on forming income from business. Each income that is a part of income from business is specified and so there is no chance for assumption of any other income, which is

not specified in the section, to be included in income from business. Such incomes of business i.e. taxable income are given under Section 7.

- 1.** Service fee.
- 2.** Amount derived from the disposal of trading stock.
- 3.** Net gain from the disposal of business assets/liabilities.
- 4.** Gain on sale of depreciable assets used in business.
- 5.** Gift received from parties in respect of business.
- 6.** Compensation received in restriction of business.
- 7.** Amount received by any investment that is directly related to business.
- 8.** Amount required being included due to change in accounting system.
- 9.** Gain due to change in exchange rate.
- 10.** Bad debt recovered.
- 11.** Underpayment of interest of loan.
- 12.** Compensation received against loss of profit/stock.
- 13.** Any benefit or perquisites.
- 14.** Amount received after the cessation of a business.
- 15.** Amount derived according to the percentage of contract completed during the year under long-term contract.
- 16.** Deducted expenditure which is not so expended.
- 17.** Other incomes required to be included, e.g. Misc. incomes, sundry incomes,  
Discount and Commission.

## **Income from Employment**

Income received by an employee in the form of salary, allowances, any facilities and benefit etc. are included under this head. Similarly, any expenses born by employer in respect of employee are also included as the source of income from employment from such accumulated income life insurance premium, donation to recognized provident fund, up to 7 percent of insured sum or Rs. 10000 annually, 5 percent of net income and 10 percent of gross salary respectively are admissible expenses. From such amount exemption limit is deductible according to the marital status of a person to compute taxable income. In this taxable income, tax rate is charged @15 percent for the first Rs.85000 and rest charged @25 percent to compute total tax liability. Following are the sources of income from employment as per section 8, 24, 25, 27, 29, 30, and 31 of ITA.

- 1. Salary and wages.**
- 2. Paid leave.**
- 3. Income received from overtime work.**
- 4. Commission and charge earned.**
- 5. Gift and reward received in connection of employment.**
- 6. Bonus income.**
- 7. Payment made for facilities enjoyed by employee but paid by employer.**
- 8. Rent expended born by employer.**
- 9. Entertainment and transportation expenses born by employer.**

**10.** Expenses paid by employer in respect of employee or his /her relatives.

**11.** Income earned by employee in respect of accepting any contract between employer and employee.

**12.** Any payment made by employer to employee in respect of employment.

### **Income from Investment**

Investment income includes income earned by any person or entity in the form of

dividend, interest, rent, royalty, income from natural resources, income received from registered retirement fund, income from insurance investment, gift and any other non business taxable income.( Section-9)

**1.** Dividends (except from resident company)

**2.** Interest

**3.** Rent

**4.** Natural resource payment

**5.** Royalty

**6.** Gain from disposal of depreciable assets (used in investment)

**7.** Gift in respect of investment

**8.** Amount derived as consideration of accepting any restriction regarding investment

**9.** Income to be included due to change in accounting method

**10.** Exchange gain



11. Bad debt recovered
12. Underpayment of interest than standard
13. Amount received from compensation
14. Amount paid to third person instead of actual payee (investor)
15. Others

Note: Above incomes are except final withholding payment.

### **2.1.6 FEATURE OF INCOME TAX ACT 2058**

Tax system is sub- system of total economy. Tax policy is changed with the change in the economic policy of the country. Change in the world economic policy and advancement in information technology has a vast impact on Nepalese economy too. Small economies like Nepal have to adopt the economic policy followed by World Bank, International monetary fund, Asian development Bank and other international agencies. Especially, after 1990s there is re-emergence of liberalization, globalization and privation system that focus on the minimum intervention of the state on private economic matters. The 1950s concept of high incentive, high tax rate is changed to the concept of, low rate, wide net” This trend is tax system is followed by most of the countries of the world. Nepal also is not exception in these respect Nepalese administrators and policy makers too have tried to change the tax policy of the country. Income Tax Act 2058 is the result of the change in all these matters. The following are the features of the Income Tax Act 2058.

**1. All tax related matters within the one act:** Before the introduction of Income

Tax Act 2058, there were almost one and half dozen acts related to income taxation. They all used to given the tax related laws governing the income taxation, even tax expert were in confused while dealing with certain problems related to the tax laws. To avoid this confusing situation, income tax has abolished all tax-related provisions given in other acts and confined all income tax related matters with in one act. Section 142 of the new Income Tax Act has would be governed by this act.

**2. Specification of tax rates:** Earlier, the tax act was only the procedural law that ad not dealt with tax rates applicable to different sources of income. Finance act of each year used to deal with the tax rates. However, the new act has embraced the tax rate applicable to all the three sources of income.

**3. Abolition of various tax related concessions, rebates and exemptions:**

one of the main reason of being the Nepalese tax system ineffective wax the tax concessions, rebate and exemption provided by the different tax laws in the past. Most of the facilities provided by the government in the past to tax payers whether corporate body or an individual, were used for tax evasion. Right now, the Nepalese tax base is very small because the facilities provided by the government in the past introduced a psychology of not paying the tax. The new Income Tax Act has abolished most of the facilities given by the earlier acts and introduced a fair system of taxation. It has tried to level the playing field.

**4. Specification of stock valuation methods:** Income Tax Act 2031 was silent the method of stock valuation used for taxation purpose. Under this act, there was only the provision that once one method of stock valuation is adopted, it should not be changed without the approval of the concerned authority. However, Income Tax Act 2058 has made a provision of valuing of goods for tax purpose.

**5. Simplification of depreciation related provisions:**

Income Tax Act 2058 has complicated provisions related to depreciation. The assets categorized for depreciation purpose were around 3 dozens. Different rates were allocated to different types of assets. The result was the confusion relating to the rate of depreciation. There was also the chance of manipulation of depreciation rates due to this confusing state. Accordingly, previous tax act had given alternatives to industries to select one depreciation method from among two- straight line and diminishing balance. However, the rate allowed for both the method was not equivalent. The rate allowed for diminishing balance method was more attractive than the rates allowed for straight line method. That means, diminishing balance method of depreciation was more attractive than the straight line method of depreciation. To avoid this chaotic situation, new tax act has tried to minimize the rooms to play. It has specified diminishing balance method based on pool system with 5 categories of assets as the system of depreciation to be used by business communities.

**6. Taxing capital gains and dividends:**

Income Tax Act 2031 had not the provision of taxing capital gains and dividends. In the past, certain efforts were made to tax these incomes

but due to different problems they were not successful. Income Tax Act 2058 in contrast has made provision in the respect. It has only made legal provisions of taxing these items but also rates of taxes for dividend is laid as 10% for natural person whereas capital gain of the business is taxed as ordinary income.

#### **7. Generous loss set-off and carries forward provision:**

Income Tax Act 2031 had made the provision of setting off and carries forwarding of business losses only for three years from the same sources of income. That means, it had only the intra head adjustment for one year and intra- head income for four year to ordinary forms of business. For financial sector and long term contract, the provision is more liberal providing the facility of recovering the loss from previous five years profit also.

#### **8. Provision of international taxation:**

Modern world is more advanced and complicated from that of 2031. At that time, the economy of most of the countries of the world was of closed type. But now the economy of most of the countries in the world is open one. Due to closed economy concept, international taxation was not felt necessary and hence there was not such tax provision in Income Tax Act 2031. But now this concept is introduced in the tax law. The provisions introduced in the tax law related to international taxation are transfer pricing, foreign tax credit, double taxation avoidance agreement etc.

#### **9. Stringent fine and penalty provisions:**

The fine and penalty for the defaulters in old tax act were not so severe as they are in new tax act. For example, the Income Tax Act 2031 had

the provision of fine of Rs. 5000 to the tax payer who does not maintain the account and a fine of Rs. 500 only who does not deposit the amount of the tax deducted at source in stipulated time. Income Tax Act 2058 has made the provision of fine and penalty more stringent. It has made even the provision of prison up to 3years.

#### **10. No submission of income statement by a person who does not have taxable**

##### **Income:**

This act has made a provision of relaxing the submission of income statement by a person who does not have taxable income of who has the income from remuneration only. (Kandel, 2004:19-22)

#### **2.1.7. Tax Exempted- Amount**

An amount of income allowed by law as tax free is the tax exempt amount of income. Exempt amount is not included in total income while calculating the net income of the person. The expenditure related to such income is also not deducted while calculating the assessable income of a person. Accordingly, no amount is deducted at source while making the payment of such amount. The following amount is exempt from tax as per section 10.

- a.** Amount driven by a person entitled to privileges under a bilateral or a multilateral treaty concluded between Nepal government and a foreign country or an international organization.
- b.** Amount derived by an individual from employment in the public service of the

Government of a foreign country provided that the individual is a resident person solely by reason of performing the employment or is a non-resident person; and

The amount is payable from the public fund of the country.

**c.** Amount derived from public fund of the foreign country by an individual who is not a citizen of Nepal or by a member of the immediate family of the individual.

**d.** Amount derived by an individual who is not a citizen of Nepal from employment by Nepal government as terms of a tax exemption.

**e.** Allowances paid by Nepal government to widows, elder citizen or disabled individuals.

**f.** Amount derived by way of gift, bequest, inheritance, or scholarship except as required to be included in calculating income from business, employment or investment.

**g.** Amount derived by an exempt organization by way of Gifts (donation) or

Other contribution that directly related to the exempt organization's functions whether or not the contribution is made in return for consideration provided by the organization For example, subscription fee received by a club is exempt from tax. Amount derived by Nepal Rastra Bank as per its objectives.

**h.** Pension received by a Nepali citizen retired from the army or police service of a foreign country provide the amount is payable from the public fund of that country.

#### **2.1.8. Business Exemptions and Concessions:**

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

**1.** Any agriculture income derived from sources in Nepa by a person other than the following is exempt from tax.

- Income from an agriculture business derived by a registered firm company, partnership or corporate body.

- Income through the land above the holding ceiling as prescribed in section 12 of land act 2021.

**2.** Income derived by cooperative societies registered under co-operative act, 2028 from business mainly based on agriculture and forest products and dividend distributed by such societies are exempt from tax.

**3.** Any person operation special industry during the whole income year will be taxed as under:

- If the industry is providing direct employment to 600 or more Nepalese citizens through the whole income year, 90% of the applicable rate (20%) is applied for the year.

- The industry operating in remote, undeveloped and underdeveloped area will have to pay 70%, 75% and 80% of the applicable tax rate (20%) respectively up to ten income years commencing from and including the year in which the operation commences.

- If both exemptions are available to the same special industry for same income, only the exemption is available as per the selection made by the industry.

- If the assets used by the special industry were used previously by another person operating the similar type of special industry , the ten

years for the latter will be counted from the period of such use by the another person previously.

- The incomes received under business exemptions and concessions should be calculated separately assuming that these incomes are received by separate person. That is, incomes received under business exemptions and concessions should be separate from other general business and investment incomes.

### **2.1.9 Tax Exempt Organization**

Exempt organization means only entity that should not pay tax legally. Non-profitable organizations are provided such facilities. ITA, 2058 has clearly maintained that tax-exempt organizations are section-2. Following are the tax exempt organization.

- a. A religious educational or charitable organization of a public character.
- b. An amateurs sporting association formed for the purpose of promoting social or sporting amenities not involving the acquisition of gain.
- c. A political party registered with the election commission.
- d. A village development committee, municipality or district development committee.
- e. Nepal Rastra Bank
- f. Nepal government.

However, any benefit acquired by any person out of assets of an amounts derived by the entity except in pursuit of the entity's functions or as payment for assets or services rendered to the entity by the person



it is not exempt from tax. ITA,2058 has mentioned the organizations which are tax free(exempt organization). Act has exempted a social, religious, educational or charitable organization of a public character, registered without having profit motive.

#### **2.1.10 Tax Rates**

As opposed to previous Income Tax Acts, Income Tax Act, 2058 has specified the tax rates applicable to the tax payer of different capacities. It was a practice in the past that the rate of tax used to be given in finance acts of each year. The tax acts were only the procedural things that used to cover only the procedural things of the tax law, not the rates of tax. Due to this practice, it was very difficult to tax payer and even to tax administrators and tax experts to know about the rates of tax applicable to a particular financial year. This practice of amending tax rates each year used to create a kind of uncertainty among taxpayers, especially to businesspersons about the tax rates. To avoid this situation, schedule 1, of Income Tax Act 2058 has included the tax rates applicable to different taxpayers within the tax law itself and amended in each year by finance act. As per the law, the rates and exemptions applicable to different types of taxpayers are as follows;

### 2.1.11. Tax to resident

**Table 2.1**

<b>Individual</b>	<b>Couple</b>	<b>Tax rate</b>
<b>1<sup>st</sup> Rs 160000</b>	<b>1<sup>st</sup> Rs.200000</b>	<b>1%</b>
<b>Next Rs.85000</b>	<b>Next Rs.85000</b>	<b>@15%</b>
<b>Balance</b>	<b>Balance</b>	<b>@25%</b>

- 1.5% special additional fee on amount where 25% tax rate is applied.
- A resident spouse may elect to be treated as individual or couple under section 50 of the act.
- An individual working in a remote area is entitled to a rebate up to a maximum of Rs. 30000 by way of additional basic exemption. The exempt limit specified in rule 38 of ITA, 2059 is as under:

**Table: 2.2**

**Remote Area exemption for individual**

<b>Area A</b>	<b>Rs.30000</b>
<b>Area B</b>	<b>Rs.24000</b>
<b>Area C</b>	<b>Rs.18000</b>
<b>Area D</b>	<b>Rs.12000</b>
<b>Area E</b>	<b>Rs.6000</b>

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

-An individual conducting a special industry through the year and only individual deriving income from exports are subject to tax only at the rate of 20% on that slab of taxable income where 25% tax rate would otherwise be applicable.

If an individual has income exclusively from a business having source in Nepal, income and annual turnover do not exceed Rs.120000 to 1200000 respectively and if the individual elects to apply this provision for the year, the individual is subject to flat rates. The rates will be as follows for an individual conducting business in;

**Table: 2.3**

**Annual Tax According to Types of Vehicle**

<b>Types of Vehicle</b>	<b>Annual tax per vehicle(Rs.)</b>
<b>a. Minibus,Mini-truck,Trucks,Bus</b>	<b>15000</b>
<b>b. Car jeep, Van, Microbus</b>	<b>1200</b>
<b>c. Three wheeler, Auto rikshaw, Tempo</b>	<b>850</b>
<b>d. Tractor and powerthriller</b>	<b>750</b>

- Gain from non- business chargeable assets is taxed at the rate 10% in the case of an individual.
- In case of an entity, gain from non- business chargeable is included in investment income and taxed at normal rate. For example, a company should pay tax at the rate of 25%
- A resident individual should pay tax on the amount only after deducting 7% of insured sum on his/her life or Rs. 10000 or actual insured premium whichever is lower.
- The taxable income of non-resident individual is taxed at the rate of 25%

## 2.1.12 Tax to Entity

**Table: 2.4**

<b>S.N.</b>	<b>Types</b>	<b>Tax Rate</b>
1.	Bank financial institution, general insurance company Or entity established under Nepal petroleum act, 2040.	<b>@30%</b>
2.	Entity wholly operating as special industry.	<b>@20%</b>
3.	Special industry providing direct employment to 600 or more Nepalese citizen.	<b>@18%</b>
4.	Special industry established in remote area.(for ten years from the year of commencement)	<b>@14%</b>
5.	Special industry established in undeveloped areas.(for ten years from the year of commencement)	<b>@15%</b>
6.	Special industry established in undeveloped areas. (for ten years from the year of commencement)	<b>@16%</b>
7.	Entity that has operated any road, bridge, tunnel, ropeway, flying bridge etc. constructed by the entity.	<b>@16%</b>
8.	Entity wholly engaged in the projects to build public Infrastructure, own, operates, and transfers it to government or Entity engaged in power generation, transmission and distribution.	<b>@20%</b>
9.	Entity that has operated any trolley bus or tram.	<b>@20%</b>
10.	An entity that has earned income from export.	<b>@20%</b>
11.	Income of an estate of a deceased resident individual. Trust of an incapacitated resident individual	<b>Tax applicable to natural person</b>
12.	Repatriated income of a foreign permanent establishment a nonresident person situated in Nepal.	<b>@10%</b>
13.	Taxable income of a non-resident person providing shipping, air, Transport or telecommunication services.	<b>@5%</b>
14.	For other entities not specified above.	<b>@25%</b>

## **2.1.13 Withholding Payments**

### **2.1.13.(a) Withholding by employers (section-87):**

Every resident employer is required to withhold tax at normal rate from a payment with a source in Nepal that is to be included in calculating income of an employee from the employment. The obligation of an employer to withhold tax (as mentioned above) will not be reduced or extinguished because of following:

- Right or an obligation of the employer to deduct and withhold any other amount from the payment or
- Any other laws that provides that an employee's income from employment will not be reduced.

### **2.1.14(b) Withholding from investment returns and service fees.(section-88):**

When a resident person pays interest, a natural resource payment, rent, royalty, service fees and retirement payment with a source in Nepal, the person will withhold tax on the gross amount of the payment at the of 15%. In case of retirement payment made by Nepal government of approved retirement fund, Gain calculated under section 65.1(Kha) will be withheld at the rate of 6%. Where a resident person pays the following payments which has a source in Nepal, the person will withhold tax as follows:

- For individual 15% of the payment amount.
- For payment of gain investment insurance, 5% of such gain.
- For payment of gain from unapproved retirement fund, 10% of such gain. Where resident bank, financial institution, other entity issuing

debenture or company listed under prevailing act pays the following interest of any amount having a nature of interest to an individual with respect to deposit debenture , debt certified and government bond will be required to withhold tax on the gross amount of the payment at the rate of 6%.

- Payment which as a source in Nepal; and
- Payment which is not received by the individual in the course of conducting a business.

#### **2.1.14. Objectives of Income Tax Act 2058**

In every country, the government collects its revenues through different sources. Out of which, taxes contribute a significant amount in the public revenues. The government mobilizes its revenue through budget in development programmers' daily administration, peace and security and public interests. Thus the good tax policies are considered as tools of social and economic revolution. The main objective of Income Tax Act, 2058 are as follows:

1. To confine all the income tax related matters within the act.
2. To develop a tax payer-friendly taxation system by making it clear and transparent.
3. To using all income generating activities into tax net.
4. To integrate Nepalese tax system of foreign countries.
5. To reduce the scope of discretionary interpretation of the tax authorities.
6. To harmonize tax rate and concessions on equity grounds.

7. To make income tax elastic and revenue productive.
8. To minimize the tax avoidance and tax evasion.
9. To widen the tax payer.
10. To make taxpayers more responsible by enforcing the self assessment system.
11. To maintain the welfare state.

## 2.2 Review of Books

In 1965, the book “Nepalma Ayakar Byabastha” written by

**Mr. Kedar Amatya**, become the historical document in the field of income tax. In his book, the writer basically analyzed the legal aspect of income tax.

In the year 1976, **Mr. Nirmal Bhattarai** and **Mr. Ratna Shrestha**, wrote a book in which information about the legal aspects of income taxation in Nepal of that period is given. This book is theoretically based rather than analytical.

In 1980, **Dr. GR Agrawal** wrote the book entitled “Resource mobilization in Nepal”. Dr. Agrawal, in his book, details explains about resource mobilization through income tax, effective tax system and policy, income tax system in Nepal, role of income tax in Nepalese tax structure, administration and legal aspects of income tax in Nepal.

In the year 1990, **Mr. Nagendra Bahadur Pradhanga** published a book named “Income tax law and accounting” In this book, Mr. Pradhanga has illustrated the process, provision and the method of assess the income tax from various sources income under Income Tax Act 1974. He has only explained the provisions relating to income tax in his book. This



is only the legal aspect of income tax but analyzed the defects, problem and role of income tax to the economic development of country.

In the year 1994, **Mr. Rup Bahadur khadka**, published a book “Neplese taxation path for reform” In his book he has described the economic policy of Nepal, improvement of tax administration, property tax as the major source of tax revenue of Nepal. He has identified the major problems of income tax as well as suggestions. Some of the problems identified by him are weak tax administration, unscientific tax assessment, narrow tax coverage and deviation from basic principle of income tax. His suggestions are use of presumptive method, extension of tax coverage, improvement in tax assessment system, inflation adjustment, introduction of current year payment basis and extension of withholding tax etc.

In 1999, **Narayan Raj Tiwari** , wrote a book entitled “Income tax system in Nepal”. This book is related with Income Tax Act 2031 and has described about the introduction of tax, theoretical concept of income tax, tax system of Nepal, taxable income, admissible and inadmissible expenses, income tax administration and etc. The process, provisions and method to assess the income tax have been illustrated with numerical example however the major problems of Neplese tax system have not been shown.

In 2001, **Mr. Kamal deep Dhakal**, wrote a book entitled “Income tax and house and compounded tax law and practice”. This book is based on B.com. and MBS syllabus and related with Income Tax Act 3031 B.S. This book is very much useful to get historical knowledge of taxation and practice under the provision of the act.

In 2002, **Bishwo deep Adhikari**, has published a book named “Income tax law:then and now”. This book is analytical rather than informatics and based on Income Tax Act 2058. He has discussed the legal provision under the act with critical analysis.

In 2003, Professor **Dr. Chandra Mani Adhakari**, wrote a book entitled “Modern taxation in Nepal: theory and practice”. He has described the provisions under Income Tax Act 2058, heretical concept of taxation, characteristic of taxation and source income. He has illustrated the method, process, provision to assess tax liability from various sources. He also tried to introduce the different aspect of tax planning including the need and bases for successful tax planning.

In 2003, **Mr. Bidhyadhar Mallik** wrote a book entitled “Nepalko Adhunic Kar Pranali”.He has discussed about the legal provisions relating to Income Tax Act 2058 in details. Mallik’s book has been divided into twenty five chapters. Mallik has escribed about development of income tax, computing of income, exempt amounts, admissible amounts, capital gain, special provisions regarding to natural persons, special provisions for entities. He has also described weakness of Income Tax Act 2031 and need of new Income Tax Act international tax, tax administration, payment of tax, income statement and tax assessment, tax rates, assessment of depreciation, and etc. He has shared his expertise in his book. His book is descriptive and analytical.

In 2003, **Mr.K.P.Aryal** and **Mr. Surya Prasad Poudel** wrote a book entitled “Taxation is Nepal”. This book is designed as per the syllabus of BBS 3rd year and based on Income Tax Act 2058. This book have include theoretical and practical aspect of taxation, method of assessment of

income tax with numerical illustration, however this book does not provide complete information about all the aspect of income tax system of Nepal.

In 2003, **Dr. Puspa Raj Kandel** published a book named “Tax law and planning in Nepal”. The book is related with Income Tax Act 2058 and based on the MBS syllabus prescribed by Tribhuvan University. He has described the sources of revenue, meaning of tax, objective of tax, cannons of taxation, principles of taxation, classification of taxes, historical development of income tax in Nepal and etc. He has also explained different terms used in Income Tax Act in details and also presented special provisions for natural person and entity, banking and insurance, business and retirement fund in the new tax act, 2058. Similarly he has also described about the classification of taxpayers, exemption limit, admissible and inadmissible expenses, capital income, capital expenditure, capital loss, sources of income, tax authorities and etc. The process, provisions and method to assess the income tax from various sources of income have been illustrated with numerical example. Similarly, he wrote a book entitled “Nepal ko Bartaman kar Byabastha” for BBS 3rd year.

In 2003, **Mr. Surendra Keshar Amatya** , **Dr. Bihari Binod Pokharel** and **Rewanta kumar Dahal** wrote a book entitled “Taxation in Nepal”. Theoretical as well as aspect of taxation have been included in this book and the book is designed to meet the requirement of BBS of 3rd year syllabus of Tribhuvan University. This book is descriptive but not analytical.

In 2003, **Mr. Ishwor Man Rai** and **Mr Narayan Prasad Baskota** published a book entitled “Taxation in Nepal”. This book is designed according to the syllabus of BBS 3<sup>rd</sup> year, Tribhuvan University. This book has been included computations regarding different sources of income.

In 3003, **Mr Ishwor Bhattarai** and **Girija Prasad koirala** published a books named “Taxation in Nepal” designed according to the syllabus of BBS 3rd year of TU and “ Tax law and tax planning” designed according to the MBS 2nd year syllabus of TU. These books are based on the Income Tax Act 2058 and are very useful. Relevant theoretical and practical aspects have been discussed in the books. The writer has shows how taxable incomes are computed under employment, business and investment sources under the Income Tax Act 2058.

In 2004, **Mr Jagadish Agrawal**, wrote a book named “Income tax theory and practice”.The book is a practitioners reference and hand book rather than theoretical compilation on the subject. The book said that the income tax is so designed to cover all the material and component required for the for a modern tax law. The book also said the Income Tax Act is good because it includes and defined the new terms and provisions; for example, foreign payment establishment, controlled entities, transfer pricing, non –business chargeable assets, qualification, allocation and characterization of amount etc.

### **2.3. Review of the Thesis**

In 1974, **Mr Narendre lal Kayastha** had conducted a research entitled “Taxation of income and property in Nepal”. He has pointed out the problems of tax system and gave appropriate suggestions for correction of policies. The major problems of tax system found by him are income

tax evasion and dominant role of indirect in total tax revenue, which are still considerable in Nepalese context.

In 1976, a richer team lead by **Bhawani Dhungana**, the researcher of CEDA has studies on “The analysis of tax structure of Nepal”. The report has declared that country to develop economy where tax policy tends to accept the ability of tax system in mobilizing the finance sources. The report has also claimed that the administration of income tax has improving because there has been an increment of tax by 23.5% between 1969/70 to 1975/76 and tremendous progress in assessment has been made.

In 1978, **Mr Ramesh B. Chipalu** studied on topic “A study on tax structure in Nepal” found that Neplese economy has become a victim of the adverse effects of deficit financing and foreign dependency. But Mr Chipalu has not discussed on the income tax separately and the major aspect of income tax has not been mentioned in the study.

In 1983, **Naina Nepal** presented her study on “A study of problems and prospects of income tax in Nepal”. Some of the problems pointed out by her are inefficient income tax administration, mass poverty, level of consciousness, low number of taxpayers, narrow coverage, assessment deficiency and etc. She has emphasized on fiscal system of Nepal, origin, meaning existing position, role, position, problems, and future prospects of income tax of Nepal. She has suggested that the government can maximize its revenue through income taxation by solving the above problems and effectively utilize the resources.

In 1984, **Dr Govind Ram Agrawal** has presented a report to Ministry of finance entitled “Direct tax Reforms in Nepal”. In his report, he had

shown the resource gap in Nepal was in the increasing trend. So, the dependency in foreign aid is increasing. He had shown an urgent need to mobilize additional resources from domestic resources. He had shown that the growth rate of direct taxes had been lower than the growth rate of total revenue as well as total taxes. Registration fees of organization are in increasing level than the income tax collection. He had strongly recommended a revenue service, political and other pressures shouldn't be subjected to tax administration. Self assessment of tax should be encouraged. Assessment of small business should be on door to door basis. Political and undesirable presser in tax administration should be minimized. Capital gain of business man should be included in income tax purpose. Most of the segmentations given by his were adopted in the new act.

In 1989, **Shanty Baral** presented a dissertation entitled "Income tax and tax structure in Nepal". She had shown the contribution of direct tax has been increasing the total revenue. She had also mentioned about the problem to raise government revenue. She said in his thesis that lacks of clear and comprehensive definition of income tax, lack of punishment to tax evaders, lack of taxpayers consciousness, lack of efficient tax administration, lack of scientific method of tax collection were the main defects of Income Tax Act and system.

In 1995, **Krishna kumar Shakya** presented a dissertation entitled "Income tax in tax structure of Nepal". In his study, he has endeavored to examine the pattern of existing income tax structure of Nepal with view on its collection, mobilization in development prospective. Some of the factors responsible for limiting Nepal's taxable capacity, pointed by him are low per capita income, extensive subsistence economy,

relatively closed economy, social and political factors; weak export position, administrative and enforcement problems of tax and etc. He has suggested for honest and efficient administration, punishment to tax evaders, scientific method of taxation and assessment of small tax payers on door to door basis and encouragement of self-assessment tax system.

In 1995, **Mr. Baland Paudel**, made a study on Nepalese tax structure in his dissertation entitled “A study of Nepalese tax structure”. He has made a review of revenue structure of Nepal government from individual taxes, analyzed the relationship of direct and indirect taxes with total revenue and GDP and assessed various weaknesses and problems of present tax system and put forward suitable recommendation to solve them. He has suggested that the tax system will be successful and effective with the political support, administrative efficiency and people’s confidence. These conditions are given to take the measure and to adopt the policy that could generate more revenue for our economic development.

In 2001, **Binita Shrestha** wrote a thesis entitled “Revenue collection from income tax in Nepal, problems and prospects”. She has analyzed the effectiveness of income tax collection from income tax and recommended measure for improvement of income tax law and management in Nepal. She has found serious resource gap problem for Nepalese economy and also found the level of tax collection has been rising. According to her study the major problems of Nepalese tax system are narrow tax coverage, mass poverty of Nepalese people, lack of conscious taxpayers, inefficient tax administration, instability in government policy and etc.

In 2002, **Jayanti Poudel** wrote a thesis entitled, “Income Taxation in Nepal: A study of its structure and productivity”. She has found that overall revenue of Nepal showed an annual growth of 16%, indirect tax has more significant contribution in total tax revenue; income tax occupied the first rank among the direct taxes. Personnel income tax slabs has been changed radically from seven slab in 1975/76 to two slab in 1999/2000, VDIS (voluntary disclosure of income scheme) could not attract more potential tax payers into tax net due to lack of good planning and adequate homework of the government, working procedure of the tax administrators are still traditional and cost of administration has not been brought to the satisfactory level. According to the study, the trend of overall revenue in Nepal shows the continuous increase over the study period with an average annual growth rate of 16%. The resource gap of the government seems to be terribly increasing.

In 2003, **Mr. Dan Bahadur PalliMagar** wrote thesis entitled “Income tax in Nepal: A study of exemptions and deductions”. He has studied the exemption and deductions provided by Income Tax Act 2058, problems and weakness on income tax system, contribution of income tax to government revenue and suggested possible area of reform. He tried to find out the position of tax administration, sufficiency of exemption times of incomes, income to be exempted but not allowed by the provision of the Act, appropriation of exemption limits, necessary of adjustment of exemption limit as per inflation, expenses should be deducted in priority, problems and weakness of income tax system and sufficiency of provisions made in the act and etc.



In 2004, **Mr. Dharma Raj Shakya** wrote thesis entitled “A study on Income Tax Act 2058”. His study was based on Income Tax Act 2058 and objectives were to examine the simplification of income tax assessment procedure; to find out the effectiveness of service delivered by tax administrators to the tax payers; to analyze the taxpayer’s, response regarding to their duties and rights; to review the provisions regarding to minimize the tax evasion, avoidance, corruption under the act and to view the structure of government revenue and position of income tax. He found that tax evasion and avoidance are the major constraints for effectively mobilize the income taxation. According to his study the reason for tax evasion and avoidance are inefficient tax administration, poor tax morality and tax payers compliance, inadequate audition and investigation, reluctance of taxpayers’ to maintain account, poor enforcement of fine and penalties, inappropriate tax act and laws and etc.

In 2004, **Mr. Girija Prasad Koirala** wrote a thesis entitled “Contribution of employment to income tax revenue of Nepal”. Mr. Koirala has found that the contribution of employment income to total income tax revenue of Nepal has not been founded satisfactory due to various reasons like low pay scale to the employees, ineffectiveness in the implementation of the act, tax evasion and etc. Similarly, correct exemption limit is not satisfactory. He suggested that separate provisions should be made regarding exemption limit to couple and family, and they should be given higher exemption limit in comparison to the individual. Some of the recommendations given by Mr. Koirala were: Income Tax Act should be made effective in the implementation aspect. The contribution of income tax revenue to tax revenue and direct

tax revenue should be increased by checking tax evasion and bring new taxpayers into tax. (Bastable). Couple should be provided more tax exemption as compared to individuals because of cost of living of them. Pension income should be taxed by giving enough exemption limits to the pension holders because in the old age, pension holders lack other sources of incomes. The troubles faced by employees should be minimized and etc.

In 2004, **Mr. Deepen Routcheetri** wrote a thesis entitled “Income tax system of Nepal and its contribution to revenue collection”. The main objectives of the study were, to examine the share of income tax revenue; to analyze the effectiveness of tax administration in income tax collection; to find out the problems relating to revenue collection from income tax and to suggest some weakness to improve the effectiveness of income tax act. Mr. Chetri found that income tax as major source of government revenue, the major source of weakness in the tax administration of Nepal is lack of organizational and individual incentives; Nepal’s tax system has significantly improved both qualitatively and quantitatively due to change in policy followed by required adjustment in the tax laws. He has recommended that there should be a policy to develop the efficient, fair and equitable tax administration in order to increase the income tax revenue. He also suggested that to make the tax administration capable of facing new challenges, there should be improvement in professionalism as well as development of new professional ethics compatible to the changed context of liberalization.

In 2006, **Mr. Hiranya Niraula** wrote thesis entitled “Implementation problem of Income Tax Act 2002”. In his thesis he has explained that

Income Tax Act 2002 is modern and advance than previous tax act however still there are many problems in current income tax act. According to Mr. Niraula, the major problems of current Income Tax Act 2002 are, illegal business activities, tax evasion and avoidance, complicated language, lack of educated people, lack of appropriate tax assessment procedure, corruption, political interferences and etc. He also suggested that to effectively generate revenue from the income taxation, the act should be effectively implemented since the act has many features. Tax payers should have positive response towards their duties and rights and the tax administration must be liable to fulfill the responsibility provided by the law that support to effective implement the act. The main recommendations given by him are:

- a. Problems of tax system like political influences, illegal business activities, complicated income tax rules and regulations, ignorance of tax officers to collect tax and taxpayers to pay tax and etc. should be corrected.
- b. Giving attractive incentives, prize or extra remuneration to the employees should minimize the corruption.
- c. Self-assessment should be encouraged, the tax assessment method under Income Tax Act 2002 is average, and so further treatment is needed.

Tax evasions and avoidance decrease the tax liability so, income tax policy and penal provisions should be good to stop these tax evasions and avoidance.

In 2007, **Mr. Santosh Khatiwada** has done thesis entitled “Attitude of businessmen towards Income Tax Act 2002(2058). The main objective of

his thesis was to analyze the impact and effectiveness of income tax on revenue generation of Nepal and give appropriate suggestions to improve the tax system so that the government can collect more revenue and use it in the economic development of the country. According to his thesis collection of income tax has faced various problems like tax evasion, poor tax administration, unsound income tax policy, lack of consciousness of people and etc. The success and effectiveness of income system entirely depends upon provisions of income tax system, sound and effective tax administration, trained employees as well as positive response and willingness of taxpayers to implement the provisions. Income Tax Act 2058 is modern and effective than the previous Income Tax Act but some of the problems still existing the act are insufficient rebates and facilities, increasing corruption, ineffective services to the taxpayers by tax administration and etc. So tax act should improved accordance with tax payer and implemented properly can solve the existing problem of tax act and help to increase the tax revenue in the total revenue of the government. Some of the recommendations made by him in order to correct the Income Tax Act 2058 as well as to improve income tax system of Nepal are:

**a.** To increase the contribution of income tax in the total revenue of the government, improvement of overall tax structure system, simplification of act and policies, adjustment of tax slab, strictly implementation of law, rule and regulation to regular taxpayers, to find the new source of revenue, increase the tax ratio to meet the deficit budget and etc. are essential.

**b.** To make the tax system effective the recommendation made by him are clear and simple tax law and rules, further explanation in simple

language to the definition made in Income Tax Act depth knowledge to the policymakers about income tax, to make the self-assessment system effective, effective auditing and accounting system should be described, direct tax system should be introduced, clear provision for deduction sufficient allowances and sufficient rebate should be made under provision, exemption limit should be adjusted according to the inflationary condition, adequate medical tax credit to individual, provisions of reward, prize and incentives to encourage the taxpayers, utilization of rights of businessmen under income tax, weak points of the act should be replaced by new policy, lower fine and penalty in general condition and higher fine and penalty for income tax evaders is essential, tax policy should be in accordance with economic policy of the country and etc.

c. To overcome from the major problems existing in the current act, the recommendations made by him are; well trained employees in the tax administration, free of political pressure to tax administrators, punishment to corrupt employees and rewards to the employees worked positively, continuous effort to develop the taxpayers positive attitude towards the tax, provide knowledge and training to taxpayers about the incentives, facilities directly related with taxpayers, improvement in poor response and unnecessary delay from the tax officers, sufficient facility and good working place should be provided to tax officials, bringing of consumer scheme to motivate them to take bill of purchasing goods, to implement VAT effectively the border point should be tight and should evaluate export/import of goods appropriately, electronic cash register machine should be provided by the government at cheap rate which is necessary for every business to billing

their sales transaction which help to solve the tax evasion, coordination between tax department, tax offices and business organization, implementation of TDS system to save tax from tax evasion, practically utilization the administrative review and the appealing system.

### **2.3 Research Gap**

Most of the precious researches are bad on the structure, provision, administration and etc. Various books, thesis, articles, report have been reviewed while preparing this thesis. Almost there were written on different objectives and topic of income taxation. Books are found mainly based on the syllabus requirement of Tribhuvan University of Nepal. The Income Tax Act 2058 is a new act and no one has studied on “attitude of government employees towards Income Tax Act 2058” as know. Thus, to fill this gap, this research has been conducted. It is based on primary as well as secondary data. Finally, the researcher believes that it is unique or original.

## **CHAPTER: THREE**

### **RESEARCH METHODOLOGY**

This chapter is devoted to the research methodology applied in the study to achieve the goals. Both primary and secondary sources of data have been used in the study. Opinion survey technique was adopted while collecting primary data. Questionnaires were distributed to income tax experts and professionals and tax payer know their opinion towards various aspects of income from resident person. Economic survey was used as the major source of secondary data. Different statistical tools were used as the major source of secondary data .Different statistical tools are used to analysis the data. In his study, correlation, simple average, percent and chi-square test for hypothesis have been used to analyze the collected data.

#### **3.1 Research Design**

This study is based on primary as well as secondary data. Primary data were collected from interviews with experts, professionals, and income tax payer. This study has given the priority to both analytical presentation as well as descriptive presentation. In descriptive design results or facts were described in the simple and systematic manner so that the reader and concerned persons can understand easily. Most of the materials of this study were concerned with past phenomena of the performance in numerical or theoretical term.

### 3.2 Population and Sample

All the tax administrators, experts and taxpayers were considered as total population. Out of them, the experts and taxpayers in Kathmandu Valley were considered as target samples. The following revenue the group and people size of respondents.

**Table: 3.1**

**Group of Respondents and Sample Size**

S.N	Group of respondent	Sample size	Code used
1.	Tax administrators	30	A
2.	Tax experts	30	B
	Total	60	

Questioner use respondents groups.

### 3.3 Nature and Sources of Data

Both primary and secondary data were used in the study. The primary data were the opinion of experts and income tax, house rent, VAT, excise duty, interest income regarding income tax to Inland Revenue. Primary data were obtained through questionnaire method (see appendix Page No-B) followed in most cases face to face interviews / discussions with the sampled persons included in the purposive sample



the secondary source of data were used the statistic relating to tax published.

### **3.4 Selection of the Respondents**

After careful study of the subject matter, a set of questionnaire was developed and distributed to two respondent groups Viz. tax experts and employees. Tax experts comprise of chartered accountants lawyers, professors and policymakers.

### **3.5 Data Collection Procedure**

A set of questionnaire was developed and distributed to the selected respondents in order to get Actual and accurate information. Distribution work was done personally rather than sending by any other means. Additional information was collected from interviews with the respondents.

### **3.6 Data Analysis Tools**

The data collected from primary and secondary sources were first tabulated in separate format systematically in order to achieve the desire objectives. The data were then tabulated into various tables according to the subject in order. Then simple analysis was done by using statistical tools such as percent, average, correlation, chi-square ( $x^2$ ) test for hypothesis etc. Available data were presented and analyzed in description way. In primary data analysis, some hypothesis was tested to know whether there was significant difference between the opinion of tax experts, professionals and income tax payers.

## CHAPTER: FOUR

### PRESENTATION AND ANALYSIS OF DATA

This is the major chapter of the study. In this chapter, the data related to the study have been tabulated, presented, analyzed and interpreted. The reliability of the study depends upon the data available and sources of data.

#### 4.1 Analysis of secondary data

The secondary data are not originally collected but obtained from various published and unpublished source. The analysis of secondary data in various matters can be done in the following ways.

**Table 4.1**  
**Mobilization of Income Tax (Rs. In Million)**

Year	Income Tax		Total Tax revenue		Non tax revenue		Total Revenue	
	Amount	%	Amount	%	Amount	%	Amount	%
2004/05	869.14	91.82	4258.69	108.27	1364.29	122.74	5622.98	111.47
2005/06	1021.51	117.53	4817.30	113.11	1415.80	103.77	6233.10	110.85
2006/07	1127.26	110.35	5410.47	112.31	1601.80	113.13	7012.27	112.50
2007/08	1178.70	104.56	5743.04	106.14	1485.16	92.71	7228.20	103.07
2008/09	1660.81	140.90	7197.34	125.32	1522.63	102.52	8719.97	120.64

Source: Annual Report of Inland Revenue Department 2008/09 (Page-23)

From the above mentioned table income tax in fiscal year 2004/05 is far less than in 2008/09. There is a long gap of 49.08% on the other hand suddenly it got 117.53% crossing the border of 100% in the next fiscal

year. That described to comparatively similar percentage 110.35 and 104.56 in the remained two Fiscal year. In the context of non tax revenues, we can find almost equal percentage in fiscal year 2004/05(108.27%) and in 2007/08(16.14%) respectively 113.11% in 2005/06 and 112.31% in 2006/07. At last it hit the highest point of 125.32% marketing the gap of 17.07% between first and final fiscal year through it was irregular. Watching the total tax revenue. We notice irregular (up and down) way of percentage between first fiscal year and last even total non tax revenue is less by 20.22% than first fiscal year in 2006/07. It dipped to 103.77% almost equal to last year but again lifted to 112.13% in 2007/08. In 2008/09 it hit the again lowest 92.71% of those fiscal years of the chart.

The revenue mobilization can be explained from following table.

**Table 4.2**  
**Inland Revenue collection and Gross Domestic Production (Rs. In Billion)**

Year	Targeted Revenue collection	Contribution in GDP	Contribution of IRD in GDP	Contribution of IRD in Tax Revenue
2003/04	98.4	11.4	5.73	63.18
2004/05	100.2	13.91	7.25	67.56
2005/06	99.7	12.31	6.75	68.53
2006/07	88.3	13.08	7.58	71.51
2007/08	101.5	13.11	7.67	73.51
2008/09	101.2	14.95	8.86	72.63

Source: Annual Report of Inland Revenue Department 2008/09 (Page-45)

Taking the data of targeted revenue collection, we see almost equal amount in fiscal year 2003/04, 98.4 billion and 2005/06, 99.7 billion on

similarly in 2004/05, and 100.2 billion. There is 88.3 billion in targeted revenue collection in fiscal year 2006/07 and 101.5 billion in 2007/08 and 101.2 billion in fiscal year 2008/09. It has unequal (up and down) amount in targeted revenue collection in every fiscal year although it is seen higher by 13.17 billion at the last fiscal year.

Contribution of IRD in GDP in 2003/04 is 5.73 billion the least amount comparing to other years. In fiscal year 2004/05 and 2006/07 almost the equal 7.25 billion and 6.75 billion amount was collected through 7.58 billion amounts collected between that fiscal year. At the last fiscal year 8.86 billion amounts was collected. As a whole it has a slight rising trend although it has irregular trends before last fiscal year. Contributions of IRD in total tax revenue in 2003/04 63.18 billion the least amount comparing to other fiscal year 2004/05, 2005/06, 2006/07 and almost equal 67.56 billion, 68.53 billion and 71.51 billion amount. At the fiscal year 2007/08 and 2008/09, 73.96 billion and 72.63 billion is contribution of IRD in total tax revenue.

**Table 4.3**

**Condition of Aggregate Revenue Collection in Fiscal Year 2008/09 (In Thousands)**

Types of Revenue	Targeted	Actual Realization	Realization percentage	Increasing Percentage
Total Revenue	141722110	143474489	101	33
Non-Tax Revenue	23905110	122892174	96	16
Tax Revenue	116560000	111092373	95	30
Indirect Tax	81173000	82731168	102	33
Direct Tax	35387000	34320739	97	49

Source: Annual Report of Inland Revenue Department (page-12)

In fiscal year 2008/09, there is a target revenue collection of 1417.2 billion and actual revenue collection is 1434.7 billion. It is greater

than the targeted amount of Rs.395 billion. Similarly Total tax revenue, Non tax revenue, Tax revenue Indirect tax and Direct tax irregular's by 33%, 16%, 30%, 33% and 49% respectively.

**Table 4.4**

**Revenue collection of Inland Revenue Department fiscal year 2008/09**  
(Rs. In Thousands)

Description	Targeted Revenue(Rs)	Realization Revenue(Rs)	Percentage%	Increasing Percentage
Tax revenue	85660000	850119150	99	39
Direct tax	270870	27247386	101	35
Income tax	24386500	24602094	101	42
House rent tax	1033200	960198	93	33
Interest tax	1667300	1685094	101	55
Indirect tax	55073000	55921806	102	36
VAT	41000000	39700921	97	33
Excise duty	14073000	16220885	115	45
Vehicles tax	3500000	1849958	53	65

Source: Annual Report and Record of Inland Revenue Department (page-13)

In total revenue contribution of tax revenue, Direct tax, Income tax, House rent tax, Interest tax, Indirect tax, VAT, Excise duty and Vehicles tax is increasing rate by 39%,35%,42%,33%,55%,36%,33%,45% and 63% respectively in fiscal year 2008/09. Similarly, contribution of direct tax indirect tax is 101% in total revenue.

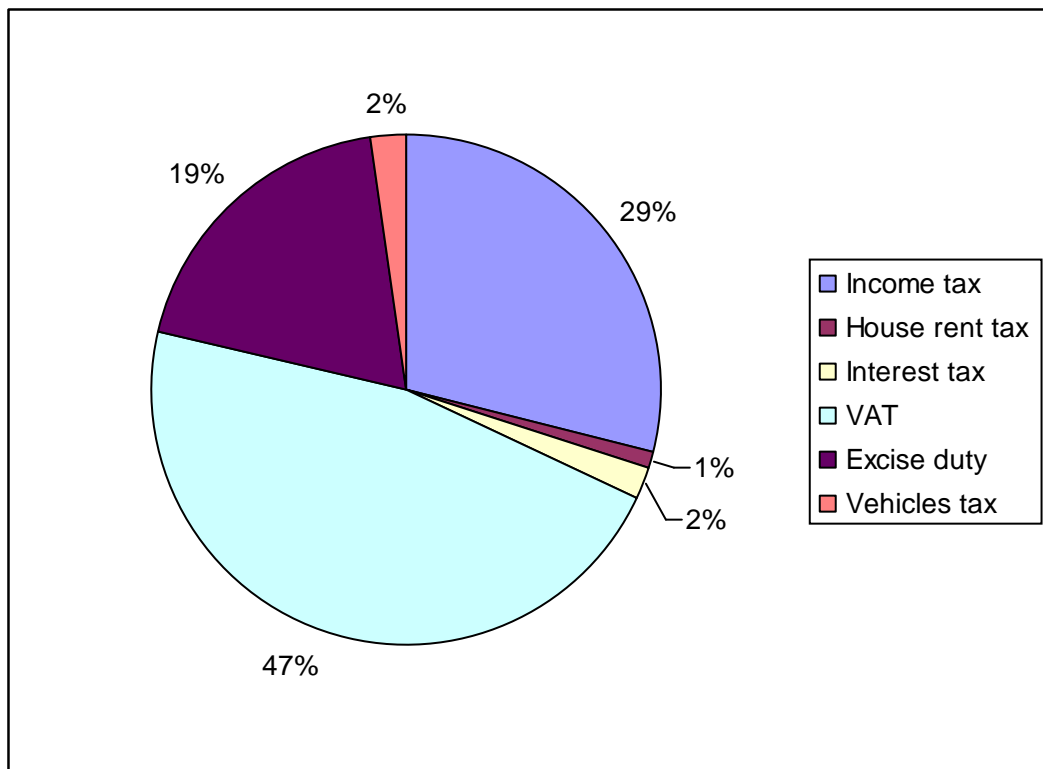
In fiscal year 2008/09 there is increase in VAT collection by 17% than fiscal year 2006/07. Similarly there is 20% increase in house rent tax and

interest tax, 21% increase in excise duty. Vehicle tax collection also increases by 122%.

The above table can be shown in pie chart as follows.

**Figure 4.1**

**Structural condition of Inland Revenue Department**



The structural condition of Inland Revenue is 47% in VAT collection, 29% income tax. 19% house rent, 2% vehicle tax and interest tax and 1% is excise duty.

**Table 4.5****Revenue Collection of Inland Revenue Department (Rs. In Thousands)**

Fiscal Year	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
<b>Targeted(Rs)</b>							
Tax Revenue	29067550	31011200	35200000	44300000	48817000	58126800	85660000
VAT	13730050	15503500	16950000	23650000	26463000	29651900	41000000
Income tax	9862500	8697500	10500000	11800000	12710500	16869200	27087000
Excise duty	4725000	6099800	7000000	7950000	8637500	10523200	14073000
Vehicle tax	750000	710400	750000	900000	1006000	1082500	3500000
<b>Actual Realization(Rs)</b>							
Tax revenue	26853422	30920989	36556530	39901151	51852586	61152297	85019150
VAT	13449123	14478896	18885400	21613043	26095599	29815702	39700921
Income tax	8059575	9514782	10466226	10933520	15731804	19077813	27247386
Excise duty	4785244	6226724	6445909	6506940	9343187	11189575	16220885
Vehicle tax	559480	700587	758995	847648	681996	1069207	1849958
Annual growth rate	5.15	15.15	18.2	9.16	30	18.64	39

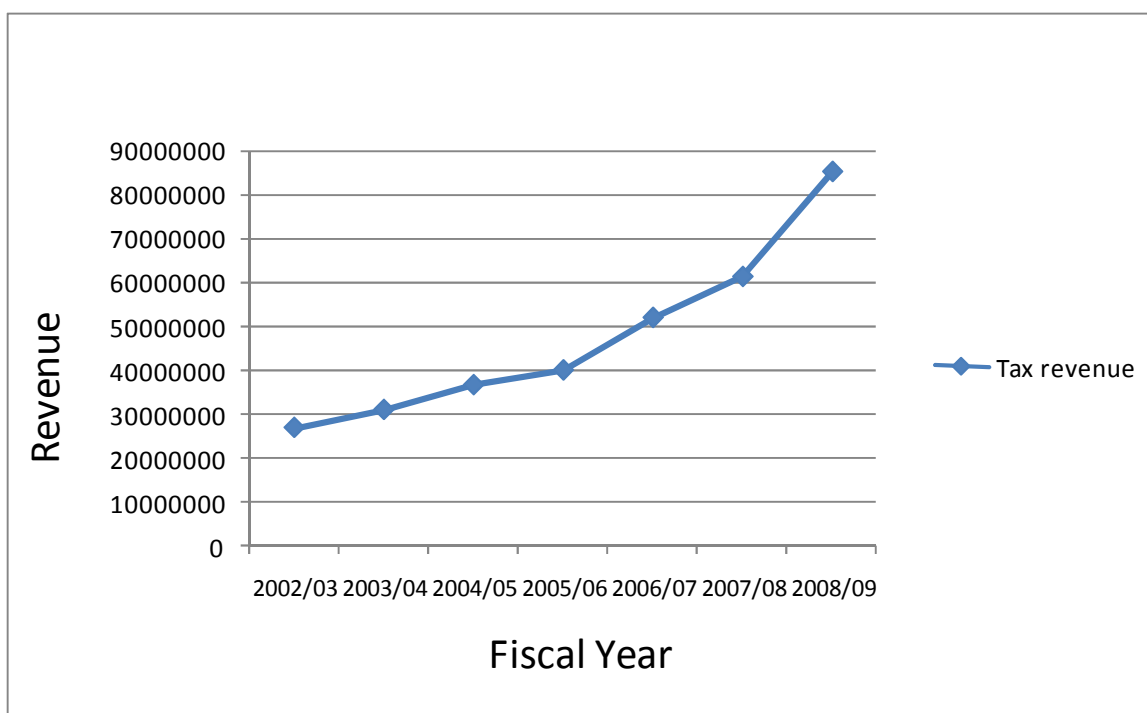
Source: Annual Report of IRD (page-17)

From the above table there is target tax revenue and actual tax realization from different sources are as VAT income tax, excise duty, vehicle tax which is increasing trend in annual increasing percentage is 5.15%, 15.15%, 18.2%, 9.16%, 30% , 18.64% and 39% in fiscal year 2003/04 to 2008/09 respectively.

The above table can be presented as figure below.

**Figure 4.2**

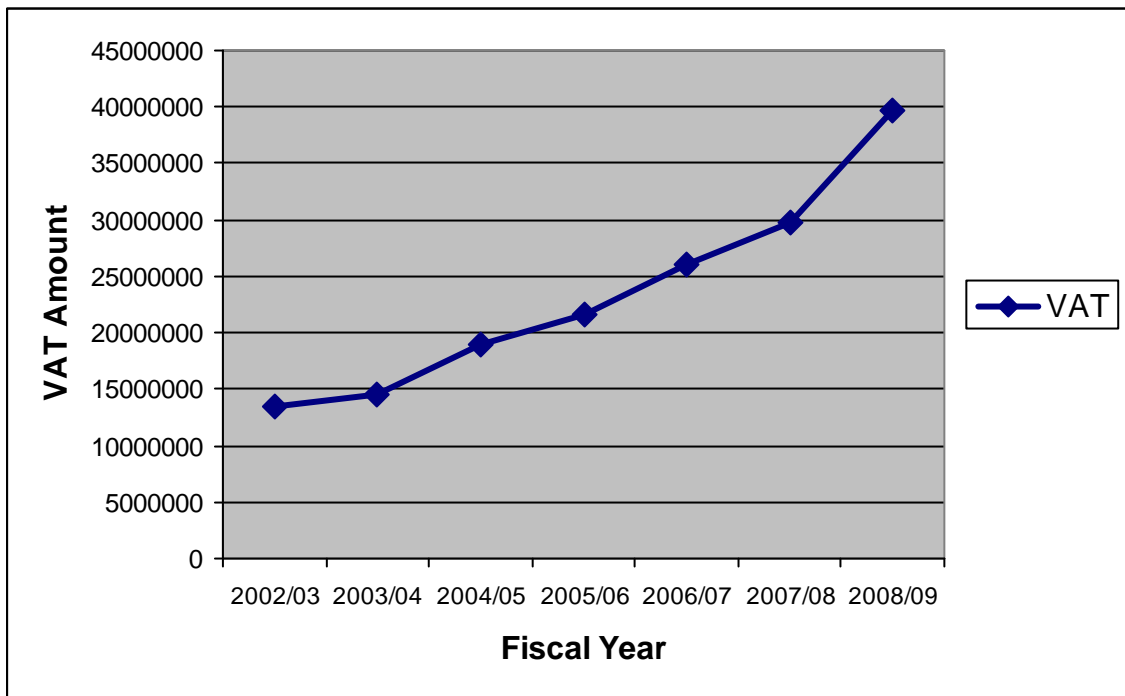
**Tax Revenue Collection (Rs. In Thousands)**



In the given figure, below 3 billion taxes was collected in fiscal year 2003/04 and rose very slightly too little above 3 billion in 2003/04. After it took same quick rise from fiscal year 2005/06 as up 2003/04 and more than 8 billion taxes was collected in the last fiscal year 2008/09.



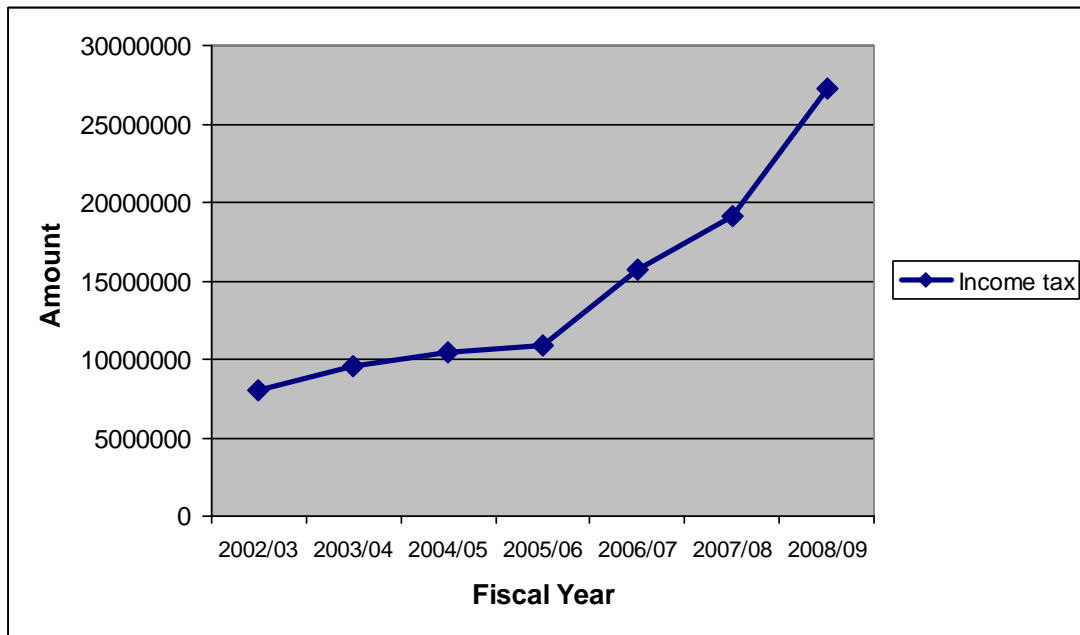
**4.3 Figure**  
**VAT Collection**



Contribution of VAT collection to the Inland Revenue in fiscal year 2003/04. 14 million than after increasing trend to the fiscal year 2008/09 by 15 million, 19 million, 22 million, 27 million, 31 million and 40million respectively.

**Figure 4.4**

**Income Tax Collection**

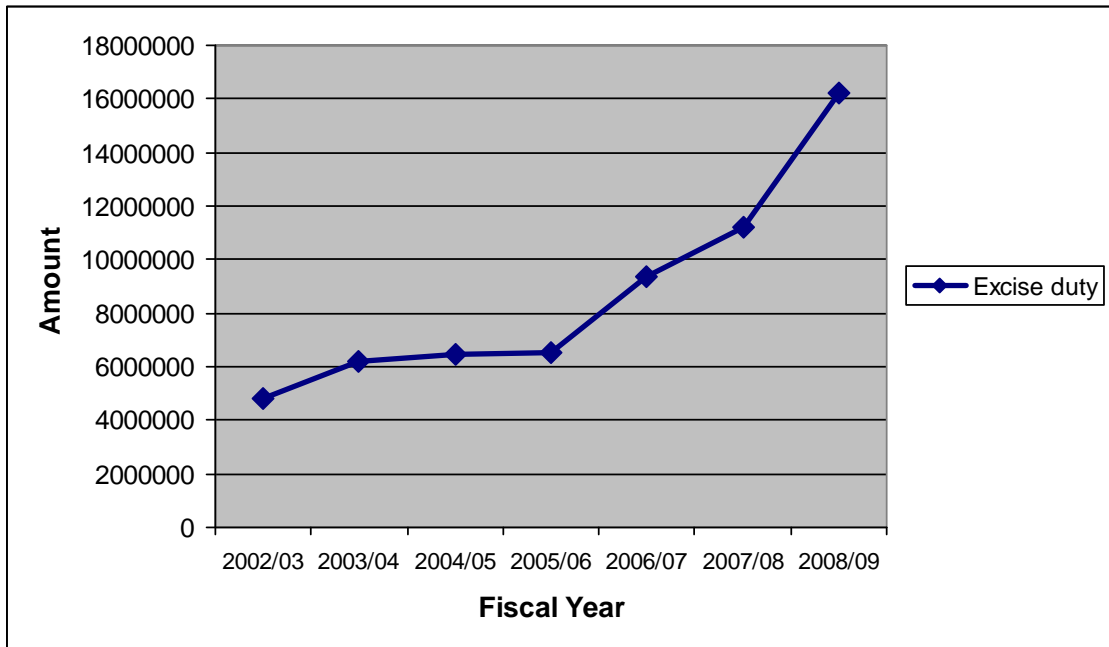


In the given figure, in the starting fiscal year 5 million rupees was collected as an income tax and continued with very slow pace and 1.1 billion rupees income tax was collected in fiscal year 2005/06. Then it took the fastest growth among these years between 2005/06 and 2006/07 and nearly 1.6 billion and 1.9 million was collected as an income tax but last it took the taxes as it was in 2002/03 and just more than 2.7 billion rupees was collected in the last fiscal year 2008/09.

**Figure 4.5**

**Income tax collection of Inland Revenue Department**

**Excise Duty**



In the given figure, almost 5 billion excise duty was collected in 2003/04, and rose quickly to 6 billion in next fiscal year but it remain same to 2005/06 at last in 2008/09 more than 16 billion excise duty was collected hitting the highest pick from 2005/06. From the above graph, it is clear that the revenue collection of fiscal year 2008/09 is greater than the fiscal year 2007/08 as 22%. Similarly, income tax and VAT collection also increases by 11% and 17% from previous income year.

Inland Revenue collection of last year was 57.11% where as 2.25 has been increased by this year. Contribution of VAT, excise duty and income tax are 47%, 19% and 29% respectively for collection of Inland Revenue department, remaining 2% and 1% contribution is related with Interest and vehicle tax.

**Table 4. 6****Comparative study of structural condition income tax (In thousands)**

Description	Fiscal year					
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Corporate income tax	4838689	7345003	7576530	11605600	13268756	19624768
Government Organization	2056635	1332430	195774	1019677	204585	2065166
Public limited company	1531274	2467789	3405582	5717056	7186458	9425132
Private limited company	150780	1531305	1703027	2306976	3140371	4197536
Investment Income tax	3539416	1885657	1958791	2306645	2452345	2472091
Employment Income tax	1391522	1675861	1771129	2007930	2451039	3195623
Industry, business, trade, occupation and other	2147894	127822	313356	255246	284997	570962
House rent tax	403282	1424776	528457	594181	7211022	960198
Interest tax	733395	757035	774820	1054912	1087927	1685094
<b>Total</b>	<b>9514782</b>	<b>10466226</b>	<b>10933520</b>	<b>15631804</b>	<b>19077813</b>	<b>27246432</b>
<b>Increase in</b>	<b>18.06%</b>	<b>9.9%</b>	<b>104</b>	<b>144</b>	<b>121</b>	<b>143</b>

Source: Annual Report of IRD (page-14)

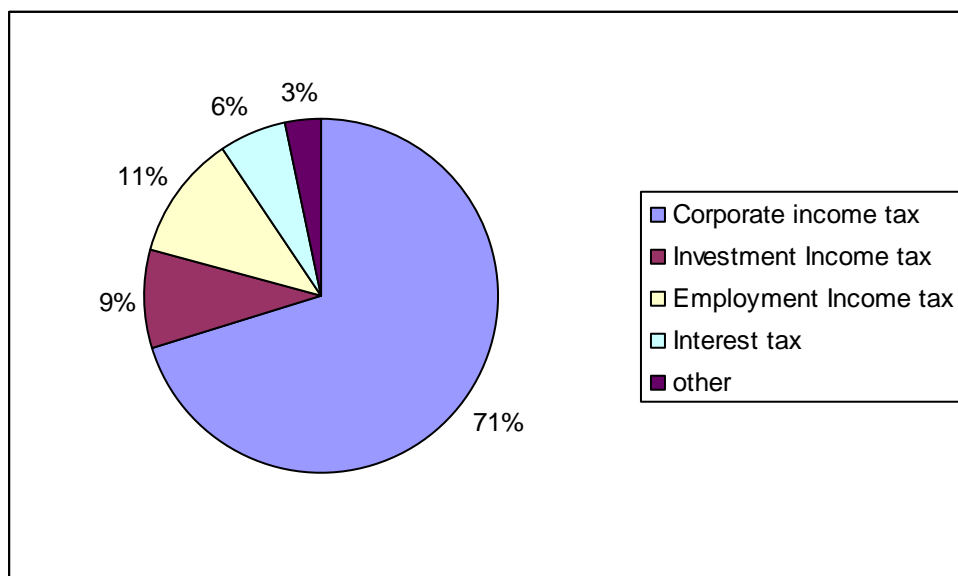
This table can be depicted as a comparative structural condition of income tax.

In the fiscal year 2003/04, 9514782 thousands rupees was collected and it had increased with 18.06% in collection but in fiscal year 2004/05 and 2005/06 total collected income tax was more than 1 billion though it had 9.9 and 104 increased in collection percentage comparing to 2003/04. In fiscal year 2006/07 more than 1.5 billion income tax was collected almost same to 2008/09 (1.93 billion) but 144% increased in collection in 2006/07 and just 121% decreased in collection 2007/08 again 2.27 billion income Tax was collected which is 143% increase in 2008/09.

This chart shows irregular amount of income tax can be collected with irregular percentage rate of collecting increased.

**Figure 4.6**

**Structural Condition of Income Tax**



In total income tax collection, contribution of corporate income tax, Investment income tax ,Employment income tax, house rent tax, interest tax and other tax are 71%,9%,11%, 6% and 3% respectively.

**Table 4.7**

**Comparative collection of Revenue in Fiscal year 2008/09**

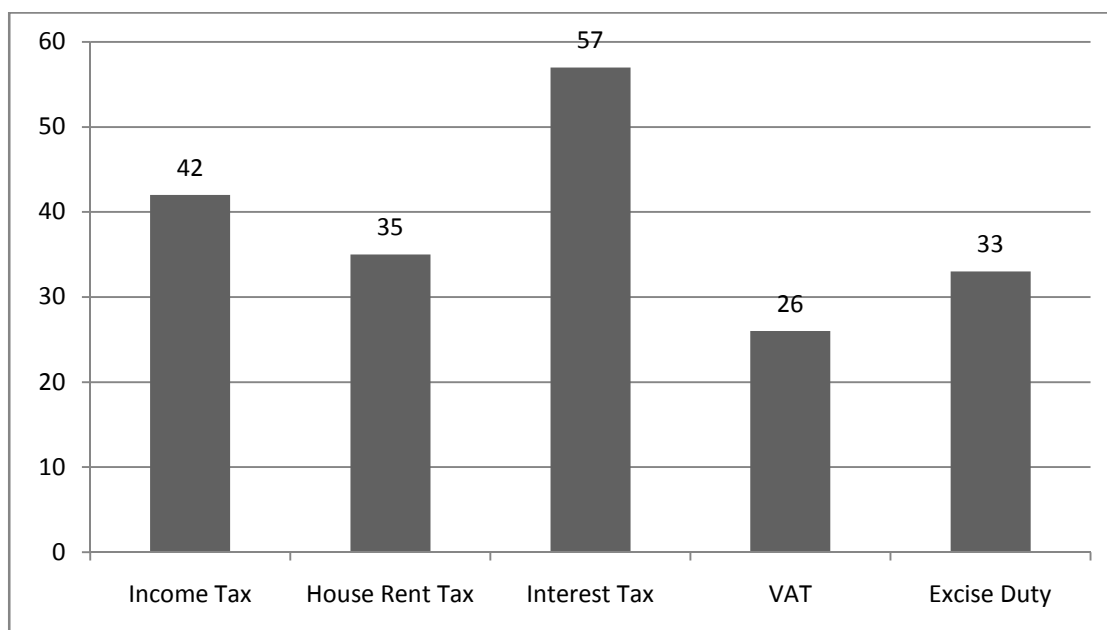
Description	Amount		Increasing percent
	2008	2009	
Income Tax	17327915	24597042	142
House Rent Tax	706063	952253	135
Interest Tax	1060261	1665308	157
VAT	11109740	14024807	126
Excise duty	8410095	11183687	133
Total	38212203	52423097	137

Source: Annual Report and Records of Inland Revenue Department fiscal year 2008/09.

From the above table, it is clear that the targeted revenue collection is lower than actual revenue collection. There is better improvement in actual revenue interest tax, VAT, Excise duty are 42%, 35%, 57%, 26%, 33%, and 37% respectively than targeted collection amount.

The above table can be presented as standard bar diagram as follows:

#### 4.7 comparative collection of revenue in fiscal year 2008/09



**Table 4.8**

#### Collection of Income Tax from Different Sources (Rs. In thousands)

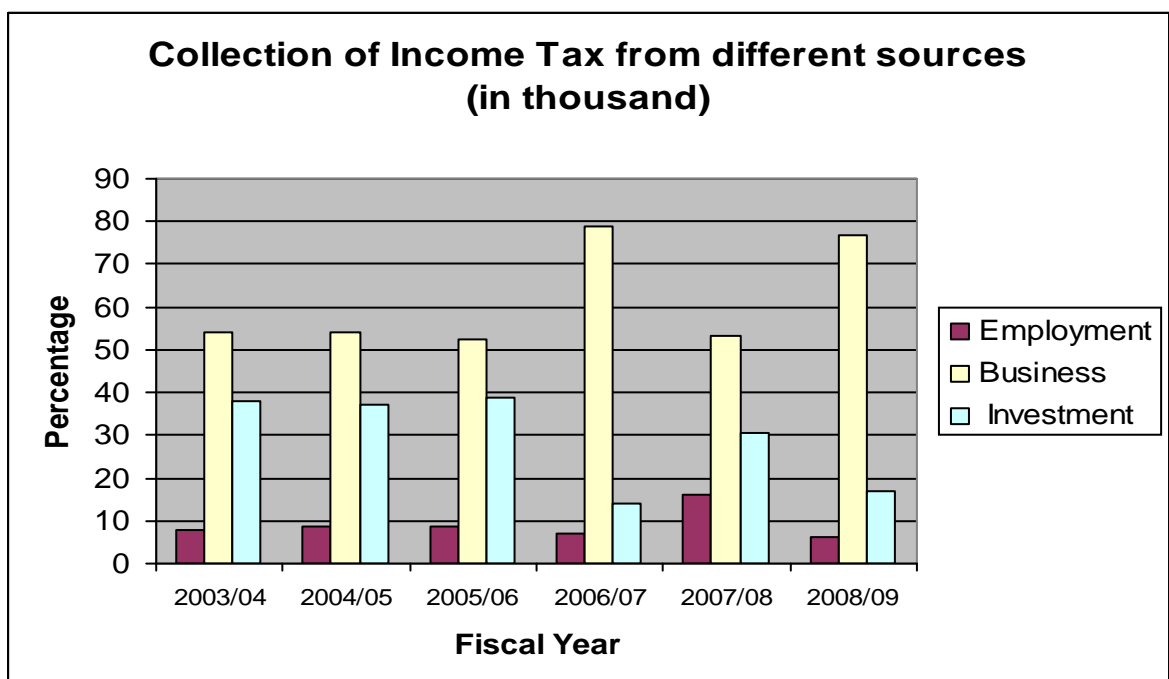
Fiscal year	Total income tax	Employment income	Business income	Investment income
2003/04	17892887	1391522	9677378	6823987
2004/05	19651636	1676982	10654646	7323987
2005/06	20541485	1751505	10806085	7983895
2006/07	29166122	2028857	23031670	4105595
2007/08	36744303	5971999	19535490	11236814
2008/09	51033163	3195623	39249536	8588004
Fiscal year	Total %	Employment%	Business %	Investment %
2003/04	100	7.78	54.08	38.14
2004/05	100	8.53	54.21	37.25
2005/06	100	8.52	52.6	38.87
2006/07	100	6.95	78.96	14.09
2007/08	100	16.25	53.16	30.59
2008/09	100	6.26	76.91	16.83

Source: IRD Report 2008/09(page-17)

From the above table, it is clear that the contribution of business is higher than Employment and investment income. The Inland Revenue Department collects Revenue at high amount from business, investment and employment respectively. The tax collection from employment income is very small quantity. In fiscal year 2008/09 the tax contribution from employment is 6.26% which was 7.78% in fiscal year 2003/04. Similarly the tax collection from investment income is 16.83% in fiscal year 2008/09 which was 38.14% in fiscal year 2003/04. The tax collection from business income is 76.91% in fiscal year 2008/09 and which was 54.08% in fiscal year 2003/04. It is clear that there is uniformity in tax contribution from business than other investment and employment income.

The above table can be shown as figure below.

#### 4.8 collection of income from different sources:





## 4.2 Analysis of Primary Data

The following table shows the groups of respondents and code used to represent them.

### 4.2.1 Most important factors for effectiveness of income tax in Nepal

In order to know the most important factor for effectiveness of income tax in Nepal respondents were requested to rank their responses on given choices. The question was “what is the most important factor for effectiveness of income tax in Nepal?” The response is given below:

**Table 4.9**  
**Important factors for effectiveness of Income tax in Nepal**

S.N.	Factors	Group			Total points	Percent	Rank
		A	B	C			
1.	Rank tax officers	56	56	56	162	27	1
2.	Honest tax payers	61	43	40	144	24	3
3.	Clear act, rules and regulations	52	46	60	158	26.33	2
4.	Effectiveness income tax administration	32	54	50	136	22.67	4
5.	Total				600	100	

Source: Opinion Survey, 2010

The important factor for effectiveness of income tax was ranked in order of the preference of the respondents was as follows:

- 1) Honest tax officers
- 2) Clear act, rules and regulation
- 3) Honest tax payers
- 4) Effectiveness of income tax in Nepal

**Table 4.10**  
**Cases in Which Aspect the Fine is higher:**

SN	Cases	Group		Total points	Percent	Rank
		A	B			
1.	Failure to maintain documentation	5	3	8	4.65	4
2.	Interest for understanding estimated tax payable by installment	21	40	61	35.45	2
3.	Interest for failure to pay tax	12	16	28	16.28	3
4.	Penalty for mixing false statement	48	27	75	43.62	1

**Source: Opinion Survey**

There was 100% response received from the respondents. Most of the respondents i.e. 43.62% says fine is higher in penalty for making false or misleading statement similarly 35.45% respondents says fine is higher in interest for understanding estimated tax payable by installment. Rest 16.28% respondent says interest to failure to pay tax is higher and 4.65% of respondent says fine is higher on failure to maintain documentation. Cases in which aspect the fine is higher are ranked below

1. Penalty for making false statement.
2. Interest for understanding estimated tax by installment.
3. Interest for failure to pay tax
4. Failure to maintain documentation".

From the fine is ranking it is clear that the fine is higher in making false statement or misleading statement.

#### 4.2.2 Effectiveness of fine and penalties.

In order to know the effectiveness of fine and penalties question was asked "Are the provision of fine and penalties in Nepalese income tax is Effective?" The responses received on it are tabulated below.

**Table 4.11**

#### **Effectiveness of Fine and Penalties.**

<b>Responses</b>	<b>Yes</b>		<b>No</b>		<b>Total</b>	
	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>
<b>A</b>	<b>16</b>	<b>53</b>	<b>14</b>	<b>47</b>	<b>30</b>	<b>100</b>
<b>B</b>	<b>7</b>	<b>23</b>	<b>23</b>	<b>77</b>	<b>30</b>	<b>100</b>
<b>Total</b>	<b>23</b>	<b>38</b>	<b>37</b>	<b>62</b>	<b>60</b>	<b>100</b>

**Source: Opinion Survey (2010)**

According to the above table the provision of fine and penalties under income tax act 2058 is ineffective since only 38 % of the respondent agrees with that the provision of fine and penalties are effective. Rest 62% of the respondent is not

Agree with the effectiveness of fine and penalties.

#### 4.2.3 Fine & penalties increase the Government Revenues

To know the view of respondent about increase in government revenue a question was asked as "Do you think fine and penalties increase the government revenue. The response has been tabulated below.

**Table 4.12**  
**Fine and Penalty Increases the Govt. Revenue.**

Responses Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	26	86	4	14	30	100
B	17	56	13	44	30	100
Total	43	72	17	18	60	100

**Source: Opinion Survey (2010)**

From the above table it has been clear that 72 % of the respondent are agree with the statement fine and penalties increases the government revenue. But rests 18% of the respondent is not agree with the statement. They say fine and penalty cannot increase the government revenue.

#### **4.2.4 Poorness of Taxpaying Habit of Nepalese people**

To know poorness of the taxpaying habit of Nepalese people, a question was asked to the respondents “Do you think that taxpaying habit of Nepalese people is poor?” The response have tabulated below.

**Table 4.13**  
**Poorness of Tax Paying Habit of Nepalese People**

Responses Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
A	26	87	4	13	30	100
B	20	67	10	37	30	100
Total	46	76	14	23	60	100

**Source: Opinion Survey (2010)**

Since 76 % of the respondents approved taxpaying habit of Nepalese people is poor & 24 % of the respondent think taxpaying habit of

Nepalese people are not poor but they have no capacity to pay tax. They say capacity is the main cause.

#### **4.2.5 Effect of Fine and Penalties to Increase Taxpaying Habit of Nepalese People.**

To know the effect of fine and penalties to increase taxpaying habit of Nepalese people a question was asked "Do you think that taxpaying habit of Nepalese people can be increased by effective fine and penalty system?". The responses received from the various respondents are given below.

**Table 4.14**

**Effect of fine and penalties to increase Taxpaying habit of Nepalese people**

<b>Responses Respondents</b>	<b>Yes</b>		<b>No</b>		<b>Total</b>	
	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>
<b>A</b>	<b>20</b>	<b>66</b>	<b>10</b>	<b>37</b>	<b>30</b>	<b>100</b>
<b>B</b>	<b>15</b>	<b>50</b>	<b>15</b>	<b>50</b>	<b>30</b>	<b>100</b>
<b>Total</b>	<b>35</b>	<b>58</b>	<b>25</b>	<b>42</b>	<b>60</b>	<b>100</b>

**Source: Opinion Survey(2010)**

From the above table it has been clear that 58 % of the respondents approved there is significant effect of fine and penalties to increase taxpaying habit of Nepalese people and 42 % of the respondents approved there is not effect of fine and penalties to increase taxpaying habit of Nepalese people. In order to know the effective level of fine and penalties to increase the tax paying habit of Nepalese people the next question was asked "If yes, to what extent fine and penalties play role to increase the tax paying habit of Nepalese people?". The responses received from the various respondents are tabulated as follows.

**Table 4.15**  
**Effective level of fine and penalties to increase taxpaying habit of**  
**Nepalese**

Effects Group\	Satisfactory	Medium	High	Total
<b>A</b>	<b>7</b>	<b>20</b>	<b>3</b>	<b>30</b>
<b>B</b>	<b>10</b>	<b>13</b>	<b>7</b>	<b>30</b>
<b>Total</b>	<b>17</b>	<b>33</b>	<b>10</b>	<b>60</b>

**Source: opinion survey (2010)**

Above table shows that 33 respondents among 60 approved the effective level of fine and penalties to increase the taxpaying habit of Nepalese people is medium and 17 and 10 respondents among 60 respondents approved the level of effect is

Satisfactory and high respectively. Hence it can be concluded that the effective level of fine and penalties to increase taxpaying habit of Nepalese people is medium.

#### **4.2.6 Appropriateness to Pay Rs 5000/- Minimum Fine:**

To know the appropriateness of payment of Rs. 5000 as minimum fine a question was asked "It is right to impose Rs.5000 as minimum fine who pay minimum income tax of Rs 1000 because of nonpayment of tax within time?" The response is tabulated in the following table.

**Table 4.16**

**Appropriateness of payment Rs.5000 as minimum fine**

Responses Respondents	Yes		No		Total	
	No.	%	N	%	No.	%
A	10	33	20	67	30	100
B	7	23	23	77	30	100
Total	17	28	43	72	60	100

**Source: Opinion Survey (2010)**

There was 100percent response received from the respondents. 72 percent respondents clear that it is not good to impose Rs.5000 as a minimum fine who pay minimum income tax Rs.1000 because of non-payment of tax within time. Only 28 percent of the respondents clear that it is right. Thus, the conclusion can be drawn out that it is not good to impose Rs. 5000 as a minimum fine who pay minimum income tax Rs. 1000.

**4.2.7 Effectiveness of Income Tax Administration in Nepal**

In order to find out the effectiveness of income tax administration, a question was asked “what do you feel about the current income tax administration of Nepal?” The respondents who agree on the effectiveness, they have got alternative to choose about the position of income tax administration. The responses received from respondents are as follows:

**Table 4.17**  
**Effectiveness of Income Tax Administration**

S.N.	Responses	Respondents			Total points	Percent
		A	B	C		
1.	Efficient	15	3	5	23	30.67
2.	Inefficient	1	15	16	32	42.67
3.	Satisfactory	9	7	4	20	22.66
Total		25	25	25	75	100

Source: Opinion Survey, 2010

From above table, it is clear that income tax administration is not efficient to collect tax and has got majority percentage. From the respondents i.e. 42.67% and they ranked some causes given in the questionnaire as tabulated below.

**Table 4.18**  
**Cause of Ineffectiveness of Nepalese income tax administration**

S.N.	Response	Group			Total points	Percent	Rank
		A	B	C			
1.	Lack of trained and competent tax person	7	76	86	169	17.14	1
2.	Complicated tax laws	8	77	76	161	16.33	2
3.	Lack of proper communication	10	42	63	115	11.66	5
4.	Lack of proper direction	3	46	49	98	9.94	6
5.	Lack of voluntary compliance by tax payer	9	67	55	131	13.29	4
6.	Unnecessary outside pressure	4	40	41	85	8.62	8
7.	Undue delay enmity assessment	6	63	64	134	13.59	3
8.	Lack of coordination of the tax department with other department	5	39	49	93	9.43	7
	Total				1598	100	

Source: Opinion Survey, 2010



The causes of ineffectiveness of Nepalese income tax administration ranked in order of responsible are as follows:

1. Lack of trained & competent tax personal
2. Complicated tax laws
3. Undue delay in making assessments
4. Lack of voluntary compliance by tax payer
5. Lack of proper communication
6. Lack of proper direction
7. Lack of co ordination of the tax department with other departments.
8. Unnecessary outside pressure.

It can be conclude that the lack of trained and competent tax personnel, complicated tax laws, undue delay in making assessments are the most important causes of ineffectiveness of Nepalese tax administration.

#### **4.2.8 Provision of Penalty who Fail to Register.**

To know the opinion of respondents about provision of penalty in case the firms / assesses failed to register their firm, a question was asked, "Do you think a provision of penalty should be incorporated in case of falling to register?" .The responses were:

**Table 4.19**

#### **Necessity of Provision of penalty who fails to register**

<b>Responses</b>	<b>Yes</b>		<b>No</b>		<b>Total</b>	
	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>
<b>A</b>	<b>30</b>	<b>100</b>	-	-	<b>30</b>	<b>100</b>
<b>B</b>	<b>30</b>	<b>100</b>	-	-	<b>30</b>	<b>100</b>
<b>Total</b>	<b>60</b>	<b>100</b>	-	-	<b>60</b>	<b>100</b>

**Source: Opinion Survey (2010)**

Above question was asked to the respondents because there is no any clear provision for those who fails to register to control illegal business.

Since cent percent of respondent approved there should be clear provision of penalty that fail to register. Hence it can be concluded that there should be provision of penalty that fail to register to reduce unauthorized business.

#### **4.2.9 Effectiveness of Tax Administration to Impose Fine and Penalties.**

In order to know the effectiveness of tax administration to impose fine and penalties in Nepal, a question was asked "Do you think the tax administration of Nepal is effective to impose fine and penalties as per necessary?" The below table gives a breakdown of responses.

**Table 4.20**

#### **Effectiveness of Tax Administration to Impose Fine and Penalties.**

<b>Responses</b>	<b>Yes</b>		<b>No</b>		<b>Total</b>	
	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>
<b>A</b>	<b>14</b>	<b>47</b>	<b>16</b>	<b>53</b>	<b>30</b>	<b>100</b>
<b>B</b>	-	-	<b>30</b>	<b>100</b>	<b>30</b>	<b>100</b>
<b>Total</b>	<b>14</b>	<b>23</b>	<b>46</b>	<b>77</b>	<b>60</b>	<b>100</b>

**Source: Opinion Survey (2010)**

From the above table it has been clear that most of the respondent (77%) thought that tax administration is not effective to impose fine and penalties in Nepal. Only 23% respondents thought that tax administration is effective to impose fine and penalties in Nepal. Most of the tax administrators are in favors with effectiveness of tax administration to impose fine and penalties because they don't want to show their weakness. Thus, it can be concluded that the tax administration of Nepal is not effective to impose fine and penalties.

In order to know the cause of ineffective tax administration the next question was asked " If no, what are the reasons?' the respondents were

requested to rank their answer from 1 to 6. The below table gives the breakdown of responses.

**Table 4.21**  
**Reasons of Ineffective Tax Administration to Impose Fine and Penalties.**

SN	Causes of ineffectiveness	Group		Total points	Percent	Rank
		A	B			
1.	Corruption	42	66	108	41	1
2.	Complicated tax law	8	4	125	4.5	5
3.	Lack of information	50	25	75	28	2
4.	Unnecessary outside pressure	18	9	27	10.5	4
5.	Lack of cooperation in tax administration	1	1	2	0.75	6
6.	Lack of competent staff	8	32	40	15.25	3
	Total`			264	100	

**Source: Opinion Survey (2010)**

The causes of ineffectiveness of Nepalese income tax administration to impose fine and penalties as per necessary were ranked in order of the preference of the respondent were as follows.

1. Corruption
2. Lack of information
3. Lack of competent staff
4. unnecessary outside pressure
5. Complicated tax law

## 6. Lack of cooperation is tax administration

It can be concluded that the corruption, lack of information, lack of competent staff and unnecessary outside pressure are the most important causes of ineffectiveness of Nepalese tax administration to impose fine and penalties as per necessary.

### 4.2.10 Sufficiency of Provision Made under the Nepalese Income Tax Act 2058

In order to know the sufficiency of provision made under the Nepalese income tax Act 2058 a question was asked "In your opinion, are the provision made under the Nepalese income tax Act 2058 sufficient in all aspects?" The responses received on it are tabulated below.

**Table 4.22**

#### **Sufficiency of Provision of Income Tax.**

<b>Responses</b>	<b>Yes</b>		<b>No</b>		<b>Total</b>	
	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No.</b>	<b>%</b>
<b>A</b>	<b>12</b>	<b>40</b>	<b>18</b>	<b>60</b>	<b>30</b>	<b>100</b>
<b>B</b>	<b>10</b>	<b>33</b>	<b>20</b>	<b>67</b>	<b>30</b>	<b>100</b>
<b>Total</b>	<b>22</b>	<b>36</b>	<b>64</b>	<b>60</b>	<b>60</b>	<b>100</b>

**Source: Opinion Survey (2010)**

Since 36 percent of the respondents were agreed the sufficiency of provision made under the Nepalese Income Tax Act, but 64% of the respondents were against the sufficiency of provisions of income tax act. Thus it can be concluded that majority of the respondents were against the sufficiency of provisions of income tax. The respondents who gave negative responses about the sufficiency of provisions of income tax were requested to write their opinion on the blank area. A question was asked "If not, in which aspect the improvement is needed?" The

opinions for the improvement of different aspects of Nepalese income tax are given below.

**Group -A**

- In Register
- Administrative review and appeal
- Penalty
- Not match able with Nepalese context
- Tax low
- Simplify the language
- Compulsory billing system
- Income tax structure
- Periodic review for improvement
- Tax

**Group B**

- Tax law
- Language
- Tax system should be flexible
- Incentives to industries who competes
- Trained staff.
- Remuneration income
- District wise tax office
- Tax administration
- Fine and penalties system
- Celerity without dual meaning
- Obligation towards tax payers
- Tax Rate
- Necessary to revise

- Education to taxpayer about tax

From the above listing most of respondents suggested to simplify the language training to staff, tax education to taxpayer, improve tax law etc. May also focused to improve the administration and computerized system.

#### **4.4 Major Findings**

##### **Major Findings from secondary sources of data**

1. There was clear indication of the time serious and growing financial resources problem in Nepal. The increasing magnitude of resource gap clearly indicator that there is an urgent need of mobilizing additional resources. Income tax as appeared one of the most effective fiscal policy instruments to mobilize additional resources and achieving the desired development objective of Nepal.
2. In fiscal year 2003/03 total revenue was dominated by tax revenue which is 78.2% and non tax revenue is only 21.9%. Similarly the tax revenue is increasing in recent days and non tax revenue is decreasing trend.
3. The IRC is able to collect income tax revenue effectively than targeted amount. In fiscal year 2008/09 the target was 1417.2 billion and actual revenue collection is 1434.7billion.
4. Revenue collection of IRC is dominated by VAT which is 47% in fiscal year 2008/09. Similarly contribution of revenue from Income tax and Excise Duty 29% and 19% respectively.

5. Income tax collection of fiscal year 2008/09 is 272.4 billion. It is the excess collection of 22% than previous fiscal year. So collection of income tax is increasing every year.
6. Contribution of income tax from business is highest percentage which is 76.91% in fiscal year 2008/09 whereas contribution of investment and employment are 16.83% and 16.25% respectively.
7. Collection of income tax, house rent tax and interest tax are 100.73, 96.18 and 73.06 respectively
8. There is overall improvement in tax collection is 37% than targeted revenue collection in fiscal year 2008/09.
9. Income tax is an important source of direct tax. Its structure of Nepal is composition of income tax from public enterprise, income tax from semi public enterprise, income tax from private corporate enterprise bodies, income tax from individuals, income tax from remuneration and tax on interest
10. Nepalese revenue structure consists of tax and non tax revenue. Tax revenue consists of customs tax of consumption and product of goods and services, land revenue and registration and tax on property, Profit and income. Non tax revenue consists of charge, fees, fine and penalty, dividend interest payment and other income. Percentage being ranked as last choice.

Revenue at high amount from business, investment and employment respectively. The tax collection from employment income is very small quantity. In fiscal year 2008/09 the tax contribution from employment is 6.26% which was 7.78% in fiscal year 2003/04. Similarly the tax collection from investment income is 16.83% in fiscal year 2008/09

which was 38.14% in fiscal year 2003/04. The tax collection from business income is 76.91% in fiscal year 2008/09 and which was 54.08% in fiscal year 2003/04. It is clear that there is uniformity in tax contribution from business than other investment and employment income.

The income tax constitutes corporate income tax, individual income tax and interest tax. On the basis of empirical investigation, data was collected and presented and analyzed, some important findings can drawn from the investigation, which were as follows

1. Most of the tax administrators has the knowledge of the fine and penalties but taxpayers has not sufficient knowledge about fine and penalties .10% respondent have no knowledge of fine and penalties.
2. According to the opinion of the respondent fine is charging higher on making false Statement or misleading statement.
3. Majority of the respondent (62%) says fine and penalty system of Nepal is not effective.72% of the respondents agrees with fine and penalties increase the government revenue.
4. Taxpaying habit of Nepalese people is poor .Since 76% of the respondent approved it. There is significant effect of fine and penalties to increase taxpaying habit of Nepalese people.
5. It is approved by 58% of the respondents. The effective level of fine and penalties to increase taxpaying habit of Nepalese people is medium. It is not good to impose Rs 5000 as minimum income tax Rs 1000 of nonpayment of Tax with in time, which was approved by 72% of the respondents.



6. The majority of respondents were against the interest for understanding estimated Tax payable by installment. Provision of penalties should be made who fail to register. To impose interest as well fine for a single mistake by tax payer is not suitable means of punishment Income tax administration of Nepal is considered as ineffective to impose fine and penalties as per necessary.
7. Main cause of ineffective income tax administration to impose fine and penalties are corruption, lack of information and lack of competent staff.
8. A provision made under the Nepalese Income Tax Act is not sufficient in all aspects. Improvements are needed in language, competent staff, tax law, tax administration, computerized system for payment of tax etc.

## **CHAPTER: FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.1 Summary**

The government requires sufficient revenue for the economic development as well as to handle day to day administration to perform activities like maintaining peace and security, lunching other public welfare and developing activities. To perform such activities, the government collects revenue from various sources such as tax revenue from public enterprises, special assessment, fees, fines, grants and assistance etc. Among them, revenue collected from tax plays a vital role in state economy. The main philosophy behind taxation is that every individual should contribute towards the expenses of the government. History of taxation begun with the development of human civilization and the history of income tax begun from United Kingdom in 1799 A.D. The histories of taxation were begun in Nepal from the ancient period in the name of Bhaga, Bhoga and Kara in Lichhevi regime. But the history of income tax was not so long in Nepal. The first income tax act was introduced as a trail in the fiscal year FY1959/60 entitled Business Profit and Remuneration Tax Act 2016 by the first elected government. There was no specific Act made to define and treat income tax. The Business Profit and Remuneration Tax Act defined income tax levied on only business income and remuneration. First comprehensive income tax introduction

In 1962 replaced by Income Tax Act 1974 was amended eight times and finally replaced by Income tax Act 2058. Government revenue was the composition of external and internal revenue. Internal revenue includes

both tax and non-tax revenue. Nepalese tax revenue was the composition of direct and indirect tax revenue. There was dominant role of indirect tax revenue in Nepalese tax revenue structure. Indirect tax revenue contributed three times more than the direct tax. Direct tax revenue was the composition of income tax, land tax, house and land registration tax and other tax. There was dominant role of income tax in total direct tax. It was in increasing trend. Income tax revenue is the composition of income tax from corporate bodies, income tax revenue from individual, income tax revenue from remuneration and income tax from interest. There was dominant role of income from individual in total income tax revenue.

Effective and efficient administrations as well as taxpayer's awareness were the basic requirements for Nepalese income tax system. Income tax administration lacks trained administrative personnel. There was no separate income tax department. A revenue office has to perform on direct taxes which may create burden to the tax personnel. Tax administration was not fully computerized or comprehensive information system. Records maintained by revenue office regarding potentials taxpayers and their economic activities were not adequate. The provisions regarding fine and penalties were not implemented effectively and efficiently. The amount received from fine and penalties ultimately included in income tax. So, extra amount received from fine and penalties were not found. It is often said that tax personnel have practical the corruptions in great extent but they were rarely punished. The provision made under the Income Tax Act 2058 was also insufficient to some aspects. There should be improvement in language with dual and vague meaning, on provision of fine and penalties, timely

improvement on the provisions as well as tax law and rules, utilization of modern information technology on tax administration, trained and efficient staff in tax administration.

## **5.2 Conclusion**

In developing countries like Nepal, lack of sufficient financial resources is the main constraints for the national economic development. A lot of funds are needed to meet the additional financial requirements for the development activities of the country. Nepal has been suffering from capital shortage to accelerate the economic growth. Nepal has been heavily relying on foreign loans and grants. Internal resources are preferable for sustainable economic development. But Nepal has been unable for proper mobilization of internal resources. Thus, fiscal deficit of Nepal has been increasing. To increase the government revenue, Nepalese government is trying to extract money or valuable contributions from people through taxation. Within tax revenue, income tax is one of the most important resources of government revenue and it is considered as a good remedy to cure growing and resource gap problems of Nepal. It is essential in getting macroeconomics policies because the alternatives ways of financing government expenditures like money creating mandating larger required reserves, domestic borrowing and foreign loans, can have very harmful effects on the economy. Lack of knowledge about law and rules, managerial inefficiency, lack of effective personnel management, lack of reward and punishment system, poor income tax assessment procedure, poor tax information system, corruption practiced in administration, very narrow coverage of income tax are the major problems of income tax management in Nepal.

Being various problems relating to income tax, revenue collection from income tax is low as compared to other developing countries like Srilanka, India, Pakistan and Bangladesh etc. Never the less contribution of income tax for the economic development of Nepal has been increasing significantly in recent years as compared to passed thirty years. But it doesn't mean that the share is that much satisfactory. So, much more effort should be made to increase it presently, income tax management is done through the Income Tax Act 2058 and Income Tax Rules 2059, in which the Nepalese tax Administration has been attempted to modify itself to meet the pressing challenge brought out by change in technology and economic policies. However still its working procedure is traditional and the cost of administration hasn't been brought to the satisfactory level. Income Tax Act 2058 is blamed that law is Complicated and vague. Their needs the efforts for simplification of law. The tax should be coherent with the economic situation of the country. For the success of income tax system or to fulfill the objectives of income tax as well as for the economic development of the countries many constraints play the vital role. Among them effective implementation of provision regarding fine and penalties system is one of the most important constraints. From the very beginning the concepts of punishment have been emerged in income tax system of Nepal for the taxpayers who do not compely the law. It is imposed according to the provision provided by income tax Act. It plays important role to collect tax in right amount in proper time or at the time of earning. There is no doubt fine and penalties must be imposed to the defective taxpayers. But this is not only the method of reducing tax evasion. Revenue

collection from income tax is in low in Nepal due to various problems related to income tax. For the economic development of Nepal, the problem relating to income tax system and effective implementation of interests, offences and penalties in Nepal should be solved and resources should be effectively utilized.

### **5.3 Recommendation**

On the basis of finding of the study, the following recommendations are made regarding fine and penalties and its administrative efficiency.

- Income tax policy should be made such that goals of imposing tax can be achieved.
- Income tax Act, rule and regulation should be made cleared and simple for all tax payers as well as related persons. It should be more effective.
- Most of the taxpayers have the knowledge of fine and penalties but tax payers have no sufficient knowledge about this. To fulfill these gaps information system should be provided by different media as well as meeting and seminar should be held.
- To get objectives made by Income Tax Act 2058 on provision regarding fine and penalties than Income Tax Act 2031, the provision of fine and penalties should effectively equally implemented to the tax evader or defaulter whether they are rich or poor.
- To increase taxpaying habit of Nepalese people provision of fine and penalties should be made effective but it is not only the method but respect to taxpayers, right behaviors towards taxpayers from tax administration, concession/ rebate/ low tax rate, effective and efficient

administration and educated people are also the factors to increase taxpaying habit,

□ It is not good to impose Rs. 5000 as minimum fine. It should be revised and class interval should be made for the different class of taxpayers to pay fine or fines should be imposed proportionately to the amount of tax liabilities.

□ Interest charged to those taxpayers who pay on the group of under estimation tax payable by installment should be made effective because it made taxpayers to pay tax on earning time and encouraged them to maintain record properly.

□ The language used in tax law and policy should be simple and clear. In spite of using the vague meaning full words clear cut provision should be made.

□ Effective information system should be established so that nobody can avoid or minimize the fine and penalties as well as tax liability by telling that he was not know the Acts, rules and laws. Penalty equal to fifty percent of the under payment of tax for making false or misleading statement unknowing or recklessly should be changed and fine should be made hundred percent. It made the people to know rules, Laws, and Acts.

□ If the provision of penalty that fail to register is not appear, illegal business will increase. So, the clear provision of penalty should be made for failure to register.

□ Timely revision should be made in the matter of income tax policy. The system of changing income tax policy with the change of government should better be avoided.

□ To promote experts, more deduction should be provided

- Income tax Act should be liberal with broad base.
- To develop the region, regional concession should be introduced.
- If there is enough reasons to believe that the taxpayers has earned from illegal business and corruption. So, the income earned should be made liable to tax at high rate without exemption limit and maximum penalty.
- Income tax policy should be made attractive also for foreign business group.
- To improve the tax collection procedure, the maximum penalties should be imposed for non-compliance of income tax within the due date.
- Success of income tax system is highly dependent upon the quality of income tax law. It should not contain any loopholes and ambiguity. Therefore it should be reviewed frequently and reformed.
- Strong political commitment is necessary for the effective implementation and income tax Act and its provisions regarding to fine and penalties.
- People should be encouraged to pay tax voluntarily. A system should be introduced that a tax paying citizen is entitled to receive more benefits and incentives than non-taxpaying citizen.
- Tax administration should be made free from corruption in all aspects specially to impose fine and penalties effectively. Discretionary power of the tax officers must be curtailed and their right and duties should be clarified in Income Tax Act. The following suggestions are made for the improvement of income tax administrations.
  - To make the administration capable of facing new challenges, there should be improvement in professionalism as well as development of



new professional ethic compatible to the changed contest of liberalization.

- The financial benefits should be increased. The salaries and incentives should be increased in accordance with the inflation not only this, the government should be target to them and gave those extra benefits accordance to their performance.
- IRD should be kept free from outside pressures.
- The tax authorities should do continuous efforts in order to develop taxpayer's positive attitude towards taxation.
- Co-ordination and cooperation between staff and department must be established.
- For IRD separate research and control unit should be established in order to find out lapses in tax policies issued by the government.
- The IRD made provision of reward to that information's who supplies information about tax evasion, a biding and abetting etc.
- Computerized and effective exchange of information should be maintained.
- Tax personnel should be encouraged punished and transferred on the basis of their work and experience not on the basis of outside pressure.

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Appendix A  
COVER LETTER

To,

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Dear sir/Madam

First of all, I would like to introduce myself as a MBS Second Year student of Nepal Commerce Campus, In order to fulfill my requirement for master of Business Studies Faculty of Management Tribhuvan University. I am preparing a thesis entitled “**Effectiveness of Income tax System in Nepal**”

I would gladly appreciate if you could kindly spare a few minutes of your valuable time infilling the questionnaire along with your valuable suggestions.

I assure you that the information provided to me will be kept strictly confidential.

Looking forward to your co-operative and support with many thanks.

Your sincerely,  
Lekh Nath Adhikari  
Shanker Dev Campus

## Appendix-I

### “Effectiveness of Income tax System in Nepal “

#### Questionnaire

**Name of the Respondent:**

**Position:**

**Department:**

(Please tick your answer in the following box, if the question is provided with two alternatives and put in order of preference

From one to last number if there are more than two alternative).

**1. In your option what are the most important factors effectiveness of**

**income tax in Nepal?**

Rank

- Moral & honest tax official
- Conscious and honest tax payers
- Clear and strict act, rule and regulation
- Effective tax administration
- Political non interference
- If other please specify

**2. Are the provision of fine and penalties in Nepalese income tax is effective?**

Yes [ ]

No [ ]

**3. Do you think fine and penalties the revenue of government?**

Yes [ ]

No [ ]

**4. Do you think that taxpaying habit of Nepalese people is poor?**

Yes [ ]

No [ ]

**5. Do you think that taxpaying habit of Nepalese people can be increased by effective fine and penalty system?**

Yes [ ]

No [ ]

**a) If, yes to what extent fine and penalties play role to increase the tax paying habit of Nepalese people?**

Satisfactory [ ] Medium [ ] High [ ]

**6. Is it right to impose Rs. 5000 as minimum fine who pay minimum income tax of Rs. 1000 because of nonpayment of tax with in time?**

**7. What do you think about the current income tax administration of Nepal?**

Efficient [ ]

Inefficient [ ]

If any inefficient please rank the possible causes

Causes

Rank

- ) Lack of trained and compliant tax person
- ) Complicated tax laws
- ) Lack of proper direction
- ) Lack of proper communication
- ) Lack of proper direction
- ) Lack of voluntary compliance by tax payers
- ) Unnecessary outside pressure
- ) Undue delay in malt assessment
- ) Lack of co ordination of tax
- ) Department with other department
- ) If any other causes

**8. Is it right to impose both interest as well as fine for a single mistake made by the taxpayers?**

Yes [ ]

No [ ]

**a) If yes, give reason (Please Rank)**

- i) Induces the taxpayer not to commit mistake. [ ]
- ii) Increase the consciousness among tax payer. [ ]

iii) Others..... [ ]

**b) If not, give reason (Please Rank).**

i) Dual burden for single mistake. [ ]

ii) It may discourage tax payer. [ ]

iii) Others..... [ ]

**9. Do you think a provision of penalty should be incorporated in case of falling to register?**

Yes [ ]

No [ ]

**10. Do you think the tax administration of Nepal is effective to impose fine and penalties as per necessary?**

Yes [ ]

No [ ]

**a) If no, give reason (Please Rank)**

i) Corruption. [ ]

ii) Complicated tax law. [ ]

iii) Lack of Information. [ ]

iv) Unnecessary outside pressure. [ ]

v) Lack of Co-operation in Tax administration. [ ]

vi) Lack of Competent staff. [ ]

**11. in your opinion, are the provision made under the Nepalese income tax Act 2058 sufficient in all aspects?**

Yes [ ]

No [ ]

**12. If not, in which aspect the important is needed? (Please, Specify).**

i) .....

ii) .....

iii) .....

iv) .....