

# CHAPTER-I

## INTRODUCTION

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

Not necessary to say that Nepal is an agricultural country and more than 80% people are economically engaged into this sector. In the fiscal year 2005/2006 and 2006/2007, the contributions of agricultural and non-agricultural sectors to GDP at the factor cost have remained 34.6% and 65.4% respectively

On the other hand, the living standard of Nepalese people has been going backward. Nepal is a least developed country where most of Nepalese remain below the poverty line and with lowest per capital income of US \$ 320 Poverty has stood as a serious challenge to the country. According to Economic Survey 2006/2007, 38% of the total population has remained below the absolute poverty line. In the context of Nepal, agriculture has been the main source of income and employment.

To increase the total revenue a sound, appropriate and efficient income tax and value added tax system is necessary. The major components of tax system such as tax policies, tax laws and tax administration must be appropriately formulated and implemented in accordance with the countries needs and situation.

Taxes are vital sources of internal revenue. Among various taxes income tax and value added tax have played the significant role in tax structure of developed countries. Income tax and value added tax have been considered best from different angles. Taxes are levied for equal distribution of income. So income tax and value added tax are the appropriate for developing nations like Nepal where the economic gap among people is very high.

“Nepal Government collects revenues from different sources. Right now the types these taxes are around twenty-four. However from revenue viewpoint only four or five types of taxes, Customs Duty, Value Added Tax, Income Tax, Excise Duty, and Local Tax. (Kandel

Pusparaj, Tax Laws and Tax Planning in Nepal, page 8) In Nepal, about 81.09% of total revenue comes from tax revenues and the rest 18.1% from non- tax revenues “

## **1.2. Focus of the Study**

Income Tax and VAT is scientific system of taxation. VAT is mainly replacement of sales tax which was very narrow based and less productive. Nepal has adopted Value Added Tax Act 2052 since 1<sup>st</sup> Marga 2054 and new Income tax act 2058 since 19<sup>th</sup> Chaitra 2058. This research study makes focus on the following:

- (a) Provision under Income Tax Act 2058 and Value Added Tax Act 2052 in relation to government revenue.
- (b) Role of Income Tax and Value Added Tax in tax system.
- (c) Basis Requirements under the act for effective tax system.
- (d) Covering all traders in tax system
- (e) Development of the accounting system

This study will examine whether it has increased the total revenue or not even in such condition and satisfaction of business person and tax administrator and make conclusion of increasing or decreasing in total revenue collection before and after implementation of Value Added Tax Act 2052 and Income Tax Act 2058.

## **1.3 Objectives of the Study**

The basic objective of this study is to analyze the impact of VAT and income tax act in total revenue presenting the provisions made by the income tax law and value added tax law. Followings are the specific objectives of the study.

1. To sketch historical general background of VAT and Income Tax in Nepal.
2. To assess implementation status of Value Added Tax Act 2052 and Income Tax Act 2058 in Nepal.
3. To examine revenue collection after application of VAT and new Income Tax Act in Nepal.
4. To assess contribution of value added tax and income tax on total revenue and total tax

Revenue in Nepal and provide suggestions on the basis of study findings.

### **1.4 Statement of the Problem**

Nowadays, every sector of the Nepalese economy is suffering very heavily due to ongoing unrest and state of uncertainty. Today investors are suspicious about the security of their investments in future; business is suffering from strangle market and ever diminishing demands. Moreover, individual professionals are also having their mind and time distracted by this situation of uncertainty. The overall economic activities of the country are in a drastic decline. The economy is in the state of recession. Per capita income of Nepalese peoples is only 320 dollar according to World Bank. It shows that Nepal still remain as one of the 9th poorest country in the world Despite more than four decade of planned. Development, the Nepalese economic is persistently suffering from general poverty and stagnation. It has led to several economic and serial disturbances in the country.

Economic development is considered as basic need for very welfare state to fulfill the aspiration of its people .Nepal is facing a serious problem of resources gap and dependency of foreign aid and loan. Now a days the government expenditure is increasing very fast while collection of resources is very low.

Even the Government of Nepal has implemented VAT from the 16 Nov.1997; various objections were risen through private sectors. Nepal Chamber of Commerce has stated the existing facilities in the sales tax, should be given in VAT also. "Various problems have indicated through private sector i.e. VAT should levied on the product basis, it should be levied partly on the product, threshold should not be limited."

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

1. Secondary data are collected and analyzed than primary data.
2. It is very difficult to get primary data and explanation.
3. This study does not cover the data of long term period due to lack of availability of up to date data.

## **1.6 Need of the Study**

For the economic development of the country, contribution of direct tax is more essential rather than indirect tax. But the whole tax structure of Nepal is dominated by indirect tax. Among the direct tax, income tax plays a significant role. But it is unpleasure to quote that the contribution of income to the national revenue is very low in Nepal. To increase its portion in national revenue, research and analysis should be done in the field of income tax. But the studies and research work is lacking in the area of income tax.

To get up to date knowledge about it, we should know the various provision provided by ITA. Among them, provision of fines and penalties play important role to collect tax revenue with in time. In the field of this provision we couldn't find any research and analysis for the fulfillment of this weaknesses this study will be helpful.

## **1.7 Significance of the Study**

The main importance of the present study lies in the role of VAT and Income Tax in total revenue. This study also gives the suggestion to the study relevant organization and others. This study helps to accountant to develop the accounting system under the VAT system. It also gives the idea about VAT and Income Tax to the consumers and other students.

## **1.8 Organization of the Study**

This study has been divided into five chapters; brief descriptions of the worse is as under:

### **Chapter I. Introduction**

This chapter consists of background of the study, introduction of the. Value Added Tax and Income Tax .It includes statement of problem objective of the study, focus of the study, limitations of the study and importance of the study.

## **Chapter II. Review of Literature**

This chapter deals with application of VAT and new income tax act, development of record system, covering strategy of government and comprising sales tax and VAT and finally effect of VAT and new Income Tax Act in total revenue .

This chapter also deals with a brief sketch of previous research studies and related publications.

## **Chapter III: Research Methodology**

This chapter describes the research methodology employed in the study. This chapter has dealt with the research design, population and sample, sources of data, data collection techniques and data analysis tools (financial tools and statistical tools) and methods of analysis and presentations.

## **Chapter IV: Presentation and Analysis of Data**

This chapter includes secondary data and primary data presentation, data analysis, interpretation, testing of hypothesis and major findings.

## **Chapter V: Summary, Conclusion and Recommendations**

The last chapter states the summary, conclusions of the whole study and recommendations. It also offers several avenues for future research. The bibliography and appendix is incorporated at the end of the study.

## **CHAPTER-II**

### **REVIEW OF LITERATURE**

Very few studies have been done on the topic of Income Tax and concerning Nepal. An attempt has been made in this chapter to review various literatures on Income Tax and VAT.

#### **2.1 Definition of Income Tax**

A tax imposed on income base is called income tax. The basic objectives of income tax are two fold- revenue collections and redistribution. Income tax is divided into two parts - individual income tax and corporate income tax. Income tax to be paid by individual or couple or sole proprietorship firm is individual income tax where as income tax to be paid by entity's is called corporate income tax.

##### **2.1.1 Historical Background of Income Tax in Nepal**

The first Parliamentary Government imposed Income Tax in Nepal in 1959. Income Tax Act 1962 was enacted in 1962 replacing business, Profit and Remuneration Tax Act of 1959. The Income Tax Act, 1962 was replaced by Income Tax Act, 1974, which was amended for eight times and existed for a period of 28 years. The Income Tax Act, 1974 and all the income tax related provisions made under other special enactment have been repealed and the existing Income Tax Act, 2058 became effective since Chaitra 19, 2058 (01, April 2002). The Act governs all income tax matters and is applicable throughout the Kingdom of Nepal. It is also applicable to residents residing wherever outside.

##### **2.1.2. Features of Income Tax in Nepal**

The Act has broadened the tax base. Tax rates are spelled out in the Act itself and the tax rates and concessions are harmonized on equity grounds. A full-fledged self-assessment system is implemented and the presumptive taxation and current year

taxation system are strengthened. The scope of discretionary interpretation of the tax administration is drastically reduced ensuring simplicity, uniformity and the transparency. The Act has also defined the power and authority of the tax administration. The Act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities. The appeal system is further streamlined by making it mandatory for the taxpayers to file an objection with the Inland Revenue Department for administrative review before appealing to the Revenue Tribunal

### **2.1.3 Features of Income Tax**

#### **Income Heads**

The Act imposes tax on those activities contributing toward the creation of wealth.

Wealth is created with the help of labor; capital and capital-labor mix activities that generate income from employment, investment and business respectively. The Act makes broad classification of income encompassing almost all income-earning activities. They are:

- A.** Employment (an individual's remuneration income from an employment for an income year)
- B.** Business (profits and gains of a person from conducting a business for an income year)
- C.** Investment (profits and gains of a person from conducting an investment for an income year)

Income and gains are ascertained only after deducting the corresponding expenses. The income from each business and investment needs to be calculated separately.

#### **Taxing Subjects**

The taxpayers on whom income tax is imposed are persons. A person can be a natural person, who is an individual or a couple but includes also a proprietorship, or it can be an artificial person, i.e. an entity. An entity means a partnership, trust, company, and foreign permanent establishment or government body.

The Act distinguishes between resident and non-resident persons. A resident person is an individual whose normal place of abode is in Nepal and who is present at any time of the year, or who is present in Nepal for 183 days or more, or who is an employee of Government of Nepal posted abroad at any time during the year.

A trust is a resident person if it is established in Nepal, or has a resident person as a trustee, or is controlled by a resident person. A Company residing in Nepal and if it is incorporated under the laws of Nepal or has its effective management in Nepal. Partnerships are always resident persons. Permanent establishments are places where a person carries on a business and are subject to tax if they belong to a non-resident person and are situated in Nepal.

### **Income Year**

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

### **Assessable Income**

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

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

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

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



## **Taxable Income**

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

Business

Employment and

Investment

## **Deductions**

Basically, all actual costs to the extent incurred in generating income from the business or investment are deducted while calculating a person's income. This generalization, however, are taken into consideration in conjunction with the special provisions made in the Act. For example, interests paid by exempt controlled entity to the parent in the course of conducting a business or investment, are deductible with some limitations. Other costs such as cost of trading stock, repair and improvement cost of owned and used depreciable asset, pollution control, research and development are also deductible with some limitations.

Depreciation allowances are granted for depreciable assets, which are categorized in 5 classes. The classes are based upon the average useful life of the assets belonging to one class. The assets of each class are placed in a pool and a depreciation rate applies to each pool

Group	Nature of Assets	Deprecation Rate
A	Land and building, structure	5%
B	Computer, furniture and data processing equipment.	25
C	Vehicles, automobiles	20
D	Earth moving equipment, capitalized P.C.C and R&D Cost. Plant and machinery	15

E	Intangible Assets Such as patent, software,	Cost / life
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Allowable limit for repair and improvement cost of owned and used depreciable asset is raised to 7% of depreciation bases.

No deductions are granted for the expenses that are of a domestic personal nature, income tax, government penalties costs in deriving exempt amounts or final withholding payment, dividends distributed by an entity, costs of a capital nature.

Cash payment of more than Rs. 50,000 at one time to a person or entity by a person having annual transaction more than 2 million is not allowable for deduction except the payment is made to following conditions.

- ) Payment made to Government of Nepal constitutional bodies, government owned corporation and bank or financial institutional.
- ) Payment made to farmers for primary agro products or primarily processed agro product.
- ) Payment for retirement contribution or retirement payment.
- ) Payment made beyond the banking facility available place.
- ) Payment made on the day when the bank is closed or any emergency payment must be made.
- ) Any payment deposited on the bank account of the payer.

### **S7.Setoff, Carry forward and Carry back of Losses**

Losses are in principle deductible but are treated differently depending on whether they result from conducting a business or an investment and whether they are of domestic or foreign nature. Losses from a domestic business can be offset against all types and sources of income, whereas losses from a domestic investment can be offset only against any type of investment income. Foreign losses can be offset only against foreign income. Foreign business losses can be offset against foreign business income or investment. Losses from foreign investment can only be offset against foreign investment income.

Unrelieved business losses of previous 4 years are allowed to carry forward.

In case of electricity projects involving in building power station, generating and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own, operate and transfer to the Nepal Government, any unrelieved loss of the previous seven years are allowed to carry forward.

If a person incurs a loss for an income-year from any banking and general insurance business, the person may carry back the loss and deduct it in calculating the income from the business for any of the five preceding income-years.

Special provisions exist in the Act on how to deal with losses incurred in conducting a business of global long-term contract.

#### **Tax Rates.**

) The taxable income of a resident individual for an income-year will be taxed at the following rates            up to Rs. 160,000 – Not taxable

Next upto Rs.100, 00 @ 15% physically challenges /disabled individual –additional 50% off

Above Rs. 200,000 - @ 25%

) The taxable income of a couple, if they choose to be treated as a couple will be taxed at the following rate.

Up to Rs. 200,000 – Not taxable

Next upto Rs.200, 000 @ 15% physically challenges /disabled individual –additional 50% off

Above Rs. 200,000 - @ 25%

. Additional tax (Surcharge) @10%

) Any individual or couple having pension income can enjoy 25% of the normal exemption limit as            an additional basic exemption.

) Any individual working in prescribed remote area is entitled to deduct prescribed amount as remote area allowance from taxable income Rs 30,000, Rs24,000, Rs18,000, Rs12,000, Rs 6,000 for A, B, C, D or E area.

) Any individual is entitled to deduct the following amount from taxable amount, if he is having investment insurance policy; "Rs. 20,000 or actual premium paid, which ever is less"

) For the purpose of the act, net gains from the disposal of non-business chargeable assets will be taxed at the rate of 10%.

) The presumptive tax for individuals conducting small business (who have turnover of Rs. 1.5 Million or an income of Rs. 150,000) in the metropolitan or sub-metropolitans, Municipalities and anywhere else in Nepal amounts to Rs. 2,000, Rs.1,500 and Rs. 1,000 respectively.

) The taxable income of a non-resident individual is taxed at the rate of 25%

) The taxable income of an entity will be taxed at the rate 25% unless prescribed otherwise.

) The taxable income of a bank, or financial institution or general insurance business, or an equity conducting petroleum work under Petroleum Act, 2040 for an income year is taxed at the rate of 30%.

) Gain from lump sum retirement payment made by an approved retirement fund or Nepal Government is taxed at the rate of 6% as a final withholding tax. Gain is calculated by deducting 50% of the payment or Rs. 5, 00,000 whichever is higher from the total lump sum payment.

) The taxable income derived by an individual from special. Industry or exports business will be taxed at the rate of 20%.

) The taxable income derived by an entity engaged in the industrial enterprise or export business or derived from operating any road, bridge, tunnel, ropeway or flying bridge construction business or any trolley bus or manufacturing business is taxed at the rate of 20%.

) The taxable income of an entity engaged in power generation transmission or distribution is taxed at the rate of 20%.

) The taxable income of an estate or trust of an incapacitated resident individual will be taxed at the normal tax rate as through the estate or trust was a resident individual.

) The repatriated income of a foreign permanent establishment of non-resident person situated in Nepal will be taxed at the present of 10 percent.

) The taxable income of a non-resident person deriving income form providing shipping air transport or telecommunication services in Nepal will be taxed at the rate of 5%.

) The taxable in come of an entity wholly engaged in the project conducted by an entity so as to build public infrastructure, own operate and transfer it to the Nepal Government in power generation, transmission or distribution for an income year shall be taxed at the rate of 20%.

### **Tax Accounting and Timing**

For tax purposes, an individual is required to maintain his accounts on a cash basis or accrual basis in calculating the individual's income from an employment or investment and a company is required to maintain its accounts on an accrual basis within the basic framework of generally accepted accounting principle.

Bad debts are allowed to be written off if a debt claim of a bank or financial institution has become bad debt as determined in accordance with the prescribed standards.

Inclusions and deductions under a long-term contract are calculated according to the percentage of the contract completed during the year.

### **Quantification, Allocation and Characterization of Amounts**

Cash payments are quantified as equivalent to the amount of transferred money or the market value of the asset. In case of a kind payment, it is equivalent to the value of the benefit of the payment. Compensations, including payments under insurance for income and losses are to be included in the calculation of income from employment, business or investment.

Payments under an annuity, an installment sale or a finance lease are aggregated and the total is divided into a capital portion and an interest portion calculated according to the Act.

Finance lease has been defined either as an agreement with the transfer of ownership at the end of the agreement or the option of the lessee to purchase the leased asset for a fixed price, or a contract with a lease term exceeding 75 percent of the asset's useful life.

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

## **10. Capital Gain Tax**

The Act has introduced capital gain tax. However, the Act does not cover all such gains i.e. only those gains, which are received from the disposal of business assets or liabilities and those from the disposal of non-business assets of an investment of a person, which are regarded as chargeable and will be taxed accordingly.

Business assets comprise assets to the extent to which they are used in a business. Non-business chargeable assets mean securities or an interest in an entity as well as land and buildings. Both definitions exclude depreciable assets or trading stock. Not included in non-business chargeable assets are also private residences of an individual owned and lived in continuously for 3 years or more if they are not disposed of for more than Rs.10 million. Since profits and gains are different bases of taxation they need to be calculated separately.

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

### **11. Special provisions for Individuals**

A resident natural person and a resident spouse of the person may, by notice in writing, elect to be treated as a single individual for a particular income-year.

Each spouse of a couple making an election as above with respect to an income-year is jointly and separately liable with the other spouse for any tax payable by the couple for the year.

A resident individual may claim a medical tax credit for an income-year not exceeding Rs 750 for any approved medical costs paid by the individual him/herself or through others during the year in respect of the individual. Tax credit limit of Rs. 750/- is calculated by multiplying the total approved medical cost by 15%. Approved medical cost does not include the cost of cosmetic surgery and medical expenses compensate by insurance company in respect of health insurance. Any unrelieved medical costs are carried forward. Medical Tax Credit facility is equally applicable to all individual taxpayers.

### **12. Special provisions for Entity**

An entity is liable to tax separately from its beneficiary who is defined as any person having an interest in an entity. Unless stated otherwise in the Act, transactions between an entity and its managers and beneficiaries are recognized.

The profit of entities can either be retained or distributed to its beneficiaries such as shareholders. The entity can also repay capital or grant collateral benefits to them. Distributions of profits and collateral benefits are dividends representing a return of interest in capital, and need to be distinguished from repayment of capital, which is the return of the capital itself. For that the Act provides a profit first rule saying that a

distribution is a return of capital to the extent that it is not a distribution of profits. If the entity repays capital it is free of tax.

Dividends of a resident company are taxed to the company's shareholders in the form of a final withholding tax. The re-distribution of such taxed dividend is tax-free. Dividends of a non-resident entity, which are distributed to a resident beneficiary, are taxed by inclusion in calculating the income of the beneficiary.

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

### **13. Special Provisions for Retirement Savings**

The Act distinguishes between the treatment of approved and unapproved retirement fund. In case where a resident person files an application with the Department intending to get approval for establishing a retirement fund, the Department shall pronounce the approval as prescribed.

An individual who is a beneficiary of an approved retirement fund may claim a reduction of retirement contributions made to the fund for an income-year. The limit of the claim is the lower of Rs. 3, 00,000 or one third of his assessable income for the year. Contributions to an unapproved retirement fund are not deductible. The income of an approved retirement fund is free of tax where as an unapproved fund itself is subject to full income tax.

### **14. International Taxation**

For taxation purposes, all payments and gains need to be considered on the basis of the source country of the payment. Details of the circumstances under which the source rules are defined are given in the Act.



Tax is imposed on the repatriated income of a foreign permanent establishment of a nonresident person situated in Nepal.

A non-resident person carrying on a business of charterer or air transport operator are taxed at a flat rate on their amounts derived from carriage of passengers, mail or goods which embark in Nepal. The provision is also applied to nonresident persons who transmit messages by any technical means if the apparatus is established in Nepal.

A tax credit may be claimed for any foreign income tax paid with respect to foreign source income. The tax credits are calculated separately for assessable foreign income sourced in each country and will not exceed the average rate of Nepal income tax applied to the assessable foreign income.

## **15. Administrations and Documentation**

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

### **Record Keeping and Information Collection**

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

Every taxpayer is required to maintain, in Nepal and in Nepali or in English language, documents as prescribed by the Department, which are necessary to explain information to be provided in a return, enable an accurate determination of the tax payable and substantiate deductions and outgoing. The documents must be retained for at least 5 years after the end of the income year to which they are relevant. If the

documents are not in Nepali or English, the taxpayer may be requested to provide at his expense a Nepali translation by an approved translator.

The Act grants, every officer with authorization from the Department, comprehensive rights to access to information, such as, full and free access to any premises, place, document or other assets situated in Nepal and right for seizure of any document that may be material in determining the tax liability of the taxpayer. Every officer of the Department will regard and deal with all documents and information coming into his possession or knowledge as secret and will not disclose it to a court, tribunal or other person except in cases explicitly allowed in the Act.

### **17. Installment Payment**

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

### **18. Annual Statement of Estimated Tax Payable**

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

### **19. Returns of Income and Assessments**

In general, every taxpayer should file a signed return of income not later than 3 months after the end of each income year.

Unless explicitly requested by the Department, no returns are required from taxpayers who have no tax payable for the year or are resident individuals who have income exclusively from an employment having a source in Nepal, who have only one resident employer at a time during the year and who do not claim a deduction of their taxable income by gifts to exempt organizations.

Agrawal (2001) wrote a book entitled "Resource Mobilization in Nepal". This book was published by CEDA, Kathmandu. Dr. Agrawal contributed towards the new dimension inside of Nepalese income taxation. Dr. Agrawal in his book, details explains about resource

mobilization through income tax. Nepalese fiscal policy, effective tax system and tax policy, income tax system in Nepal's role of income tax in Nepalese tax structure, administrative and legal aspects of income tax in Nepal. His main contribution from this book is concerned to the empirical investigation of facts and figures about the income tax in Nepal. He also calculated the responsiveness and various projections for future about income.

Amatya, Pokharel and Dahal (2004) wrote a book entitled "Taxation in Nepal" Mr. Amatya, Pokharel and Dahal have described the provisions made under income tax laws. This book is divided in 31 chapters in their book, the authors have described about income tax and its development in Nepal, tax accounting qualification, allocation and characterization of amounts exemptions concession facilities and tax rates, expenditures expressly disallowed for deduction , capital or revenue incomes and expenditure, special provision for natural person and entity, income head and sources, income from employment income from business set off, carry back and carry forward of losses, income from investment, net gain from disposal of assets and liabilities and capital gain taxation, total assessable income taxable income and tax liability, international taxation, total assessable income taxable income and tax liability, international taxation, from of documentation, PAN and maintains of document. Income return and tax assessment, payment collection and refund of tax administration, rights and duties of tax payers and other person's penal provisions, appeal property tax in Nepal, and value added tax in Nepal.

Aryal and Poudel (2005) had shown overall tax system in Nepal in the book "Taxation in Nepal". In his book, he had described the introduction development, existing structure, main problems and possible direction of reform. His identification of major problems was weak tax administration, imbalance and inadequate organizational pattern, lack of adequate information system. Although he had not mentioned the legal provision of income tax, his book is very useful in various aspects of income tax.

This book has been written to fulfill the course requirement of Tribhuvan University. It is based on the syllabus of bachelor level of management, law and CA and it is also for master's level of management and law.

## **2.4 Review of Related Studies**

Shrestha (1984) in her dissertation has studied the origin, definition, concept, historical aspects, role, objectives and structure of income tax. She has also examined per capita burden of income tax in Nepal and the major problem existing in Nepalese income tax system identified by her, is income tax evasion. The reasons for the tax evasion are low tax paying capacity of Nepalese people, absence of clear and comprehensive definition, high tax rate, lack of system of heavy punishment etc. Tax administration is not efficient because of lack of trained & skilled personnel, lack of separate source for income tax revenue, lack of proper incentive & low salary of tax officers. She suggests that the income tax law should be simplified, tax base should be broader, income tax department should be made efficient and loopholes should be plugged. She has recommended that the practice of evasion must be checked if the taxes are to contribute to the economic growth of Nepal by channelizing more resources. She has not presented the legal provisions of income tax law and has not conducted the empirical investigations.

Subedi (2001) has discussed about the role, legal aspect, historical background and cost of collection of the income tax. He has examined the contribution of income tax to total revenue and to total tax revenue, the growth on income tax collection and its ratio. He has also discussed on income tax evasion, direct and indirect taxes. Elasticity of income tax and ratio of cost to tax have also been calculated in the study. He has identified income tax evasion and poor role of income tax as the major problems in Nepalese income taxation.

Nepal (2002), in her study has emphasized on fiscal system of Nepal, origin, meaning, existing position, role, problems and future prospective of the income tax in Nepal. The major problems existing in Nepalese income tax system, identified by her are the inefficient income tax administration, mass poverty, lack of tax consciousness, low number of taxpayers, lack of cooperation between taxpayers and department, narrow coverage, assessment deficiency etc. She has suggested that if these problems can be solved and resources are effectively utilized the future of income tax would be bright. She suggests that the exemption limit should be separate to couple & family and the tax rate & exemption limit should be elastic & progressive.

Shrestha (2002), in his dissertation, has given some general ideas about income tax relating to historical background and some problems existing in income tax of Nepal. He has described the various aspects and provision of income tax but has not shown the major problem and it is not also helpful to study the various parts of income tax at present.

Kayastha (2004), in his dissertation, has analyzed the contribution of income tax and property taxes to overall revenue generation in Nepal and has also pointed out the drawbacks of the system at that time along with the policy suggestions to remove them. His study on legal and administration aspect was also helpful to find out some relative information regarding income tax in Nepal. He has pointed out that the major problems of income tax in Nepal are income tax evasion at high level and greater role of indirect tax in tax revenue. These problems are still considered as the major problem in Nepalese income tax system.

Pandey (2005), in his dissertation, has discussed the legal aspect, role and problems of income tax, structure and economic effects of income tax in Nepal and the mode of mobilizing additional resources from income tax. He has identified two main things: one is the role of indirect taxes are more significant than direct taxes because of various problems of impose direct taxes. The other is role of income tax to control the inflationary trend within the country. He has found out that income tax has contributed 4% in 1999/00 and 10% in 2004/2005 of the total tax revenue. The direct tax contribution is 4% in total tax revenue. Per capita burden of income tax is Rs.0.2 in 1999/00 and has increased to Rs.7 in 1967/68 to 5.6% in 2004/2005.

He has identified that the problems of income tax are lack of up-to-date roll of existing as well as potential taxpayers, lack of record keeping, lack of maintaining accounts by taxpayers, lack of coordination between various tax departments & revenue department and leakage in personal income tax the system of granting income tax holiday to industries should be scrapped, and income tax account assessment & collection method must be scientific. He has not studied other major aspects of income tax.

Tuladhar (2005) has shown the growing resource gap problem in the Nepalese fiscal system .He has found out that tax effort in Nepal has seemed quite insufficient. In 2004/2005, Nepal has realized only 5.6% of GDP, which was quite low in compare to other developing countries. He has used the formula  $\log y_t = \log a + b \log y_{t-1} + ut$  to calculate the elasticity and buoyancy

of income tax. For the period of 1999/00 to 2004/2005, elasticity of income tax is 2.2, which means that a rupee change in GDP causes a change of Rs.2.2 in income tax revenue. Similarly the buoyancy was 2.41 for the period of 1999/00 to 2004/2005. Here the elasticity & buoyancy of income tax was greater than one, which shows that income tax has positive response to change in GDP. The difference between buoyancy and elasticity was 0.21, which shows that the vigorous discretionary changes, mainly the improvement of tax administration, are needed to mobilize additional resources from income tax.

He has suggested widening income tax base, income tax holiday to new industries and reform of income tax administration. He has also stressed on mobilizing additional domestic resources to solve this problem. The legal aspects and problems of income tax are also shown in his study but other aspects like evasion, exemption etc. have not been discussed.

Suwal (2006), in her dissertation, has studied the problem of resource gap in Nepalese finance. She has examined various problems in Nepalese income tax system and importance of income tax in solving the financial problem in Nepal, per capita income burden, and economic effects of income tax on production and trend of income tax in Nepal. The major problems identified by her are the absence of clear and comprehensive definition of income, low tax paying capacity and tax consciousness, high tax rate, corruption etc. She has found out that the reasons of tax evasion are loopholes, widespread illegal business activities, open boarder, lack of account & records of taxpayers, delays in tax administration, lacks of responsibility & honesty among tax officers. She has suggested some improvement to Nepal Government regarding income tax and administration for the collection of income tax. She has advised for the application of scientific methods for the purpose of accounting assessment and collection of income tax and widening tax coverage. She has not mentioned the research methodology of her study and there is no mention of legal provisions. She has not conducted the empirical investigation also.

Siwakoty (2007) has examined various factors persisting in the field of income tax. He has described the role of income tax in Nepal's tax structure, personnel management aspect of tax adjustment. He has identified the role of income tax as economic growth, equitable distribution and stabilization growth. The major problems identified by him are evasion at high level, delay

in assessment, normal role of income tax, lack of public information, complicated act and other defects in Income Tax Act. He has found out that the tax department has no well-trained and expert personnel, there is not any training and development opportunity to the personnel and the workload is also distributed unevenly. There is high use of best judgment assessment method, no compulsion to maintain books of account, no compulsion of auditing of account of all type of business, ineffective use of fines and penalties, no provision of tax review commission, no provision of sales promotion outside the country, lack of weighted deduction. He has suggested for progressive tax, honest and efficient administration, research units in tax offices and penalties for taxpayers who do not maintain accounts. He has recommended that there should be provision for weighted deduction in act and the time limit for assessment should be reduced. He has analyzed especially the Income Tax Act 2058.

Regmi (2008) has studied the trend and share of income tax in total tax revenue & in GDP of Nepal. He has described the growth objective and stabilization objective of income tax. He has found out that income tax can check the inflationary trend within the country as well as it directs the flow of resources of the economy into useful & productive channels and increase the productive capacity of the economy. He has suggested that the practice of evasion of tax must be checked to contribute taxes to the economic growth of Nepal. He further suggests for widening tax coverage, application of scientific assessment method, simple & easy procedure of tax payment, and establishment of research unit. He has not included the comprehensive aspect of income tax.

## CHAPTER- IV

### PRESENTATION AND ANALYSIS OF DATA

#### 4.1. Government Expenditure, Receipts and Deficit.

Nepal is a developing country where most of the people live under the poverty line. In the context of Nepal, government expenditure is rising rapidly but the government revenue is not growing equivalently as per the expenditure. That's why the country is facing the deficit financing. The below table represents the status of government expenditure, revenue and deficit from the fiscal year 1997/098 to 2008/09.

Table No. 4.1

#### Government Receipts, Expenditure and Deficit

*(Rs. in million)*

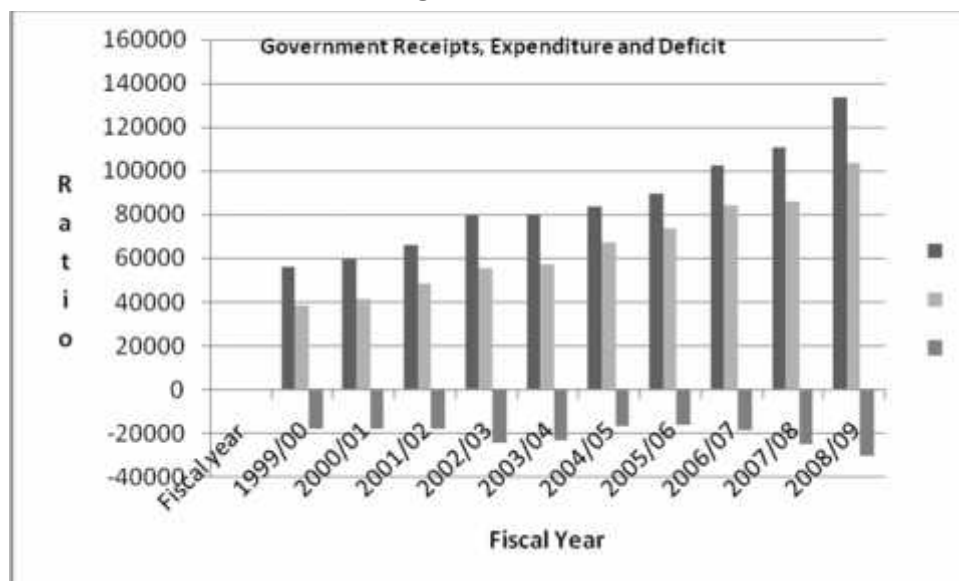
Fiscal year	Expenditure	Receipt	Deficit
1999/00	56118.3	38340.5	-17777.8
2000/01	59579.	41587.6	-17991.4
2001/02	66272.5	48605.5	-17667
2002/03	79835.1	55647	-24188.1
2003/04	80072.2	57131.6	-22940.6
2004/05	84006.1	67568.9	-16437.2
2005/06	89442.6	73614.4	-15828.2
2006/07	102560.4	84513.9	-18046.5
2007/08	110889.2	86109.6	-24779.6



2008/09	133604.6	103512.29	-30092.31
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Source: Economic Survey, 2008/09, Ministry of Finance (MOF)

**Figure No. 4.1**



From above table and figure we know that government receipt is not sufficient to cover the expenditure. In each and every year government is in deficit. Deficit amount is gradually in increasing trend.

## 4.2 Revenue Structure of Nepal

Every state is responsible to perform numerous activities for the betterment of the people in the country. A government needs huge volume of income to fulfill various types of expenditure. For this purpose the government collects revenue from different source like grants, administrative incomes, business incomes and taxation. Generally the government revenue are classified into two categories namely tax revenue and non-repayment and their sum constituted the government revenue. Besides these sources, government has other sources, which are subject to repayment such as loans and however grants are not compulsorily repaid. These sources are desirable only to meet the fiscal deficits.

The trends and composition of tax revenue and non-tax revenue in different fiscal years are presented below:

**Table No. 4.2**  
**Structure of Revenue in Nepal.**

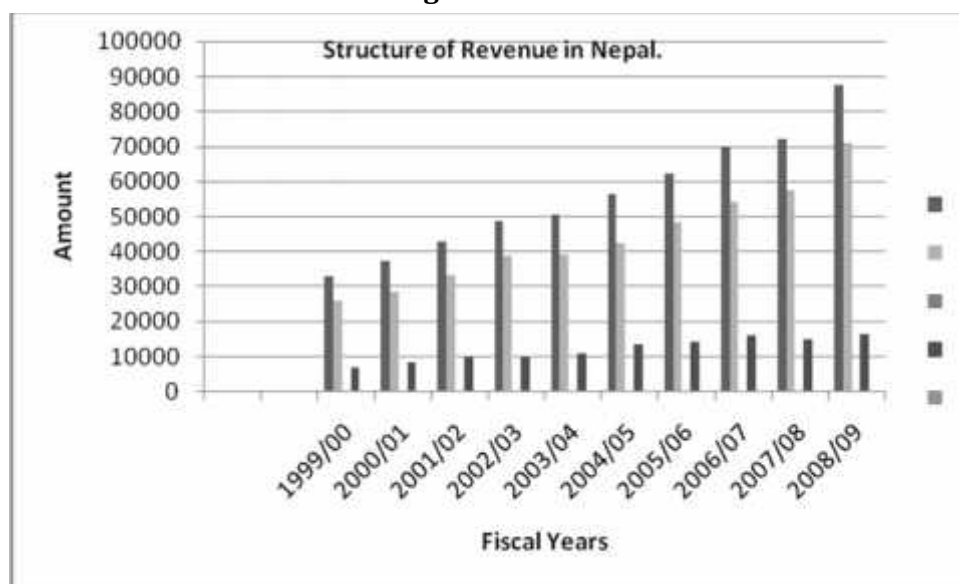
Fiscal Year	Total Revenue	Tax Revenue		Non-Tax Revenue	
		Amount	% as total Rev.	Amount	% as total Rev.
1999/00	32937.9	25939.8	78.75	6998.1	21.25
2000/01	37251.3	28752.9	77.29	8498.4	22.81
2001/02	42983.7	33152.1	77.29	9741.6	22.71
2002/03	48893.9	38865.1	79.49	10028.8	20.51
2003/04	50445.6	39330.6	77.97	11115.0	22.03
2004/05	56229.7	42587.0	75.79	13642.7	24.26
2005/06	62331	48173	77.28	14158	22.72
2006/07	70122.7	54104.7	77.16	16018	22.84
2007/08	72282	57430.4	79.45	14851.6	20.55
2008/09	87717	71127	81.08	16590	18.92

*Source: Economic Survey 2008/2009, MOF*

From the above table we come to know that the share of tax revenue in the total revenue has been always greater than the share of non-tax revenue. In the year 1999/00, the share of tax revenue was 78.75% and share of non-tax revenue was 21.25 percent. Like wise, in the year 2004/05, the share of tax revenue was 75.74 percent where as non tax revenue was only 24.26

percent only. In year 2008/09, the share of tax revenue was 81.08 where as non tax revenue was only 18.92 percent which indicates that tax revenue contributes about three quarters of total revenue. Above table shows the amount of both tax revenue and non-tax revenue has increased but contribution of non-tax revenue to total revenue is very low. It is quite satisfactory because the tax revenue has increased more significantly than the non-tax revenue over the period of 1999/00 to 2008/09.

**Figure No. 4.2**



From the year 1999/00 to 2008/09 the amount of tax revenue has been increasing every year with the amount of Rs 25939.8 million to Rs 71127 million but figure in percentage of tax revenue in total revenue has been fluctuating in different years. From the year 1999/00 to 2002/03 the percentage contribution of tax revenue was increased up to 79.49 percent from 78.75 percent. In the year 2004/05 its contribution was decreases to 75.79 percent. Then in the year 2008/09 it contribution was increased to 81.08 percent. Like wise, the trend of non- tax revenue collection was also increase during the period of 1999/00 to 2001/02 as it increase from Rs 6998.1 million to Rs 9741.6 million respectively. From the above table and figure what we come to know that the amount of both tax revenue and non-tax revenue has been increasing but the percentage contribution is fluctuation in different years.

### **4.3 Tax Revenue Structure of Nepal**

Tax is a compulsory contribution by the tax payer to the government. Taxation is the main source of income of the government excluding foreign aid. Tax revenue comprises compulsory, unrequited, non-payable receipts collected by the government for public purpose. It includes interest collected on tax arrears and penalties collected on non-payment or late payment of taxes. Tax revenue is the principle source of the government revenue; however its contribution differs significantly in different countries. In Nepal, tax revenue is major source<sup>4</sup> of government to mobilize internal source effectively and properly as it has been dominating the government revenue by contributing around three quarters of total revenue.

In the fiscal trends of Nepal, tax revenue structure is a combination of two tax elite. They are namely direct tax and indirect tax. The trend and composition of tax revenue for the fiscal year 1999/00 to 2008/09 are given in the table below.

**Table No. 4.3**  
**Structure of Tax Revenue**

Fiscal Year	Total Tax Revenue	Direct Tax		Indirect Tax	
		Amount	% as total Rev.	Amount	% as total Rev.
1999/00	25939.8	6187.9	23.85	19751.9	76.15
2000/01	28752.9	7516.1	26.14	21236.8	73.86
2001/02	33152.1	8951.5	27.0	24200.6	73.0
2002/03	38865.1	10159.5	26.14	28705.7	73.86
2003/04	39330.6	10597.5	26.94	28733.1	73.06
2004/05	42587.0	10105.8	23.73	32481.2	76.27
2005/06	48173	11912.6	24.73	36260.4	75.27
2006/07	54104.7	13071.8	24.16	41032.9	75.84
2007/08	57430.4	13968.1	24.32	43462.3	75.68
2008/09	71127	18980	26.68	52147	73.32

*Source:  
Economic  
Survey,  
2007/2008  
& 2008/09*

From the above table, we can conclude that the whole Nepalese tax structure is dominated by indirect tax revenue. Although the indirect tax revenue dominates the total tax structure but share of indirect tax as percentage of total tax revenue is in decreasing trend. The table also shows that the share of the direct tax to total tax revenue is increasing in subsequent years. But in the year 2004/05 the share of indirect tax to total tax revenue has increase to some extent.

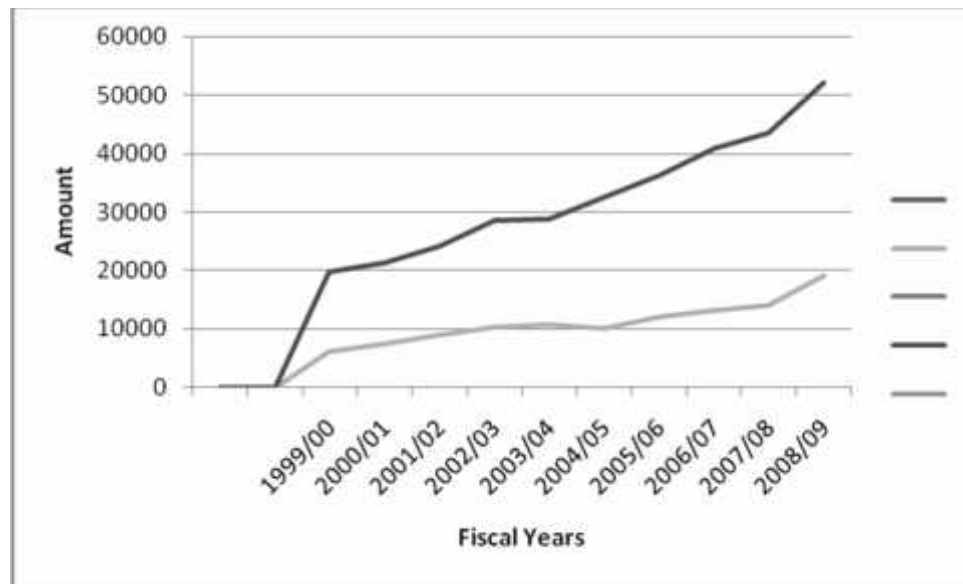
In the year 1999/00, the share of direct tax was 23.85 percent and share of indirect tax was 76.15 percent. Like wise in the year 2004/05 the share of direct tax was 23.73 percent and the share of indirect tax was 76.27 percent. But in the year 2008/09, the share of indirect tax has come down to 73.32% but the share of direct tax has gone up to 26.68 percent.

Although the amount of indirect tax is increasing the increments is in decreasing trend. But in the year 2004/05 the trend of increment has increased to some extent. From the above table it is

clear that the average share of direct tax revenue in total tax revenue for the period 1991/92 to 2004/05 was 22.41 percent and the share of indirect tax revenue was 77.59 percent.

Being developing countries it is usual to have the tax revenue structure dominated by indirect tax revenue. But if a country wants to move towards economic development rapidly then it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax revenue.

**Figure No. 4.3**  
**Structure of Tax Revenue**



#### **4.4 Direct Tax Revenue and Indirect Tax Revenue**

A direct tax is tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is the same. It is the tax on income and property. Income tax, Property tax, Vehicle tax, Interest tax, Death tax, gift tax are the examples of direct tax. In Nepal direct taxes contribute about 21% in the tax revenue of the government.

Indirect tax a popular approach concerning taxation implies in the world is a very powerful missile of fiscal policy adopted in the especially for the optimum level of resource mobilizing with the principle more gain from the tax payers, no pain to the tax payers. Theoretically it is a

tax, which falls firstly, and directly on the tax payers but the other person must bear it due to the shirking of tax burden. So the real income is indirectly affected. In short indirect tax is imposed on one person but is paid either partly or wholly by another person. So the impact and the incidence of tax are on different person Nepal depends highly on the indirect tax revenue rather than the direct tax revenue because there is not any good alternative especially for the optimum level of revenue mobilization, on the other hand wide spread poverty, heavy dependency on agriculture, snail's pace industrialization, low level of income and wealth and very weak administration. Since 1951, indirect tax was effective and proper, its tax mobilization was quickly boosting. So most of the developing countries mobilizes it effectively and properly of the domestic resources.

The major components of indirect tax in Nepalese tax structure constitutes custom duty excise duty, sales tax /VAT and contract tax. Custom duties are composed of mainly import duties, export duties. Other components of indirect tax like entertainment tax, hotel tax and other tax contribute very nominal share because they are included in VAT since 1997. Others form of indirect taxes includes remission of Indian excise duties, road bridge tax and other taxes.

In Nepalese tax structure the indirect tax refers to three categories of taxes namely customs duties, sales tax/ VAT and excise duties. Of the total indirect tax revenue realized during the study period, customs duties constituted the highest share by sales tax /VAT and excise duty. The share of the major components of the indirect taxes is given below.

**Table No. 4.4**

## Composition of Direct Tax Revenue

*Rs. Million*

Fiscal Year	Income Tax	House & Land Tax	Vehicle Tax	Interest Tax	Other Tax	Land Revenue	House and land redg. Fee	Total Direct Tax
1999/00	4685.9	110.7	174.9	212.2	-	2.0	1002.2	6187.9
2000/01	5850.7	123.3	219.4	319.5	-	1.3	1001.8	7516.1
2001/02	7006.2	118.5	396.5	414.5	-	4.6	1011.3	8951.5
2002/03	8650.1	2.9	429.6	463.9	-	5.1	607.8	10159.5
2003/04	8436	2.3	559.7	467.7	-	0.8	1131	10597.5
2004/05	7102.2	-	559.5	864.0	165.8	0	1414.3	10105.8
2005/06	8512.5	-	700.6	733.4	268.6	0	1697.5	11912.6
2006/07	9402.4	-	806.5	757	306.7	0	1799.2	13071.8
2007/08	9598.8	-	847.6	774.9	565.7	0	2181.1	13968.1
2008/09	13979.1	-	995	1054.9	697.8	0	2253.5	18980.3

*Source: Economic Survey, 2008/09*

Above table shows that the direct tax is in increasing trend. Its share in the fiscal year 1999/00 is Rs. 6187.9 million and it reached up to Rs. 10159.5 million in the year 2002/03. Likewise, the share of Income Tax to direct tax is also in increasing trend which contributed Rs 10579.5 million in the year 2003/04 and it reached up to Rs 18980.3 Million in the year 2008/09. But table shows decreasing in direct tax since last two years. That's why the economic activities were decreased due to the problem of security and political instability.

### 4.5 Revenue Collection from Income Tax

Income Tax generates more revenue with less distortion. The revenue collection from income tax in different fiscal year is presented in table below

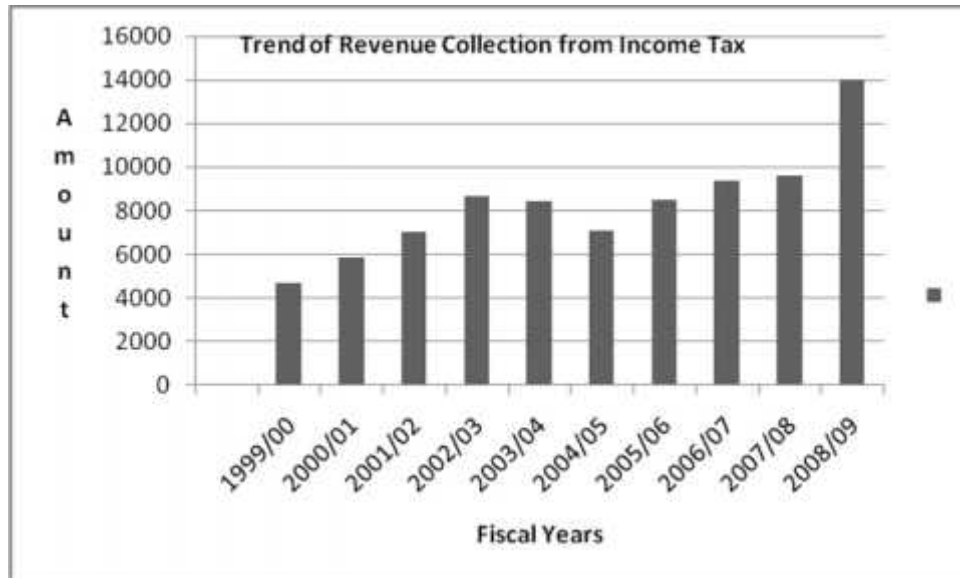


**Table No. 4.5**  
**Trend of Revenue Collection from Income Tax**  
*Rs in million*

<b>Fiscal Year</b>	<b>Revenue Collection From Income Tax</b>	<b>Percentage Change</b>
1999/00	4685.9	0
2000/01	5850.7	24.86
2001/02	7006.2	19.75
2002/03	8650.1	23.46
2003/04	8436	-2.48
2004/05	7102.2	-15.81
2005/06	8512.5	19.86
2006/07	9402.4	10.45
2007/08	9598.8	2.09
2008/09	13979.1	45.63

*Source: Economic Survey, 2008/09*

**Figure No. 4.4**



Income Tax generated about Rs. 4685.9 million revenue in FY 1999/00. In FY 2002/03 it reached up to Rs. 8650.1 million as increased by 23.46 percent to previous year 2002/03.. The trend Income Tax collection increase up to FY 2002/03 and in FY 2003/04 and 2004/05 Due to problem of security and political instability it is decrease by 2.48 percent and 15.81 percent to previous year. Though the trend of revenue collection from Income Tax is fluctuating the collection trend of revenue through Income Tax is not so bad. It is expected that Income Tax will generate more and more revenue in the days to come when "Income Tax Act 2058" is implemented effectively and efficiently.

Statistical tool, called least square method under the time series can be used to analyze the trend of revenue collection from Income Tax to estimate the possible future revenue collection from Income Tax for a given time. A straight-line trend shows the relationship between the time and the Income Tax collection of the relevant year. In this method it is assumed that the Income Tax are consistently changed with the change in time and such change can be expressed by the component of time series. To fit the straight line trend, the time factor is considered as dependent factor upon time. Then the straight line trend of actual Income Tax 'Y' upon time 'X' is expressed by:

$$Y = a + bx$$

**Table No. 4.6**  
**Revenue Collection from Income Tax**

Fitting straight-line trend by least square.

*Rs in million*

Fiscal Year (X)	Income Tax(y)	X	X <sup>2</sup>	XY
1999/00	4685.9	-4.5	20.25	-21086.55
2000/01	5850.7	-3.5	12.25	-20477.45
2001/02	7006.2	-2.5	6.25	-17515.5
2002/03	8650.1	-1.5	2.25	-12975.15
2003/04	8436	-.5	.25	-4218
2004/05	7102.2	.5	.25	3551.1
2005/06	8512.5	1.5	2.25	12768.75
2006/07	9402.4	2.5	6.25	23506
2007/08	9598.8	3.5	12.25	33595.8
2008/09	13979.1	4.5	20.25	62905.95
N = 10	∑Y= 83223.9	∑X = 0	∑X <sup>2</sup> = 82.5	∑XY= 60054.95

We have,

The least square trend be

$$Y = a + bx$$

Where,

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

$$= X \frac{83223.9}{10} - X \frac{60054.95}{82.5}$$

$$= 8322.39 - 727.94$$

This trend line shows the positive Income Tax Revenue for long future, which is beneficial for government. By using trend line equation, we can estimate the Income Tax revenue for fiscal year 2007/08 as:

$$\begin{aligned} \text{Income Tax Revenue for 2007/08; } Y &= 8322.39 + 727.94 \times 5.5 \\ &= 12326.06 \text{ million} \end{aligned}$$

The positive Income Tax Revenue of the government for FY 2007/08 will be Rs 12326.06 if the trend does not change.

**Table No. 4.7**  
**Composition of Indirect Tax**

<b>Fiscal Year</b>	<b>Customs Duties</b>	<b>Excise Duties</b>	<b>Sales Tax/VAT</b>	<b>Other Taxes</b>	<b>Total Indirect Tax</b>
1999/00	8502.2	2885.8	7122.6	1241.3	19751.9
2000/01	9517.7	2983.2	7882.2	883.7	21266.8
2001/02	10813.3	3127.6	9854.9	404.8	24200.6
2002/03	12552.1	3771.2	12047.8	334.6	28705.7
2003/04	12658.8	3807	11964	303.3	28733.1
2004/05	14236.4	4785	13459.7	0	32481.1
2005/06	15554.8	6226.7	14478.9	0	36260.4
2006/07	15701.6	6445.9	18885.4	0	41032.9
2007/08	15344	6507.6	21610.7	0	43462.3
2008/09	16708	9343.2	26095.6	0	52146.8

*Source: Economic Survey, 2008/09*

Above table shows that the contribution of customs duties to indirect tax is in increasing trend. Its share in the fiscal year 1999/00 is Rs. 19751.9 million and it reached up to Rs. 52146.8 million in the year 2008/09. Likewise, the share of sales tax /VAT to indirect tax is also in increasing trend which contributed Rs. 7122.6 million in the year 1999/00 and it reached up to Rs. 26095.6 million in the year 2008/09. But in the fiscal year 2003/04 revenue collection from VAT has been decreased because of the problem of peace and security and political instability.

Similarly revenue collection from excise duties is increasing continuously in the subsequent years of study.

#### 4.6 Revenue Collection from VAT.

Value Added Tax is the best form of sales tax, which is neutral regarding method of production and helpful in generation of more revenue collection. Because of its broad coverage, neutrality, transparency and fairness. VAT will generate more revenue with less distortion. The revenue collection from VAT in different fiscal year is presented in table below:

**Table No. 4.8**  
**Trend of Revenue Collection from VAT**

*Rs. in Million*

<b>Fiscal Year</b>	<b>Revenue Collection from VAT</b>	<b>Percentage Change</b>
1999/00	7122.6	-
2000/01	7882.2	10.66
199/00	9854.9	25.03
2002/03	12047.8	22.25
2003/04	11964	-0.70
2002-03	13459.7	12.50
2005/06	14478.9	7.57
2006/07	18885.4	30.43
2007/08	21610.7	14.43
2008/09	26095.6	20.75

*Source: Economic survey, 2008/09*

**Figure No.4.5**



VAT generated about Rs. 7122.60 million revenue in FY 1999/00. In FY 2000/01 it reached up to Rs. 7882.20 million as increased by 10.66 percent to previous year 1999/00. Similarly, revenue collection from VAT in FY 1999/2000, 2003/04 and 2004/05 are Rs. 9854.90, Rs. 12047.80, Rs. 11964 and Rs. 13459.7 million respectively. The trend Vat collection increase up to FY 2002/03 and in FY 2003/04 and 2004/05 it is decrease by 0.695 percent to previous year due to the problem of security. It is because Industry and trade was not in regular operation But in FY 2004/05 it is increase by 12.50 percent to previous year. Like wise in year 2005/06 it is increase by 7.57% to previous year and increase continuously through out year 2006/07 to 2008/09 by 30.43, 14.43, 20.75 respectively. Though the trend of revenue collection from Vat is fluctuating the collection trend of revenue through VAT is not so bad. It is expected that Vat will generate more and more revenue in the days to come when it is implemented effectively and efficiently. Since Vat is as broad based tax, it will provide a suitable base of revenue to the government.

Statistical tool, called least square method under the time series can be used to analyze the trend of revenue collection from VAT to estimate the possible future revenue collection from VAT for a given time. A straight-line trend shows the relationship between the time and the VAT collection of the relevant year. In this method it is assumed that the VAT are consistently changed with the change in time and such change can be expressed by the component of time

series. To fit the straight line trend, the time factor is considered as dependent factor upon time. Then the straight line trend of actual VAT 'Y' upon time 'X' is expressed by:

$$Y = a + bx$$

## CHAPTER –V

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Summary

Tax means compulsory contribution from a person to the government to betray expenses incurred in the common interest of all without reference. In another words, tax is compulsory contribution imposed by public authority using the rights given by the law. In modern age the purpose of tax has shifted from security to economic development. Tax is the main source of financing government activities. In very country the largest part of government revenue is raised through taxation. Tax may be imposed on person's income or wealth. On the basis of its nature, tax can be classified into direct and indirect tax like Income Tax and Value Added Tax.

The share of tax revenue in the total revenue has been always greater than the share of non-tax revenue. In the year 1999/00, the share of tax revenue was 81.09% and share of non-tax revenue was 18.01 percent. Like wise, in the year 2004/05, the share of tax revenue was 75.74 percent where as non tax revenue was only 24.26 percent only which indicates that tax revenue contributes about three quarters of total revenue. Above table shows the amount of both tax revenue and non-tax revenue has increased but contribution of non-tax revenue to total revenue is very low. It is quite satisfactory because the tax revenue has increased more significantly than the non-tax revenue over the period of 1999/00 to 2008/09.

Direct tax is in increasing trend. Its share in the fiscal year 1999/00 is Rs. 6187.9 million and it reached up to Rs. 18980 million in the year 2008/09. Likewise, the share of Income Tax to direct tax is also in increasing trend which contributed Rs 4685.9 million in the year 1999/00 and it reached up to Rs 13979.1. Million in the year 2006/01. But table shows decreasing in direct tax 2003/04 and 2004/05, that's why the economic activities were decreased due to the problem of security and political instability.

Income Tax generated about Rs. 4685.9 million revenue in FY 1999/00. In FY 2002/03 it reached up to Rs. 8650.1 million as increased by 23.46 percent to previous year 2001/02. The



trend Income Tax collection increase up to FY 2002/03 and in FY 2003/04 and 2004/05 Due to problem of security and political instability it is decrease by 2.47 percent and 15.81 percent to previous year art to increase in year 2006/07 reached up to 9402.4 million as increased by 10.45 to previous year and again it' s Though the trend of revenue collection from Income Tax is fluctuating the collection trend of revenue through Income Tax is not so bad. It is expected that Income Tax will generate more and more revenue in the days to come when "Income Tax Act 2058" is implemented effectively and efficiently.

The contribution of customs duties to indirect tax is in increasing trend. Its share in the fiscal year 1999/00 is Rs. 8502.2 million and it reached up to Rs. 16708 million in the year 2008/09. Likewise, the share of sales tax /VAT to indirect tax is also in increasing trend which contributed Rs 7122.66 million in the year 1999/00 and it reached up to Rs. 26095.6 million in the year 2008/09. But in the fiscal year 2003/04 revenue collection from VAT has been decreased because of the problem of peace and security and political instability. Similarly revenue collection from excise duties is increasing continuously in the subsequent years of study.

VAT generated about Rs. 7122.60 million revenue in FY 1999/00. In FY 2000/01 it reached up to Rs. 7882.20 million as increased by 10.66 percent to previous year 1999/00. Similarly, revenue collection from VAT in FY 1999/2000, 2003/04 and 2004/05 is Rs. 9854.90, Rs. 12047.80, Rs. 11964 and Rs. 13459.7 million respectively. The trend Vat collection increase up to FY 2002/03 and in FY 2003/04 and 2004/05 it is decrease by 0.695 percent to previous year due to the problem of security. It is because Industry and trade was not in regular operation But in FY 2004/05 it is increase by 12.50 percent to previous year. Though the trend of revenue collection from Vat is fluctuating the collection trend of revenue through VAT is not so bad. It is expected that Vat will generate more and more revenue in the days to come when it is implemented effectively and efficiently. Since Vat is as broad based tax, it will provide a suitable base of revenue to the government.

From the above table we come to know that the share of sales tax/VAT in the total tax revenue has been always greater than the share of income tax revenue. In the year 1999/00, the share of VAT was 27.46% and share of share of income tax was 18.06 %. Like wise, in the year 2004/05, the share of VAT was 31.6 percent where income tax was only 16.68 percent only

which indicates that Income Tax and VAT contributes about a third of total tax revenue. Above table shows the amount of both sales tax/VAT and income tax revenue has increased but contribution of income tax to total tax revenue is very low

From the above table we come to know that the share of sales tax/VAT in the total revenue has been always greater than the share of income tax revenue. In the year 1999/00, the share of sales tax/VAT was 21.62% and share of share of income tax was 14.23 Like wise, in the year 2004/05, the share of sales tax /VAT was 23.94 percent where income tax was only 12.6 percent only which indicates that Income Tax and VAT contributes about one quarter of total revenue. Above table shows the amount of both sales tax/VAT and income tax revenue has increased but contribution of income tax to total revenue is very low. It is quite satisfactory because the VAT revenue has increased more significantly than the income tax revenue over the period of 1999/00 to 2008/09.

## **5.2 Conclusion**

Nepal being one of the least developed nations in the world has always suffering from the social and economic problems. She is having hard time raising sufficient revenue and has consistently incurred budgetary deficits. Because of poor performance of internal resource collection and mobilization, the dependency on foreign grants and loan is always there.

- ) Lack of sufficient financial resources is the major constraint of economic development in developing countries like Nepal. Moreover, Nepal has a great problem of misuse of available resources, lack of good governance, which has slowed down the development of the nation.
- ) Tax performance is one among many factors that influences economic growth. Taxation is essential in the getting macroeconomic polices because the alternative ways of financing government expenditure like money creation, mandating larger required reserves, domestic borrowing and foreign loans, can have very harmful effects on the economy.

- J Income tax can be viewed as an important factor of domestic resource mobilization. It is considered as a good remedy to cure growing resource gap problem in Nepal. It is a direct tax and has two types of objectives. One is raising the revenue and the other is to distribute the national income and property equally and minimize the social and economic disparity.
- J The strategy to increase income tax revenue should base on widening of tax base and fair and equitable tax administration. The prospects of widening of tax base are to bring in more and more people under the tax net and to bring in more and more unreported and under reported income to the purview of taxation. The number of taxpayers can be increased with the effective tax policy. The identification of unreported and under reported personal income is a complicated process. Though this problem cannot be resolved completely but can minimize through efficient tax administration.
- J Presently income tax revenue is collecting in accordance to the Income Tax Act 2058. It is blamed that the law is complicated and vague. There needs the efforts for simplification of the law. If the tax law fails to be par with the international tax norms, it will not able to attract the foreign investment. The tax law should be in coherence with the economic situation of the country. Simplification can be introduced through policy changes, legal changes, structural changes, procedural changes and changes in the mentality.
- J The effectiveness of tax system depends upon the existing management and leadership. A vigilant & transparent tax administration capable of timely reviews in policy backsliding would be a pre-requisite for sustaining the gains in the revenue front. The realization of sincere & active supports of officials involved and taxpayers affected should remain always in high priority in the tax administration.
- J Nepal is moving in path of economic fiscal reform. Despite the country's unfavorable situation and international slackness in economic activities, economic reformation efforts by Nepalese policymakers are in a positive track. Presently, clear-cut anxiety is

visible in them to do something in a real sense. This might be the result of the present situation, which has force them to think seriously. If this seriousness continues for a long-term, it would be a good signal for the nation.

- J Introduction of Value Added Tax, self-assessment of Income Tax, harmonized system, integration of Value Added Tax and Income Tax departments, army mobilization for smuggling control are some of the projects and programmed, currently running to strengthen the tax system. But revenue mobilization has not been encouraging even after many reformations.
  
- J It is most important to increase our revenue mobilization capabilities. Our economy is exceedingly reliant on indirect taxes for revenue mobilization. Effort should be made to increase the contribution of direct tax, more precisely the income tax, in the revenue structure. It is imperative now to take a close look at the role of income tax in the total tax structure with a view to improving the horizontal as well as vertical equity as far as possible without losing any amount of the tax revenue. This imperative tax policy should concentrate on expanding the tax base, thereby improving the resource mobilization capacity of tax system.
  
- J The tax policy needs a clear-cut and long-term vision. Frequent changes in fiscal policies and programmed show a never-ending phenomenon of transitional period. It is difficult but not impossible to think over very seriously by concerned high authority and general people to bring income tax system in the right direction and right shape in order to enhance the economic development of Nepal.

The following conclusions are drawn through the study:

- J The present level of revenue collection of the government is not satisfactory. There should be an attempt to increase it.
  
- J Income tax plays a significant role in the revenue collection of Nepal. It is the suitable means to raise the revenue.

- J Nepalese people are not well informed on the tax system. An effective information system should be built up in order to educate the taxpayers.
- J The income tax system of Nepal has not reached at the satisfactory level yet. Complicate income tax act, rules & regulation, lack of education & awareness in taxpayers, inefficient income tax administration are considered as the major problem in income tax system of Nepal.
- J Progressive income tax rate is considered as the suitable means of tax rate in Nepal.
- J Self-assessment method is the appropriate method while assessing the income tax in order to increase the voluntary compliance by taxpayers.
- J There exists the problem of tax evasion in the income tax administration of Nepal. Lack of consciousness in taxpayers, unwillingness of taxpayers to pay tax administration, loopholes in income tax act are the major factors responsible for tax evasion. It can be controlled through simplifying assessment procedure, providing good incentives to taxpayers, providing proper training & suitable incentives to personnel etc.
- J Complexities in income tax act, delay in the procedure and the unnecessary formalities are the major problems in assessment & collection of income tax in Nepal.
- J The provision of fees, fines and penalties under the income tax system of Nepal are considered as reasonable.

### **5.3 Recommendations:**

On the basis of this study, the following recommendations are made in order to increase the contribution of income tax and value added tax in revenue collection of Nepal and administration efficiency of income tax.

- J People should be encouraged to pay tax voluntarily. A system should be introduced that a taxpaying citizen is entitled to receive more incentives than a non-taxpaying citizen.

- J There should be a policy to develop the efficient, fair and equitable tax administration in order to increase the tax revenue.
- J Nepalese taxation should be moved towards the direct tax based collection, which will be proved a more civilized tax system rather than giving a major role to the direct tax.
- J Taxpayers, who submit true income statement within the specified period of time, should be provided certain percentage of tax rebate.
- J Tax administration problems in Nepal can be facilitated a great deal by extending the scheme of withholding over a wide area; adopting the presumptive approach in taxing the hard-to-tax groups and developments of an efficient information system.
- J 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.
- J It needs to develop an effective integrated information system for monitoring the performance of tax offices and its officials, facilitating information sharing among different tax offices. The development of computerized information system is very much essential. Many of the ills of the tax system can be remedied if only a good information system is set up and secure a greater coordination and exchange of information among tax collecting agencies.
- J The introductions of new know-how, techniques and upgrade technology in the system are very much essential to strengthen the capacity of tax administration.
- J There has been an increasing use of information technology in the tax administration around the world since it facilitates day-to-day administration, reduces contact between taxpayers and tax collectors and enhances transparency. Nepalese income tax system should make electronic filing returns possible. Similarly, direct crediting of all refunds to the bank account of the taxpayers, through electronic clearance system, has to be introduced.
- J The tax administration should follow the system of MIS in order to increase the efficiency and effectiveness of the administration.
- J Tax law should be simplified. Instead of using vague meaningful words, clear-cut provision should be made.

- J A fast-moving machinery of adjudication of tax cases is necessary if tax laws are to be enforced efficiently. Long delays in settling tax case can frustrate all attempts to punish evasion.
- J With a large and growing population of taxpayers it is simply not possible to check the returns filed by every assesses. It is better to proceed on the basis of “self-assessment”, taxpayers declare accepting whatever on their own subject to random checks. Every taxpayer should be under a credible threat of getting caught for misdemeanor if self-assessment is to work.
- J A proper and effective audit system is most necessary in order to make any self-assessment system successful. The performance of audit is poor in Nepal, both qualitatively and quantitatively. The taxpayers consider that they are being harassed by tax audit where as the government does not get much revenue as a result of audit. Audit has always been controversial in Nepal. A scientific system of selection of taxpayers for audit such, as on the basis of the computer-generated intelligence may be relevant for Nepal.
- J Taxation of industries or economic agents causing damage to the environment or giving rise to social cost should be higher than that of those preserve the environment.
- J The range of taxpaying circle under the tax net is very narrow in Nepal. The tax administration has not been able to induce individuals to pay income tax. One of the effective steps to encourage people to pay tax may be the incentive to regular taxpayers. The challenge of bringing more people under the tax net can be faced only through effective tax administration and by educating taxpayers.
- J Presently in many offices of Nepal, voluntary retirement scheme has been introduced in order to root out the problem of overstaffing. Income tax system can play a significant role to encourage the voluntary retirement scheme. A certain amount of retirement payment should be placed under exemption.
- J The exemption limit must be adjusted in accordance to the inflationary situation of the country on the yearly basis.
- J There should be effective utilization of human resources in tax administration for the better productivity. Better and formal motivation helps to maintain financial and organizational discipline. In the Inland Revenue Department, all employees are not well

trained. There is inconsistency, in posting and work- load division. Transferring of staffs from tax department to other department should be smooth considering the cadre development and professionalism. The work should be calculated to every position according to the nature of the job. The span of every tax officer and personnel relating to investigating to collecting functions should be determined. Working hour for every file should be fixed according to the nature of business to be assessed. It should be calculated for the effective utilization of time, cost and human effort.

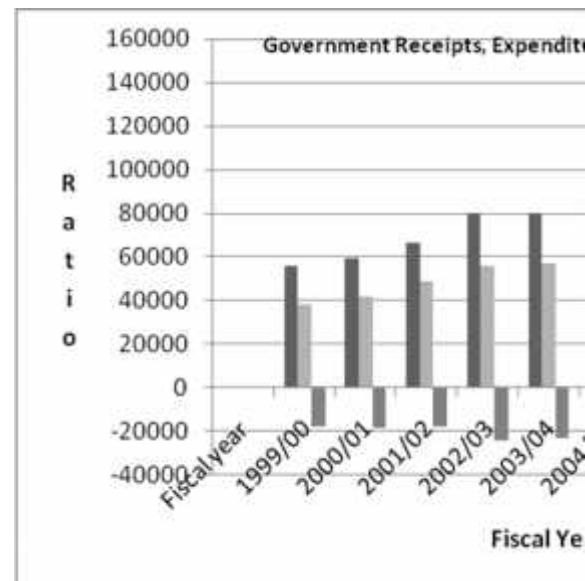
J A system of rewards for tax officials might be less expensive but more efficient way of securing better enforcement. The efficacy of monetary rewards and what could be the best way to reward tax officials, however, remains to be adequately researched. It is necessary to be cautious in giving large financial rewards as it can demoralize officials who do not have the same opportunity to reap such rewards and breed a mercenary culture, which can scarcely be conducive to good tax administration. It is important to drive home the message that honesty is honored and also rewarded with out-of-turn promotion and higher responsibilities while corruption gets punished.

From some years there is a practice of taking foreign consultancy for the administration of income tax in Nepal. For the short term or to achieve a specific objective, it is a better step. Obtaining foreigners to administer taxes cannot be a long-term solution to a country's administrative ills. Native experts and masterminds should be utilized for the sustainable development of income taxation in Nepal.



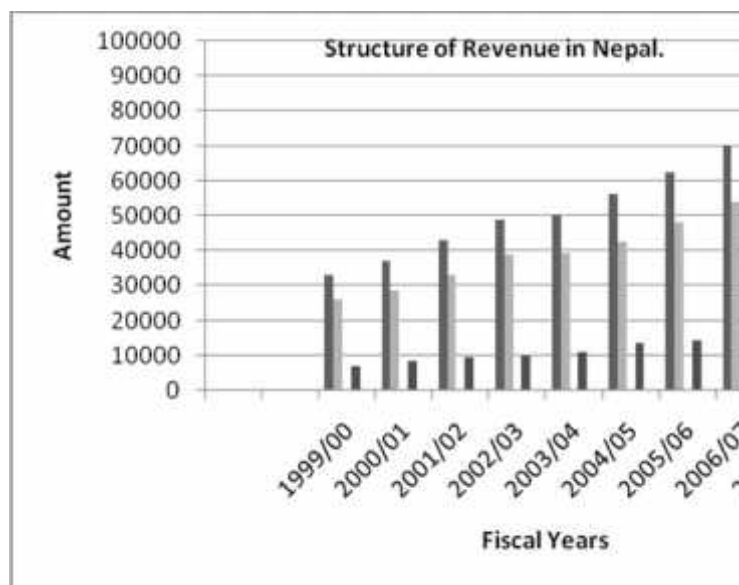
Government Receipts, Expenditure and Deficit

Fiscal year	Expenditure	Receipt	Deficit
1999/00	56118.3	38340.5	-17778
2000/01	59579	41587.6	-17991
2001/02	66272.5	48605.5	-17667
2002/03	79835.1	55647	-24188
2003/04	80072.2	57131.6	-22941
2004/05	84006.1	67568.9	-16437
2005/06	89442.6	73614.4	-15828
2006/07	102560	84513.9	-18047
2007/08	110889	86109.6	-24780
2008/09	133605	103512	-30092



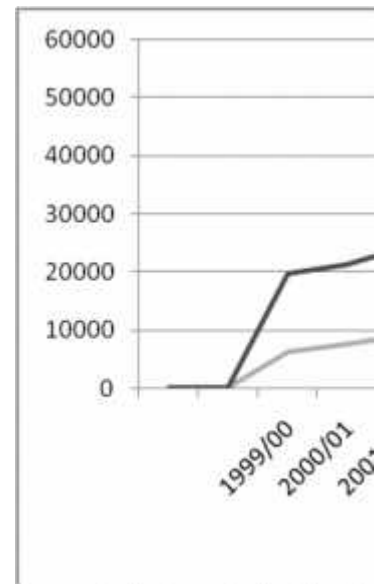
	Total	Tax Revenue	
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	Revenue	Amount	% as total Rev.	Amount	
1999/00	32937.9	25939.8	78.75	6998.1	
2000/01	37251.3	28752.9	77.29	8498.4	
2001/02	42983.7	33152.1	77.29	9741.6	
2002/03	48893.9	38865.1	79.49	10028.8	
2003/04	50445.6	39330.6	77.97	11115	
2004/05	56229.7	42587	75.79	13642.7	
2005/06	62331	48173	77.28	14158	
2006/07	70122.7	54104.7	77.16	16018	
2007/08	72282	57430.4	79.45	14851.6	
2008/09	87717	71127	81.08	16590	



		Direct Tax		Indirect Tax
		Amount		
1999/00		6187.9		
2000/01		7516.1		
2001/02		8951.5		

2002/03		10159.5		
2003/04		10597.5		
2004/05		10105.8		
2005/06		11912.6		
2006/07		13071.8		
2007/08		13968.1		
2008/09		18980		



1999/00	
2000/01	
2001/02	
2002/03	

2003/04	
2004/05	
2005/06	
2006/07	
2007/08	
2008/09	

<b>Fiscal Year</b>	<b>Revenue Collection from VAT</b>
1999/00	7122.6
2000/01	7882.2
199/00	9854.9
2002/03	12047.8
2003/04	11964
2002-03	13459.7
2005/06	14478.9
2006/07	18885.4
2007/08	21610.7
2008/09	26095.6

<b>Fiscal Year</b>	<b>Total Tax</b>
--------------------	------------------

	Revenue
1999/00	
2000/01	
2001/02	
2002/03	
2003/04	
2004/05	
2005/06	
2006/07	
2007/08	
2008/09	

**Contri**

<b>Fiscal Year</b>
1999/00
2000/01
2001/02
2002/03
2003/04

2004/05
2005/06
2006/07
2007/08
2008/09

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## QUESTIONNAIRE

Please tick ( ) the answer of your choice and put the alternatives in order of preferences.

1. Do you think there is poor tax paying habit of Nepalese people?

a. Yes (.....)      b. No (.....)

If Yes, what are the major causes of poor tax paying habit of Nepalese people.  
(Please rank your answer 1 to 7 scales)

- a) Poverty ness of tax payer [.....]
- b) Little knowledge of tax and its importance [.....]
- c) Widespread practices of illegal business [.....]
- d) Lack of incentives for regular tax payers [.....]
- e) Defective tax administration system [.....]
- f) Complexity of tax laws and policies [.....]
- g) Poor public relation by tax office and authorities [.....]
- h) If others, please specify. ....

2. Do you think that income tax is an effective tool to reduce the gap between rich and poor in Nepal?

b. Yes (.....)      b. No (.....)

If No, what are the major causes of ineffectiveness of income tax in reducing the gap between rich and poor in Nepal? (Please rank your answer 1 to 9 scales)

- a) Widespread evasion of tax [.....]
- b) Small number of tax payers [.....]
- c) Avoidance of tax liability [.....]
- d) Poor tax paying capacity [.....]
- e) Lack of tax consciousness [.....]
- f) Defective government expenditure programs [.....]
- g) Defective tax rates [.....]
- h) Raising inflation [.....]
- i) Poor income tax administration [.....]
- j) If others, please specify. ....

3. Do you think there is problem in Income Tax Act 2058 in Nepal?

c. Yes (.....)      b. No (.....)

If Yes, what are the major problems in implementation of Income Tax Act 2058 in Nepal? (Please, rank your answer in order of priority)

- a) Lack of educated people [.....]
- b) Political problem [.....]
- c) Complicated language [.....]

- d) Ineffective enforcement of fine and penalty [.....]
  - e) Illegal business activities [.....]
  - f) Tax evasion and avoidance [.....]
  - g) Low responsibility of tax payer and tax authorities [.....]
  - h) Lack of appropriate assessment procedure [.....]
  - i) Inappropriate rate and exemption limit [.....]
  - k) Inadequate economic policy [.....]
  - l) Other (Please specify) .....
4. In your opinion is the Income Tax Act 2058 a modern and more effective Tax Act than Income Tax Act 2031?
- a. Yes (.....)      b. No (.....)
5. Do you think that contribution of Income Tax on national revenue is satisfactory through Income Tax Act 2058?
- a. Yes (.....)      b. No (.....)
6. Is rebate and facilities provided by Income Tax Act 2058 to special industries are adequate? (please tick ( ) anyone).
- a. Yes (.....)
- If Yes,
- a. Very low (.....)    b. Low (.....)      c. Medium (.....)
- d. High (.....)      e. Very high (.....)
7. Are the revenue administrative and revenue tribunal are effective to give the correct decision to tax payer?
- a. Yes (.....)      b. No (.....)
8. Is the tax administration office providing effective service to the tax payer and other related people after the new act 2058?
- a. Yes (.....)      b. No (.....)
- If no, why may be the reasons? (Please rank your answer in the order of priority)
- a) Lack of training and career development [.....]
  - b) Lack of motivation [.....]
  - c) Lack of reward and penalties [.....]
  - d) Political effect [.....]
  - e) Lack of physical facilities [.....]
  - f) Lack of sufficient budget [.....]
  - g) Lack of sufficient field offices [.....]
  - h) Negligence of tax payer and tax authorities [.....]
  - i) If others (please specify) .....
9. Do you think corrupt practice exists in Income Tax Administration of Nepal?

- a. Yes (.....)      b. No (.....)

If Yes, what are the major causes of corruption in Income Tax Administration of Nepal? (Please rank your answer in the order of priority)

- a) Dishonest tax payers [.....]
- b) Dishonest tax personnel [.....]
- c) Political uncertainties and political pressures [.....]
- d) Lower remuneration of Tax personnel [.....]
- e) Weaknesses of acts, rules and regulations [.....]
- f) Other (please specify) .....

10. How can corrupt practice existed in Nepalese Income Tax administration be minimized? (Please rank your answer in the order of priority)

- a) Severe actions to corruptors [.....]
- b) Development of check and balance system [.....]
- c) Moral education to tax personnel [.....]
- d) Reduction of tax officer's discretionary power [.....]
- e) Additional incentives to tax personnel [.....]
- f) Regular supervision of tax personnel [.....]
- g) Other (please specify) .....

Thank you very much for your kind help and cooperation.