CHAPTER – 1
INTRODUCTION

1.1 General Background of the Study

Nepal is one of the least developed among developing countries of the world. A probe into the nature and conditions of Nepalese economy reveals the dominant features. The prominent characteristics are mainly; widespread poverty, rapid population growth, low income level, extreme disparity, dependence on agriculture, lack of industries, lack of saving and capital, dependence on foreign aid, unemployment, unexploited resources, lack of infrastructure and adverse balance. Despite, Nepal aims for self reliant economic system to accelerate the living standard of people. With the view of attaining full employment equilibrium, high growing level of national income and high economic growth along with maintaining economic stability, government is supposed to employ its revenue and spending programs. Hence government plays significant role in producing desirable effects and avoid undesirable effects on the level of income, output, and social welfare. On this light it can be stated that the perquisite for economic development is productive utilization of revenue. And good tax system a perquisite to attain goal of required revenue. The goal may be obtained through many ways. In this modern age, a government needs a lot of revenue in order to influence the macroeconomic performance of economy or fiscal policy to carry out functions of the government: national defense and to redistribute resources among individuals or classes in the population. In this context, tax is a significant and indispensable source of State Revenue of the government. According to its nature, it is the most reliable, certain, flexible and convenient source to obtain the required amount. Therefore, the government of any country upholds main priority in tax revenue.

Basically, the sources of government revenue can be classified into external and internal. External sources of government are uncertain, inconvenient and not good for healthy development of nation because they have to pay after a certain period of time. So, it is better to mobilize internal sources rather than external sources.

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

The principle sources of domestic revenue are customs tariffs, value-added taxes (VAT), excise duties, and income taxes on personal and corporate incomes. There are also local development taxes, as well as license and registration fees for houses, land and vehicles.

The VAT was introduced in November 1997 as a reform designed to replace sales taxes and most excises. The "octori," a traditional local tax on trade, was also eliminated at this time. Five years after its introduction, however, the VAT had yet to be completely implemented, as indicated by a finding that whereas net taxes from VAT have increased 65% over the first five years, refunds have increased by a factor of 23. The VAT rate is 13% collected at every stage of selling goods and services. Small business with annual turnover of less than NR2 million (about $25,000) are not required to register for the VAT, but businesses who import more than NR10,000 (about $130) at a time, must register. Goods exempted for the VAT include primary food stuffs, agricultural products, and industrial machinery, though the government plans to reduce this list as part of its Economic Reform Plan for 2002/03. There is no VAT on goods for export, nor on raw materials imported by an export promotion industry, nor the products of such an industry.

Excise taxes are applied mainly to goods deemed hazardous to health, such as alcoholic beverages, cigarettes and soft drinks. In January 2002, a new Excise Act went into effect that raised rates slightly as part of the government's effort to pay for increased security expenditures since 2001.

On April 1, 2002 the government put into effect a new Income Tax Act, replacing the previous act of 1958, and developed in close cooperation with the IMF. The new act covers all sources of income—from employment, business and investment—and encourages current year self-assessment and pooled depreciation. In July 2002, personal income tax brackets were adjusted upward somewhat. With these adjustments, there are two tax tiers, 15% and 25%. For individuals, income below NR65,000 (about $850) is exempt, and for couples, NR85,000 (about $2100). The highest marginal rate, 25%, applies to income above NR140,000 (about $1850) for individuals, and NR160,000 (about $2000) for couples.

Companies engaged in construction, transportation, manufacturing and power generation are subject to a 20% corporate income tax, whereas financial institutions are liable for 30%. All other businesses are assessed at 25%.

About 11.1% of state revenue comes from state-owned businesses and property. Under the Industrial Enterprise Act and the Foreign Investment and Technology Act, industries that install pollution-control, environmentally-friendly technology are eligible for a rebate of 50% of its investment from taxable income. After the equipment comes into operation, 10% of gross profits can be deducted from taxable income.

Since 1997, Nepal has received technical support in implementing its tax reforms from the Danish International Development Agency (DANIDA) and German Technical Cooperation (GTZ). In 2002, these agencies were working in an alliance they called Revenue Administration Support (RAS). The major structural reforms in which the RAS has assisted were the merger in late 2001 of the Department of Taxation with the VAT Department to form the Inland Revenue Office, and the subsequent consolidation of the 40 income tax offices and 17 VAT offices into 21, one-point-of-service, Inland Revenue Offices distributed around the country. In their division of labor, DANIDA has been supporting the mergers and the implementation of the VAT and the new income tax, while GTZ has focused on the development of Nepal's income tax/VAT system software, and the introduction of the new income tax.

Tax simply means a liability to pay an amount to the government. It is compulsory contribution to the national revenue from the taxpayers according to law. Tax is a 'contribution ' that involves a sacrifice on the part of contributor. Every tax necessitates a deduction from wealth of the contributor, even though compensation may be indirectly brought about through its action. Tax revenue is the important sources of government revenue. Taxation is regarded as an effective instrument, which monitor various economic activities in a country. The examples of the sources of tax revenue are customs, excise, value added tax, corporate and personnel income tax etc. Governments collect revenue through taxation with major objectives of economic development and economic stability. It is the main sources of government revenue since it occupies the most important place in the government treasury. The contribution of tax revenue to total revenue is 81.09 percent in fiscal year 2006/07 and was 80.40 percent in fiscal year 1996/97.

Tax are emphasized in all countries developed as well as developing because they have the potentiality for increasing the yield of tax system and achieving a system of taxation that satisfies the demand for equity and social justice.

According to professor Plehn, " Tax are general contribution of wealth receive upon persons, natural or corporate to defray expenses incurred in conforming common benefits upon the residents of states."

From the above statement, every nation needs sources of revenue. The another source of revenue is tax revenue. A tax is a compulsory contribution imposed by a public authority, irrespective of exact amount of services rendered to the tax payer in return and are imposed as a penalty for any legal offence. Now it can be concluded that tax is a compulsory contribution made by taxpayers to the government without having any direct personal benefits. Amount collected through taxation is spend for common interest of the people and it is collected from have and spent for the interest of have not in the society.

Basically, tax can be categorized into two broads viz, direct taxes and indirect taxes. If a person must have to pay directly the tax liability to the government such tax is known as direct tax. A direct tax is really paid by the person on whom it is legally imposed. The liability of direct tax cannot be transferred to others and must be paid by the taxpayer to whom it is legally imposed. The impact of direct tax is limited within the taxpayer who is liable to pay such tax is limited within the taxpayer such tax. Income tax, gift tax, interest tax, property tax, death tax, contract tax etc. are the typical examples of direct tax. The government collects and realizes such taxes directly from the taxpayers.

Direct tax is an effective instrument to instill consciousness of the citizens as to how their contribution plays the principal role in the development of the nation as a whole. In Nepal, direct taxes contribute 21 percent of the tax revenue of the government.

On the other hand next category of tax is indirect tax. When a tax is levied on one person but paid wholly or partly by another, it is termed as indirect tax. Such type of tax in collected from other persons by subsequently transferring tax liability. It is imposed on one person who does not bear it from his/her own income. Instead, the tax liability is transferred by collecting it from customers by adding it to the price of goods or services. Hence, the government indirectly collects such taxed from the general public. Sales tax, entertainment tax, excise duty, custom duty, value added tax, hotel tax are some instances of indirect tax.

On this light, income tax is one of the component of taxation and major sources of government revenue. Income tax is the tax of equity. It is imposed on the basis of paying capacity of the tax payers. So, it will be possible to reduce the gap in income by imposing higher rates of those who have higher income and from the collected amounts, providing necessary assistance to the people with very poor economic condition. Income tax is levied on the earnings of a person or corporation. Commonly, it is a progressive tax because the tax rate increases with increasing income. It includes employment earnings, interest income, business income, investment income etc. Income taxes provide the largest single source of government revenues in most developed countries. The revenue generated pay for a substantial part of government operations and services to the public. In Nepal income tax constitutes around 30 percent of the total tax revenue. The contribution of income-based taxes is much smaller to the total revenue for developing countries in comparison to developed countries and is likely to remain same in future despite the efforts over the years of many least developed countries to raise more revenue. The basic causes as to yield of income tax lesser in developing countries are commonly problems of defining income, problems of assessing and measuring it, the choice of rate, allowance and reductions and difficulties of tax collection.

Great Britain is the first country in the world to introduce the modern income tax.Although the taxes were collected in various forms in ancient era, the history of modern income tax is not too old in Nepal. The idea of introducing income tax in Nepal was originated in the early 1950s when a multiparty democracy political system was introduced. In 1951, the finance minister in his budget speech declared the intention of the government to levy an income tax. Now, Income Tax Act, 2002 is in practice.

1.2 Statement of problems

Economic development is the prime concern of every nation of the world. Underdeveloped countries are facing serials problems in the process of the economic development. Nepal is also not exception to this condition. Nepal has been suffering from resources constraints, massive poverty, rapid growth of population, increasing seasonal and functional unemployment, diseases, aggressive dependent on the agriculture, subsistence living standard and poor infrastructure since four decades of planned development efforts.

A government needs development with higher economic growth to overcome from such problem for which government should have adequate financial resources. Despite the various measures adopted by the government to boost up revenue collection, there is still a substantial resources gap between revenue and expenditure. 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 very beginning of her development phase. The resource gap was Rs. 5318.30 in the year 1996/97, and then after is started to follow increasing trend and apparently it is Rs.16,565.30 in the year 2006/07. Government should manage its funds from internal and external sources to meet the growing national expenditure.

It is necessary to raise its internal sources of revenue to raise government revenue. Internal sources of revenue constitute tax and non tax revenue. The highest contribution of tax revenue in the national revenue was 80.8 percent in the fiscal year 1988/89 and it was 80.4 percent in the fiscal year 1996/97 but it was 77.2 percent in the fiscal year 2004/5 and now it is 79.45 in the fiscal year 2006/07. It has been declining in succeeding years which is not a good indication at all.

Government has adequate various policies and system to enhance the revenue structure of Nepal but there is still higher tendency of income tax evasion. However, Income tax is one of the components of tax revenue and major source of government revenue, the contribution of income tax to total revenue is not in a satisfactory level. The parliament of Nepal enacted Income Tax Act, 2002 to enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation and to amend and integrate the laws relating to income tax. But the Income Tax Act, 2002 itself is not free from some problems associated with policy making, implementation, revenue collection etc. Therefore, there is need of improvement of income tax collection system to mobilize internal sources, which is considered as the optimal solution of resources gap and high dependency on foreign loans.

1.3 Objectives of the study

The principal objectives of this very study are to analyze the contribution of income tax on national revenue of Nepal. Other specific objectives of the study are listed below:

- To appraise the share of income tax on GDP.
- To scrutinize the contribution of direct tax in total tax revenue.
- To scan the existing income tax revenue collection method in Nepal.
- To provide valuable suggestion and proposition for improvement, enhancement and upgrading in the existing system of the income tax collection.

1.4 Significance of the study

Ironically, this study is conducted in order to convert the theoretical concepts and knowledge on income taxation to the practical aspects as a partial fulfillment of the requirement of master of business studies (MBS) under the faculty of management, Tribhuwan University. The prime focus of the study is to accomplish the effectiveness of income tax collection procedure in Nepal and its contribution on national revenue. Thus, the study helps to minimize the tribulations associating the income tax provisions faced by tax payers in varied mode. The study is functional and constructive to taxpayers, administrators, teacher, students and tax experts.

1.5 Limitations of the study

Of course there exists countable deficiencies and hurdles as to this study as information regarding the income taxation are not adequate. Every individual study is conducted under certain specific assumptions accompanied by cascading constraints and limitations. Likewise this very study is also confined by some constraints. Some of the specific constraints of the study can be recapitulated as under:-

- As this study is primarily based on secondary data and primary data, the reliability entirely depends on it.

- Since the data concerning income tax are inadequate, the problem of non accessibility of required data and information regarding income tax may limit the scope of this study.

- Sampling error may occur in the study.

- The basic confines of this study are time constraints, limited budget, and lack of experience and non availability of up-to-date information.

- Despite these limitations, this study tries to provide valid result as well as in depth of income tax.

1.6 Organization of the study

The entire study has been designed into six main chapters. Each chapter is devoted to some aspects of the study on contribution of income tax on national revenue. They are:-

- Introduction.
- Review of literature.
- Research Methodology.

- Data Presentation and Analysis.
- Summary, Conclusion and Recommendations.

The introduction chapter includes general background of the study, statement of the problem, objectives of the study, significance of the study, limitation of the study and organization of the study.

The second chapter review of literature is done to know what research had been done in the related topic in various days and what is to be done at present or in future through different relevant books, journals, published/unpublished dissertations.

Research Methodology is mentioned in the third chapter, which includes types of research, research design, population and samples, nature and sources of data, procedures of data collection and data processing and analysis procedure.

The fourth chapter data presentation and analysis is the main part of the research. The content of this chapter are resource gap in Nepal, tax-GDP ratio, Nepalese government revenue structure, composition of tax revenue in Nepal, composition of indirect tax revenue, composition of direct tax revenue, composition income tax, contribution of income tax on direct tax revenue, total revenue and GDP, income tax collection performance in Nepal, exemption limit and personal and corporate tax rate.

Findings, conclusion and recommendation are presented in the fifth chapter, which is the last chapter of this study. Lastly, essential appendices and bibliography have been presented at the end of the study.

CHAPTER –2
REVIEW OF LITERATURE

This very chapter highlights upon the existing literature and research related to the present study with a sole purpose of exploring out what had already been explained and additionally, how the present research is different from previous magnitude .Precisely, the review of literature pinpoint the related books and other materials that are very helpful for conducting research on the particular topic. It aids researcher in determining the discoveries that have been made in the related topics and further the new contribution and propositions can be made if necessary. It, in fact, provides the strong foundation for advancing a comprehensive theoretical framework.

This chapter has been categorized into two parts: - Review from supportive text and Review from previous related researches. The first one stresses about the theories and behavior of the text while the later one emphasizes on all those published researches and dissertations.

2.1 Review of Supportive Text

It is particularly concerned with theories and peculiarities of income tax and Income Tax Act.

2.1.1 Evolution of Taxation

In early days, taxes were considered as immediate source during the scarcity. Taxes were calculated at the time of emergencies to finance wars and to provide communal services. Taxes were levied on the basis of welfare of the people. Taxes were not compulsory payment at that time. People voluntarily paid the tax because non-payment of tax was taken as sin in the Hindu system.

Great Britain was the first country in the world to introduce the income tax in 1799. It imposed income tax in order to finance war with France. Similarly, in U.S.A. the first federal tax was imposed in 1862 with the same motives of financing civil war. However, in the beginning, these countries impose income tax temporarily until 1860. Thereafter, since 1913, it was accepted as permanent tax. In this way, income tax was accepted by different countries gradually. Italy started it in 1864, and New Zealand adopted in 1891.Austrailian and Canada had followed the income tax in 1915 and 1917 respectively. After First World War, the income tax became an important source of tax revenue in many developed countries, by 1939; it has become the most important source of revenue in most developed countries and had made appearance in a number of developing nations. (Agrawal, 1980).

In our neighboring country India, the income taxation was started in 1860 by the British, the income taxation was started in 1860 by the British government to relief from economic burden created due to first democratic revolution. It was then regularly collected after the participation of Income Tax Act 1886. (Dhakal,2059).

In this way, Income Tax has become the regular source national income for all countries over the world. In the beginning, income tax was generally levied at a flat rate. The principal of progressive rate of income tax had been adopted by the United Kingdom and New Zealand since 1999. Now-a-days, a progressive rate is commonly used rather than flat rate in all over the world.

2.1.2. Taxation In Ancient Nepal

Nepalese ancient tax system was based on Vedas, Smritis and Purans. Directives propounded by Manu, Yagnabalkar, Chanakya etc. guided the taxation system. At that time, the principle of collecting tax from the people was imposition of tax without harming the activities of the people (Kandel, 2060) was the major source of revenue. In ancient Nepal, there did exist irrigation tax and religious moment preservation tax in the time of the king Ansuvarma of Nepal. There was tax for purification of casts as well as cremation of the dead.

Although there are not any reliable records about taxation in ancient and medieval Nepal, however, tax has been one of the major sources of government revenue from the ancient time in Nepal. Taxes were then levied on the merchants, traders and farmers in the form of cash, kind and labor.

2.1.3. Taxation during Unified Nepal (1825-1903)

During the period of 1825-1903, the major sources of revenue were land and homestead taxes, monopolies customs transit and market duties, mines and mints, the export of forest product, bird, animals and various levies and fines. The taxes were usually collected at three levels.

- Royal Palace: to finance occasional and ceremonial needs. The taxes were broad based and progressive.
- Government: to finance administrative, military and other purposes assessed on official functionaries, occupational groups and other people.
- Local: perquisites of local officials' functionaries.

The various taxes levied during that period were narrow in base and were imposed primarily on occupations and economic activities, not on income or property. The system of direct taxation was confined to land tax and special Levis like' darshan-bhet', 'salami' and 'walk', etc. In 1826, King Prithvi Narayan Shah (Architect of Modern Nepal) of Gorkha lands, the founder of the present kingdom of Nepal, conquered Kathmandu valley. Within the next two decades, more than 60 petty kingdoms and principalities in the hill region came under the authority of the new power. Most of the territories in plains that had been annexed by Nepal were ceded to the British in the Treaty of Sugauli 1873 .These frontiers were maintained for nearly half a century when the Western Terai area was restored to Nepal as compensation for the assistance Kathmandu extended to the British in the India revolt of 1914. Anyway, the shah dynasty has occupied the throne of Nepal since 1820 to 1903. From 1903 to 2007, however, effective power was in the hands of the Rana family, in which the eldest member of this family, succeeded as hereditary Prime Minister and Defector (Regmi, 2035)

2.1.4 Taxation during Rana Regime

Imposition and collection of taxes during the 104- year autocratic rule of the Rana family in Nepal prior to 2008 B.S was the prerogative of the federal rulers. Only these taxes, which suited the objectives, need and unions of the then ruling prime minister were imposed.

Income & expenditure of the state were not made public. No budget was over framed during that period. There was no difference between the income of the state and the income of then prime minister.

The major source of the revenue in Nepal till 2007 were land tax, custom and excise duties in the form of lump sum contracts, royalties, entertainment tax, and a few other minor taxes. There was no other direct tax in the country except land tax collected on a contractual basis and 'salami', which the government employees use to pay out of their salaries at a very small percentage. The 'salami' was abolished in 2007 B.S. Since most of the revenue in Rana Nepal collected by award of periodic contracts, the need wasn't felt for the development of effective revenue administration system. The Rana rule was done away with in 1951. Since then, no taxes are levied and collected in Nepal except in accordance with the law.

2.1.5 Taxation in Modern Nepal

After the independence of the country in 1951, the role of government has changed. Since then, the government was enforced to operate development activities, besides governing the regular function of maintaining law and order by the collection of revenue. A sound and efficient income tax system is necessary to maximize the revenue collection from income tax. Whole income tax system is made of three sub system i.e. income tax policy, income tax laws and income tax administration. Income tax policy is determined by the government itself through ministry of finance. Income tax policy should be such that the main objectives of the income tax can be attained.

Parliament makes the law to implement the various policies. The government levy and collect the income tax in accordance with law. The constitution of the kingdom of Nepal, 1990 has made the clear provision about it. "No taxes shall be levied and collected except in accordance with law (constitution of kingdom of Nepal, 1990). Present legal provision of income tax is associated with constitution of the kingdom of Nepal, 1990; Income Tax Act , 2002, Income Tax Rules 2002, Finance Act of Concerned financial year etc.

2.1.6 Concept of Income Tax

Income tax is the most important single source of revenue for the government in all countries. Before establishing an income tax rate, income should first be defined clearly. "Income, as the economic gain received by a person during particular period" More clearly income is the function of the person's consumption during the period and the net increase in the individual's personal wealth during the period.

Symbolically, it can be written as

$$\mathbf{Y = C + \triangle W}$$

Where,

Y = Income

C= Consumption

$\triangle$W= Change in Personal Wealth

2.1.6.1 Historical Background

Income Tax was imposed in Nepal by the first Parliamentary Government 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 Nepal.

INCOME TAX RULES, 2000

Nepal Government has formed the following rules pursuant to the power granted by Section 138 of the Income Tax Act, 2058.

1. Short Title and Commencement

1) These Rules shall be called the Income Tax Rules, 2058.
(2) These Rules shall come into force immediately.

2. Definitions:

Unless otherwise implied by the subject or the context, in these Rules,-

(1) "the Act" means the Income Tax Act, 2058.
(2) "Permanent Account Number" means the account number allocated by the Department to a person so as to identify the person for tax purposes.

3. Application for Exemption:

(1) An entity deserving the status as an exempt organization under section 2(s) of the Act shall require to furnish an application with the Department attaching the following details therewith-
(a) In case of the organizations required to be registered by the prevailing laws, a copy of the certificate of registration,
(b) A copy of its charter of establishment, and
(c) A copy of the certificate of permanent account number (PAN) if acquired.

4. Entity Exempt by Advance Ruling

The Department may prescribe any entity, other than the entities formed without a profit motive as referred to in Section 2 (s) (1) of the Act, as entitled to enjoy tax exemption by advance ruling under Section 76 of the Act.

5. Financial Statement to be Submitted

The entity registered under Rule - 3 (2) and the entity entitled to enjoy tax exemption under Rule - 4 shall compulsorily file with the Department a copy of its audited financial statements for an income-year not later than three months after the end of the year. In case where an exempt organization fails to file such the statement, the entity shall not be entitled to enjoy tax exemption until the statement is filed with the Department.

6. Payments of Small Amounts

A payer may make a payment of an amount not exceeding Rs. 500 at a time as the payment of small amount referred to in Section 8(3)(d) and paragraph (a)(2)(C) of the Clarification of section 21 of the Act for a provision of tea, stationery, awards, emergency medical treatment, or a similar provision approved by the Department.

7. Not to be Included in Depreciation Basis

Any excess cost or a part of the excess cost referred to in Section 16 (3) of the Act shall not be included in calculating depreciation basis of a group of assets at the end of the income-year for the purpose of calculating the limitation under Section 16 (2) of the Act.

8. Method of Accounting

(1) For the purposes of tax accounting under Section 22 of the Act, the accounting standard prescribed by the prevailing laws, if any, shall be followed.

(2) If there are no accounting standard as referred to in sub-rule (1), tax accounting shall be done as per the standard prescribed by the Department on ground of any prevalent international principles and practices.

9. Standards for Determining Bad Debts

For the purposes of paragraph (a) of Section 25(2) and paragraph (c) (1) of Section 40(3) of the Act, the determination of whether a debt claim of a bank or financial institution is a bad debt shall be made in accordance with the standards as issued by the Nepal Rastra Bank.

10. Contracts with a Deferred Return

Any contract of a person shall be a contract with a deferred return if the person does not show the details prescribed by the Department regarding estimated gain and estimated loss during every six-month period from the commencement of the contract.

11. Excluded Contract:

The following contracts shall be termed as excluded contract:

(1) Any contract created by reason of an interest in an entity or by obtaining a membership in a retirement fund; or

(2) Any contract of investment insurance.

12. Other Provisions Regarding Long-Term Contract:

(1) Cumulative inclusions under a contract of a person at a particular time means amounts under the contract required to be included at the time or a previous time in calculating the person's income from an employment, business, or investment, disregarding the calculations as for a normal income year.

(2) Cumulative deductions under a contract of a person at a particular time means amounts under the contract that may be deducted at the time or a previous time in calculating the person's income from a business or investment, disregarding the calculations as for a normal income year.

(3) Percentage of contract completed as referred to in Section 26 (2) of the Act shall be determined at a particular time (the time) as follows-

(a) In the case of a contract for manufacture, installation, or construction, or, in relation to each, the performance of related services, is determined by comparing cumulative deductions under the contract at the time with estimated cumulative deductions under the contract at the time the contract is to end;

(b) To the extent to which a contract is not covered by paragraph (a), is determined in the manner prescribed by the Department subject to the paragraph (a).

(4) Provisions regarding long-term contract under Section 26 of the Act shall not apply to a person for an income-year unless the person is required to file an estimate of tax payable for the year under Section 95.

(5) Provisions regarding long-term contract under Section 26 of the Act shall apply to-

(a) A contract for manufacture, installation, or construction, or, in relation to each, the performance of related services, at the time the Act comes into effect; and

(b) A contract occurred as to satisfy the time and conditions prescribed by the Department to the extent to which the contract is not covered by paragraph (a).

SPECIAL PROVISIONS FOR INDIVIDUALS AND ENTITIES

13. Approved Medical Costs and its Limit.

(1) For the purposes of calculating the medial tax credit of an individual under section 51 of the Act, the following costs are treated as approved medical costs:

(a) insurance premiums paid for health insurance by the individual;
(b) costs incurred in filling prescriptions of diagnosis issued to the individual by recognized hospitals, nursing homes, health centers; and
(c) payment of bills issued to the individual by recognized hospitals, nursing homes, health centers, medical practitioners, or pharmacists including cost of medicines consumed in course of medical treatment.

(2) Notwithstanding sub-Rule (1), the following costs are not treated as approved medical costs:

(a) Costs incurred for cosmetic surgery; and
(b) Costs referred to in sub-Rule (1)(b) that are reimbursed under insurance referred to in sub-Rule (1)(a).
(3) The limit for claim of medical tax credit under section 51(3) of the Act is Rs. 750.

14. Amount of Dividend Not to be Included in the Income of Entity

(1) For the purposes of proviso of Section 56 (3) of the Act where an entity distributes a dividend to a beneficiary that is not a distribution of profits, and that consists of the following provisions, which is not made in conducting a business of the entity, the amount of the dividend shall not be included in calculating the income of the entity.

(a) The provision of services by the entity to the beneficiary; or
(b) The availability for use, by the beneficiary of an asset owned by the entity.

(2) In the circumstances mentioned in sub-Rule (1), the entity is not allowed any deduction under the Act, including by way of depreciation, the extent to which the deduction relates to the provision of the services or the holding of the asset.

15. Carry back of Losses of Banking and General Insurance Businesses

(1) Banking and general insurance businesses shall follow the steps described below in carrying their losses back to the previous five income years -

(a) Where any banking or general insurance business incurs a loss in an income-year; and the business has an outstanding risk-bearing fund (reserve fund) accepted as deductible expenses for previous income-years, the loss shall first be reduced by the amount of the risk-bearing fund and only the unrelieved loss shall be carried back to the previous income years.

(b) The unrelieved loss under paragraph (a) shall be carried back by way of deduction first in calculating the income for the earliest income-year available and then gradually from the income of later years.

(2) The tax payable for an income-year, to which a loss has been carried back under paragraph (a) and (b) of sub rule (1), shall be recalculated at the tax rate of that income year and overpaid tax shall be refunded in accordance with section 113 of the Act after adjusting due amount, if any, to the business.

2.1.6.2 The Special features of the Income Tax Act, 2002

- 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.

2.1.6.3. 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 a 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. Investment (profits and gains of a person from conducting an investment for an income year)

C. Business (profits and gains of a person from conducting a business for an income year)

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

2.1.6.4. 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.

2.1.6.5. 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-June to mid-July).

2.1.6.6 Assessable Income

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

A. 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

B. 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)

2.1.6.7 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 person’s assessable income for the year from each of the following income heads:

- **Business**
- **Employment**
- **Investment**

Taxable income includes:

- earnings from employment
- earnings from self-employment
- most pensions income (State, company and personal pensions)
- interest on most savings
- income from shares (dividends)
- rental income
- income paid from a trust .

2.1.6.8 Tax Rates

- The taxable income of a resident individual for an income-year will be taxed at the following rates:

Up to Rs.140, 000 in case of Couple (includes widow &widower) & Rs. 115,000 in case of unmarried – Nil

Next Rs. 85,000- 15%

Balance -25%.

Above 25% shall be 20% only if individual is engaged in special industry.

Non Resident

Any Amount -25%

-Additional Income Tax@1.5% levied earlier has been withdrawn.

-In case of women having income from salary only shall be allowed a rebate of 10% in tax payable calculated as above.

- Any individual or couple having pension income can enjoy 25 percent 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.

- Any individual is entitled to deduct the following amount from taxable amount, if he is having investment insurance policy :

Deduction equal to life insurance premium paid or Rs. 20,000/- whichever is lower is allowed from taxable salary (Earlier it was"Rs. 10,000 or 7% of insured amount or the actual premium paid, which ever is less.")

- Special duty on taxable income is reduced to 1.5%.

- For the purposes of the Act, net gains from the disposal of non-business chargeable assets will be taxed at the rate of 10 percent.

- The presumptive tax for individuals conducting small businesses (who have a 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 percent.

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

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

- Gain from Lump sum retirement payment made by an approved retirement fund or HMG/N is taxed at the rate of 6 percent as a final withholding tax. Gain is calculated by deducting 50 percent of the payment or Rs. 500,000 whichever is higher from the total lump sum payment.

- The taxable income derived by an individual from special industry or export business will be taxed at the rate of 20 percent.

- The taxable Income derived by an entity engaged in an industrial enterprise or export business or derived from operating any road, bridge, tunnel, ropeway, or flying bridge. Construction business or any trolley bus or tram manufacturing business is taxed at the rate of 20 percent.

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

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

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

- The taxable income of a non-resident person deriving income from providing shipping, air transport or telecommunication services in Nepal will be taxed at the rate of 5 percent.
- The taxable income of an entity wholly engaged in the projects conducted by any entity so as to build public infrastructure, own operate and transfer it to the HMG/N in power generation, transmission, or distribution for an income-year shall be taxed at the rate of 20 percent.

2.1.6.9 Business Exemptions, Exempt Amounts and Other Concessions

- The following amounts are exempt from tax :

A. Amounts derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between Government and a foreign country or an international organization;

B. Amounts 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 amounts are payable from the public funds of the country;

C. Amounts 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. Amounts derived by an individual who is not a citizen of Nepal from employment by Government on terms of a tax exemption;

E. Allowances paid by Government to widows, elder citizens, or disabled individuals;

F. Amounts derived by way of gift, bequest, inheritance, or scholarship, except as required to be included in calculating income under this Act;

G. Amounts derived by an exempt organization by way of gift; or other contributions that directly relate to the organization's function, whether or not the contribution is made in return for consideration provided by the organization, and

H. Pension received by a Nepali citizen retired from the army or police service of a foreign country provided the amounts are payable from the public fund of that country.

- An agricultural income derived from sources in Nepal during an income-year by a person, other than the income from an agriculture business derived by a registered firm, or company, or partnership, or a corporate body, or through the land above the land holding ceiling as prescribed in the Land Act, 2021, is exempt from income tax.

- Incomes derived by cooperative societies, registered under Cooperative Act, 2048 (1991), from business mainly based on agriculture and forest products such as sericulture and silk production, horticulture and fruit processing, animal husbandry, diary industries, poultry farming, fishery, tea gardening and processing, coffee farming and processing, horticulture and herb processing, vegetable seeds farming, bee-keeping, honey production, rubber farming, floriculture and production and forestry related business such as lease-hold forestry, agro-forestry, cold storage established for the storage of vegetables and business of agricultural seeds, insecticide, fertilizer and agricultural tools (other than machine operated) and rural community based saving & credit cooperatives are exempt from tax. Dividends distributed by such societies are also exempt from tax.

2.1.6.10Deductions

- 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 deductable 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 deductable 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.

- 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 and cash payment above Rs. 50,000 under prescribed conditions.

2.1.6.11 Setoff, Carry forward and Carry back of Losses

- Losses are in principle deductable 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 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.

2.1.6.12 Tax Accounting and Timing

- For tax purposes, an individual is required to maintain his accounts on a cash 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.

2.1.6.13 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.

2.1.6.14 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.

2.1.5.15 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%. Any unrelieved medical costs are carried forward. Medical Tax Credit facility is equally applicable to all individual taxpayers.

2.1.6.16 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. Collateral benefit, which can be characterized as a kind of hidden distribution of profit. 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.

2.1.6.17 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 deductable. The income of an approved retirement fund is free of tax where as an unapproved fund itself is subject to full income tax.

2.1.6.18 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.

2.1.6.19 Administration and Documentation

- The Department is charged with the responsibilities of administering the Act and the provisions thereto. 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.

2.1.6.20 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.

2.1.6.21 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.

2.1.6.22 Annual Statement of Estimated Tax Payable

- Every person who is an installment tax payer 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.

2.1.6.23 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.

- Unless an assessment has been amended or reduced by order of the Revenue Tribunal or of a court, the Department may amend an assessment within 4 years in order to adjust the assessed person's liability to tax in such manner as, according to the Department's best judgment, is consistent with the intention of the Act. An assessment may be amended at any time in cases of fraud.

- Where the department makes a jeopardy or amended assessment, it will serve a written notice on the taxpayer.

2.1.6.24 Administrative Review and Appeal

- A taxpayer who is aggrieved by a review able decision may file an objection within 30 days after the decision is made. In doing so, such Taxpayer has to deposit 50% of due amount. The Department may extend this period for another 30 days upon request. The Department may stay or amend or do necessary corrections with regard to these review able decisions. If the Department fails to serve a taxpayer with a notice of an objection decision, within 90 days, the taxpayer may elect to treat the Department as having refused his objection and appeal to the Revenue Tribunal.

2.1.6.25 Offences

- Offences are dealt with in the Act in a sense of criminal offences of taxpayers as well as tax administrators. They lead to punishment in the form of fines and imprisonment on conviction. The offences attracting both a fine and the imprisonment include failures to comply with the Act, failures to pay tax, maintaining documentation or filing income returns and statements of estimated tax, making false or misleading statements, impeding or coercing the tax administration, offences by the authorized and unauthorized persons, offences of aiding or abetting, etc. In case if the Tax return file is not submitted within the period prescribed by the act, the late fee will be charged at the rate of 0.1% per year of the turnover.

2.1.6.26The Super Act

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

2.2 Review of Previous Related Researches

First of all, income tax was imposed in Nepal in Fiscal year 1959/60 under the 'Business Profit Remuneration Tax Act 1960' : then after, various studies were made concerning with various aspect of this act such as the structure, role, productivity, legal and administrative framework etc. Summary of the relevant studies are presented below:

Amatya prepared a book " Nepal ma Aayakar ko Byabastha". He has tried to describe about income tax and provision regarding income tax. His contribution was first in this field. Basically he analyzed legal aspect of income tax in Nepal at that period. (Amatya, 1965*).*

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

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

Kayastha has tried to analyze the contribution of income and property taxes to overall revenue generation in Nepal. He has studied on legal and administrative aspect income tax system of Nepal and pointed out some drawbacks.

In 2005 Luitel had conducted a research in the topic"A study on contribution of income tax to the government revenue of Nepal". In his study, he has found the income tax was a suitable source of mobilizing internal resources. He has also found the contribution of income tax on GDP, Total revenue, Total Tax revenue, Direct Tax revenue in 1988/89 were 1.03, 11.31,13.99 and 66.07 percent respectively, which increased to 1.83, 14.17, 18.71and 73.83 percent respectively in the year 2002/03.

He recommended that there is urgent of strong political commitment, stability and security of investment to increase revenue from income tax in Nepal. (Luitel, 2005).

Agrawal has provided details information in various aspects of income taxation in his report prepared in 1978. His study is the first comprehensive scientific study in this field. He has organized his study on nine chapters. Resource mobilization through income tax, fiscal policy, effective tax system, role of income tax, legal provision in regard to income tax, legal aspects of income tax, legal aspects of income tax, administrative aspect etc. have been discussed. The study is very useful in finding out the reality about income tax in Nepal. This research study was made 26 years before.However a comprehensive study and has included various aspects of income tax system of that period which are fully relevant today. (Agrawal, 1978).

Panday, in his study has discussed various aspect of income tax such as legal aspects, income structure, role of income tax, problems of income taxation, economic effect of income tax in Nepal. According to him, income tax played a significant role in the economic development Nepal. He found the capita burden of income tax was 0.2 in 1962/63 and it had increased to Rs. 7 in 1975/76. He had stated that indirect tax had a dominating role in the total tax revenue. His suggestions about income tax were capital gain should bring in tax net; income tax accounting assessment and collection method must be scientific etc. (Pandey, 1978*)*.

Siwakoti has explained the various aspect of income tax. His study emphasized on drawing a clear sketch of role of income tax, structure of income tax, projection of income tax, legal aspect of income tax act and problems of income tax, major problem existing in Nepalese income tax act and problems of income tax.

Major problems existing in Nepalese income tax system, stated by him are narrow coverage, unscientific and time consuming assessment and collection procedure, complicated act and defective income tax act.(Siwakoti, 1987).

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

Acharya has mentioned the main objectives of income tax are to achieve social justice, to check inflation and to collect more government revenue. He had identified the contribution of individuals in total income tax revenue seems to be greatest during his study period followed by public enterprise and private corporate bodies respectively. He has also analyzed the administrative and legal aspect and administrative aspects and underwriting with the consent of taxpayers to raise income tax revenue. (Acharya, 1994).

Shahu has found that 0.35 percent of total population came under the categories of taxpayers during his study period. Main objective of his study was to study Nepalese tax structure, rate and contribution of income tax on national revenue. He has identified that income tax has been gradually increasing and was in the forth place in the tax structure of Nepal.

He has not discussed the major aspects of income tax clearly and analytically, so it is incomplete study and all things mentioned in it are not also fully relevant today because it was made 11 years ago. (Shahu, 1995).

Shrestha's study had covered the historical background legal provisions, structure of income tax, income tax administration in Nepal and empirical investigation. Her findings about tax structure were the dominant share of tax revenue . The tax/GDP ratio was not found satisfactory with compared to SAARC countries. It was 6.81 percent for the period of 1984/85 and 9.36 percent in 1998/99. There was a serious problem for Nepalese economy. There was dominance of indirect tax revenue. She had found various problems of income tax system in Nepal. They were narrow tax coverage, mass poverty of Nepalese people, lack of conscious tax payers, widespread evasion and avoidance of income tax, unscientific tax assessment procedure, inefficient tax administration, complicated tax laws and procedures, instability in government policy. (Shrestha, 2001).

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

Mallik had published book named "Modern Income Tax of Nepal ".He had described historical aspect of income tax and legal provisions relating to income tax with numerical examples. This book is very useful to know the general information and legal provisions of income tax Act, 2002. (Mallik, 2060).

Palli Magar had covered tax structure, role of income tax and exemptions and deductions provided in the lax.

He had found there was dominated share of tax revenue in Nepalese government revenue. Income tax had occupied third position in his study period and it was in increasing trend. He is totally concentrated on the exemption and deduction in his study. (Magar, 2003).

Kandel had criticized the income tax Act 2002 on several grounds. Exemption of agricultural income from income tax, export duties levied on export, inequality between different capital earned income(i.e. tax on interest, dividend and capital gain) withdrawal of the provision of exemption suddenly and no adjustment for inflation are the major issue he raised in his article. He further criticized the act for the provision of income tax from export as 0.5 percent of total export because it is not good choice of income tax base.

Bhandari has found that Nepalsese tax revenue is the composition of direct and indirect tax. . Main objective of his study was to study Nepalese tax structure, rate and contribution of income tax on national revenue There is dominant role of indirect tax revenue in Nepalese tax revenue structure(i.e contribution of direct tax to total tax revenue was 24.2 percent whereas contribution of indirect tax to total tax revenue was 75.8percent in the fiscal year 2004/05). In addition to it he found that important factors for raising government revenue in Nepal were clear Act, Rules and Regulation, Effective tax administration, conscious and hones tax payers, moral and honest tax officers, political non-interruption based on the preference of the respondents. He had recommended in his study that income tax policy should be formulated according to the economic policy, it should be revised timely and should be formulated on the basis of critical analysis of existing situation.

CHAPTER 3
RESERCH METHODOLGY

Research is defined as human activity based on intellectual application in the investigation of matter. The primary aim for applied research is discovering, interpreting, and the development of methods and systems for the advancement of human knowledge on a wide variety of scientific matters of our world and the universe. Research can use the scientific method, but need not do so.

Scientific research relies on the application of the scientific method, a harnessing of curiosity. This research provides scientific information and theories for the explanation of the nature and the properties of the world around us. It makes practical applications possible. Scientific research is funded by public authorities, by charitable organisations and by private groups, including many companies. Scientific research can be subdivided into different classifications according to their academic and application disciplines.

Historical research is embodied in the historical method.The term research is also used to describe an entire collection of information about a particular subject.

Primary research (also called field research) involves the collection of data that does not already exist. This can be through numerous forms, including questionnaires and telephone interviews amongst others.

- The term is widely used in market research and competitive intelligence
- Could be very expensive because many people need to be confronted.

- Take too long and by the time the research is complete may be out of date.
- People may have to be employed or avoid their primary duties for the duration of the research.
- People may not reply if emails or letters used.

Secondary research (also known as desk research) involves the summary, collection and/or synthesis of existing research rather than primary research, where data is collected from, for example, research subjects or experiments.

The term is widely used in market research and in medical research. The principle methodology in medical secondary research is the systematic review, commonly using meta-analytic statistical techniques, although other methods of synthesis, like realist reviews and meta-narrative reviews, have been developed in recent years.
Secondary research can come from either internal or external sources.

3.1 Research Design

Overall plan of any proposed activity can be seen in design of the study . A complete research is accompanied by the effective research design indeed. It constitutes the procedure, technique and overall frame work of the study. Basically the data and information of the study are concerned with past phenomenon of the performance. Thus it can be also regarded as historical research design. The historical method comprises the techniques and guidelines by which historians use historical sources and other evidence to research and then to write history. There are various history guidelines commonly used by historians in their work, under the headings of external criticism, internal criticism, and synthesis. This includes higher criticism and textual criticism. Though items may vary depending on the subject matter and researcher, the following concepts are usually part of most formal historical research:

- Identification of origin date
- Evidence of localization
- Recognition of authorship
- Analysis of data
- Identification of integrity
- Attribution of credibility

Thus thus study also has followed an analytical as well as descriptive reasearch design.

3.2 Source of information for this study

The information is basically based on the field work procedure. Mainly two important sources:- primary as well as secondary sources were taken during the study. Primary sources were used for primary data and seocndary sources were supposed to be used for secondary data.

3.2.1 Primary Data

Primary data and information have been collected through administrating structured questionnaire to sample of population. The same questionnaire was distributed to all respondents. Tax administrators are selected from tax department and various sectors of tax officers. Tax experts are the professors, auditors and chartered accountants. Tax payers are selected representing various sectors i.e manufacturing company, trading company, private banks, insurance company, finance company, departmental stores etc.

3.2.2 Secondary Data

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

- Budget speech and Economic Survey of various years, Ministry of Finance, Government of Nepal.
- Economic review and economic report, Nepal Rastra Bank.
- Reports and records of Department of Taxation, Ministry of Finance, Government of Nepal.
- Dissertation related to income tax.
- Books related to income tax and public finance.
- National and international newspaper, journals, and news , magazines.
- Other relevant records and data have been used in this study.

3.3 Data Collection Procedure

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

3.4 Population and Sample

The study covered only selected areas as well as selected people as sample size. The population of the study is the people who come under the income tax bracket, who are affected by the tax policy of the government. In order to fulfill the objectives of this study, the 60 sample size is selected from

Kathmandu district. All the experts and tax payers in Nepal were considered as total population. Out of them, the experts and taxpayers in Kathmandu valley were considerd as target sample. The respondents have been divided into two groups. The following table shows the groups of respondents and the size of samples.

Table 3.1: Group of Respondents and Size of Samples

S.No.	Groups of the respondents	Sample Size
1	Income Tax Officers	30
2	Income Tax Experts	30
	Total	60

3.5 Profile of Respondents

Questionnaires were distributed to 120 respondents : tax officers and tax experts. All of them, questionnaires were received from both groups. The following table reveals the different numbers and percentage of the respondents.

Table 3.2 Profile of Respondents

S.N.	Respondents	No.	Total Sample	Respondents Received	
			%	No.	%
1	Tax Officers	30	50	30	50
2	Tax Payers	30	50	30	50
	Total	60	100	60	100

Source: Primary Data

CHAPTER-4
DATA PRESENTATION AND ANALYSIS

In earlier chapters, general background and research methodology have been highlighted along with review of relevant literature pertinent to this purpose study. Now, it comes to the most important component of the study, which deals to the analysis of income tax and its contribution to national revenue. The whole analysis is based upon existing problems ad prospects of the revenue collection.

This very chapter is classifies into two parts. They are:

4.1 Analysis of Primary Data

4.2 Analysis of Secondary Data.

4.1 Analysis Of Primary Data

This chapter attempts to analyze the data on various subject matters directly collected from the respondents. The respondents were requested to fill the pre-structured questionnaire designed after the extensive preview of literature. Respondents were selected from various government and non government bodies of Kathmandu valley. Respondents are divided into two groups i.e. Tax Officers and Tax Payers. Tax Officers includes chartered accountants, auditors, tax administration and experts as well .Similarly, tax payers includes banks and financial institution and general public.

Altogether, 60 respondents were enquired about the questionnaire. The questionnaire includes six(6) questions in total related to the study. All the questionnaire was in objective form including various response: (a) yes/no response (b) Ranking response (c) Statement response.

After the completion of filled questionnaire, the data were entered in the data processors for the further processing. Collected were attempted to present in table .

4.1.1 Frequency Analysis of Respondents

Respondents are selected from two different groups tax officers and tax payers. Fifty percent out of sixty are tax officers and remaining are tax payers. All respondents responded all questions in the questionnaire. Responses of respondents in various questions are tabulated below:

Table 4.0 Frequency Analysis of Respondents

Respondents	Frequency	Percentage (%)
Tax Officers	30	50
Tax Payers	30	50
Total	**60**	**100**

Source: Field Survey 2008

4.1.2 Result Of Empirical Investigation

Is Contribution of Income Tax To National Revenue Of Nepal Satisfactory

Even the voice "Contribution of income tax to national revenue is not satisfactory is realized day by day and about 20% on the national revenue is contributed by income tax. To know the fact ; a question was asked i.e. " In your opinion ,is Contribution of Income Tax to National Revenue of Nepal Satisfactory? Final opinion is summarized below.

Table 4.1 Is Contribution of Income Tax to National Revenue Of Nepal Satisfactory?

Response / Respondents	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Officer	27	90	3	10	30	100
Tax Payer	25	83	5	17	30	100
Total	**52**	**86.66**	**8**	**13.33**	**60**	**100**

Source : Opinion Survey ,2008

90 percent Tax Officers argue that contribution of income tax to national revenue is satisfactory while 83 percent tax payer are standing in this position. In aggregate, results had shown that 86.6 percent respondents believe that Nepalese tax contribution is satisfactory.

In order to recognize the major reason for lower contribution of income tax, next question was put," If no, what may be the major reasons?" Respondents ranked the prominent reasons as they were requested to give ranking 1-5 according to preference. Following table summarizes the response.

4.1.3 Major Reasons For Low Contribution Of Income Tax

Table 4.2 Reasons for Low Contribution Of Income Tax

S.N.	Reasons	Points Received				
		Tax Off.	Tax Payer	Total	%	Rank
1.	Defectiveness Of Income Tax	-----	4	4	6	5
2.	Mass Poverty & Low Income Level	12	4	16	27	2
3.	Increasing Habit Of Tax Evasion	18	5	23	38	1
4.	Inefficient Tax Administration	-----	6	6	10	4
5.	Inappropriate Rate & Exemption Limit	----	11	11	19	3
	Total	30	30	60	100	

Source : Opinion Survey ,2008

Above table concludes that the reasons for low contribution of income tax to national revenue are ranked as follows:

- Increasing Habit Of Tax Evasion
- Mass Poverty & Low Income Level
- Inappropriate Rate & Exemption Limit
- Inefficient Tax Administration
- Defectiveness Of Income Tax

From the result of opinion survey table, increasing habit of tax evasion is ranked as the most important reasons for low contribution of income tax to national revenue among the five reasons. Then after Mass poverty and low income level tool the second most important reasons and inappropriate rate and exemption limit, inefficient tax administration and defectiveness of income tax were ranked as third, forth and fifth most important reasons respectively for low contribution of income tax to national revenue in Nepal.

4.1.4 More Appropriate Income Tax Assessment Method

Tax assessment system is one of the most important factors in revenue collection. Therefore, assessment procedure should be appropriate and effective. Hence a question –" Which Income Tax Assessment Method is More Appropriate in Nepal? was put to the respondents. Their opinion can be summarized as below:

Table 4.3 More Appropraite Income Tax Assessment Method

S.N.	Methods	Points Received				
		Tax Off.	Tax Payer	Total	%	Rank
1.	Self Assessment	19	17	36	60	1
2.	Jeopardy Assessment	6	3	9	15	3
3.	Amended Assessment	5	10	15	25	2
	Total	30	30	60	100	

Source : Opinion Survey ,2008

Above table concludes the most important methods of tax assessment method ranked as follow:

- Self Assessment Method
- Amended Assessment Method
- Jeopardy Assessment Method

From above table, Self Assessment method is ranked as most important method. While Jeopardy and Amended Assessment methods were ranked as second and third method that are considered to be effective.

4.1.5 Problems Faced By Tax Payers While Paying Income Tax

To know the problems faced by the taxpayers while paying income tax, the respondents were requested to rank their choice from 1 to 5 according to their preference. The question was-" In your opinion what types of problems are faced by the tax payers while paying income tax?" Responses received from respondents are tabulated as below.

Table 4.4 Problem Faced By Tax Payers While Paying Income Tax

S. N.	Problems	Points Received				
		Tax Off.	Tax Payer	Total	%	Rank
1.	Consuming Unnecessary Time	----	5	5	8	5
2.	Expectation Of Illegal Incentives	----	9	9	15	4
3.	Vague Provisions of Income Tax Law	20	3	23	38	1
4.	Lengthy Process	10	2	12	20	2
5.	Lack Of cooperation by tax administration	---	11	11	19	3
	Total	30	30	60	100	

Source : Opinion Survey ,2008

From the above table, the major problem faced by the tax payer while paying income tax are ranked in order of preference of the respondents as follows:

- Vague Provisions Of Income Tax Law
- Lengthy Process
- Lack Of Cooperation By Tax Administration
- Expectation Of Illegal Incentives
- Consuming Unnecessary Time

Here, among the problems in paying income tax given in the structured questionnaire, respondents presented their most important preference to the problem: Vague provisions of income tax law as major problem in tax paying, Lengthy process, Lack of cooperation by tax administration, expectation of illegal incentives , Consuming unnecessary time are ranked as second, third, forth, fifth important problems in tax paying.

4.1.6 Suitable Income Tax Rate

For the sole purpose of finding the suitable income tax rate, respondents were asked to provide their opinion regarding this. The question was-"Which

Income Tax Rate is suitable for Nepal?" Their opinion are summarized here under:

Table 4.5 Suitable Income Tax Rate

S.N.	Rate	Points Received				
		Tax Off.	Tax Payer	Total	%	Rank
1.	Progressive	19	25	44	73	1
2.	Proportional	11	5	16	27	2
3.	Regressive	--	--	--	--	3
	Total	30	30	60	100	

Source : Opinion Survey ,2008

From the above table the suitable income tax rate were ranked according to the preference of respondents as under:

- Progressive
- Proportional
- Regressive

From the above table, Progressive tax rate was preferred to be the best income tax rate. While proportional and regressive were considered to be the subsequent ones.

4.1.7 Factor For Effectiveness Of Income Tax In Nepal To Raise Government Revenue

Eventually questions regarding the factor for effectiveness of income tax in Nepal to raise government revenue was asked to the respondents and their opinions were ranked in the following table:

Table 4.6 Factor to Raise Government Revenue

S.N.	Factor	Points Received				
		Tax Off.	Tax Payer	Total	%	Rank
1.	Clear Act, Rules & Regulation	--	11	11	18	3
2.	Conscious & Honest Tax Payers	12	--	12	20	2
3.	Moral & Honest Tax Officers	8	2	10	16	4
4.	Effective Tax Administration	--	8	8	13	5
5.	Political Non Interruption	10	9	19	33	1
	Total	30	30	60	100	

Source : Opinion Survey ,2008

Respondents ranked their opinions concerning the major factors for effectiveness of income tax as under:-

- Political Non Interruption
- Conscious And Honest Tax Payers
- Clear Act, Rules And Regulation
- Moral And Honest Tax Officers
- Effective Tax Administration

According to the respondents the most important factor essential for raising government revenue is Political Non Interruption. While Conscious and honest tax payers, clear act, rules and regulation, moral and honest tax officers and effective tax administration were the second, third, fourth and fifth factors respectively essential for raising government revenue.

4.2 Analysis of Secondary Data

In this study, different types of data, which is significant to government revenue are presented and analyzed. Also in this part of the chapter, there are different data relating to the land revenue are presented and analysis to fulfill the objective of this studies.

4.2.1 Resource Gap in Nepal

In spite of deliberate advancement efforts over four decades, Nepal has been suffering from resource constraints, mass poverty, rapid growth of population, aggressive dependence on agriculture, subsistence living standard etc. like other developing countries in the world.

In Nepal, the resource mobilization is still poor that does not cover the growing expenditure . Fiscal deficit is due to the continuously growing expenditure of the government owing to which our country is facing the mounting burden of foreign loan. Widening inclination of the different resource gap is shown in the table 4.1.

Table 4.7 : Resource Gap in Nepal

(Rs. In Million)

Fiscal Year	Total Expenditure (A)	Total Revenue (B)	Resource Gap[1] (A – B)	Foreign Grants (C)	Resource Gap[2] {A– (B + C)}	Foreign Loan (D)	Resource Gap[3] {A–(B+ C+D)}
1996/97	50,723.70	30,373.5	20350.2	5988.3	14,361.90	9043.6	5,318.30
1997/98	56,118.30	32,937.9	23180.4	5402.6	17,777.80	11054.5	6,723.30
1998/99	59,579.00	37,251.0	22328.0	4336.6	17,991.40	11852.4	6,139.00
1999/00	66,272.50	42,893.6	23378.7	5711.7	17,667.20	11812.2	5,855.00
2000/01	79,835.10	48,893.6	30941.5	6753.4	24,188.10	12044.0	12,144.10
2001/02	80,072.30	50,445.6	29626.7	6686.2	22,940.50	7698.7	15,241.80
2002/03	84,006.10	56,229.7	27776.4	11339.1	16,437.30	4546.4	11,890.90
2003/04	89,442.60	62,331.0	27111.6	11283.4	15,828.20	7629.0	8,199.20
2004/05	102,560.40	70,122.7	32437.7	14391.2	18,046.50	9266.1	8,780.40
2005/06	110,889.10	72,282.1	38,607.0	13827.4	24,779.60	8214.3	16,565.30
2006/07	133,604.00	87,712.00	45,892.00	15,800.00	30,092.00	10,053.00	20.039.00

Source : Economic Survey, 2006/07, Ministry of Finance, 2007, Kathmandu.

As shown in the table, resource gap[1] of Rs. 20350.2 million in fiscal year 1996/97, which increased to Rs 23,180.4 in the fiscal year 1997/98. Likewise, it has been decreased to 22,328 in the fiscal year 1998/99. It shows that there has been decreasing and in fluctuating trend in the resource gap between the fiscal years 1996/97 to 2005/06i.e in the study period of 11 years. However, it has increased up to Rs. 38,607.0 million in the fiscal year 2005/06 and 45,892 in the fiscal year 2006/07. Similarly Resource gap[2] (after considering foreign grants) was Rs. 14,361.90 in the fiscal year 1996/97 and it further widened up to 24, 188.10 in the fiscal year 2000/01.

However, there has been declining trend between the fiscal year 2001/02 to 2003/04 . But it has again followed the inclining trend in the fiscal year 2004/05 and 2005/06 and 2006/07. The government took internal and external loan to meet the deficit finance. Foreign Loan had been taken in the fiscal year from 1995/96 to 2006/07. After foreign loan financing , resource gap[3] was Rs 5,318.30 million in the starting year 1996/97 and had increased to 6,723.30 in the fiscal year 1997/98. But it has been decreased in the fiscal years 1998/99 and 1999/00. Hence there has been increasing and decreasing pattern in the resource gap[3] in the study as well. And it has increased to Rs. 16565.3 and 20,039 in the fiscal year 2005/06 and 2006/07. The study shows that even after loan financing, cash deficit is remained in Nepalese public finance. Thus, this increasing resource gap indicates that it is necessary to mobilize additional domestic resources. The ultimate and the best measure to fill up the resource gap is to increase public revenue through effective tax system.

4.2.2. Nepalese Government Revenue Structure

Government collects revenue from different sources. Basic source of government revenue are classified into tax and non-tax revenue. The composition of government revenue from the fiscal year 1996/97 to 2005/06 is presented below in the table 4.2. The tax revenue of fiscal year 2006/07 is 91.09 percent as compared to 80.4 percent in fiscal year 1996/67.

Table 4.8 : Composition of Total Revenue

(Rs. In Million)

Fiscal Year	Total Revenue	Tax Revenue		Non- Tax Revenue	
		Amount	% As Total Revenue	Amount	% As Total Revenue
1996/97	30,373.50	24,424.30	80.40	5,949.20	19.58
1997/98	32,937.90	25,939.80	78.75	6,998.10	21.24
1998/99	37,251.00	28,752.90	77.18	8,498.40	22.81
1999/00	42,893.60	33,152.10	77.28	9,741.60	22.71
2000/01	48,893.60	38,865.10	79.48	10,028.80	20.51
2001/02	50,445.60	39,330.60	77.96	11,115.00	22.03
2002/03	56,229.70	42,587.00	75.73	13,642.70	24.26
2003/04	62,331.00	48,173.00	77.28	14,158.00	22.71
2004/05	70,122.70	54,104.70	77.15	16,018.00	22.84
2005/06	72,282.10	57,428.13	79.45	14,853.90	20.55
2006/07	87,712.00	71,126.00	81.09	16,585.00	18.90

Source : Economic Survey, 2006/07, Ministry of Finance, 2007, Kathmandu.

The share of non-tax revenue of fiscal year 2005/06 was 20.55 percent and was 19.59 percent in the initial period of the study i.e. fiscal year 1996/97. This indicates the role of tax revenue is very important in revenue mobilization of Nepal to meet the government expenditure. The total tax revenue in the fiscal year1996/67is Rs.24,424.30million which is increasing every year and reached to Rs57,428.13million in the fiscal year 2005/06 but in the percentage on the total revenue has been fluctuating from 80.40 percent to 81.09 percent. The highest contribution of tax revenue to total revenue was 80.40 percent in the initial year 1996/97 and the lowest contribution was 77.15 percent during the study period of ten years (i.e. 1996/97 to 2005/06) . Similarly from the fiscal year 1996/97 to 2004/05, the amount of non- tax revenue have also increasing trend from Rs.5,949.20 million to Rs.16,018.00 million and it has decreased to

Rs.14,853.90 million in the fiscal year 2005/06 and 18.9 in the fiscal year 2006/07 but in percentage contribution term it is found that there has been fluctuating trend. The study shows that the share of tax revenue has always been greater that the share of non-tax revenue.

4.2.3 Composition of Tax Revenue in Nepal

Tax revenue is the major source of the government 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. In the context of Nepalese economy, tax revenue is the major measure to mobilize internal resources effectively and properly as it has been dominating the government revenue by contributing around 80 percent of total revenue. Tax revenue in Nepal constitutes direct and indirect tax revenue. The figure of direct and indirect tax revenue from fiscal year 1996/97 to 2005/06 is presented in the table as below:

Table 4.9: Composition of Total Tax Revenue

(Rs. In Million)

Fiscal Year	Total Tax Revenue	Direct Tax Revenue		Indirect Tax Revenue	
		Amount	% of Tax Revenue	Amount	% of Tax Revenue
1996/97	24,424.30	5,340.00	21.86	19,084.30	78.13
1997/98	25,939.80	6,187.90	23.85	19,751.70	76.14
1998/99	28,752.90	7,516.10	26.14	21,236.80	73.85
1999/00	33,152.10	8,951.50	27.00	24,200.60	72.99
2000/01	38,865.10	10,159.40	26.14	28,705.70	73.85
2001/02	39,330.60	10,037.17	25.52	29,293.43	74.48
2002/03	42,587.00	9,548.01	22.42	33,038.99	77.58
2003/04	48,173.00	11,209.86	23.27	36,963.14	76.73
2004/05	54,104.70	12,265.54	22.67	41,839.16	77.33
2005/06	57,428.13	13,966.52	24.32	43,461.61	75.68
2006/07	71,126.00	17,297.00	26.68	53,828.00	73.31

Source : Economic Survey, 2006/07, Ministry of Finance, 2007, Kathmandu.

Figure 4.1 : Bar Diagram Of Total Tax Revenue

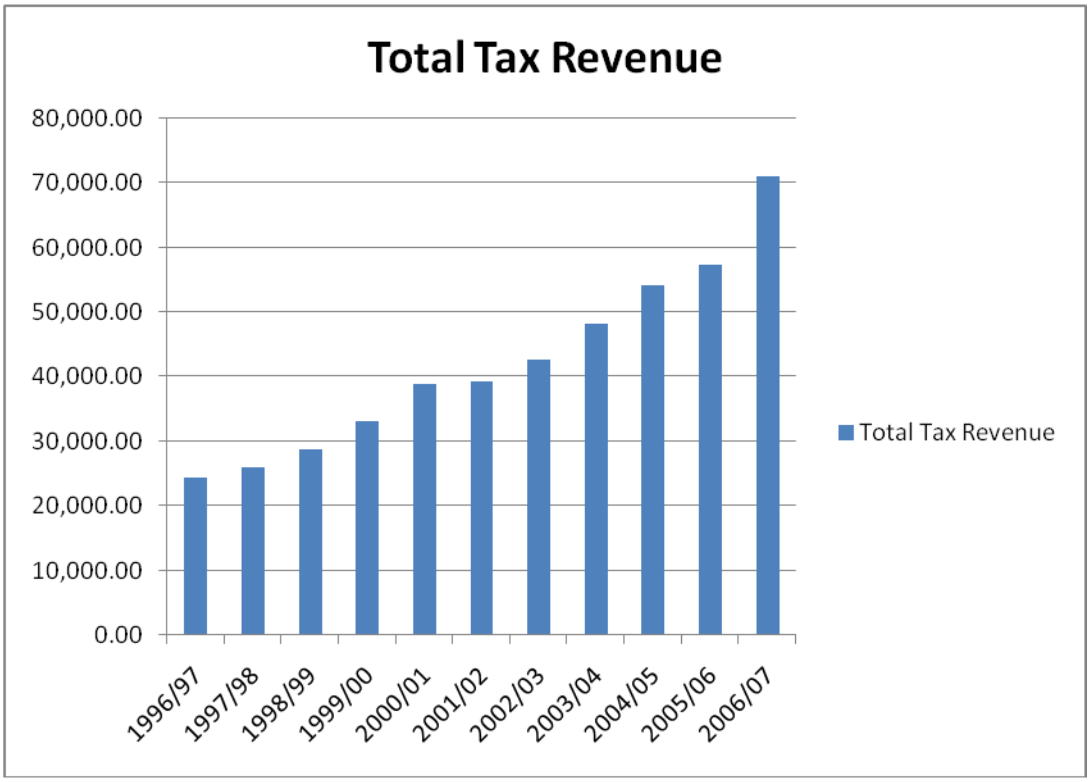
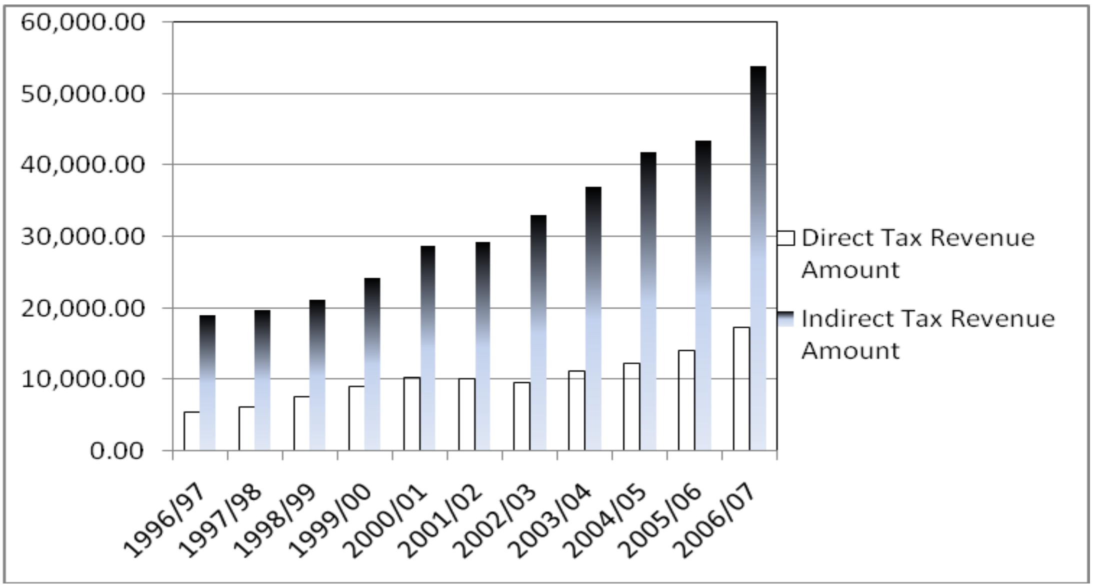


Figure 4.2 : Bar Diagram Of Direct and Indirect Tax Revenue



The trend is also in absolute vale. As shown in the table and graph diagram, Total tax revenue, direct tax and indirect tax is seem to be increasing except in the fiscal year 2002/03, direct tax revenue has decreased to Rs.9,548.01million. Direct tax includes income tax, land revenue and registration, urban house and land tax, vehicle tax, property tax where as indirect tax includes customs, VAT, entertainment tax, hotel tax, air flight tax, contract tax, road and bridge maintenance tax, etc.

The amount of direct tax revenue was Rs.5,340million in the fiscal year 1996/97 and it was Rs.17,297.00 million in the fiscal year 2006/07.It is increasing every year except in the fiscal year 2002/03. While Indirect tax revenue is in inclining trend. It was Rs.19,084.30 in the fiscal year 1996/97 and was Rs.53,828.00 million in the fiscal year 2006/07. Percentage contribution of direct tax to total tax revenue is in fluctuating over the study period from 21.86 percent to 26.88 percent.

4.2.4 Composition of Direct Tax Revenue

Direct tax is levied by the government on the income and wealth received by individual, household and business enterprises in order to raise the national revenue as an instrument of fiscal policy. It is equitable as it is imposed on person as per the property or income of the taxpayer. In Nepalese economy, direct tax is composed of different taxes namely, income tax, land tax , property tax and wealth tax, tax on registration. In Nepalese tax revenue structure, the contribution of direct tax is shown in the table 4.4.

Table 4.10 :Composition of Direct Tax

(Rs. In Million)

FY	Total Direct Tax	Land Revenue & Registration				Tax on Property, Profit & Income				
		Land Tax	House, Land Regd.	Total	% of total direct Tax	Income Tax	Tax on Property	Other Taxes	Total	% of total direct Tax
1996/97	5,340.00	5.9	1009.5	1015.4	19.01	4123.4	201.2	0.0	4324.6	80.99
1997/98	6,187.90	3.6	1000.6	1004.2	16.23	4898.1	285.6	0.0	5183.7	83.77
1998/99	7,516.10	1.3	1001.8	1003.2	13.35	6170.3	342.7	0.0	6512.9	86.63
1999/00	8,951.50	4.6	1011.3	1015.9	11.35	7420.6	515.0	0.0	7935.6	88.65
2000/01	10,159.40	5.1	607.8	612.9	6.03	9114.0	432.5	0.0	9546.5	93.97
2001/02	10,037.17	0.8	1131.0	1131.8	10.68	8903.7	562.0	0.0	9465.7	89.32
2002/03	9,548.01	0.0	1414.3	1414.3	13.99	8132.0	559.5	165.8	8857.3	87.65
2003/04	11,209.86	0.0	1697.5	1697.5	14.25	9514.5	700.6	268.6	10483.7	88.00
2004/05	12,265.54	0.0	1799.2	1799.2	13.76	10466.1	806.5	306.7	11579.3	88.58
2005/06	13,966.52	0.0	2181.0	2181.0	15.61	10940	848.0	467.2	12255.2	87.74
2006/07	17,297.00	0.0	2253.0	2253.0	13.03	15,731	324	265	16320.0	94.35

Source : Economic Survey, 2006/07, Ministry of Finance, 2007, Kathmandu.

In the table, direct tax is classified into two categories such as land revenue and registration and tax on property, profit and income. Land revenue and registration is further classified into land revenue and house and land registration fees. House and land revenue registration is higher than land revenue each year. The share of land revenue and registration was Rs. 1015.4 in the fiscal year 1996/97 and it has fluctuation trend during the study period. It has decreased to Rs. 1004.2 and Rs. 1001.8 in the fiscal years 1997/98 and 1998/99 and again it has increased to Rs. 1,015.90 on the fiscal year 1999/00 but there after it has decreased to Rs. 607.8 in the fiscal year 2000/01 while it is found that it started to increase from the fiscal year 2001/02 till 2005/06 and in the fiscal year 2005/06 it has reached to Rs. 2181.0 and Rs.2253 in 2006/07.

In term of percentage, there has also been fluctuating trend. The highest percentage contribution was in the fiscal year 1996/97 i.e. 19.01 percent and the lowest contribution was in the fiscal year 2000/01 i.e.6.03 percent.

Another source of direct tax revenue is tax on property, profit and income. The share of property, profit and income tax to direct tax is 80.99 percent in the fiscal year 1996/97 and 94.35 percent in the fiscal year 2006/07 and the highest contribution is in the fiscal year 2006/07 i.e. 93.97 percentage. However, total amount has inclining trend ranging from Rs.4324.6 to Rs.16,320 from the fiscal year 1996/97 to 2006/07.

4.2.5 Composition of Income Tax Revenue

Income tax is an important source of the direct tax. Nepal is imposing three different types of income tax. They are individual income tax, corporate income tax and interest tax. Individual income tax covers all individuals having taxable income. Corporate income tax is levied on the profit of corporation. A corporation is a separate entity. The interest tax is levied on the interest received.

Table 4.11: Structure of Income Tax Revenue

(Rs. In Million)

FY	Total Income Tax Revenue	Public Enterp.	Semi-Public Enterp.	Private Corporate Bodies	Individuals	Remuneration	Tax on Interest
1996/97	4123.4	1231.1	0.0	858.4	1711.4	168.1	154.4
1997/98	4123.4	1317.8	0.0	925.1	2120.8	322.2	212.2
1998/99	6170.3	1526.5	0.0	1155.0	2772.7	396.5	319.5
1999/00	7420.6	2198.8	0.0	1339.5	3016.4	451.5	414.4
2000/01	9114.0	2928.0	0.0	1924.3	3200.5	597.3	463.9
2001/02	8903.7	1769.3	0.0	1412.0	4419.1	835.6	467.7
2002/03	8132.0	1251.0	0.0	1236.3	3362.3	1252.6	864.0
2003/04	9514.5	2056.6	0.0	1531.3	3533.4	1391.2	733.4
2004/05	10466.1	1332.4	0.0	2467.8	3926.3	1675.9	757.0
2005/06	10940	4042.6	0.0	7039.2	9658.6	0000.0	774.9
2006/07	15731	5717	0.0	2306	2306	0000.0	1054

Source : Economic Survey, 2006/07, Ministry of Finance, 2007, Kathmandu.

Income tax was introduced in Nepal for the first time as business profit and remuneration tax in 1960. The composition of income tax revenue for the recent 10 years has been presented below in the table 4.5. Income tax is increasing in the years 1996/97 to 2000/01 (i.e. Rs.4123.4, Rs.4123.4, Rs.6170.3, Rs.7420.6)but thereafter it has started to decline in the years 2001/02 and 2002/03.i.e.(Rs.8903.7, Rs.8132.0).But again, it has followed inclining trend in the year 2003/04, 2005/06 and 2006/07(i.e. Rs. 9514.5, Rs.10940 and Rs.15,731). This amount is the total of income tax from public enterprises, semi- public enterprises, private corporate bodies, individuals, remuneration and tax on interest. The highest amount of income tax i.e. Rs.15,731 had been collected in the fiscal year 2006/07.

Contribution of income tax from public enterprises to total income tax is 24.91percent in average. Total amount contribution from public enterprises has fluctuating trend during the study period of 11 years. It has increased from the year 1996/97 till 2000/01 from Rs. 1231.1 to Rs. 2928.0. But thereafter, it has started to declined from Rs. 1769.3 to Rs. 1251.0 in the fiscal year 2001/02 and 2002/03 respectively. However, it finally has increased to Rs.2056.6 in the fiscal year 2003/04 and the highest contribution has been made in the fiscal year 2005/06 i.e. Rs.4042.6and Rs 5,717 in 2006/07.The contribution of income tax from public in comparison to private corporate bodies is not satisfactory. The main reasons for unsatisfactory contribution of income tax from public enterprises were poor performance of public enterprises, weakness in government's economic policy, defective income tax etc.

Contribution of income tax from semi public enterprise to total income tax is nil during the study period of eleven years(i.e. from 1996/96 to 2006/07) .It has not contributed even 1 percent on any year of the study period. Average contribution of private corporate bodies is Rs.25,105 million from the year 1996/97 to 2005/06. Comparatively, contribution of individuals to total income tax is greater than others in each year. Share of individuals was Rs. 1711.4 in the starting year 1996/97 while it has increased to Rs.2,306 million in the fiscal year 2005/06.

Tax revenue from remuneration is increasing each year except the year 2005/06 and 2006/07.It was Rs.168.1 million in the fiscal year 1996/97 and it has reached to Rs.1675.9 in the fiscal year 2004/05 but it is found that there has been nil during the fiscal year 2005/06 and 2006/07.Tax on interest is increasing till the year 2002/03 but it has declined thereafter till the fiscal year 2006/07.It was Rs.154.4 million in the fiscal year 1996/97 while it is Rs.1051 in the fiscal year 2005/06.

Figure 4.3 : Composition Of Income Tax

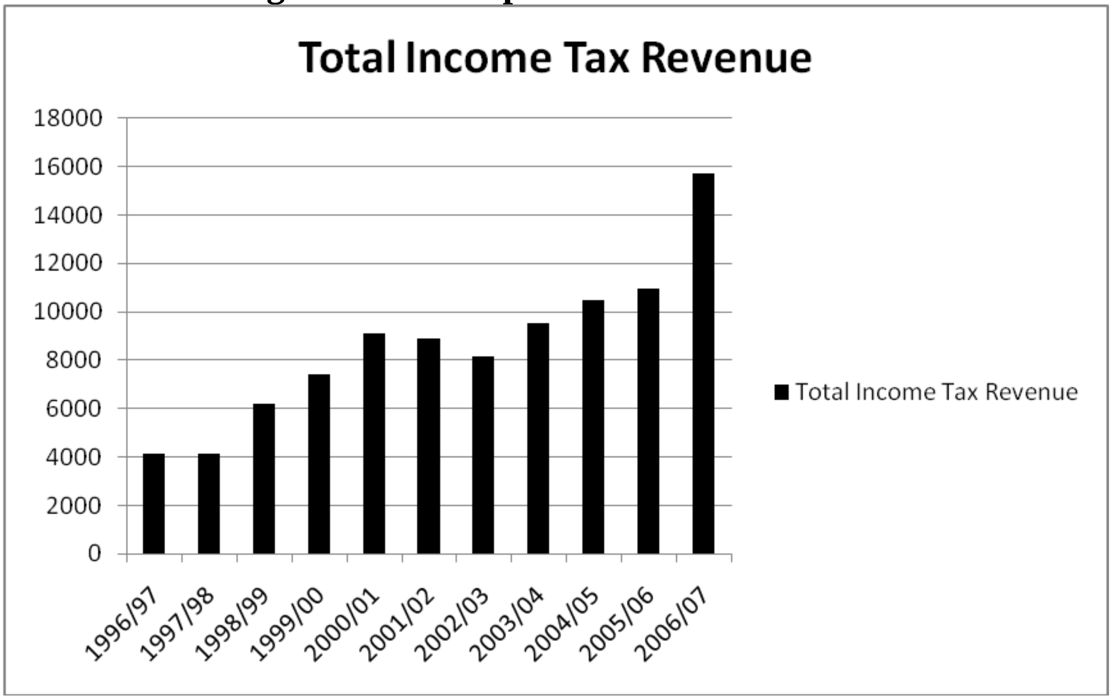
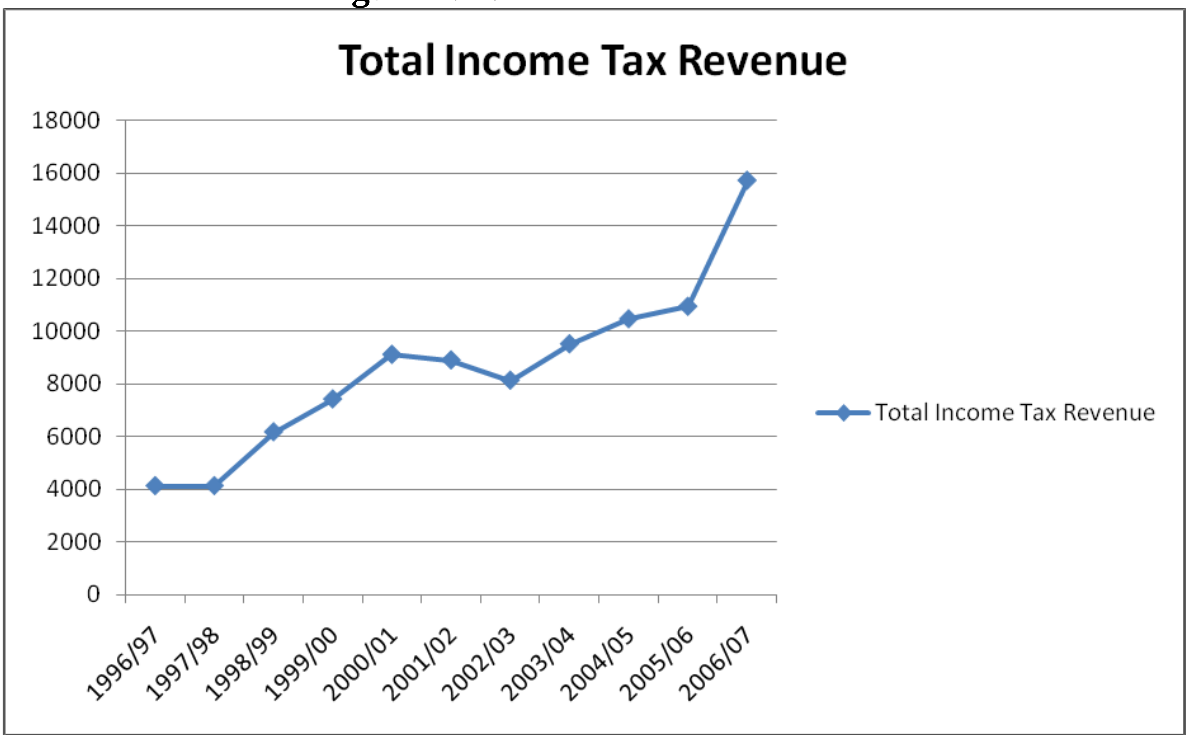


Figure 4.4 : Trend Of Income Tax



The above graph diagram depicts the composition of income tax and trend of income tax revenue as described in the table 4.5.

4.2.6 Contribution Of Income Tax

Contribution of income tax to the Direct Tax, Total Tax Revenue, Total Revenue, Gross Domestic Product is shown in the table below :

Table 4.12: Contribution of Income Tax On Direct Tax, Total Tax Revenue and Total Revenue

(Rs.In Million)

FY	Income Tax	Direct Tax		Total Tax Revenue		Total Revenue	
		Amount	% of Income Tax on Direct Tax	Amount	% of Income Tax on Total Tax	Amount	% of income Tax on Total Revenue
1996/97	4,123.4	5,340.00	77.21	24,424.30	16.88	30,373.50	13.57
1997/98	4,898.1	6,187.90	79.15	25,939.80	18.88	32,937.90	14.87
1998/99	6,170.3	7,516.10	82.09	28,752.90	21.45	37,251.00	16.56
1999/00	7,420.6	8,951.50	82.89	33,152.10	22.38	42,893.60	17.30
2000/01	9,114.0	10,159.40	89.71	38,865.10	23.45	48,893.60	18.64
2001/02	8,903.7	10,037.17	88.70	39,330.60	22.63	50,445.60	17.65
2002/03	8,132.0	9,548.01	85.16	42,587.00	19.09	56,229.70	14.46
2003/04	9,514.5	11,209.86	84.87	48,173.00	19.75	62,331.00	15.26
2004/05	10,466.1	12,265.54	85.32	54,104.70	19.34	70,122.70	14.92
2005/06	10,940	13,966.52	78.33	57,428.13	19.04	72,282.10	15.13
2006/07	15,731	17,297.00	90.95	71,126.00	22.11	87,712.00	17.93

Source : Economic Survey, 2006/07, Ministry of Finance, 2007, Kathmandu.

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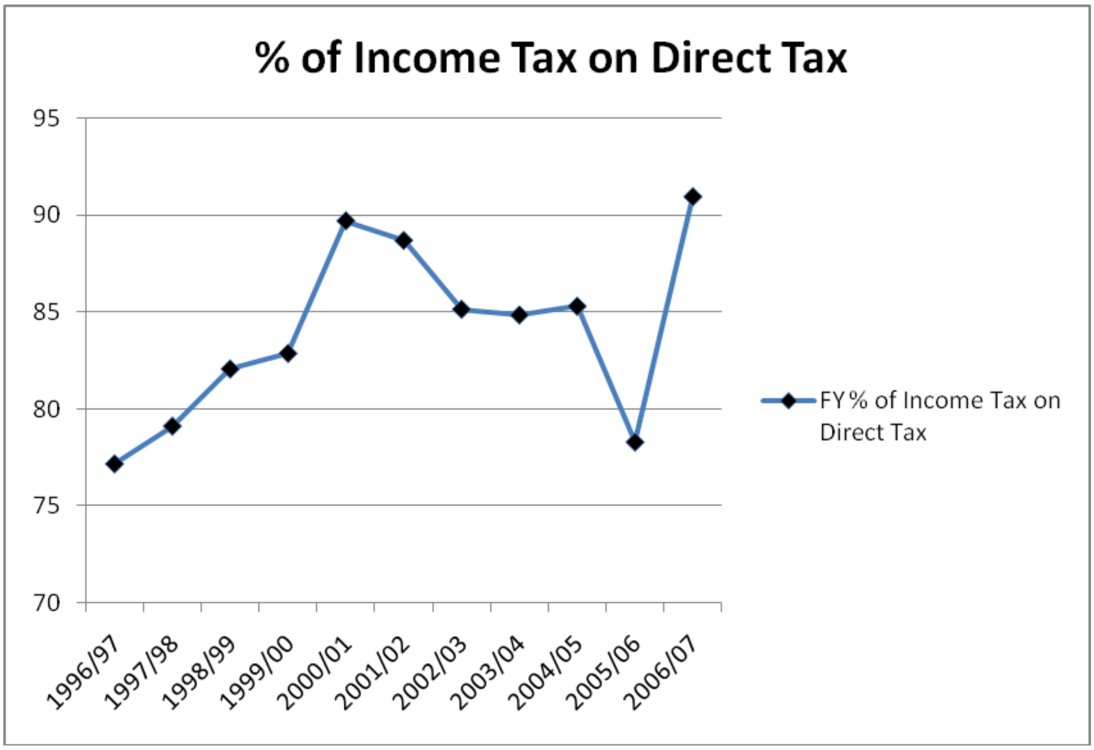
4.2.7 Contribution Of Income Tax To The Direct Tax Revenue

The table 4.6 deals the contribution of income tax to the direct tax revenue in Nepal. Income tax has dominated role in the direct tax revenue. Average share of income tax to direct tax is 83.34 percent. In the beginning of the study it was 77.21 percent and it reached maximum up to 90.95 percent in the fiscal year 2006/07.The contribution of income tax to the direct tax is presented below in the figure 4.4 below:

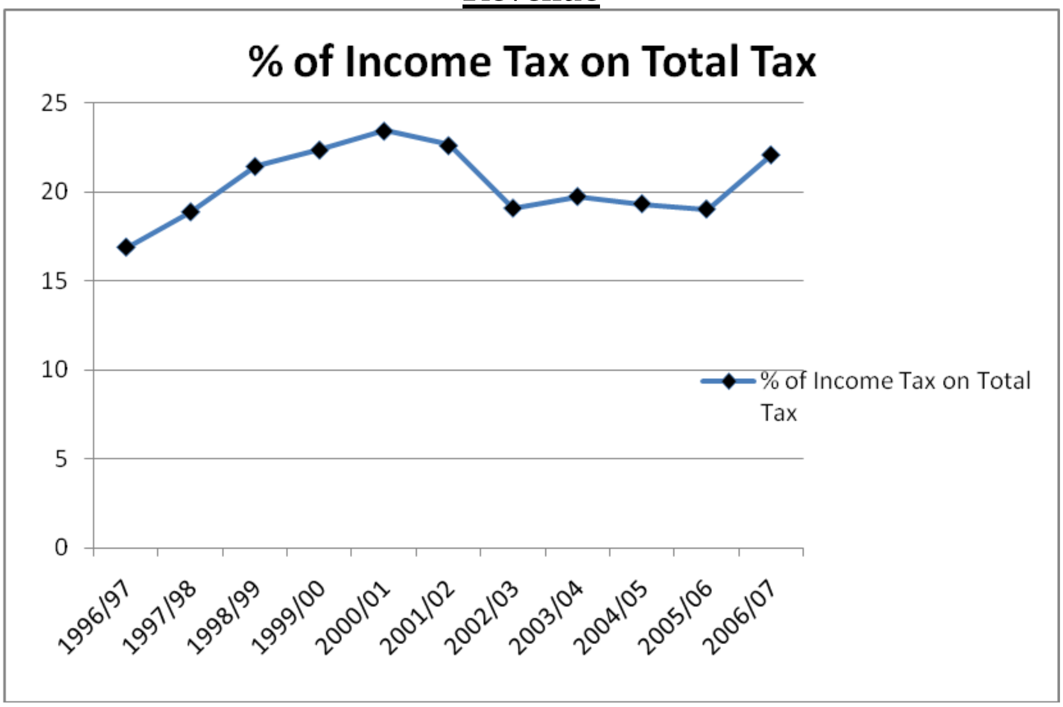
Figure 4.5 : Trend Of Income Tax As Percentage of Direct Tax Revenue



4.2.8 Contribution Of Income Tax To Total Tax Revenue

Total tax revenue constitutes direct tax and indirect tax revenue. There is dominant role of indirect tax in the Nepalese revenue structure. The contribution of income tax to the total tax revenue is presented in the table 4.6. Contribution of income tax to the total tax revenue was 16.88 percent in the initial period of the study. The highest contribution was 23.45 percent in the fiscal year 2000/01. The results are shown in the figure 4.5 below.

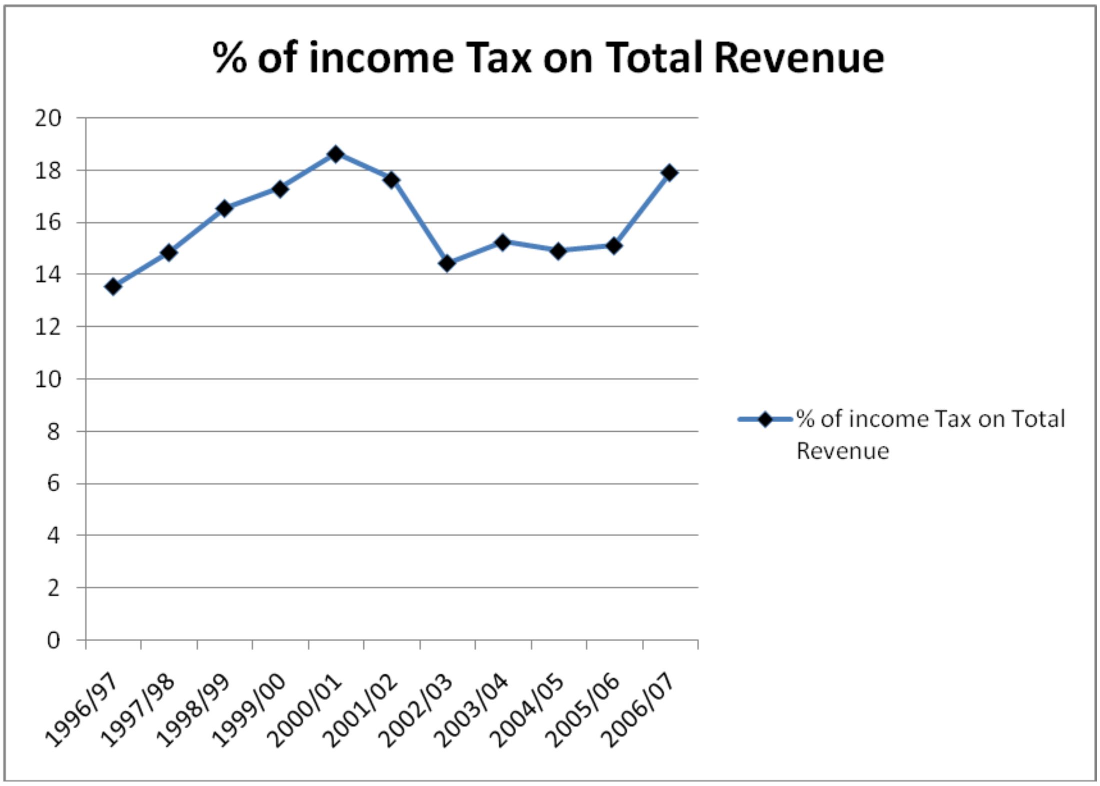
Figure 4.6 : Trend Of Income Tax As Percentage of Total Tax Revenue



4.2.9 Contribution Of Income Tax To The Total Revenue

Total revenue constitutes tax and non-tax revenue. In the Nepalese government revenue structure, tax revenue has occupied the most part of the public revenue i.e. near about two third part in total revenue. Share of income tax as a percentage of total revenue has fluctuated from 13.57 percent to 15.13 percent during the study period of eleven years i.e. from the fiscal year 1996/97 to 2006/07. The figure 4.6 below shows income tax as a percent of total revenue.

Figure 4.7: Trend of Income Tax As Percentage of Total Revenue



4.2.10 Contribution Of Income Tax in the Gross Domestic Product

Contribution of income tax in the Gross Domestic Product is determined in the table below:

Table 4.13: Contribution of Income Tax Revenue On GDP

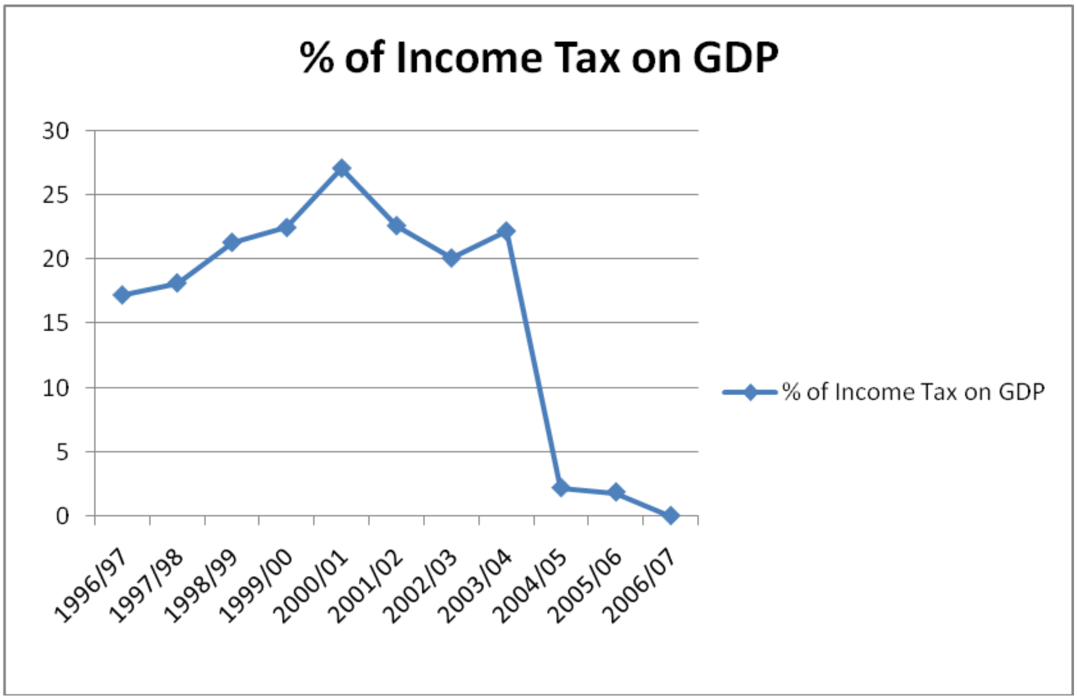
(Rs. In Million)

FY	GDP	Income Tax	% of Income Tax on GDP
1996/97	239.39	41.23	17.22
1997/98	269.57	48.98	18.16
1998/99	289.39	61.70	21.32
1999/00	330.02	74.20	22.48
2000/01	336.25	91.14	27.10
2001/02	393.57	89.03	22.62
2002/03	404.48	81.32	20.10
2003/04	428.48	95.14	22.20
2004/05	474.13	10.47	2.21
2005/06	582.92	10.94	1.87
2006/07	521.89	15.73	0.03

Source : Economic Survey, 2006/07, Ministry of Finance, 2007, ktm.

Table 4.7 depicts the percentage contribution of income tax in gross domestic product(GDP) was 17.22 percent in the initial period of the study. Maximum contribution of income tax revenue as a percentage of GDP is 27.10 percent in the fiscal year 2000/01.But it is found that there has been lowest contribution in the fiscal year 2005/06 i.e.1.87 percent and 0.03 in 2006/07 which is not comparatively satisfactory figure. The figure 4.7 below shows the contribution of income tax on GDP.

Figure 4.8: Trend of Income Tax As Percentage of GDP



4.3 Major Findings

Income tax is a suitable means for collecting government revenue. It may enhance the revenue of the government, promote justice in distribution of wealth and encourage private sector investment. Government revenue is the composition of internal and external revenue. External sources are uncertain, inconvenient and not good for healthy development of nation because they have to be paid after a certain period of time. So it is better to mobilize internal sources rather than external sources. Internal sources constitutes of tax and non-tax revenue in Nepalese government revenue. Tax revenue is the important sources of government. The examples of the sources of tax revenue are customs, excise, value added tax, corporate and personnel income tax . But the contribution of income tax revenue shows the decreasing trend as it had contributed by 80.40 percent in fiscal year 1996/97 in the total revenue but it decreased to 79.45 percent in 2005/06.However, it has increased to 81.09 percent in the fiscal year 2006/07.

Major Findings of this study are summarized as below:

- Resource gap in Nepal is inclining trend. Thus, this increasing resource gap indicates that it is necessary to mobilize additional domestic resources. The ultimate and the best measure to fill up the resource gap is to increase public revenue through effective tax system.

- Nepalese tax revenue is the composition of direct and indirect tax. There is dominant role of indirect tax revenue in Nepalese tax revenue (i.e. contribution of direct tax to total tax revenue was 26.68 percent whereas contribution of indirect tax was 73.31 percent in the fiscal year 2006/07.

- Direct tax is levied by the government on the income and wealth received by individual, household and business enterprises in order to raise the national revenue as an instrument of fiscal policy.

- Direct tax is classified into two categories such as land revenue and registration and tax on property, profit and income. Land revenue and registration is further classified into land revenue and house and land registration fees.

- Income tax is an important source of the direct tax. Nepal is imposing three different types of income tax. They are individual income tax, corporate income tax and interest tax. Individual income tax covers all individuals having taxable income. Corporate income tax is levied on the profit of corporation. A corporation is a separate entity. The interest tax is levied on the interest received.

- The composition of income tax revenue for the recent 11 years was analyzed. Income tax is increasing in the years 1996/97 to 2000/01 (i.e. Rs.4123.4, Rs.4123.4, Rs.6170.3, Rs.7420.6)but thereafter it has started to decline in the years 2001/02 and 2002/03.i.e.(Rs.8903.7, Rs.8132.0).But again, it has followed inclining trend in the year 2003/04 and 2005/06(i.e. Rs. 9514.5, Rs.10940 and Rs.15731 in the fiscal year 2006/07). This amount is the total of income tax from public enterprises, semi- public enterprises, private corporate bodies, individuals, remuneration and tax on interest. The highest amount of income tax i.e. Rs.10490 had been collected in the fiscal year 2005/06.

- The contribution of income tax to the direct tax revenue in Nepal was studied carefully. Income tax has dominated role in the direct tax revenue. In the beginning of the study it was 77.21 percent and it reached maximum up to 90.95 percent in the fiscal year 2006/07 while it was 78.33 percent in the fiscal year 2005/06. Share of income tax as a percentage of total revenue has fluctuated from 13.57 percent to 17.93

percent during the study period of ten years i.e. from the fiscal year 1996/97 to 2006/07.

- The contribution of income tax from public in comparison to private corporate bodies is not satisfactory. The main reasons for unsatisfactory contribution of income tax from public enterprises were poor performance of public enterprises, weakness in government's economic policy, defective income tax etc.

- The percentage contribution of income tax in gross domestic product(GDP) was 17.22 percent in the initial period of the study. Maximum contribution of income tax revenue as a percentage of GDP is 27.10 percent in the fiscal year 2000/01.But it is found that there has been lowest contribution in the fiscal year 2006/07 i.e.0.03 percent which is not comparatively satisfactory figure

Further from the empirical investigations, following findings were revealed.

Is Contribution of Income Tax To National Revenue Of Nepal Satisfactory

90 percent Tax Officers argue that contribution of income tax to national revenue is satisfactory whole 83 percent tax payer are standing in this position. In aggregate, results had shown that 86.6 percent respondents believe that Nepalese tax contribution is satisfactory.

Major Reasons For Low Contribution Of Income Tax

The reasons for low contribution of income tax to national revenue are ranked as follows:

- Increasing Habit Of Tax Evasion
- Mass Poverty & Low Income Level
- Inappropriate Rate & Exemption Limit
- Inefficient Tax Administration
- Defectiveness Of Income Tax

More Appropriate Income Tax Assessment Method

The most important methods of tax assessment method ranked as follow:

- Self Assessment Method
- Amended Assessment Method
- Jeopardy Assessment Method

Self Assessment method is ranked as most important method. While Jeopardy and Amended Assessment methods were ranked as second and third method that are considered to be effective.

Problems Faced By Tax Payers While Paying Income Tax

The major problem faced by the tax payer while paying income tax are ranked in order of preference of the respondents as follows:

- Vague Provisions Of Income Tax Law
- Lengthy Process
- Lack Of Cooperation By Tax Administration
- Expectation Of Illegal Incentives
- Consuming Unnecessary Time

Among the problems in paying income tax given in the structured questionnaire, respondents presented their most important preference to the problem: Vague provisions of income tax law as major problem in tax paying, Lengthy process, Lack of cooperation by tax administration, Expectation of illegal incentives , Consuming unnecessary time are ranked as second, third, forth, fifth important problems in tax paying.

Suitable Income Tax Rate

The suitable income tax rate were ranked according to the preference of respondents as under:

- Progressive
- Proportional
- Regressive

Factor For Effectiveness Of Income Tax In Nepal To Raise Government Revenue

Respondents ranked their opinions concerning the major factors for effectiveness of income tax as under:-

- Political Non Interruption
- Conscious And Honest Tax Payers
- Clear Act, Rules And Regulation
- Moral And Honest Tax Officers
- Effective Tax Administration

CHAPTER - 5
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Today the prime concern of every nation of this world is rapid economic development and Nepal is no exception to this continuing process. Nepal aims for self- reliant economic system to update its living standard of people. Thus, a lot of money has to be spent to carry out developments plans, handle day-to-day administration, to maintain peace and security and to launch other public welfare activities. So government collects revenue either to pay regular expenditure or to development works. Every nation wants to improve its current status through proper utilization of resources. The sources of government revenue can be classified into external and internal. The most important sources of government revenue are internal those constitute tax and non tax revenue.

A tax is compulsory contribution imposed by a public authority, irrespective of exact amount of services rendered to the tax payer in return and are imposed as a penalty for any legal offence. Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefits upon the resident of the states. Basically tax can be classified into two broad categories viz. direct taxes and indirect taxes. Income tax, gift tax, interest tax, property tax, death tax, contract tax etc. are the typical examples of direct tax. The government collects and realizes such taxes directly from the taxpayers. A direct tax enhances the consciousness of the citizens.

Income tax is direct tax and is superior to indirect tax like sales tax, excise duty etc. because it is imposed on the basis of paying capacity of the taxpayer. People whose income is below the taxable rate are free from the tax bracket. Income tax helps to increase the consciousness of people because the people who have paid the income tax will be interested on public expenditure .They can observe the use of collected fund from them in the form of income tax. The contribution of income-based taxes is much smaller to the total revenue for developing countries in comparison to developed countries and is likely to remain same for sometime come despite the efforts over the years of many least developed countries to raise more revenue. They are mainly four reasons why income tax yields is less in developing countries. They are: problems of defining income, problems of assessing and measuring it, the choice of rate, allowances and reductions and difficulties of tax collection.

5.2 Conclusion

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

The success of effectiveness of income tax system entirely depends upon the implementation of provisions, which is the major responsibility of income tax administration. Income tax system of Nepal has recognized as an inefficient system. Various problems existed in the income tax system such as increasing habit of tax evasion, inefficient income tax administration, defective income tax law are the reasons of lower contribution of income tax. But if we analyze the data relating to it then we can find out revenue collection from income tax is increasing continuously. Provisions in Act have to be made clear, Some reforms in income tax administration are needed to raise the income tax revenue.

5.3 Recommendations

After the study of income tax, income tax is supposed to play vital role in the development of the economy of the nation. After looking back to the history of Nepal, there is only one main sources of government revenue i.e. Income Tax Revenue.

After comprehensive study, it is desired to provide following recommendations :-

i. Tax ratio should be increased gradually on long run basis to fulfill the deficit in budget. For this, the tax base should be widened. The principle of ability to pay should completely adopted.

ii. Income tax policy should be formulated according to the economic policy, it should be revised timely and should be formulated on the basis of critical analysis of existing situation.

iii. The authorities involved in formulating income tax policies must have deep knowledge and experience in the stated fields.

iv. Income tax rules and regulation should be clear and simple for all taxpayers as well as for tax administrators. Following recommendations are made in income tax law relating provisions.

v. The language of Act should be clear and simple.

vi. The assessment and tax collection provisions should be clear and simple so that taxpayers would be encourage to pay income tax.

vii. The assessment of time limit after the submission of income assessment should be reduced.

viii. The definitions made in Income Tax Act should be further clarified and well defined.

- The provisions of rewards, prizes and incentives should be introduced in the Act to encourage the taxpayers to pay tax voluntarily rather than coercive measures.

- The rate of fines and penalties and punishment should be mad higher rate far income tax evaders.

- A research and intelligence center should be established in each tax office for proper planning and to collect the information in regarding to income tax evaders, potential new taxpayers and non-residents who have conducted business without registration.

- Tax personnel should be encouraged, punished and transferred on the basis of their work & experience. Regular and effectiveness training program.

- Effective public participation is necessary to minimize the income tax evasion. The tax authority should do continuous effort in order to develop the taxpayers' positive attitude towards taxation.

- Clear provisions should be made in case of deduction. All the items of deductions should be clearly defined in the Act.

- To promote export, more deduction should be provided.

- The provisions of tax deduction at sources and advance payment of tax should be extended to difference sources of income as far as possible.

- Income tax administration implements the tax laws. Therefore, effectiveness of income tax system depends upon the income tax administration. In Nepal, one of the most important reasons for unsound income tax system inefficient and unscientific administration. Following recommendation are made for the improvement of income tax administration.

ix. Delays in assessment should be reduced as much as possible.

x. Computerized information system is necessary to keep up to date records of income tax.

xi. Proper tax education should be provided to tax officials as well as tax inspectors and taxpayers as well regularly.

xii. Cost of income tax collection is one of the determinants of efficiency of administration. Therefore, the concerned authority should pay due attention to it and should be reduced.

xiii. Unnecessary outside pressure should be avoided.

xiv. Skilled and Trained Income tax experts/professionals should be increased effective tax administration.

The administration should pay more attention to bring the income from house and land rent, doctors' clinic, consultancy service, tuition, research works, into tax net. In these sectors, income tax has been highly evaded.

Gap between expenditures and revenue collection needs to be minimized for the fiscal balance. However, the increase in revenues is not keeping pace with the increase in expenditures. It therefore, calls for prompt actions towards gearing up revenue mobilization, improvement in current expenditure management and expansion in capital expenditures.

Adjustment made in the customs duties and excise, positive changes observed in taxpaying attitude, increase in non-tax revenue collection, to mention a few, have provided a breathing space due to positive changes in revenue collection this year compared to the past performances. To maintain this momentum, the task of tracking and plugging leakage in tax revenue lies ahead.

Measures to make the tax administration fully automatic, to make the customs evaluation system more objective through administrative reforms, to simplify the income tax procedures and to reduce the tax exemption ceilings should receive priority attention.

Tax revenue has an important role in revenue generation. To further reap its potential, review of tax base and rates changes is in order. Programs designed to enhance taxpayer awareness through tax education should go a long way in increasing tax revenue.

Burden of foreign debt servicing on internal revenue has been raising due to the increasing use of foreign aid in the development works. To keep the foreign debt servicing liability within sustainable limit special focus to increasing national saving rate, avoiding as well as containing unproductive current expenditure, and making the development expenditure more productive is warranted.

In foreign aid, grant element needs to be enhanced and its use needs to be prioritized. Overall, rational utilization of foreign aid should be a matter of constant review.

Opportunities of enhancing national income need to be exploited with vigor. In this context, comparative advantage as well as potentials of agriculture production needs to be developed and exploited. In the agriculture sector, special program designed to expand cultivation and production of tea; cardamom, coffee and several others need to be executed. Oilseeds, lintel, and fruit are also other items that need production specialization program. Potentials of industry, tourism, and information technology based services await further development and expansion efforts.

Now that Nepal is a member of the World Trade Organization (WTO), the role of customs in the overall revenue generation will be waning. In this context, efforts need to be more focused to making the direct tax particularly income tax, and indirect tax, particularly the value added tax, more revenue productive.

Priority attention to reaping the advantages of being a WTO member is also called for, particularly, through expansion and diversification of trade among WTO member countries. Measures of increasing access to international trade, to available facilities and to enhancing efficiency need to be under constant review.