A STUDY ON THE REFORMS IN INCOME TAX SYSTEM AND IT'S EFFECTIVENESS IN NEPAL

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RECOMMENDATION

This is to certify that the thesis

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Entitled

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And it's Effectiveness

In Nepal

has been prepared as approved by this Department in the prescribed

Format of management. This is forwarded for examination.

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VIVA-VOCE SHEET

We have conducted the viva voce examination of the thesis submitted

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and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for Master in Business Studies (M.B.S.)

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DECLARATION

I hereby declare that the study work reported in the thesis entitled “A Study on the Reforms in Income Tax System and It’s Effectiveness in Nepal” submitted to Shanker Dev Campus, faculty of management, Tribhuvan University, is my original work done in the form of partial fulfillment of requirement for the Master of Business Studies (M.B.S.) under the supervision of Prof. Dr. Kamal Deep Dhakal, Shanker Dev Campus.

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This Study report as a dissertation on Master‘s Course in Business Study states " A Study on The Reforms in Income Tax System and its Effectiveness in Nepal'' with an effort to the readers with facts, figures and data on different aspects of Income tax System in Nepal in which they might be interested. Having Nepalese perspective and being a partial fulfillment of the requirements for MBS under the faculty of management of TU, It is extremely based on models of study involving the use of quantitative as well as qualitative model to light on the reforms described by changing trends and practices.

Compilation of factual information requires a great deal of struggle in a country like ours yet the readers may find some information and data as either too insufficient or limited.

First of all, I am indebted to get a golden opportunity to work under the admirable and direct supervision of respected Campus Chief Prof. Dr. Kamal Deep Dhakal as thesis guide Shanker Dev Campus, to whom I wish to express my heartfelt gratitude for his inspiration and exclusive consideration, guidance and support for every moment as without his co-operation this thesis couldn't have been appeared in this final form for my entire study.

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I am hopeful that this task will be helpful to the students of business studies and to those who want to make further study under this topic.

Bikram Thapa Magar

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Abbreviation

Sec. = Section

F.Y. = Fiscal Year

S.No. = Serial Number

BS. = Bikram Sambat

U.K. = United Kingdom

IRD = Inland Revenue Department

FNCCI = Federation of Nepalese Chamber of Commerce and Industry

E-Governance = Electronic Governance

VAT = Value added Tax

ITAC = Income Tax Administration Consolidation Project

HMG = His Majesty Government

GTZ= German Government

DOT = Department of Taxation

KTSC = Kathmandu Tax Payers Service Center

PAN = Permanent Account Number

E-VAT = Electronic VAT Returns Filing System

E-PAN = Electronic Permanent Account Number System:

E-TDS = Electronic Tax Deduction at Source System

E-TDSS = Electronic Tax Deduction at Source System

SMS = Short Message Service

TDS = Tax Deducted at Source

NEPSE = Nepal Stock Exchange

VDIS = Voluntary Disclosure Income Scheme

GDP = Gross Domestic Product

RS= Rupees

CEDA = Center for Economic Development and Administration

CHAPTER – I
INTRODUCTION

1.1 General Background

Nepal being the least developed and developing nation with mixed economic system where public participation dominants the private participation, Nepal government has to play major role in its development and for the sake of which it has to spend a lot of money for fulfilling its responsibility towards the welfare of the its public. Government thus, needs to make expense on security or for health or education or other developmental activities towards its people. In each country, a lot of fund is spent by the public authority for the protection of common people and for the creation of various socioeconomic infrastructures. The expenditure of Nepalese government is increasing year by year because of time, increase in population, social progress, war or preparation for war, increase in price, national income, global crisis etc.

Although the taxes were collected in various forms in ancient era, the history of modern income tax is not very old in Nepal. The idea of introducing income tax in Nepal originated in the early 1950s when a multi-party democratic political system was introduced. In 1951, the then Finance Minister in his budget speech declared the intention of the government to levy an income tax.

Attempts were made to introduce income tax in subsequent years. In 1954, an income tax with Rs.10, 000 basic allowance and progressive taxes ranging from 5 to 25 % was proposed. Due to political instability, it could not be introduced until 1958. (2065; Ishwor Bhattarai)

The first elected government in 1959 finally introduced Business Profits and Salaries Tax Act, 1960 in Nepal. At that time, income tax was levied only on business profits and salaries. After about three years experience of income tax, the government replaced the prevailing tax Act by income Tax Act, 1962. The coverage was extended in the Act. In 1974, Income Tax Act, 2031 was enacted. The Act remunerated income sources into five groups as Agriculture ,Industry Trade profession or Occupation,Remuneration,House and compound Rents and other sources.

However, agricultural income was kept outside the tax net except few years through the Finance Acts. To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend and integrate the laws relating to income tax, the parliament of Nepal enacted Income Tax Act, 2058. This Act has replaced income tax Act, 2031, which was amended and reformed for eight times and existed for a period of 28 years. Government of Nepal framed Income Tax Rules, 2059 in 2059 to help clarifying the Act.

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) with numerous reforms . 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. Also, Nepal had signed Double Taxation Treaty for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and treaties with China 14th May 2001, Austria15th December 2000, India18th January1987, Korea 5th October 2001, Mouritious 3rd August 1999, Norway13th May 1996, Pakistan 25th January 2001, Thailand 2nd February 1998 and SriLanka, 6th July 1999. *(Annual Report of Inland Revenue Department, 2064/65).*

To meet the growing public expenditure, the government has to manage its Funds. In Nepal, government uses internal and external sources. This kind of fund is received from foreign countries and international organizations. External sources of fund are more important for underdeveloped and undeveloped countries like Nepal. It is used for economic development, reconstruction, foreign exchange, to recover from crisis condition, etc. External resources are uncertain, inconvenient and not good for healthy development of nation because they have to be paid after a certain period of time. On the other hand, internal sources of fund includes both tax and non-tax revenues. Continuous uses of external sources of fund to raise necessary public fund is not good because it reduces the liquidity position of the government. So, internal sources of fund are more important not only for financing necessary funds but also for mobilization of internal sources. It is better to mobilize internal sources rather than looking with beggar’s eyes to the donors. (Sharma, Neelam Kumar and Luitel, Chakrapani; 2003).

However, government has not been able to mobilize the internal revenue adequately because its revenue is just enough for meeting regular expenditure without no surplus for development expenditure which limited the capacity to mobilize the foreign assistance also as no foreigner would finance cent percent in any projects. Like developed countries, developing countries try to mobilize their internal sources to finance necessary funds for regular and developmental activities. Nepal is not an exception. But Nepal's experience shows that she has mobilized internal resources fewer than expected. Income tax plays a vital role in the economic development of Nepal. It is a tool of achieving maximum social and economic objectives as laid down by the Government of Nepal. It is also recognized as a good financial tool to make narrow the inequality in income. It reduces the regional economic imbalance by providing tax concessions and tax holidays to the business and industries which are established in remote and backward areas as "the compulsory contributions from the persons to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred".*(Pokhrel, Amatya and Dahal,2004:3)*

1.2 Statement of Problems:

A tiny landlocked country in South Asia, Nepal remains a multi party, multi linguistic, democratic country and its Administration system frequently get amended or modified in order to meet changing circumstances for the future operation of nation. Nepal's current economic situation is beset with nearly half of the population living below poverty line, and unemployment and disguised unemployment together depriving one half of the labor force. However, being the least developed and developing country, it attempts to maximize public welfare through its taxation mechanism.*(Ramesh Ghimire, 2004*) Despite it faces challenges from its own internal affairs such as political instability being the major includes conflicting political views, philosophies and practices of various political parties and their involvement in parliament. It is difficult to satisfy all the vested interests of all political parties at once. So with frequent changes of some expected and some unexpected events and government with its policy, each and every time changes. These days' large numbers of members of minister of council get appointed from different parties and they formulate policy that best suit the country for its betterment. However, it becomes worthless with dissolution of government. Again with new coalition government formation, new policies are prepared planned to execute. Government attempts to do new different from previous and needs to modify previously formulated policies despite low economic growth rate, growing unemployment and intensifying poverty culminating into the vicious cycle of low income, low saving, low investment and low growth leading the country to low level of equilibrium.

Hence, The Reforms in Income tax plays a very important role in the national economy. It is looked upon as a tool for achieving the social and economic objectives laid down in our constitution. It has been identified as a good financial mean to narrow the disparities in income. Economic imbalance is also being reduced by providing incentives and concessions in income tax for starting new industries in backward areas. Thus, income tax is not only government revenue but also an effective instrument to ensure balanced economic growth. The absence of sound tax system leads to the economic backwardness and economic backwardness to all other forms of backwardness.

Income tax system of Nepal has been facing managerial problem. The income tax administration of Nepal has been blamed of inefficient. Since the government expenditure is growing, the sources of government revenue must be increased. Income tax is assumed as the best source of government revenue. The goodness of income tax is that only a capable taxpayer has to pay tax. Furthermore, only those taxpayers will pay tax whose income is above the exemption limits. In Nepal, the evasion of income tax is more pronounced especially by the people of high income business class. Taxpaying habits and tax consciousness are very low; so many problems frequently arise in tax collection phase.

Tax composition of Nepal shows that the Government of Nepal highly depends on direct and indirect tax. People in developing nations tend to have greater propensity to evade taxes. This is because they have lesser knowledge about income tax, and they have to maintain their livelihood from their limited income. The rich people used to avoid taxes by recourse to legal loopholes and taking advantage of an inefficient tax management. The tax management personnel are provided many discretionary powers which encourage them for corruption. Income tax management is not so efficient. It is not free from problems. The income tax management has become unable to widen the income tax coverage.

In Nepal, the coverage of income tax is very low. In Developed countries, 30 % to 40 % of total population pays income tax, and it occupies 21 % to 40 % of government revenue. (Agrawal, 1978).

The tax authorities are inefficient and ineffective in enforcement. There are less integrated programs for taxpayers' education, guidance and counseling. Tax Officers are looked upon as heaven for corruption, inefficiency, delays, unfair dealings, harassment and incompetent personnel. The assessment procedure of income tax is not effective. Undue delay in tax assessment not only reduces the total revenue but also bring harassment to the taxpayers. As a source of internal resource mobilization and the instrument of social the problem underlying it is there is not provision of tax education in the secondary level and only a few number of people know about the tax and its importance towards economic development of the nation. Because of the absence of proper knowledge of tax system, Nepalese taxpayers do not make timely assessments. As a source of internal resource mobilization and the instrument of social justice, income tax is not successful to achieve such goal.

However, Income tax collection has been increasing more than the targets and tax collection expenditure is also decreasing per year. Because of the absence of proper knowledge of tax system, Nepalese taxpayers do not make tax planning. Tax evasion and avoidance are increasing tremendously. The income tax system of Nepal has been criticized in many ways, especially in terms of its policies, laws and management. Nepal is facing problem of income tax management.

So the necessity to conduct study on problems of inconsistency, flexibility in tax system and the need for reforms in Tax system is the most. Hence, some queries and doubts emerged in the mind have been stated as research question.

Research Question:

- What will be the effect of frequent changes in tax rates, exemption limits etc on the tax payer with changes in income tax policy?
- Weren't past Tax policy effective in favor of tax administration?
- Tax administration or IRD office was not achieving their objectives, not fulfilling its mission, was it?
- Is there any inconsistency in tax policy and commitment of tax administration?
- Ministry of Finance and Inland Revenue Department are achieving the targets, Is it?

1.3 Objectives of the study:

The objective of the study is to study and analyze the reforms in tax system and identify its effectiveness. In order to achieve main objective following supplementary objectives are stated.

- To study and analyze changes and effectiveness of reforms in Income tax system.
- To make recommendations for future taxation policy.

1.4 Scope of the Study:

The objectives of the study define the scope of the study and that the area of the study is limited to findings and reforms in Income Tax Policies and system as well as it covers the method of measuring effectiveness which probably have not been formulated so far in this area. So, there is a need for study in the reforms of income tax system in Nepal. Since many problems associated with the income tax are originated from its inflexibility in practices and management and frequent amendments. So far, the researcher has also attempted to include the current, latest updated issues with regard to Income Tax Matters but not covering entire aspects. This study is useful to the policy makers to get inputs for making the tax system efficient and steady in nature.

1.5 Limitations of the Study:

The limitations of the study are indicated by the scope of study on particular aspects i.e. the entire study will be focused on reforms of income taxation in Nepal, not covering the entire aspects.

- This study has been strictly confined to the study of changes showing reforms of income tax in Nepal. Though with the changes in time, The Income Tax Act itself changes backed by Income Tax Rules, Finance Ordinance and Finance Bill. The study doesn't cover the overall changes of the Act, Rules and Bill etc.
- The data presented are secondary in nature and to great extent primary views collected through survey are used.

- The study has considered past few years' situations and events (data) and, if possible current issues have been also attempted to include to some extent.
- Because of the time and budget constraints few samples representing different groups are selected for the study.
- The unavailability of up-to-date data on various aspects of income tax has also limited the study.
- The sample has been selected only from particular area and sampling followed is judgmental and convenient type.

1.6 Chapter Scheme of the Study:

The final study has five chapters. The first chapter being introduction includes Background, statement of the problems, objectives of the study, scope of the study, and limitations of the study.

Second chapter is the review of literature including conceptual review, reviewing of different relevant books, journals previous research work if any and unpublished dissertations.

The third chapter is research methodology which includes research design, population and sample, data collection, data analysis and data processing.

The fourth chapter is about data presentation and analysis. (Use of statistical tools to interpret the data).

Summary, conclusion and recommendation are presented in the final chapter.

CHAPTER – II
CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2. 1 Conceptual Framework

Conceptual or theoretical framework of definition and other tax related aspect, previous research work /dissertation and books (relevant articles, newspaper,etc)are comprised in the Review of literature chapter.

The theories and concepts which are used in study in order to generate background information which has been used to analyze changing trend of taxation in Nepal are stated.

Reviewing is an act of exploring previous research study on particular topics, identifying previous research work's limitations and attempting to contribute new findings or to make addition in stock of knowledge.

No research or study can be claimed as the single piece however it can be possible if study is conducted for the first time on latest new topic. And in the next time the same will get followed by others as their topic of study , then they go on continuing with identifying new findings and so on.

Hence, the study, probably is new in the sense that the topic doesn't match exactly same to others' topic of the study .However, it can't be guaranteed that content or the efforts on study will be the newest. Hence, any resembles will be coincidence only.

2.1.1 Concept of Income Taxation

The new income tax act has consolidated all the income tax related provisions provided by other acts while minimizing the exemption level and thus widening the tax base. There are some new provisions in this income tax act in order to bring all incomes under the tax net. This law has provided some new concepts and new provisions which may take some time to adjust with the new legal environment.

The income tax act imposes tax on income or wealth created by a person in the course of an earning activity. There are basically three sources that generate income: labor, capital, and labor plus capital. Correspondingly, the act imposes tax on income from employment - which is labor, income from investment - which is capital, and income from business - which is labor plus capital. Income created outside these sources is not taxable. A typical example for such type of income is winnings from gambling. They are not connected with an earning activity and therefore not taxable.

In the case of employment and investment of an individual, income is recognized for taxation purposes only at the time when it is paid for. But in the case of an entity, income is recognized in accrual basis. Payments can be made in cash or in kind. If the taxpayer receives a benefit not in the form of money but in the form of other benefits for example, free housing or facility of a car, for which he does not have to pay, this benefit has to be valued at and converted into money and is then taxable. The rules provide regulations on how to assign a certain amount of money to a specific benefit.

Income from employment is the remuneration. Income from a business and investment comprises profits and gains from conducting the business and the investment. While profits are directly connected to an earning activity in the sense that the taxpayer receives them once he has carried out the earning activity, gains are incorporated into the value of an asset. They result from the increase in the value of asset and are realized once the asset is disposed of in any manner. This is also the moment when they are recognized for tax purposes, i.e. when they are taxed.

Administratively the income tax act is based on a self-assessment system. That requires the taxpayer to calculate the tax by himself using the income tax forms prescribed by the tax administration. The tax authorities have basically to accept the taxpayer’s declaration. Only if the tax administrators find reasons for a change of what the taxpayer has declared they should amend the taxpayer’s statement.

Income tax rules are in place binding the tax authorities as well as the taxpayer and guide the taxpayer on how to handle specific tax matters. If the taxpayer wants to object to a decision of the tax administration the income tax act makes it mandatory for him to, first, file an objection with the Inland Revenue Department for review, second, appealing to the Revenue Tribunal, if he is not satisfied with the review decision.

2.1.2 Meaning and Definition of Income Tax

Taxes on income are the most important single source of revenue for government of developed and also developing countries either it contribute more or less.

The first problem encountered in establishing an income tax is the definition of income. Income, as the economic gain received by the person during the particular period, is most satisfaction defined by Henery Simons as the algebraic sum of two items:

A. The person's consumption during the period, and

B. The net increase in the individual's personal wealth during the period

Symbolically, $Y = C + \blacktriangle W$

where, Y = Income

C = Value of Consumption

$\blacktriangle W$ = Net Increase of Personal Wealth Respectively

It is very difficult to define income precisely. So income is exemplified rather than defined income tax laws of various countries. For example, Sec.2 of the Indian Income Tax Act, 1961 keeps profits and gains; dividends, voluntary contributions received by charitable trust, value of any perquisite of profit in lieu of salary, any capital gain, winning from lotteries, cross word puzzles.

According to income Tax Act 2058, Income means a person's income from employment, income from investment or business and the total of that income as Calculated in accordance with this act. Income taxes as the word itself a tax on income. In a broad sense income tax is a levy based upon the production or receipts or gain of the taxpayers with in a definite period of time. Thus, income tax is chargeable on any person who is and assesses and whose total income exceeds the maximum exemption limit, at the prescribed rates and from the very beginning, income tax has been always regarded as a tax has based on the cannon of ability.

2.1.3 History of Income Tax in Nepal

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

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

2.1.4 Legal Provision of Income Taxation

The function of revenue collection has remained one of the key activities of the government from ancient time in Nepal. During that time, very few economic activities were operated on the country. Hence, government could not collect huge amount of money in the form of taxation. At that time, taxes were levied for the merchant, travelers and farmers in the form of cash, kind or labor. In some occasion, gold and agricultural products were also paid taxes but the nature of these taxes was temporary and taxes were raised for special purposes.

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

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

The major source of revenue in Nepal till 1951, were land tax, custom and excise duty in the form of lump sum contracts, royalties on forest, royalty on supply of porters and soldiers, entertainment tax and a few other minor taxes. Incomes were not taxed for raising regular revenues of the state treasury but for meeting specific expenditure of the household of extra ordinary expenditure necessitate by war or other emergencies. There was no direct tax in the country except land tax collected on a contractual basis and “Salami” which the government employees used to pay out of their salaries at very small percentages. The Salami was abolished in 1951. The Rana rulers didn’t think of development of effective revenue administrative system. After the advent of democracy in country in 1951, no taxes are levied and collected in Nepal except in according with law.

2.1.5 History of Income Tax in the International Context

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

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

2.1.6 Brief Description of Present Income Tax Act scenarios with reforms made by Finance Bill 2066/2064:

After the independence of the country in 1951, the role of government has changed. Since the government was enforced to operate development activities besides governing the regular function of maintaining law and order and the collection of revenue (Bhatta and Shrestha, 1981:3).

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 laws 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” (Interim Constitution of Nepal,(2007) present legal provision of income tax is associated with Interim Constitution of Nepal, 2007; Income Tax Act, 2058; Income Tax Rules, 2059; Finance Act of concerned financial year etc.

Taxes are imposed at two levels in Nepal. Government of Nepal (Central Government) levies taxes nationwide whereas the local governments levy locally in different forms. Every year Government of Nepal tables the Finance Bill in the parliament to impose tax. Tax is fixed by the Finance Bill. The Finance Bill is published in the Nepal Gazette.

The following tax-related Acts and Rules are effective in Nepal:

- Income Tax Act, 2002 and Income Tax Rules, 2002
- Value Added Tax Act, 1996 and Value Added Tax Rules, 1996
- Excise Act, 2001 and Excise Rules, 2001
- Customs Act, 1962 and Customs Rules, 1962
- Vehicle Tax Act, 1974
- Tax Arrears Clearance Commission Act, 1976
- RevenueTribunalAct,1974

Originally, these laws are published in the Nepal Gazette. Nepal kanoon Kitab Bebastha Samiti (A Division of Law ministry) reproduces all the acts and rules. Both the Gazette and reproduced books are in Nepali language and are treated as legal documents.

I. The Special features of the Act

- 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.

II. Income Heads

- The Act imposes tax on those activities contributing toward the creation of wealth. Wealth is created with the help of labor, capital and capital-labor mix activities that generate income from employment, investment and business respectively. The Act makes broad classification of income encompassing almost all income-earning activities. They are:

A. Employment (an individual's remuneration income from an employment for an income year)

B. 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.

III. 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.

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

IV. 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) .

V. 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 and Investment .

Tax Rates (From Fiscal year2066/67)

- The taxable income of a resident individual for an income-year 2066/67 will be taxed at the following rates:

Up to Rs.160,000 – 1 %

From Rs.160,000 - up to Rs.260,000- @ 15 % plus Rs. 1600

Above Rs. 260,000 - @ 25 % plus Rs.16600.

- The taxable income of a couple, if they chose to be treated as a couple will be taxed at the following rates;

Up to Rs.200, 000 – 1 %

From Rs.200, 000 – up to Rs.300, 000- @ 15 % plus Rs. 2000

Above Rs. 300,000 - @ 25 % plus Rs.17000.

- The business person who have registered own Proprietary firm should not pay above 1 (one) % tax.

- 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:

"Rs. 20,000 amount or the actual premium paid, which ever is less."

- 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.2 million or an income of Rs.200,000) in the Metropolitan or Sub-Metropolitans, Municipalities and anywhere else in Nepal amounts to Rs 5,000 Rs. 2,500 and Rs.1,500 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 GON is taxed at the rate of 5 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, and 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 government of Nepal in power generation, transmission, or distribution for an income-year shall be taxed at the rate of 20 percent.

The rate of tax on income repatriated by a foreign permanent establishment to its head office is reduced to 5 % as against 10 % previous rate.

VI. 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, herbiculture 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.

VII. Deductions

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

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

- 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.

VIII. Setoff, Carry forward and Carry back of Losses

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

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

- In case of electricity projects involving in building power station, generating and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own, operate and transfer to the 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.

IX. 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.

X. 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 recharacterize 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.

XI. 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 1 year or more if they are not disposed of for more than Rs.5 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.

XII. 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.

XIII. 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.

XIV. Special Provisions for Retirement Savings

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

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

XV. 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.

XVI. 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.

XVII. 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.

XVIII. 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.

XIX. 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.

XX. 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.

XXI. 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.

XXII. The Super Act

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

2.1.6. 1Indicators and Effectiveness of Reforms in Income tax system:

The IRD is currently responsible for the administration of Value Added Tax, Income Tax, and Excise Duty. Likewise, the IRD is also responsible for monitoring non-tax revenue of the government.

Service being the motto, the goal of Income tax system is to optimizing the Inland Revenue through fair, efficient and effective tax system for which IRD time to time issues circulars, directives, manual, guidelines etc. Maximizing voluntary tax compliance and providing taxpayer friendly services are the standing objectives. IRD provide services through 22 field offices including a Large Taxpayer Office. *(Source: Annual Report of Inland Revenue Department, 2064/65).*

Present Income Tax System possesses the following reforms despite the tax administration is facing new challenges because of intensity of economic development and liberalization process going on in the Nepalese Economy. The tax administration is able to provide effective and efficient services, provided the available resources are effectively used for the development. Income Tax System has committed towards its future directions, which have been mentioned in its mission, vision, norms and values.

This Income Tax System has mission of collecting tax revenue by providing fair efficient and effective services in economic way to the taxpayers in accordance with the revenue mobilization policies of Nepal Government. It has embraced the vision of Globally Compatible Taxpayer Friendly Tax Administration and Augment revenue collection from fair, efficient and effective Income Tax system. Income Tax System has reformed its norms and values as, Fair and equal treatment to all, Work with self-respect without any sort of fear, panic and prejudice in any circumstances, Be sensitive to provide services as per the demand of change, Be careful towards building professionalism and efficiency in work, Be devoted towards continuous pursue of new and latest methods to increase the quality of service and to apply them in practice, and Work jointly with team spirit by extending mutual cooperation and respect for achieving the goal of the Organization.

The increasing number of registered Taxpayers per employee of the IRD, higher Tax collection than tax targets in most of the fiscal years and increasing number of collection of taxes per Rupee of administrative Costs denotes the reforms of prevailing Income Tax System and it's effectiveness. Income Tax system has reached to the present height of reforms with the contributions of FNCCI, non government Sectors, Nepal chamber of Commerce, different organizations & institutions and citizen organizations. Income Tax system has been computerized and e-Governance has been practicing widely in Nepal.

The Income Tax System has committed the reformed goals of providing high quality service to the taxpayers, serving the taxpayers with politeness, making tax assessment with fair and best judgment through the efficient manpower, constantly awaking of the need for the reform in tax administration and is committed to simplify the procedural requirements for the taxpayers, arrange to disseminate complete and clear information to the taxpayers that helps them settle tax liability make the tax paying procedure more simple and convenient. The Income Tax System has reformed Arrangements of the delivery of Services. The Department under income tax system has 22 tax offices including 21 Inland Revenue offices and one large Taxpayer office all over the kingdom for achieving the goals and objectives of the Department. Altogether 924 personnel are being involved in the Department and in the Offices under the Department. This number of employee is the sum of Revenue administration – 591 and From other Services – 333.Income Tax System has made Arrangements for different type of Taxpayers including small Taxpayers.

Income Tax System has been providing the following services as per the commitment made by tax administration to give taxpayer-oriented quality service taking the convenience and interest of the taxpayers into consideration.

(1) *Small Taxpayers Service* :Small taxpayers, with a business turnover of Rs. 2 million or a net income of Rs. 200,000/- can pay presumptive tax of Rs.5000/ in Metropolitan or Sub-Metropolitan Cities; Rs. 2,500/ in Municipalities and Rs. 1500/ elsewhere respectively. They can pay their tax either directly to the concerned tax office or deposit with the bank. Except otherwise proved from the records maintained for tax purpose, the presumptive tax paid by the small taxpayers shall be deemed to have been made final tax assessment and the evidence of tax paid by them shall be treated as equivalent to the tax clearance certificate. It is the expectation that this provision will relief the taxpayers from the intricacy of their time to time contact with the tax office.

(2) *Self Assessment System*: Self assessment system was introduced in Nepal during fiscal year 1992/93. All Companies registered under the Company Act and the taxpayers with an annual turnover of more than Rs. 10 millions are compulsorily required to file their income returns on

self assessment basis. According to this system, all taxpayers with an annual turnover of more than Rs. 2.5 millions need to get their income returns tax-audited by the registered tax auditors. It is hoped that both the accountability and the self compliance will be enhanced by this arrangement. It is very essential to scrutinize the income returns produced in the self assessment system, and through proper auditing and enforcement, punish effectively the tax evaders or abettors. A process of sampling and audit of the self-assessment income returns have been established and an "Experts Committee" have been formed to audit the large taxpayers 'returns, of a size of Rs. 100 millions of turnover or Rs. 10 millions of net income or more.

(3)Service Delivery in the Districts without Tax Offices: The taxpayers, other than importers and exporters, can renew their income tax registration certificates at the District Treasury Offices by settling their previous year's liabilities, if they feel to do so. Similarly, the small taxpayers and the public vehicle-owners, who fall under the presumptive tax category, can get their tax-clearance certificates, by paying such presumptive taxes.

(4)Information at the Web-site: Taxpayer service and information desks have been established in all tax offices to provide the required information to the taxpayers. The Department has made arrangements to make available all the legislation, formats, reports and relevant information to the public at its Web-site www.dot.gov.np. Or www.ird.gov.np. The Department also publishes different manuals, guidelines, circulars, reports and statistical yearbook to make the public aware of different Acts and Rules on Income Tax, Departmental Rulings and the Progress Reports. A continuous process of dialogue and interactions have been initiated both at the central and field level to increase the cooperation and trust between the tax administration and the Taxpayers. Income Tax System aims at making tax administration "Taxpayer Service Oriented" by solving the taxpayers' problems through mutual discussions.

(5)Review of Operation: The payment of tax on the current year basis in three installments was introduced in the fiscal year 1998/1999 but this system was fully introduced in the 1999/2000. Provision of installment payment of current year's tax in the manner mentioned below has been continued for all taxpayers other than small tax payers with an objective of facilitating the easy

payment of tax by the taxpayers and the timely realization of tax by Nepal Government. By the end of Poush 40 percent, By the end of Chaitra 70 percent, By the end of Ashadh 100 percent.

(6)New Tax Proposals (F/Y2000/2001): Surcharge (additional tax) previously levied at the rate of 30 percent and 5 percent for nonresidents and residents respectively has been dropped to 1.5 %, which will ultimately encourage the foreign investment. Small Taxpayers Income Assessment Committee has been dissolved and a new presumptive tax system has been introduced with a view to facilitating the small taxpayers for settling their tax matters. Provision for Hearing Taxpayers' Complaints: Anyone, who finds that the tax officials have not acted or behaved as was expected, can file a complaint to central monitoring unit of Ministry of Finance and Department of Taxation. Provision for Pay as You Earn:

(7)Expert's Committee and Joint Tax Audit Team: An expert's committee comprising of tax officials having specialized knowledge of the related field has been formed under the Department of Taxation with a view to audit and scrutinize the complicated and sophisticated returns of income resulting from advancement in information technology; the technicalities of record keeping by large taxpayers; and the complications and varieties of skill and efficiency appeared in the field of tax planning. Similarly, a provision of auditing a taxpayer's transaction from both the income tax and VAT aspects by a joint team has been made with an objective of facilitating taxpayers by reducing formalities. In this way the function of clearance of the tax returns is being enhanced by the Department.

(8)Income Tax Administration Consolidation Project- ITAC

According to the agreement between HMG and GTZ (German Govt.), this project , since some years, is working in modifying and improving the structure of Income tax administration, its management and also timely improvement of income tax laws. It has also contributed in the development of manpower. This project has developed software for the purpose of registration of the tax payers and is developing another software for tax collection purpose. It has started not only the networking of computers for interrelations and information exchange between the Department of Taxation (DOT) and different district tax offices but also the computerization of all the activities of the Department .This project has also targeted to install a software for collection of taxes as collection module in all the Income tax offices and Value Added Tax offices of the country.

(9)Establishment of Kathmandu Tax Payers Service Center (KTSC). This KTSC is established for the purpose of providing computerized Income tax registration certificate from one window in a simple and easy way and also to provide permanent account number (PAN) which is necessary to use as a permanent account number for income tax offices, VAT offices and customs offices. This center has also made a provision to obtain permanent account number for the persons (tax payers) who have to deduct the tax at source. Income Tax System has been modernized with taxpayer's friendly system and has applied electronic system of tax collection for which it has introduced the followings.

E-TDS, E-PAN, E-Vat and E-Filing

Inland Revenue Department has recently started accepting Electronic Filling of TDS, Installment Returns of Income Tax and Electronic Registration of PAN (EPAN). Taxpayer can visit the website www.ird.gov.np and use the EPAN, ETDS and E-Filling features available online.

(a) E-VAT (Electronic VAT Returns Filing System)

Taxpayers can access this facility through the internet from over the entire nation. Taxpayers can find help from www.ird.gov.np,e-Filling,Opaerating Manuals.

(b)E-PAN (Electronic Permanent Account Number) System:

To the end of fiscal year 2064/65, 1469 businessmen have obtained e-PAN card through this system.

(c) IE-TDS (Electronic Tax Deduction at Source) System or Electronic Tax Deduction at Source System (e-TDSS) is an Internet based system. This allows withholders, withholdees and tax officers to access system from anywhere with Internet connection. The main objective of the system is to do away with the necessity of collecting TDS certificates from the withholders so that withholdees can submit the TDS as credit in their tax returns. System is also expected to reduce the error in TDS information thus helping taxpayer with correct TDS information on time. Effort has been made to simplify the system so that the system can be operated without any training. Only requirement will be access to Internet and skill to operate Internet.

To the end of fiscal year 2064/65, 9321 documents have been verified through which the revenue of 1arab, 92 crore,31 lacks and 87 thousands have been collected and 15 inland revenue offices have been obtaining e-TDS under this system.

(d) E-Installment (Electronic Estimated Income Tax Returns) System

(e) SMS System: IRD has launched its SMS System for those who want to know registration and VAT returns filing status of a PAN. IRD has launched its SMS System for those who want to know registration and VAT returns filing status of a PAN.

(10)Personnel List:

Inland Revenue Department and its other 22 offices have total of 924 staffs as follow. Among which 591 are from Revenue Administration and 333 are from other services.

Table No.1.1

Personnel List

S.No.	Particulars	Administration	Others Services	Total
1	Gagetted I class	7		7
2	Gagetted II class	41	7	48
3	Gagetted III class	200	5	205
4	Non-Gagetted I class	197	112	309
5	Non-Gagetted II class	145	12	157
6	Driver	0	38	38
7	Office Assistant	0	160	160
Total		590	334	924

Source: Annual Report of Inland Revenue Department, 2064/65

(11)Foreign tax credit

If an individual or entity residing in Nepal derives income from a foreign country the foreign income is taxed in Nepal under the concept of global taxation: the taxation of income is linked with the residence; each taxpayer residing in Nepal has to pay tax on his global income in Nepal. But foreign income is presumably also taxed in the foreign country so that there is a chance for double taxation. In order to avoid this and ensure that the income in Nepal is only taxed once, foreign tax paid in the foreign country can be offset against the Nepali income tax. The taxpayer can reduce his Nepali income tax by claiming a foreign tax credit (*s 71 (1))*. Income tax system has made provision of Double Taxation Avoidance Agreement with foreign countries which has relieved the taxpayer to the greater extent.ITA 2058 section73 has made this provision.ITA2031 too had made such provision. Under this provision Nepal has made double taxation avoidance agreement with 10 foreign countries up to the fiscal year 2064/65.

2.1.6.2 Reforms made in Income Tax by Finance Bill 2066:

Finance Bill 2066 has amended the definition of **Income (Sec 2 Ja)** as "Person's income from any employment, business, investment or income from windfall gain and the total of that income as calculated in accordance with this Act."Before application of Finance Bill 2066, ITA 2058 has excluded casual receipts (windfall gain) from the income definition.

Finance Bill 2066 has added **sub section Ja1 as,Sec 2 Ja1** "Windfall gain includes prizes, lotteries, gifts, Baksis, jitauri and gain received occasionally."

As per Finance Bill 2066, **Sec2 Da** "Non business chargeable asset means securities or interest in an entity as well as land and building excluding the following assets.

(a) Business assets, depreciable assets or trading stock.

(b) Private residential house of natural person that has been (i) owned intermittently for at least ten years or more and (ii) resided for total period of at least for ten years either continuously or intermittently.

(c) Private residential house and land of natural person that is disposed in for less than Rs.50 lakhs.

Finance Bill 2066 has amended normal interest rate of 15 % as 10 % p.a. of **section 2 KaBa**.

Finance Bill 2066 has added sub-sections **Gha** after **Ga** for Section5 as, subsection **Gha** "Windfall Gain."

Finance Bill 2066 has added subsection **Jha** after **Ja** for Section10 as, sub-section **Jha** "Any type of Income of Nepal Government".

Sec11(sub- section3)"Special Industry has been defined as special industry and Telecommunication industry".

Sec11(sub- section3Ka) "Special industry and communication industry providing direct employment to 300 or more Nepalese citizens throughout the whole year, 90 % of the applicable tax rate is applied for the income of that year. Industry providing direct employment to 1200 or more Nepalese citizens throughout the whole year, and industry providing direct employment to more than 100 Nepalese citizens including at least 33 % from the women, disabled person and Dalit,80 % of the applicable tax rate is applied for the income of that year.

Sec11(sub- section3Kha) "Special industry operating in remote, undeveloped and underdeveloped area will have to pay 50 %,70 % and 75 % of the applicable tax rate respectively up to ten income years commencing from and including the year in which the operation commences." Before application of Finance Bill 2066, applicable tax rate were70 %, 75 % and 80 % respectively.

Sec 89 ka, "Any resident entity other than resident entity established under prevailing Act involving in the buying and selling transactions of securities from which if any person derive the gain from the disposal of securities calculated according to section 37, the advance tax will be as follow.

(a) Stock Exchange can deduct 10 % advance tax from the gain derived from the disposal of the securities of entity registered under stock exchange and 15 % for others' gain.

(b) Entity not registered under stock exchange can deduct 10 % advance tax from the gain derived from the disposal of its securities from the resident person and 15 % from others' gain.

Finance Bill 2066 has added **sec 89kha** as, Tax deduction on capital gain "Land Revenue office has to deduct the following advance tax from the capital gain derived from disposal of land and house of natural person during its registration.

(a)5 % if the non business chargeable asset(house and land) has been owned for more than5 years,

(b) 10 % if the non business chargeable assets (house and land) has been owned for less than 5 years.

Finance Bill 2066 has amended some sections **<u>of Annex 1</u>** as follow:

(1) Natural Resident Person: The taxable income of natural resident person of an income year is taxed under sub-section 2 and4 of Annexe1 with following tax rates,

(a) 1 % of the taxable income from employment up to Rs160,000 but the sole proprietor tax payer are not taxed.

(b) Up to Rs.160, 000 @ Rs1600 and aboveRs.260, 000 @ 15 %

(c) Up to Rs260000 @ Rs 16600 and Above Rs. 260,000 @ 25 %.

(2) Taxable income of couple selected as per section50 of an income year is taxed under the sub-section4 of this Annex as follow:

(a) 1% of the taxable income from employment up to Rs200,000 but the sole proprietor tax payer are not taxed @ 1 %.

(b) Up to Rs200000 @ Rs2000 and above Rs 300000 @15 %

(c) Up to Rs300000 @ Rs17000 and above Rs300000 @25 %.

2.1.6.3Reforms made in Income Tax Act, 2058 by finance Act 2064

Followings are the major amendments, additions and cancellations of the various provisions in Income Tax Act, 2058 made by Finance Act, 2054.The amended provisions shall be effective from 2064.04.01 for the financial year 2064-65.

1. Section 2 (Dha): Nepal Rastra Bank and Nepal government are previously included in a list of tax exempted entity but this FA has withdrawn them from the list. It means for the financial year2064-65 they shall not be availed the facilities provided to tax exempted entities.

But the new inserted section 10(Jha) has allowed tax exemption to Nepal Government on its any kinds of Income.

2. Section 2(katha1): The addition in the section has defined “Electronic means” as IRD approved means of transmission including computer, fax, E-mail, Internet, electronic cash machine and fiscal printer.

3.Section 2(kaba): The amendment to the section has prescribed the rate of general interest at 10% instead of previously prescribed at 15%.During the year2064-65, wherever, the interest is chargeable for delay in payment of revenue or IRD has to pay interest for delay in settlement of refunds, the rate of interest shall be 10%p.a.

4. Section11 (3ka),(3kha) and (3Ga): the exemption and concession provided to certain industries by the previous Finance Acts and Income Tax Act,2058 has been amended and the amended provisions for such exemption and concessions are as follows:

Sub-section (3Ka): Exemption or concessions regarding income tax and tax on dividend distributed by them are provided to industries established at specified economic zone as follows:-

a).In case the industry is established at specified economic zone situated at Himali districts or at any hilly districts notified by Nepal government, the industry shall avail a tax exemption for ten years from the commencement of the business of the industry. After expiry of the 10years, a tax concession of 50 % of the tax rate applicable shall be available.

b).Any industry established at any other specified economic zone shall avail tax exemption for 5 years from the commencement of the business of the industry. After expiry of the 5 years, a tax concession of 50 % of the tax rate applicable shall be available.

c).The above industries established at any specified economic zone shall avail tax exemption on dividend distributed for 5 years from the commencement of the business. After expiry of the 5 years, for a maximum period of 3years a tax concession of 50 % of the tax rate applicable shall be available.

d).Tax concessions at 50 % is provided on income generated as service charge or royalty for technology transfer or management services provided by a foreign investor for the industries established at any specified economic zone.

Sub-section (3kha): Any industry established at any remote area shall avail a tax exemption for the period of 10years from the commencement of the business.

Sub-section (3Ga): Any information technology based industry established at any information technology park as notified by Nepal Government shall avail a tax concession of 25% of the rate applicable.

5.Sub-section(7): Those industries availing tax exemption or tax concession under sub-section(3ka) and (3Ga) shall not avail the facility in case the assets it has acquired for the industry were already used by another person for such industry or for any other business.

6. Section 12ka: Deduction for donation etc: The previous provision for deduction for donations etc provided to a tax exempted entity is remained unchanged but, certain new deductions are allowed under this section. The provision is as follows:

In case any company incurs expenses on preservation and development of ancient, religious or cultural assets established in Nepal; and /or incurs expenses for construction of public infrastructure required for development of games and sports: under the following conditions the following deduction shall be allowed:

-The company shall have taken prior permission from IRD for incurring the expenses.

-The maximum limit of the deduction shall be RS.10 lakhs or 10 % of the assessable income during the year whichever is lower.

7. Section20:

Sub-section(1)(Kha):According to the previous provision a loss from a general business could be carried forward for 4years but this fiscal year has extended the period for 7years. Now onwards a loss from business could be carried forward for setoff from profit of coming 7 years.

Sub-section (2): The provision for a loss from an investment is allowed to setoff from an income from another investment during the same year is continued without any amendment. Previously the loss from investment was not allowed for carry forward. The fiscal year has allowed a loss from an investment to be carried forward and setoff from the future income from the same investment or any other investment for the 7 subsequent years.

Sub-section (8): This new sub-section has disallowed to carry forward such losses incurred by a person during the period of tax exemption or tax concessions available to it for the period in which it is not entitled to such exemptions or concessions.

It means that a person who is entitled to tax exemption or tax concession under section11 shall have to carry forward its losses incurred during the period of tax exemption or concession for the period up to which the exemption or the concession is available to it.

8. Section 59

Sub-section (2) and (3): These sub-sections are regarding carry back facilities for losses provided to Banking business. The fiscal year has repealed these sub-sections and now onwards the carry back of losses is not allowed to any banking business.

9. Section69

Sub-section(2)(kha)(3):This fiscal year has allowed a general insurance business to deduct the sum total of the following amounts provided for risk coverage fund. This amount is allowed for deduction from the taxable income of the general insurance business. The amount is sum of the following amounts:

i) 50 % of the net premium credited to the income statement during the year: and

II) 115 % of the pending and unsettled claims outstanding at the end of the year.

But the company has to take these amounts that shown as expenses during the year as profit during the subsequent year.

Sub-section (3) and (4): These sub-sections are regarding carry back facilities for losses provided to General insurance business. The fiscal year has repealed these sub-sections and now onwards the carry back of losses is not allowed to any General insurance business.

10. Section 65:Addition to the clarification of the section: It is further clarified that the fund in which there is no any contribution of the employee (non contributory fund), the payment from the fund shall not be treated as received from an unapproved retirement fund. For example, gratuity or compulsory retirement compensation etc shall not be taken as received from unapproved retirement fund.

11. Section85

Sub-section (1): A new phrase is added to the sub-section and thereby IRd is empowered to notify a tax payer to make a payment of tax through electronic means.

12. Section88

Sub-section (1): commission and sales bonus are included in the list of TDS deductible payments. With regard to commission, it is a part of service fee as per definition given in the Act, and so it is not a new provision but only a clarification. But, confusion was there that sales bonus is treated as a discount or a commission. Now it is clarified that in either case the TDS at the rate of 15 % shall be deducted from the payment of sales bonus. Sales bonus is not defined anywh3ere in the Act, however , sales bonus is understood by volume discounts, incentives payments, base don volume of sales made by the trader,

13. Section 89ka: New section 89 ka is introduced and thereby NEPSE is allowed to deduct TDs from the payment of capital gain on security transactions. This section is applicable for all persons having transactions relating to sell and purchase of securities through NEPSE during the year except the resident entities who have taken license from Security Board for dealing in securities (such as security dealers).

(ka) This section empowers NEPSE to deduct TDS from payment of capital gain incurred by a person while selling its interest in a resident entity (sell of shares). The capital gain is derived as per the provisions stated in section 37 of the Act. This provision is applicable for the securities which are listed with Security Board.

(Kha) This section also empowers a resident entity to deduct TDS on capital gain incurred by a person while its interest in that resident entity (sell of shares). The capital gain is derived as per the provisions stated in section 37 of the Act.

In both the cases TDS shall be deducted as under: If the seller is:

a) Resident Natural person:10 % of the capital gain

b) Other persons: 15 % of the capital gain.

14. Section100

Sub-section (2): The sub-section is amended by this fiscal year. In case a tax officer decides to make a jeopardy assessment of a taxpayer, it may do that but he should follow the instructions as stated in section96 (2) Ka)(1),(2) AND (3) and the procedure should be justified.

15. Section114

Sub-section (1ka): As per the added sub-section a notice issued by tax officer as per section 90 (8), as stated above, is added to the list of matters that can be referred for Departmental review.

16. Section115

Sub-section6: As per the amendment, a person who applies for Departmental Review has to deposit 100 % of the undisputed amount and 1/3rd of the disputed amount before the application is submitted.

17. Schedule1:

The initial exemption limit for natural persons and first slab of tax is amended as follows:

	Single	Couple
Initial exemption limit	115000	140000
First slab for 15 %	85000	85000

2.2 Review of Related Studies

Many books, dissertations, articles and reports are published and different individual and institutions concerning in income tax conduct researches and studies. Many individuals and institutions have studied on the various aspects relating to administrative problem legal aspects and trends of income tax system. These studies are useful in the field of income tax. The Study attempts to confine the effort on the topic under income tax act 2058. Some of the books, articles and dissertations that are reviewed during the study are as follow:

2.2.1 Review of Books

Only some few books are reviewed.

Poudyal & Timilsina (1990) "Income Tax in Nepal". This book is extremely based on the syllabus of B.Com. They described the theoretical as well as practical aspect of income tax in Nepal. Provision and methods of assessment have been described with numerical examples. But the major problems and defects of income tax system of Nepal have not been analyzed. (Poudyal &Timilsina, 1990)

Prandhanga (1993)"Income Tax Laws and Accounting." Mr. Pradhananga has given explanation of Income Tax made under income tax laws.Through this book Mr. Pradhananga has described about the income tax and its development in Nepal. He has also described about fines and penalties, appeal, contribution of income tax for the development of nation, income tax administration and official, collection and return of income tax and admissible and inadmissible expenses etc.

Tiwari (1999) has presented a book about income tax system in Nepal. Basically this book is written for the students of Tribhuvan University and it is equally useful to the taxpayers, tax administrators, and the person who want to get theoretical as well as practical knowledge about income tax. He has described the provision under income tax act 2031, income tax rules, provision under finance act 2055, other provisions, information and acts related income etc. He has not analyzed the major problems of income tax system. (Tiwari, 1999).

Adhikari (2003) has presented a book on modern income tax . He has discussed the provision under Income Tax Act 2058. His book is analytical rather than informative .He has to introduce different aspect of tax planning needs and base for successful tax planning. He has also presented historical background, income tax laws and its implements, assessment of tax and tax authorities and duties. (Adhikari,2003).

Aryal & Poudyal (2004) has published a book named ‘‘Taxation in Nepal’’.They have described the theoretical and practical aspect of income tax & VAT. This book is extremely based on B.B.S. Third year syllabus as prescribed by Tribhuvan University. This is very useful to get knowledge about income tax act 2058, although it is unable to describe the tax structure of Nepal and the problem of income tax system. (Aryal & Poudyal, 2004)

Bhattarai and Koirala (2065) the fourth Edition “Taxation in Nepal with Tax Planning and VAT”. This book has been written to fulfill the master course of T.U. this book has been organized in 23 chapters. In this book, the writers have described the precious related to the income tax assessment and tax planning they have also presented on Overview of relevant tax laws: income tax act 2058 with the adjustments of amendments made in different Rules.

2.2.2 Review of Previous Research and Dissertations

The researcher didn’t find any topic of the study exactly similar with his topic of the study. However, the researcher finds the key words “Income Tax” in most of the searched research’s topic. So, the researcher has attempted to make review of that research work as follow.

Shakya (1995) presented a dissertation named, Income Tax System in Tax structure of Nepal.” His study was done with basic objectives of analyzing the causes o f heavy reliance of indirect taxes, analyzing the volume of indirect tax revenue and direct tax revenue in total tax structure highlighting the revenue assessment procedure form different sources and suggesting to improve on them. In his study, he has identified income tax has occupied fourth position among tax revenue of Nepal. Custom duty, sales tax and excise duty has occupied first second and third position respectively in Nepalese tax revenue.

Pant (1996) presented his master's level dissertation entitled 'A Study on Income Tax Management in Nepal'. He has identified various problems of income tax management in Nepal and among them lack of managerial efficiency is the main problem. Lack of effective personnel management poor reward and punishment system weak income tax assessment procedure, poor tax information narrow coverage of income tax the other problems of income tax management are in Nepal identified by him.

Bhattarai (1997) has prepared a dissertation with objectives to examine the Effectiveness of corporate income tax imposition in Nepal and to recommend an optimum model of corporate income tax system for Nepal. In this study, he has found out that there is lack of balance between rights and duties of tax officer and tax payer. There is also frequent change in income tax act and finance act. There is lack of balanced delegation of authority, responsibility and accountability. Poor rewards and punishment system and lack of systematic evaluation and control mechanism are the drawbacks of then tax system.

Shrestha's (2001) study had covered the historical background legal provision, structure of income tax, income tax administration in Nepal and empirical investigation. Her findings about tax structure were: there was dominant share of tax revenue in Nepalese government revenue. She had found various problems of income tax system in Nepal which were narrow tax coverage mass poverty of Nepalese people, lack of conscious of taxpayer's widespread evasion and avoidance of income tax unscientific tax assessment procedure, instability of government policy. Her suggestion for minimizing tax evasion were control illegal business activities, enforce proper auditing and investigation, enforce heavy fines and penalties and maintain proper records and accounts.

Poudel (2002) presented a dissertation entitled "Income taxation in Nepal: A Study of its Structure and Productivity." The objectives of her study were to analyze the structure of income tax in Nepal, to estimate the elasticity and buoyancy of income tax in Nepal, to assess the role of income tax administration in Nepal to evaluate the success of voluntary disclosure income scheme (VDIS) program in brief and to provide the suitable recommendation for improving the scenario of income tax. She has found that overall revenue of Nepal showed and annual growth of 16%. Income tax occupied the first rank among the direct taxes, personal income tax slabs has been changed radically from seven slabs in 1975/76 to two slabs till now. VDIS couldn't attract more potential taxpayers in to tax net due to lack of good planning and adequate homework of the government, working procedure of the tax administrators are still traditional and cost of administration ahs not been brought to the satisfactory level.

Palli Magar (2003) presented a dissertation entitled ''Income Taxation in Nepal; A Study of its Structure and productivity.'. He has identified that there was dominated share of tax structure in Nepalese government revenue. Income tax has occupied third position in his study period and it has increasing trend. The tax GDP ratio was not found satisfactory with the income tax, there was the dominated role of corporate income tax, there was the dominated role of corporate income tax but it was in decreasing trend and contribution of individual income tax was second position and it was in increasing trend.

Kafle (2004) has described the contribution of income tax from public enterprise to public revenue of Nepal, with special reference to Nepal Electricity Corporation. He has mainly focused about conceptual framework, legal provision and structure of income tax, Conceptual framework of PE's and the Nepal Electricity Corporation, Contribution of income tax to the public revenue and contributed portion of income tax of Nepal electricity Corporation to the total income tax. He has conducted an empirical investigation about various aspects of PEs income tax impositions in Nepal. He has taken 65 persons as a sample. Tax experts, taxpayers, tax administrators and Nepal electricity corporation's officers are the sample of his study. His findings about the tax structure were: composition of government revenue where the tax revenue constituted 77 %.In total tax revenue, indirect tax constituted 78 %.The share of income tax to direct tax revenue has been fluctuating significantly. The contribution of income tax revenue from Nepal Electricity Corporation in total tax revenue and total government revenue was 0.26 % and 0.21 % respectively in the fiscal year 2001/02.

Sharma (2005) has made thesis entitled " An analysis of Fine and Penalties regarding income tax system in Nepal" which had described about tax structure of Nepal and analyzed provision of fine and penalties under income tax law examining the taxpayer's knowledge and tax officer's views about the fine and penalties . The thesis tries to find out the role of fine and penalties to increase taxpaying habit of Nepalese people and provided suggestion about fine and penalties regarding to income tax system.

Shrestha, Neena (2006) has tried to shown the contribution of income tax on the structure of government revenue in Nepal .She stated that the composition of tax and non tax revenue is still less satisfactory in Nepal. She found that the total revenue is total tax revenue and direct tax revenue has an increasing trend in Nepal.

Bastola , Pabitra (2007) presented a dissertation entitled " The role of Income Tax in National Economy and Income Tax Management in Nepal" had concluded that the lack of sufficient financial resources is the major constraint of economic development in developing countries like Nepal and lack of managerial efficiency is one of the major problems of effective personnel management. Nepal has been facing the problem of capital deficiency to accelerate her pace of economic growth. Her suggestion to make effective tax administrative system are, Proper incentives and recruitment selection of personnel is prioritized. There must be provision of high penalty and fines to corrupted personnel's. Income tax law should be clear and practical each and every terms of the act should be clearly defined. There should be applied scientific method for the purpose of accounting assessment and collection of income tax. There must be maintained record of income tax assesses in income tax office.

Neupane, Dipendra R.(2008) " A comparative Study on contribution of Direct Tax and Indirect Tax to National Revenue of Nepal". The researcher has described the total revenue of government in its historical perspectives, income tax structure, elasticity and buoyancy of income tax in Nepal. He had more emphasized on the contribution of income tax as he had mentioned the contribution of indirect tax is about twice than direct tax. Similarly, within the tax revenue the direct tax is the largest source of revenue. About the tax administration of Nepal, he had found that the working procedure was traditional and the cost of administration had not been brought to satisfactory level.

Lama, Niranjan (2009) in his thesis "A Study on Effectiveness of Implementation Aspects of Tax Planning in Nepal" has deep study on tax planning regarding its effective implementation. People in developing country like Nepal tend to greater propensity to evade taxes, lack of proper measurement of tax assessment. Nepal is facing the problem of tax evasion. Because of this resources have not been mobilized efficiently and resources gap is increasing year by year in Nepal. He has mentioned the following objectives and methodology for specific findings and recommendations.

Objectives: To study the concept of tax planning. To examine the use of tax planning in Nepalese organizations and to examine the implementation of tax planning.

Methodology: It is concerned with effective implementation of tax planning in Nepal. Thus information concerning tax planning as a whole is taken out for considerations to reflect real phenomenon .The sample size was determined to 20 persons out of the total population.20 persons selected through different groups of manufacturing companies, trading companies, commercials banks, and insurance companies.

Findings: The major findings are: The provision of best judgments assessment should be put into practice in its true spirit. In addition to others financial and non financial assistance including incentives to be provided by government to financial institutions for revival of sick industries.

Tax rebates to non industrial company set up industrially backward areas. Different tax rates for residential and non residential companies.

Conclusions: There are many research works carried out on income tax in Nepal with regard to its administration, legal, assessment procedure of income tax, role of income tax on economy, role of direct and indirect tax etc.Very few studies have attempted to include reforms and changes in income tax system in Nepal. This study mainly focuses on the reforms made in income tax system and act and its effectiveness with respect to their periods in Nepal in a more specific way.

CHAPTER- III
RESEARCH METHODOLOGY

This chapter is fully devoted to the research methodology applied in the study for the achievement of desired objectives. Having identified a thesis topic and conducting the preliminary literature review the next logical step is to chalk out the route map for the research project called research design. Looking at the research process one can identify various approaches.

Although choosing the research philosophy is dependent on the choice of strategic aims and hypotheses of the study, it would be misleading to prefer a single approach to the others. A combination of researches approaches often gives better results as it is often known.

Since it is perfectly alright to combine approaches, it can be deduced that it is perfectly alright to 'mix and match' different research strategies with the different Research approaches.

(Source: www.masterpapers.com)

3.1 Research Design

It is the strategy, plan and structured way of inquiry and investigation to acquire replies and answers to the research question. This is followed to ascertain the answers to the predetermined questions in the research. Out of the 50 questionnaires distributed, only few respond to it and opinion of 35 respondents associated with the income tax administrators, experts and taxpayers are collected through questionnaires. The research methodology followed in the study can be termed as survey cum analytical research design.

3.2 Population and Sample of the study

The Population of study will be the respondents selected out of the questionnaires distributed to the tax experts, tax payers and tax expert from particularly Kathmandu valley. Nearly 35 samples from Kathmandu valley were taken to fulfill the objectives of the study. The data used in this study are of few fiscal years which are secondary in nature extracted from different sites of ministry of finance, Inland Revenue Department office, Nepal Rastra bank and many others. Sample then extracted will be based on judgmental/convenient sampling procedure for collecting their views and opinions to measure the degree of effectiveness of reforms in income taxation in Nepal. The respondents have been divided into there groups. The following table shows the groups of respondents and size of samples.

Table: 3.1

Groups of Respondents and Size of samples

S.N.	Group of Respondents	No. of Questionnaire Distributed	Sample size (Respondents)	% of Respondents
1	Income Tax Staff	15	8	23
2	Income Taxpayers	25	20	57
3	Income Tax Experts	10	7	20
	Total	50	35	100

The Respondents are selected from the lists received from various knowledgeable sources using judgmental convenient sample technique for their views with regard to the topic of study. The selected number of respondents is further categorized as follow for the simplicity of the study.

Table No.3.2

Classification of Respondents

S.N.	Groups of Respondents	Sample Size
1	Income Tax Staffs Tax officer-2 Tax inspector-4 Other officers-2	8
2	Income Tax payers (i)commercial-6 (ii)Small business-7 (iii)Income Earners-4 (iv)Professions-3	20
3	Income Tax Experts Lawyers-2 Economists-2 Accountants-3	7
	Total	35

3.3 Data Collection Methods and sources of Data:

Having decided upon the research strategies, the next step is to collect the data from data sources. Limited by the choice of time horizon, a lot of the data used in the research is likely to be secondary in nature covering periods of few years. Typically secondary data are of the following types:

The secondary sources are the information received from books, journals, newspapers, reports and dissertations. The major sources of Secondary data are as follow:

Economic surveys and budget speeches of various years, Ministry of Finance.

Books of public finance and income tax

Reports and records of Department of Taxation, Ministry of Finance

Publication of CEDA, Tribhuvan University.

Newspapers & magazines, conference papers, reports and mostly from internet, etc.

The literature reviews typically constitute the majority requirement of secondary data(required for furthering & supporting the analysis of findings from questionnaire distribution) are the typical kinds of secondary data that are used in the study. Secondary data are nowadays mostly available through the Internet. Alternatively, libraries are goods sources of books on leading theories and thinking of experts on the subject. In the present research we will generally lean on secondary data. Primary evaluation will be made through opinion survey with the help of questionnaire distribution to the concerned respondents. The questionnaires are administrated by the researcher in personal meeting with the respondents and additional informational are also gathered from contact with the respondents.

3.4 Tools Used For Analysis and Interpretation of Data

The data obtained through the various methods discussed above would be either quantitative or qualitative. Since the research is mostly interpretive in nature, there is unlikely to be too many data that might require elaborate statistical analysis of quantitative data.

Quantitative analysis is more likely to be secondary and exploratory (or descriptive) in nature, summarizing data in the form of charts, tables, bar diagram, percentages. In the event that a survey is carried out, the data obtained are mostly be categorical, hence is likely to be ranked across a scale. The accumulated secondary data and primary opinions are firstly tabulated into separate forms systematic way. Then simple statistical analysis such as percentages is calculated as per requirements and they have been presented and analyzed in descriptive way. Graphs and charts are also presented to interpret graphically the findings and information of the study.

This data might be represented in terms of frequency, chi-square test etc. It is highly unlikely the research might require the necessity of inferential data analysis.

(Source: www.thesisblog.com)

CHAPTER –I V
DATA PRESENTATION AND ANALYSIS

4.1 Income Tax in Nepal.

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

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.

Parliament makes the laws 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 believed and collected except in accordance with law” (Interim Constitution of Nepal,(2007) present legal provision of income tax is associated with Interim Constitution of Nepal, 2007; Income Tax Act, 2058; Income Tax Rules, 2058; Finance Act of concerned financial year etc.

Taxes are imposed at two levels in Nepal. Nepal Government (Central Government) levies taxes nationwide whereas the local governments levy locally in different forms. Every year Government of Nepal tables the Finance Bill in the parliament to impose tax. Tax is fixed by the Finance Bill. The Finance Bill is published in the Nepal Gazette.

4.2 Contribution of Income Tax in total Tax revenue

In the modern world, income tax plays significant role in the overall tax structure. In most of the advanced countries, the share of income tax is very high, but in developing countries the share of income tax is very low yet occupies a very important place in overall tax structure. The role of income tax to total revenue has been presented below.

Table No.4.1

Contribution of Income Tax in Total Revenue

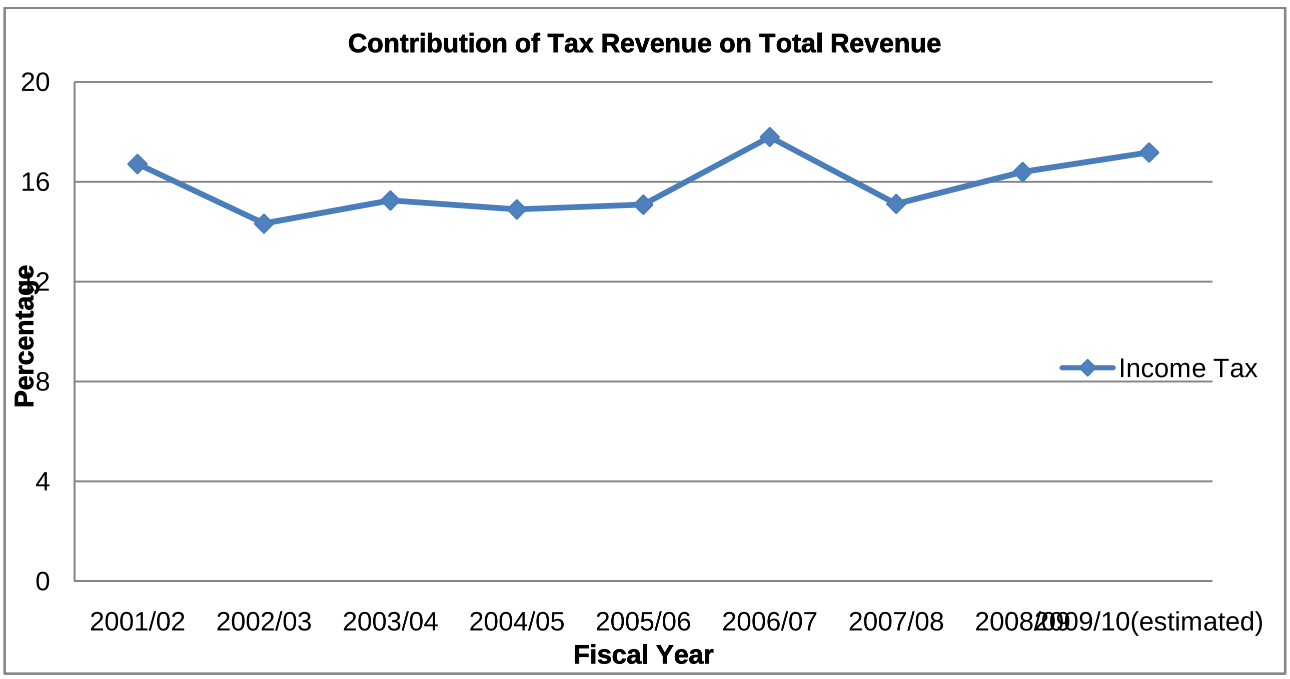
(Rs in Millions)

Fiscal Years	Total government Revenue	Income Tax	% of income tax on total revenue
2001/02	50445. 50	8436.07	16.72
2002/03	56229. 80	8059.575	14.33
2003/04	62331. 00	9514.78	15.26
2004/05	70122. 70	10452.637	14.9
2005/06	72282 .10	10911.13	15.09
2006/07	87712.1	15621.430	17.8
2007/08	107622.5	16273.079.3	15.12
2008/09	142,211	23331.9	16.4
2009/10(estimated)	176,504	30330	17.18

Source: Financial Comptroller General office

The above Table No.4.1 shows that the role of income tax has been changing. It was 16.72 % of the total revenue in the fiscal year 2001/02 and 14.33 % in the fiscal year 2002/03, again it Increased to 15.26 % in the next fiscal years. There has been fluctuating trend in the contribution of income tax from private corporate, public enterprise, individuals and remuneration. The estimated income tax from these sectors is 17.18 % of the total tax revenue of Rs.1765504 millions for the fiscal year 2009/10.The above tabulated fluctuating trend of income tax can be presented through graph as follow. The average contribution rate of income tax was 15.86 % for the past 8years.

Figure No.4.1Contribution of Tax Revenue on Total Revenue



The above mentioned data in Table No.4.1 has been graphically presented in line graph. The line graph clearly presents varying nature of contribution of income tax on total tax revenue. The average contribution of 15.86 % of income tax has shown in the figure.

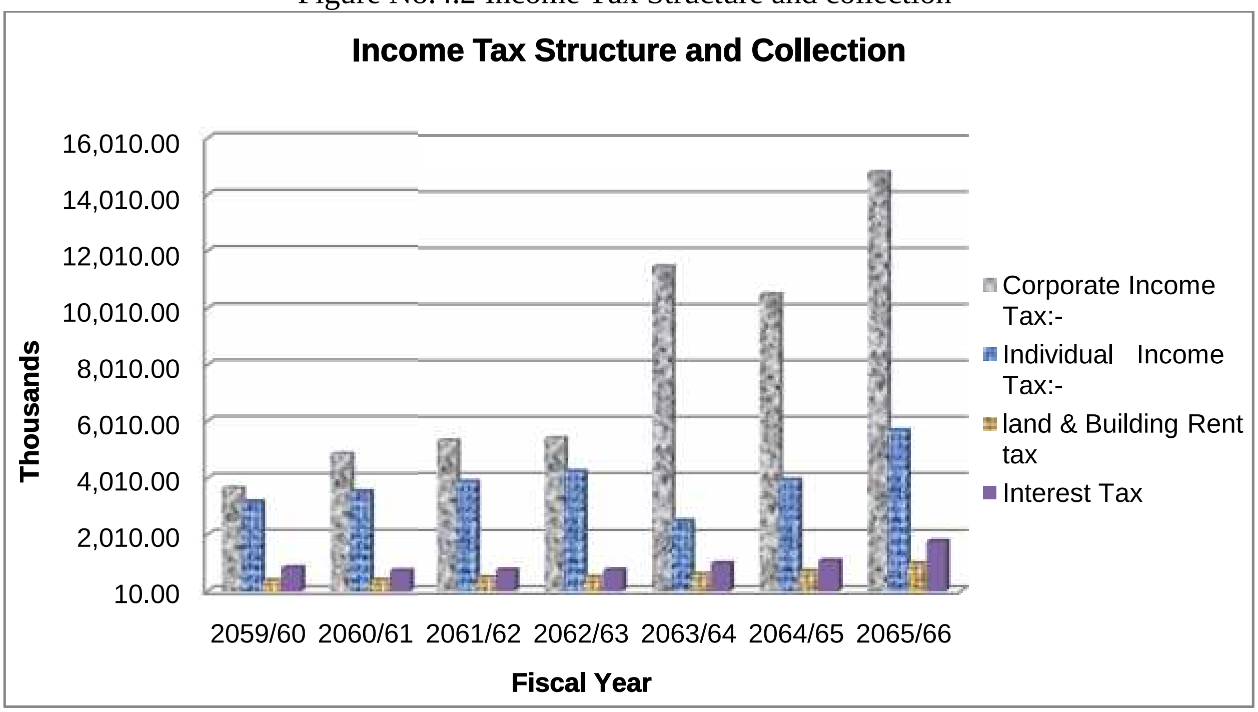
Table No.4.2

Comparative Study of Income Tax Structure & Collection (Rs in thousand)

Particulars	F.Y. 2059/60	F.Y. 2060/61	F.Y. 2061/62	F.Y. 2062/63	F.Y. 2063/64	F.Y. 2064/65	F.Y. 2065/66	F.Y.(Estimated) 2066/67
Corporate Income Tax:-	**3,655,556**	**4,838,689**	**5,327,323**	**5,410,384**	**11,515,835**	**10,531,414**	**14,860,742**	**20,000,000**
Government Corporation	1251615	2056635	1331561	185888	1018318	204585	321030	400,000
Public Limited company	1236268	1531274	2467622	3537448	5711298	7186458	9919687	13,300,000
private Limited Company	1167673	1250780	1528140	1687048	4786219	3140371	4620025	6,300,000
Individual Income Tax:-	**3177104**	**3539416**	**3871676**	**4234653**	**2510078**	**3932636**	**5691101**	**6941300**
Income Tax on Remuneration	1240291	1391522	1676982	1751505	2028857	2451039	3270600	4,180,000
Trade,industry,occupation, Business and others.	1936813	2147894	2194694	2483148	481221	1481597	2420501	2,761,300
land & Building Rent tax	**381715**	**403282**	**496306**	**509062**	**599369**	**721102**	**993670**	**1,359,600**
Interest Tax	**845200**	**733395**	**757332**	**757032**	**996148**	**1087927**	**1786387**	**2,029,100**
Total	**8059575**	**9514782**	**10452637**	**10911131**	**15621430**	**16273079**	**23331900**	**30330000**

Note: others include capital gain, Dividends, windfall gain, other income from investment etc.

Figure No.4.2 Income Tax Structure and collection



The above presented table and figure reveal the income tax structure and collection of different fiscal years. The income tax structure comprises income tax from Government Corporation, income tax from public limited company, income tax from private limited company, income tax on remuneration, interest tax, tax on land and building and tax from industry, business and others.

The corporate income tax, Individual income tax, interest tax and tax on land & building have increasing trend which are precisely presented in the above graph.

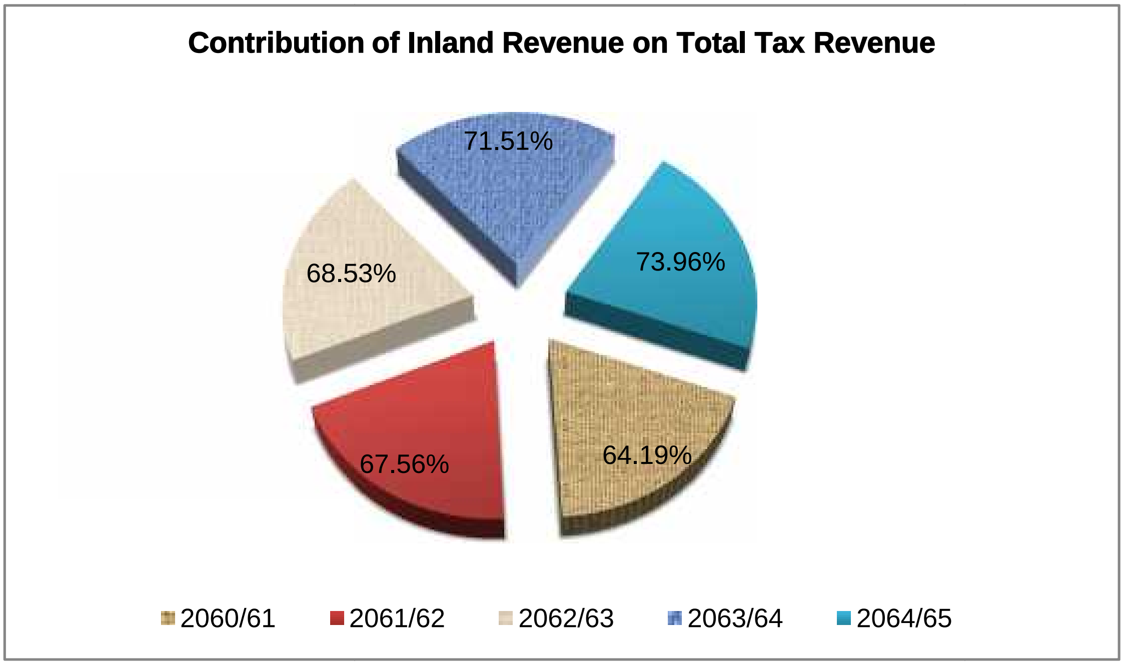
Table No.4.3

Relative Importance of Inland Revenue

(Rs in thousands)

Particulars	**F.Y.2060/61**	**F.Y.2061/62**	**F.Y.2062/63**	**F.Y.2063/64**	**F.Y.2064/65**
Total GDP	472424000	504101000	582950000	670588700	820814000
Total Revenue	62331000	70122700	71733127	87711208	107622480
Tax Revenue	48173000	54104700	57430400	71127000	85155457
Inland Revenue	30920989	36552762	39354686	50859454	62979367
Contribution of Total Revenue on Total GDP	13/19	13/91	12/31	13/08	13/11
Contribution of Tax Revenue on Total GDP	10/20	10/73	9/85	10/61	10/37
Contribution of Inland Revenue on Total GDP	6.55	7.25	6.75	7.58	7.67
Contribution of Inland Revenue on Total Tax Revenue	64.19	67.56	68.53	71.51	73.96
Source:Economic Survey & Office of Auditor General					

Figure No.4.3 Contribution of Inland Revenue on Total Tax Revenue



It has been clear from the above graph that the role of Inland Revenue on the total tax revenue of the government from the fiscal year 2060/61 has been increasing to the present 2064/65. It was increased by 3.37 % in fiscal year 2061/62 than the fiscal year 2060/61 of 64.19 %. Again, it was increased to 68.53 % in fiscal year 2062/63 by 0.97 %. Similarly, in fiscal year 2063/64 it was 71.51 % increased by 2.98 % and it was 73.96 % increased by 2.45 % in fiscal year 2064/65.

4.3 Composition of Total Income Tax

Until 2050/51, income tax was divided into three income heads income tax, individual income tax and remuneration tax. After 2050/51, tax base is expanded by including interest tax and house and land rent tax. Corporate income tax is collected from government corporations. Public and private limited companies and partnership firms. Personal income tax is collected from remuneration, business, profession and vocations. Interest tax is collected from bank or financial institution and house and land rent tax is levied on income obtained from letting house and land.

The component of income tax in fiscal year 2058 was divided into three income heads such as employment income, investment income and business income. The main components of the total income tax which contribute to the total government revenue are Income Tax from Public Enterprise, Private corporate, Individuals and Income Tax from Remuneration from the fiscal year 2001/02 to estimates of 2009/10 too.

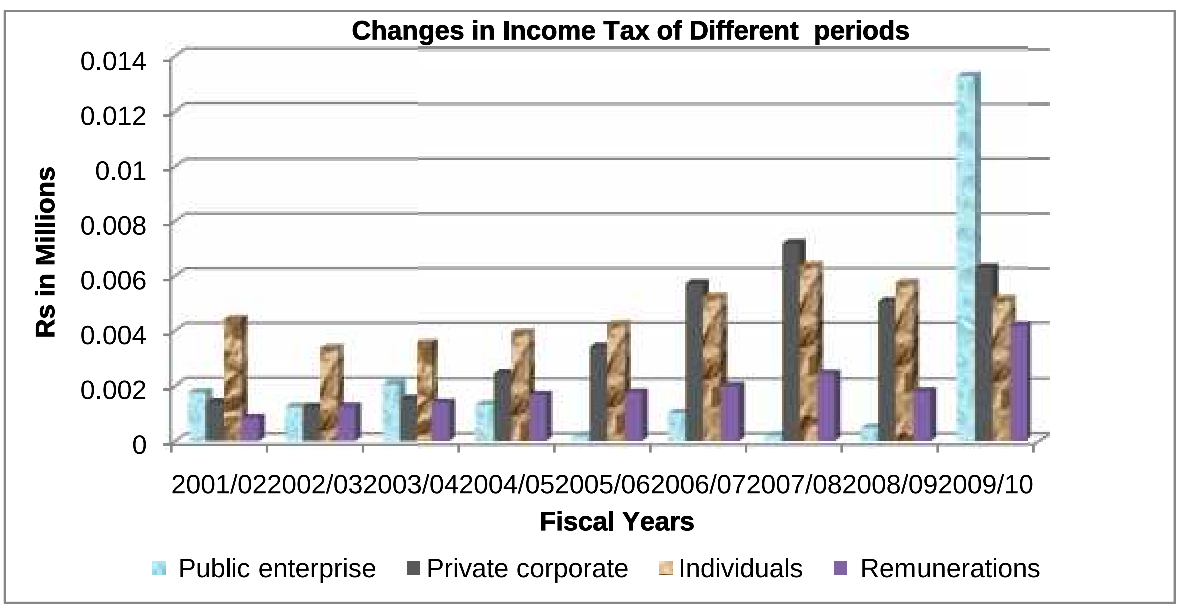
Table No.4.4

Components of Income Tax (Rs in Millions)

Fiscal Years	Public enterprise	Private corporate	Individuals	Remunerations	Total
2001/02	1769.33	1412.01	4419.09	835.56	8435.99
2002/03	1251.02	1236.27	3362.2	1252.6	7102.09
2003/04	2056.6	1531.3	3533.4	1391.2	8512.5
2004/05	1332.4	2467.8	3926.3	1675.9	9402.4
2005/06	195.7	3404.3	4234.7	1764.1	9598.8
2006/07	1019.7	5717.1	5234.4	2007.9	13979.1
2007/08	204.58	7186.46	6381.21	2451.04	16223.29
2008/09	481.4	5062.9	5739.1	1806.4	13089.8
2009/10	13,300	6,300	5,150	4,180	28,930
Total	21610.73	34318.14	41980.4	17364.7	**115273.97**

Source: Budget Speech and Economic Survey of Different years

Figure No.4.4Changes in Income Tax of Different Periods



4.4 Income Tax Rates and Exemption Limit

Income tax rate influence the amount that is collected as income tax to the revenue of the government. It also affects the taxpayers. The social justice also can be achieved through progressive tax rate.

If the income tax rate is very high, the taxpayer can't bear the burden. On the other hand, if income tax rate is low, the objective of the income tax can't be achieved. That is why income tax rate has been changed frequently.

It is practiced not only in Nepal but in most of the countries of the world. Nepal has adopted progressive tax rate. Exemption limit is an important variable while managing the income tax. For every year, Finance act prescribes the exemption limit for individual, Families, couple and corporations.

Table No.4.5

Income tax rate in Nepal for Personal income

(Slabs over Exemption Limits)

Slabs	1		2	
Fiscal Year	Amount(Rs)	Rate (%)	Amount(Rs)	Rate (%)
1996/97 to1997/98	40000	10	25000	20
1998/99	45000	15	Balance	25
1999/00to2006/07	75000	15	Balance	25
2007/08to2008/09	85000	15	Balance	25
<u>2009/10:</u> **Individuals:-** 160000to260000	15% plus1600			
Above260000			25 % plus16600	
Couples:- 200000to30000	15%plus2000			
Above300000			25 % plus17000	
source:www:ird.gov.np				

The table No.4.5 shows during the fiscal years 1996/97 to1997/98 the first slab of Rs.40000 taxed at 10 % and the second slab of Rs.25000 taxed at rate of 20 % was prevailed. Whereas during fiscal year 1998/99, it was Rs.45000 taxed at the rate of 15 % as first slab and balance at the rate of 25 % as second slab. The first slab and second slab were changing and during1999/00 to 2006/07 it was75000 taxed at the rate of 15 %as first slab and balance at the rate of 25 % as second slab whereas during 2007/08 to 2008/09 it changed to Rs.85000 taxed at the rate of 15 % as first slab and balance at the rate of 25 % as the second slab.

However, for the fiscal year 2009/10, there are wide changes with regard to the individuals and couples. The first slab of Rs.160000 to 260000 is taxed at the rate of 15 % plus1600 and the second slab of above Rs.260000 is taxed at the rate of 25 % plus16600 for the individuals. The first slab of Rs.200000 to 300000 is taxed at the rate of 15 % plus 2000 and the second slab of aboveRs.300000 is taxed at the rate of 25 % plus 17000 for the individuals.

Table No.4.6

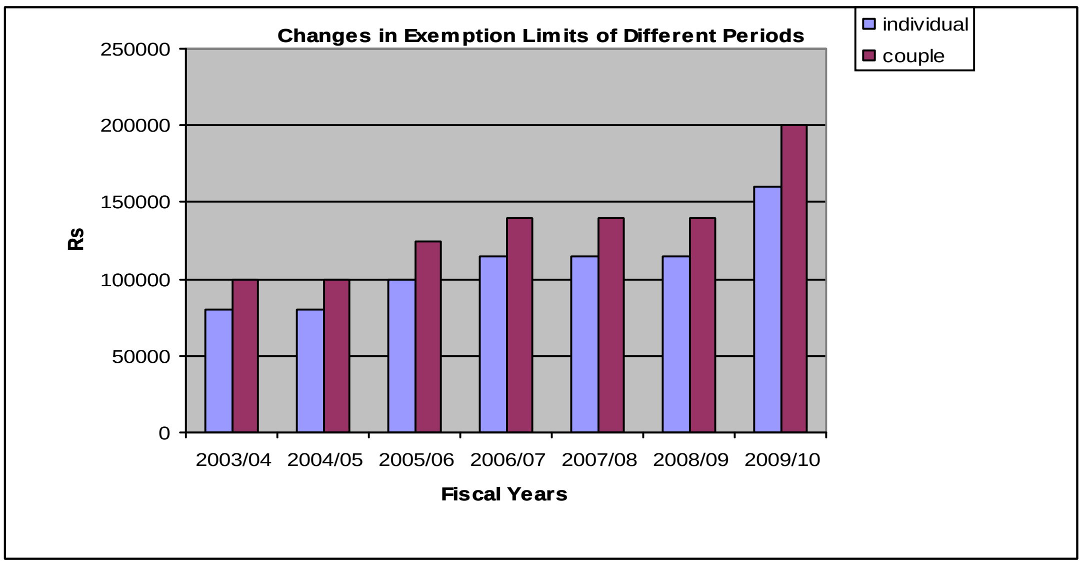
Exemption Limits of Income Tax in Nepal

(Amounts in Rs)

Fiscal year	Individual	Couple
2003/04	80000	100000
2004/05	80000	100000
2005/06	100000	125000
2006/07	115000	140000
2007/08	115000	140000
2008/09	115000	140000
2009/10	160000	200000
source:www:ird.gov.np		

In the fiscal year 2003/04 and 2004/05, the individual and the couple received same amount of exemption limit respectively. But in the year 2005/06 and 2006/07 individual having the taxable income up to Rs 100,000 and Rs 1,15,000 are exempted from tax and for the couple is Rs 125000 and 140000 respectively. From 2006/07 both the individuals and couples were enjoying the same exemption limits of Rs.115000 and 140000 respectively up to 2008/09.However, government has changed the limits in Fiscal year 2009/10. It has been shown in the above table.

Figure No.4.6 Changes in Exemption Limits of Different Periods



The above graph clearly presents that both the individuals and couples were enjoying same exemption limits of Rs.80000 and Rs.100000 respectively during the fiscal years 2003/04 and 2004/05. However, it was changed to Rs.100000 for individual and Rs.125000 for couples in the fiscal year 2005/06. They enjoyed same exemption limits during fiscal year 2006/07, 2007/08 and 2008/09.The individual and couple exemption limits have been changed in the current fiscal year 2009/10 with different provisions.

4.5 Reforms in Income Tax Act

Features of Income Tax Acts

Income Tax Act2031	Income Tax Act2058 updated by Finance Bill2066
ITA, 2031 had a narrow tax base. Global Incomes of residents weren't brought into tax net. Only the incomes originated in Nepal were taxed.	All income tax related matters are confined within the act by abolishing all tax related concessions, rebates and exemption provided by different acts. This Act has been made super in regard to al income tax matters..
Income tax related matters were governed by various Acts. Dispersion of tax related Acts had arisen confusion in the effective implementation of the Act.	The Act has broadened the tax base. Tax rates have been spelled out in the Act.
There was no clear provision regarding taxation of capital gains. The Act was also silent with regard to international taxation.	The Act has introduced a pool system of charging depreciation A provision has also been made for depreciating intangible assets.
The fine and penalty imposed by the Act were very low. As a result, the level of voluntary compliance had decreased substantially.	The Act has first introduced the taxation of capital gains.
There was a weak mechanism to control the tax avoidance scheme of taxpayers. The taxpayers used to evade tax through transfer pricing, splitting of income etc. The tax office had no free access to information.	The act has provided liberal loss set-off and carry forward/back ward provisions. Inter-head adjustments of losses have been clearly specified. Such provision has been made from international perspective.
Tax accounting method was not prescribed in the Act. Despite the provision of self-assessment in the Act, it had not been implemented properly. The self-assessment was only in name than in practice.	The Act has first introduced a provision for administrative review to allow the tax administration to correct mistakes made by tax administrators internally.
The act had not distinguished civil liabilities of the taxpayers from criminal liabilities. The tax authorities were empowered to act as a court.	The Act has made provisions for a stringent fine and penalty for the defaulter. There have been made provisions for punishments in the

	fines up to Rs300000 and imprisonment on conviction up to 3 years.
The taxpayers were allowed to lodge an objection against assessment with the Revenue Tribunal or the Director General. The Director General was empowered to act as a court and there were complaints that he used to make decisions in favor of tax officers. There were no provisions for administrative review.	Global incomes of a resident are made taxable. Non residents are also taxed on their incomes with source in Nepal. List of expenses are inclusive. All expense relating to income has been made admissible.
	The Act has made provision for international taxation. Foreign tax credit has been introduced for the first time
	The Act has separated administrative and judicial responsibilities by distinguishing civil liabilities of the taxpayers from criminal liabilities.

Table No.4.7

Changes in Income Tax Act

Basis	During Regime of ITA2031	During Regime of ITA2058
Global Income of Resident	Not taxed	Taxed
Income tax matter	Governed By different acts	Confined within single Act
Capital Gain	unclear provisions	Clear provision
Fine Penalty	Very low	Stringent
International taxation	Silent	Provision made for first

		time
Administrative Review	No provision	Introduced for first time
Accounting method	Not prescribed	Well prescribed

Table No.4.8

An Overview of Reforms

Changes Made In	**Before2066/67** **Annual Tax**	**From 2066/67** **Annual T ax**
Metropolitan, Sub metropolitan	2000	5000
Municipalities	1500	2500
Villages/anywhere else	1000	1500
Carry forward of losses:-	Unrelieved loss of previous 7years are allowed to carry Forward while calculating Business income.	Unrelieved loss of previous 4 years are allowed to carry forward while calculating Business income.
	Loss of entity engaged in Building public infrastructure To operate and transfer to Nepal Government such as building of Power station, electricity generation and transmission of electricity & the entity engaged in petroleum business Under Petroleum Act2040 can be Carried forward up to next	Loss of entity engaged in Building public infrastructure To operate and transfer to Nepal Government such as building of Power station, electricity generation and transmission of electricity & the entity engaged in petroleum business Under Petroleum Act, 2040 can be Carried forward up to next

	12years.	7years.
Excluded from Non Business chargeable Assets	A private residential house of an Individual owned continuously For three years or more and lived by the individual continuously or intermittently for a total of three years or more and disposed of in less than one corer rupees.	A private residential house of an Individual owned and lived continuously for 1year or more if they are not disposed of for more than Rs.5millions.

Source:IRD.gov.np

4.6 Latest Issues with Regard to Income Tax:

Government has declared to celebrate fiscal year 2009/10 as Tax Participation year.

4.6.1Tax Elasticity and Buoyancy

A time series analysis (sample period from 1975-2007) of tax elasticity and buoyancy demonstrates that the tax system in Nepal is inelastic (less than unity) with a more than unitary buoyancy coefficients reflecting a significant revenue collection emanating from the discretionary changes in the tax policy. Total tax revenue, which forms approximately 81 percent of the total revenue mobilization in Nepal, has elasticity co-efficient of 0.50 which is half of the buoyancy coefficient of 1.10. From these results, it can be easily concluded that there is very low automatic growth of the tax revenue reflecting a very inelastic tax structure.

(Source:Economic Report of Nepal Rastra Bank,2007/08)

4.6.2 Dual Standards in social security tax

Jobholders with an annual income of up to Rs.160, 000 have to pay a 1 % social security tax, whereas traders have been exempted from it. The government has stated in the budget announcement of the current fiscal year that it would impose a 1 % tax for social security for both government and private sector employees."Those with their own businesses, however, have to pay the 1 % social security tax if their annual income is more than Rs160, 000."said Bishnu Nepal, deputy director general of the Inland Revenue Department.

A salaried married couple however can pay social security tax up to their income at Rs.200, 000. Couples who earn up to Rs 200, 000 through their firms, however, don't come under the social security tax net. But all earners whether they are salary holders or self-employed have to pay social security tax if their income crosses the first slab of Rs160, 000 for individual and Rs 200, 000 for couples where income tax is imposed,''said Nepal.

When asked about different provisions for salary earners and persons earning through business, revenue secretary Krishna Hari Baskota said that providing exemption to certain segments of the population and bringing other under the tax net was a natural process in the government's tax policy.

"A one day's salary of government employees had been deducted for the youth self-employment programme last year too," he said. The government has been providing allowances for elderly, widows, and the disabled and marginalized communities which it wants to expand in the future. Likewise, those making an income of up to Rs 150, 000 and those doing business transactions up to Rs1.5milllion have to pay an accumulated tax of Rs5, 000 for this year in metropolitan and sub metropolitan cities. The tax is Rs.2500 in the municipalities and Rs 1500 in the villages.

They are usually small businessmen and they make up 65 % of the total number of taxpayers in the country, said the IRD.

Although the first slab of income tax is imposed on those with incomes aboveRs160,000 they have to pay tax on their income up to Rs150000 or on their annual transactions of Rs1.5million rupees.

Officials said that imposition of taxes on a reduced amount of income wasn't aimed at compensating for the exemption in the social security tax but because small traders were allowed to run their business without keeping accounts.

(*Source: The Kathmandu Post, Aug30, 2009*)

4.7 Estimates and Collection of Income Tax.

In present situation, the revenue from the income tax has increasing trend. During fiscal year 2059/60, 81.72 % of the targeted income tax was collected. It was less than targeted income tax collected in fiscal year 2060/61.i.e.109.4 % of the targets. Similarly, For the fiscal years 2061/62 and 2062/63, 99.55 % and 92.34 % of the targeted income tax were collected respectively and in the fiscal year 2063/64, 122.9 % of the targeted income tax was collected.

Table No.4.9

Changes in Income Tax Targets and Income Tax Achievements.

(Rs.In Thousands)

Fiscal Years	Target Income Tax	Achieved Income Tax	% of achievements
2059/60	9862500	8059575	81.72
2060/61	8697500	9514782	109.4
2061/62	10500000	10452637	99.55
2062/63	11800000	10896449	92.34
2063/64	12710500	15621430	122.90
2064/65	19387509	17327915	89.38

Source: Auditor General office, Anamanagar2065

Figure No.4.7 IncomeTax Targets and Collection

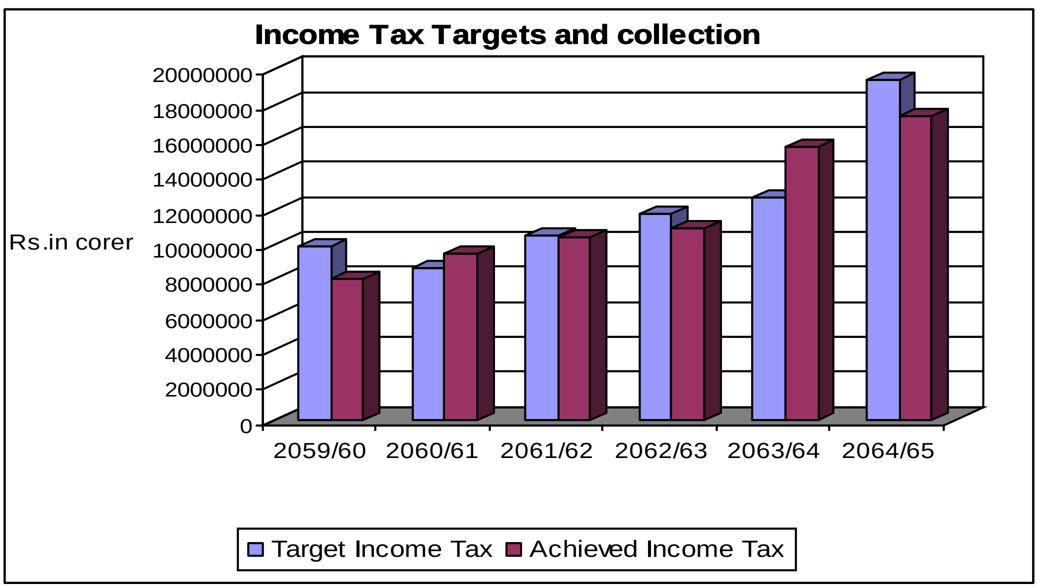


Table No.4.10

Taxable income for resident for fiscal year 2066/67

Taxable income limit for	Individuals Tax	Couples Tax

individual couples	Rate	Rate
Up to 160000	1 %	
Up to 200000		1 %
160000to260000	15 % plus1600	
200000to300000		15 % plus2000
Above 260000	25 % plus16600	
Above 300000		25 % plus17000
Source: ird.gov.np		

Nepal Government has made some changes in income exemption limits and introduced lump sum tax amount from the fiscal year 2066/67. Individual having Income up to Rs.160000 will have to pay 1 % tax on his income where as couples having income Rs.200000 will have to pay 1 % tax on their income. Between the incomes of Rs.160000 to 260000, individual are liable to pay 15 % plus Rs.1600 as tax and between the income of Rs.200000to 300000, couples are liable to pay 15 % plus 2000 as tax. Also, above Rs.260000, individual will be charged 25 % plus Rs.16600 and above Rs.300000, couple will be charged 25 % plus Rs.17000 as tax on their income.

Table No.4.11

Registered Tax payers

S.No.	Fiscal Years	PAN	Increased%	VAT	Increased%
1	2060/61	162172	16	34174	14
2	2061/62	191156	18	39776	16
3	2062/63	225304	18	46831	18
4	2063/64	245550	9	52965	13
5	2064/65	287233	17	59707	13
	Average Increment		16		13

Source: Inland Revenue Department

With regard to the registration of Income tax payers and VAT payers, VAT registered tax payer were 26388 up to the fiscal year 2058/59 whereas it was 59707 to the end of fiscal year 2064/65.It was an average increment of 13 % of VAT registered taxpayers during the previous five years and similarly, after the execution of Income Tax Act 2058, the number of the registered taxpayer for PAN has been gradually increasing. It was 104617 Income taxpayer registered up to the fiscal year 2057/58 whereas it has increased to 287233 to the end of fiscal year 2064/65. And during previous five years it was increasing at an average of 16 % of registered income taxpayers. The details of the registered taxpayers have been mentioned in above schedule. It doesn't seem that the number of registered VAT payers has been increasing enthusiastically. It is also essential to increase the number of taxpayers in order to increase the bases of tax. The more the increase in Tax Compliance, Tax collection increase in the same proportion. It will be more precise from the following graphs.

Figure No.4.8 Status of Taxpayer Registration

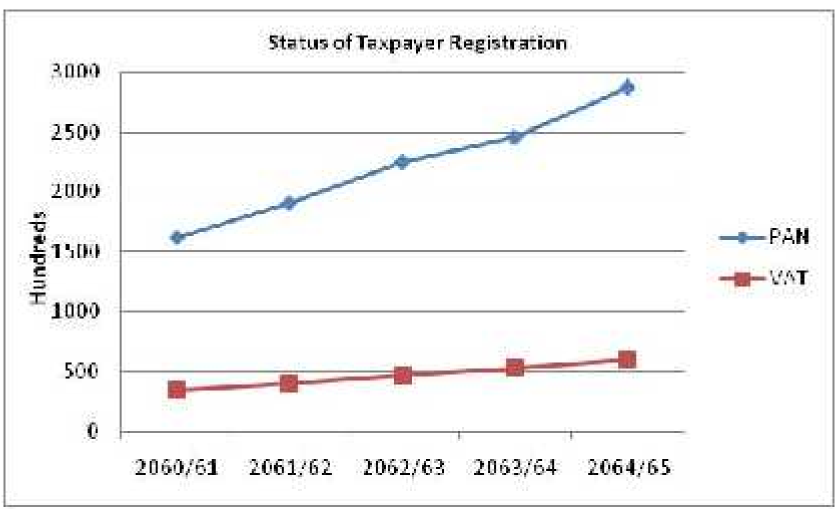


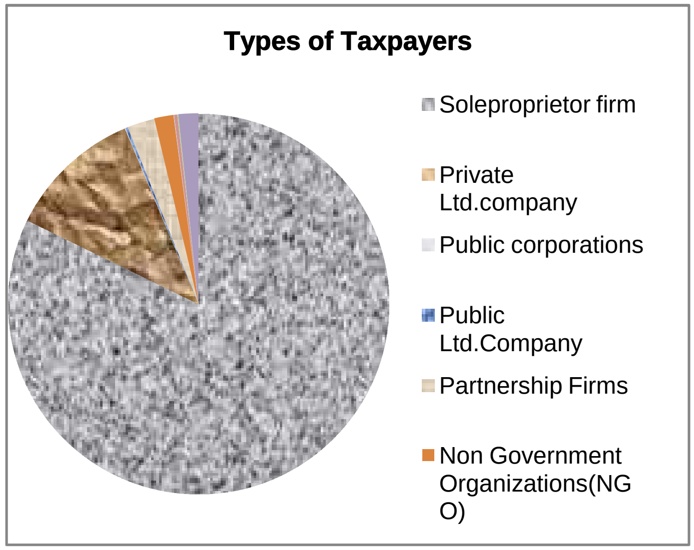
Table No.4.12

Types of Taxpayers

As on end of the fiscal year 2064/65

S.No.	Types of Taxpayers	Total
1	Soleproprietor firm	234244
2	Private Ltd.company	0
	a)Educational Institutions	32609
	b)Hospitals	0
	c)others	0
3	Public corporations	153
4	Public Ltd.Company	633
5	Partnership Firms	6613
6	Non Government Organizations(NGO)	4652
7	INGO	83
8	Cooperative Societies	802
9	Welfare Societies	239
10	others	4794
	Totals	284822

Figure No.4.9 Types of Taxpayers



4.8Analysis of Empirical Investigation

An empirical investigation has been conducted to identify the views and opinions of respondents with regard to the effectiveness of reforms in income taxation through questionnaires distribution. Out of the total samples collected, opinions are mainly taken from the persons with background in income tax System who have been assumed to be representative of all. Opinion survey has been conducted. Over 50 questionnaires were distributed and about 35 respondents' selected for the study that are mainly from backgrounds of tax payers, tax staffs and tax experts. The views gathered through questionnaires from the respondents have become information .Their views are tabulated into the separate format and expressed in terms of percentage of total number which has analyzed in descriptive ways.

4.8.1 Significant role of Income Tax for meeting objectives of the country

In order to collect and to analyze thereafter the views of the sample respondents about the effectiveness of reforms in income taxation, a question was asked "Does the reforms made in income tax system play significant role for the national development and for its effectiveness in meeting objectives of the country"? The responses received are tabulated as follow.

Table No.4.13

Views on Effectiveness of reforms in Income Tax System

Respondent Group	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax staff	5	14	3	8	8	23
Income Tax Experts	4	11	3	8	7	20
Income Taxpayers	10	29	10	29	20	57
Total	19	54	16	45	35	100

Source: Opinion Survey2009

From the above table, we can now conclude that 54 % of the respondents agreed that the changes in Income Taxation for reforms are effective with regard to development of the country and 45 % were against the statement that income taxation changes are effective.

Besides, Income tax is a major source of government revenue and it plays significant role for the economic development of any country.

4.8.2 The major problems caused by the inconsistent income tax policy

With an objective to explore the views about problems that can be aroused due to inconsistency in income taxation, respondents were asked a question provided with options for answer requesting them to rank the respective options and the major problems stated were, Misuse of power by tax administrator, uncertainty of employee training and requirement, Bewilderment in power responsibilities, loss of consciousness of tax payers and Delay in tax assessment. Thereafter the received responses are tabulated as follow to analyze.

Table No.4.14

Problems caused by inconsistent income taxation

S.N.	Problems	Tax Staff	Tax Expert	Tax Payers	Total	%	Rank
1	Misuse of power by tax administrator	3	4	5	12	20	3
2	Uncertainty of employee training and requirement	5	1	5	11	18	4
3	Bewilderment in power and responsibilities	4	4	3	11	18	4
4	loss of consciousness of tax payers	5	5	3	13	21	2
5	Delay in Tax Assessment	4	5	5	14	23	1
Total					61	100	

Source:Opinion Survey,2009

The above obtained data can be analyzed as the biggest problem that can be produced due to the inconsistency of income taxation is the delay in tax assessment which leads to consume lots of time for revenue collection for Inland Revenue Office. It is because the income tax payers are the main source of tax revenue for the government and they are disturbed to assess their tax liabilities.

4.8.3 Effectiveness of Income Tax in fulfilling objectives of government.

With an objective to predict whether the changes in income taxation has been effective or not in meeting its targets, the respondents were forwarded the question, “Do you think The changes in income taxation has been effective in fulfilling objectives of government or not”? They were also provided the three options, highly effective, fairly effective and less effective to rank these options within the scale of 3. The results collected are tabulated systematically as follow.

Table No.4.15

Measure of effectiveness of income Tax

S.N.	Options	Tax Staff	Tax Expert	Tax payers	Total	Rank
1	Highly Effective	3	3	1	7	1
2	Fairly Effective	2	1	2	5	3
3	Less Effective	1	2	3	6	2
Total		6	6	6	18	

Source: Opinion Survey, 2009

It has been cleared now that changes in income taxation are highly effective from above analysis. The options of highly effective got 7 out of 18 and are ranked first.

4.8.4 The effect of frequent changes in tax slab amount, tax rates, exemption limits etc on the tax payer.

In order to accumulate information and to explore on the effects of changes in tax slab amount, tax rates, exemption limits on the tax payers, the respondents who supported the reasons of Increased tax evasion, Discontent and Demoralization of tax payers and Satisfactory according to government targets and Increased inconsistency between Act and policies are tabulated below with their respective points.

Table No.4.16

Evaluation of Effects of changes in tax rates, exemption limits etc.

S.No.	Reasons	Tax staff		Tax Expert		Tax payer		Total points	Rank
		No.	Points	No.	Points	No.	Points		
1	Increased tax evasion	2	4	1	3	4	2	19	3
2	Discontent and Demoralization of tax payers	2	4	3	3	7	4	45	1
3	Satisfactory according to government targets	2	4	2	4	4	3	28	2
4	Increased inconsistency between Act and policies	2	4	1	4	4	4	28	2
	Total	8		7		20		120	

Source: Opinion Survey,2009

Hence, from the above analytical table, we can conclude that the major effects of frequent changes in income tax rate, exemption limits and others greatly affect the income taxpayers. The survey reveals that the demoralization and discontent among the taxpayers is the main problem caused by frequent amendments in the tax act and tax rules.

4.8.5The past tax policy was not effective in favor of tax administration.

Again as responses forwarded by respondents, we asked them whether the past tax policy were not in favor of tax administration and the responses are analyzed as follow to conclude on the statement.

Table No.4.17

Past tax policy were not effective

Respondent Group	I don't Know		Yes		No		Total	
	No.	%	No.	%	No.	%	No.	%
Income tax staff	2	6	3	9	3	9	8	23
Income tax Experts	1	3	3	9	3	9	7	20
Income Taxpayers	5	14	8	23	7	20	20	57
Total	8	23	14	41	13	38	35	100

From the above table we can conclude that the majority of the respondents are in favor that the past tax policy were not effective i.e. 41 % respondents opine that past policy were ineffective.

4.8.6 Inconsistency in tax policy and commitment of tax administration.

With an objective to predict whether the changes in income taxation has been consistent with tax policy and commitment of tax administration or not in meeting its targets, the respondents were forwarded the question, 'Is there any inconsistency in tax policy and commitment of tax administration? They are also provided the three options, highly inconsistent, less inconsistent and fairly inconsistent to rank these options. The responses were collected and tabulated systematically as follow.

Table No.4.18

Inconsistency in tax policy and commitment of tax administration

S.No.	Options	Tax staff		Tax Expert		Tax payer		Total %	Rank
		No.	%	No.	%	No.	%		
1	Highly inconsistent	1	3	2	6	8	23	32	2
2	Less inconsistent	5	14	4	11	5	14	39	1
3	Fairly inconsistent	2	6	1	3	7	20	29	3
	Total	8	23	7	20	20	57	100	

Hence, from the above analytical table, we can conclude that the majority of the respondent's i.e.39 % opines there is less inconsistent in tax policy and tax commitment of tax administration besides frequent changes in income taxation such as income tax rate, exemption limits and so on. The opinion survey reveals that the tax payers have shown high participation with this regard that is to say about 57 % of respondent's represents tax payers and 23 % represents tax staff and 20 % represents tax experts.

4.8.7 The proper tax exemption limits

The finance Bill 2066 has amended some extent the income tax act. The tax payers are being granted different exemption limits in different fiscal years. To address the changes in exemption limits the respondents were asked a question," What should be the proper tax exemption limits? " They were also provided the two options; prevailing exemption limits for fiscal year 2066/67 as proper limits and other previous years' exemption limit as proper exemption limits. The responses gathered are analyzed as follow.

Table No.4.19

The proper exemption limits

S.No.	Options	Tax staff		Tax Expert		Tax payer		Total %
		No.	%	No.	%	No.	%	
1	(a)Exemption limits of 2066/67	3	9	4	11	12	34	54
2	(b)Previous years' exemption limit	5	14	3	9	8	23	46
	Total	8	23	7	20	20	57	100

Source: Opinion Survey, 2009

Hence, we can conclude from the support of the above table that majority of 54 % of the respondents are in favor of the exemption limits declared in the current fiscal years 2066/67 and 46 % of the respondents have favored previous years' exemption limits practiced before 2066/67. Among the 54 % of the respondents, 34 % of the tax payers were in favor of the high exemption limits which were declared for the fiscal year 2066/67.

Also among 46 % of the respondents supporting the previous year's exemptions limits, the highest 23 % of the tax payers were in support of the exemption limits which were practiced in previous years and detail is shown below.

Table No.4.20

Specified Exemption Limits

Respondents	Individuals Limits	Couples Limits	
	Rs.	Rs.	No.
Income Tax Staff:-			
Total of (a)	160000	200000	**3**
	115000	140000	2
	100000	125000	3
Total of (b)			**5**
Income Tax Payer:-			
Total of (a)	160000	200000	**12**
	115000	140000	5
	100000	125000	3
Total of (b)			**8**
Income Tax Experts:-			
Total of (a)	160000	200000	**4**
	100000	125000	2
	115000	140000	1
Total of (b)			**3**

4.8.8 Achievements of the targets with regard to changes in Income taxation.

A sample of 35 respondents as selected in a large population in metropolitan area to determine their concerns about targets that the Ministry of Finance and Inland Revenue Department are achieving, a question was asked to them with options as achievement higher than targets, achievement lower than targets and achievement equal to the targets, ‘‘Ministry of Finance and Inland Revenue Department are achieving the targets with regard to changes in Income taxation, Are they?”. The responses gathered thereafter are tabulated and analyzed as follow.

Table No.4.21

Achievement of targets with regard to changes in Income Taxation

S.No.	Options	Tax staff		Tax Expert		Tax payer		Total %	Rank
		No.	%	No.	%	No.	%		
1	Achievement higher than targets	4	11	4	11	9	26	48	1
2	Achievement lower than the targets	1	3	1	3	5	14	20	3
3	Achievement equal to the targets	3	9	2	6	6	17	32	2
	Total	8	23	7	20	20	57	100	

Source: Opinion Survey, 2009

The above tabulated and calculated data can be interpreted as, the majority of 48 % of the respondents opine that the Ministry of Finance and Inland Revenue Department are achieving their targets higher than the set targets and 32 % of the respondents respond that the concerned offices are achieving their targets equal to the set targets.

4.8.9. Effectiveness in Income Taxation.

Income Tax system of Nepal has been blamed that it is not efficient enough. In order to know the views about reforms in Income taxation, a question forwarded in the questionnaire was
“Is the changes in Income Taxation of Nepal efficient”? The respondents were provided the options/ reasons for changes to rank them. The responses received were tabulated as follow:

Table No.4.22

Effectiveness in Income Taxation

Respondent Group	I don't Know		Yes		No		Total	
	No.	%	No.	%	No.	%	No.	%
Income Tax staff	1	3	5	14	2	6	8	23
Income Tax Experts	2	6	4	11	1	3	7	20
Income Taxpayers	3	8	8	23	9	26	20	57
Total	6	17	17	48	12	35	35	100

Source:Opinion Survey,2009

From the above analysis, we knew that 48 % of respondents expressed their ideas in support of the effectiveness of the changes in income taxation and only 35 % of the respondents are against the effectiveness of the changes in income taxation whereas 17 % of the respondents are neutral. However, changes always don't give positive meaning to the income taxpayers all the time. Despite its inefficiency due to too many existing problems, the other respondents stated the probable problems as below:

Those who didn't agree with the views mention the reasons of inefficient of income taxation as follows;

- Inefficient tax management
- Inadequate government homework for the amendment of policy.
- Income tax itself is the defective.
- Frequent changes leads to contradiction in policies and practices.
- Uncertain future prospects of Taxation.

4.8.10 There are widespread changes in income taxation in order to minimize corruption in Nepal.

With an objective to gather views on this regard, the respondents were asked a question, "There are widespread changes in income taxation in order to minimize corruption in Nepal" Do you agree with this statement?

Table No.4.23

Minimization of corruption due to changes in Income Tax Act

S.No.	Respondent Group	I don't Know		Yes		No		Total	
		No.	%	No.	%	No.	%	No.	%
1	Income Tax staff	2	6	4	11	2	6	8	23
2	Income Tax Experts	1	3	5	14	1	3	7	20
3	Income Taxpayers	9	26	4	11	7	20	20	57
Total		12	35	13	36	10	29	35	100

Source: Opinion Survey, 2009

Hence, the above analysis reveals that majority of 36 % of the respondent support that the changes made in Income Taxation is efficient to minimize the corruption and other 29 % of the respondent don't agree with the statement whereas 35 % of the respondents don't express their views.

Chi-Square (χ^2) Test:

Under this test we try to find out how far the observed values of a given phenomenon are significantly different from the expected values which is done by comparing the desired value of χ^2 from the formula with the table value of χ^2 for the required degree of freedom depending on the number of observation and level of significance of 5 % normally. In this test, the attributes are classified into a two way table or a contingency table as the case may be. The observed frequency in each cell is known as cell frequency. The total frequency in each row or column of the two way contingency table is known as marginal frequency. This test shows whether there is any association or relationship between two or more attributes composed with regard to the effectiveness of reforms in Income Tax System.

Test of Hypothesis:

Table No.4.24

Test of Hypothesis

Respondents	Yes	No	Total Row
Tax staff	6	2	8
Tax expert	5	2	7
Tax payers	9	11	20
Total column	20	15	35

Null Hypothesis ($H_\circ$): There is no significant difference between views of income tax staffs, income tax experts and income tax payers or their views are independent of each others with regard to reforms in Income taxation.

Alternative Hypothesis (H_1): There is significance difference between views of income tax staffs, income tax experts and income tax payers with regard to the effectiveness of reforms in income taxation.

Test statistic under **$H_\circ$**:

$$\chi^2 = \sum \frac{(O-E)2}{E}$$

Where, O = observed frequency,

E = Expected frequency $= \frac{RT \times CT}{N}$

RT = Row total

CT = Column Total

N = Grand Total = 35

Table No.4.25

Calculation of chi-square $(\chi)^2$

∴

O	E	O-E	$(O-E)^2$	$\frac{(O-E)2}{E}$
6	4.571	1.429	2.0420	.44672
2	3.428	-1.428	2.0391	.5948
5	4	1	1	.25
2	3	-1	1	.3333
9	11.428	-2.428	5.8951	.51584
11	8.571	2.429	5.9000	.68836
Total				2.82902

Calculated χ^2 $= \sum \frac{(O-E)2}{E} = 2.82902$

Degree of Freedom = (r-1) (c-1) = (3-1) (2-1) =2

Level of significance = 5 %

Tabulated value of χ^2 at 0.05 level of significance for 2 degree of freedom is 5.99.

Decision: Since the calculated χ^2 is less than the tabulated χ^2 at 0.05 level of significance, the null hypothesis $H_\circ$ is accepted. Therefore, alternative hypothesis rejected and we can conclude that there is no significant evidence of a relationship between views of income tax staffs, income tax experts and income tax payers with regard to the reforms in income taxation. i.e. The views according to respondents groups vary.

4.9. The Major Findings:

4.9.1 Results of Empirical Investigation

Major findings are stated below:

- The changes in income taxation play significant role for meeting the objectives of the country and the changes are effective. Besides, Income tax has become major source of government revenue.
- The biggest problem that can be produced due to the inconsistency of income taxation is the delay in tax assessment which leads to consume lots of time for revenue collection for Inland Revenue Office. It is because the income tax payers are the main source of tax revenue for the government and they are disturbed to assess their tax liabilities.
- The analysis has revealed that the changes in Income taxation for reforms are highly effective to meet the objectives of the government.
- The survey reveals that the demoralization and discontent among the taxpayers is the main problem caused by frequent amendments in the tax act and tax rules besides increased tax evasion, satisfactory according to government targets and increased inconsistency between Act and Policies.
- The empirical study shows that the majority of the respondents are in favor that the past tax policy were not effective i.e. 41 % respondents opine that past policy were ineffective.
- The survey study reveals that the majority of the respondents' i.e.39 % opines there is less inconsistent in tax policy and tax commitment of tax administration besides frequent changes in income taxation such as income tax rate, exemption limits for reforms in it.
- The opinion survey reveals that the tax payers have shown high participation with this regard that is to say about 57 % of respondent's represents tax payers and 23 % represents tax staff and 20 % represents tax experts.

- The majority of 48 % of the respondents opine that the Ministry of Finance and Inland Revenue Department are achieving their targets greater than the set targets and 32 % of the respondents respond that the concerned offices are achieving their targets equal to the set targets.

- The empirical analysis with regard to the effectiveness of reforms in Income Taxation has shown that the 48 % of respondents expressed their ideas in support of the effectiveness of the reforms in income taxation and only 35 % of the respondents are against the effectiveness of the reforms in income taxation whereas 17 % of the respondents are not known about effectiveness. Those who didn't agree with the views mention the reasons of inefficient of income taxation as follows; Inefficient tax management ,Inadequate government homework for the amendment of policy, Income tax itself is the defective, Frequent changes leads to contradiction in policies and practices and Uncertain future prospects of Taxation.

- There are widespread changes in income taxation for its reforms in order to minimize corruption in Nepal, analysis reveals that majority of 36 % of the respondent support that the changes made in Income Taxation is efficient to minimize the corruption and other 29 % of the respondent don't agree with the statement whereas 35 % of the respondents don't express their views.

4.9.2 Results of Secondary Data Analysis

The Major Results are stated as below:

- The role of income tax has been changing. It was 16.72 % of the total revenue in the fiscal year 2001/02 and 12.63 % in the fiscal year 2002/03; again it increased to 15.26 % in the next fiscal years.
- There has been fluctuating trend in the contribution of income tax from private corporate, public enterprise, individuals and remuneration. The estimated income tax from these

sectors is 16.39 % of the total tax revenue of Rs.1765504 millions for the fiscal year 2009/10. The average contribution rate of income tax was 14.48 % for the past 8years.

- The component of income tax in fiscal year 2058 was divided into three income heads such as employment income, investment income and business income. The main components of the total income tax which contribute to the total government revenue are Income Tax from Public Enterprise, Private corporate, Individuals and Income Tax from Remuneration from the fiscal year 2001/02 to estimates of 2009/10 too.

- If the income tax rate is very high, the taxpayer can’t bear the burden. On the other hand, if income tax rate is low, the objective of the income tax can’t be achieved. That is why income tax rate has been amended frequently.

- Reforms in income tax system are practiced not only in Nepal but in most of the countries of the world. Nepal has adopted progressive tax rate. Exemption limit is an important variable while managing the income tax. For every year, Finance act prescribes the exemption limit for individual, Families, couple and corporations.

- For the fiscal year 2009/10, there are wide changes with regard to the individuals, couples and many others. The first slab of Rs.160000 to 260000 is taxed at the rate of 15 % plus1600 and the second slab of above Rs.260000 is taxed at the rate of 25 % plus 16600 for the individuals. The first slab of Rs.200000 to 300000 is taxed at the rate of 15 % plus 2000 and the second slab of above Rs.300000 is taxed at the rate of 25 % plus17000 for the individuals.

- Total tax revenue, which forms approximately 81 percent of the total revenue mobilization in Nepal, has elasticity co-efficient of 0.50 which is half of the buoyancy coefficient of 1.10. From these results, it can be easily concluded that there is very low automatic growth of the tax revenue reflecting a very inelastic tax structure.

- Those making an income of up to Rs 200, 000 and those doing business transactions up to Rs 2milllion have to pay an accumulated tax of Rs5,000 for this year in metropolitan and sub metropolitan cities. The tax is Rs.2500 in the municipalities and Rs 1500 in the villages.

- Contribution of Inland Revenue on Total Tax Revenue was 64.19 % in the fiscal year 2060/61, 67.56 % in the fiscal year 2061/62, 68.53 % in the fiscal year 2062/63,71.51 % in the fiscal year 2063/64 and73.96 % in the fiscal year 2064/65.

- In present situation, the revenue from the income tax has increasing trend. During fiscal year 2059/60, 81.72 % of the targeted income tax was collected. It was more than targeted income tax collected in fiscal year 2060/61.i.e.109.4 % of the targets. Similarly, in the fiscal year 2063/64, 122.9 % of the targeted income tax was collected. For the fiscal years 2061/62 and 2062/63, 99.55 %and 92.34 % of the targeted income tax were collected respectively.

- Nepal Government has made some reforms in income exemption limits and introduced lump sum tax a mount from the fiscal year 2066/67. Individual having Income up to Rs.160000 will have to pay 1 % tax on his income where as couples having income Rs.200000 will have to pay 1 % tax on their income. Between the income of Rs.160000 to 260000, individual are liable to pay15 % plus Rs.1600 as
  tax and between the income of Rs.200000 to 300000, couples are liable to pay15 % plus 2000 as tax.. Also, aboveRs.260000, individual will be charged 25 % plus Rs.16600 and above Rs.300000, couple will be charged 25 % plus Rs.17000 as tax on their income.

Chapter V
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Nepal government has to play major role in its development and for the sake of which it has to spend a lot of money for fulfilling its responsibility towards the welfare of the its public. The idea of introducing income tax in Nepal originated in the early 1950s when a multi-party democratic political system was introduced. In 1951, the then Finance Minister in his budget speech declared the intention of the government to levy an income tax. Attempts were made to introduce income tax in subsequent years. In 1954, an income tax with Rs.10, 000 basic allowance and progressive taxes ranging from 5 to 25 % was proposed. Due to political instability, it could not be introduced until 1958

The first elected government in 1959 finally introduced Business Profits and Salaries Tax Act, 1960 in Nepal. At that time, income tax was levied only on business profits and salaries. After about three years experience of income tax, the government replaced the prevailing tax Act by income Tax Act, 1962. The coverage was extended in the Act. In 1974, Income Tax Act, 2031 was enacted.

To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend and integrate the laws relating to income tax, the parliament of Nepal enacted Income Tax Act, 2058. This Act has replaced income tax Act, 2031, which was amended for eight times and existed for a period of 28 years. Government of Nepal framed Income Tax Rules, 2059 in 2059 to help clarifying the Act.

Developing countries try to mobilize their internal sources to finance necessary funds for regular and developmental activities. Nepal is not an exception; it reduces the regional economic imbalance by providing tax concessions and tax holidays to the business and industries which are established in remote and backward areas as the compulsory contributions from the persons to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred.

The function of revenue collection has remained one of the key activities of the government from ancient time in Nepal. During that time, very few economic activities were operated on the country. Hence, government could not collect huge amount of money in the form of taxation. At that time, taxes were levied for the merchant, travelers and farmers in the form of cash, kind or labor. In some occasion, gold and agricultural products were also paid taxes but the nature of these taxes was temporary and taxes were raised for special purposes

During the period of Rana Regime, there was not formal provision for imposition and collection of taxes. Taxes were imposed according to the objectives, needs and whims of the ruling the Prime Minister. There was not provision of separating the personal income of prime Minister and state treasury. There was not system of preparing government budget. The surplus of revenue over expenditure was considered the personal income of Rana Prime Minister. The income tax act and the rules come into existence in different ways. As any other law the income tax act has to pass the parliament through Finance Act/Ordinance Constitution, Income Tax Rules and Provisional Tax Realization Act.

There is interrelationship between Income Tax Act and decisions of the court. The Supreme Court often interprets the unclarified matters of the Act. Such decisions of the court are known as precedents. Until and unless such unclarified matters are clarified in the Act, the precedents of the court will be enforced as laws. Some Amendments have been made by Finance Bill 2066 and others. Income tax system of Nepal has been facing serious managerial problem. In Nepal, the evasion of income tax is more pronounced especially by the people of high income business class. Taxpaying habits and tax consciousness are very low; so many problems frequently arise in tax collection phase.

Tax composition of Nepal shows that the Government of Nepal highly depends on direct and indirect tax. People in developing nations tend to have greater propensity to evade taxes. This is because they have lesser knowledge about income tax, and they have to maintain their livelihood from their limited income. The rich people used to avoid taxes by recourse to legal loopholes and taking advantage of an inefficient tax management. The tax management personnel are provided many discretionary powers which encourage them for corruption. Income tax management is not so efficient. It is not free from problems. There are less integrated programs for taxpayers' education, guidance and counseling. Tax Officers are looked upon as heaven for corruption, inefficiency, delays, unfair dealings, harassment and incompetent personnel. The assessment procedure of income tax is not effective. Undue delay in tax assessment not only reduces the total revenue but also bring harassment to the taxpayers.

Income tax is not collected properly and tax collection expenditure is increasing per year. Because of the absence of proper knowledge of tax system, Nepalese taxpayers do not make tax planning. Tax evasion and avoidance are increasing tremendously. Taxes are imposed at two levels in Nepal. Government of Nepal (Central Government) levies taxes nationwide whereas the local governments levy locally in different forms. Every year Government of Nepal tables the Finance Bill in the parliament to impose tax.

Administratively the income tax act is based on a self-assessment system. That requires the taxpayer to calculate the tax by himself using the income tax forms prescribed by the tax administration. The tax authorities have basically to accept the taxpayer’s declaration. Only if the tax administrators find reasons for a change of what the taxpayer has declared they should amend the taxpayer’s statement. Income tax rules are in place binding the tax authorities as well as the taxpayer and guide the taxpayer on how to handle specific tax matters. If the taxpayer wants to object to a decision of the tax administration the income tax act makes it mandatory for him to, first, file an objection with the Inland Revenue Department for review, second, appealing to the Revenue Tribunal, if he is not satisfied with the review decision. The new income tax act has consolidated all the income tax related provisions provided by other acts while minimizing the exemption level and thus widening the tax base.

5.2 Conclusion

Through the hypothesis testing, it has been concluded that there is evidence of dis-similar relationship between views of income tax staffs, income tax experts and income tax payers with regard to the reforms in income taxation i.e. the views according to respondents groups vary.

The Study has concluded that Income tax act has to be passed through the parliament by Finance Act/Ordinance Constitution, Income Tax Rules and Provisional Tax Realization Act to get amended. Every year Government of Nepal tables the Finance Bill in the parliament to impose amendments in tax.

The tax authorities have basically to accept the taxpayer’s declaration. Only if the tax administrators find reasons for a change of what the taxpayer has declared they should amend the taxpayer’s statement. Income tax is not collected properly and tax collection expenditure is increasing per year. Because of the absence of proper knowledge of tax system, Nepalese taxpayers do not make tax planning. Tax evasion and avoidance are increasing tremendously

The study concludes that there are less integrated programs for taxpayers' education, guidance and counseling. Tax Officers are looked upon as heaven for corruption, inefficiency, delays, unfair dealings, harassment and incompetent personnel. The assessment procedure of income tax is not effective. Nepal Government has made some reforms in income exemption limits and introduced lump sum tax amount from the fiscal year 2066/67.

In present situation, the revenue from the income tax has increasing trend. Total tax revenue, which forms approximately 81 percent of the total revenue mobilization in Nepal, has elasticity co-efficient of 0.50 which is half of the buoyancy coefficient of 1.10. From these results, it can be easily concluded that there is very low automatic growth of the tax revenue reflecting a very inelastic tax structure. For the fiscal year 2009/10, there are wide changes for reforms with regard to the tax affairs for individuals, couples and many others. And for every year, Finance act prescribes the exemption limit for individual, Families, couple and corporations. That is why income tax rate has been changed frequently.

Through the Analysis of the study, it has been concluded that there has been fluctuating trend in the contribution of income tax from private corporate, public enterprise, individuals and remuneration. The role of income tax has been changing.

There are widespread changes for reforms in income taxation in order to minimize corruption in Nepal. The majority of changes made in Income Taxation are efficient to minimize the corruption. The majority of respondents expressed their ideas in support of the effectiveness of the changes in income taxation. Those who didn't agree with the views mention the reasons of inefficient of income taxation as follows; Inefficient tax management, Inadequate government homework for the amendment of policy, Income tax itself is the defective, Frequent changes leads to contradiction in policies and practices and Uncertain future prospects of Taxation.

The study has concluded that the majority of the respondents have opined that the Ministry of Finance and Inland Revenue Department are achieving their targets greater than the set targets. The tax payers have shown high participation with this regard that is to say about 57 % of respondents' represents tax payers and government of Nepal has also declared fiscal year 2066/67 as Tax Participation year. The majority of the respondents i.e.39 % has opined that there is less inconsistent in tax policy and tax commitment of tax administration besides frequent changes in income taxation such as income tax rate, exemption limits.

The Study has concluded that the majority of the respondents are in favor that the past tax policy were not effective. The demoralization and discontent among the taxpayers is the main problem caused by frequent amendments in the tax act and tax rules besides increased tax evasion, satisfactory according to government targets and increased inconsistency between Act and Policies.

The biggest problem that can be produced due to the inconsistency of income taxation is the delay in tax assessment which leads to consume lots of time for revenue collection for Inland Revenue Office. The changes in income taxation for reforms play significant role for meeting the objectives of the country and the changes are effective according to the Research study.

5.3 Recommendation

On the basis of the findings mentioned above as conclusion, the study finds the scope of recommendation in the following areas as follows:-

Every year Government of Nepal tables the Finance Bill in the parliament to impose amendments in tax matters, it should consider the changes in income taxation which can play significant role for meeting the objectives of the country and the changes should be highly effective. The tax authorities have basically to accept the taxpayer's declaration. Only if the tax administrators find reasons for a change of what the taxpayer has declared they should amend the taxpayer's statement. Tax administration is recommended to minimize the tax related crime of tax evasion and avoidance with proper tax collection and minimizing tax collection expenditure to make changes in taxation effective.

The concerned tax administrations are recommended to promote and expand integrated programs for taxpayers' education, guidance and counseling. Government must be able to create positive view with regard to Tax Officers duties as they are looked upon as heaven for corruption, inefficiency, delays, unfair dealings, harassment and incompetent personnel in previous years. The assessment procedure of income tax should be made effective.

Nepal Government should make some changes for reforms in income tax matters according to the requirements of country's needs. In present situation, the government should attempt for the increasing trend of revenue from the income tax. Total tax revenue, which forms approximately 81 percent of the total revenue mobilization in Nepal, should have high elasticity co-efficient of the buoyancy coefficient. From these results, it can be easily recommended that there will be high automatic growth of the tax revenue reflecting a very elastic tax structure.

For every year, concerned tax administration should made changes through Finance act which prescribes for the income tax act amendment. That is why income tax rate has to change frequently.

Government should be able to properly manage fluctuating trend in the contribution of income tax from private corporate, public enterprise, individuals and remuneration and many others. The role of income tax has to be changing and income tax base should be widened. Government should made widespread changes in income taxation in order to minimize corruption in Nepal and changes made must be efficient to minimize the corruption. It must gather expressed ideas in support of the effectiveness of the changes in income taxation.

Government should properly tackle the reasons of inefficient income taxation such as inefficient tax management, inadequate government homework for the amendment of policy, defective Income tax, Frequent changes leads to contradiction in policies and practices and uncertain future prospects of Taxation.

The Ministry of Finance and Inland Revenue Department are achieving their targets greater than the set targets and such tax collection must be properly utilized for the concerned development activities of the country. The government is highly recommended to make proper initiation and promotion of tax participation i.e. the tax payers should willingly show their high participation with this regard. There should be low degree of inconsistency in tax policy and tax commitment of tax administration besides frequent changes in income taxation such as income tax rate, exemption limits. The government is fully liable to make its tax policy more effective.

The demoralization and discontent among the taxpayers is the main problem caused by frequent amendments in the tax act and tax rules besides increased tax evasion, hence the government is recommended to seriously consider such effects. The government should pay due respect to the biggest problem that can be produced due to the inconsistency of income taxation, delay in tax assessment which can lead to consume lots of time for revenue collection for Inland Revenue Office.

In order to increase in tax revenue, voluntary compliance should be made effective, rampant must be checked and efficiency of tax administration should be increased. In revenue mobilization front, controlling revenue leakages and increasing tax compliance, widening tax net, controlling under-invoicing in custom operation and encouraging issuing the value added tax invoices are some of the existing challenges ahead.

If the government does not make any effort to mobilize the internal resources, its revenue may not be sufficient even to meet the regular expenditure.

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APPENDIX-A

Cover Letter

Dear Sir,

First of all, I would like to introduce myself as a student of Shanker Dev Campus, Master in business Studies (MBS) final year. I am going to prepare a dissertation entitled "A Study on The Reforms in Income Tax System and Its effectiveness in Nepal" to fulfill partial requirement of Master's Degree of Business Studies of Tribhuvan University of Nepal.

I have sent this questionnaire to spare some of your valuable time to provide your suggestions and opinions concerning with income tax system and its reforms in Nepal, which will be very useful and guide me for completing my study. I would be very much appreciated if you could provide your important time for filling this questionnaire.

I assure to keep every detail you provide me confidential.

I am looking forward to your co-operation and support with many thanks as soon as possible.

Yours Sincerely,

Bikram Thapa

Appendix- B

Questionnaire Models Distributed to respondents.

Name:…………………. Designation………………

Office/ Organization……… Occupation……………….

Please tick (√) the answer of your choice or wherever appropriate, put rank in order of preference from one to last number of alternative.

1. The Reforms made in income tax system play significant role for meeting objectives of the country, Do you agree?

Yes { } No { } I don't know { }

2. Is the change in income taxation of Nepal efficient?

Yes { } No { } I don't know { }

3. If no, rank the reasons provided below within the scale of 3, 3being the most important one and so on.

i. Frequent changes lead to contradiction in policies. { }

ii. Brings inconsistency in practices. { }

iii. Uncertain future prospects of taxation. { }

4. What are the major problems caused by the inconsistent income tax policy? (Rank answers within the scale of 5, 5being the most important one and so on.)

i. Misuse of power by tax administrator { }

ii. Uncertainty of employee training and requirement. { }

iii. Bewilderment in power and responsibilities. { }

iv. Loss of awareness of tax payers. { }

v. Delay in tax assessment.{ }

5. Do you think reforms in income tax system have been effective in fulfilling objectives of government? (Rank your answer within the scale of 3, 3being the most important one and so on.)

i. Highly effective { }

ii. Fairly effective { }

iii. Less effective { }

6. What should be the proper tax exemption limits?

i. Prevailing exemption limit for fiscal year2066/2067

ii. Other prescribed limits from previous years (Please specify)

a. Individual limits Rs……..

b. Couple limits Rs………..

7. There are widespread changes in income taxation in order to minimize corruption in Nepal. Do you agree with this statement?

Yes { } No { } I don't know { }

8.What will be the effect of frequent changes in tax slab amount, tax rates, exemption limits etc on the tax payers?(Rank in scale of 4)

i. Increased tax evasion

ii. Discontent and Demoralization of tax payers

iii. Satisfactory according to government targets.

iv. Increased inconsistency between Act and policies.

9. Weren't past Tax Policy effective in favor of tax administration?

Yes { } No { } I don't know { }

10 Tax administration or IRD office is not achieving their objectives, Is it?

Yes { } No { }

11. Is there any inconsistency in tax policy and commitment of tax administration?

i. Highly inconsistent.

ii. Less inconsistent

iii. Fairly inconsistent

12. Ministry of Finance and Inland Revenue Department are achieving the targets with regard to changes in Income taxation, Are they? (Rank the answer)

I .Achievements higher than targets

ii. Achievement lower than targets

iii. Achievement equal to targets.