

CHAPTER I

INTRODUCTION

1.1 General Background

Nepal formally becomes a republic on May 28, 2008. Along with the change in the political spectrum, the prospects and challenges in the realm of economic development have started to be realigned in the sharper focus. In conjunction with the change in the political outlook, the change of making the economic transformation process dynamic and raising, on a sustained basis, the standards of living of the people in general through fully capitalizing on the available strengths and opportunities constitutes priority agenda of the national economic management exercise. This would call for the Objective analysis, assessment and knowledge as to the economy's current trend, structure, outcomes potentialities and challenges for steering the necessary policy directions and management responsibilities, facilitating the development process, and institutionalizing the visions of the future development strategies.

Economic development is the prime concern of every nation of the world. It is an economic tools to show or measure one's strength and power. We can say that it is a ray of achievement and prosperity. Because 'economy' is the main element of the development system. Without the proper improvement in the economy the development can't march towards the achievement of the goal. Therefore economy is the main element of the countries development goal. If there is minimum fall in the economy it needs a proper feedback mechanism to improve the system. So economic development is the strength of the nation. Now a days Nepal is not exception to this ever continuing process, aimed at the betterment of her people and society. Because economic prosperity is the mechanism which helps to operate the development projects in the nation such as infrastructure, electricity, communication, education, security, water distribution, medical facility etc. So, to fulfill these basic needs of the nation economic development must be done.

Because to fulfill these responsibility, government has to spend a lot of fund. It should spend for the fulfillment of common benefits of the people and operation of various socio-economic programme. There are three types of expenditure which are incurred by the government i.e. protection, commercial and public expenditure. If the nation has sufficient fund it will be able to achieve maximum social welfare. So demand of the fund is increasing day by day to meet these development projects.

Nepal is a small landlocked country with an area of 1, 47,181 sq. km. and around 26.44 million population lies between two large neighboring economics India and China witnessed an Impressive growth by 9.2 and 11.2 percent in 2007 respectively. Nepal a low growth economy with a lower per capita income in the region, Higher economic growth has been attain in FY2007/08 compared to the last few years. The economic growth is estimated to have been expanded by 5.56% at the basic price and per capita income of US\$ 320 in fiscal year 2007/08 with the country ranking 142nd out of 177 countries in the United Nation Development Program's human development index. This position is lowest among the SAARC countries. So it indicates that our nation is facing major economic development problem because economic development of the nation is directly related with human development. So it needs to be more concentrate in the economic development of the nation. Because of increasing population, inflation and security expenses the government has to manage huge amount of fund.

So for the economic development of the nation through investment in productive sector the government needs fund to operate it's essential projects. Basically the government manages its required funds from external and internal sources. External source of funds is from foreign grants and loans. Such external sources are uncertain, inconvenient and not good for healthy development of the nation if we heavily dependent on them. Because grants and loans are burden that we have to repay with certain interest after a limited time period. Though internal source mobilization is the best option to finance resources. Internal source of

fund includes both tax and non-tax. Tax sources include the amount which are compulsorily contributed by taxpayers to the government in the form of direct tax (Direct tax is really paid by the person on whom it is legally imposed e.g. income tax, property tax, gift tax etc.) and indirect tax (indirect tax is imposed on one person but partly or wholly paid by another e.g. VAT/sales tax, entertainment tax, custom duties, excise duty etc.). Non-taxes sources are imposed as per need of the government in the form of fees, fines, penalties etc. It shows that taxes are the better source of public revenue and it has been taken as the best effective tool for raising the public fund rather than non-tax sources. Tax is the main source of financing government activities. In every country, the largest part of the government revenue is raised through taxation. According to the Seligman, "Taxation is the compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred. Therefore it is clear that tax is a compulsory levy and the taxpayer does not have any right to receive direct benefit from the tax paid. It is spent by the government for common benefits and interest of the people and nation. Thus its importance cannot be ignored on the overall policy scheme of the government of the developing economy. Taxes are not voluntary purchase payments but mandatory impositions, payable in line with whatever tax statute has been legislated.

In current phase Nepal government has facing critical problem of rising domestic i.e. internal resources and this problem is getting quite serious. This is definitely on alarming situation and needs serious attention of the government because lack of sufficient financial resources it puts a heavy break on the overall development of the nation. Tax system is only mechanisms which regulates and make strength the internal source of government to generate revenue for the development of the nation. "A tax system is composed of three interrelated and interacting parts they are: policy, law and administration. Tax policies must be formulated carefully with reference to the national development objectives. Policies should be cast in the technical requirement of laws. Tax laws should be implemented by the administrators. In the relationship between these three

variables, tax policy provides the design of the legal structure, and the legal structure is the framework on which an effective tax administration must be built. This requires that tax planners, legal experts and tax administrators should not only work closely but also be involved in each of the progressive steps from the very outset of a tax concept" (Agrawal, 1978: 38).

A tax system must strive to achieve a balance between tax policy, law and administration. So it shows that sound tax policy, simple tax laws, effective tax administration and climate of tax consciousness leads the economic development of the nation, i.e. they are the core measures of effective tax system for the economic development. Tax system is the sub-system of total economy. Tax policy is changed with the change in economic policy of a country. Change in world economics policy and advancement in information technology has a vast impact on Nepalese economy too. Small economies like Nepal have to adopt the economic policy followed by World Bank. International monetary fund, Asian Development Bank and other international agencies. Especially, after 1990s, there is reemergence of the liberalization globalization and privatization system that focuses on the minimum intervention of the state on private economic matters. The 1950s concept of 'high incentive, high tax rate' is changed to the concept of 'low rate, wide net', this tends in tax system is followed by most of the countries of the world. Nepal is also not an exception in this respect and Nepalese administrators and policy makers too have tried to change the tax policy of the country. Income tax act 2058 is the result of the change in all these matter. Before this act, income tax act, 2031 was enacted. Since 19th Chaitra 2058, income tax act, 2058 has been introduced in Nepal. This act was brought in Nepal to avoid the following defects of income tax act, 2031.

- a. Narrow base of tax
- b. Taxing only the income originated in Nepal
- c. Dispersion of tax related acts i.e. income tax related provision were given in different acts.
- d. Low penalty to tax evaders.
- e. Incompatible to self assessment system and

f. Unsuitable to modern economy.

In Nepal, there are various problems to collect tax although the legal provision has been made and updated timely. There are various problems in income tax practices in Nepal such as: narrow coverage, unscientific tax assessment, deviation from the basic principles of income taxation, long-time-lag, no adjustment for inflation defective system from the perspective of international taxation. Some others feeling of people about tax as a penalty, leakage in tax, lack of tax consciousness of people, inability of tax administration to cover new taxpayer, delay in computation and collection system etc. Therefore it shows that tax administration is the top most part of the tax system because all other efforts may prove futile and may even bring disrepute to the fiscal authority if tax administration is weak. It is easy to formulate tax policies but much difficult to administer them. So the taxation laws and policies must be clearly written should provide minimum room for discretion.

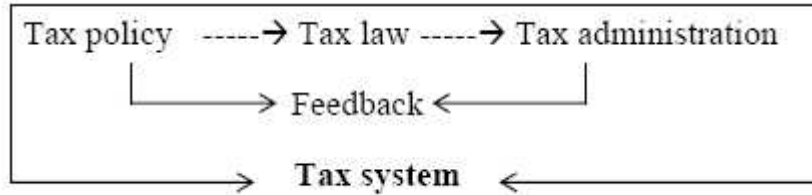
1.2 Statement of Problem

Economic and industrial enhancement is the core vision of every nation. It is a top priority for the development of nation and regarded as the life blood of the country for the betterment of the people to make their living standard high. But under developed countries are facing various problems in the process of economic development, due to lack of sufficient resources. To achieve desirable goal of the nation it needs huge amount of revenue. But our nation is facing the serious problem of resource gap ($\text{Resource Gap} = \text{Expenditure} - \text{Revenue}$). "The main reason for this growing resource gap is the lop-sided growth of government expenditure as compared to revenue generation from domestic sources. The main cause of resource gaps are significant increases in both regular as well as development expenditure of the government, increasing cost of maintenance, debt servicing burden and rising rate of inflation.

The problem of resource gap may be financed by foreign loans and internal borrowing. From the various economy surveys it indicates that our country has

been highly depending on foreign loan and internal loan. These increasing trend of resource gap make known that additional mobilization of internal resources is urgently needed, therefore to rise government revenue to solve the core problem of resource gap it is necessary to raise its internal sources of revenue. Due to some problem the internal sources of revenue has not been generating as per expectation. Such as poor utilization of natural resource base, small and stagnant industrial sector, partial magnetization of the economy, poor performance of public sector enterprises, poor rate of economic growth, inadequate tax efforts, lack of adequate and reliable data base, unwanted pressure from vested interest group and deficiencies in tax policies, laws and administration.

So, to solve the problem of resource gap, domestic resource mobilization is best option but without active performance of tax administration this goal can't be grabbed. Tax policy is the framework for the formulation of better tax law though tax administration is the centre point of this tax system i.e. composed of three interrelated and interacting parts: policy, law and administration which implement this tax laws and policy for the betterment of tax system. By the help of which our nation can generate reliable revenue and our problem of resource gap could be minimize. The ability of tax system in mobilizing additional resources, therefore, will act as the main determinant of the level of public expenditure in Nepal. Therefore objective based tax policies, simple and clear tax laws as well as effective tax administration, staffed by competent personnel and supported by appropriate technology will facilitate for the formulation of effective tax system. But the tax system of Nepal has not been far from the problem of adequate planning of tax policies on a long term basis, lack of stability in tax policies and poor tax administration capability as well as general lack of tax consciousness in people, the tax system of Nepal has not been operating in desirable way. So, it needs improvement in the feedback mechanism which makes this system reliable and effective.



1.3 Objectives of the Study

As income tax contribution is height in our national revenue for the economic enhancement and to reduce resource gap. The main objectives of this study are as follows:

1. To examine the income tax administration in Nepal.
2. To find out the course of corruption and evasion under income tax system.
3. To find out the contribution of income tax to government revenue in Nepal.
4. To analyze the ways and means for increasing tax consciousness in the public.
5. To provide necessary suggestions and recommendations.

1.4 Scope of the Study

As stated earlier, for the mask tax environment, the role of tax system is very important; income tax is the major part of the government revenue. Though, if we analyzed and find the major strength and loopholes in the income tax system, the government revenue could be March towards flourishing trend. We know that income tax system is formulated form the combination of sub-systems. Income tax policy, income tax act, and income tax administration. Where income tax administration plays the vital role.

So, this study aims to find out the administrative aspect of income tax system and its legal aspects. It also find out the course of corruption and evasion under income tax system. Apart form these the study also conducted to find out contribution of income tax to government revenue and historical prospective of income tax in Nepal.

1.5 Need of the Study

For the economic development of the country, contribution of proper income tax system is more essential. But the income tax system in Nepal is dominated by traditional concept and lack of far sighted. Within Income tax system income tax administration plays a significant role. But it is unpleasure to quote that this contribution of income tax administration for the musk tax environment in Nepal has not achieved its goal as desired. To increase its potential for the improvement of income tax system and implementation of income tax laws and policies for the achievement of desired goal, research and analysis should be done in the field of income tax system.

1.6 Limitation of the Study

As every study is followed by some limitations, this study is also not free from limitation. The limitation of this study can be pointed as follows:

-) The views of respondents are collected only from Kathmandu valley.
-) Few samples have been selected from opinion survey considering time.
-) Tax is a complex system though, effectiveness of income tax system is mainly taken as research matter.
-) Due to time constraint the research is not carried out as desired.

1.7 Organization of the Study

The present study has organized in five different chapters. **The first introduction chapter** includes background of the study, statement of Problem, objectives of the study, scope of the study, need and significance of the study, limitations of the study and organization of the study.

The second chapter review of the literature is done to know what research had been done in the related topic in previous days what it to be done at present or in future. This chapter has been divided into two main aspects: (1) conceptual framework (b) review of related materials i.e. review of books, review of thesis, review of newspapers, magazine, journals etc.

Research methodology is mentioned in the **third chapter**. It includes research design, population and sampling, sources of data, procedure of data collection and tools used for analysis.

Detail information regarding income tax Administration in Nepal and presentation and analysis of data has been made in the **fourth chapter**. The data collected from various sources have been tabulated in their sequential order and data have described, analyzed and projected with statistical tool as well as general accounting and taxation principle.

The **fifth chapter** consists of brief summary, conclusions and recommendations of the study. Lastly, essential appendices, bibliography have been presented at the end of the study.

CHAPTER II REVIEW OF LITERATURE

2.1 Conceptual Framework

2.1.1 Concept of Tax

Economic development and enhancement is the prime concern of every nation. To achieve this goal government of the nation has to operate various development projects in nation. Government has to spend a lot of fund in the field of education, construction, electricity, health, communication, security etc. In order to carry out these projects the government needs sufficient fund. So, the government collects revenue from different sources such as tax revenue form public enterprises, special assessment, fees, fines, penalties grants and loans etc. Among these sources tax is the most important and reliable source for the government revenue. The government revenue can be classified into two categories (a) Taxable (b) Non-taxable. Whereas taxable source is more important than non-taxable. Because taxable source occupies most important place in the government treasury. Because of importance of this source in revenue mobilization of country, some people like to say tax as the sinews of the state.

A tax is a compulsory levy and these who are taxed have to pay the sums irrespective of any corresponding return of services or goods by the government. It is a personal obligation to pay tax and there is no direct relationship among tax, benefits, and individual taxpayers.

According to Adam Smith, the father of political economy, "A tax is a contribution form citizens for the support of the state" (Goode, 1984).

According to Professor Saligman, "A compulsory contribution form a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred" (Lekhi, 2000: 146).

According to Plehn, "Taxes are general contribution of wealth levied upon person natural or corporate to defray expenses incurred in conferring common benefit upon the residents of the states" (Dhakal, 1998: 2).

From the definition given above, it makes clear that tax is a compulsory levy and those who are taxed has to pay it without getting corresponding benefit and services or goods from the government. The primary purpose is to divert control of economic resources from taxpayers to the state for its own use or transfer to other for public welfare as a whole.

2.1.2 Classification of Taxes

There is variation in classification of taxes between economists and tax accounts. The major classification of tax may be direct taxes, indirect tax, progressive taxes, proportional taxes, regressive taxes, degenerative taxes, multiple taxes, single taxes etc. however taxes are broadly classified into two groups: Direct tax and Indirect tax.

Direct tax

Direct tax is a personal tax and both impact and incidence of tax is borne by the taxpayer. There is no possibility of forward and backward shifting. SO, full burden of tax is borne by the same taxpayers. According to Dr. Dalton, 'A direct tax is really paid by the person to whom it is legally imposed.' In the world, most of the developed countries generate $\frac{3}{4}$ th of their internal revenue form direct taxes and out of which income tax is the major component. In Nepal, contribution of direct taxes to the total tax revenue accounts about 26.68%. Examples of direct taxes are income tax, gift tax, interest tax, property tax, vehicle tax, house and land tax etc. direct tax is equitable, certain, elastic and economic also. Direct tax creates public awareness by inspiring to assess the utilization of Revenue paid by them whether in productive sector or not. In another font, direct tax has some demerits as well. As the impact and incidence of direct tax is to be borne by same person may fill economic burden, inspiring the possibility of tax evasion. As the taxpayers feel the burden of tax imposed by government directly there may be tax-evading attempts. There may be lack of mass participation and it may discourage saving and investment in the economy.

Indirect tax

Indirect tax is the tax collected from other persons by transferring the tax liability, by the taxpayers. The taxpayer transfers the burden of tax to other in the society partially or fully. It is imposed on one person but the incidence of the tax is borne by another person through backward and forward shifting processes. In the case of indirect tax, the person paying the tax and the person bearing the burden of tax is different. Value Added Tax, hotel tax, entertainment tax, excise duty, export and import duties etc are the examples of indirect tax. Nepal is heavily relying on indirect tax revenue, which seems to be approximately 79% of total tax revenue (Surendra Keshar Amatya, Bihare Binod Pokhrel and Rewanta Dahal, Taxation in Nepal, 2004).

2.1.3 Objectives of Tax

Tax is one of the best means to collect the government revenue for the economic development and to meet day-by-day expenses of the nation. Developed as well as developing nation generates revenue through taxation. The main objectives of tax are: (Bhattarai, Koirala 2064).

i. To raise more revenue

The government requires carrying out various development and welfare activities in the country. For this, it needs a huge amount of funds. The government collects fund by imposing taxes. So, raising more and more revenues has been an important objective of tax.

ii. To prevent concentration of wealth in a few hands

Tax is imposed on persons according to their income level. High earners are imposed on high tax through progressive tax system. This prevents wealth being concentrated in a few hands of the rich. So, narrowing the gap between the rich and the poor is another objective of tax.

iii. To redistribute wealth for the common good

Tax collected by the government is expended for carrying out various welfare activities. In this way, the wealth of the rich is redistributed to the whole communities. Tax helps in redistributing wealth in the country.

iv. To boost up the economy

Tax serves as an instrument for promoting economic growth, stability and efficiency. The government controls or expands the economic activities of the country providing various concessions, rebates and other facilities. The effective tax system can boost up the economy.

v. To reduce unemployment

The government can reduce the unemployment problem in the country by promoting various employment-generating activities. Industries established in remote parts and industries providing more employment are given more facilities. As a result, the unemployment problem can be reduced to a great extent through liberal tax policy.

vi. To remove regional disparities

Regional disparity has been a chronic problem to the developing countries like Nepal. Tax is one of the way through which regional disparities can be minimized. The government provides tax exemptions or concession for industries established activities carried out in backward areas. This will help increase economic activities those areas and ultimately regional disparity reduces to minimum. (Bhattarai, Koirala, 2064)

2.1.4 Cannons of Taxation

There are different views regarding the requirements in a good tax system. Adam Smith view in this respect is generally accepted as the characteristics of a good tax system. The cannons that are given by Adam Smith are as follows: (Kandel, 2003).

i. Cannon of equality

One of the Adam Smith's cannon of taxation is the cannon of equality emphasizing on paying the tax on the basis of the ability to pay. In the words of Adam Smith himself,

"The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities."

Canon of equality says that the people should contribute to the government as per the benefits that they get from the government.

ii. Canon of certainty

Another quality of a tax system as laid by Smith is the canon of certainty. Certainty, in the words of Smith, is related to the time, method, manner and quantity of paying the tax. In his own words,

"The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person."

iii. Canon of simplicity

Simplicity is another quality that should be in a tax system. Most of the taxpayers are ordinary people who neither have sufficient tax-related knowledge nor the capacity to hire tax experts. That is why the tax system should be of such type that can be followed by ordinary people in the society. In this respect, Adam Smith says,

"Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay."

iv. Canon of economy

Adam Smith says, "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible. Over and above what it brings into the treasury of the state."

That means, the cost of collecting the tax should be very small. There should be minimum difference between the amount that people take out of their pocket to pay tax and the amount that actually goes to the state treasury.

Besides the above stated canons of taxation given by Adam Smith, there are others too developed by other economists. These canons given by other economists are as follows:

v. Canon of productivity

Canon of productivity says that every tax system should be revenue productive. It means that there should be those taxes only, which provide adequate revenue. Taxes that do not provide sufficient revenue should be withdrawn.

vi. Canon of flexibility

Flexibility indicates two things. First, a tax system should have the characteristics of revenue elasticity. There should be built-in tie-up between the economic activity of a country and revenue mobilization. Higher the economic activity, higher will be the revenue. Second, the tax system should be of that type which provides revenue as per the necessity of the situation. If there is need of higher revenue, the tax system should provide as per the needs.

vii. Canon of diversity

Tax system should not totally depend on one source of revenue. It is risky to the government to depend upon only one source. That means the sources of taxation should be diversified as far as possible. This principle says that tax should be levied on various stages and various sources. There should be multiple taxes in place of single tax. Similarly, a tax system should be of that type, the burden of which is diversified on the people of different walks of life.

viii. Canon of simplicity

Simplicity means understandable. The tax system should be simple to understand and application in public life. A complex tax system creates unnecessary hassles. Simple tax system with higher tax rate induces the taxpayer to compliance.

ix. Canon of uniformity

Uniformity in this context means uniformity in depreciation system, tax rate, stock valuation system, accounting method, dividend distribution system, accounting system, appeal and penalty system, method of payment of tax and time of the payment of tax (Kandel, 2003).

2.1.5 Historical Background

The history of the taxation is as long as the history of man. According to Dr. Govinda Ram Agrawal "Taxation is as old as time itself."

In early days, taxes were collected by tribe rulers, community heads etc. for communal services rendered and as a contribution to communal resources for times of emergencies. These taxes were in the form of cattle, food grains, animal

skin and labor etc. If we go through Vedas, we will find that the work of the king was to serve and secure people, maintenance peace and other social work. To perform these works, he used to take cattle from animal products crops from agricultural Producers and gold, silver, copper etc. from trade. If we overview the ancient Hindu tax system we will find that this tax system was based on the theory like such as the water of the earth goes in the sky from the heat of the sun and latter it rains again on the earth. Similarly, the duty of the king was to tax people and to spend the taxes amount for the welfare of the people. According to K.P. Jayaswal, "The Hindu theory of taxation is of immense importance from the constitutional point of view, taxes had been fixed by law and scales had been embodied in the scared common law. The consequences was that whatever the form of government, the matter of taxation was not an object of ruler's caprica. No friction could therefore legally arise between the crown and the people on the question of taxation" (Jayaswal, 237, 238). In these days, the people were eager to pay tax because they thought not paying the tax was a great sin. At that time, there was not the problem of leakage of tax.

According to K.P. Jayaswal, "Even those practicing austerities in it to the king. It is the share of him who projects them" (Jayaswal).

The people were taxed only in those businesses which were profitable. The tax system was based upon the ability of the people to pay.

If we go to the western hemisphere, the early Romans were bound to pay pool tax too. Tax was levied on the people who have polling rights. "Ancient Athens used to derive its revenue from taxes like customs, sales and poll tax on aliens and slaves. One who was taxed and failed to pay was guilty of a capital offence" (Encyclopedia International, 1975). After the end of the Punic war Romans were relieved from the poll tax. Emperor Augustus introduced land and inheritance tax. Juices Caesar was the first ruler to collect tax through government institutions. At the time of Jelius Caesar he levied 1% sales tax.

In early days the tax was collected by middlemen. But under the Caesarean regime it was the duty of civil servants to collect the taxes. King Johnn (1967-1216 A.D.) tried to enlarge royal income with new levies. It causes

the struggle between king and barems. Then the principle that taxes are to be imposed only with the concept of the governed" was developed.

We can classify the history of taxation in Nepal in the following manner.

- a. Taxation in ancient Nepal.
- b. Taxation after unified Nepal.
- c. Taxation in Rana regime.

2.1.5.1 Taxation in Ancient Nepal

Reliable records about taxation in ancient and medieval Nepal are not available. However, taxation takes its earliest form in the actions of petty rules, scatted in various parts of the country which extracted levies and to us form the travelers and merchants. Although land tax was the major source of revenue in ancient Nepal, there did exist irrigation tax and religious moments preservation tax in the time of king Amsuvarma of Nepal. There was tax for purification of castes as well as cremation of the dead.

In ancient Nepal, taxes were levied in the form of kind, cash and Labour. Specific portions of agricultural produce were payable to the king as tax. There also existed tax payable in gold. Fixed taxes were levied in the villages. Compulsory manual work form all artisans and labourers was also a common way of paying taxes. The nature of taxation was temporary and taxes were raised for special purposes (Agrawal, 1980: 42).

2.1.5.2 Taxation During Unified Nepal (1768-1816)

During the period 1768-1816, the major sources of revenue in Nepal were land and homestead taxes, monopolies customs, transit and market duties, mines and mints, and export of forest produce, birds, animals and various levies and fines. Maximization of revenue was the main objective of the tax policies during that period. Local administrators were directed "To take whatever is paid willingly by the people." The taxes were usually collected at three levels.

- a. Royal palace: to finance occasional and ceremonial needs. The taxes were broad based and progressive.

b. Government: to finance administrative, military and other purpose, assessed on official functionaries, occupational groups and other people.

c. Local: Perquisites of local officials, functionaries, collection of customs, transit and excise duties were given on contracts. In some parts of terai, taxes were collected at specific rates on jewelers, textiles, falcons, horses, elephants, homespun cloth, yarn, blankets, borax, wax copper, iron, paper, tobacco, herbs, drugs, cotton, salt, yak's tail, musk, sheep and goats. Levying duties on timber exports was revenue from forests.

The various taxes levied during that period were narrow in base and were imposed primarily on occupations and economic activities, not on income or property. The system of direct taxation was confined to land tax and special levies like "darshan-bhet", "salami", "walak," etc. There was no taxation of income in the modern sense of income tax.

2.1.5.3 Taxation During Rana Regime in Nepal (1847-1951)

Imposition and collection of taxes during the 104-year oligarchic rule of the Rana family in Nepal prior to 1951 was the prerogative of the feudal rulers. Only those taxes were imposed to suit the objectives, needs and whims of the then ruling Prime Minister. Income and expenditure of the state were not made public. No budget was ever framed during the Rana Regime. There was no difference between the income of the state and the income of then Prime Minister.

The major sources of revenue in Nepal till 1951 were land tax, custom and excise duties in the form of lump sum contracts, royalties on felling of trees, royalty on supply of porters and soldiers, entertainment tax, and a few other minor taxes, 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 a very small percentage. The "salami" was abolished in 1951. Since most of the revenue in Rana Nepal was collected by award of periodic contracts; the need was not felt for the development of effective revenue administration system.

The Rana rule was thrown away within 1951. Since then, no taxes are levied and collected in Nepal except in accordance with the law.

2.1.6 Concept and Meaning of Income Tax

The word 'tax' was derived from the Latin word 'taxore' or 'taxo' which means estimation, appreciation or value. Income, as the economic gain received by the person during the particular period, is most satisfactory defined by Henry 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, $Y = C + W$

Here, Y, C, and W refer income, consumption and change in wealth respectively. Generally, income tax is imposed on net income which comes after deducting the cost of production from gross income. Net income may be real income and is more comprehensive and includes not only money income but also other incidental advantages. Real income is therefore the true index of ability to pay (Dhakal, 2004: 6). Income tax greatly helps redistribution of economic means by the transformation of wealth from persons with higher economic level to persons with lower economic level, which will result in the minimization of gap between 'haves and have not'. It is a direct tax whose contribution is higher in the government revenue.

According to income tax act 2002, Sec. 2. (h), income means "a person's income from any employment, business or investment and the total of that income as calculated in accordance with this act." This act has defined a person as an individual or entity. According to section 5 of the act, the taxable income of a person for an "income year" is equal to the amount as calculated by subtracting reduction, if any, claim for the year under this act is made from the total person's assessable income from each of the following heads:

- a. Business
- b. Employment
- c. Investment

2.1.7 Income Tax in the International Context

Income tax was first introduced in Great Britain in 1799 in order to finance wars with France. Only after 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 US 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 in 1864, New Zealand in 1891, Australia in 1915 and Canada in 1917. After First World War the income tax became an important source of tax revenue in many developed countries. By 1939, it has become the most important source of revenue in most developed countries and had made appearance in a number of developing nations (Agrawal, 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.

2.1.8 Income Tax in Modern Nepal

Income tax is comparatively new in the Nepalese tax system. After the independence of the country from Rana rule in 1951, the government was bound to operate development activities besides performing the regular functions of maintenance of law and order. In order to raise excess government revenue, for the implementation of development activities, the idea of introducing income tax in Nepal originated only in the early 1950s. The then finance Minister, in his 1951 budget speech (the first budget speech of Nepal), said "A proposal to levy an income tax including tax on agricultural income is under consideration. The tax, however will not fetch much revenue in the coming two or three years. Initially, the tax will be used to familiarize people with this tax rather than as a revenue

earner. As the tax develops, it will be a major source of revenue" (Budget speech, 1951, in Khadka, 1994: 105).

Income tax was finally introduced by the first elected government in the fiscal year 1959/60. It was known as business profit and remuneration tax. Business and remuneration ordinance, 2016 B.S. was issued to expedite the provisions made in the finance act. The imposition of the tax was governed by business profit and remuneration tax, act, 1960 (2017 B.S.) and the rules were made under it. According to the act only business profit and remuneration income were subject to tax but the revenue from these taxes could not be collected properly according to original estimate. The tax was introduced on an experimental basis on business and salaries, which are easier to assess than other form of income such as agricultural income (Dhakal, 2004: 80).

2.2 Legal Provision: Historical Development of Legal Provision of Income Tax in Nepal

Legal provision is the guidance which provide guideline by how and which measures to be taken to do required things. It shows the way to move. For the economic development of the nation. 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). For the development of the nation it needs huge amount of revenue. So, to generate the required revenue the government has introduced income tax in Nepal only in the early 1950s. Thereafter the first budget speech of Nepal government by the finance minister, in 1951, he said "a proposal to levy an income tax including tax on agricultural income is under consideration. The tax, however will not fetch much revenue in the coming two or three years. Initially, the tax will be used to familiarize people with this tax rather than as a revenue earner. As the tax develops, it will be a major source of revenue" (Budget speech, 1951, in Khadka, 1994: 105).

In Nepal parliaments makes the law to implement the policies and the government impose the law to collect the income tax. The constitution of Nepal has made the clear provision about it. "No taxes should be levied and collected except in accordance with law." In Nepal income tax was introduced by the first elected government in the fiscal year 1959/60. By the name of "Business profit and remuneration act 1960." present legal provision of income tax is associated with interim constitution of Nepal, 2063 B.S., income tax act 2002; income tax rules 2002; finance act of concerned financial year etc.

2.2.1 Business Profit and Remuneration Act 1960

The government of Nepal introduced a formal tax for the first time in Nepal in 1960 (2017 B.S.) in the form of "Business Profit and Remuneration Tax." The "Business Profits and Remuneration Act 1960" governed it. According to this act only business profits and remuneration on income were subjected to tax but the revenue for these taxes should not be collected properly according to originals estimates (Dhungana, 1976: 66). It had 22 sections.

Main features of income tax act 1960 were as follows:

- i. Only business profit and remuneration income were subject to tax. Thus the coverage of income tax was to narrow.
- ii. Tax on remuneration was to be deducted at source.
- iii. The basis for calculating the tax liability for remuneration was the income of the current year whereas for business profits, it was the profit of the preceding fiscal year.
- iv. There was a provision of tax exemption on salary of foreign citizen, dividend of shareholders, profits to be spend in religious or public welfare activity, crop from own land, allowances granted by HMG to ministers, assistant minister, chairman, speaker and deputy speaker, amount drawn from provident or saving fund.
- v. The tax officer was empowered to assess tax on best judgement estimation only incase of false statement of in absence of income tax return.
- vi. There was a provision of fines ranged form Rs. 500 to Rs. 5000 in case of defaults.

vii. The first court of appeal against the tax officer's assessment was local; "Bada Hakim" or Magistrate. Thereafter, taxpayer could appeal to the 'Revenue and tax court' but he need to deposit fixed amount of tax (Dhungana, ibid).

2.2.2 Income tax act 1962

'Business profit and remuneration tax act 1960' was replaced by 'Income tax act 1962'. It had come in implementation from July, 1962. It was an extension of the previous act. It has 29 sections. It was amended only one time in 1972. The additional features of this act were as follows:

- i. Income was defend as all kinds of income including income from business, salaries, any professions, rent form house or land, investment in cash or bind, agriculture, insurance agencies and any other sources.
- ii. Act has defined basic terminology such as taxpayer, tax officer, company, firm, profit, remuneration, tax assessment, non-resident etc.
- iii. Status of taxpayer was defined on personal as well as residential for the tax purpose.
- iv. Procedure for income tax assessment and methods for calculating net income were stated.
- v. Provision was made to carry forward of losses for a period of two years.
- vi. The provision was made to constitute the net income assessment committee with five members.
- vii. The basis was specified for assessing tax on the best judgement estimate of the officers.
- viii. To broaden the tax coverage, agricultural income was brought under the income tax net for the first time. But the financial act 1966 exempted this income fully form tax net. Again it was brought into tax net by financial act 1973. However, it was again exempted form 1977.
- ix. Provision was made for reassessment of tax as well as rectification of arithmetic errors.

2.2.3 Income Tax Act 1974

Considering this act incapable of fulfilling the needs of the time, existing act was replaced by another act 'Income tax act 1974.' This new act was brought in practice from October 1974. It had 66 sections. This act was amended in 1977, 1979, 1988, 1984, 1985, 1986, 1989 and lastly in 1993.

Main features of this act as amended are as follows:

- i. It had clarified the certain terminology used in act e.g. income tax, taxpayer, non-resident, tax assessment, income year, gross income, net income, agriculture income, remuneration income, loss etc.
- ii. Income head was classified into five categories: (a) Agriculture income, (b) Industry, trade, profession or occupation, (c) Remuneration, (d) House rent and compound rent and (e) others.
- iii. The methods of computing net income from various sources had been specified.
- iv. Appointment rights of tax officers had provided to HMG and rights of tax officers had mentioned clearly.
- v. This act had made the provision of self-assessment of tax for the first time in Nepal.
- vi. The provision of carry forward of loss for three subsequent years was made.
- vii. The act had made it obligatory for taxpayers to register their industry, business, profession or vacation in the tax office before starting the work.
- viii. The expenses allowed for deduction while computing net income had clearly specified for all sources of income.
- ix. Procedure for assessment, reassessment, jeopardy assessment, tax deduct at source, payment and refund of tax had specified.
- x. There was additional provision of exemption from income tax than the former act as follows: Income of Guthi; Income of Village Development Committee, Municipality; Amount Received against life insurance.
- xi. A right, duties, forms, appeals were specified.
- xii. Provisions of penalty up to Rs. 5000 in case of failure of maintain or preserve accounts.

2.2.4 Income Tax Act 2002

To enhance revenue mobilization through effective revenue collection procedure for the economic development of the nation, and to amend integrates the law relating to income tax, the Parliament of Nepal enacted the Income Tax Act 2002. This Act has replaced Income Tax Act 1974, which was amended for eight times and existed for a period of twenty-eight years. The Act is quite advance in modern concept. According to the size, contents and style of presentation it is a big departure of the previous Act 1974. The Act is enacted from 1st April 2002, and first rule of this Act is also published in same year and affected from 10 June 2002. To make the Act more practical and to eliminate confusion and confusing terms the Act has been composed in 143 sections within 24 chapters plus schedules of provision.

According to the policy maker and tax experts the objectives of the Act could be pointed out as follows:

- © To bring all the income generating activities within tax net.
- © To increase the base of taxation,
- © To bring all the income tax related provisions within one act.
- © To make income tax related provisions clear and transparent.
- © To interlink Nepalese tax system with tax system of other countries.
- © To make the system based accounting.
- © To minimize tax avoidance and evasion.
- © To make tax system compatible to modern economy.
- © Reducing the scope of discretionary interpretation of the tax administration thereby ensuring simplicity, uniformity and the transparency.
- © Defining the power as well as authority of the tax administration.
- © Separating administrative and judicial responsibilities.
- © Distinguishing tax payers' violation of civil duties and criminal offence, and
- © Further streamlining the appeal system by making it mandatory for the taxpayers to file an objection with the Department of Taxation before appealing to the Revenue Tribunal.

The act has following features:

1. All the related matter within one act

- © Abolition of all tax related concessions, rebates and exemption provided by different act

2. Specifications of tax rates

- © Appendix for tax rates
- © Embracement of the tax rates applicable to all the sources of income

3. Specification of stock valuation methods

- © According to the Act 1974 approval of the concerned authority is required to change the stock Evaluation method once one method is adopted, but the act 2002 has made clear provision regarding the valuation of stock for tax purpose

4. Provision of tax accounting

- © Prescription of the method and basis of tax accounting.
- © Cash basis or accrual basis accounting for different income heads and persons

5. Provision for quantification, allocation and characterization

- © Quantification of amount of transfer of assets and amount of any fringe benefit
- © Allocation of income from joint owned investment
- © Characterization of payment under annuities, installment sales, financial leases and arrangement of transfer pricing
- © Provision against the splitting the income

6. Simplification of depreciation related provision

- © Categorization of assets into five pools
- © Pool based depreciation of assets
- © Specification of Diminishing Balance Method as the depreciation method for the purpose of taxation

- © Depreciation of intangible assets and approved method of depreciation is Straight Line Method. Specification of depreciation rate for five pool individually

7. Taxing capital gain and dividend

- © Specification of tax rate for natural person and entity
- © Provision of withholding payment for this attempt

8. Generous loss set-off and carry forward provision

- © Inter-head and intra-head adjustment of losses both are clearly defined
- © Provision of carry forward as well as back ward of losses for the financial sector

9. Provision of international taxation

- © Provision of transfer pricing, foreign tax credit, double taxation avoidance agreements.
- © Global income of resident is made taxable

10. Stringent fine and penalty provision

- © High amount of fine and penalty
- © Provision of imprisonment

11. Other

- © All expanses relating to income is admissible
- © No submission of income statement from the person not having taxable income
- © No submission of income statement by the person, who has income from remuneration only
- © Taxpayers' right to appeal against departmental action
- © Clear address of time, palace and procedure of collection, remission and refund of tax
- © Every assessment treats as self-assessment

2.2.4.1 Source of Income

The new Income Tax Act 2002 has subjected the taxpayer's income into three categories. The act defines income in terms of the sources only. The act defines income as "a person's income from any employment business or investment and the total of that income."

1. Employment Income:

Under this source of income, all payments and benefits received by the employee including past, present, as well as future employment are taxable. The examples of employment benefits are salary, house rent, pension, gratuity, dearness allowance, medical allowance etc. It also includes payments relating to the change of terms of employment, fringe benefit, various types of allowances, payment received through third parties etc.

A. Incomes include in employment income:

As per section eight following payments made to the employee from the employer are included in employment income.

- © Payments of wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts, Bonus and other facilities.
- © Payment of any personal allowance including any cost of living, subsistence, rent, entertainment, and transportation allowance
- © Payment providing any discharge or reimbursement of cost
- © incurred by the individual or an associate of the individual
- © Payment for the individual's agreement to any condition of the employment
- © Payment for termination or loss of service or compulsory retirement
- © Retirement contribution including those paid by the employer to a retirement fund in respect of the employee and retirement payments
- © Other payment made in respect of the employment
- © Other payment made in respect of tax accounting such as transfer of the assets (sec27.a), vehicle facility and .house facility (sec 27.b), expenses made by employer for the provision of domestic assistants, food, house-hold utilities of the employee (sec. 27.c), reduced amount of interest paid to employer as per concession rate with compared to standard rate (sec. 27.d),

compensation (sec. 3.a, 62and 92) and amount of bill directly paid by the employer (sec 27.e)

B. Exempt amount and other concessions:

1. General exemption (sec. 10)

- ⊙ An amount derived by a person entitled to privilege under a bilateral or multilateral treaty conducted between HMG Nepal and foreign country or an international organization.
- ⊙ An amount derived by an individual from employment in the public service of a foreign company provide that, the individual is a resident solely by the reason of employment to a non resident person, and the amount is paid from public fund of the country.
- ⊙ Allowances paid by the way of gift, bequest, inheritance or scholarship.
- ⊙ Amount derived by an exempt organization by the way of, gift or
- ⊙ donation, and other contribution that directly related to the organization's function weather or not the contribution is made in return for consideration provided by the organization.
- ⊙ Amount received by Nepal Rastra Bank as its objectives.
- ⊙ Amount received as pension from foreign government treasury by Nepalese citizen as a retired army or police.
- ⊙ Amount derived by an individual who is not a citizen of Nepal, who is employed by HMG Nepal in terms of tax exemption

2. Gift and donation to exempt organization: As per section 12 a person may claim to have their taxable income for an income year reduced by gifts and donation made by a person during the year to an exempt organization that are approved for the purpose of this section by the department

3. Final withholding payments (sec. 8.3 a &92)

4. Meals and refreshment expenses paid by the employer (sec. 8.3b)

5. Discharge or reimbursement of expenses used for employer's business purpose or employer's admissible deductions form business or investment (sec. 8.3).

6. Payment of small amounts (sec. 8.3 b)

7. Special provision of exemption for retirement payment and leave pay (sec. 20.6 a &b)

8. Other, common deductions (sec. 12 & 63), exemptions, medical tax credit (sec.51), foreign tax credit (sec. 71) and special fee (sec.16.2 of Finance Ordinance 2060).

C. Special provision for retirement savings:

- ⊙ As per section 63.2, a natural person who is the beneficiary of an approved retirement fund may claim to reduce the taxable income by retirement contribution made to the fund by the natural person during the year
- ⊙ In case an approved retirement fund ceases to be unapproved, the amount of contribution made in such retirement fund taxed as company tax rate (sec. 64.3).
- ⊙ Interest payment made by the retirement fund is taxable @ 6%, and if the payment is made as a lump sum payment, it is treated as a gain from the disposal of a non-business chargeable asset of an investment (sec 64.1 & 2).
- ⊙ The incomings for an asset being an individual's interest in an approved retirement fund includes reductions claimed by the individuals as per the section 63.2 for retirement contribution made with respect to the interest

2. Business Income:

The source of income 'business' includes industry, trade, profession, vocation or isolated transaction with a business character and a past, present or prospective business. But, this source does not include employment income.

A. Inclusions of business income:

- ⊙ Service charge (sec. 7.2a)
- ⊙ Sales or disposal of business or trading stocks (sec.7.2b)
- ⊙ Net profit or gain by disposal of business assets or liabilities (sec.7.2c)
- ⊙ Amount received against disposal of depreciable assets (sec. 7.2d)
- ⊙ Prizes or gifts received in connection to the business (sec. 7.2e)
- ⊙ Amount received by any investment that is directly related to the business (sec. 7.2g)

- © Amount received instead of any restriction regarding to the business (sec. 7.2f)
- © Amount included under the charge of accounting system (sec. 22.6)
- © Amount included by reason of timing (sec. 24.3)
- © Excess amount received due to exchange rate (sec. 24.4)
- © Recovery of bad debts (sec. 25.1)
- © Proportionate amount under long-term contract (sec. 26.1)
- © Amount received for compensation (sec. 31)
- © Difference amount of interest paid with the standard rate of interest (sec. 27.1 d)
- © Amount paid to third person instead of actual payee (sec.29)
- © Other amount including under business income

B. Admissible expenses and other consideration:

- © General deduction includes all the expenses relating to the business that the expenses are made by the taxpayer to produce business income during the year. Example if such expenses are manufacturing expenses, administrative expenses, selling and distribution expenses etc (sec. 13)
- © All the interest derived by the entity during the year included in calculating the entity's taxable income 50% of the entity's Taxable income for the year calculated without including any interest derived or incurred by the entity (sec. 14).
- © After calculating value of opening stock adding total purchase during the year and subtracting the closing stock the remaining is cost of business stock and is admissible (sec. 15).
- © Repair and maintenance cost equal to 5% of the depreciation base of respective asset is admissible. If it exceeds the limit then the balance amount is added to the depreciation base writing off in the subsequent year (sec. 16).
- © Actual or 50% of taxable income calculated without deducting cost of research and development and ignoring the limitation whichever is less is eligible expenses for research and development. Excess amount of such cost is added to the assets category 'D'. In the same

- © way in case of pollution control cost taxable income is calculated without deducting the cost and ignoring the limit, then excess amount is transferred to pool 'D' of assets as done for research and development cost (sec.17 & 18).
- © Rs. 100000 or actual or 5% of taxable income calculated without deducting gift and donation and ignoring the limitation whichever is less is allowable deduction for donation (sec. 12).
- © The depreciation made as per five categories of depreciable assets is admissible expenses for depreciation (sec. 19, sch. 2).
- © Set off of losses from the profit of any business or investment to the subsequent four year can done by ordinary business. In case of electricity project, public infrastructure building with the motive to transfer in near future to HMG can carry forward its losses up 10 next 7 years. And, in case of bank and general insurance business carry back ward up to 5 years and forward up to 4 years for its business losses can be done. But the losses in investment cannot be carried forward and backward, (sec. 20).
- © Business exemptions and facilities (sec. 11).
- © Common deductions such as retirement contribution (sec.63).
- © Statutory exemption limit, remote area allowance as an additional exemption limit, additional exemption for pension income and life insurance premium.
- © Medical tax credit (sec 51), foreign tax credit (sec 71) special fee 1.5% as prescribed by the Finance Ordinance 2060.

C. Inadmissible expenses (sec.2J)

- © Personal or domestic expenses
- © Income tax paid, bribe, fine and penalty paid to the government or political subdivision of any country by breaching of any law
- © Expenses incurred in acquiring tax-free income or exempted
- © amount or final withholding payment
- © Distribution of profit by entity whatever in the way by capitalizing the profit or issuing bonus share
- © Capital nature expenditure and foreign income tax except as specified by the tax laws.

- © Any cost incurred in cash exceeding Rs.50000 is not allowed if the taxpayer lives in the place where banking service is available within 10 kilometers area and if annual turnover of taxpayer is more than 20 lakhs; unless the payment is made to HMG, constitutional bodies, government owned corporation, former producing agricultural product, retirement contribution, banking service and closed payment made to bank account of payee.
- © Any other amount, which is denied by other provisions of the law

3. Investment Income:

The investment means holding one or more assets of similar nature or investing in such assets. However, the non-business chargeable assets hold for personal use by the owner himself and the employment or business is not investment.

A. Inclusion of investment income:

- © Dividend other than final withholding (sec. 9.2a).
- © Gain from investment insurance other than final withholding (sec. 9.2a).
- © Interest income, rent received, receipt income, royalty income not deducted tax at source and amount received in respect of in-approval retirement fund as per sec. 9.2a.
- © Amount received from disposal of depreciable assets (sec. 9.2c).
- © Amount received as consideration for accepting restriction on investment (sec. 9.2f).
- © Income including under investment due to change in accounting method (sec. 22.6)
- © Amount of income included by the reason of timing (sec. 24.3).
- © Under paid amount of interest as per market rate (sec. 27.1).
- © Recovery of bad debts (sec. 25.1).
- © Income received as compensation (sec. 31).
- © Income received form joint investment (sec.30).
- © Net gain from the disposal of non-business chargeable assets of a natural person (sec. 9.2b).
- © Gift received in respect of investment (sec. 9.2d).

- © Other amount to be included under investment income

B. Admissible expenses and other consideration:

- © General deduction (sec. 13).
- © Interest expenses (sec. 14)
- © Repair and maintenance cost (sec. 16)
- © Depreciation allowances (sec. 19)
- © Others, common deduction (sec. 12 & 63), exemption, medical Tax credit (sec. 51), foreign Tax credit (Sec. 71), final withholding payment (sec. 92), & special fee as per section 16.2 of Finance Ordinance 2060

2.2.4.2 Return of Income Tax Assessment

A. Return of income

Every taxpayer should file return no later than 3 months after the end of each financial year at the place prescribed by the department. The law has prescribed that following items should be-included in filing the return.

- © The person's assessable income from business, investment in the year and the source of that income.
- © The person's taxable income for the year and the amount of tax payable with respect to that income.
- © Incase of foreign permanent establishment of a non-resident person situated in Nepal, foreign permanent establishment's repatriated income for the year and the tax payable with respect to the income.
- © Any tax paid by the person by the way of withholding, installment to assessment for which credit is available.
- © The amount of tax still to be paid after deducting the tax already paid.
- © Any other information that the department prescribes

❖ Return of income not required

A person who does not have taxable income may not required to file return. This provision is applicable to resident person who has income exclusively from employment having source in Nepal, who has only one resident employer at a

time during the year, who does not claim a deduction from his taxable income by gift to exempt organization.

❖ **Extension of file of return**

A person who is required to file the return of income makes written request to the department by the due date for filing return, the department may on such terms and condition as prescribed by the department, and where reasonable clause is shown shall extend the date by which the return is to be filed. The department may grant extension, which shall not in total exceeds three months.

Special provision for individual & entity:

Individual:

- ⊙ A resident natural person and resident spouse of the person may, by notice in writing, elect to be treated as a single individual for particular income year.
- ⊙ According to section 50, resident couple can elect to file return jointly by having joint request for particular year. In such case they would be collectively responsible for filing return.
- ⊙ A resident natural person may claim a medical tax credit not exceeding Rs.750 per year. Any amount exceeding the limitation is carry forward to subsequent year.
- ⊙ This facility is equally applicable to all the taxpayers.

Entity:

- ⊙ Transaction between an entity and its manager is tax free.
- ⊙ Repayment of capital by the entity such as to shareholders is tax free.
- ⊙ Payment of dividend tax deducted at source is tax free

B. Income tax assessment procedure

The meaning of assessment is determine something for specific purpose. The word assessment is used in a number of provision in a comprehensive sense and it can comprehend the whole procedure for ascertaining and imposing liability upon the taxpayer and the machinery for enforcement thereof.

Income tax assessed under different method viz. Official assessment Committee assessment and Self-assessment system. Traditionally, income tax is assessed under the official assessment system, where taxpayers are required to submit their tax return to the tax officer and tax officials are required to make an assessment of taxable income (Khadka, 2001:71).

In the Income Tax Act 1974, the term assessment is used with different aspects in different places. Sometime it is used as a meaning of the computation of income, sometime the determination of tax liability and sometime the whole procedure laid down in the act for imposing liability upon the taxpayers. The assessment procedure of income tax according to the Act 1974 is as follows

1. Submission and filing of income statement
2. Assessment of net income
3. Assessment of tax liability
4. Tax assessment order

Income Tax Act 2002 has focused on self -assessment system. Under this law, every assessment is treated as self-assessment. Basically, in the Act, three types of assessment system is mentioned namely Self-assessment, Jeopardy assessment and Amended assessment in section 99,100 and 101 respectively.

Self-Assessment (section 99)

Assessing the tax liability by the taxpayer himself is known as self-assessment of tax. According to the Act, where a person files a return for income year, an assessment is treated as made on the due date of filing the return. This type of assessment is to be made by the taxpayers' who actually have:

- ⊙ Taxable income
- ⊙ Income not exempted from tax.
- ⊙ Income is not of that type where final with holding is made.

In such assessment the taxpayer should show,

- a. Tax payable by the person
- b. Amount of tax still to be paid by the person for the year being the amount shown in the return.

If in case, a person fails to file a return by the due date, the person is even treated to have made an assessment on the due date for filing the return and his assessed tax for the year will be equal to the sum of tax withheld and tax paid in installment. The Department may, and then, proceed for an amended assessment. Jeopardy Assessment (section 100)

In some doubtful situation the tax officials may make jeopardy assessment. The assessment is initiated prior to the date of filing an income return. The assessment is actually made according to the best judgment basic under the special circumstances as when:

- a. The person becomes bankrupt, is wound -up or goes into liquidation
- b. The person is about to leave Nepal indefinitely
- c. The person is otherwise about to cease activity in Nepal, or
- d. The Department otherwise considers it appropriate

Jeopardy assessment can be made either for the whole year or for the part of the year. If the assessment is made for whole year the taxpayer is not required to file the return for the year. But, if the assessment is made for the part of the year then the taxpayer is required to file the return of income for the year on due date.

The Department may give the 7 days of time to the taxpayer to produce proof, if any, in own favor with respect of the jeopardy assessment. Moreover, if the tax officials made the jeopardy assessment, they are required to provide written notice of the assessment to the taxpayer mentioning the total tax liability, tax payable, payment date, manner and reason of the assessment, place and manner of objecting of the assessment.

Amended assessment (section 101)

The Department may amend an assessment made by the taxpayer to adjust the assessed person's tax liability. It is done according to the intention of the Act. The tax officials may amend both the self-assessment and Jeopardy assessment so as to adjust the tax liability. Amended assessment is carried out after filing return or after the expiry of due date for filing income return. The tax officials may amend an assessment according to the best judgment for as many times as the

tax officials think appropriate. The Department may amend an assessment within four years at any time where the assessment is inaccurate by the reason of fraud or any unwillful neglect by or on the behalf of the assessed person.

The tax officials may not amend an assessment if the assessment has been amended or reduced assessed tax by the Revenue Tribunal or a court of competent jurisdiction except where the order is reopened. This provision should not be a barrier to amend in the case where an order for reinvestigation is issued. Where the Department makes amended assessment the Department shall be required to serve a notice of the assessment to the person stating,

- a. Tax payable by the person, tax still to be paid for the income year or the period to which assessment is made
- b. The manner in which the assessment is calculated
- c. The reason why the Department has made assessment
- d. The date on which the assessment is payable, and
- e. Time, place and manner of objecting to the assessment.

2.2.4.3 Income Tax Collection Procedure

Collection basically refers to the collection of tax from defaulters. Collection is one of the important functions of the modern tax administration, which needs to follow up continuously on non-fillers and non-payers. Tax officials should remind non-fillers and non-payers regularly about their liabilities and conduct tax collection visits. In the absence of such measures, the number of non-filler would increase and the due amount will swell. This may lead to a situation where the good taxpayers may turn into bad taxpayers and government will lose revenue in both nominal and real term (Khadka, 2001:80).

According to the Income Tax Act 2002, a tax officer can recover due amount but adopting any or all of the following methods.

1. By impounding or sequestering or auctioning the movable and immovable property owned by the taxpayers.

2. By impounding the deposit held by the taxpayers in his name in any government officer or any corporate body controlled by HMG or the amount due to taxpayer from such office or body or by directing the payment of such amount to the tax officer.

3. By suspending the business and exports and imports of the taxpayer

In the Income Tax Act 2002 following measures for the recovery of the due amount is mentioned in chapter 20.

a. Section 103: Collection through withholding

© The withholding agent required to withhold from the payment remains first charge on that payment and should be deducted prior to any other deduction even the deduction to be made according to the order of the court.

© Tax deduction at source cannot be attached to debt or liability of the agent.

© In case of liquidation, the withheld tax doesn't become the part of asset of the agent.

b. Section 104: Charge over Asset

If the taxpayer is-not able to pay tax on or before the due date, the government can create charge over the asset of the taxpayer by serving notice to him stating:

© Details of the asset auction

© The extent of charge (tax payable, interest occurred etc.)

© Any cost of charge and auction

If the charge on land and building is taken, the government files application to register the charge in Land Revenue, who shall suspend the sale or transfer of ownership.

c. Section 105: Auction of Charged Asset

The Department may notify the tax debtors as regards to the Department's intention to sell charged asset held by the debtors, and the proposed method and timing of sale.

Auction of land and building may be held within 30 days after taking possession auction of tangible assets other than land and building within 10 days after taking possession and perishable goods within 1 day after taking possession.

Procedure of Auction

- © A 15-day notice is published at least in one local daily newspaper.
- © Market price of the asset determined in presence of representative of the local auction officer and representative of local government officer.
- © Auction is done in presence of representative of local administrative officer.

The auction should realize at least market price of the asset determined. If the amount is not realized a 70 days notice is published and auction is done. If the amount offered is still less than market price of the asset, a 3 day notice is published. The proceed amount is first paid to cover the cost of charge and sale of asset, then to pay the tax payable, interest occurred and the remainder shall be paid to the debtors.

If the proceed of the sale is not sufficient to pay in full the cost, tax and interest, the Department shall proceed to collect the outstanding amount from the tax debtors with fresh auction.

d. Section 106: Departure Prohibition Order

If a person did not pay tax within payable time, the Department can serve notice to the Immigration Office to prevent the person from leaving the country (Nepal) for a period of 72 hours from the time of the notice served. If the person pays the tax or makes an arrangement for payment, tax administration may be notice in writing served on the office, withdraw the order.

e. Section 107: Liability of the officer of the Entity

Every person who is officer at the time of payment or six-month before of the entity is jointly or severally liable to pay tax.

f. Section 108: Recovery of Tax from Receiver Receiver refers to:

- © A liquidator.
- © A receiver appointed out of or by court of an asset or equity.
- © A mortgage.
- © An administrator or executor or a direct heir of deceased individual estate.
- © Any person conducting the affairs of incapacitated person.

g. Section 109: Recovery of Tax from person owing money to Tax Debtors.

If the tax debtors fail to pay tax on or before the date it is payable, the department may serve notice in writing to any person to pay tax, the person who owes or subsequently owe money to the tax debtors.

h. Section 110: Collection of tax from the Agent of Non - resident

The Department may by services of a notice in writing require a person who is in possession of an asset owned by the tax debtor to pay the tax on the behalf of the tax debtor up to the market value of the asset. Incase of such payment, the person may recover the payment from the tax debtor an amount not exceeding the payment. The tax debtor may not make claim against the person with respect to the retention.

i. Section 111: Suit for unpaid tax

The Department can recover the unpaid amount of tax from tax debtor by suing in the competent court.

j. Section 112: Remission

If the Department is satisfied and certified writing that the tax or interest or penalty cannot be effectively collected, HMG Nepal may remit in whole or part of such amount payable by the person.

k. Section 113: Refund and set off

If the Department is satisfied that a person has paid tax in excess of the person's tax liability, the Department shall apply life excess in reduction of any tax payable but unpaid by the person and refund the reminder if any, to the person.

2.2.4.4 Tax Rates

The Act 2002 has simplified the tax rates applicable for the different groups of taxpayer's or all the source of income. A schedule for income tax rates has been managed in the Act. Applicable tax rates for individual or natural person, entity, and special industry are as follows.

A. Natural person:

(i) Individual (Resident)

Up to Rs.80000	Nil
From Rs. 80001 up to Rs.155000	@15%
Above Rs. 155000	Rs.11250 + @25%

**On more than Rs.
155000**

(ii) Resident couple:

Up to Rs. 100000	Nil
From Rs. 100001 up to Rs. 175000	@ 15%
Above Rs. 175000	Rs.11250+ @25%
	On more than Rs. 175000

(iii) The taxable income of non-resident individual is taxed at 25%

(iv) The presumptive tax for individuals conducting small business having annual turnover of Rs. 1200000 or income of Rs. 120000 are taxed in amount of Rs.2000 if his/her business place is in Metropolitan city or sub-Metropolitan city, Rs.1500 if it is in Municipality and Rs.1000 if business runs in any where else in Nepal.

B. Entity:

(i) Bank and financial institution @ 30%.

(ii) Industrial enterprise engaged in an industrial activities which is concerned with any road, bridge, rope way or any trolley bus or tram manufacturing entity is taxed at 20%.

(iii) Entity wholly engaged in power generation, transmission or distribution is taxed at 20%.

(iv) The taxable income of a non-resident person with respect to shipping, air transport or tele-communication service is taxed at the rate of 5%.

(v) The taxable income of a foreign permanent establishment of a nonresident person situated in Nepal is taxed at 10%

(vi) Other entity taxed at 25%.

C. Special industry:

(i) Industry that provides employment to 600 or more Nepalese citizens during each day of the income year shall be taxed at 90% of the rate or only 10% of tax payable amount otherwise applicable to that income tax rate is same as other entity

(ii) Industry operating in a remote area, under-developed or undeveloped areas will be taxed at 70%, 80% & 75% respectively of the rate applicable for the period of 10 income year. Commencing from and including the year in which the operation commences.

2.2.4.5 Depreciation Rates

To manage the allowable deduction of depreciation a schedule has been included in the Act 2002. For the purpose of depreciation the assets are divided into five categories. The rate of depreciation, category of assets and brief of assets in each pool are as follows:

Table 1
Depreciation Rates and Assets Category

Depreciation rate	Asset category	Assets
5%	A	Building, structure and similar work of permanent nature etc.
25%	B	Computer, data handling equipments, fixture, office furniture etc.
20%	C	Automobile, bus, minibuses

15%	D	Construction and earth moving equipments and any other assets not included under A, B and C
Assets/useful life	E	Intangible assets

The allowable depreciation equals to depreciation base multiplied by depreciation rate. Depreciation base (DB) is calculated as;

Opening stock of DB	***
+ Purchase of the year	***
- Sales of the year	***
Depreciation base	***

In the context of purchase of depreciable assets, if assets are purchased between beginning of financial year to end of Poush, then whole cost is added in depreciation base. If the assets are purchased between beginning of Magh to end of Chaitra, then 2/3 of cost of purchase is added in the base and if the assets are purchased between beginning of Baishak to end of the financial year then only 1/3 of the cost is added to the depreciation base.

2.2.4.6 Set Off, Carry Forward and Carry Back of Losses

As per the Act 1974 only the provision of carry forward could be used by entity to set of its losses. But as per the Act 2002 doing not only carry forward also carry back a entity can set off its business/investment losses.

A. Carry forward of loss

In carry forward of loss, a loss is allowed to recover from future profit. In case of ordinary business for the four year loss can be carried forward. Loss of project engaged in construction of infrastructure development and operation which will be transferred to HMG Nepal or project related to the construction, production and transmission of power is allowed to carry forward of loss for seven years.

B. Carry Back of loss

If the losses are allowed to recover from the tax already paid, then it is known as carry back of loss. Certain taxpayer, like, banking and insurance companies can carry back their loss to preceding five years. The entities are also facilitated to carry forward of loss for four years.

C. Other provisions

- ⊙ Set off of loss from investment whose source in Nepal can be set off against profit of investment both with source in Nepal as well as foreign source.
- ⊙ Loss in foreign source income can be set off only with the profit of foreign source.
- ⊙ Loss in non-taxable income can be set off only with income from non-Taxable income
- ⊙ Loss from business with source in Nepal can be set off against business and investment income from any source.
- ⊙ Loss from business with foreign source can be set off against business and investment income with foreign source income only.
- ⊙ Loss from investment with source in Nepal can be set off against investment income with source in Nepal as well as foreign source
- ⊙ Loss from investment with foreign source can be set off against investment income with foreign source only.
- ⊙ Loss from business with foreign source can be set off against income from business and investment with foreign only

2.2.4.7 Tax Deduction at Source (TDC)

A system of deducting tax at source while making payment to employees, security holders, and other persons receiving payment is called tax deducted at source (TDC) or withholding of tax. Provisions, for this purpose have been made in section 87, 88 & 89 in the Act 2002.

A. Withholding agent

A person required withholding tax at the time of payment for employment, investment return, service fees or contract. In other words, tax with holder is the intermediary who has duty of deducting amount of tax while making the payment and depositing it to the office.

B. Withholdee

A person receiving or entitled to receive payment from which the tax is deducted.

C. Types of with holding payment

There are two types of with holding payment.

(i) Advance with holding payment: The payment received should include as income while filing return is advance with holding payment,

(ii) Final with holding payment.

If the tax deducted at source is taken as final and it should not be included in final return, it is final with holding payment.

D. Types of payment, Tax rate and types of with holding tax as per Income Tax Act 2002.

Table 2
Withholding of Tax as Per Act 2002

S.N.	Section	Type of payment	Tax rate	Type of tax
1	87	Remuneration	As per Sec. 1	F/A
2	88.1	Interest not related with business, paid to natural person by bank, financial institution or entity and company with issuing debenture.	6%	F
3	88.1	Other interest payment	15%	A
4	88.1	Payment for nature resource, royalty	15%	A
5	88	Meeting allowances	15%	F
6	88.1	Payment of other rent	15%	A
7	88.1	Service fees/ charges	15%	A

8	88.1	Payment or rent to natural person	15%	F
9	88.1	Payment for approved retirement fund	6%	F
10	88.2	Payment of dividend from resident person	5%	F
11	88.2	Net income from investment	10%	F
12	89	Payment of insurance premium or contract amount in excess of Rs. 50000/-	15%	A

E. Section 92

As per the section following items are treated as final withhold:

- © Dividend paid by a resident company
- © Rent for the lease of land or building and furniture having on source in Nepal and that is received by individual other than conducting business.
- © Gain from investment insurance and unapproved retirement interest paid to a resident person.
- © Interest paid by bank or financial institutions
- © Meeting allowances
- © Gratuity paid to employees

The person who is required to withhold should deposit the withheld amount of tax to Inland Revenue Department within 15 days of the withholding.

The particulars to be given by the with holding agent with depositing the withheld amount are:

- © Name, address and permanent account number (PAN) if it is available
- © Tax deducted at sources against each payment and other information demanded by the department
- © Total amount of payment from which the tax is withhold

F. Section 103

As per the section priority of deduction should be given by the withholding agent who is required to with hold the taxes are as follows.

- © Tax that a with holding agent is required to withhold from payment is a first charge or that payment and should be deducted prior to any other

deduction, even the deduction to be made according to the order of the court

- © Tax withheld and any other assets withheld by the agent for the purpose of tax shall be treated as held from HMG.
- © The amount of tax withheld is not subject to attachment in respect of debt or liability of the agent.

2.2.4.8 Gain on Disposal of Assets

Types of assets

- i. Business assets: Except trading stock and depreciable assets.
- ii. Depreciation assets: Those assets whose value decreases due to wear and tear or obsolesces or passing of time
- iii. Non-business chargeable assets: Securities or interest in a security as well as land and building, it includes; a private resident of an individual that has been owned continuously for three years or more or lived in any individual continuously for a total of 3 years or more, private resident of an individual that is disposed off for less than Rs. 10 million and disposed off by the way of any type of transfer other than sell and purchase made within three generation. Capital gain means excess of sales price over purchase price. Gain or loss from disposal of assets means gain or loss from disposal of business and non-business chargeable assets.

Disposal of assets includes following transaction besides direct sales.

- © Parting ownership
- © Merging with another assets
- © Leading under financial lease
- © Surrender the ownership
- © Lost of an asset
- © Destroy of an asset
- © Death of an individual owing the assets

Computation of gain or loss from disposal of assets is carried as follows:

Gain/Loss = Sum of incomings for the assets - sum of outgoing for the assets.

Where,

Outgoing = Expenditure incurred such as cost of acquiring, cost of construction, preparing, maintenance etc.

Incoming = Sum of amount received against disposal of assets.

2.2.4.9 International Taxation

As per section 6, Nepal as well as foreign source of income of a resident person from any employment, business or investment is treated as an assessable income or taxable income. The major provision for international taxation provided by the Act is as follows. (Note that such taxation is introduced in Nepal for the first time).

- ⊙ Source having in Nepal, the income, loss, gain and other payments of non-resident person is taxable as per section 67.
- ⊙ As per section 68 a foreign permanent establishment of a non-resident person situated in Nepal is liable to pay tax with respect to its income.
- ⊙ A non-resident entity in which a resident person holds an interest, directly or indirectly (sec 69).
- ⊙ A non-resident carrying on a business such as air transport, shipping, tele-communication is taxed at flat rate on their income (sec. 70).
- ⊙ Repatriated income of a foreign permanent establishment of non-resident person situated in Nepal is taxable as per section 6.
- ⊙ A tax credit may be claimed for any foreign income tax paid with respect to foreign source of income but the tax credit should not exceed the average rate of Nepalese income tax applied to the such income.

2.2.4.10 Installment Payment of Income Tax

Every person who is an installment taxpayer for an income year is required to file annual statement of estimated tax by the due date of payment of first installment i.e. end of Poush. Provision for the installment tax payment is created in section 88, 94 & 95 in the Act. According to these provisions installment payment of tax should made as follows:

1st installment 40 % of tax by the end of Poush

2nd installment 70 % of remaining tax by the end of Chaitra

3rd installment 100 % of remaining tax by the end of Ashad

2.2.4.11 Tax Accounting and Timing

Chapter six of this Act has been composed for the existence of similarities in tax accounting and timing of activities among the various taxpayers. This chapter has five sections 22, 23, 24, 25 & 26 respectively. For the purpose of tax an individual other than natural person having employment or investment or both income is required to accounting as per cash basis. A natural person operating proprietorship business is liable to maintain his account either cash or accrual basis. Company including corporate bodies, any un-incorporated association, committee, institution, trust, partnership, retirement fund, co-operatives, joint ventures, foreign companies and other prescribed foreign institution are required to maintain account in accrual basis. And other entities, business or investment can maintain its account either cash or accrual basis. Besides above in this chapter provision for adjustment of bad debts and inclusions and deduction under a long-term contract have been mentioned.

2.2.4.12 Quantification, Allocation and Characterization of Amount

The section 27 to 35 of the Act are aim to take control over the following things.

- © To quantify a person's income as well as amount to be included and deducted in calculating the income in Nepali rupees, if the income is in currency other than the Nepali rupee.

- © To allocate the indirect payments of a person and jointly owned
- © Investment of a person with another person, amount to be included and deducted in calculation & apportionment of interest in the investment among the joint owners.
- © To the characterization of compensation payment of a person under annuities installment sales and financial lease.
- © To central over the tax evasion and avoidance through transfer pricing, arrangement between associates and income splitting.

2.2.4.13 Right and Duties of Taxpayers

Taxpayer means a person who is under the obligation to pay income tax according to income tax law. The term also includes any person who has to pay tax and on whom the tax officer has served any notice or taken any action under income tax act. Income tax Act 2002 has defined the taxpayer as different persons; accordingly, the Act has defined the taxpayer's rights and duties.

1. Rights of taxpayers

- © To get due respect
- © To getting notice of tax related information as per the law
- © To submit clarification in-case related to tax
- © To appoint auditor or lawyer for defending
- © To get secrecy maintained as regards to the confidential matter
- © To get refund of the excess amount of tax from the government
- © To submit return
- © To get personal ruling
- © To study the public circulars

2. Duties of taxpayers

- © To register and get Permanent Account Number
- © To provide information to tax office if there is change in any details of Permanent Account Number.
- © To deduct tax at source

- © To pay tax installment
- © To provide information asked by the tax officer
- © To attend tax office if he /she is ordered to do so.
- © To adopt accounting method prescribed by HMG.
- © To pay tax within stipulated time and place.
- © To file returns within stipulated time.
- © To maintain books of account and other documents properly.
- © To file statement of tax withhold.

2.2.4.14 Rights, Power and Duties of Tax Administrators

The outline of tax authority or administration hierarchy is as follows:

1. His Majesty's government.
2. Director general of Inland Revenue Department
3. Deputy Director general, chief tax administrator, director, chief tax officer or officer appointed as the chief of a tax office.
4. Tax officers and other officers.

1. Power of His Majesty's government

- © To allow deducting any amount of gifts or expenses for special purpose.
- © To establish offices of the department and prescribe their jurisdiction.
- © To make agreement to avoid double taxation.
- © Power to prescribe the situation for requirement of permanent account number.
- © To be a plaintiff and to investigate and file lawsuit.
- © To take service of expert.
- © To issue an order or direction.
- © To enact rules.
- © To change in schedules.

2. Rights and powers of director general

- © To decide or prescribe certain entity as exempt organization.
- © To allow deduct losses from a business of long term contract.
- © To prescribe accounting and to accept change in method of accounting.
- © To accept the tax accounting.
- © To adjust the splitting of income.
- © To approve retirement fund.
- © To delegate and authority and assign officers.
- © To issue public circulars.
- © To specify form of documentation.
- © To require a person to show PAN.
- © To rectify the defective documents
- © To obtain information
- © To use best judgment assessment
- © To extend the time to file income return
- © To make official assessment
- © To seize assets of tax debtor and auction the assets
- © To prohibit departure
- © To recover tax arrears from receiver and person owing money of tax debtors
- © To recover tax arrears from agent if non-resident
- © To lodge lawsuit for unpaid tax
- © To adjust and refund
- © To make assessment and charge of interest and penalties
- © To order for payment of amount of fine
- © To take departmental action
- © To exercise power enjoyed by the court
- © To develop and issue directives

**3. Powers of Deputy Director General, Chief Tax Administrator, Director
Chief Tax Officer, or Officer appointed as the Chief of IRO**

- © To issue public circular
- © To specify the form of documents

- © To stay or otherwise affect a review able decision
- © To allow or disallow the objection by any person in whole or part
- © To compound an offence
- © To delegate the exercise of any such power to another tax office

4. Powers of tax officer and other officer

- © To issue public circular
- © To specify the form of documents
- © To stay or otherwise affect a review able decision
- © To allow or disallow the objection by any person in whole or part
- © To compound offences
- © To access information
- © To issue notice to the person owing money to tax debtor for the purpose of recovery of tax

5. Duties of Tax Officials

- © To provide Public Circulars
- © To provide personal ruling
- © To provide PAN
- © To maintained official secrecy of the documents or information
- © To provide evidence of tax payable
- © To notify the decision of extension of time to file income return
- © To treat as a self-assessment
- © To notify about the seizure of asset
- © To notify about he auction of seized assts
- © To get pre-approval for extension of the time limit of departure prohibition order
- © To serve a notice to the receiver of debtors
- © To serve notice to person owing or holding money to tax debtors.
- © To serve a notice to the agent of non-resident tax debtor.
- © To refund excess tax paid by a person.
- © To review of decision.

- © To notify about the assessment of interest and penalties.
- © To specify necessary information in issuing an order for payment of amount fine.
- © To keep with an identity card

[Source: Taxation in Nepal by Surendra Keshar Amatya, 2004]

2.2.4.15 Penal Provision

Penal provisions are a part of any tax law. It must be remembered that not all taxpayers comply with the tax laws voluntarily. Some potential taxpayers may try to remain out of the tax net, some taxpayers may not maintain proper account, some taxpayer may not submit tax return, some taxpayers may not pay tax and so on. It is necessary to take action against those who do not comply with the tax laws. In this context, there is a universal practice around the world to include penal provisions in the tax law (Khadka, 2001:94).

Income tax Act 2002-has included detailed penal provision, which is divided into two parts.

- A. Interests and Penalties.
- B. Offences.

A. Interests and Penalties

The circumstances in which a tax office imposes interest and penalty are as follows:

1. Penalty for failure to maintain documentation or file statement or return of income (Section 117)

When the person fails to do the things above he is liable to pay penalty as 0.1 % per annum on assessable income without any deduction or Rs 1000 per annum whichever is higher.

2. Interest for understating estimated tax payable by installment (Section 118)

If an installment payer's estimate of tax payable for any income year is less than, 90 percentage of the correct amount, the person is liable to pay an interest. The

interest amount could be 15 percentages per annum for each month and part of month from the date of due until the date of tax payable on an assessment.

3. Interest for failure to pay tax (Section 119)

A person who fails to pay tax on or before the date on which the tax on or before the date on which the tax is payable is liable to pay interest for each month and part of month for which any of the tax is outstanding. The applicable rate of such interest is 15% per annum.

4. Penalty for making false or misleading statement (Sec 120)

A person who makes and presents the false or misleading statement or omits any matter from the statement knowingly or recklessly is liable for a penalty. The rate of such penalty is 50% of the underpayment of tax if it happens to be without knowingly or recklessly but the underpayment is made knowingly then at such circumstances the person is liable to 100% of underpayment of tax as penalty.

5. Penalty for Aiding or Abetting (Sec 121)

A person who knowingly or recklessly helps or assists another person to commit an offence or counsels or influences another person to commit the tax misleads such a person is liable for a penalty equal to 100% of the underpayment of tax

B. Offences

Income Tax Act 2002 has pointed out following offences to take action against the non-compliances.

1. Offences of failure to pay tax (Sec. 123)

A fine of Rs 5000 to Rs 30000, or an imprisonment for one month to three months, or both.

2. Offences for submitting false or misleading statement (Sec. 124)

A fine of Rs 40000 to Rs 160000, or an imprisonment for six months or two years, or both.

3. Offences of impeding and coercing tax administration (Sec. 125)

A fine of Rs 5000 to Rs 20000, or an imprisonment for one month to three month, or both. Half of such offences are for the person who attempts to support any one on impends.

4. Offences by authorized and unauthorized person (Sec. 126)

A fine of rupee not more than 80000, or an imprisonment for not more than one year or both is liable for the person who is authorized and violating official secrecy.

If in the case of unauthorized person a fine of Rs 80000 to Rs 240000, or an imprisonment of one to three years, or both is liable.

5. Offence of Aiding or Abetting (Sec 127)

The person who knowingly aids or abets another person to commit an offence is liable to half of the penalty that is imposed on the main offender. But full penalty; equal to main offender, is imposed on the government officials who aid others to commit such an offence.

6. Offence of failure to comply with Act (Sec. 128)

A fine of Rs 5000 to Rs 30000 for the person who fails to comply with any provision of the Act and the rules.

2.2.4.16 Administrative Review and Appeal to Revenue Tribunal

As per section 115 a person who is not satisfied with the review able decision, may file an objection in writing and specifying the grounds in detail upon which it is made within 30 days, after the decision is made. In case the time passed over, and then the taxpayer can apply for extension for a period within the 7 days. If the department finds reasonable causes, it can extend for a period not exceeding 30 days by which objection must be filed. In the following decisions or against the following decision made by the department to the concentration of taxpayer, the taxpayer can appeal to the Revenue Tribunal.

- © Advance ruling issued by the department
- © Decision made by the department regarding estimated tax
- © Decision made by the department to require the person to file return
- © Decision made by the department on an application by a person to extend the due date by which the person must file return.

- © An assessment of income tax payable or interest and penalties payable by the person.
- © Notification of the department stating an amount to be set aside by a receiver
- © A decision by the department to require to pay money owing to a tax debtor.
- © A decision by the department to require to pay tax on behalf a non-resident person.
- © A decision by the department on an application by the person to refund tax.
- © A decision by the department on an application by the person for an extension of time within which to file an object.

Suggestion of the Taskforce/NG (2003) Regarding Income Tax Act 2002:

With respect to income tax act, 2002, the task force/NG(2003) explained its demerits vague, complicated and use of difficult language. In this connection the taskforce stated: (Dhakal, 2004: 66-67)

"Many people regard income tax act 2002 to be complicated. There are many reasons behind it. For example, with the intention of modernizing the income tax, there has been the use of various tedious, new and difficult concepts and definitions. Similarly, the presentation of this act was also different from previous. At times, there is the need to refer to different sections and sub-sections. From the legal point of view, this type for presentation however has its own importance. The language used in the act is also not simple. Selection of new words has also made this act difficult to understand in the beginning. Due to difficulty in understanding the act, it has created an environment of fear among the taxpayers" (Task force/HMG, 2003: 47).

To overcome the problems of the act the taskforce/HMG (2003) has suggested:

- © Simplification of the difficult points.
- © Publication and distribution of booklets and guidelines.
- © Publication of articles, advertisements and notice about tax in journals and newspapers.
- © Launching tax programs on radio, T.V., etc for providing information to the public.
- © Conducting interaction and workshop programme etc.

© In this regard, in "Public statement on income and expenditure of the fiscal year 2003/04", the finance minister expressed: "A income tax act, 2002 has been enacted recently; it will take some time to know its implications. Nevertheless, efforts have been made to make the act simple and understandable to eliminate taxpayer grievances on ambiguity contained in the language. Similarly, making manual and directives public within six-month period will make income tax system taxpayer oriented" (Public statement on, Income and expenditure of five fiscal year 2003-2004: 41, HMG/N).

2.3 Review of Literature

2.3.1 Review of Literature before 1990s

Various books are written, articles are published and different individuals and institutions in concerning to income tax conduct researches. Income tax was firstly imposed in Fiscal Year 1959/60 in Nepal under the 'Business profit remuneration tax act 1960'. Then after, various studies were made concerning with various aspect of this act such as the structure, role, productivity, legal and administrative framework etc. Summary of relevant studies are given in the following paragraphs:

Mr. Amatya conducted a study through a book published in 1965. The title of the book is "Nepalma Aayakar Byabastha." He has analyzed the legal aspects of income taxation in his whole book. His contribution was first in this field (Amatya, 1965).

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

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

and administration to increase government revenue through income tax (Lent, 1968).

Mr. Kayastha has tried to analyze the contribution of income and property taxes to the national revenue of Nepal. He has pointed out the problems of tax system and gave enough suggestions for policy correction. The suggestions given by him in 1974 were still considerable in the Nepalese context. Major problems of income tax system in Nepal mentioned by him are income tax evasion and dominant role of indirect tax in total tax revenue (Kayastha, 1974).

Bhattarai and Shrestha have described about tax act rules and regulations. They have tried to give details theoretical knowledge about legal aspect of tax rather than critical analysis (Bhattarai and Shrestha, 1976).

Dhungana, Kayastha and Rai have published a report entitled "An analysis of tax structure of Nepal" dealing the tax structure of Nepal. Writers have analyzed the income tax in Nepal and recommended to reform income tax to reduce resource gap and mobilize additional resource. Report wasn't analytical (Dhungana, et al 1976).

Professor Dr. Govinda Ram Agrawal in his research report "Resource Mobilization For Development: The Reform of Income Tax in Nepal", 1978 has analyzed the various items of income system of Nepal. Role of income tax, legal aspect of income tax and administration, problems facing by the tax authority, tax evasion problems etc. are the major things that he has analyzed in his research report. As the reason of the tax evasion the government revenue is decreasing. To minimize tax evasion it needs continuous process, the tax evasions are not the matter that can be isolated. Various tax-promoting points as such are the major suggestions regarding tax evasion that he has given in his report. Major reasons of inefficiency of tax administration that he has stated in his report are failure to locate new taxpayer, failure to maintain proper account and record, defective selection of personnel, lack of training and competent tax personnel, undue delay in making assessment, lack of motivation in tax personnel, existence of corruption, complicated tax law and procedures, instability in government policy, etc. (Agrawal, 1978).

Pandey, in his study had discussed various aspect of income tax such as legal aspects, structure of income tax, role of income tax, problems of income taxation, economic effect of income tax in Nepal. He had highlighted on tax structure of Nepal. According to him, income tax played a significant role in the economic development of Nepal. He found the capita burden of income tax was Rs. 0.2 in 1962/63 and it had increased to Rs. 7 in 1975/76. He had stated that indirect tax had a dominated role in the total tax revenue. Lack of scientific record keeping, lack of maintaining accounts by taxpayers, lack of coordination, lack of scientific method of income tax assessment and collection procedure, lack of honest tax officers are the major problems identified by him. His suggestions about income tax were capital gain should bring in tax net, income tax accounting assessment and collection method must be scientific etc. His study was done with main objectives of examining the economic effects of income tax but he had not described it with numerical examples and empirical investigation (Pandey, 1978).

In the year 1980, Dr. Agrawal has presented another research report concerning about the income tax administration. He states, tax administration is an important sub-system in the total system that can either carefully tend or mercilessly kill the goose that lays golden eggs. It is the essence of implementing tax policy and laws. Too much pre-occupation with to do in terms of tax policy and law alone is not good unless attention is given to how to do it in terms of tax administration. He has found that, there are no integrated programs for taxpayers' education, assistance, guidance and counseling. About the major problems of tax administration he found are corruption, unfair dealings, harassment and incompetent personnel, etc. (Agrawal, 1980).

In 1981, Rojalin Singh Suwal made a study concerning income taxation in Nepal. She has examined the various problems in Nepalese income tax system and importance of income tax in solving financial problems in Nepal, per capita burden of income tax, and effects of income tax in production and trend of income tax in Nepal etc. The major problems that she has identified are the absence of clear and comprehensive definition of incomes, low tax paying capacity and tax consciousness, high tax rates, corruption etc. (Suwal, 1981).

Subedi has analyzed about the role of income tax on national revenue of Nepal. He has examined the growth of income tax collection, its ratio to GDP, cost of income tax collection and elasticity. He has also included historical perspective and legal aspect of income tax in his study. He has pointed out that tax evasion, inefficient tax administration and dominated role of indirect tax are the major problems in Nepalese tax system. He has suggested that tax administrative reform is the major necessity in development of income tax system (Subedi, 1982).

In 1982, Mr. Purusottam Subedi conducted a study. In this study, he has mentioned role, legal aspects, historical background, elasticity and cost of income tax collection. He has also discussed on income tax evasion, contribution of direct and indirect tax. He has identified income tax evasion and poor performance of income tax is the major problem of Nepalese income taxation (Subedi, 1982).

Nepal has critically examined the income tax system of Nepal in that time. Her study has been conducted with purpose of examining the role of income tax in overall tax structure, analyzing the problems and prospects of income tax in Nepal and highlights the future prospective of the Nepalese income tax (Nepal, 1983).

In 1984, Roshani Shrestha has conducted a study concerning with the origin, definition, concept, historical background, role, objectives and structure of income tax. The major problems existing in Nepalese income tax system identified by her is tax evasion. She has recommended that the practice of evasion must be controlled, and then income tax can contributed toward the economic growth of Nepal by channeling more resources (Shrestha, 1984).

Regmi has prepared a dissertation with the main objective of examining the trend of income tax in Nepal, ascertaining the share of income tax to total tax revenue and its ratio to gross domestic product. He has also stated as a great problem in income tax in Nepal. To increase the revenue of government, he has recommended that income tax law should be clear and precise, scientific method

for accounting assessment and collection of income tax, widening tax coverage, easy and simple procedure of tax payment, public awareness (Regmi, 1986).

Mr. Chudamani Siwakoti has conducted a study in the year 1987. . As per his study the major problems of Nepalese income taxation are income tax evasion at high rate, delay in assessment, insignificant role of income tax in total tax structure, lack of public information about tax, complicated act, etc. In the finding of his study he has stated progressive tax, honest and efficient tax administrators and research units in tax administration are the crucial things for revenue maximization through income taxation (Siwakoti, 1987).

Mr. Prem Timilsina conducted a study in Nepalese tax evasion practice. Basically he has tried to suggest the Nepalese government the causes of tax evasion. According to him if the tax evasion practice is controlled indefinitely Nepal can maximize revenue and mobilize such revenue toward national development. In 1987 the study was conducted (Timilsina, 1987).

Baral 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 total revenue; total tax revenue and direct tax revenue have an increasing trend in Nepal but in low rate. She has mentioned that tax evasion as the major problem of income tax system in Nepal. In her study, inefficient tax administration, unconsciousness of taxpayer, lack of scientific method of tax assessment and collected have identified as the major reasons for tax evasion at high level (Baral, 1989).

Poudyal and Timsina had described the provisions and laws related to income taxation of Nepal in a book named "Income tax in Nepal." this book is extremely based on the syllabus of B.Com. They were described the theoretical as well as practical aspects of income tax. He has not analyzed the role of income tax, income tax structure and defects of income tax in Nepal. The book was descriptive rather than analytical (Poudyl and Timsina, 1990).

2.3.2 Review of Literature After 1990s to 1999

Bhandari has tried to examine historical background, tax structure in Nepal and contribution of income tax to economic development of Nepal. He has stated that actual collection of revenue through income tax was lower than its estimated targets because of the poor tax paying habit of Nepalese taxpayer, poor tax administration system, widespread evasion of income tax. He has suggested to make effective personnel management, increasing habit of tax paying of Nepalese taxpayer through proper tax education and better public communication system, minimize tax evasion, reduce tax collection cost (Bhandari, 1994).

Khadka had discussed the economic policy of Nepal, VAT as a long-term tax for Nepal. Income tax, improving tax administration, tax reform strategy. He had analytically described about development, existing structure, main problems and possible direction of reform of income tax. He had identified the major problems of income tax as narrow coverage, unscientific tax assessment and collection, defective system from the perspective of international taxation. Weak tax administration, imbalance and inadequate organizational pattern, inadequate physical and other facilities, inadequate tax training, predominance of low level non-technical posts, debatable scope of revenue investigation department, lack of information system were the major problems of tax administration identified by him. He had suggested some suggestions to overcome from the problems of income tax which were extension of tax coverage, scientific method of tax assessment, extension of withholding tax, inflation adjustment etc. He had also identified some possible direction for administrative refer. They were reorganization and expansion, applying integrated information system, research unit on taxation, strengthening the revenue service. His book was analytical and very useful to obtain the various aspects of income tax (Khadka, 1994).

Mr. Acharya has conducted a study on Income Tax in Nepal: A study of its structure, productivity and problems. He has analyzed the exemption limit, allowance, rate structure, tax administration and problems concerning the legal aspect in his study. According his study the main objectives of income tax should be to achieve social justice, to check inflation and to collect more government

revenue. Further he has identified the contribution of individual income tax is highest in comparison to other income tax paying groups such as public enterprises, remuneration etc. (Acharya, 1994).

Khadka has conducted a research on 'Nepalese Taxation: A path for Reform' Mar burg Germany, tax system. The major issues are; narrow tax base, less productive, Inelastic, Distortions, Inequality, Complicated Procedures, Lack of coherent and stable tax policy, Weak tax administration, Low level of voluntary tax compliance etc. In his research he has indicated possible directions for reform as recommendations.

- © Necessary to launch a comprehensive long-term tax reform program with the aim of establishing an ideal tax system over the years.
- © Improving tax administration.
- © Raising the level of voluntary tax compliance (Khadka, ibid).

In the year 1995, Mr. Krishna Kumar Shakya has mentioned in his study Nepalese income tax net is limited by various factors such as low per capita income, extensive subsistence economy, relatively closed economy, weak export position, etc. According to his study lack of comprehensively and clearly defined income taxation process, lack of punishment to the tax evader, low tax paying capacity and non-response of taxpayers, lack of effective tax administration, scientific method of tax collection and collector are the main reasons for growing income tax evasion (Shakya, 1995).

Pant 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 system, lack of taxpayer's education, very narrow coverage of income tax are the other problems of income tax management in Nepal identified by him (Pant, 1996).

In the year 1998, a book based on syllabus of BBS third year Professor Kamal Deep Dhakal has published. The book contained three things, Income Tax as per Act 1974 house and compound tax and value added tax. After the year he has

published the same book in the edition 2000 and 2001. He has included all the changes regarding the provisions in the editions (Dhakal, 1998).

In the year 1999 Mr. Narayan Raj Tiwari conducted a study through book named Income Tax System in Nepal. The book is also based on syllabus of TU. The book is knowledgeable for theoretical as well as practical knowledge about Income Tax Act 1974 (Tiwari, 1999).

2.3.3 Review of Literature after 1999

Timilsina has concentrated his study on mainly on the analysis of exemption and deduction of Income Tax Acts of Nepal. In his study, he showed that contribution of corporate tax is higher compared to individual income tax. He recommended to increase the exemption limit for an individual; to a minimum of Rs. 90,000 and for family exemption based on the mo of dependent children and parents. He further recommended levying income tax on agriculture, capital gains and other sources to raise tax base (Timilsina, 2001).

A study conducted by Bibha Pradhan is in the boundary of role of income tax in Nepal and role of public enterprises in government revenue. She has concentrated her study in Nepal Telecommunication Corporation. Main problems that she has stated in her study are least contribution of income tax form public enterprises, weakness in government policy and deficiency in legislation. She has identified the clear cut provision of income taxation, checking discretionary power of tax personnel, reward and punishment system to increase voluntary compliance and to control corruption, tax education to taxpayers and reduction of undue delay in tax assessment etc. can establish a better income tax system in Nepal (Pradhan, 2001).

In the year 2001, Dr. Rup Khadka has published a book named "Income Taxation in Nepal: Retrospect and Prospect." This book is complete information of Nepalese income taxation. From the income tax around the world to the draft income tax act 2001 (later it become Income Tax Act 2002), all the information

and major provisions regarding the matter are mentioned in the book. Besides these, Income Tax Act 1960, 1962 and 1974 in detail are also presented in the book. He has described what is the practice in the world, what was the practice in Nepal, and at present, the all terms relating to the tax. The book is a knowledgeable for all of them those who are concerned about income tax such as CA, Auditor, Administrator, Policy-maker, Teachers, Students etc. (Khadka, 2001).

In the year 2001 Dr. Chandra Mani Adhikari has published an article form *Rajaswa* vol. 2. In his article he has explained the need of tax policy that can play significant role in the Nepalese economy. According to him, a little attention on tax administration can minimize the role of tax policy. Nepalese income tax is waiting for a comprehensive and integrated taxation plan and scientific implementation of the same by the way of reform. Further he has stated Nepalese tax system has three types of gaps: they are investigation and identification gap, return filling gap, assessment and collection gap. He has suggested that the tax administration should consider as an important component of tax policy to achieve the goal of revenue maximization through taxation (Adhikari, 2001).

Pradhan has presented a dissertation named, "Contribution of income tax form public enterprises to public revenue of Nepal." She tried to analyze the contribution of income tax form PEs to public revenue of Nepal. She has also showed the contribution of income tax form NTC to total tax and total income tax revenue of Nepal as well as the effectiveness of income tax revenue collection from NTC (Pradhan, 2001).

Poudel 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 of 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%, indirect taxation has more significant contribution in total tax revenue, 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 in 1999/2000, VDIS could not attract more potential taxpayers into tax net due to lack of good planning and adequate homework of the government, working procedures of the tax administrators are still traditional and cost of administration has not been brought to the satisfactory level (Poudel, 2002).

Mr. B.K. Singh has stated the problems facing by the taxpayer and their attitude towards Nepalese tax system in his study conducted in 2002. According to him tax administrators making black money through best judgment of income tax assessment and taxpayers are saving their tax payments of serving bribe to the tax administrators in different form. In his finding he states the major defects of income tax assessment in Nepal. Most appropriate and reliable method of income tax assessment is the assessment of income tax on the basis of account submitted by taxpayer. Due to committee and beat judgment assessment taxpayers are not motivating to pay tax and maintaining accounts. Tax assessment process is often delayed in Nepal, due to lack of relevant information to the taxpayers and no extreme effort by the administration to manage income tax, etc. Further he states the major reasons behind the delay in tax assessment are ineffective and inefficient tax personnel, no provisions to penalize the incompetent tax personnel, inadequate fine and penalty provisions, and delay in Revenue Tribunal decisions. The study is based on Income Tax Act 1974 (Singh, 2002).

Kandel had criticized the Income Tax Act 2002 on several grounds. Exemption of agriculture income from income tax, export duties levied on export, inequality between different capital earned income (i.e. tax on interest, dividend and capital gain) withdrawal of the provision of exemption suddenly and no adjustment for inflation are the major issue he raised in his article. The further criticized the act for the provision of income tax form export as 0.5 percent of total export because it is not good choice of income tax base (Kandel, 2003).

Adhikari has discussed the legal provision of new Income Tax Act, 2002. His book is analytical rather than informative. Writer has not included administrative aspect, role and structure of income tax in his book. The book has only focused on the legal aspect of income tax. Agreement and protocol relating to avoidance of double taxation and the prevention of fiscal evasions with respect to taxes on income between different countries had also included in his book (Adhikari, 2003).

Mallik had published book named "Nepalese Modern Income Tax System." He had described historical aspects of income tax and legal provisions relating to income tax with numerical examples. This book is very useful to know the general information and legal provision of Income Tax Act 2002. His book was informative rather than analytical. He had not analyzed the role of income tax, structure of income tax in Nepal (Mallik, 2003).

Mr. R.K. Lamsal has published a technical not as per requirement of courses of BBS and MBS giving the name tax law and tax planning. The book is conducted within seven chapters. Each chapter of this book contains practical problems and solution regarding the provisions of act 2002 (Lamsal, 2003).

Mr. P.R. Kandel has published a book named tax laws and tax planning in Nepal in the year 2003. The book is about Income Tax Act 2002 and value added tax. This book is also prepared as per syllables of MBS, T.U. for the practical problems and provisions relating to the act this book could be a useful source. And, the practical problems and provision relating to VAT is also given equally important in the book (Kandel, 2003).

Magar wrote a thesis entitled 'Income Tax in Nepal: A Study of Exemptions and Deductions.' He had recovered tax structure, role of income tax and exemptions and deductions provided in the law. He had found that there was dominated share of tax structure in Nepalese government revenue. Income tax had occupied third position in his study period and it was increasing trend. The tax/GDP ratio was not found satisfactory. With the 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. Lack of trained employees, shortage of income tax experts/professional in tax administration, lack of public participation, faulty organizational structure of tax administration, weakness in government policy, defective income tax act were the major cause for inefficient tax administration, observed by him. His suggestions about exemption were: revision of exemption limit, elimination double taxation on dividend, tax rebate for submitting true income statement in time, increase income tax rate slab up to 10, increase the exemption limit to individual as well as family etc. Besides above suggestions, his suggestions about deduction were; clear provisions for deduction; fully allowed interest expense, pollution control expenses, repair and improvement expenses, research and development expenses. He is totally concentrated on the exemption and deduction in his study. He has not study about various aspect of income tax (Magar, 2003).

Adhikari wrote a book entitled 'Modern Taxation in Nepal: Theory and Practice'. This book also has been written according to the syllabus requirement of different faculties. Especially, the BBS 3rd year syllabus of Tribhuvan University has been taken into consideration. Income Tax act, 2058 as amended by Finance Ordinance, 2060 has also been included. Theoretical as well as practical aspects have been put in the book (Adhikari, 2003).

A book published by Mr. Ishwor Bhattarai and Girija Prasad Koirala however the concentrated in the syllabus of MBS second year of TU the book is quite informative. The book has much more practical problems and solutions regarding income tax assessment form different groups of income. Note to remember (NTR) in each and every chapter has made the book more use full to all the user of book (Bhattarai, 2004).

A book by Surendra Kershar Amatya and other two senior tax expert is published in the year 2004. The book aims to fulfill the course requirement of BBS, BBA, LLB, LLM, CA, MPA, BMS and MBA students. The book has defined all the terms relating to income tax and value added tax. The examples presented in the book help to reader to know more about provisions and procedures of act. Furthermore this book has enough practical examples also (Amatya, 2004).

Mr. Shakya had conducted 'A study of Income Tax Act 2002'. The general objective of the study is to overview the new Income Tax Act 2002. Basically he has tried to find out effectiveness and problems of implementation of Income Tax Act 2002. He had suggested that the effective implementation of an act, first of the entire act should be understandable to the taxpayers as well as tax administration, tax education should be provided to increase the voluntary compliances of exiting taxpayers and to increase the numbers of taxpayers, self-assessment of income tax should be done effectively within the mutual understanding and belief between taxpayer and tax administrator and the corruption should be minimized to make take administration effective (Shakya, 2004).

Rai presented a dissertation named "An analytical study on Income Tax Act, 2058" in 2004 has focused her study to analyze various expect of Income Tax Act, 2058 in reference to income heads. She examined income tax in its historical perspective and reviewed the income tax system of Nepal in context of its contribution to the total revenue and total government revenue. She wanted to find out the ways and means for increasing tax consciousness among the Nepalese people. She has suggested that the laws relating to income tax should be clear, simple and comprehensive. It should not contain any loopholes and ambiguity. Therefore it should be reviewed frequently. She wanted to make clear that in Nepal, one of the must important reasons for unsound income tax system is inefficient and unscientific income tax administration (Rai, Rina: 2004).

Mr. Gautam has concentrated his study on "Contribution of income tax to national revenue of Nepal." In his study, he analyzed the contribution of income tax to national revenue of Nepal and volume of indirect tax and direct tax in total tax revenue. He also examined the effectiveness of Income Tax Revenue collection in Nepal.

In his study he found that the contribution of tax revenue shows the decreasing trend as it had contributed by 85.2 percent in fiscal year 1982/83 on the total but it was decreased to 78.0 percent in 2001/2002. He also stated that there is dominant role of indirect tax revenue in Nepalese taxes revenue. Average

contribution of direct and indirect tax revenue to total tax revenue is 20.63 percent and 79.40 percent over the study period. Lastly he recommended that taxes ratio should be increased gradually on long run basis to meet the deficit in budget. For this, the tax base should be widened. The principle of ability to pay should be completely adopted (Gautam, 2004).

Mr. Kafle (2004) has presented a dissertation entitled, "Income tax contribution from Nepalese public enterprises" mainly focused on Nepalese electricity authority. In his study, he had reviewed and analyzed the contribution of income tax from PEs to national revenue and examined the effectiveness of income tax revenue collection from PEs. He has found the contribution of income tax from NEA to total tax revenue and total income tax revenue on national revenue of Nepal and examined the major problem of income tax system. He found NEA had been contributing income tax revenue not effectively but traceable contribution to total income tax revenue. Income tax revenue from NEA is fluctuated year by year. In the fiscal year 1999/00 income tax revenue collection jumped a figure of Rs. 260 millions a year before to Rs. 571.4 million an increase of 119.77 percent, then after it declined to 49.1 millions in the fiscal year 200/01. The contribution of income tax revenue from NEA in total tax revenue and total government revenue is 0.26% and 0.21% respectively in the fiscal year 2001/02 (Kafle, 2004).

Dr. Dhakal's study on "Income tax administration in Nepal: Areas for reform" analyzed historical perspective on income tax in Nepal, tax Structure in Nepal, administrative aspects of income tax in Nepal, the ways and means for increasing tax consciousness in the public, and he has conducted an empirical investigation regarding the problems on various aspects of income tax administration system of Nepal. His study emphasized on drawing a clear sketch of income tax administration in Nepal and its problems. He also gave recommendation for the improvement of income tax administration in Nepal. According to him the tax administration in Nepal is facing the following problem (Dhakal, 2004).

i. Failure to locate new taxpayers

- ii. Poor-record keeping system of taxpayers
- iii. Weak tax administration
- iv. Poor training opportunities
- v. Lack of motivation in tax personnel.(Dhakal, 2004)

Khadka wrote a book entitled "Modernizing tax administration in Nepal." this book is very much useful to anyone who is interested in Nepalese income taxation. This book gives almost complete information about the tax system of Nepal from its ancient time to current situation of income tax system. He has shared his expertise in his book. Basically author focuses on the administrative aspects of the tax system in Nepal (Kahadka, 2005).

Sharma has prepared a master degree thesis entitled "An analysis of fines and penalties regarding Income Tax System in Nepal." He has described about tax structure of Nepal, analyze the provision of fines and penalties under income tax law, examined the taxpayer's knowledge and tax officers views about fines and penalties, tried to find out the role of fines and penalties to increase tax paying habit of Nepalese people and provided suggestions about fines and penalties regarding to income tax system (Sharma, 2005).

Mr. Regmi Kumar Bikram has presented a dissertation entitled "Income Tax Administration and Its Effectiveness in Nepal." He has analyzed contribution of Indirect Tax and Direct Tax in Total Tax Revenue and find out the share of income tax in total tax revenue. He has examined the effectiveness of income tax revenue collection and administrative aspect of income tax in Nepal. He has described that effectiveness of income tax system depends upon the income tax administration. According to him, in Nepal, one of the most important reasons for unsound income tax system is inefficient and unscientific income tax administration. For the improvement of income tax administration he has suggested that delays in assessment should be reduced as possible, computerized information system is necessary to keep upto date records of income tax, proper tax education should be provided to tax officials as well as taxpayers regularly, cost of income tax collection is one of the determinants of efficiency of administration. Therefore, the concerned authority should pay due

attention to it should be reduced, unnecessary outside pressure should be avoided and income tax experts/profession should be increased in tax administration. He pointed out that the administration should pay great attention to bring the income from house and land rent; doctors; clinic, consultancy service, tuition, research works into income tax net. In these sector, income tax has been highly evaded (Regmi, 2006).

Mr. Oli has presented his thesis entitled, 'Contribution of Income Tax on Government Revenue of Nepal' and had tried to analyze the income tax structure and problems of resource gap in Nepal. He identified and predicated the share and trend of corporate income tax on government revenue.

In his study, he stated that normally 15 to 18 percent total tax/GDP ratio is regarded as moderate standard. But Nepalese total tax/GDP ratio is contributing 9.37% only on an average. So, the government uses appropriate measure to meet the standard, for that government can increase the portion of direct tax by bringing the education, public transportation etc. into tax net. He further added that the government has launched the ASYCUDA, consumers awareness lottery, 3 years consumers reforms and modernization action plan 2060 and self-assessment of tax by income tax act, 2058 which have positive impact on revenue collection. So, these programs should be continued further to strengthen and effectiveness in tax collection and avoiding tax evasion (Oli, 2006).

Shrestha (2006), has prepared a master degree thesis entitled "Contribution of income tax to government revenue in Nepal." She has described about the contribution of income tax to national revenue of Nepal and analyzed the volume of indirect tax and direct tax in total tax revenue. She also examined the effectiveness of income tax revenue collection in Nepal and tried to found views of the taxpayer, tax experts and tax officers (Shrestha, 2006).

Mini Singh (2006) had conducted her study entitled "Income tax collection from public enterprises." She has mainly focused on Nepal Telecom. In her study she analyze the resource gap pattern of Nepalese government and the income tax structure of Nepal. She has stated the contribution of income tax from public enterprises in government revenue and showed the contribution of income tax of

Nepal tele-corporation in government revenue, direct tax, income tax, corporate tax revenue.

In her study she has mentioned that the FY 1889/90, contribution of income tax from PEs to government revenue was 2.59%. In the year 203/04, it was 3.30%. Similarly, in corporate tax, PEs share has covered more than 50%. In initial stages, PEs contributed almost total share of corporate income tax. In the Fy 1989/90 the share of corporate income taxes from PEs was 97.90%. And its share has decreased to 42.49% in 2003/04. In total income tax revenue form PEs, NTC has contributed highest. NTC has 31.22% share of total income tax revenue from PEs in the Fy 1989/90.

She analyzed that contribution percentage of income tax from NTC to government revenue is fluctuating and decreasing during the study period even the amount of contribution is increasing. It was 2.52% in Fy 1995/96 and decreased to 1.89% in F/Y 2003/04. So, NTC should give high priority to increase the amount of revenue so that the contribution to government revenue would be increased. For that, NTC should prepare and implement profit planning and control concept effectively (Singh, 2006).

Dhungel (2006) had presented a dissertation entitled "Special provisions to individuals under income tax act 2058." She had examined and analyzed the effectiveness of special provisions provided by ITA 2058 to individual and identified the other provisions to be included in the special category. She also wanted to make aware about special provisions to individual (taxpayers) and tax experts. She has found special provisions to individual provided by ITA 2058 is not sufficient and more provisions should be provided and the retirement contribution should be wholly exempted, the tax concession to individuals working at different area is contradictory. Tax experts are satisfied and taxpayers are not satisfied (Dhungel, 2006).

2.4 Research Gap

Research means to search or study about a phenomenon. The word research, it composed by 're' and 'search' where 're' means repeatedly or again and again,

search means to investigate or find. Thus, to search again and again is research. Generally, research is an effort to search new fact, knowledge, and principle in scientific manner.

To achieve the ultimate goal of taxation, only tax policies and acts are not enough. For the achievement of targeted goals, the plans and policies must be implemented in efficient and effective manner. Tax administration is an important part of taxation system. It is necessary for successful implementation tax laws and policies.

Most of the previous research studies were based on laws, provisions and structure of tax revenue. Various reports, articles, books and thesis have been reviewed while preparing this thesis. Almost these were written on different objectives and topics of income taxation. Books are found mainly based on the syllabus requirement of T.U. of Nepal. The income tax system is the advance study topic which covers all the three important elements of the income tax system i.e. income tax administration, income tax act, and income tax policies. Most of them have indicated the inefficiency of tax administration, widespread of tax evasion and weak government laws policies. No attention has been paid on the administrative aspect and its effectiveness. The role of tax administration is crucial for the effectiveness of tax collection. Thus, to fill the gap, this research has been conducted. Finally, the researcher believes that it is unique and original.

CHAPTER III

RESEARCH METHODOLOGY

This chapter is dedicated to research methodology in the study for the achievement of desired objectives. The most of the data required for the study are applied from the primary data sources.

3.1 Introduction

A sound research study needs to follow a proper methodology in order to achieve predetermined objectives. Research methodology is a sequential procedure and methods to achieve the objectives of the study. In this chapter, an appropriate research methodology has to be followed. Thus, this chapter deals with the research design, nature of data, data collection and processing and statistical tools used.

3.2 Types of Research

This study includes three types of research as descriptive, analytical as well as empirical.

a. Descriptive research includes surveys and fact-finding inquires of different kinds. The major purpose of descriptive research is the description of the statue of affairs as it exist at present. The study of income tax act, income tax rules, and finance act were made for descriptive research. This thesis is mostly based on this type of research.

b. Analytical research has to use facts or information already available and analyze these to make a critical evaluation of material. As per this research type the chapter four has been composed.

c. The empirical research relies on observation alone after without due regards for system and theory. It is data based research coming up with conclusion, which is capable of being verified by observation. In such a research it is necessary to get at facts first hand, at their source and actively to go about doing certain things, to stimulate the production of desired information. Following the

research type the chapter four has been composed where an opinion survey had been conducted.

3.3 Research Design

To achieve the stated objective of the study, the study of income tax administration, income tax act, finance act and other related acts, rules, regulations and policies are made for descriptive and analytical research. For an empirical research an opinion survey has been conducted. The opinion of the various 60 respondents associated with distinct denomination i.e. tax administrators, tax experts and taxpayers were collected through structured questionnaire with reference to income tax system in Nepal, major problem of income tax administration, essential factors for making income tax administration effective, remedies to minimize corrupt practice existed in Nepalese income tax administration and reason of all these existence, examine the effectiveness of income tax policies, tries to find out its effectiveness and suitable principle of income tax policy for Nepal, reasons for income tax evasion, remedies to control the income tax evasion, consciousness of taxpayer for voluntary compliances and examine the contribution of income tax to national revenue of Nepal is satisfactory or not. Hence, the research methodology followed in the study can be termed as survey cum analytical and descriptive research design.

3.4 Population and Sample

In order to achieve the objective of the study, 60 samples from Kathmandu valley is selected. The respondents have been divided into three groups. The following table shows the group of respondent and size of sample.

Table 3

Group of Respondents and Size of Sample

S.N.	Group of respondents	Sample size
1	Income tax administrators	20
2	Income tax experts	20
3	Income taxpayers	20
Total		60

3.5 Nature and Source of Data

Data, which is essential to describe this study, are collected from two sources i.e. primary and secondary source.

- a. Primary data: The primary data have been collected from the responses of persons representing from various sectors through structured questionnaire. The same questionnaire was distributed to three group i.e. tax administrator, tax experts and taxpayers. Tax administrator is selected from tax department, various sectors of tax offices in Kathmandu valley. Tax experts are the CA/ACCA, lecturers, reputed auditors lawyers who have knowledge and ideas about income tax. Taxpayers are selected from different field i.e. manufacturing companies, trading companies, banks and finance companies, solo business and employee etc.
- b. Secondary data: The secondary sources of data are the information received from books, journals, newspapers, reports, dissertation, website etc. The major source of secondary sources of data are as follows:
 1. Economic survey and budget speech of various years, ministry of finance of Nepal/government.
 2. Publication of CEDA, T.U.
 3. Publication of central bureau of statistics/NG and department of Inland Revenue.
 4. Publication of UNO and World Bank etc.
 5. Books related to income tax and public finance.
 6. National newspapers, journals, souvenir and news magazines.
 7. Website of IRD www.ird.gov.np

8. Library of different campuses.

3.6 Data Collection Procedure

Data of this study are collected from two sources. Primary data are collected from tax administrators, tax experts and taxpayers by using questionnaire. A total seventy five sets of questionnaires were distributed to the three distinct types of seventy five respondents. Distribution was done personally through field visit rather than sending by any means to get accurate and actual information in time. Out of the seventy five questionnaires distribute sixty were received. Secondary data are collected from published reports of different organizations.

3.7 Data Processing and Analysis Procedure

The information received in different aspects of income tax from primary and secondary sources of data were first processed for tabulation and analysis. For the purpose of analysis generally simple statistical tools have been used which are as follows:

- i. Simple percentage
- ii. Simple average
- iii. Graphs, charts and diagrams
- iv. Rank correlation coefficient

3.8 Weight of Choice

The respondents are requested either to rank their answer or to give yes/no response or to write their opinion. In the case of ranking the answer, the scale varies from question to question. The scale is given according to the number of probable answer. For e.g. if the probable answers are 6, the scale is given 1 to 6 where 1 stands most important and 6 least important. The total points get by each choice are converted into percentage of total points available to the all choice. The choice having higher percentage is ranked as most important and the choice having lowest percentage is ranked as least important.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

4.1 Income Tax as a System

The implementation of any task is to achieve the specified goal or objective required for the set of organs in and with the common structure or function. Simply we can say a sound system is essential to achieve the specified goal. In the content of income tax, same thing remain, a sound, appropriate and effective income tax, i.e. maximize the revenue collection. In general there is three sub-systems in income tax system, they are:

1. Income tax administration
2. Income tax law
3. Income tax policy.

1. Income Tax Administration

The implementation of income tax law policy, strategy rule and program is carried by income tax administration. While income tax is concerned with public affairs the entire thing above is carried by the administration of government. Income tax administration implements the income tax provision made by the income tax law, policies and program of the government. Furthermore, law and policies are corrected and reformulated through the feed back information from the experience of the administration.

"Tax administration is an important sub system in the total tax system that can either carefully tend or mercilessly kill the goose that lays golden eggs. It is the essence of implementation tax policies and laws. Too much pre- occupation with what to do in terms of tax policies and laws alone is not good unless attention is given to how do it terms of tax administration" (Agrawal G.R, 1980:99).

2. Income Tax Law

To implement the policies taken by the government it requires the legal support, a constant law. Only as per the law a government authority can collect income

tax and so on. The constitution of country is a body that determines the law and makes provision. Income tax law is generally association with the;

- (a) Constitution of the country
- (b) Income Tax Act
- (c) Finance Act
- (d) Rules of concerned Act, and
- (e) Legal precedence established by the court

3. Income Tax Policy

The government itself through Ministry of Finance determines income tax policy. Income tax policies are the broad objectives and ways of doing in the matter of income tax. Generally, the policy of government is seen in the finance act of the country. Income tax policies can be divided into short term and long-term policy. Short term policy can be defined as the steps that are taken within period of one year and long term policy as the steps that are taken in more than one year period. The government, objectives of such taxes, sound levy, types of tax, mobilization of revenues collected from the taxes etc. are the ingredients of income tax policy. Policies play the supportive role to the income tax law.

4.1.1 Income Tax Administration in Nepal

4.1.1.1 General Background

Administration is the design of implementation of government polices. An efficient and effective administration is essential to achieve the objectives of any system. So, it is also taken as the heart of any system. Tax administration is regarded as tool for including some responsibility for determining the policies and the programs of government related to tax. Specifically, it is the planning, organizing, directing, coordinating and controlling of government organizations related to taxation. The shape of tax system in practice is determined to a great extent by the way it is administered. Administrative reform must go hand in hand with structural tax reform. While stressing the central role of administration in successful tax reform in developing countries, attention was drawn to three aspects of tax technology:

- (I) The role of administrative incentives;
- (II) Costs of taxation and other quantitative questions and
- (III) The link between expenditure.

The Inland Revenue Department administers income tax of Nepal. The Ministry of Finance, Customs administration, Revenue investigation administration and the Revenue Administration Training Center are also involved in the administration of income tax directly or indirectly. The Ministry of Finance is at the apex of the tax administration. It is responsible for overall administration of the government's fiscal and the monetary Policy. The Revenue Division of this ministry is responsible for formulation tax policy and setting up appropriate tax administration to implement tax policy. It coordinates the activities of all revenue departments, including the Inland Revenue Department and monitors the positions of revenue collection. It is responsible for the research, planning and analysis of the tax system. The customs administration collects advance income tax on imports. The Revenue Investigation administration investigates cases where revenue leakage was involved, with or without collusion between taxpayers and tax collectors. The Revenue Administration Training Center impacts training, workshops, and seminars for tax officials.

4.1.1.2 The Evolution of Modern Tax Administration

Efforts aimed at modernizing tax administration go back to the year 1951, the year the Ministry of Finance first came into being. The ministry had a revenue section to deal with tax administration at a central level. This section formulated tax policies and regulations, which were gazetted forthwith. Efforts were undertaken to abolish the contract system of revenue collection. Similarly, steps were also undertaken to abolish internal customs offices. Customs offices at the border points replaced offices known as Bazaar Adda. Customs tariffs were rationalized even as the authorities annulled Sanad Sawat (tax laws), which went back to the Rana regime. The years, which followed, saw enforcement of several steps with the holistic view of modernizing the tax administration. What follows is a brief outline of the steps taken.

4.1.1.3 Customs and Excise Administration

Under the Indo-Nepal Treaty of 1950, Nepal was obligated to open customs offices in different parts of the Terai region. Bhairhawa, Biratnagar, Birgunj, Janakpur and Nepalgunj were border towns which possessed such offices. Subsequent phases saw such customs offices opening up elsewhere too. These offices were classified into different categories on the basis of the volume of exports and imports and eventual collection of revenue.

The Office of the Customs Commissioner was set up in 1957. It was a central level body. However, this office was converted into the Customs and Excise Department in 1959, a year that saw customs offices assigned the duty of collecting excise duty on agricultural contracts and industrial production along with customs duties. In 1966, as the scope of both customs duties and excises expanded, the Customs and Excise Department was split into two separate departments: the Customs Department and the Excise Department. Various customs offices and sub-offices were created under the Customs Department just as various excise offices were created under the Excise Department. These offices were classified into different categories. For example, excise offices were classified into 5 categories as follows:

Table 4
Excise Office Classification

Class of office	Annual revenue collection (Rs. in 000)
Class A	Over Rs. 4,000
Class B	Rs. 1,000 to Rs. 4,000
Class C	Rs. 500 to Rs. 1,000
Class D	Rs. 100 to Rs. 500
Class E	Upto Rs. 100

4.1.1.4 Land Revenue Administration

The Land Revenue Department is the oldest revenue department and was under the jurisdiction of the Ministry of Finance until late 1987, at which point it was put under the jurisdiction of the Ministry of land reform and Management. The

number of land revenue offices has increased over the years, and now there is at least one land revenue office in each district. There are 3 land revenue offices in the Kathmandu district, 2 offices in the Kailali, Jhapa, Morang, Siraha, Nawanparasi, Baglung and Sankhuwasabha districts and one office each in another 67 districts, making for a total of 84 land revenue offices.

The land revenue administration maintains records of land ownership, is involved with the registration of land transactions, issues certificates of land ownership and collects house and land registration duties. Until January 1996, the land revenue administration used to collect land revenue directly in those districts where the land survey had been completed under the Land (Survey and Management) Act 1964, while land revenue used to be collected through middlemen in other districts. The function of collecting the land revenue was transferred to local bodies like Village Development Committees (VDCs) and municipalities in early 1996 (Khadka, 2005)

4.1.1.5 Tax Administration

Tax administration was created as the Tax Directorate in 1959, the Internal Revenue Department in 1961/62 and the Tax Department in 1963/64. In 1964, there were tax offices in 6 places like Kathmandu, Birgunj, Biratnagar, Nepalgunj, Bhairhawa and Janakpur, Kathmandu, there were two offices: known as the eastern and western offices. The number of tax offices increased gradually. Tax offices were classified as zonal offices and branch offices over the years. For Example, there were 12 zonal offices and 12 branch offices under these zonal offices until 1977/78. In 1978/79, zonal and branch offices were converted into tax offices.

The number of tax offices increased over the years. Similarly, area offices and unit offices were set up in smaller areas over the years. The number of tax offices, area offices and unit offices was 31, 7 and 2, respectively in 2001-the year when tax administration and Value Added Tax (VAT) administration were merged together and the Inland Revenue Administration was created.

Originally, the Tax Department and field offices under this department were responsible for administering income tax, foreign investment tax, and urban

house and land tax Several new taxes including air travel tax, hotel tax, contract tax, house rent tax, sales tax, road toll, vehicle tax, interest tax and loan tax were introduced over the years which were kept under the hand of this administration. However, there was more or less the same organizational structure with unchanged strength. This ruled out any chance of this department keeping pace with the development of the tax system. Moreover, the only tax which interested the officials was income tax, and other varieties received little attention.

4.1.1.6 Sales Tax Administration

Sales tax, which was one of the major sources of tax-based revenue, had remained very much neglected from the administrative point of view for a long time. It was administered by the Tax Department, but there was not much organizational support with unchanged staff. As the Tax Department was already saddled with the task of administering about a dozen other taxes, it could not pay any attention to the implementation aspect of the sales tax.

However, sales tax started attracting some attention in the mid-1980s. This is made evident by the creation of a sales tax unit within the Tax Department in 1984/85, tasked with looking into sales tax matters. Similarly, tax officials were deputed to handle this in tax offices. The arrangement did not prove as effective as expected largely because officials were not interested in remaining involved in the administration of sales tax. This was enough for the authorities to consider a separate unit for its administration. Consequently, sales tax branch offices were set up in six big industrial cities (Bhairhawa, Biratnaar, Birgunj, Janakpur, Kathmandu and Nepalgunj) in 1985/86, with Dharan and Hetauda having the same in the course of 1988/89.

The year 1992 saw creation of a separate Sales Tax Department, and the sales tax branch offices were brought under the purview of this department. 1993 saw the Excise Department and the Sales Tax Department merging together to form the Sales Tax and Excise Department. The Sales Tax and Excise Department had 18 field offices and 471 officials out of 471 staff. Evidently, the number of non-gazetted staff was too many, with most of them experienced only in excise administration.

The mechanism surrounding sales tax and excise duty administration was functioning in a traditional way. Under this system, the same officer used to be responsible for the discharge of every task like registration, assessment and collection of a specific tax in a particular area. Evidently, such an organizational structure suffered from many limitations. For example, since it used to take a long time and considerable investment to train a tax officer on all aspects of taxes, it was not possible to create any specialists. Absence of internal monitoring created scope for nefarious collusion between taxpayer and tax officer, leaving the system prone to corruption and abuse of authority. Additionally, the system suffered from a lack of an inspection, audit and enforcement section. This has to be viewed against the backdrop of a scenario whereby sales tax and excise administration were deemed as the least important assignments of overall revenue administration, so much so that revenue officials preferred to work either in the tax or the customs offices. Conversely, officials who could not be tolerated in the tax or customs administration used to be transferred to the sales tax and excise administration, which mobilized more than 40 percent of total tax revenue, was very much a neglected segment of the revenue administration.

This explains why the structure of the mechanism involved in sales tax and excise duty was not deemed fit for possible switchover to VAT. The need was felt for a revamp and necessary reorientation of the concerned section of the bureaucracy before the enforcement of VAT. Soon a new organizational structure and personnel administration system was drawn up, and subsequently approved. VAT administration went into Enforcement on July 16, 1996, with Sales Tax and Excise Duty Administration being converted into VAT Administration.

4.1.1.7 VAT Administration

The VAT organization was structured along functional lines. Sections and sub-sections were created for each function. Large taxpayers, tax refund, taxpayer service, tax audit and investigation, internal monitoring, collection and registrations were important sections. The duties of each unit and the job description of each position in the organization were spelt out clearly. Under the

functional structure, a tax officer was made responsible to carry out a specific job like registration, collection, refund or audit. The inherent idea is to allow any tax officer to meet his/her career aspirations and interests and to nurture specialists in the area of tax administration. Evolution of a corruption-free system was considered as a precondition for an efficient and transparent tax administration.

Since the bulk of the tax come from a few taxpayers that pay high taxes, a large taxpayer unit was created within the Department of VAT in order to treat them in the way that best suited their needs.

Similarly, an internal monitoring unit was also created in order to examine whether or not all tasks assigned to the VAT administration were carried out in the desired fashion. To this end, personnel from the internal monitoring section analyzed the performance of various sections in the department and field offices. They fixed targets for frequency of visits, and the issues which must be looked into in each major area of work. They prepared a checklist that covered all major functions of the tax administration based on advice, from the management of the VAT Department. The unit visited VAT offices periodically and extended advice to VAT forces in case of errors, and also submitted reports to the higher functionaries outlining their findings. They also conducted follow-

up their reports and dealt with any special issues that cropped up from time to time.

Since about 60 percent of total revenue was generated from imports by the customs offices, it was necessary to conduct internal monitoring of imports. However, this proved ineffective since it was restricted in scope. The idea concerning internal monitoring was agreed to in principle, but was not implemented owing to a lack of interest on the part of the customs administration. Meanwhile, a new personnel administration system was introduced for the administration of VAT. Under this system, the number of gazetted officers was raised while the numbers of non-gazetted clerical personnel were cut down.

The Department of VAT and its field offices were responsible for administering VAT and excise duty. The Department of VAT was responsible for setting operational guidelines, program development and evaluation, designing forms

and instructional material, compiling statistics and performing analysis, and drawing up budgets allocating resources. Offices under it were responsible for collecting VAT and excise duty.

However, VAT administration was not attractive. In fact, even the staffs were keen to be transferred to customs. Similarly, those posted at the Ministry of Finance or at the customs or other tax offices did not want to be transferred to the VAT administration (Khadka, 2005).

4.1.1.8 Existing Organizational Structure: An Overview

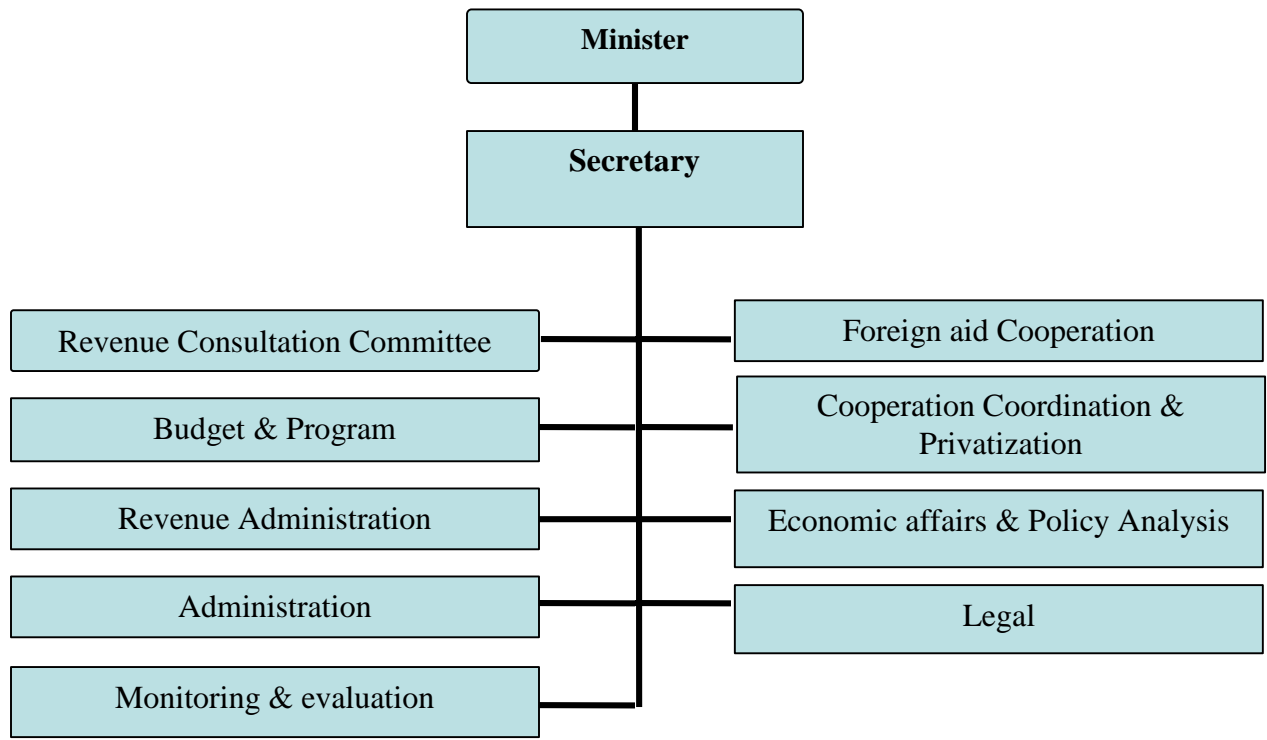
The Ministry of Finance is the apex body concerning tax administration. The Finance Minister presides over the affairs of the ministry. A Finance Secretary and other senior level bureaucrats assist any incumbent minister with day-to-day work.

The Ministry of Finance is divided into nice divisions: the Revenue Administration Division, the Foreign Aid Co-ordination Division, the Budget and Program Division, the Economic Affair and Policy Analysis Division, the Corporation Co-ordination and Privatization Division, the Revenue Consultation Committee, the Administration Division, The Legal Division and the Monitoring and Evaluation Division. The exists organizational structure of this ministry is given in figure 4.1.

The Revenue Division of the Ministry of Finance is responsible for overall formulation of tax policy and for evolving appropriate tax administration to implement the taxation policy. It co-ordinates and supervises the functioning of the revenue departments and the Revenue Administration Training Center. It also monitors the status of both tax and non-tax revenue collection. The Revenue Consultation Committee reviews the implementation of taxation policy and recommends measures concerning reform in the taxation system and tax administration.

The Administration Division is concerned with personnel administration for the whole tax administration. It is involved in creating new positions, filling vacant positions; inter departmental transfers and so on. Similarly, the Law Division is tasked with dealing with legal matters associated with various taxes.

Figure 4.1
Ministry of Finance Organization Structure



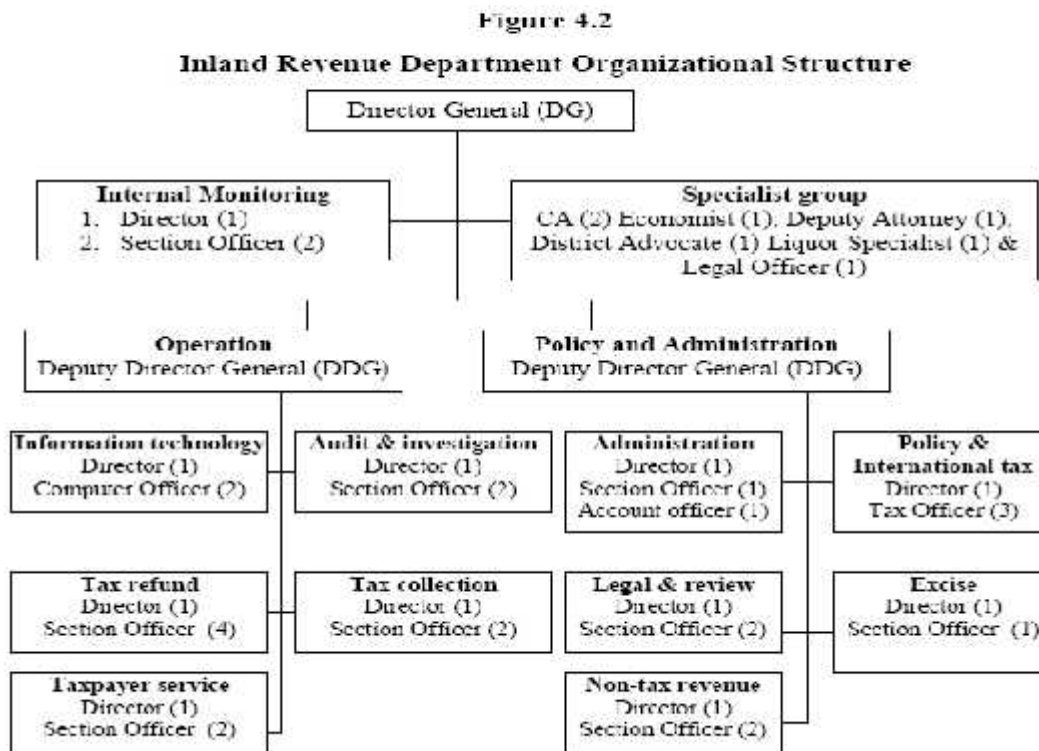
There are three branches of tax administration under the Ministry of Finance: Inland Revenue administration, Customs Administration, and Revenue Investigation Administration. There is also a Revenue Administration Training Center. An outline of these administrative is given below.

4.1.1.8.1 Inland Revenue Administration

The Inland Revenue Administration is responsible for the administration of VAT, income tax, excise duties and vehicle tax. This administration also administers the tourism development fee and motion picture development fee on behalf of the Nepal Tourism Development Board and Motion Picture Development Board, respectively. It also collects health tax, which is levied on tobacco products and alcoholic beverages. Revenue mobilized from this tax, however, is allocated to funding programs aimed controlling cancer.

The Inland Revenue Administration consists of the Inland Revenue Department, 1 Large Taxpayer Office (LTO), 21 Inland Revenue Offices (IROs) and 16 window offices. Inland Revenue Department issues directives and guidance to the Large Taxpayers' Office/Inland Revenue Offices and monitors their functioning. While the Large Taxpayers' Office/Inland Revenue Offices are responsible for the day-to-day operations of collecting taxes, window offices extend some basic services such as supplying tax-related information to the taxpayers and receiving returns from them.

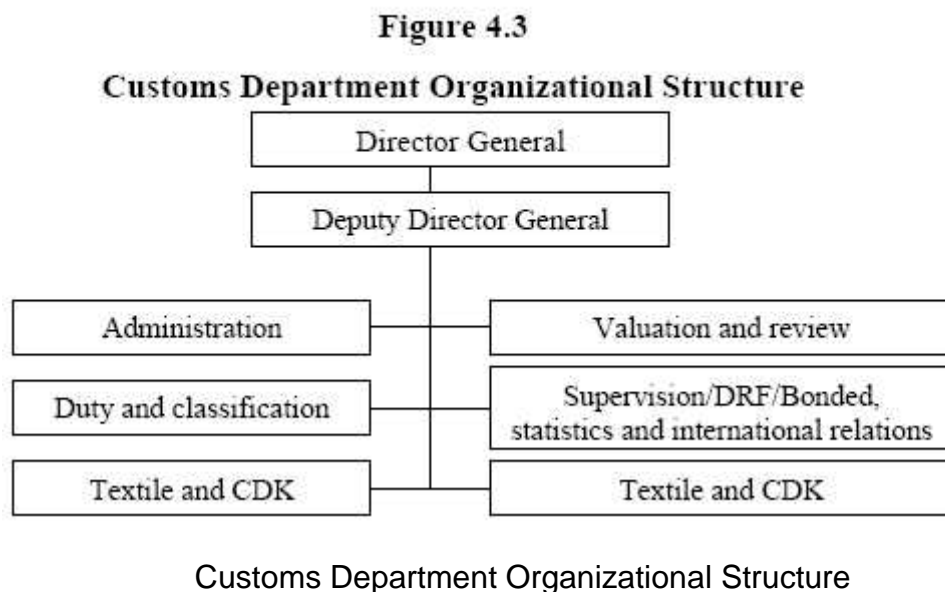
The Inland Revenue Department is structured along functional lines, which means there are different sections and sub-sections according to the major functions of the department. The Organizational structure of the Inland Revenue Department is given figure 4.2 below.



4.1.1.8.2 Customs Administration

The Customs administration is mainly responsible for enforcing customs duties, agricultural reform levies, VAT and excise duty on imports. It also collects the local development fee and special duties.

The Customs Department is involved in outlining operational guidelines, program development and evaluation, designing forms and instruction manuals, collecting and publishing international trade statistics, compiling statistical analyses, developing budgets, allocating resources and dealing With matters relating to the World Trade Organization, etc. Customs offices are responsible for assessing and collecting customs duties, preventing fraud and smuggling and controlling carriers, persons and articles entering into and leaving the country. These offices are also involved in collecting VAT, excise duties and advance income tax, if any, on imports. They also collect special duty on imports and the local development fee, a tax levied on the imports of goods on behalf of the municipalities. The organizational structure of the Customs Administration does not strictly follow a particular line. While the organizational structure of the Customs' Department looks like a functional one, the organizational structure of customs offices does not follow the functional line. The Organizational structure of the Customs Department is given figure 4.3 below.

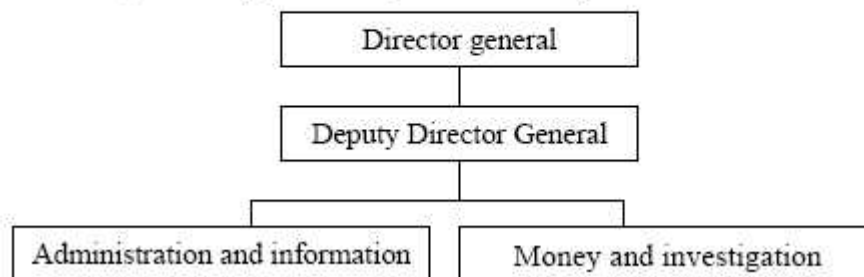


4.1.1.8.3 Revenue Investigation Department

The Revenue Investigation Department investigates cases of fraud and issues surveillance orders on suspected business enterprises, taxpayers and even tax officials. It reviews suspect tax assessments and investigates possible cases of collusion between taxpayers and tax officials. There are 4 unit offices under the Revenue Investigation Department. The unit offices located in Itahari, Pathlaiya and Butwal cover the eastern, middle and western development regions respectively while the unit office located in Kohalpur covers the mid-and far-western development regions. A sub-unit has also been created at Thankot under the Revenue Investigation Department. The Organizational structure of the Revenue Investigation Department is given figure 4.4 below.

Figure 4.4

Revenue, Investigation Department Organizational Structure

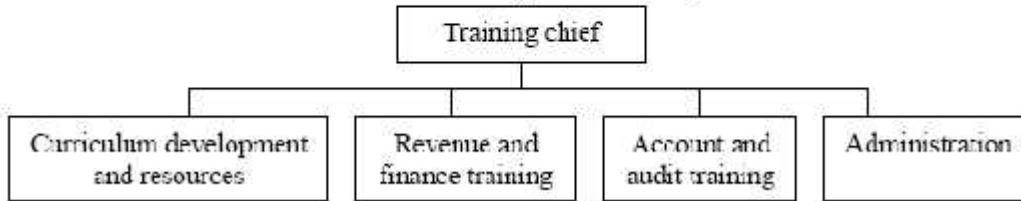


Revenue, Investigation Department Organizational Structure

4.1.1.8.4 Revenue Administration Training Center

Revenue Administration Training Center is involved in conducting training programs for revenue and accounts officials. It organizes various short-term and medium-term training programs. Short-term programs such as introductory, refresher and crash courses last up to 2 weeks, while medium-term programs generally last 5 weeks. This center also organizes seminars and workshops on current and topical issues. It is also supposed to prepare manuals and also compile existing tax laws. The Organizational structure of the Revenue Administration Training Center is given below.

Figure 4.5
Revenue Administration Training Center Organizational Structure



4.2 Data Presentation and Analysis

In this chapter data and information regarding income tax system are presented and analyzed. This analysis attempts to throw light on various aspects of income tax system in Nepal and tried to find out it's problems and prospects. Basically, this study has focused on empirical study whereas some sort of secondary data analysis regarding revenue structure in Nepal and within this special concern has been given to income tax. Data and information collected from different sources related to the income tax system are presented in this chapter to make research findings more meaningful. In this chapter data gathered from different sources are presented, analyzed compared, and verified with the use of various financial tools and statistical tools. In fact, the presentation and analysis of data is the important chapter, which determines findings of the research and helps to fulfill research objectives.

4.2.1 Analysis of Secondary Data

Secondary data is defined as data collected earlier for a purpose other than the one currently being persuaded. Secondary data are often in the form of raw data and published materials. However the unpublished data such as records or statistics gathered or compiled by others prior to the study are also secondary data (Wolf and Part 2007: P 194). In this section data collected from different sources such as IRD, CBS, MOF, NRB etc. has been presented in tabular form/diagram/chart and analyzed as below:

4.2.1.1 Revenue Structure in Nepal

Government collects revenue from different sources. Basic sources the government revenue are classified into tax and non tax revenue. Where as Taxation are the major sources of revenue in the country besides non-tax revenue. Among the developing countries, Nepal also has uses her full effort for sustaining fiscal stability through using taxation effectively. In 1952/53, when the Nepal government prepared and presented the first annual budget to the people in her history, the contribution of tax revenue to the total revenue was only 56.16 percent, while the contribution of non-tax revenue was 43.84 percent (Dahal, 1983:248). Today the tax revenue has played significant role in the public revenue of Nepal. Tax revenue contributes about 81 percent of total revenue, while non-tax revenue represents about 19 percent of total revenue at the central level. Nepal government has introduced several taxes,. In the category are custom, excise, sales tax/VAT, income tax, land revenue and registration as the major taxes imposed by the government while non tax revenue comes in the form of fees, fines, penalties, royalties, dividends, interest, forest revenues, minting and others. The composition of revenue structure of Nepal since 1991/92 is presented in the table 5 which shows that tax and non-tax revenue are the major source where as tax is the dominant sources for generating revenue i.e. during 1991/92 to 2006/07.

Table 5:
Revenue Structure in Nepal

Rs. In Million

Fiscal Year	Total Revenue	Tax Revenue		Non-Tax Revenue	
		Amount	Percent	Amount	Percent
1991/92	13512.7	9875.6	73.08	3637.1	26.92
1992/93	15148.4	11662.5	76.99	3485.9	23.01
1993/94	19580.8	15371.5	78.50	4209.4	21.50
1994/95	24575.2	19660.0	79.90	4945.1	20.10
1995/96	27893.1	21668.0	77.68	6225.1	22.32
1996/97	30373.5	24424.3	80.41	5949.2	19.59
1997/98	32937.9	25939.8	78.75	6998.1	21.25
1998/99	37251.0	28752.9	77.19	8498.1	22.81
1999/00	42893.8	33152.1	77.29	9741.6	22.71
2000/01	48893.6	38865.1	79.49	10028.8	20.51
2001/02	50445.5	39330.6	77.97	11115.0	22.03
2002/03	56229.8	42587.0	75.74	13642.7	24.26
2003/04	62331.0	48173.0	77.29	14158.0	22.71
2004/05	70122.7	54104.7	77.16	16018.0	22.84
2005/06	72282.1	57430.4	79.45	14851.7	20.55
2006/07	87712.10	71126.7	81.1	16585.5	18.91

Source: Economic Survey, 2007/08, G/N Ministry of Finance, 2008.

The above table reflects that the non tax revenue was in increasing trend from fiscal year 1996/97 to 2004/05. It was 5949.2 million in fiscal year 1996/97 and 16018 million in fiscal years 2004/05. But the non tax revenue collection in FY 2005/06 was decreased to Rs. 148651.7 million and but it increased to Rs 16585.5 million in FY 2006/07. The contribution of non tax revenue was maximum 26.92% in FY 1991/92 and minimum 18.91% in FY 2006/07. It shows

that non tax revenue is in fluctuating trend in both total amounts as well as percentage contribution to actual government revenue.

Similarly tax revenue was also gradually increasing in every year since 1991/92 to 2006/07 amounting Rs. 9875.6 million to Rs. 71126.7 million. It shows that from 1991/92 to 2006/07 the amount of tax revenue is increasing every year but the figure in percentage of tax revenue to the total government revenue has been fluctuating in different years. The contribution of tax revenue was highest 81.67% in total in FY 2006/07 and lowest 73.08% in FY 1991/92.

Tax revenue is the composition of direct tax and indirect tax. Direct tax includes income tax, (corporate tax, individual tax, house and land rent tax, interest tax) property tax and land revenue and Registration tax. Similarly indirect tax includes customs, excise on industrial products, VAT/Sales tax, entertainment tax, hotel tax, air flight tax, contract tax etc. Indirect tax are the major instruments of Nepalese tax structure.

4.2.1.2 Composition of tax revenue in Nepal

Tax revenue is the composition of direct tax and indirect tax. Direct tax includes income tax, (corporate tax, individual tax, house and land rent tax, interest tax) property tax and land revenue and Registration tax. Similarly indirect tax includes customs, excise on industrial products, VAT/Sales tax, entertainment tax, hotel tax, air flight tax, contract tax etc. Indirect tax are the major instruments of Nepalese tax structure.

Table 6
Composition of Tax Revenue

Fiscal year	Total tax revenue	Direct Tax Revenue		Indirect Tax Revenue	
		Amount	Percentage	Amount	Percentage
1991/92	9875.6	1595.2	16.15	8280.4	83.85
1993/94	11662.5	3036.2	17.46	9626.3	82.54
1994/95	19660.0	3849.3	19.58	15810.7	80.42
1995/96	21668.0	4655.9	21.49	17012.1	78.51
1996/97	24424.3	5340.0	21.86	19084.3	78.14
1997/98	25939.8	6187.9	23.85	19751.9	76.15
1998/99	28752.9	7516.1	26.14	21236.8	73.86
1999/00	33152.1	8951.5	27.00	24200.6	73.00
2000/01	38865.1	10159.4	26.14	28705.7	73.86
2001/02	39330.6	10597.5	26.94	28733.1	73.06
2002/03	42587.0	10105.8	23.73	32481.2	76.27
2003/04	48173.0	19912.6	24.73	36260.4	75.27
2004/05	54104.7	13071.8	24.16	41032.9	75.84
2005/06	57430.4	13968.1	24.32	43462.3	75.68
2006/07	71126.7	18980.3	26.68	52146.4	73.31

Source: Economic Survey, 2007/08, G/N Ministry of Finance, 2008.

Likewise other developing countries Nepalese tax structure also as dominated by indirect taxation in the revenue structure which contributed 83.85% in FY 1991/92, which was heights figure of study period and minimum in FY 1999/00 about 56.42%. In FY 2006/07 the contribution of indirect tax to total revenue is 73.31%. Among the three components of indirect tax custom duty plays as major sources. In FY 2000/01 which contributed 32.30%. The proportion of custom has been decreased to 23.49% in FY 2006/07. After the FY 2004/2005 VAT has exceeded its performance. It seems that VAT was gradually occupying higher portion on total revenue collection during study period. It contributed maximum 37.63% In FY 2005/06 and minimum 23.22% in FY 2003/04. In FY 2006/07 the proportion of VAT is slightly decreased to 36.69% with compare to 37.63% in FY

2005/06. The trend of VAT shows it will increase and plays major role in the government revenue. Whereas, small proportion but constantly increasing trend of excise duty also contribute some portion on the government revenue. It contribute 13.14% in FY2006/07 whereas it was 9.70% on tax revenue.

Direct tax plays inverse role although it has to contribute higher percentage in the government revenue but in developing countries due to culture of evasion and avoiding of tax it's contribution is not as satisfaction as desired. In developed countries its portion is high because people feel proud of paying tax. In FY 2006/07 the contribution of direct tax revenue is 26.68%. Income tax occupies higher percentage on direct tax and plays a vital on the government revenue. Income tax contributes maximum 18.63% in FY 2001/02 and minimum 13.56% in FY 1996/97. Trend of income tax has been increasing to FY 2001/02 i.e. from 13.56% to 18.68% and decreased to 14.56% in FY 2002/02. Income tax is the composition of corporate tax, individual tax, house rent and interest tax.

4.2.1.3 Structure of Income Tax

Income tax is an important Source of direct taxation Nepalese. In the present situation, Nepal is levying for different types of income tax. They are corporate individual, house and land rent and interests. The corporation income tax can be divided within three sub-heading. They are government academy, public company and private corporate bodies.

When income tax was introduced in Nepal as business profit and remuneration tax in 1959/60, it had contributed only Rs. 203 thousand as revenue. Income tax is increasing each year. The composition of income tax revenue for last 16 years is presented in table.

**Table 7:
Structure of Income Tax Revenue**

(Amount in million)

Years	Total income tax		Public enterprises		Private company		Individual income		Remuneration		Tax on interest	
	Amo.	%	Amo.	%	Amo.	%	Amo.	%	Amo.	%	Amo.	%
1991/92	875.0	100	176.4	20.2	6.5	0.7	617.9	70.6	54.7	6.3	19.5	2.2
1992/93	1198.2	100	257.9	21.5	9.5	0.8	800.7	66.8	56.7	4.7	73.4	6.1
1993/94	1921.2	100	536.2	27.9	19.7	1.0	1184.8	61.7	83.8	4.4	96.7	5.0
1994/95	2823.4	100	860.2	30.5	440.1	15.6	1293.1	45.8	118.4	4.2	111.6	4.0
1995/96	3431.4	100	1144.5	33.4	563.9	16.4	1470.1	42.8	133.1	3.9	119.8	3.5
1996/97	4123.4	100	1231.1	29.9	858.4	20.8	1711.4	41.5	168.1	4.1	154.4	3.7
1997/98	4898.1	100	1317.8	26.9	925.1	18.9	2120.8	43.3	322.2	6.6	212.2	4.3
1998/99	6170.3	100	1526.5	24.7	1155.0	18.7	2772.7	44.9	396.5	6.4	319.5	5.2
1999/00	7420.6	100	2198.8	29.6	1339.5	18.1	3016.4	40.6	451.5	6.1	414.4	5.6
2000/01	9114.0	100	2928.0	32.1	1924.3	21.1	3200.5	35.1	597.3	6.6	463.9	5.1
2001/02	8903.7	100	1769.3	19.9	1412.0	15.9	4419.1	49.6	835.6	9.4	467.7	5.3
After the impose of new income tax act 2002												
2002/03	7966.2	100	1251.0	15.7	1236.3	15.5	3362.3	42.2	1252.6	15.7	864.0	10.8
2003/04	9245.9	100	2056.6	22.2	1531.3	16.6	3533.4	38.2	1391.2	15.0	733.4	7.9
2004/05	10159.4	100	1332.4	13.1	2467.8	24.3	3926.3	38.6	1675.9	16.5	757.0	7.5
2005/06	10373.7	100	195.7	1.9	3404.3	32.8	4234.7	40.8	1764.1	17.0	565.7	5.5
2006/07	15034.01	100	1019.7	6.78	5717.1	38.02	5234.4	34.82	2007.9	13.36	1054.1	7.01

Source: Yearly book of IRD (2001/02 and 2005/06 and economic survey 2007 and 2008)

According to the table 7 income taxes was increasing each year except FY 2001/02 and 2002/03. In FY 2001/02 and 2002/03 it was decreased by Rs 191 million and Rs. 560 million respectively comparing to previous year. But after the proper implementation of Income Tax Act 2002 it seems that income tax is in increasing trend, i.e. increased to Rs. 9245.9, Rs. 10159.4, Rs. 10373.7 and 15034.01 million in FY 2003/04, 2004/05, 2005/06 and 2006/07 respectively. Corporate income tax plays the dominant role to generate revenue before and after the impose of Income Tax Act 2002 it is in satisfactory level as compared to other sources. Because in developing as well as least developing countries corporate tax is more than individual (World Bank). Corporate income includes income of government academy, public company and private corporate. Where

government academy plays significant role before the impose of New income tax act. But after the implement of income tax act 2002 public company as well as private corporate plays dominant role. Government sector gradually seeing weaker because of privatization due to weak fiancé performance and management. According to the table it seems that up to fiscal year 2000/01 government sector occurs big portion (i.e. 29%, 26%, 24%, 29% and 32% from FY 1996/97, to FY 2000/01) and than it was gradually decreased to 1% in FY 2005/06. But in FY 2006/07 it seems increased to 6.7 percent. Private company which registered under private limited act, that is operated jointly or solely show that after the impose of New Income Tax Act 2002 it also started to increase gradually (i.e. 15.5%, 16.6%, 24.3%, 32.8% and 32.02 from FY 2002/03 to FY 2006/07). Although it is in decreasing trend before improvement of New income tax act 2002.

According to the table individual source of income tax also contribute reliable portion on the total income tax. It seems that it's portion is in increasing trend up to FY 2002/03, i.e. 42.2% after that it slightly decreased to 34.82% in FY 2006/07 If we go through the table the performance of remuneration after new Income Tax Act 2002 was excellent where its contribution in FY 1991/92 is 6.3% and in FY 2001/02 is 9.4% and after that it's make feel jump up to 15.7% in FY 2002/03 and moving towards satisfactory level.

Interest Income was also in positive way which contributes 2.2% in FY 1991/92 and increased to 10.8% in FY 2002/03. It shows after the implement of New Income Tax Act 2002 Nepalese Income tax system is in the way of achievement but still there is lot to do in this field.

4.2.1.4 Composition of direct tax revenue

Direct tax is levy to government for income generation and holding of wealth by natural person as well as business enterprises. It is paid by the imposed person himself and it follows the progressive principle. In Nepal direct tax is composition of land revenue and registration tax and tax in property, profit and income. Share of different components of direct tax shown in table 8

Table 8
Composition of direct tax revenue

Fiscal year	total direct tax	Land revenue and registration				Tax on property, profit and income				
		Land tax	House Land registration	Total	% of direct tax	Income tax	Tax on property	Other tax	Total	% of D tax
1991/92	1595.2	64.8	571.3	636.1	39.88	875.0	67.7	16.4	959.1	60.12
1992/93	2036.2	69.4	685.5	754.9	37.07	1198.2	80.0	3.1	1281.3	62.93
1993/94	2855.3	61.0	772.2	833.2	29.18	1921.2	49.8	51.1	2022.1	70.82
1994/95	3849.3	34.9	902.8	937.7	24.36	2823.4	88.2	0.0	2911.6	75.64
1995/96	4655.9	18.2	1048.4	1066.6	22.91	3431.4	157.9	0.0	3589.3	77.09
1996/97	5340.0	5.9	1009.5	1015.4	19.01	4123.4	201.2	0.0	4324.6	80.99
1997/98	6187.9	3.6	1000.6	1004.2	16.23	4898.1	285.6	0.0	5183.7	83.77
1998/99	7516.1	1.4	1001.8	1003.2	13.35	6170.3	342.7	0.0	6513.0	86.65
1999/00	8951.5	4.6	1011.3	1015.9	11.35	7420.6	515.0	0.0	7935.6	88.65
2000/01	10159.4	5.1	607.8	612.9	6.03	9114.0	432.5	0.0	9546.5	93.97
2001/02	10597.5	0.8	1131.0	1131.8	10.68	8903.7	562.0	0.0	9465.7	89.32
2002/03	10105.8	.0	1414.3	1414.3	13.99	7966.2	559.5	165.8	8691.5	86.01
2003/04	11912.6	0.0	1697.5	1697.5	14.25	9245.9	700.6	268.6	10215.1	85.75
2004/05	13071.8	0.0	1799.2	1799.2	13.76	10159.4	806.5	306.7	11272.6	86.24
2005/06	13968.1	0.0	2181.1	2181.1	15.61	10373.7	847.6	565.7	11787.0	84.39
2006/07	18980.3	0.0	2253.5	2253.5	11.87	15034.01	995.0	697.8	16726.81	119.75

Source: Yearly book of IRD (2001/02 and 2005/06 and economic survey 2007 and 2008)

Direct tax is classified into land revenue and registration tax on property profit and income. Land revenue and registration is sub classified into land tax and house and land registration. The role of land tax is very nominal, nil for last 4 years, started to declining from 1992/93 amounting 64.8 millions up to 2001/02 amounting 0.8 million. The land revenue and registration category is fully dependent on house and land registration and has a zigzag trend within study period. It is in increasing trend up to 1995/96 and started to decline slowly for next 3 years. It increased gradually for 1999/00 and become the lowest share to revenue in 2000/01 when its share to direct tax is only 6.03 % amounting 612.9 million. It is further in increasing trend after that has reached to 2181.1 million, occupying 15.61 % of direct tax revenue. The highest percentage contribution from this category was in 1991/92 as 39.88 %. The mean contribution of land

revenue and registration is 15.16 % which is nearly about the share in latest FY of study.

Other source of direct tax revenue tax on property, profit and income has been subdivided into income tax, tax on profit and other tax. Income tax is the major within them and constitutes income tax from public enterprises, income tax from private corporate bodies, income tax from individuals' income tax from remuneration and tax on interest. Tax on property includes vehicle and urban houses and land tax. This category of direct tax seems to be increasing trend up to 2000/01 and it declines for next three years. It declines to 84.39 in year 05/06 highest share is in 06/07 with 119.75%.

4.2.1.5 Contribution of Income Tax to GDP & to total Revenue

Revenue collection from income tax is in increasing trend but the performance is not satisfactory because we can measure the performance of income tax according to it's contribution in GDP even though it is not absolute technique in developing countries but due to lack of reliable data it is widely applicable technique. If we go through the table it shows that Income Tax GDP Ratio is in decreasing trend it clearly that performance is not satisfactory as desired. But the sign of hope is still left because revenue from Income tax is in increasing way.

Table 9
Contribution of Income Tax to GDP & to total Revenue

Fiscal Year	Total income tax Revenue	Percentage of income tax to GDP	Total Revenue	Percentage of income tax to Revenue
1991/92	875.0	0.60	13512.7	6.48
1992/93	1198.2	0.73	15148.4	7.91
1993/94	1921.2	1.00	19580.8	9.81
1994/95	2823.4	1.34	24575.2	11.47
1995/96	3431.4	1.43	27893.1	12.30
1996/97	4123.4	1.53	30373.5	13.58
1997/98	4898.1	1.69	32937.9	14.87
1998/99	6170.3	1.87	37251.0	16.56
1999/00	7420.6	2.03	42893.8	17.30
2000/01	9114.0	2.34	48893.6	18.64
2001/02	8903.7	2.20	50445.5	17.65
2002/03	7966.2	1.89	56229.8	14.17
2003/04	9245.9	2.16	62331.0	14.83
2004/05	10159.4	2.27	70122.7	14.49
2005/06	10373.7	2.19	72282.1	14.35
2006/07	15034.01	3.05	87712.10	17.34

Source: Yearly book of IRD (2001/02 and 2005/06 and economic survey 2007 and 2008)

Table 9 shows the contribution of income tax to GDP. The contribution of income tax to GDP in FY 1991/92 was just 0.60 percent. It was continuously increasing rapidly up to 2000/01 and reach at maximum level of 2.34 percent. It can not be continued for the following period of new act and started declining .It decline to 2.20 percent in 2001./02and again to1.89 percent in 2002/03.It slowly increased to 2.16 percent and 2.27 percent for following two years and again decline to 2.19 percent in 2005/06 It tends to 3.05 percent. In FY 2006/07.

The contribution of income tax to total revenue was 6.48 percent in FY1991/92. It is positively correlated with time up to 2000/01. Its share in 2000/01 was 18.64 percent. It declines for the next two years to 17.65 and 14.17 percent. It gradually increased for 2003/04 years to 14.83 percent and again decreased to 14.49 and 14.35 percent for the last two years. But it increased to 17.34 percent in FY 2006/07.

4.2.1.6 Soundness of Income Tax to Achieve the Estimated Goal

To measure the effectiveness of the Income Tax system, it is directly related to income tax administration, which is the main organic function of the system. So we can measure it with the application of the Revenue Gap Technique. The following table shows its soundness.

Table 10:
Resource Gap in Nepal:

Rs. In Million

Fiscal Year	Total Expenditure	Total Revenue	Resource Gap	Percent increased
1991/92	26418.2	13512.7	12905.5	
1992/93	30897.7	15148.4	15749.3	22.04
1993/94	33597.4	19580.8	14016.6	-11.00
1994/95	39060.0	24575.2	14484.8	3.34
1995/96	46542.4	27893.1	18649.3	28.75
1996/97	50723.7	30373.5	20350.2	9.12
1997/98	56118.3	32937.9	23180.4	13.91
1998/99	59579.0	37251.0	22328.0	-3.68
1999/00	66272.5	42893.8	23378.7	4.71
2000/01	79835.1	48893.6	30941.5	32.35
2001/02	80072.2	50445.5	29626.7	-4.25
After the Impose of New Income Tax-2002				
2002/03	84006.1	56229.8	27776.3	-6.25
2003/04	89442.6	62331.0	27111.6	-2.39
2004/05	102560.4	70122.7	32437.7	19.65
2005/06	110889.2	72282.1	38607.1	19.02
2006/07	133604.60	87712.10	45892.5	18.87

Source: Economic Survey, 2007/08, G/N Ministry of Finance, 2008.

The gap between government expenditure & internal Source is known as resource gap. In Nepal the source mobilization is still poor due to resource constraints, mass poverty, rapid growth of population, aggressive dependence on agriculture etc & is not sufficient to cover the growing expenditure. Fiscal deficit is widening due to continuously growing expenditure of the government instead of the low revenue performance.

As shown in table, resource gap of 12905.5 million in FY 1991/92 reached to 45892.5 million in 2006/07. It is continuously increasing rapidly. It seems to be decreased in five fiscal year comparing to former year but the decreased rate is low & while it increasing it is generally covering two digits up to 32 percent increase with respect to former year. In 1993/94 it decreased by 11 percent due to effective collocation of revenue. In 1995/96 The resource gap has increased by 28.75 percent comparing to resource gap of 14484.8 million of fiscal year 1994/95. This is due to rapid growth of government expenditure from 39060 million to 46542.4 million. The same scenario seems in FY 2000/01 while government expenditure expended from 66272.5 to 79835.1. It is 32.35 percent increased value. Increasing trend of regular three years appears from 2001/02 to 2003/04. It is due to slow growth in government expenditure & comparatively rapid growth in revenue collection. The gap is being wider for last four years of study period while resource gap of 27111.6 in 2003/04 increased to 32437.7 in 2004/05, 38607.1 in 2005/06 & 45892.5 in 2006/07.

4.2.2 Empirical Analysis

4.2.2.1 Introduction

An empirical analysis has been conducted in order to find out various aspects of income tax system in Nepal from the real life experience. The major tool used for this purpose is an opinion survey through questionnaire. A total of eighty sets of same questionnaire were distributed to three groups of respondents divided into taxpayers, tax Administrators and tax experts. Only sixty responses of distributed questionnaire were received. The responses received from these

respondents have been arranged, tabulated and analyzed in order to facilitate the descriptive analysis of this study.

The questionnaire either asked for a yes/no response or asked for ranking of choice according to assign weights and number of alternatives. If the number of alternatives were six then the first preferred choice got six points and the less preferred choice got one point. Any alternatives, which were not ranked, won't get any point. The total points available to each choice were converted into percentage in reference to the total points available for all choices. The choice with the highest score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as last choice.

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

**Table 11:
Group of Respondents**

S.N.	Group of Respondents	Sample Size
1	Tax Expert	20
2	Tax administrator	20
3	Taxpayer	20
Total		60

4.2.2.2 Soundness of Nepalese Income Tax System

A question provided with two alternatives (yes/no) was asked to the respondents to know the view regarding soundness of income tax system in Nepal, a question, "Do you consider that income tax system in Nepal is sound?" was asked. The responses are tabulated as follows:

**Table 12:
Soundness of Nepalese Income Tax System**

Response	Yes		No		Total	
	No.	Percent	No	Percent	No	Percent
Tax administrator	14	70	6	30	20	100
Tax expert	3	15	17	85	20	100
Taxpayer	1	5	19	95	20	100
Total	18	30	42	70	60	100

Source: Opinion survey, 2008.

From the opinions survey, it is found that 70 percent tax administrator, 15 percent tax experts and 5 percent taxpayers recognize income tax system in Nepal is sound. Whereas, 30 percent tax administrator, 85 percent tax expert and 95 percent taxpayer recognize that income tax system in Nepal is not sound. In aggregate, 30 percent respondent approve in seam tax system in Nepal is sound and 70 percent respondent approve income tax system in Nepal is not sound.

4.2.2.3 Causes for Unsound Income Tax System

The respondents who were considered that income tax system in Nepal is not sound requested to illustrate the causes which are responsible for unsound income tax system in Nepal a question was asked "If no, what are the causes which are responsible for creation of unsound income tax system in Nepal?" The respondents were requested to rank their responses in the order of priority, 1 is most important whereas 6 is the least important. The responses of the respondents are tabulated as

Table 13:
Causes for Unsound Income Tax System

S.N	Major Problems.	Respondents				Percent	Remarks
		Tax Adm.	Tax Expert	Tax payer	Total		
1	Defective income tax administration.	14	82	104	200	23.23	2
2	Lack of good economic policy.	13	20	33	66	6.67	6
3	Complicated income tax act, rules and regulation.	30	83	93	206	23.93	1
4	Corruption and evasion.	9	59	86	154	17.89	3
5	Lack of tax consciousness.	31	64	49	144	16.72	4
6	Lack of training and sufficient incentives to employees	29	28	34	91	10.57	5
Total					861	100	

Source: Opinion survey, 2008.

In accordance to the preference of the respondents, the major causes for unsound income tax system in Nepal are ranked as follows;

1. Complicated income tax act, rules and regulation.
2. Defective income tax administration.
3. Corruption and evasion.
4. Lack of tax consciousness.
5. Lack of training and sufficient incentives to employees.
6. Lack of good economic policy.

From the above results, it can be concluded that the income tax system is not sound and satisfactory because of complicated income tax act, rules and

regulations, defective income tax administration and corruption and evasion as well as lack of tax consciousness in taxpayers.

To know whether the opinion of tax administrator and taxpayers are related or not, we can test rank correlation coefficient. But the view of tax expertise kept in constant.

Hypothesis:

There is not significant relationship between the views of tax administrator and taxpayers with respects to causes for unsound income tax system in Nepal.

H_0 = (Null hypothesis) There is no significance between the opinion of tax administrator and taxpayers with respect to causes for unsound income tax system in Nepal.

H_1 = (Alternative Hypothesis): There is significance between the opinion of tax administrator and taxpayers with respect to causes for unsound income tax system in Nepal.

Calculating correlation by formula,

$$R = \frac{\sum d^2}{n \sum f^2 - \sum Z^2}$$

$$Pr < 0.6745 \mid \frac{\sum Zr^2}{\sqrt{n}}$$

Let, variable x and y denotes views of tax administrator and taxpayers respectively.

Table 14
Calculation of correlation coefficient

S. N .	Problems	Total Points (x)	Rank (R ₁)	Total Points (y)	Rank (R ₂)	Different of rank (R ₁ -R ₂)	Square of difference (R ₁ -R ₂)
1	Defective income tax administration.	14	4	104	1	3	9
2	Lack of good economic policy.	13	5	33	6	-1	1
3	Complicated income tax act, rules and regulation.	30	2	93	2	0	0
4	Corruption and evasion.	9	6	86	3	3	9
5	Lack of tax consciousness.	31	1	49	4	-3	9
6	Lack of training and sufficient incentives to employees	29	3	34	5	-2	4
						d=0	d ² =32

Sources: Opinion Survey, 2008

$$R=1-\frac{6(32)}{6(5^2-1)}=0.0857$$

$$Pr=0.6745 \left| \frac{1Zf0.0857}{\sqrt{6}} \right| \times 0.2733$$

Here, r is less than Pr. the relation is not significant because to be significant r should be 6 times greater than Pr. So, null hypothesis is rejected. It means that the opinion of taxpayer and tax administrator regarding causes for unsound income tax system in Nepal is significantly difference.

4.2.2.4 Effectiveness of Income Tax Act 2002

To measure the effectiveness of the new income tax act 2002 in comparison to the previous income tax act 1974 a question "Is the new income tax act 2002 of Nepal effective to create sound income tax system in comparison to previous act 1974?" was asked. The responses received from the respondents are tabulated as below:

Table 15
Effectiveness of Income Tax act 2002

Responses Respondents	Yes		No		Total	
	No.	Percent	No.	Percent	N0	Percent
Tax Administrator	17	85	3	15	20	100
Tax expert	19	95	1	5	20	100
Tax payer	14	70	6	30	20	100
Total	50	83.33	10	16.67	60	100

Source: Opinion survey, 2008.

As per the above table, 50 respondents are in favour of the act 2002 and 10 respondents have responded the act is not so effective to create sound income tax system in comparison to previous act 1974. To know the reasons behind the responses of the both respondents, those who are in favour of the act and those who are not, were asked additional questions and requested them to rank reasons in the order of priority, the questions were:

- i. If yes what are the reasons?
- ii. If no, what are the reasons? From the 60 numbers of respondents 50 said, the act is effective, of which 17 were tax administrator, 19 were tax expert and 14 were taxpayer. The responses of these are tabulated as below:

Table 16
Reasons for Effectiveness of Income Tax act 2002

S.N	Feature of income tax act 2002.	Respondents				Percent	Remarks
		Tax Adm.	Tax Expert	Tax payer	Total		
1	Abolition of Various tax related concession, rebates and exemptions.	40	49	59	148	19.84	3
2	Taxing capital gain and dividend.	74	71	57	202	27.08	2
3	Specification of stock valuation method.	38	35	26	97	13	4
4	Provision of international taxation	72	91	42	205	27.48	1
5	Stringent fine and penalty provision.	33	40	19	94	12.60	5
Total					746	100	

Source: Opinion survey, 2008

The first preferred choice got five points and the less preferred choice got one point in descending order to the priority based ranking of the respondents. According to the above table the reason behind the effectiveness of the act can be ranked as following.

1. Provision of international taxation.
2. Taxing capital gain and dividend.
3. Various tax related concession, rebates and Abolition of exemptions.
4. Specification of stock valuation method.
5. Stringent fine and penalty provision.

There are some other respondents who said the act is not so effective out of 60 respondents 10 responded that the act is not effective. The responses received from them are shown below:

Table 17
Reasons for Ineffectiveness of Income Tax act 2002

S. N	Problem	Respondents				Percent	Remarks
		Tax Adm	Tax Expert	Tax payer	Total		
1	Difficulty in language.	14	5	28	47	31.33	1
2	Long procedure	13	3	21	37	24.67	2
3	Ineffective income tax adm.	8	1	8	17	11.33	5
4	Inappropriate rules and regulations	6	4	23	33	22	3
5	Ineffective reward and punishment system.	4	2	10	16	10.67	4
Total					150	100	

Source: Opinion survey, 2008

From the above table we can conclude that major defects of the act or the major problems of the act can rank as follows:

1. Difficulty in language.
2. Long procedure
3. Ineffective income tax administration
4. Inappropriate rules and regulations.
5. Ineffective reward and punishment system.

Hypothesis:

There is no significance relationship between the opinion of tax administrator and taxpayers with respect to the factors for ineffectiveness of Nepalese income tax act 2002.

H_0 (Null hypothesis) = There is no significant difference between the opinion of tax administrator and taxpayers with respect to the factors for ineffectiveness of Nepalese income tax act 2002.

H_1 (Alternative hypothesis)= There is significant relationship between the opinion of tax administrator and taxpayers with respect to the factors tax ineffectiveness of Nepalese income tax act 2002.

Correlation:

There is no significant difference between the opinion of tax administrator and taxpayers with respect to the factors for ineffectiveness of income tax act 2002.

$$R = \frac{\sum d^2}{n \sum f^2} \frac{1}{Z^2}$$

$$Pr < 0.6745 \mid \frac{1}{\sqrt{n}} Z r^2$$

Let, variable x and y denotes views of tax administrator and taxpayers respectively

Table 18
Calculation of correlation coefficient

S. N .	Problems	Total Points (x)	Rank (R ₁)	Total Points (y)	Rank (R ₂)	Different of rank (R ₁ -R ₂)	Square of difference (R ₁ -R ₂)
1	Difficulty in language.	14	1	28	1	0	0
2	Long procedure	13	2	21	3	-1	1
3	Ineffective reward and punishment system.	8	3	8	5	-2	4
4	Ineffective income tax administration	6	4	23	2	2	4
5	Inappropriate rules and regulations.	4	5	10	4	1	1
						d=0	d ² =10

Sources: Opinion Survey, 2008

$$R = \frac{6(10)}{6 \times 5^2} \times 0.5$$

$$Pr = 0.6745 \mid \frac{1 \times 0.5}{\sqrt{5}}$$

Here, R is greater than Pr. The relation is not significant because to be significant R should be 6 times greater than Pr. So, null hypothesis is rejected. It means that the opinion of taxpayer and tax administrator regarding ineffectiveness of Nepalese income tax act 2002 is significantly different. However, the value of R is moderate; therefore there is some relationship between views of tax administrator and taxpayers.

4.2.2.5 Provisions and Procedure of Income Tax Act 2002

To know the level of understanding of the people in regarding to the overall provisions and procedure a question "Is the provision and procedure of income tax act 2002 simple in comparison to the act 1974?" was asked. The response is tabulated as below:

Table 19**Simplicity in provision and procedure of income tax act 2002.**

Responses Respondents	Yes		No		Total	
	No.	Percent	No.	Percent	N0	Percent
Tax Administrator	14	70	6	30	20	100
Tax expert	16	80	4	20	20	100
Tax payer	13	65	7	35	20	100
Total	43	71.67	17	23.33	60	100

Source: Opinion survey, 2008.

From the above table it is cleared, the income tax act 2002 has brought significant change in its provisions and procedures in comparison to the previous act 1974. 71.67% of the total respondents approved the provisions and procedures of the act are simple. Whereas 35% of respondent approved the new income tax act 2002 has not simplified the provision and procedure.

4.2.2.6 Effectiveness of Income Tax Administration in Nepal provision.

To know the respondents view regarding effectiveness of income tax administration in Nepal, a question, "Do you agree that Nepalese income tax administration is effective was asked. The responses are effective?" tabulated as follows:

Table:-20**Attitude towards Effectiveness of Income Tax Administration in Nepal.**

Responses Respondents	Yes		No		Total	
	No.	Percent	No.	Percent	N0	Percent
Tax Administrator	16	80	4	20	20	100
Tax expert	2	10	18	90	20	100
Tax payer	-	-	20	100	20	100
Total	18	30	42	70	60	100

Sources: Opinion Survey,2008.

From the above table it has been clear that Nepalese income tax administration is not effective. Most of the respondents i.e. 70% of respondents recognize it ineffective whereas only 30% respondents recognize its effectiveness.

4.2.2.7 Major Reasons of Weak Income Tax Administration.

The question was asked with the aim of searching the reasons for unsound income tax administration, a question, "If not what are the major problems of income tax administration in Nepal?" was asked. The responses of those respondents are tabulated as below:

Table:- Table:21
Major Reasons of Weak Income Tax administration

S. N	Problems	Respondents				Percent	Rank
		Tax Adm	Tax Expert	Tax payer	Total		
1	Lack of trained and competent staff.	23	86	71	180	19.93	3
2	Misuse of power by tax administrator.	8	89	98	195	21.59	1
3	Lack of physical facilities and computerized system in the tax office.	20	29	29	78	8.64	6
4	Lengthy process of income tax assessment	17	38	74	129	14.29	5
5	Corruption.	6	84	101	191	21.15	2
6	Lack of coordination within the tax department	10	52	68	130	14.40	4
Total					903	100	

Sources: Opinion Survey, 2008

The major problems of income tax administration in Nepal ranked in the under of priority by the respondents are as follows:

1. Misuse of power by tax administration.
2. Corruption.
3. Lack of trained and competent staff.
4. Lack of coordination within the tax department.

5. Lengthy process of income tax assessment

6. Lack of physical facilities and computerized system in the tax office.

The other problems or reasons stated by some respondents are lack of willingness in personnel, lack of right people at the right place, defective income tax act etc.

Hypothesis:

There is no significant relationship between the opinion of tax administration and taxpayers with respect to the major reasons of weak income tax administration.

H_0 (Null hypothesis) = There is no significant difference between the opinion of tax administrator and taxpayers with respect to the major reasons of weak income tax administration.

H_1 (Alternative hypothesis) = There is significant difference between the opinion of tax administrator and taxpayers with respect to the major reasons of weak income tax administration.

Correlation:

There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the major reasons of weak income tax administration.

Calculation correlation by formula,

$$R = \frac{6 \sum d^2}{n \sqrt{\sum Z^2}}$$

$$Pr < 0.6745 \mid \frac{1 - Zr^2}{\sqrt{n}}$$

Let, variable x and y denotes views of tax administrator and taxpayers respectively

Table 22
Calculation of correlation coefficient

S. N .	Reasons	Total Points (x)	Rank (R ₁)	Total Points (y)	Rank (R ₂)	Different of rank (R ₁ -R ₂)	Square of difference (R ₁ -R ₂)
1	Lack of trained and competent staff.	23	1	71	4	-3	9
2	Misuse of power by tax administration	8	5	98	2	3	9
3	Lack of physical facilities and computerized system in the tax office.	20	2	29	6	-4	16
4	Lengthy process of income tax assessment	17	3	74	3	0	0
5	Corruption.	6	6	101	1	5	25
6	Lack of coordination within the tax department	10	4	68	5	-1	1
						d=0	d ² =60

Sources: Opinion Survey, 2008

Here, R is less than Pr and negative. The relation is not significant because to be significant R should be 6 times greater than Pr. So, null hypothesis is rejected. It means that the opinion of tax administrator and taxpayer regarding major reasons of weak income tax administration in Nepal is significantly difference.

4.2.2.8 Essential Factors for making Income tax administration effective.

To know the essential factors which are responsible for making income tax administration effective in Nepal, a question, "What are the essential factors for making income tax administration effective in Nepal for the establishment of effective income tax system?" was asked. The responses of these respondents are tabulated as below:

Table: 23**Essential Factors for making Income tax administration effective**

S. N	Problems	Respondents				Percent	Rank
		Tax Adm	Tax Expert	Tax payer	Total		
1	Proper training to tax personnel.	90	82	52	224	17.48	3
2	Tax education to tax payers.	32	102	87	221	17.25	4
3	Increment of salary/incentives of tax personnel	97	30	37	164	12.80	6
4	Promotion of tax personnel based on performance.	95	33	39	167	13.04	5
5	Simple tax law	51	96	115	262	20.45	1
6	Establishment and implementation of effective reward and punishment system	54	77	112	243	18.97	2
Total					1281	100	

Sources: Opinion Survey, 2008

The essential factors for making income tax administration effectiveness the establishment of effective income tax system ranked in the order of priority by the respondents are as follows:

1. Simple tax law
2. Establishment and implementation of effective reward and punishment system.
3. Proper training to tax personnel.
4. Tax education to tax payers.
5. Promotion of tax personnel based on performance.
6. Increment of salary/incentives of tax personnel.

4.2.2.9 Corruption in Income Tax Administration

A question provided with two alternatives (yes/no) was asked to the respondents to know the view regarding corruption in income tax administration of Nepal a question " There is high degree of corruption in income tax administration of Nepal, Is it true?" was asked. The responses are tabulated as follows:

Table:-24

Corruption in Income Tax Administration

Responses	Yes		No		Total	
	No.	Percent	No.	Percent	N0	Percent
Tax Administrator			20	100	20	100
Tax expert	20	10			20	100
Tax payer	20	100			20	100
Total	40	66.67	20	33.33	60	100

Sources: Opinion Survey, 2008.

In this respect all the respondents from tax expert and tax payers said 'yes' but all the tax administrator said there is no corruption even though some tax administrator agree that there is corruption in income tax administration informally but they don't want to express due to their personal problem.

4.2.2.10 Measures to Minimize Corruption

To know the measures to minimize corruption in Income Tax Administration a question was asked to those respondent who said 'yes' a question is "If yes, how can it be minimized?" The responses of these respondents are tabulated as below:

Table:-25
Measures to Minimize Corruption

S.N	Measures	Respondents				Percent	Remarks
		Tax Adm.	Tax Expert	Tax payer	Total		
1	Regular supervision of tax personnel.		84	79	163	19.40	3
2	Additional incentive to tax personnel.		33	28	61	7.26	6
3	Strong action against corrupt personnel.		94	99	193	22.98	1
4	Deduction of tax officer's discretionary power.		69	86	155	18.45	4
5	Moral education to tax personnel.		44	35	79	9.40	5
6	Declaration of property of tax personnel each year.		96	93	189	22.5	2
Total					840		

Sources: Opinion Survey, 2008

The measures to minimize corruption ranked in the order of priority by the respondents are as follows:

1. Strong action against corrupt personnel.
2. Declaration of property of tax personnel each year.
3. Regular supervision of tax personnel.
4. Deduction of tax officer's discretionary power.
5. Moral education to tax personnel.
6. Additional incentive to tax personnel.

4.2.2.11 Effectiveness of Income Tax Policy

To know the opinion of the respondents, about the effectiveness of Income Tax Policy, a question, "Do you think Nepalese income tax policy is effective?" was asked. The respondents were requested to give their answer in the form of 'yes' or no'. The response received from them is tabulated as below:

Table 26
Effectiveness of Income Tax Policy

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax adm.	14	70	6	30	20	100
Tax expert	8	40	12	60	20	100
Tax payer	5	25	15	75	20	100
Total	27	45	32	55	20	100

Sources: Opinion Survey, 2008

As per above result, 55% respondent said that the income tax policy is not effective as desired whereas 45% respondent said income tax policy is effective.

To know the ineffectiveness regarding income tax policy additional question was asked. If no, what are the reasons?

The Responses of these Respondents are tabulated as below:

Table: 27
The Responses of These Respondents

S. N	Measures	Respondents				Percent	Remarks
		Tax Adm.	Tax Expert	Tax payer	Total		
1	Lack of far-sighted income tax policy	31	30	8	69	17.47	3
2	Lack of experts in policy making level	15	10	14	39	9.87	6
3	Administrative inefficiency for the proper implementation of the income tax policy.	7	48	35	90	22.78	1
4	Due to lack of revised timely in income tax policy	24	30	8	62	15.70	4
5	Income tax policy has to been formulated as per economic policy of the country	29	33	20	82	20.76	2
6	Highly ambitious but tells result oriented	20	14	19	53	13.42	5
Total					395	100	

Sources: Opinion Survey, 2008

As per the above table, the responses of respondents can be ranked as follows:

1. Administrative inefficiency for the proper implementation of the income tax policy.
2. Income tax policy has to been formulated as per economic policy of the country
3. Lack of far-sighted n income tax policy
4. Due to lack of revised timely in income tax policy

- 5. Highly ambitious but tells result oriented.
- 6. Lack of experts in policy making level

Hypothesis:

There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the reasons for ineffectiveness of income tax policy.

H_0 (Null hypothesis) = There is not significant difference between the opinion of tax administrator and taxpayers with respect to the reasons for ineffectiveness of income tax policy.

H_1 (Alternative hypothesis) = There is significant difference between the opinion of tax administrator and taxpayers with respect to the reasons for ineffectiveness of income tax policy.

Correlation:

There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the reasons for ineffectiveness of income tax policy.

$$R = \frac{\sum d^2}{n \sum f^2}$$

$$Pr < 0.05 \left| \frac{\sum Zr^2}{\sqrt{n}} \right.$$

Let, variable x and y denotes views of tax administrator and taxpayers respectively

Table 28
Calculation of correlation coefficient

S.N	Reasons	Total Points (x)	Rank (R ₁)	Total Points (y)	Rank (R ₂)	Different of rank (R ₁ -R ₂)	Square of difference (R ₁ -R ₂)
1	Lack of far-sighted n income tax policy	31	1	8	5.5	-4.5	20.25
2	Lack of experts in policy making level	15	5	14	4	1	1
3	Administrative inefficiency for the proper implementation of the income tax policy..	7	6	35	1	5	25
4	Due to lack of revised timely in income tax policy	24	3	8	5.5	-2.5	6.25
5	Income tax policy has to been formulated as per economic policy of the country	29	2	20	2	0	0
6	Highly ambitious but tells result oriented.	20	4	19	3	1	1
						d=0	d ² =49.5

Sources: Opinion Survey, 2008

Since, R is in negative therefore there is negative relationship between the views of tax administrator and taxpayers. It means that the opinion of tax administrator and taxpayers regarding reasons for In effectiveness of income tax administration is significantly difference. Therefore null hypothesis is rejected.

4.2.2.12 Income Tax Evasion in Nepal

Income tax evasion has existed more or less in all the nations. It is high level in underdeveloped counties since must of the business man do not keep their account of income and expenditure. If it is compulsory by law, they keep two or more sets or accounts of business operations. They use one for their internal

purpose and other for the tax purpose. It is done especially with the aim of evading tax liability. So, to know whether there was wide spread evasion of income tax or not, a question "Do you think there is wide-spread evasion of income tax in Nepal?" was asked based on 'yes' or 'no'. The responses received from them are as below:

Table 29
Income Tax Evasion in Nepal

Response	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax adm.	16	80	4	20	20	100
Tax Expert	18	90	2	10	20	100
Tax payer	12	60	8	40	20	100
Total	46	76.67	14	23.39	60	100

Source: Opinion Survey, 2008

As per the above table it shows that 76.67 percent of the total respondents agreed that there was widespread evasion of income tax however 23.33 percent respondents ignore it.

The respondents, who agree upon wide-spread evasion of income tax, were asked additional question and requested them to rank reasons in the order of priority, the question if yes, please give reasons.

The responses of these respondents are tabulated as below:

Table-30
Reasons of Income tax Evasion.

S. N	Problem	Respondents			Total	Percent	Rank
		Tax Adm.	Tax Expert	Tax payer			
1	Poor tax morality and tax payer's compliance	80	35	21	136	13.55	5
2	Administrative inefficiency	39	94	66	199	19.82	1
3	Loopholes in income tax act.	60	72	36	177	17.63	4
4	Ineffective use of fine and penalties	82	70	40	192	19.12	2
5	High corruption	36	78	68	182	18.13	3
6	Widespread illegal business activities.	70	30	18	118	11.17	6
Total					1004		

Sources: Opinion Survey, 2008

According to the above table the reason behind the in wine tax evasion can be ranked as follows:

1. Administrative inefficiency
2. Ineffective use of fine and penalties
3. High corruption
4. Widespread illegal business activities.
5. Poor tax morality and tax payer's compliance
6. Loopholes in income tax act.

The other reasons stated by some respondents are inadequate quailing and investigation, complicated income tax law, high tax rate, lack of political commitment, open border with India etc.

4.2.2.13 Measures to Control the Income Tax Evasion

To know the view regarding measures to control the income tax evasion a question, "How can we control the income tax evasion in Nepal for the flourishing

income tax system," was asked. The responses received from respondents presented on table below:

Table: 31
Measure to control the Income tax Evasion

S. N	Reasons	Respondent				Percentage	Rank
		Tax Adm.	Tax Expert	Tax payer	Total		
1	Providing education and incentives to tax payers	72	90	110	272	20.21	3
2	Removing complexities in tax laws	88	102	87	277	20.58	2
3	Formulating strict laws for penalties and fines to tax evaders	97	58	41	286	21.25	1
4	Punishing strictly to the corrupted employee	47	64	95	206	15.30	4
5	Making coordination of tax administration to auditor general department.	42	27	35	104	7.73	6
6	Better coordination with tax department of custom, excise, industry and trader and commerce	70	79	52	201	14.93	5
Total					1346	100	

Sources: Opinion Survey, 2008

As per the above table the measures to control the income tax evasion in Nepal for the flourishing income tax system can be ranked as follows:

1. Formulating strict laws for penalties and fines to tax evaders
2. Removing complexities in tax laws

3. Providing education and incentives to tax payers
4. Punishing strictly to the corrupted employee.
5. Better coordination with tax department of custom, excise, industry and trader and commerce.
6. Making coordination of tax administration to auditor general department.

4.2.2.14 Appropriate Method of Income Tax Assessment

Major part of the whole process of income taxation is income tax assessment. A sound and convenient assessment procedure or method may help to increase number of assessment and compliances taxpayers. It is very important to manage the income tax, because the amount or revenue realized through income tax is depend upon the assessment. To know the opinion of respondents regarding appropriate method of income tax assessment in Nepal a question 'which method is more appropriate in Nepal while assessing the income tax?' was asked. They were requested to tick one among the given three options. The responses received are as below:

Table 32
Appropriate method of income tax assessment

Difficulties	Respondents			Total	Percent	Rank
	Tax Adm.	Tax Expert	Tax payer			
Self Assessment.	16	20	20	56	93.33	1
Assessment of the best judgment	3			3	5	2
Assessment by committee	1	20		1	1.67	3
Total	20	20	20	60	100	

Sources: Opinion Survey, 2008

As per above table self assessment method is appropriate method of income tax assessment.

4.2.2.15 Taxpayers Consciousness for Voluntary Compliance

Conscious tax payers are the sign of effective reform in the tax system. To know the consciousness of tax payer for voluntary compliance a question "Do you think that the taxpayers were conscious for voluntary compliance?" was asked. The questions were asked in the form of 'yes' or 'no' The responses of respondents are as follows:

Table 33
Taxpayers Consciousness for Voluntary Compliance

Response	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Adm.	6	30	14	70	20	100
Tax Expert	3	15	17	85	20	100
Tax payer	12	60	8	40	20	100
Total	21	35	39	65	20	100

Sources: Opinion Survey, 2008

As per above table 35 percent of the total respondents said 'yes' whereas the remaining 65% percent said that the tax payer were not conscious for voluntary compliance. The respondent who said 'no' were asked to rank the suggestions for educating taxpayers for increasing tax consciousness for voluntary compliance. The response received is as follows:

Table: 34
Suggestion for Educating Tax payers

S.N	Suggestion	Respondent				Percentage	Rank
		Tax Adm.	Tax Expert	Tax payer	Total		
1	Door to door campaign problem	58	54	18	130	15.80	4
2	Providing incentive to taxpayers	17	73	64	154	18.71	2
3	Introducing Tax education in school curriculum	65	79	31	175	21.26	1
4	Giving advertisement in radio, TV, Cinema, newspaper, hording boards, and posters.	45	50	20	115	13.98	5
5	Making better coordination with FNCCI, chamber of commerce and NGOs	39	51	13	103	12.52	6
6	Opening more branches of tax offices in different places	68	56	22	146	17.74	3
Total					823	100	

Sources: Opinion Survey, 2008

As per the above table suggestion for educating tax payers for voluntary compliance can be ranked as follows:

1. Introducing Tax education in school curriculum
2. Providing incentive to taxpayers
3. Opening more branches of tax offices in different places.
4. Door to door campaign problem
5. Giving advertisement in radio, TV, Cinema, newspaper, hording boards, and posters.

6. Making better coordination with FNCCI, chamber of commerce and NGOs.

4.2.2.16 Contribution of Income Tax Revenue

Income tax has contributed about 20 percent to public revenue in Nepal. It is blamed that contribution of income tax to national revenue is not satisfactory. To know the fact, the question was asked to respondent "In your opinion, contribution of income tax to national revenue of Nepal satisfactory?" Opinion result is presented in the table below:

Table 35
Contribution of Income Tax Revenue

Response	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Adm.	17	85	3	15	20	100
Tax Expert	17	85	3	15	20	100
Tax payer	18	90	2	10	20	100
Total	52	86.67	8	13.33	60	100

Sources: Opinion Survey, 2008

As per above table in aggregates, 86.67 percent respondents argue that Nepalese income tax contribution is satisfactory. Whereas 13.33 percent respondent said that contribution of income tax revenue is not satisfactory as desired.

In order to know the major reasons for lower contribution of income tax, next question was asked, "If no, what are the major reasons? The respondents were requested to rank their choice from 1 to 6 according to performance.

Table 36

Reasons for Low Contribution of Income Tax to National Revenue

S. N	Difficulties	Respondents				Percent	Rank
		Tax Adm.	Tax Expert	Tax payer	Total		
1	Defective of income tax act	6	6	9	21	12.5	5.5
2	Mass poverty and low income level	12	7	6	25	14.88	4
3	Increasing habit of tax evasion	17	14	2	33	19.64	2
4	lack of tax consciousness	16	16	4	36	21.43	1
5	Ineffective income tax administrative	5	15	12	32	19.05	3
6	Inappropriate ratio and exemption limit	7	4	10	21	12.5	5.5
Total					168		

Sources: Opinion Survey, 2008

As per in above table reasons for low contribution of income tax to national revenue can be ranked as follows:

1. Lack of tax consciousness
2. Increasing habit of tax evasion
3. Ineffective income tax administrative
4. Mass poverty and low income level
- 5.5 Inappropriate ratio and exemption limit
- 5.5 Defective of income tax act

4.3 Major Findings

The major finding of the secondary data:

1. Nepalese revenue structure classified into tax and non tax revenue. but collection of these revenue is not sufficient to cover expenditure in Nepal. The tax revenue has very dominating role i.e. 73.08% of total revenue in 1991/92 and 81.1% in 2006/07. Share of non tax revenue for the same period seems to be 26.92% and 18.91% respectively. The tax revenue contributed amount of 9875.6 million and 87712.10million in 1991/92 and 2006/07 respectively.
2. Tax revenue is the composition of direct tax and indirect tax. Likewise other developing countries Nepalese tax structure is also dominated by indirect taxation in the revenue structure. Which contributed 83.85% in FY 1991/92. Which was the highest figure in the study period and minimum in FY 1999/2000 about 73% where as 73.31% in FY2006/07. Where as direct tax contributes only 16.15% in FY 1991/92 and 26.68% in FY2006/07. Although it has to contribute higher percentage in the government revenue. Due to the problem of evasion and avoiding of tax in developing countries its contribution is negligible. It reveals that tax structure of Nepal is not Justifiable on equity ground and progressiveness because indirect tax is considered regressive in nature.
3. In Indirect tax revenue is the composition of custom duty, excise duty and VAT/sales tax and custom duty plays the major role up to FY2003/04 i.e. 32.29%. After FY 2004/05 VAT /sales tax gradually occupying higher proportion i.e. 34.91%, 37.63% and 36.39% in FY 2004/05, FY 2005/06 and 2006/07 respectively. While excise duty small portion but it is in constantly increasing trend i.e. 11.33% in FY2005/06 and 13.14% in 2006/07 respectively. Direct tax revenue is the composition of income tax, property tax and revenue and registration tax where income tax plays the dominant role from FY 1991/92 to FY 2006/07 about 13.56% and 15.08% respectively income tax is the combination of corporate tax, individual tax, house lend rent tax and interest tax where corporate tax contributes higher percentage on income tax.

4. Income tax is the major source of direct tax revenue. The amount from income tax was 875.0million in 1991/92 and 15034.01 million in 2006/07.
5. The role of income tax from public enterprises is decreasing trend the maximum contribution from public enterprises on total income tax revenue was 33.4 % in FY 1995/96. which tends to1.9% in FY 2005/06 but it increased to 6.78% in FY 2006/07.
6. Income tax from individual has the major role in income tax and bears dominating rolke in period of the study. It has contributed 70.6% in FY1991/92. Its lowest share is 35.1% 2000/01. Its shares in FY 2006/07 is 34.82% .
7. Income from remuneration was 54.7 million in 1991/92 and reached to 2007.9 million in 2006/07 with regular growth.
8. Tax on interest is another source of income tax. Which had slow increassing trend in amount? Which shares on total income tax revenue is 105.1 million in FY 2006/07.
9. Generally income tax performance can be measured in term of their contribution percentage into GDP. It shows that 0.60% in FY 1991/92 and 3.05% in FY 2006/07 which is the highest figure of the study period. The contribution of income tax to total revenue is in increasing trend. Percentage of income tax to total revenue was 6.45% in FY 1991/92. This figure is increased to 17.34% in FY 2006/07.
10. Government revenue is not sufficient to cover the growing expenditure in Nepal so resource gap is widening. Resource gap of 12905.5 million in FY 1990/91 and reach to 45892.5million in 2006/07. It is continually increasing rapidly.

Findings of the empirical study:

The following are the findings of empirical study

1. With respect to the causes for unsound income tax system in Nepal. There was variation in the views of respondents group.

Though in ranking together the views of al respondents from each group, complicated income tax Act, rules and regulation, defective income tax

administration, corruption and evasion as well as lack of tax consciousness are the main problems regarding unsoundness of income tax system in Nepal.

2. The newly introduced Income Tax Act 2002 is seems effective to create sound income tax system in comparison to previous act 1974 because the New Tax Act has features of provision of international taxation, taxing capital gain and dividend income. Abolition of various tax related concession, rebates and exemption, which were not covered by the previous Act 1974 as prescribed by the respondents. Except these others features are speciation of stock valuation method, stringent fine and penalties etc. However all these features are included in the act, the Act is not free from it's drawbacks. Difficulty in language. Long procedure and ineffective income tax administration for the proper improvement of the Act are the major reasons for its ineffectiveness. Inappropriate rules and regulations and ineffective reward and punishment system are also the negative aspect of the act.

3. With respect to the major reason of weak income tax administration the views of respondent groups were different as per one overall ranking. Measure of power by tax administrator, 'corruption', and lack of trained and competent staff were recognized as the major reason behind weak income tax administration.

4. With respect to the essential factors for making income tax administration effective as per the overall ranking "proper training to tax personnel, tax education to taxpayer' and 'Increment of salary/incentives of tax personnel were the important factors to make income tax administration effective and reliable.

5. Corruption is the major problem in the income tax administration but income tax administrator denies that there is not corruption in administration however some administrator agree regarding this point informally but they doesn't want to express. So, if we go through the views regarding tax experts and taxpayers there is still corruption in income tax administration their views regarding measures to minimize corruption is different but if we got though overall ranking, strong action against corrupt personnel, Declaration of property of tax personnel each year and regular supervision of tax personnel were the essential factors to minimize corruption.

6. With respect to ineffectiveness of income tax policy. The supervision of respondents were varied from each other if we go through overall ranking administrative in affiancing for proper implementation of the income tax policy', Income tax policy has not been formulated as per economic policy of the country and 'lack of far-sighted' were the main reasons for ineffectiveness of income tax policy.

7. With respect to the suitable income tax policy or principle especially related to the rates 55% obtained by progressive rat policy and 45% obtained by proportional rat policy while regressive and digressive policy rate wasn't preferred by the respondents.

8. Opinions regarding reasons for Income Tax evasion differ among respondents therefore through overall ranking 'administrative inefficiency', 'inefficiency use of fine and penalties' and 'high corruption' were main reasons behind income tax evasion. Income tax evasion is the crucial problem to generate revenue so this problem should be minimized and solved. So, the measures to control the income tax evasion were, 'formulating strict law for fines and penalties to tax evaders', removing complexities in tax law, and 'providing education and incentives to tax payers were the overall views given by respondents.

9. With respect to the difficulties faced by tax payers while Assessing income tax, 'complex legal process, high expectations of taxable income by tax personnel and 'lack of cooperation from tax administration were main reason regarding difficulties of assessment procedure.

10. With respect to appropriate method of Income Tax, Assessment 93.33% received by self-assessment, 5% received by Assessment on the best judgment and 1.67% received by assessment by the committee. So, self-assessment is the best procedure to assess the income tax.

11. Taxpayers play the vital role in the field of taxation so taxpayer should be educated regarding various aspect of tax. Opinion regarding suggestion for educating taxpayers differ among respondents, therefore through overall ranking "introducing tax education in school curriculum', provide incentive to tax payers',

and 'opening more branches of tax offices in different places' were the main suggestion given by respondents.

12. With respect to reasons for low contribution of income tax to national revenue, 'lack of tax consciousness', 'increasing habit of tax evasion' and 'ineffective income tax administration' were main reasons declared by respondents.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

In developing countries like Nepal, lack of sufficient financial resources is the main constraint for national economic development. A lot of fund is required to meet the additional financial requirements for the development activities of the country. Nepal has been suffering from capital shortage to accelerate the economic growth. The expenditure of Nepalese government is increasing year by year. To meet the additional capital requirements Nepalese government has been using external and internal resources. Internal resources are preferable for sustainable economic development. Nepal has been unable for proper mobilization of internal revenue. Thus, fiscal deficit and resource gap of Nepal has been increasing every year.

To solve this problem, Income Tax is the most important source for internal revenue in which better Income Tax administration system assist to achieve that goal. Regarding this fact, this study attempts to analyze the importance and contribution of Income Tax Administration and income tax act as well as income tax policy to create flourishing income tax system in Nepal. After identifying introduction about it, review of literature has been observed to address core element like Income Tax and its development and other element regarding Income Tax system.

Descriptive cum historical research design has been used to search its objectives. Difference interaction method and strategy have been used to collect secondary data as well as primary data were also collected by using survey method. Analytical tools such as table, percentage, bar graph, trend lines, and rank correlation are used for research methodology.

In the contest of globalization the developing countries are seen to suffer because of less efficient tax administration due to lack of understanding and faith between taxpayers and income tax administration. It seems they are failure to walk in parallel way, within the boundary of coordination. So, it is

essential to make respectable relationship between taxpayers and tax administration to avoid the obstacles for the fluent operation of income tax system in Nepal.

Similarly, the laws should be well defined and firm. The loopholes in laws should be immediately eliminated. The first elected government in 1959 A.D. finally introduced Business Profits and Salaries Tax Act, 1960 in Nepal. At the time, income tax laws levied only on business profit and salaries. About after 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 1974 A.D. (2031 B.S.) was enacted. The act remunerated income sources into five groups (a) Agriculture (b) Industry, Trade, Profession or Occupation (c) remuneration (d) House and Companies rents (e) 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, 2002 A.D. (2058 B.S.). This act has replaced Income Tax Act 1974 (2031 B.S.) which was amended for eight times and existed for a period of 28 years. Government of Nepal formed income tax rules, 2059 B.S. in 2059 B.S. to help clarifying the act.

Lastly, a good Income Tax System is one which is as little burden some to people as possible, simple and clear tax laws, sound and effective income tax administration, tax consciousness on general public, adoption of principle of equity and ability to pay principle, appropriate income tax policies, minimum cost of collection etc. are the major characteristics of effective income tax system. Though, efforts have been made to hold these characteristic in Nepalese Income Tax System, the complete success has not been achieved until proper implementation of these major characteristic. So let's take a vow to make better Income Tax Administration to change the nation into developed country.

5.2 Conclusion

Taxes are the backbone of the nation without strong backbone government of the nation cannot stand properly. So, nowadays taxation has become a really of life without which government cannot sustain itself.

Taxation is a suitable means for the government to rise revenue and mobilization of the domestic resources. To achieve the goal of national development and for the economic growth of the country it is a duty of every taxpayer to voluntarily comply the tax. It may be only possible form conscious, responsible and educated taxpayers. So, the government of the nation should lunch the programme to make taxpayer conscious and responsible apart form this government should make them clear and satisfied that the revenue is going to utilize in proper way in the productive sector for the welfare of the every citizen of the nation. The proper and effective implementation of Tax Laws is necessary to create a welfare state, equalities among the people and to avoid evil consequences of tax evasion ad tax avoidance.

Nepalese tax structure is the combination of various tax within this Tax Structure Income Tax plays significant role on revenue. To meet the government expenditure, achieve the goal of national development not only that, to decrease poverty and illiteracy has equally important role of Income Tax. After the great revolution of 2007 B.S. Most of the development activities have been conducted with the foreign grants and loans because of poor performance of internal revenue collection and mobilization, we have passed the long journey but still we were reliance on foreign grants and loans. The example of the other nation reversals that the dependency on foreign loan for long period may be very dangerous; country like Canada has also used foreign lone if we study her history but Canada used it properly and achieved her goal in the short term period now Canada is one of the developed country in the world. So, we should not depend on the external sources for the long-term it doesn't mean that we have to stay alone in the world but we should learn to stand on our own foot for our existence, sovereignty and freedom of a country.

Income tax is one of the important measure to collect the internal revenue and to turning the gap between have and have not to reduce the social imbalance. This goal can not be achieved without sound and effective income tax administration because without healthy brain the body can't work properly. So, there are various challenges towards income tax administration.

Tax payer is the centre point without their proper support the goal can not achieve. So, they should made conscious though proper tax education. The effort should be made to bring all potential new taxpayers into tax net on regular basis tax administration should play friendly role towards taxpayers. Because the tax administration is the bridge between taxpayer and the government. To make the taxpayer and tax administrator clear the Tax Laws should be well defined and firm. The loophole in laws should be immediately eliminated. Another core problem of the Nepalese Income tax system is Income tax evasion so only the sound administration can minimized and solve this problem.

A sound income tax system is the combination of simple and clear tax laws and policies income tax administration. Conscious tax payers are the four strong pillars of the good income tax system. Though efforts have been made these pillars strong and effective to move towards the path of success. We are still in the half-way of the road many things remained to be reformed in Nepalese Income Tax System. We are in the era of New Nepal so let's make commitment with word and the action to make our nation developed, advanced and powerful through proper utilization of our own internal revenue and resources.

5.3 Recommendations

Now Nepal has entered in to the federal Republican state. Willingness of people from new government are so high, Therefore there is an urgent need to take immediate and long run measures to expand economic activities in order to fulfill people heightening aspirations. Acceleration in development activities, notable expansion in revenue mobilization at least to the level that could meet the recurrent and principal repayment expenditure. The gap between the expenditure and revenue must be lowered for fiscal stability. To solve this problem, Income

Tax is the most important source for internal revenue in which better Income Tax administration system assist to achieve that goal. Nepalese Income Tax System is not free from problems many challenges has been coming in it's way but also the good sign of prospects has been seen after Income Tax Act reform in 2002.

The following suggestions are made for the betterment of income tax system in Nepal.

1. Suggestions regarding Income tax policy

- a. Tax policy should be formulated on the basis of feedback system of existing situation what are the problems and weaknesses of existing period should be recognized and the tools to minimize such problems should be formulated for this purpose an income tax reform commission of high level with the Chairman of Ministry of Finance with adequate and proper representation from all concerned sectors should be established.
- b. Long term revenue policy needs to be formulated to tie up revenue with the economic growth, making revenue growth perfectly elastic to economic growth.
- c. To meet the resource gap and the budget deficit the tax base should be widened but the principle of ability to pay should be considered.
- d. To achieve the goal as per Income Tax Policy, Income Tax Administrative should implement these policy effectively.
- e. Income tax policy should be for sighted and should be formulated as per the economic policy of the country.
- f. For the improvement of industrialization tax holiday has been provide. But it is seen in practice that taxpayers have evaded or avoided tax by registering a name of industry which is provided with Income Tax holiday under the law but they run other business transaction. So, this kind of illegal activity should be strictly watched. To solve this problem the top level committee should formulate special policy to minimize misuse of tax holidays.
- g. Income Tax Policy should be progressive and appropriate rebate should be provided to the taxpayer who submit true income statement within the defined time limit.

2. The success and effectiveness of income tax system entirely depends upon implementation of provisions which is the major responsibility of Income Tax Administration. In Nepal, one of the most important reasons for unsound income tax system is tax Administration. On the basis of the study, the following recommendations are made for the improvement of **income tax administration in Nepal**.

a. All the tax personnel (Human Resources) should be given comprehensive training for efficiency, effectiveness and professionalism on various aspects of taxation on a regular basis. For this it is better to establish 'Tax Training centre' within the tax department with highly qualified, experienced trainers in sufficient number.

- b. The rights and duties of Tax Administrator should be clearly defined and their evaluation should be done with the principle of "Management by objectives".
- c. There should be fair, scientific and transparent system regarding the promotion of tax personnel. Basically the following criteria should applied. (i) Job performance (ii) Honesty (iii) Merit and academic qualification (iv) Leadership (v) Seniority
- d. Tax personnel should be motivated through punishment and reward system. Reward should be given for better performance and penalty should be given to poor performance. The current salary scale should be increased, working environment of the tax offices should be improved and vehicle and necessary machinery should be provided.
- e. The tax administration should be made free from corruption for this strong action should be taken against the corrupted employee, upto date records from the time of recruitment to the present about income and property of each tax personnel, his family and near relatives should be maintained. The internal audit and control system should be clearly defined and applied in real sense. The tax administration should be made entirely free from the unnecessary pressure and interference of influential persons.
- f. The Tax Administration should use computerized system effectively. It's own software should be developed and implement property to achieve the goal of e-governance.
- h. The administration should try to increase effective public participation to minimize the income tax evasion. For this, proper education in regard to taxation should be provided to general public.
- i. The administration should pay great attention to bring the income from consultant services, NGOs and private boarding school/colleges, tuition institute into Income Tax net. In this sectors Income Tax has been highly evaded for this purpose coordination with chamber of commerce, FNCCI, Banks, customs and local governments should be done.
- j. A research and intelligence sector should be established in each tax office for proper planning and to collect the information in regard to Income Tax evaders,

potential new taxpayers and non-resident who have conducted business without registration.

k. Cost of Income Tax collection is one of the determinants of efficiency of administration. Therefore, the concern authority should play due attention to it should be reduce.

l. Political intervention as well as outsider pressure should be avoided and autonomous working environment should be provided.

m. Service delivery by the tax administration to the tax payers needs to be improved as per the need of the time. Revenue linkages through the rampant and illegal use of the duty –free goods need to be controlled. To this propose efforts should be made toward full automation of tax administration, simplifying income tax procedure.

n. Tax office should be decentralized for broad coverage of geographical region.

Separate income tax department should be established for specialization of income tax.

3. The law is the path on which the systems have to move to make the way smooth the laws should be clear, comprehensive and simple. It should not contain any loopholes and ambiguity therefore it should be reviewed frequently and reformed. The following recommendations are made regarding **income tax act in Nepal.**

a. For the effective implementation of an Act, first the entire Act should be understandable to the taxpayers as well as tax administrators. However the attempts are made in the Act 2002 composition of the Act is difficult. A reader has to turn out the pages here to there to understand the Act. If the Act is composed as per head of the incomes, individuals and entities it will be easier to understand whether the taxpayer is individual or entity and other related provision should be given with schedules.

- b. The income tax Act 2002 could be an effective means to generate more revenue from income taxation if the act is effectively implemented since the Act has so many features. It has included so many new Provisions and procedures which cannot be found and which were excluded by the Act 1974. Provision and procedure of the Act 2002 is an average type in terms of simplicity such as language, time consumption. The confusions and misunderstandings regarding such provisions can be eliminated by providing orientation to taxpayers and training to tax administrators.
- c. If there is enough reason that the taxpayer has earned from illegal business and corruption the income should be made liable to tax net at high rate without exemption limit. It does not mean he may escape from punishment.
- d. The rate of fine and penalties should be increased. The provision of fines, penalties and punishment should be made at a higher rate for income tax evaders.
- e. The special package of reward, prize and incentives should be introduced in the act to encourage the taxpayers, to pay voluntarily.
- f. Pollution control expenses should allow deducting fully while such expenses are directly concerned with the human well-being.
- g. The assessment and tax collection provisions should be made clear and simple so that taxpayers would be encouraged to pay income tax.
- h. The revenue tribunal should be fully developed as a legal authority for appeal and its decisions should be made final in most of the cases. Only the serious cases should be entered in the appellate court. The cases concerning high amounts and violation of legal rights of taxpayers should be defined as serious cases.

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Appendix-A

Cover Letter

To,

.....

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Dear Sir,

First of all, I would like to introduce myself as a student of Nepal commerce Campus, MBS final year. In order to fulfill my practical requirement of Master's Degree in Faculty of Management. I am preparing a thesis titled "**Analytical Study of Administrative Aspect of Income Tax System in Nepal.**"

I would gladly appreciate if you could kindly spare a few minute of your valuable time in filling this questionnaire enclosing with your valuable suggestions.

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

Looking forward to your cooperation and support with many thanks.

Your Sincerely,

.....

Prem Prasad Neupane

QUESTIONNAIRE

Topic: Analytical Study of Administrative Aspect of income tax system in Nepal

(Please either tick () your answer or rank in order of preference from 1 to 7 where 1 is the most important and 7 is the least important)

1. Do you consider that income tax system in Nepal is sound?

i. Yes () ii. No ()

(a) If no, what are the causes which are responsible for creation of unsound income tax system in Nepal? (Please put in order of priority)

- i Defective income tax administration ()
- ii Lack of good economic policy ()
- iii Complicated income tax act, rules and regulation ()
- iv Corruption and evasion ()
- v Lack of tax consciousness ()
- vi Lack of training and sufficient incentives to employees ()
- vii Others (please specify)

2. Is the new income tax act 2002 of Nepal effective to create sound income tax system in comparison to previous act 1974?

i. Yes () ii. No ()

(a) If yes, what are the reasons? (Please rank your answer in the order of priority)

- i Abolition of various tax related concessions, rebates and exemptions ()
- ii Taxing capital gain and dividend ()
- iii Specification of stock valuation method ()
- iv Provision of international taxation ()
- v Stringent fine and penalty provision ()
- vi Others (please specify).....

(b) If no, what are the reasons? (Please rank your answer in the order of priority)

- i Difficulty in language ()

- ii Long procedure ()
- iii Ineffective rewards and punishment system ()
- iv Inefficient income tax administration ()
- v Inappropriate rules and regulations ()
- vi Other (please specify).....

3. Is the provision and procedure of income tax act 2002 simple in comparison to the act 1974?

- i. Yes () ii. No ()

4. Do you agree that Nepalese income tax administration is effective?

- i. Yes () ii. No ()

(a) If no, what are the major problems of income tax administration in Nepal? (Please rank your answer in the order of priority)

- i Lack of trained and competent staff ()
- ii Misuse of power by tax administrator ()
- iii Lack of physical facilities and computerized system in the tax office ()
- iv Lengthy process of income tax assessment ()
- v Corruption ()
- vi Lack of coordination within the tax department ()
- vii Others (please specify)

5. What are the essential factors for making income tax administration effective in Nepal for the establishment of effective income tax system?

- i Proper training to tax personnel ()
- ii Tax education to taxpayers ()
- iii Increment of salary/incentives of tax personnel ()
- iv Promotion of tax personnel based on performance ()
- v Simple tax laws ()
- vi Establishment and implementation of effective reward and punishment system ()

vii Others (please specify).....

6. "There is high degree of corruption in income tax administration" of Nepal? Is it true?

i. Yes () ii. No ()

(a) If yes, how can it be minimized? (Please rank your answer in the order of priority)

i Regular supervision of tax personnel ()

ii Additional incentive to tax personnel ()

iii Strong action against corrupt personnel ()

iv Deduction of tax officer's discretionary power ()

v Moral education to tax personnel ()

vi Declaration of property of tax personnel each year ()

vii Others (please specify).....]

7. Do you think Nepalese income tax policy is effective?

i. Yes () ii. No ()

(a) If no, what are the reasons? (Please rank your answer in the order of priority)

i Lack of far-sighted in income tax policy ()

ii Lack of experts in policy making level ()

iii Administrative inefficiency for the proper implementation of the income tax policy ()

iv Due to lack of revised timely in income tax policy ()

v Income tax policy has not been formulated as per economic policy of the country ()

vi Highly ambitious but less result oriented ()

vii Others (lease specify)

8. Do you think there is widespread evasion of income tax in Nepal?

i. Yes () ii. No ()

(a) If yes, please give reasons (Please rank your answer in the order of priority)

i Poor tax morality and taxpayer's compliance ()

ii Administrative inefficiency ()

- iii Loopholes in income tax law ()
- iv Ineffective use of fine and penalties ()
- v High corruption ()
- vi Widespread illegal business activities ()
- vii Others (please specify).....

9. How can we control the income tax evasion in Nepal for the flourishing income tax system?

- i Providing education and incentives to taxpayers ()
- ii Removing complexities in tax laws ()
- iii Formulating strict laws for penalties and fines to tax evaders ()
- iv Punishing strictly to the corrupted employees ()
- v Making co-ordination of tax administration to auditor general's department ()
- vi Better co-ordination of tax department with department of custom, exercise, industry and trade and commerce ()
- vii Others (please specify)

10. What method is more appropriate in Nepal while assessing the income tax?

- i Self-assessment ()
- ii Assessment on the best judgement ()
- iii Assessment by the committee ()

11. Do you think that the taxpayers were conscious for voluntary compliance?

i. Yes () ii. No ()

(a) If no, please give suggestions for educating taxpayers for increasing tax consciousness for voluntary compliance? (pleas rank your answer in the order of priority)

- i Door to door campaigning programme ()
- ii Provide incentive to taxpayers ()
- iii Introducing tax education in school curriculum ()
- iv Giving advertisement in radio, TV, cinema, newspapers hoarding boards, posters ()

- v Making better coordination with FNCCI, chamber of commerce and NGOs ()
- vi Opening more branches of tax offices in different places ()
- vii Others (please specify).....

12. In your opinion, is contribution of income tax to national revenue of Nepal satisfactory?

i. Yes () ii. No ()

(a) If no, what are the major reasons?(Please rank your answer in the order of priority)

- i Defective of income tax act ()
- ii Mass poverty and low income level ()
- iii Increasing habit of tax evasion ()
- iv Lack of tax consciousness ()
- v Ineffective income tax administration ()
- vi Inappropriate rate and exemption limit ()
- vii Others (please specify).....

Name:

Occupation/profession:.....

Name of organization:.....

Address:.....