

# CHAPTER ONE

## INTRODUCTION

### 1.1. General Background

Nepal, the Himalayan country, the land of Buddha, non-aligned, small and land-linked country in South Asia has always exist as a sovereign nation. It is situated between the two large and densely populated countries of Asia - China in the North and India in the South, East and West. The shape of Nepal is rectangular and it has an area of 147, 181 sq. kms. The length (East to West) is 885 kms. And the width (North to South) is non-uniform, approximately 193 kms in average ranging from 145Kms to 241Kms. It is situated between longitudes 80°4'E to 88°12'E and latitudes 26°22'N to 30°27'N, along the Southern slopes of the Himalayas (snow peaks). Although the breadth of the country is narrow, all varieties of climate and topography can be found in this country ranging from the sub-tropical to the alpine. The lowest altitude starts from 60 meters above the sea level in the Southern plain to 8, 848 meters in the Northern part. Mt. Everest the highest peak in the world with an altitude of 8,848 meters lies in Nepal. Physically, the country is divided into three regions running from East to West, namely; the Tarai (Plain area), the Hills and the Mountain. As per population census 2001, The Total population of the country has been 231,51,423 having growth rate of 2.25%.

Nepal's per capita income is very low. "According to World Bank report 2008, Nepal's per capita income has been American Dollars 290." (International Forum Year Book January 2008). "Economic Survey 2064/65 published by Ministry of finance states that the per capita income has been reached to Dollar 476." It is one of the lowest in the world. Income distribution is significantly influenced by disparities in the distribution of assets and income generating opportunities. Lower saving of individuals has been the major cause for the lower saving of the household and lower investment. Very low levels of revenue generation and relatively higher expenditure in social and economic infrastructures have been the features of Nepalese economy. As a result, budget deficit continues to remain at high level.

Most of development projects & programs are financed through foreign loan and aid leading to problems of increasing debt servicing.

Out of the total estimated expenditure Rs. 99 billion 605.9 million and 56 thousand will be borne from current source of revenue; Rs.27 billion 460.9 million and 14 thousand from foreign grant, and Rs.17 billion 367.4 million and 30 thousand from foreign loan. Thus, a total of Rs. 44 billion 828.3 million 44 thousand will be mobilized from foreign aid. However, despite resource mobilization from these two sources, there will be a deficit of Rs. 24 billion 561.3 million. (Budget Speech F/Y 2064/65).

Government is an organization. It is the executive body of any nation for economic and other activities. During the classical and neo-classical time period the role of government was underestimated / neglected. They believed that the government is best which governs least, generally for economical development. Their economic idea was based upon Laissez Fair Doctrine. According to this concept, economic functions best under private initiative and competitive environment rather than under control. Role of public finance can be reduced into very limited according to their perception.

But there are some serious limitations of uncontrolled economy. First of all it is not possible the existence of perfect competition in economy. Profit is the motive than public need. There are not effective solutions for problems of unemployment, inequality and poverty especially for minority and disables. Importance of government control in economy seems to be more important during depression phase of trade cycle. Some tasks such as implementation of development plan to improve lifestyle of people maintain law and order, peace and security in nation and launch public welfare program in health and education sectors there is no alternatives of government. Therefore, role of government keeps much importance in economy. Being an organization financial flow is regarded as lifeblood for government also. Government collects funds from different internal and external sources to fulfill its requisites. External sources of government are foreign loan, grants, external borrowings etc. Tax, income from public enterprises, special assessment, fees, penalties, and fines are internal sources of revenue.

Nepal has one of the least developed economies of the world. Up to running 11<sup>th</sup> plan it has completed 50 years of planned economy but there is no effective and significant achievement due to ineffective and effortless plan, program and policy. On the other side globalization, international marketing and economic liberalization have made every country of world to take its prime concern on rapid growth of economy. Nepal cannot be an exception. Nepal aims for self-reliant economic system to upgrade living standard of its people. A lot of money has to be invested to achieve maximum national objectives. External sources are uncertain, inconvenient and not good for durable economical development. Internal revenue is the most important and reliable source for government.

The internal source of government constitutes non-tax and tax revenue. Examples of non-tax revenue are fees, fines, royalty and income from public enterprises. In Nepal the contribution of non-tax revenue in total revenue is 18.90% in FY 2006/07. (Economic Survey 2008).

Tax revenue is the important source of revenue. Simply, tax is the liability imposed upon natural as well as artificial individual to pay an amount as compulsory contribution to public authority. Tax is only levied as per law enacted by authority and this do not provide any special and corresponding benefits to taxpayers for paying tax, but amount thus collected is spent for common interests and public welfare. Tax is classified into direct and indirect tax. Direct tax is directly levied either for generation of income or for handling assets while indirect tax is collected indirectly for consumption or expenditure. The person himself who is legally imposed to pay should pay the direct tax. Income tax, Rent tax, Interest tax, house and land tax are the examples of direct tax. Another individual than the legally imposed person pays indirect tax wholly or partly. Value Added Tax (VAT), Costume duty, entertainment tax and so on falls under this category. The contribution of tax revenue in national revenue is 81.09% in F.Y. 2006/07 (Economic Survey 2008).

Taxes in income are the most important source of revenue for governments of developed countries. But developing countries at present produce far less revenue than costume duties and taxes on internal transactions. But these taxes are emphasized in all developed as well as developing countries, because they have the potential for increasing the yield of the tax system and achieving a system of

taxation that satisfies the demand for equity and social justice (Singh, 2001, 283). Income tax may be levied on the individuals as well as business firms. The former is known as personal or individual income tax or simply tax, while the next is known by the name of corporate income tax or corporation tax.

Income tax is tax of equity. It is imposed on the basis of paying capacity of taxpayers. So it will be possible to reduce the gap in income by imposing higher rate to those who have higher income to provide necessary assistance though this amount to people with poorer economic condition.

One of the fundamental characteristics of tax is that it can only be levied as per law. Recent Constitution of Nepal 2063, article 89 (1) has declared this statement. Changes and amendments in laws are made as per requirement. Generally change in tax law is needed when economic policy of country is changed. Current world economy is moving along with liberalization, globalization and privatization. To get maximum benefits from these factors for rapid economic growth of nation, Nepal is also trying to improve its existing economic policy. Therefore for timely improvement and change in existing tax law, after long discussion and investigation income tax act 2058 was passed and enacted through legislation replacing existing income tax act 2031. Government has made and enacted Income tax regulation 2059 to facilitate the act.

## **1.2. Statement of the Problems**

It has been about half of century Nepal is trying on planned developing efforts. But it is already suffering from resource constraints, massive poverty, and rapid growth of population, increasing frictional and seasonal unemployment, diseases, and aggressive dependent on the agriculture, subsistence living standards and poor infrastructure.

A government needs development with higher economic growth to overcome such serious problem for which the government should have adequate financial resource. In Nepal, resource mobilization is still poor that does not cover the requirements. The gap between government expenditure and internal source is known as resource gap. Nepal has been suffering from this problem and is highly

dependent on foreign sources. Resource gap has incurred in Nepalese finance because the expenditure of government is increasing at a faster rate than the increase in revenue. The resource gap is widening continuously with the incremental of total expenditure in respect to total revenue collection. The resource gap was only 4137.6 million in 1982/83, it became 15749.3 million in 1992/93 and further it widened to 38607.1 million in 2005/06. The total national revenue for year 2006/07 has been 87712.1 million and the total expenditure for this year has been 133604.6. So the resource gap for this year has been 45892.5. Percentage increased of resource gap in comparison to year 2005/06 has been 18.87%. To meet these gap government manage its fund from external sources in the form of grant, loan and borrowing. As stated earlier, external sources are uncertain, inconvenient and not good for durable economical development it is better to mobilize internal source.

To raise government revenue, it is necessary to raise its internal sources of revenue. Internal sources of revenue constitute tax and non-tax revenue. The contribution of tax revenue in the national revenue is 79.45% in 2005/06 and that was 79.49% in 2000/01. For year 2005/06, increase in revenue is 3.08% and in tax revenue is 6.14% comparing to former fiscal year. For F/Y 2006/07, increase in revenue is 21.34% and in tax revenue is 23.84 comparing to F/Y2005/06. It seems to be in increasing trend, but not sufficient to recover the raise in expenditure (Economic survey 2008). The government of Nepal has adopted various policies to strengthen the revenue structure in context of changing economic policy. For the Restructuring of Income tax system change in existing act has been made in 2058. But it is not seems to be so specific and effective regarding its contribution in revenue. Amount of income tax collected in 2000/01 was 9114.0 just before the act and 10373.7 for its fifth year of implementation in 2005/06. The contribution of income tax in national revenue was 18.64% and 14.35% for the same two years. The amount of income tax collected in year 2006/07 is 15034.2 million. The percentage contribution of income tax to national revenue in year 2006/07 is 17.14%. Comparing to developed countries, this is a very low contribution and the indication of biased situation of income tax revenue with total revenue is a matter of worry.

There are many problems in Nepalese income tax system. Government is already not able to increase the income tax as per requirement after the ambitious change in law. Inefficient tax administrative system, widespread income tax evasion, complicated and frequent change in tax rate and lack of awareness and feelings of responsibility in taxpayers are appearing as major factors for low contribution of income tax in national revenue. Internal conflict of nation and political instability has affected the economic system indirectly but very seriously. It has damaged as well as destroyed the environment for generating more income. Where income is limited, certainly the tax from income will not be so optimistic.

The specific issues addressed by the study were:

1. Whether there is the government of Nepal has been able to collect the income tax from the present structure?
2. Whether the use of modern technology such as information technology in tax collection offices has been used or not?
3. Whether there is skilled manpower worked under revenue department?
4. Whether the Nepalese taxpayers have awareness and feeling of responsibility for paying tax?
5. Whether there is effective and timely monitoring?
6. What is the role of income tax in total tax structure?
7. Whether there is any resource gap in Nepalese economy or not?

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

1. To find out the parts of national revenue occupied by income tax and its trend.
2. To analysis the composition of income tax revenue from various sources.
3. To analysis the contribution of income tax in national revenue before and after enactment of Income Tax Act 2058.
4. To analysis the strengths & weaknesses of Income Tax Act 2058.
5. To provide suitable suggestions for the betterment of income tax system in Nepal.

## **1.4. Importance of the Study**

Some fact that come from research in any topics is important in it self. This study is valuable and important for those, who are interested to know about the impact of income tax in National revenue before and after the enactment of income tax act 2058. Basically, Tax Administrators, Tax authorities, Taxpayers, potential researcher, students, teachers and other concerned authorities will be benefited from this study. Researcher hopes that this study will help to government and other institutions to formulate their policies and programs about tax system. This study is important to measure the impact and contribution of income tax in National Revenue of Nepal.

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

1. The study is mostly depended upon the secondary data.
2. The study period is limited that is data of only sixteen years has been used (before ten years and after six years of new act)
3. Act is analyzed for on economic consideration, not on legal consideration.
4. Opinion Survey has been made on sample of Kathmandu and Pokhara valley so may not represent country as a whole.
5. Result is mostly dependent upon quantitative data.

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

This study has been organized in five chapters. The first chapter is introduction chapter. It constitutes general concept about the chosen topics under general background and problems appeared related to subject matter under statement of the problem. Objectives and limitations of study have also been pointed in this chapter.

The second chapter is Review of Literature. It constitutes Review of Literature through different relevant books, articles and unpublished dissertation & definition, legal provisions and income tax system. It is focused on defining the related terms such as revenue, tax, income tax etc and developing the concepts on them. History of income tax and provisions in act has been analyzed on comparative aspects.

The Third chapter is Research Methodology. It includes types of research, research design, population and samples, nature and source of data, data collection procedure and data processing and analysis procedure.

The fourth chapter is the main body of research named as Data Presentation and analysis. The contents of this chapter are related to presentation of secondary data of Nepalese economy specially linked with income tax such as resource gap, composition of revenue, composition of tax revenue, composition of direct tax revenue, composition of income tax revenue and so on for selected time period. Different tables and diagrams are also presented in these chapters. It also includes results of opinion survey about the efficiency and effectiveness of new act & major Findings also presented in this chapter.

The fifth chapter includes Summary, Conclusion and Recommendation. It is the last but not the least chapter. Suggestions for betterment of income tax system in Nepal have been made within the frame of conclusions of study.



# CHAPTER TWO

## CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

### 2.1. Definitions

#### 2.1.1. Revenue

Revenue is regular income of government from internal resources for execution of different bodies of nation.

According to Revenue Leakage (Investigation and Control) Act 2052:

"Revenue means the amount that is to be paid to government as costume duty, excise duty, income tax, entertainment tax, hotel tax, sales tax, vehicle tax, rent tax, contract tax, property tax and the word also indicates other taxes according to existing law."

Revenue amount is collected through different medium from public people and spent from state for welfare of people, so it is also called public income. Government levies costume, excise, income tax, VAT, land tax, fees and penalties as source of revenue. Revenue can be divided into tax revenue and non tax revenue.

Government income specified in act and law to be paid by person, firm, industry, business, trade, profession or organization for execution of some task or work or for holding of some kinds of assets is known as tax revenue. For example: costume, excise, land tax, VAT etc.

Revenue gained by government for distribution of public service or for public service or for direct facilities provided or for fees and penalties to state against violation of rules and regulation is known as non tax revenue. For example: income from sales of government goods and services, principle, interest, dividend, royalty, fine, penalty, seizing etc. are non tax revenue.

Sources of revenue:

- a) Taxes
- b) Fees

- c) Amount for goods and services provided
- d) Fine/penalty
- e) Franchise cost
- f) Gifts and donations

### **2.1.2. Tax**

Tax is an important source of revenue for government. It is compulsory provision to citizen imposed by law to pay as monetary term to government without any expectation of some specified return. Economists and scholar have expressed their view in tax as follows:

"A tax is a compulsory contribution imposed by a public authority irrespective of the exact amount of service rendered to the taxpayer in return and not imposed as penalty for any legal offence."-Dalton.

"A tax is a compulsory contribution of wealth of a person or body of persons for the service of public powers." – Bastable

"A tax is a compulsory payment to government without expectation of direct expenses of direct return in benefit to the taxpayer." – P. E. Taylor

"Taxes are compulsory contributions to public authorities to meet the general expenses of the government which have been incurred for the public good and without reference to special benefits." - Findlays Shirras. (Lekhi, 2000:146)

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

"Tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interests of all without reference to special benefits conferred." – Professor Saligman (Lekhi, 2000:146)

Among above, the first three states that the tax is compulsory levy and the taxpayer does not have any right to receive direct benefits from tax paid. The remaining definitions also clears about the expense of collected tax in common interests of residents of nation.

According to definition, tax has major three characteristics:

- a) It is a compulsory monetary contribution.

- b) Taxpayers should not expect special treatment as a return of tax.
- c) Amount collected from tax should be expended for public of whole nation.

Taxes are levied primarily to raise revenue for the government expenditures, although they raise other purposes as well. The concept of modern tax contains different fundamental principles such as:

- a) No taxation without representation. Tax can be levied only with the approval of citizens through their representatives.
- b) Foreigners are to pay more tax than citizens
- c) Progressive principle i.e. more tax for more income.
- d) Tax should be collected compulsorily.
- e) Taxpayers are compelled to pay as their liability.

Tax can be classified into direct and indirect tax.

i) Indirect tax:

Indirect tax is imposed on one person but paid partly or wholly by another. It is transferable and people pay tax when they receive or consume goods or services. It is transferable and people don't feel burden of lump sum. There is mass participation because every person pays tax for receipt of goods or services. Indirect tax can be charged at higher rate for harmful goods such as cigarette and alcohol to discourage them. So indirect tax is flexible. Examples of indirect taxes are customs, excise, value added tax, entertainment tax etc.

There are some limitations of indirect tax. Every person either rich or poor has to pay equal amount of tax for reception of goods or services so it is tougher for poor. The higher rate, if imposed, may reduce consumption and it effects on production and employment. There is no certainty about collection of indirect tax.

ii) Direct tax:

Direct tax is paid by same person who is legally imposed. It is paid according to the income or property earned by a person. It is found equal with property. There is certainty about time, design and process of payment. Taxpayers can easily estimate their liability and government can easily increase or reduce according to needs. Income tax, contract tax, vehicle tax are examples of direct tax.

Direct tax is levied on direct persons, so they may not be ready to pay voluntarily. And of course they try to pay lowest tax as possible as and also exercise

for tax evasion. Direct tax is also expensive for collection. Direct tax discourages private saving and investment and there is lack of mass participation.

### **2.1.3. Income**

Income generally means monetary or equivalent gains during a period from property, business, labor etc.

According to Dictionary of Economic Terms, income mean " The wealth measured in money, which is at the disposal of an individual or a community per year or other unit of time; it may be regarded as a flow of purchasing power which may be expended at once on goods or services or retained for the purposes of capital accumulation."

According to Professor Haig " Income is net accretion of economic power between two points in time and this net accretion of economic power consists of two distinct parts: consumption and net capital accumulation."

Henry Simons has more clearly defined the term income by algebraic method. According to him, income is algebraic sum of two items:

- i) The person's consumption during the period, and
- ii) The net increase in the individual's personal wealth during the period.

Symbolically,

$$Y = C + W$$

Where,

Y = Income

C = Consumption

W = Change in wealth (Due & Lander, 1977: 223)

There is difficult to find specific definition of income all over the world specially, for the purpose of tax. For example Sec 2 of Indian tax act 1961 keeps profits and gains, dividend, voluntary contributions received by charitable trusts, value of any perquisites or profit on lieu of salary, any capital gain, winning from lotteries, cross word puzzles etc under the head of income (Krishnaswami, 2006: 18).

Income Tax Act 2002, Nepal describes three major heads of income, income from employment, income from business and income from investment. Section 5 describes that that taxable income of a person for an income year is equal to the

amount as calculated by subtraction of reduction from the total of total assessable income of person from each of the income head of employment, business and investment.

#### **2.1.4. Income Tax**

Income tax as the word refers itself as tax on income. In a broad sense, income tax is a levy based upon the productions or receipts or gains of the taxpayers within a definite period of time. (Encyclopedia America, vol.14, pg 749.)

There is no specific definition for income tax as it varies for countries according to diversity of economic structure, nature of government and the status of people.

In General income tax is imposed on net income. Net income comes after subtraction of the cost of production from gross income. In practice the expenses incurred in earning the income and appropriate exemptions are deducted to find out the taxable income. Net income may be real income or money income. Real income is more comprehensive and includes not only money income but also other incidental advantages. Real income should therefore be the true index of ability to pay. So income tax should be charged on real net income of the individual and not on his net money income. (S.N. Agrawal, Indian Public Finance, Vara and Co. Public P. (Ltd.), Bombay, 1967, page 104.)

There are two types of income tax such as

- i) Personal income tax: Levied on the personal contribution rather than an extraction of economy. Here assumption is that all income is directly received by an individual.
- ii) Corporate income tax: Tax is assessed on the profit of the corporation. It is considered the best one because the bulk of business activity in most advanced countries is carried on under the corporate form of organization.

## **2.2. History of Income Tax**

### **2.2.1. International Context**

Pluto, an ancient philosopher has said that where provision for income tax, there honest person pays more and fraud pays less. This statement shows the

presence of income tax in ancient era. But this fact is not proven. It is assumed that Dutch state Batavian Republic is the first country to impose income tax system. Arguments are made that the Great Britain to be the first introducer of income tax. In 1793, to collect the war expenditure for the war with France, Britain started the system and eliminated it after the end of war in 1801. The system was reestablished in 1826. Custom, excise duty, ticket fee etc were the main taxes in Britain before this. In fact, whenever be the start of income tax system, the credit for improvement and development of the system goes to Britain. USA introduced a kind of income tax system in 1861. The purpose was to bare the expenditure of internal war. Like in Britain the system eliminated in 1872 and reestablished in 1894. After the declaration of Supreme Court for income tax to be illegal, again removed in 1895. Later corporate income tax introduced in 1909 and income tax system in 1913 after amendment to US constitution. France tried for it from 1848. 1<sup>st</sup> income tax system became successful in 1909 after frequent opponents of people in 1870 and 1887. History of income tax in Germany is after 1891. (Kandel: 2003).

In neighboring country India, at first income tax was introduced in 1860. After introducing 'Income Tax Act 1886' in 1886, it was imposed as permanent. Italy adopted income tax in 1864, Newzeland in 1891, Australia in 1915 and Canada in 1917. After First World War the income tax become an important source of tax revenue in many developed countries. By 1939, it has become a most important source of revenue in most developed countries and had made appearance in a number of developing nations. (Agrawal: 1978)

In the beginning of introducing time it was generally levied on flat rate. Only after 1909, the principle of progression was introduced from UK and Newzeland.

### **2.2.2. Development of Income Tax system in Nepal**

History of income tax system in Nepal Can broadly divided into two parts:

1. Before 1951, Ancient era and
2. After 1951, modern era

1. Taxation in ancient Nepal, Before 1951

This era is known as non-systematic era for taxation. Although, the function of revenue collection has remained one of the key activities of the government from

ancient time in Nepal, no any rules and laws were present to facilitate revenue collection in that period. During that time, very few economic activities were operated in the country. Hence, government could not collect huge amount of money in the form of taxation. At that time taxes were levied to the merchant, travelers and farmers in the form of cash, kind or labour. In some occasions, gold and agricultural products were also paid as taxes. But nature of taxes was temporary and taxes were raised for special purposes (Regmi: 1971).

In the Lichhavis regime, taxes from agricultural income and business were introduced as a direct tax for the first time in Nepal. Tax on agricultural income was called "Bhaga" and tax on business was called "Kara". Irrigation tax and religious monuments preservation taxes were also existed at the time of King Anshuverma of Nepal. During the period of 1768 – 1846 AD, different types of taxes were levied to generate maximum revenue. The major sources of revenue were: Birta and Kipat, taxes on land, monopolies costumes, transit and market duties, mines and mints, export of forest products, birds and animals and various lees and fines. Taxes were collected in three levels: Royal palace level, government levels and local levels. The various taxes levied during that period were narrow in base and were imposed primarily on occupations and economic activities, not in income or property. There was no taxation of income in the modern sense of income tax.

During The Rana Regime, there was not formal provision for imposition and collection of taxes. Taxes were imposed according to the objectives, needs, and whims of the ruling prime minister. There was not provision for separating personal income of prime minister and state treasury. There was no provision of government budget. Surplus of revenue over expenditure was considered as the personal income of ruling prime minister.

Tax revenue was known as Lagati and non-tax revenue was called Haswali. The major source of revenue in Nepal till 1951 were: land tax, costume and excise duty in the form of lump sum contracts, royalties on forests, royalty on supply of porters and soldiers, entertainment tax, license (gun) tax, sales of government assets, post office charge and other few sources. Incomes were not taxed for raising regular revenue of the state treasury but for meeting specific extraordinary expenditure necessitated by war, disasters or other emergencies. (Subedi, 2004)

There was no direct tax of specific volume in the country except land tax and salami. Land tax was collected on a contractual basis and salami was a small percentage of salary of government employs. The salami was abolished in 1951. The Rana rulers did not think of development of effective revenue administrative system. So after the advent of democracy in 1951, government ensured to levy any kind of tax as per law only.

## 2. Taxation and income tax in modern Nepal, After 1951

After the independence of country in 1951, the role of government has been changed. The government was enforced to operate development activities besides governing the regular function of maintaining law and order. A sound and efficient income tax system is necessary to maximize the revenue. Whole income tax system is subdivided into tax policy, tax law and tax administration. Government through ministry of finance determines income tax policy and tax administration is empowered with civil servants with appropriate organization.

Parliament makes laws to implement the policies. The government levies and collects tax as per law. Different laws have been made and amended since 1951 in form of act and regulations. A brief overview on different laws related to income tax is stated below.

### **2.2.3. Before 1959 (2016)**

The idea of introducing income tax in Nepal originated in early 1950s, when a multi-party democratic political system was introduced. In 1951, the then finance minister in his budget speech declared the intension of government to levy an income tax.

Attempts were made to introduce income tax in subsequent years. In 1954, an income tax with Rs. 10,000 basic allowances and progressive taxes ranging from 5 to 25 percent was proposed. Due to political instability, it could not be introduced until 1958. (Koirala and Bhattarai: 2004, 7)



#### **2.2.4. Economical Act 1959**

In 1959, income tax introduced through economical act. This act has made provision of tax from 5 percent to 25 percent in remuneration and business profit. The major provisions on act were (Kandel: 2003):

- i. Ten tax rate provision.
- ii. Tax rebate provision for industries.
- iii. Rebate for industry was 25 percent and that for small and cottage industry was 50 percent.
- iv. Provision of tax for house and land of urban area.
- v. Provision for tax in foreign investment.

#### **2.2.5. Business Profit and Remuneration Act 1960**

The government of Nepal introduced a formal tax act for the first time in Nepal in 1960 (2017 Jesth 2<sup>nd</sup>) in the form of "Business Profits and Remuneration Act 1960." According to this act only business profits and remuneration on income were subjected to tax but revenue for these taxes could not be collected properly as per estimates. It had 22 sections (Dhungana, 1976).

Main features of Income the act were as follows:

- i. Only business profit and remuneration income were subject to tax. The coverage of income tax was too 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 profit, profit of the preceding fiscal year was taken.
- iv. There was a provision of tax exemption on salary of foreign citizen, dividend of shareholders, profits to be spent in religious and public welfare activity, crop from own land, allowances granted by HMG to ministers, assistant ministers, chairman, speaker and amount drawn from provident fund of saving fund.
- v. The tax office was empowered to assess tax on best judgment estimation only in case of false statement or in absence of income tax return.

- vi. There was a provision of fines ranged from Rs.500 to Rs.5000 in case of defaults.
- vii. The first court of appeal against the tax officer's assessment was local Badhakim or magistrate. People could appeal to Revenue and Tax Court but he need to deposit certain amount.

### **2.2.6. Nepal Income Tax Act 1962**

Business Profit and Remuneration Act 1960 was replaced by Nepal Income Tax Act 1962. It was 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. Nine types of income source were defined. They were income from business, salaries, profession, rent from house or land, investment in cash or bond, agriculture, insurance agency and any other sources.
- ii. Act has defined certain terminologies such as taxpayer, tax officer, company, firm, profit, remuneration, tax assessment, non resident person etc.
- iii. Status of taxpayer was defined for the tax purpose such as personal, residential.
- iv. Procedure for income tax assessment and methods for calculating net income were stated. Act was based on Best judgment system.
- 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 judgment estimate of the officers.
- viii. To burden the tax coverage, agriculture income was brought under the income tax net for the first time. But the financial act 1966 exempted this income fully from tax net. Again it was brought into tax net by financial act 1973. It was again exempted from 1977.
- ix. This act had provision to bring Nepali citizen and government personnel into tax net earning everywhere of the world. But financial act 1963 limited it within country.

- x. Provision was made for reassessment of tax as well as rectification of arithmetic errors.

### **2.2.7. Income Tax Act 1974**

To fulfill the needs of time, existing act was replaced by another act named Income Tax Act 1974. This new act was brought in practice from October 1974. It had 66 sections. Amendments were made in the act in 1977, 1979, 1988, 1984, 1985, 1986, 1989 and lastly in 1993.

Main Features of the act were as follows:

- i. Clarification of tax related terminologies such as income tax, taxpayer, resident, tax assessment, income year, gross income, net income, income from different sources, loss etc
- ii. Classification of income head into five categories: i) Agriculture income ii) Industry, trade, profession or occupation iii) Remuneration iv) House rent and compound rent and v) others. (Agriculture income removed after F.Y. 1975/76)
- iii. Specification the method for computing net income from different sources.
- iv. Clear mentions about rights of tax officers.
- v. Amendment of 1993 in this act introduced self-assessment system for the first time replacing judgment system.
- vi. Provision of carry forward of loss for three subsequent years.
- vii. Obligatory provision for taxpayers to register industry, business, profession or vocation in the tax office before starting work.
- viii. Clear specification for expenses allowed for deduction for computation of net income.
- ix. Specification of the procedure for assessment, reassessment, jeopardy assessment, tax deduction at source, payment and refund of tax etc.
- x. Specifications about rights, duties, forms and appeal.
- xi. Provision of penalty up to Rs. 5000 in case of failure of maintain or preserve account.

### **2.2.8. Income Tax Act 2002**

Income tax act 2058 is in operation after 19th Chaitra 2058 in Nepal. The act was introduced to overcome the defects and to fulfill the objectives mentioned below. (Kandel: 2002).

Defects:

- i. Narrow tax base and not provision for worldwide income, capital gains etc.
- ii. Presence of separate income tax related acts such as Employee Provident Fund Act 1962, Citizen Investment Trust Act 1992, Industrial Enterprise Act 1992, and Electricity Act 1992 etc.
- iii. Not ensuring the principle of equity and progressivism since tax was levied on the basis of nature of organization, nature of person, nature of income. Natural person's taxable income had declared on the basis of organization's memorandum and objectives rather than transaction.
- iv. Low penalty rate according to change of time for evasion of tax.
- v. Not clarity for definitions, explanations, legal provisions etc related to administration for implementation of self assessment system since provision of this was made by amendment.
- vi. Not clarity about accounting system and inadequate penalty for not maintaining account accordingly.
- vii. Not provision for controlling transfers pricing, interest expenses, thin capitalization etc.
- viii. Incapable to fulfill the need of time brought by globalization and economic liberalization.

The act, replacing the former has objectives as follows:

- i. To make timely improvement in Nepalese tax system according to modern economy and tax system of other countries.
- ii. To widen the tax net.
- iii. To make income tax related provisions clear and transparent.
- iv. To make tax system based on account.
- v. To minimize tax avoidance and evasion and encourage tax planning.
- vi. To integrate all the provisions of income tax in one act.

- vii. To provide managed system for the enlarged scope of income tax in agriculture, cooperatives, dividends, export, foreign investment etc.
- viii. To separate administrative and judicial responsibilities.
- ix. To ensure simplicity, uniformity and transparency.
- x. To define the power as well as authority of tax administration.
- xi. To distinguish taxpayers' violation of civil duties and criminal offences.
- xii. To make tax administration more responsible and effective.
- xiii. To make taxpayers more responsible emphasizing self assessment system.
- xiv. To make simple the process of re-appeal.

## **2.3. Main Features of Income Tax Act 2002**

Income tax act 2002 has some special features superior than the former Acts. They are explained as well as listed below:

### **2.3.1. Source of Income**

For the purpose of assessment of income, the new act has classified the income source as following heads:

- A) Business Income
- B) Employment Income and
- C) Investment Income

#### **A) Employment Income**

Income Tax Act 2002 has defined the remuneration income. Following payments made by employer to individual during one income year should be included while calculating income from employment for the purpose of tax:

- a) Payments of wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts, bonuses and other facilities.
- b) Payments of any personal allowance including any cost of living, subsistence, rent, entertainment and transportation cost.
- c) Payment of reimbursement of cost incurred by the individual or an associate of the individual.
- d) Payment for the agreement to any conditions of the employment.

- e) Payment for the termination or loss or compulsory retirement.
- f) Retirement contributions including those paid by the employer to the retirement fund in respect of the employee and retirement payments.
- g) Other payments in respect of the employment.
- h) Other amount as given in chapter 6 of the act, perquisites and gains due to change in tax accounting required to be included.
- i) The amount of difference of the interest on loan paid by employer lower than the market rate.
- j) Market value of assets in case of the transfer of the assets.

While calculating the net income from employment of natural person, the following amounts are to be excluded on employment income:

- a) Amounts exempts under section 10 and final withholding payments.
- b) Meals or refreshment provided in premises operated by or on behalf of an employer to the employer's employees that are available to all the employers in similar ways.
- c) Any discharge or reimbursement of costs incurred by the individual that serves the proper business purposes of the employer; or that would otherwise be deductible in calculating the individual's income from any business or investment.
- d) Payment of the prescribed small amounts which are so small and thus unreasonable or administratively impracticable to make accounting for them.

## **B) Business Income**

Business income includes profits or gains made by person in one income year for the purpose of income tax. As stated in Act, business income constitutes:

- a) Service Charge (Sec. 7.2)
- b) Sales or disposal of business/trading stock (Sec. 7.2)
- c) Net gain from the disposal of business assets/liabilities (Sec. 7.2)
- d) Amount received from disposal of depreciable assets.
- e) Prize or gift from business activities (Sec. 7.2)
- f) Amount received for acceptance of any business restrictions (Sec. 7.2)
- g) Amount from change of accounting method (Sec. 24)
- h) Excess amount due to exchange rate currency (Sec. 24)

- i) Bad debt recovered (Sec. 25)
- j) Proportionate amount under long term contract (Sec. 26)
- k) Amount received for compensation (Sec. 31)
- l) Other amount received under business income (Sec. 7.2)

Following amounts are to be excluded in calculation of person's profits and gains for tax purpose:

- a) Exempt amount under section 10
- b) Taxation on dividends under section 54
- c) Final withholding payment under section 92

### **C) Investment Income**

Income of any person from investment for the tax purpose of one income year is the person's profit and gains from conducting investment for the year and should include:

- 1) Any dividend, interest, natural resource payment, rent, royalty, gain from investment insurance, gain from unapproved retirement fund interest or retirement payment made by an approved retirement fund. (Sec. 9.2)
- 2) Net gains from the disposal of the person's non business chargeable assets of investments. (Sec. 9.2)
- 3) Excess amount of incomings over the depreciation basis including outgoings on the disposal of the depreciable assets of the investment of the person. (Sec. 9.2)
- 4) Gifts and prizes received in connection with investment. (Sec. 9.2)
- 5) Retirement contribution including those paid to a retirement funds in respect of the person and retirement payments on respect of investments. (Sec. 9.2)
- 6) Amount received instead of acceptance of any restrictions regarding investment. (Sec. 9.2)
- 7) Amount included under change of accounting method. (Sec. 24)
- 8) Excess amount received due to exchange rate currency. (Sec. 28)
- 9) Bad debt recovered. (Sec. 25)
- 10) Proportionate amount under long term contract (Sec. 26)
- 11) Amount received for compensation (Sec. 31)

12) Other amounts required to be included on tax accounting or quantification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business. (Sec. 9.2)

Following amounts are to be excluded in calculation of person's income from investment for tax purpose:

- a) Exempt amount under section 10
- b) Taxation on dividends under section 54
- c) Final withholding payment under section 92
- d) Amounts those are included in calculating the person's income from any employment or business.

### **2.3.2. Allowable Expenses**

The special provisions for expenses allowable for deduction from assessable income of one income year is stated in different section of the act, which clearly not mentioned in above paragraphs are:

- i. All the expenses are allowed to deduct provided that the expenses are made by the same taxpayer in the same year in the production of income. (Sec. 13)
- ii. Interest on loan taken for the business purpose is deductible. However, the amount of such interest will not exceed 50 percent of the taxpayer's taxable income for the year calculated without including the interest received or without deducting any interest incurred by the taxpayer in case of the person controlled by tax exempt entity. (Sec. 14)
- iii. The cost of trading stock is deductible. The allowable for trading stock is calculated by adding opening value of stock plus purchase value minus closing value of trading stock. (Sec. 15)
- iv. The cost of repair and improvement of the depreciable assets used in business or investment are deductible. Those costs should not exceed 7 percent of the depreciable basis of the pool at the end of the income year. (Sec. 16)
- v. Cost expended for device to control pollution is deductible up to limit of 50 percent of the taxpayer's taxable income of the concerned income year. Non deductible cost can be capitalized as depreciation in subsequent years. (Sec. 17)



- vi. Act has allowed to deduct research and development cost up to limit of 50 percent of the taxpayer's taxable income of the concerned income year. Cost over than limit can be capitalized as depreciation in subsequent years. (Sec. 18)
- vii. Donation granted to tax exempt organization is deductible up to limit of five percent of accessible income or rupees one lakh which one is less. But government can allow more than the limit for special condition for special organization or special purpose by publishing notice in Nepal gadget.
- viii. Depreciation of the depreciable assets used in business for the income year computed on pool basis of depreciation is deductible. (Sec. 19) According to annex 2 of Act, following basis is adopted for depreciation.

**Table 2.1**

**Depreciation Rate for Different Pool**

S.N.	Pool	Type of Assets	Depreciation Rate
1	A	Building, structure and construction of permanent nature	5%
2	B	Computer, Data operating machine, furniture, fixture and office equipments	25%
3	C	Automobiles, buses and minibuses	20%
4	D	Construction and excavation machines, research and development and pollution control cost more than specified limit.	15%
5	E	Invisible assets other than stated as depreciable assets in pool D.(Software, license etc.)	Rate calculated from dividing its total cost by usable period.

- ix. The loss can be set off from profit of any business or investment in the same year. Carry forward of loss for same business is allowable for subsequent four years for general business. Carry back and more year carry forward provision for special industries has also been included in Act. For example business associated with public infrastructure can carry forward their loss for seven

subsequent years and banking business can carry back the loss. Special provision for business of global long-term contract also exists in act. (Sec. 20)

No deductions are granted for the expenses that are of a domestic personal nature, income tax, bribes, fines, penalties, costs in deriving exempt amounts or final withholding payments, capital nature expenditure, cash expenditure exceeding limit while banking facilities available and dividend distributed by entity.

#### **2.3.4. Method of Income Tax Assessment**

Income Tax Act 2002 provides for the following major methods of assessing income tax:

##### **a. Self-assessment of tax:**

Act has fully applied the self-assessment tax system. It has made more responsible to taxpayers and reduces the compliance cost. Taxpayer himself determines his tax liability with find and penalty if any under this system. If tax authority doubts about the income of taxpayer, it can investigate. Otherwise that becomes the final.

##### **b. Jeopardy Assessment:**

The provision for jeopardy assessment is made under sec. 100. When the person becomes bankrupt, is wound up, goes into liquidation, is about to leave Nepal indefinitely, is about cease activity in Nepal or department consider to be appropriate, jeopardy assessment is carried out. If assessment is made with respect to full income year, the assessed person will not file return of income for the year, however with respect to part of an income year the assessed person is still required to file return for the income year. Where department makes a jeopardy assessment, it should serve of the assessment on the person.

##### **c. Amended Assessment:**

Tax department may amend an assessment made by the taxpayer under sec. 99 and sec. 100. Department may re amend the amended assessment. The department may not amend as assessment if the assessment has been amended or reduced pursuant to an order of Revenue Tribunal or court of competent jurisdiction except the order is reopened.

### **2.3.5. Appeal**

A person who is not satisfied with the decision of income tax officer has the right of appeal. In former act, the provision for appeal to two alternatives either to Revenue Tribunal or to Director General of Income Tax Department was available. While in Income Tax Act 2002, taxpayer have to go to Director General of IRD first and then if unsatisfied can go to Revenue Tribunal.

#### **a. Appeal to Director General**

A person who is aggrieved by reviewable decisions can appeal against such decisions to the department within 30 days after the decision is made. While Filing the appeal the taxpayer is required to deposit half of the amount of the tax payable. (Sec. 115)

#### **b. Appeal to Revenue Tribunal**

If the taxpayer is unsatisfied with the decision of Director General may appeal to Revenue Tribunal. Taxpayer has also to submit a copy of appeal to IRD within 15 days. However the operation on decision by IRD is not affected by the appeal. If Director General of Department has made the decision relating to administrative review, the appeal to Revenue Tribunal would be effective.

The taxpayer who is aggrieved with the decision of Revenue Tribunal may appeal to Appeal Court. If the decision made by Appeal Court is also unsatisfactory to taxpayer, it can be appealed to Supreme Court.

### **2.3.6. Fines and Penalties**

#### **a. Penalty for failure to maintain documentation or file statements or return of income:**

A person who fails to maintain proper documentation for an income year or file return for an income year is liable to pay fees for each month and part of month during which the failure continue. The rate would be 1.5 percent per annum of the person's assessable income with a gross of any deductions or Rs. 1000 per month whichever is higher. Accordingly, a withholding agent who fails to file a statement as required is liable to pay a penalty at 1.5 percent per annum to the amount of withheld or Rs. 1000 per month whichever is higher applied for each month and part of a month during which the failure continues.(Sec. 117)

**b. Interest for understating estimated tax payable by installment:**

A person who understates estimated tax payable by installment basis is liable to pay interest for each month and part of month from the date the first installment is payable until the date the tax is payable on assessment. The amount of interest is calculated at the standard interest rate.(Sec. 118)

**c. Interest for failure to pay tax:**

A person who fails to pay tax on or before the date on which the tax is payable is liable to pay interest for each month and part of a month for which any of the tax is outstanding calculated as the standard interest rate applied to the amount outstanding. (Sec.119)

**d. Penalty for false or misleading statements:**

A person who makes a statement to the Department that is false or misleading in a material particular or omits from the statement made to the Department any matter or thing without which the statement is misleading in a material particular is liable for the penalties as follows:

- a) Where the Statement is happened to be false or misleading without knowingly or recklessly, 50 percent of the underpayment of tax; or
- b) Where the statement is made false or misleading knowingly or recklessly, 100 percent of the underpayment of tax.

**e. Penalty for Aiding and Abetting:**

A person who knowingly or recklessly aids or abets another person to commit an offence related to failure to comply with this act, failure to pay tax, makes false or misleading statements or impedes tax administration to counsels or induces another person to commit such an offences is liable for penalty equal to 100 percent of the underpayment of that tax.

**2.3.7. Other Provisions**

- a. Income tax provisions are included within one act. Existing two acts terminated and amendments have made to other 15 acts for this purpose.
- b. The provision of international taxation has introduced. The provisions are transfer pricing, foreign tax credit, double taxation avoidance agreement etc.
- c. Capital gain, dividend etc. has brought in tax net.

- d. Income from approved retirement fund is free from tax and retirement payments in hand of employee are taxable.
- e. Provision for resident and non resident persons. Residents are taxed on their worldwide income but non residents are taxed only in their income sourced in Nepal.
- f. Authorities and responsibilities of tax payers as well as tax administrators are specified.

## **2.4 Review of Literature**

System of income tax in Nepal starts from 1959 through economical act. Various studies have been carried out and article, books and researches have been written and published on different aspects of income tax in Nepal. Some of conclusion and summary of literature about income tax reviewed during this study are given in the following paragraph.

Mr. Kedar Bahadur Amatya (1965) prepared a book, "Nepal Ma Aayakar Ko Byabastha" analyzing the legal aspects and description of income tax system of that period. This is the first published book on income tax.

Mr. George E. Lent (1968) has presented a report entitled, "Survey of Nepalese Tax Structure" to IMF, Fiscal Affair Department. He has critically analyzed the scope of income tax, tax structure, taxable income exemption and allowemces in Nepal at that time. He has suggested to reform income law and administration to increse government revenue through income tax. He has also suggested to increase income tax rate at lower taxable income and to reduce at intermidiate income bracket.

Three researchers Mr. Bhavani Dhungana, Mr. Narendra Lal Kayastha and Mr. Bal Prasad Rai (1976) have published a report "An analysis of tax structure of Nepal". The researchers have analyzed the income tax in Nepal and recommended to reform income tax to reduce resource gap and mobilize additional resources.

Mr. Govinda Ram Agrwal (1978) has provided details information in various aspect of income taxation in his report entitled " Resource Mobilization for Development: The Reform of Income Tax in Nepal". His study is the first comprehensive study in taxation of Nepal. The study has covered period of nine

years from 1967 to 1976. The nine chaptered research shows picture of resource gap of Nepal in its first chapter. Fiscal policy, effective tax system, role of income tax, legal and administrative aspects, historical background of income tax etc. have been also discussed. He has presented various mathematical calculations such as per capita burden of income tax, buoyancy coefficient and elasticity coefficient of income tax etc using the double log linear model. He has identified the major problems as inefficiency of tax administration and income tax evasion. He also identified tax authorities are insufficient in enforcement of law and there are not integrated programs for taxpayers' education, assistance, guidance and consulting. All things stated in research are not fully relevant today.

Mr. Govinda Lal Shrestha(1967) has prepared a Masters Degree thesis entitled "Income tax in Nepal". He has described about historical background, income tax act, rules and administrative aspects but has not shown problems related to income tax.

Mr. Narendra Lal Kayastha(1974) has tried to analyze the contribution of income and property taxes to overall revenue collection of Nepal. He has also studied history, legal and administrative aspects of income tax system in Nepal and pointed out some drawbacks such as income tax evasion and greater role of indirect tax in national revenue.

Mr. Kedar Bilas Pandey(1978) has discussed about legal aspect, structure, role, problems etc related to income tax and Economic effect of income tax in Nepal. He has found income tax playing significant role in economic development of Nepal. His study shows that income tax contributed 4% to tax revenue and per capita burden of income tax was only Rs. 0.2 in 1962/63. Contribution of income tax increased to 10% of tax revenue and Rs. 7 per capita income tax burden in 1975/76. He has also pointed the significant role of indirect tax in total revenue. The major problems in taxation, according to him were lack of scientific record keeping, lack of maintaining accounts by tax payers, lack of coordination between tax departments and revenue department, leakage in personal income tax collection. He has suggested to bring capital gain and bank interest into income tax net, to make scientific income tax accounting assessment and collection procedure, to scrap the system of income tax holiday to industries etc.

Mr. Purushottam Subedi(1982) has analyzed about the role on national revenue, legal aspect and historical background of income tax in Nepal. He has examined the growth of income tax collection, its ratio to GDP, cost of income tax collection and elasticity. He has pointed out tax evasion, inefficient tax administration and dominating role of indirect tax as major problems and suggested to reform tax administration.

Ms. Naina Nepal(1983) has examined origin, meaning, existing position, role, problems and future prospective of the income tax in Nepal. Inefficient income tax administration, mass poverty, lack of tax consciousness, low numbers of tax payers, lack of coordination between taxpayers and department, narrow coverage, assessment deficiency were analyzed as major problems by her. She has suggested to separate exemption limit for family and couple and to make elastic, scientific and progressive tax rate and exemption limit.

Mr. Shambhu Nath Regmi(1986) prepared a dissertation with the objective of examining the trend of income tax in Nepal, ascertaining the share of income tax to total tax revenue and its ratio to GDP. He has concluded that income tax can check the inflationary trend of country and it also directs the flow of resources of the economy into useful and productive channels and increases the productive capacity of the economy. He has suggested for precise and clear tax law, widening tax coverage, scientific method for accounting assessment and collection of income tax, easy and simple procedure for tax payment, establishment of research unit and public awareness.

Mr. Chudamani Siwakoti(1987) has especially analyzed the Income Tax Act 1974. He has described the role of income tax as economic growth, equitable distribution and stabilized growth. The major problems identified by him are evasion at high level, delay in assessment, nominal share of income tax, lack of public awareness, complicated act, untrained and inexpert administrative personnel, lack of training and development opportunities and unevenly distributed workload to personnel. There is also high use of best judgment assessment method, no compulsion to maintain books of account and auditing accounts of all type of business, ineffective use of fines and penalties, no provision of tax review commission, no provision of sales promotion out of country and lack of weighted

deduction. He has suggested for progressive tax, honest and efficient tax administration, research unit in tax offices and penalties for not maintaining accounts. He has recommended for provision of weighted deduction and reduce time limit for assessment.

Ms. Shanti Baral(1989) has tried to shown the contribution of income tax on the structure of government revenue in Nepal. She found that total revenue, total tax revenue and direct tax revenue have an increasing trend in Nepal but in unsatisfactory rate. She has found that contribution of direct tax has been decreasing and that of indirect tax is increasing each year. Exemption in agriculture income is other reason for less collection of revenue. In her study, inefficient tax administration, unconsciousness of tax payers, lack of scientific method of tax assessment and collection have been identified as the major reasons for tax evasion at high level. She has suggested that the tax administration should be honest and efficient, tax evaders should be punished, there should be scientific method for tax collection, administration cost should be minimized, research unit should be established and delays in assessment procedure should be reduced.

Mr. Santosh Raj Poudyal and Mr. Prem Prasad Timsina (1990) described the provision and laws related to income taxation in Nepal in "Income Tax in Nepal. This Book was extremely based on the syllabus of B. Com. They have described the theoretical as well as practical aspects of income tax. They analyzed the role of income tax, income tax structure and defects of income tax in Nepal. The book was descriptive rather than analytical.

Mr. Hari Bahadur Bhandari(1994) 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 target. It was due to poor tax paying habit of Nepalese tax payer, poor tax paying system and spread evasion of income tax. He has suggested making effective personnel management, tax education and better public communication system, to revise and restructure exemption limit and to reduce tax collection cost.

Mr. Rup Bahadur Khadka (1994) published a Book "Nepalese Taxation: A Path for Reform". The book is divided into seven chapters: the general economic



condition of Nepal, commodity taxes, income taxes, property taxes, local taxation, tax administration, and the strategy for tax reform respectively. 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. He has also pointed out 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.

He has suggested for extension of tax coverage, scientific method of tax assessment, extension of withholding tax, inflation adjustment etc. He has also suggested to administration for reorganize and expansion, integrated information system, research unit, strengthening the revenue service etc. This book was analytical and useful to know different aspects of income tax.

Mr. Sanjaya Acharya(1994) has identified the contribution of individuals to be greatest to income tax revenue followed by public enterprises, remuneration, house rent and interest tax, semipublic enterprises and private corporate bodies respectively in his study period. He has recommended simplifying the tax structure, legal and administrative aspect. Exemption limits for remuneration and business individual should be different according to him.

Mr. Shiva Narayan Shahu(1995) has studied on Nepalese tax structure, role and contribution of income tax on national revenue. He has identified that 0.35 percent of total population came under categories of taxpayer. Income tax has been gradually increasing and was in fourth place in the tax structure of Nepal. He has not discussed the major aspects of income tax clearly and analytically and the study is not fully relevant today.

Mr. Krishna Kumar Shakya(1995) has tried to analyze the causes of heavy reliance of indirect taxes, to analyze volume of indirect tax revenue and direct tax revenue in total tax structure, highlighting the revenue assessment procedure from different sources and suggesting for improvement. He has identified that income tax has occupied fourth position among tax revenue following custom duty, sales tax

and excise duty. He has mentioned Nepalese taxable capacity is limited by various factors such as low per capita income, extensive subsistence economy, relatively closed economy, political and social factor, weak export position and administrative and enforcement problems of tax department.

He found that the ratio to GDP, total revenue, total tax revenue and direct tax revenue have been increasing in Nepal but in very low rate. Tax evasion is the main reason for this. Lack of clear and comprehensive definition of income, lack of punishment to the evaders, low tax paying capacity and non conscious of tax payers, lack of inefficient tax administration, lack of scientific method of tax collection and lack of trained tax collectors were the main reasons of tax evasion, He has suggested increasing efficiency of income tax. His major recommendations were assessment of small taxpayers should be on a door-to-door basis, self-assessment of tax should be encouraged and salary as well as income tax exemption line should be tied up with the cost of living index. The study was based on old income tax act.

Mr. Kamal Deep Dhakal (1998) published a modified edition of book named "Income tax and house and compound tax law and practice with VAT". He has described historical aspects and legal provisions related to income tax and presented methods of income tax assessment with numerical examples, This book was fully based on the syllabus of BBS third year and MBS second year and was published before coming new income tax act 2002. The book is very useful to know the general information and legal provision of income tax act 1974. His book is informative rather than analytical.

Ms. Binita Shrestha(2002) has mentioned historical background, legal provisions, structure of income tax, income tax administration in Nepal and empirical investigation. She has found there was dominant share of tax revenue in Nepalese government revenue but the contribution of tax revenue was in decreasing trend. Tax/ GDP ratio was not satisfactory since it seems to be only 6.81 percent in 1984/85 and 9.36 percent in 1998/99. There was serious and growing financial resource gap in Nepalese economy. It was Rs. 4478.2 million in 1984/85 and increased to 22328.0 Million in 1998/99. The contribution of direct tax and indirect tax on total tax revenue were 17.76 percent and 82.24 percent in 1984/85 and become 26.14 and 73.86 percent in 1998/99, which shows the dominant role of

indirect tax. Income tax revenue was playing significant role in direct tax revenue and its share was in increasing trend. In income tax, contribution from individuals was greatest in every fiscal year and was in increasing trend.

She has identified various problems in income tax system such as narrow tax coverage, mass poverty of Nepalese people, lack of conscious of taxpayer, widespread evasion and avoidance of income tax, unscientific tax assessment procedure, inefficient tax administration, complicated tax laws and procedure and instability in government policy. Failure to locate new tax payers, failure to maintain proper accounts and records, defective selection of personnel, undue delay in making assessment, lack of motivation in tax personnel and existence of corruption were also identified by her as the major weak points of income tax administration in Nepal.

She has made some suggestion for betterment of income tax system. Agriculture income and capital gain should be brought into tax net. Making people conscious, reforming income tax assessment, reforming the tax administration and minimizing the tax evasion were also included in her suggestions. She has suggested for computerization and effective exchange of information, tax education to taxpayers, tax inspector and officials, effective personnel management, enforce proper auditing and investigation to control illegal business activities and tax evasion, enforce heavy penalties and fines and maintain proper records and accounts for the improvement of income tax administration.

Ms. Bhibha Pradhan(2002), in her study of contribution of income tax from public enterprises to public revenue includes historical background, contribution of income tax to the public revenue, contribution of Nepal Telecommunication Corporation to income tax, effectiveness of income tax collection. She has found that the contribution of income tax from public enterprises in Nepal was not significant due to poor achievement, weakness in government's economic policy and deficiency in legislation. NTC has been contributing effectively to total income tax revenue. Average contribution of income tax from NTC to total income tax revenue, total direct tax revenue, total tax revenue, and total government revenue was 15.06 percent, 2.37 percent, 11.1 percent and 1.93 percent respectively in average in 1998/99. She

also found that contribution of tax revenue on GDP of Nepal was lower than other SAARC countries except Bangladesh.

Her suggestion for income tax system were clear cut provision, discretionary power of tax officers should be curtailed, assessment and collection provision should be made clear and simple, provision of reward, prize, incentive should be introduced to encourage the taxpayers to pay voluntarily, compulsory provision of auditing etc. She has also suggested promotion and rewards to active, efficient and honest tax personnel; tax education to tax payers; strict actions against corruption; reduction of delays in tax assessment for the improvement of income tax administration in Nepal.

Revenue Consultation Committee Report (2001) has emphasized to simplify the tax policy to increase voluntary compliance. The report has recommended for written communication between taxpayer and tax administration rather than the informal relation and has suggested to widen the income tax base by including all kinds of taxpayer and income and to find out the taxpayers of new sector. Suggestion has provided to make the act more transparent and clear to attract foreign and domestic investor for this purpose. The report also has suggested increasing income tax exemption limit with considering purchasing power and inflation rate.

Mr. Vidyadhar Mallik (2003) has published a book "Nepalese Modern Income Tax System" with twenty-six chapters and eight annexes. He has described historical aspects of income tax, changes brought by the Income Tax Act 2002 and the development of income tax management in Nepal. He has also described different legal provisions relating to Income tax with numerical examples. The book is very useful to know the general information and legal provisions of new Income Tax Act. His book was informative rather than analytical. He has not analyzed the role of income tax, structure of income tax in Nepal.

Dr. Pushpa Raj Kandel (2003) published a book named "Tax Laws & Tax Planning in Nepal". The book is based on new syllabus of BBS and MBS. It has five parts, sixteen chapters and seven annexes on basic concept, provision of income tax act 2002, tax administration, house and land tax, VAT, tax laws and tax planning etc. The book is more informative rather than analytical.

Mr. Tirthaman Sherchan (2003) conducted a study basically focused on provision of fines and penalties. The objectives of this study were analyzing tax structure of Nepal, analyzing the provisions of fines and penalties under income tax law, know the taxpayers knowledge and know views of tax officers about fines and penalties. His major findings have shown that the dominating share of tax revenue is in decreasing trend from 81.73 percent in 1975/76 to 77.97 percent in 2001/02. The contribution of income tax is in increasing trend and has occupied third position in his study period. It was 7.83 percent in 1975/76 and became 17.6 percent in 2001/02. There was dominated role of corporate income tax but was in decreasing trend and contribution from individual income tax is in second position with increasing trend in total income tax. The tax/GDP ratio was not found satisfactory.

He has found the taxpayers to be unknown about new act and lacking the habit of paying tax. He has considered income tax administration of Nepal as ineffective to impose fines and penalties as per necessity and its due to corruption, lack of competent staffs and complicated tax law.

He has suggested revising the provision of fines and penalties, introducing reward and prizes, clear income tax rules and regulations, clear right and duties of tax officers, timely revision in income tax policy and computerized system for payment of income tax. He has recommended for education to taxpayers and information spreading through different media, meetings and seminars for consciousness about income tax. of income tax administration.

Mr. Dan Bahadur Palli Magar (2003) has conducted a study basically concentrated on the exemption and deduction provision of income tax law. He found that there was dominated share of tax structure in Nepalese government revenue. He found the contribution of direct tax and indirect tax to be 25.56 percent and 74.44 percent of total tax revenue in 2001/02. Income tax has occupied third position on the basis of mean contribution among sources of revenue and is in increasing trend. The tax GDP ratio was not found satisfactory. With income tax, corporate income tax is in first position with dominating role and in decreasing trend while income tax from individual is occupying second position and is in increasing trend. He has stated the major causes for inefficient tax administration as lack of trained employees, shortage of income tax experts and professionals in tax administration, lack of public

participation, faulty organizational structure of tax administration, weakness in government policy and defective income tax act.

He has suggest for revision the exemption limit, elimination double taxation in dividend, tax rebate for submitting true income statement in time, increase income tax rate slab up to 10, increase exemption limit to individual as well as family, special package for industrial development in remote area, tax provision for agriculture income above some specified exemption etc. His major suggestions about deduction are clear provision for deduction, fully allowed interest expenses, pollution control expenses, repair and improvement expenses and research and development expenses. His study has covered exemption and deduction provision of income tax laws. He has not mentioned other various aspects of income tax.

Mr. Ishwor Bhattarai and G.P. Koirala (2003) have co-authored two books entitled "Taxation in Nepal and Tax Laws and Tax Planning in Nepal". The first book is designed according to the requirements of bachelors of business studies 3<sup>rd</sup> year syllabus and next one is based on MBS second year syllabus Tribhuvan University. Both of these books are useful and relevant for university students as well as others having interest in this discipline.

Mr. Sushil Kumar Dahal (2005) has studied with the objectives of analyzing contribution of income tax and volume of indirect and direct tax, examining the effectiveness of income tax revenue collection, knowing view of tax payer tax experts and tax officers about various aspects of income tax and to recommend possible measures.

His major findings are: There is dominant role of tax revenue in Nepalese government revenue, but is in decreasing trend. It was 85.2 percent in 1982/83 and is 78.0 percent in 2001/02. Average contribution of direct and indirect tax in his study period is 20.63 percent and 79.40 percent respectively. The resource gap is in increasing trend and tax GDP ratio is not found satisfactory. Income tax is the important source of internal revenue and occupies third position after costume duty and VAT. He has found income tax from individuals to be occupying first position but with decreasing trend. He has also stated that mass poverty and low income level, increasing habit of tax evasion, inefficient income tax administration are the major reasons for low contribution of income tax and lengthy process, vague provisions of

income tax laws consuming unnecessary time, lack of awareness are major problems facing by tax payers.

He has made some recommendations. Tax ratio should be gradually increased to adopt principle of ability; Income tax policy should be timely revised by income tax experts following economic policy of nation; Income tax rules and regulation should be clear and simple; rate of fines and penalties should be increased; a research and intelligence centre should be established in each tax office, tax personnel and tax payers should be encouraged as well as punished for their works; separate income tax department should be established; income tax net should be broad by bringing house and land rent, doctors' clinic, consultancy service, tuition, research etc into income tax net are the major recommendations made by him.

Besides these books and dissertations some reports and articles published in different newspapers and magazines and government publications such as budget speech, economic survey, national plan etc were reviewed during the study period.

After reviewing the above thesis, it is found that various studies have been done on the topic of income tax and its determinants. Here the researcher has highlighted national revenue occupied by income tax and its trend. Comparison of impact of income tax before and after the enactment of income tax act 2058 has also been done. The main contribution of this study is analyzing the current revenue structure with respect to income tax of government of Nepal. Furthermore it tries to suggest some specific measures for the betterment of tax system of Nepal. This dissertation mainly focused on current situation of income tax system.

# **CHAPTER THREE**

## **RESEARCH METHODOLOGY**

Methodology part of every research work serves as the bridge linking two edges of river. It is the road map of every research work whether scientific or applied research. It suggests every researcher to get the easy and efficient destination achievement stated in research objectives.

"Research methodology refers to the various sequential step to be adopted by a researcher in studying problem with certain object in view. It would be appropriate to mention that research project are not susceptible to any one complete and inflexible sequence of steps and the type of problems to be studied will determine the particular steps to be taken and their order too." (C.R. Kothari, Quantitative Techniques, 1994)

By above definition research methodology is a technique of analyzing the obtained data to solve the research problem. It consists of descriptive approach and statistical tools. Descriptive approach is used to analyze the research problem, and other theoretical problem. Statistical tools are used to analyze the numerical data. Researcher has used the following methodology to complete the research.

### **3.1. Types of Research**

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

### **3.2. Research Design**

Research design means an overall framework or plan for the collection and analysis of data. "Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research questions and to control variance." (Fred N. Kerlinger, Foundation of Behavioral Research)

To conduct the research of this study, descriptive and analytical research design has been adopted. The study is based on historical data and an "ex post facto" research because no variables are in the control of researcher and no



variables in this research is manipulated during the study period. Descriptive research design is used for conceptualization, problem identification, conclusion and suggestion. Analytical research design is used for analyzing the data to find out the result. This study is based on primary and secondary data.

The research study is focused on role of income tax and composition of income tax revenue and its trend before and after enactment of Income Tax Act 2002 in Nepal. To achieve the stated objectives, data has presented and analyzed from different sources. An opinion survey is carried out with 60 respondents associated with different denomination related to income tax i. e. tax experts, tax administrators and taxpayers. The opinions were collected through structured questionnaire. The questionnaire included the role of income tax, effectiveness of income tax system, trend of income tax and reason, suggestion to reform income tax system, most important factors of new act etc. Thus, the study is descriptive, analytical and empirical.

### 3.3. Population and Sample

To fulfill the objectives of the study, 60 samples size is selected from different denomination. Persons selected for empirical study are carefully selected by consultation with lecturers and best judgment method. The respondents are from three groups. The group of respondents and size of sample is stated in table 4.1.

**Table 3.1**  
**Group of Respondents and size of samples**

S. No.	Groups of Respondents	Sample Size
1.	Income Tax Experts	20
2.	Income Tax Administrators	20
3.	Income Tax Payers	20
	Total	60

### 3.4. Nature and Sources of Data

The data collected to describe this study are from two sources i.e. primary and secondary. The major sources among them are stated below:

### 1. Primary Data:

To know the views of different persons related to income tax, an opinion survey is carried out through structured questionnaire to sample population. The questionnaire was same for all the respondents. The persons involved in survey are from different parts. Tax administrators are from IRD and various sectors of tax offices. Tax experts are the lecturers, auditors, CAs etc. Selection of taxpayers is made from various sectors manufacturing, service, trading, financial etc.

### 2. Secondary Data:

The comparative progress study and other basic analysis of study is made by secondary data. The sources of secondary data during this study are:

- i. Economic Survey of various years, Ministry of Finance, GOV/Nepal.
- ii. Budget Speech of various years, Ministry of Finance, GOV/Nepal.
- iii. Reports of Internal Revenue Departments of various years.
- iv. Different books related to income tax and public finance.
- v. Dissertations related to income tax.
- vi. Different Newspapers, journals, souvenir, magazines.
- vii. Web sites of different organizations such as World Bank, IMF, MOF, IRD etc.
- viii. Other relevant records and data.

Secondary data from FY1991/92 to 2005/06 has been used in this study.

## 3.5. Data Collection Procedure

Necessary data for this study are collected from various sources, out of them only related data are taken into consideration. Primary data and secondary data are collected through following method:-

### **a) Questionnaire Method**

To know the views of different persons related to income tax, questionnaire method has been used. Opened, closed and mixed questionnaire methods are used to collect the data. Yes/No question, multiple choice question and descriptive questions with ranking are design to get the response. Due to various limitations only 75 questionnaire forms are distributed to the income tax experts, income tax

administrators and income tax payers. Twenty-five questionnaires are distributed to each group and only 60 of them are collected during research period.

#### ***b) Interview Method***

To make the study more reliable, interview of some concerned personalities are taken. Interviews are related to income tax contribution to national revenue, its impacts, tax paying awareness and practice etc. Structured and unstructured interview has been used for the data collection. Formal and informal discussions are holding with students, teachers of taxation and related person of concerned companies in order to make the study reliable.

#### ***c) Historical Data Record Method***

It is the main sources of the data for this study. Historical data are collected from reliable sources as accurate as possible by researcher and has to visit different offices, libraries and bookstalls and various GO/N reports, prospectus of concerned companies and newspaper. Previous data, which has used by other party, are also useful for this study.

### **3.6. Data Processing and Analysis Procedure**

Collected data from various sources are thoroughly reviewed and sorted on the basis of their homogeneous nature and resemblance of the facts. The sorted data are arranged and presented systematically in suitable tables. The processed and tabulated data were analyzed through different statistical tools such as percentage, simple average, graphs, tables, charts etc for clear and systematic presentation of findings. To analyze the data obtain from various sources, statistical, mathematical and financial tools are used. Brief explanations of such types of statistical tools used in this study are as follows:-

#### ***a) Percentage***

Percentage is the proportion of one unit on the whole unit. It measures the proportion of one unit among all units. To find out the resource gap in Nepal, composition of total revenue in Nepal, composition of tax revenue in Nepal, composition of direct tax revenue in Nepal, it is important.

### **b) Average**

Average measures, which condense a huge unwieldy data into single value, which represents the entire data. Since an average represents the entire data, its value lies between the two extreme observations i.e. largest and the smallest items.

### **c) Correlation Co-efficient (r)**

Correlation analysis is the statistical tool that can be used to describe the degree to which one variable is linearly related to another. The coefficient of correlation measures the direction of relationship between two sets of figures. It is the square root of the coefficient of determination. Correlation can either be negative or it can be positive. If both variables are changing in the same direction, then correlation is said to be positive but when the variations in the two variables take place in opposite direction the correlation is termed as negative.

The strength of correlation between the variables can be quantified. This is achieved by calculating the correlation coefficient. The correlation coefficient varies between +1 and -1; with +1 representing perfect positive correlation and -1 representing perfect negative correlation.

Calculation of Rank Correlation by formula,

$$Pr = 6.6745 \times \frac{1 - r^2}{\sqrt{n}}$$

### **d) Coefficient of Determination (r<sup>2</sup>)**

The coefficient of determination is a measure of the degree (extent or strength) of linear association or correlation between two variables. One of which happens to be independent and other being dependent variables. In other words, r<sup>2</sup> measure the percentage of total variation in dependent variable explained by independent variables. The coefficient of determination has value range from 0 to 1. If r<sup>2</sup> is equal to 0.85 that indicates that the independent variables used in regression model explain 85% of the total variation in the dependent variable. A value of one

occur only if the unexplained variation is zero which simply means that all the points in the scatter diagram fall exactly on the regression line.

***g) Statistical Table***

Collected data from primary and secondary sources are setting on the various types of table. Simple and complex statistical table has been used for the study. Such types of table are formulated according to the required of research objectives.

***h) Statistical Diagrams***

For analyzing the collected data, various statistical diagrams are used according to the requirement of the objectives. Multiple bar diagram, and line graph has been utilized for this study.

# **CHAPTER FOUR**

## **PRESENTATION AND ANALYSIS OF DATA**

Income tax is related to different other economic factors of nations. For better knowledge of role of income tax some macro economic factors also discussed in this chapter.

### **4.1. Resource Gap in Nepal**

The gap between government expenditure and 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 and 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. To cover this gap Nepal is facing the increasing burden of foreign loan. The widening trends of the resource gap in different years are shown in table 5.1.

As shown in table, resource gap of 12905.5 million in FY 1991/90 reached to 38607.1 million in 2005/06. It is continuously increasing rapidly. This change of fifteen year shows 199 percent growth in resource gap. It seems to be decreased in five fiscal year comparing to former year but the decreased rate is low and 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 collection 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 expanded from 66272.5 to 79835.1. It is 32.35 percent increased value. Decreasing trend of regular three years appears from 2001/02 to 2003/04. It is due to slow growth in government expenditure and comparatively rapid growth in revenue collection. The cause may be armed conflict problem in the country. The gap is being wider for last three 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 and 45892.5 in 2006/07.

**Table 4.1**

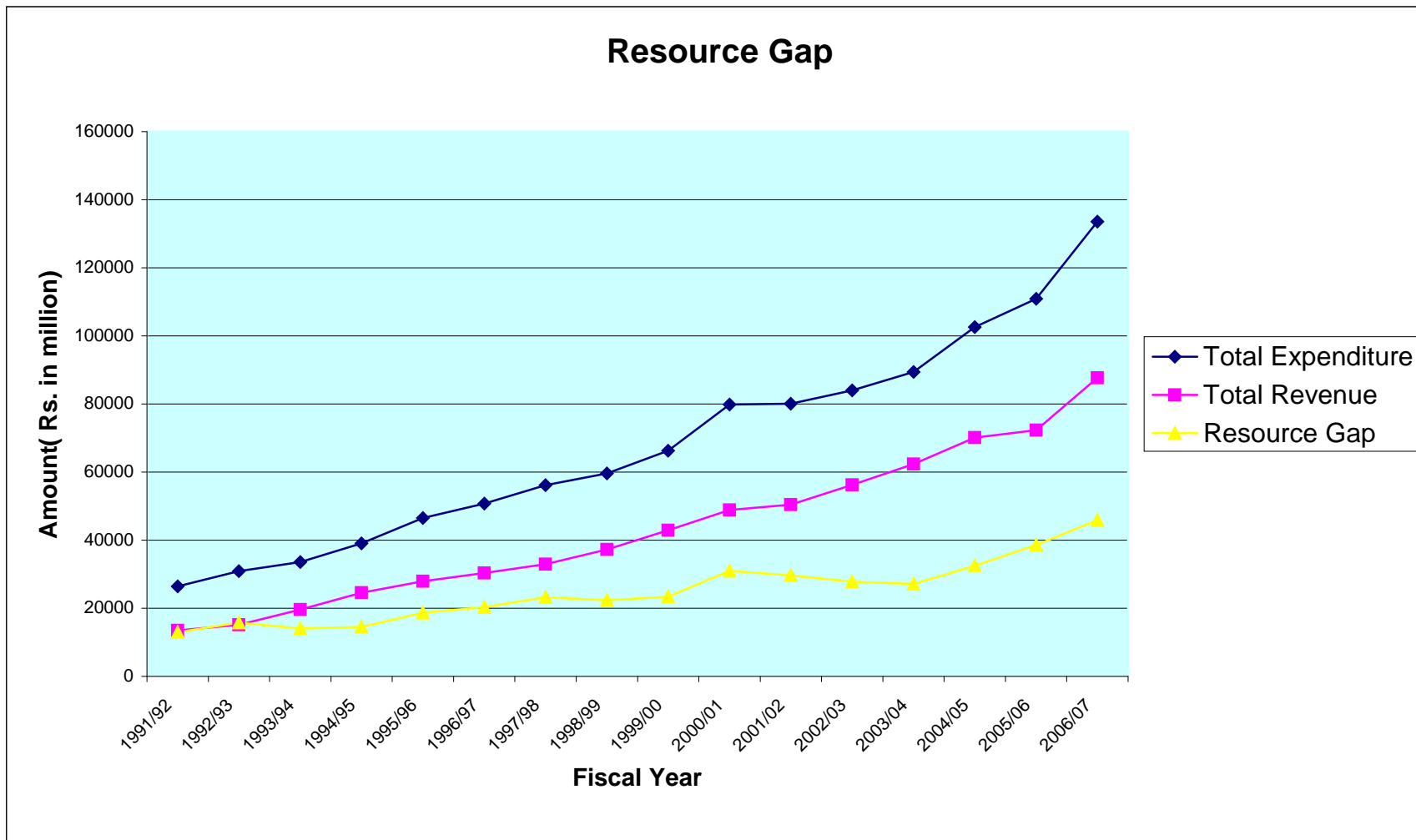
**Resource Gap in Nepal**

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
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	133604.6	87712.1	45892.5	18.87

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

Figure 4.1





## 4.2. Nepalese Government Revenue Structure

Nepal's public economy is suffering from low revenue performance and growing public expenditure. The basic sources of revenue are tax revenue and non-tax revenue but collection of these revenues is not sufficient to cover expenditure. The composition of tax revenue and non-tax revenue from FY 1991/92 to 2005/06 is presented in table 5.2. This shows the dominated role of tax revenue as 73.08 percent of total revenue in 1991/92 and 79.45 percent in 2005/06. Share of non-tax revenue for the same period seems to be 26.92 percent and 20.55 percent respectively. The amount of tax revenue is continuously increasing but that of non-tax revenue is fluctuating, that's why the share of tax revenue and non-tax revenue are not uniform. The tax revenue seems to be 81.09 percent as maximum and 73.08 percent as minimum contribution to national revenue in 2006/07 and in 1991/92 respectively within the study period.

The tax revenue contributed amount of 9875.6 million and 57430.4 million in 1991/92 and in 2005/06 respectively. Figure 4.2 shows that the increase is generally in constant rate. The increase of tax revenue within 15 years is found to be 620.22 percent. The contribution of non-tax was 3637.1 million and 14851.7 in subsequent fiscal years. It shows the increasing nature of non-tax revenue but it has also decreased comparing to former year in FYs 1992/93, 1996/97, and in 2005/06. The increase of non-tax revenue within study period is 355.99 percent. Mean contribution of tax revenue and non-tax revenue within study period are found as 77.99 percent and 22 percent respectively. Composition of tax revenue and non-tax revenue is shown in figure 5.2.

Table 4.2

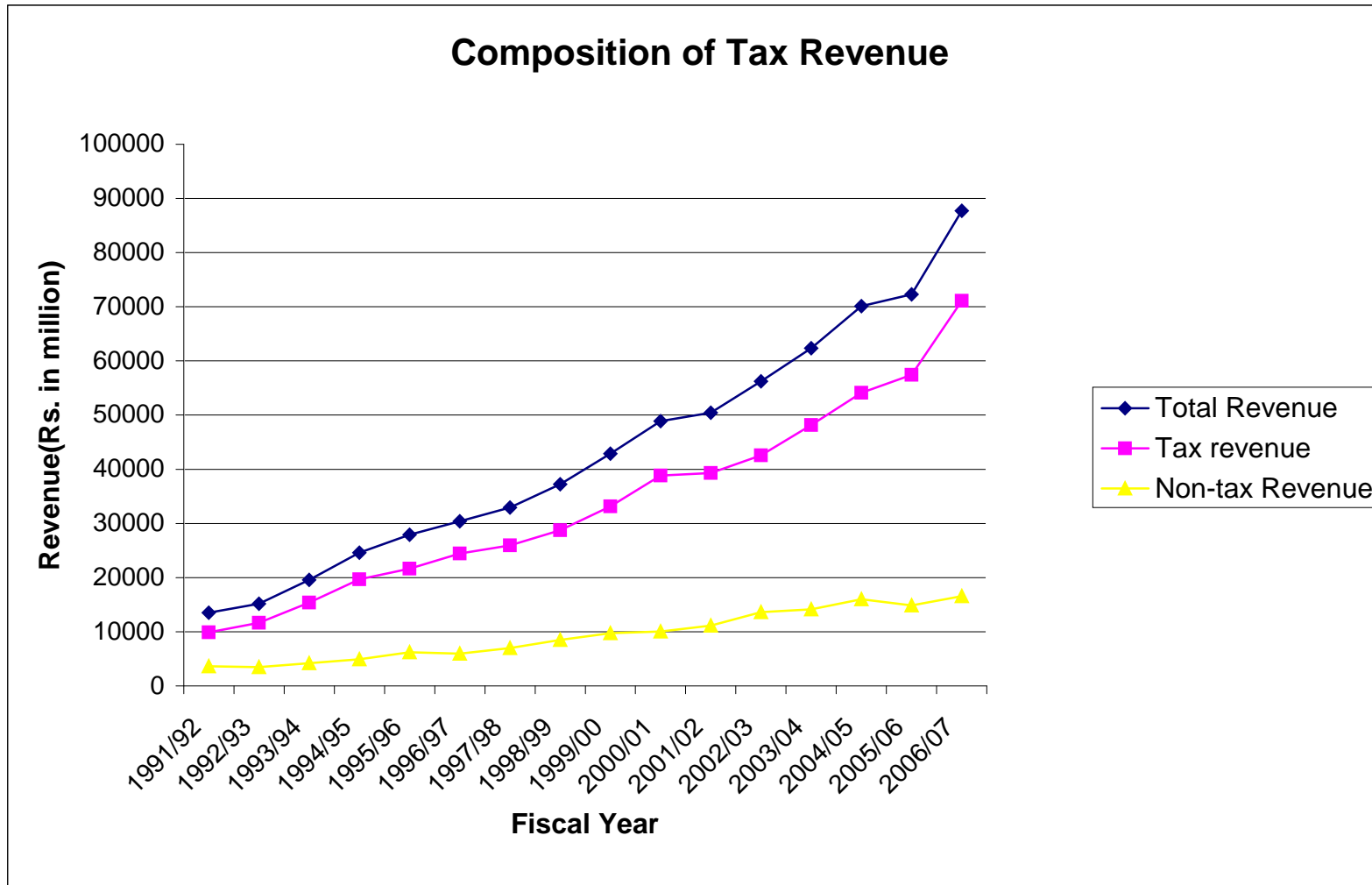
## Composition of Total Revenue in Nepal

Rs in Million

Fiscal year	Total Revenue	Tax revenue		Non-tax Revenue	
		Amount	Percentage	Amount	Percentage
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	19580.9	15371.5	78.50	4209.4	21.50
1994/95	24605.1	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	87712.1	71127	81.09	16585.1	18.90

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

Figure 4.2



### 4.3. Composition of Tax Revenue in Nepal

Tax revenue is the major source of government. In Nepal contribution of tax revenue is about 80 percent. It is the tools to mobilize internal resources effectively. The tax revenue constitutes direct and indirect tax. Direct tax includes income tax, land and revenue and registration, urban house and land tax, vehicle tax and indirect tax generally includes costumes, VAT, excise.

The share of direct tax and indirect tax in total tax revenue is presented in figure 4.3. This shows the increasing trend of both direct and indirect tax. Indirect tax has a leading role in total tax revenue up to 83.85 percent within the study period. Although the amount of indirect tax is increasing, its share to total tax is decreasing. Its share was 83.85 percent in FY 1991/92 and reduced to 73 percent in 1999/00 and gradually increased to 75.68 percent in 2005/06. In the other hand direct tax has an increasing trend. Its share became 24.32 percent in 2005/06 from 16.15 percent in 1991/92. The share of direct tax revenue in F/Y 2006/07 is 26.68%, it causes the indirect tax revenue decreases by 2.37% (i.e. 73.31%) comparison to F/Y 2005/06. The mean contribution of direct tax and indirect tax to total tax revenue are 23.05 percent and 76.94 percent within study period.

The graph of composition of direct tax and indirect tax revenue presented in fig. 4.3 shows the totally correlation between indirect tax and total tax revenue due to dominating role of indirect tax revenue.

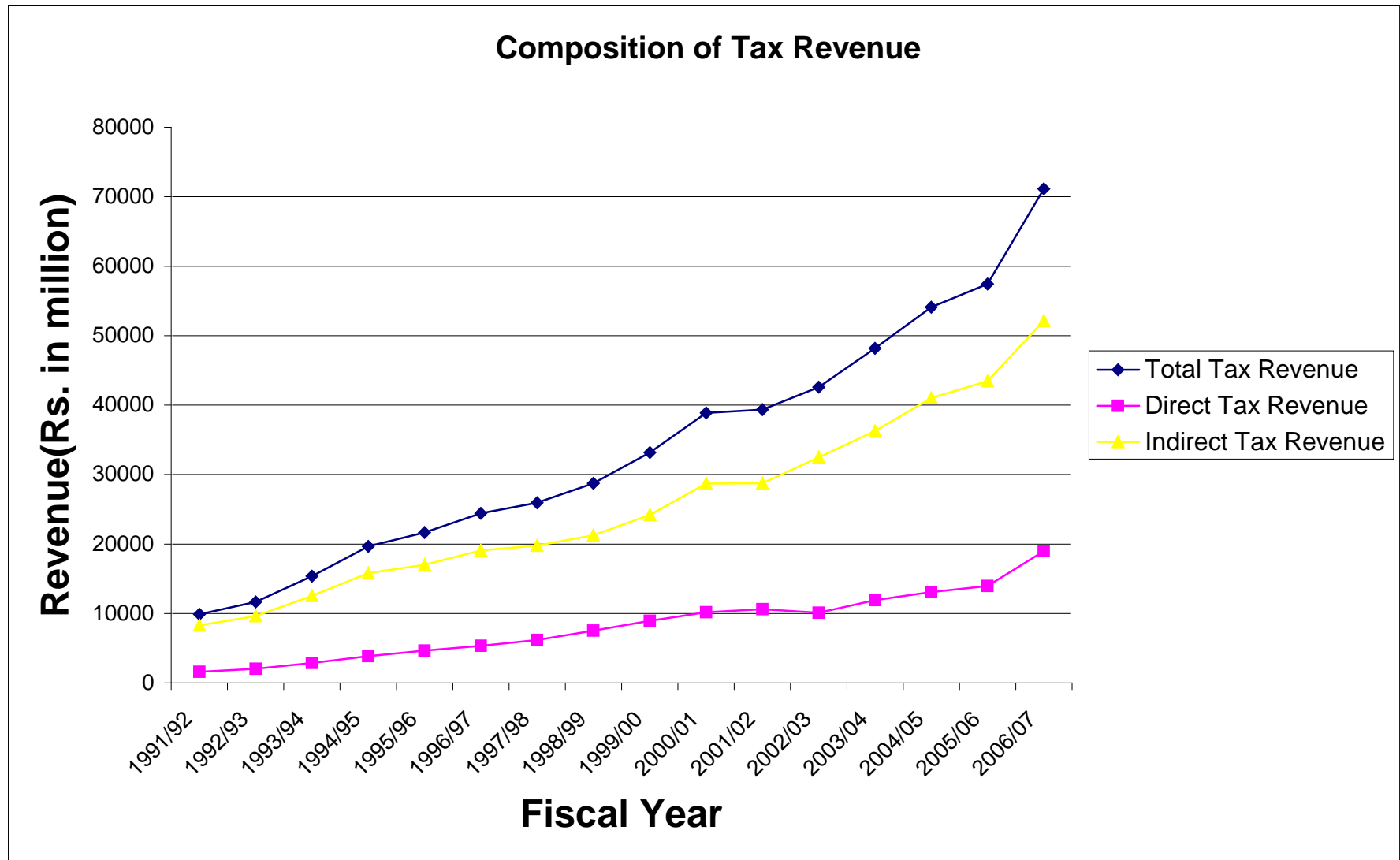
**Table 4.3**  
**Composition of Tax Revenue**

Rs in Million

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
1992/93	11662.5	2036.2	17.46	9626.3	82.54
1993/94	15371.5	2855.3	18.58	12516.2	81.42
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	11912.6	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	71127.00	18980.30	26.68	52146.70	73.31

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

Figure 4.3



## 4.4. 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 the composition of land revenue and registration tax and tax on property, profit and income. Share of different components of direct tax are shown in table 4.4.

Direct tax is classified into land revenue and registration and 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 five 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 three years. It increased gradually for 1999/00 and became the lowest share to revenue in 2000/01, when its share to direct tax is only 6.03 percent amounting 612.9 million. it is further in increasing trend after that and has reached to 2181.1 million, occupying 15.61 percent of direct tax revenue at F/Y 2005/06. In F/Y 2006/07 the percentage share of direct tax revenue is decreased by 3.74% in comparison to the F/Y 2005/06. The highest percentage contribution from this category was in 1991/92 as 39.88 percent. The mean contribution of land revenue and registration is 15.16 percent, which is nearly about to 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 sources 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 tax and urban house and land tax. This category of direct tax seems to be in increasing trend up to 2000/01 and it declines for next two years. It is further increasing after 2003/04. Highest share is in 2000/01 with 93.97 percent and lowest in 1991/92 with 60.12 percent. Mean contribution is 81.27 percent.

**Table 4.4**  
**Composition of Direct Tax Revenue**

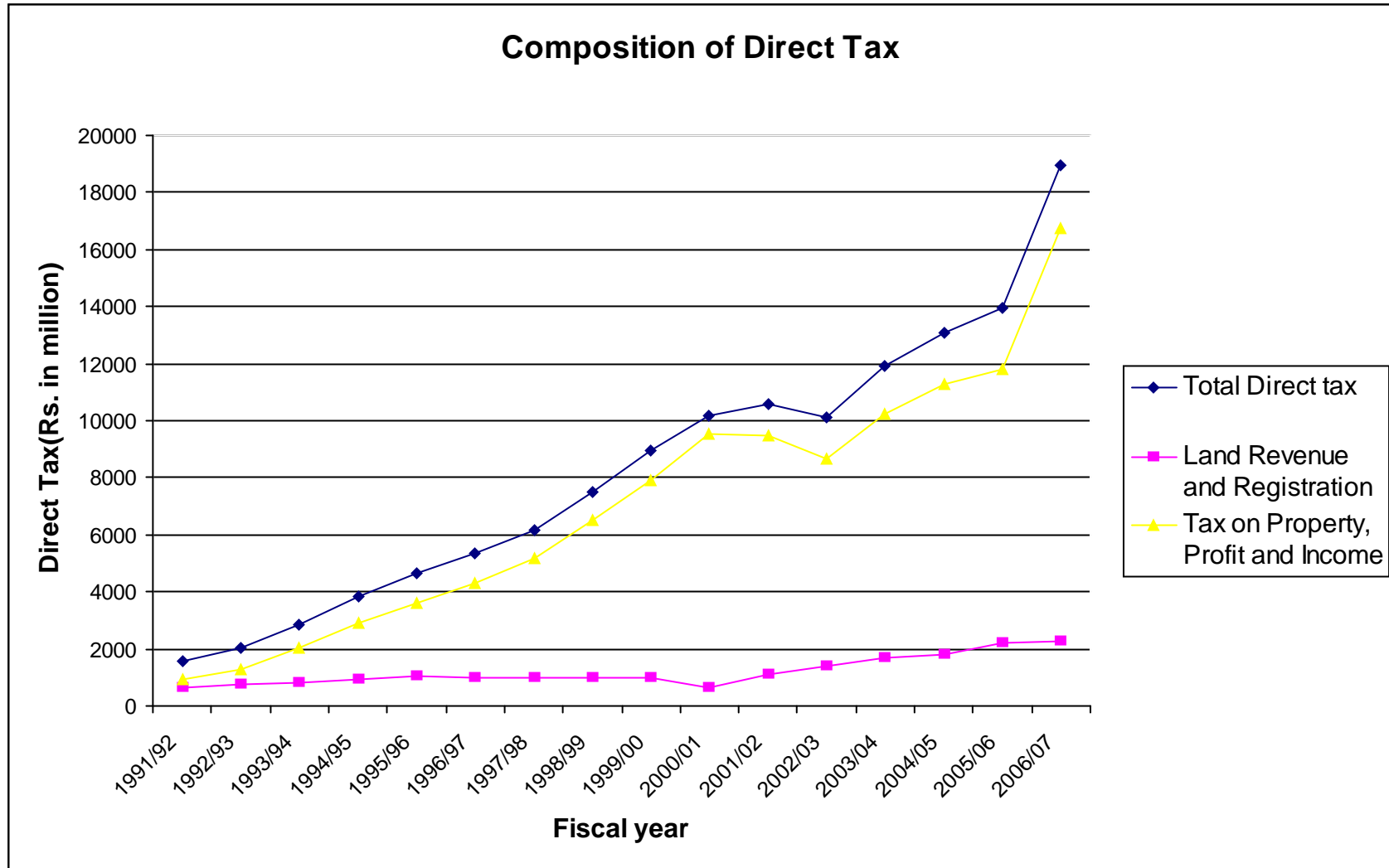
Rs in Million

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	0.0	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	15034.00	995.0	697.8	16726.8	88.12

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



Figure 4.4



## 4.5. Composition of Income Tax

Income tax is the major source of direct tax revenue. It was first introduced as business profit and remuneration tax in 1959/60 in Nepal. It contributed only 203 thousands in that FY. It reached 10373.7 million after 46 years in FY 2005/06, which is out of range of compare. The income tax collections in different income years are shown in table 5.5.

Total Income tax is increasing each year without in 2001/02 and 2002/03. The amount from income tax was only 875.0 million in 1991/92 and its increasing trend is optimistic up to 2000/01 while it reaches to 9114.0 million. Then it declined for next two years. It became 8903.7 million in 2001/02 and further decreased to 7996.2 million in 2002/03. Its trend is gradually increasing after this within study period.

Income tax constitutes Income tax from public enterprises, semi public enterprises, private corporate bodies, individual, remuneration and tax on interest. The share of these different sources in percentage is shown also presented in table 4.6.

The table shows that role of income tax from public enterprises is significant. It has contributed 22.2 percent to total income tax in average. The trend of income tax from public enterprises is fluctuating. It was 176.4 million in 1991/92 and gradually rises up to 2928.0 million in 2000/01. Its maximum and minimum shares were 33.4 percent and 20.2 percent in 1995/96 and 1991/92 respectively in the previous period. After 2001/02 its trend is declining and has not met the record of 2000/01. Its condition in 2005/06 is very low as 195.7 million and just covers 1.9 percent of total income tax. It is slightly increased in year 2006/07 which has been 6.78% contribution into the total income tax. The share of income tax from private corporate bodies is 19.5 percent in average. It was in increasing trend up to 2000/01 from 6.5 million in 1991/92 to 1924.3 million. It also declined for next tow years after 2001/02 and slightly increased in 2003/04 than former year. It seems to catch the trend before 2000/01 in recent years.

Same trend appears in case of income tax from individual. It has the major role in income tax and bears dominating role in former period of the study. It has contributed up to 70.6 percent in 1991/92. Although the amount is increasing up to

2001/02, its share is in declining trend. After a huge contribution of 4419.1 in 2001/02, it declines to 3362.3 million in next fiscal year and unable to meet the record in subsequent year up to 2005/06 while the amount is 4234.7 million after slow growth in preceding years. Its lowest share is 34.81 percent in 2006/07 and average share is 46.08 percent. Only one sub category of income tax is income tax from remuneration, which has never declined. It was 54.7 million in 1991/92 and reached to 2007.9 million in 2006/07 with regular growth. Its share in total income tax is also positive and is highest in second last year of study period i.e. 17.0 percent in 2005/06. Average contribution is 8.76 percent within study period. Tax on interest is another source of income tax which had slow increasing trend in amount up to 2002/03 from 54.7 million in 1991/92 to 864.0 million. But it declines for next year to 733.4 million, slowly increased for 2004/05 to 757.0 million and again decreased notably to 565.7 million in 2005/06. It is slightly increase in year 2006/07 i.e. 1054.9 million. Its average contribution is 7 percent in total income tax revenue in 16 years study period.

Table 4.5

### Composition of Income Tax Revenue

Rs in Million

Fiscal Year	Total Income Tax Revenue	Public Enterprises *	Private corporate bodies	Individuals	Remuneration	Tax on interest
1991/92	875.0	176.4	6.5	617.9	54.7	19.5
1992/93	1198.2	257.9	9.5	800.7	56.7	73.4
1993/94	1921.2	536.2	19.7	1184.8	83.8	96.7
1994/95	2823.4	860.2	440.1	1293.1	118.4	111.6
1995/96	3431.4	1144.5	563.9	1470.1	133.1	119.8
1996/97	4123.4	1231.1	858.4	1711.4	168.1	154.4
1997/98	4898.1	1317.8	925.1	2120.8	322.2	212.2
1998/99	6170.3	1526.5	1155.0	2772.7	396.5	319.5
1999/00	7420.6	2198.8	1339.5	3016.4	451.5	414.4
2000/01	9114.0	2928.0	1924.3	3200.5	597.3	463.9
2001/02	8903.7	1769.3	1412.0	4419.1	835.6	467.7
2002/03	7966.2	1251.0	1236.3	3362.3	1252.6	864.0
2003/04	9245.9	2056.6	1531.3	3533.4	1391.2	733.4
2004/05	10159.4	1332.4	2467.8	3926.3	1675.9	757.0
2005/06	10373.7	195.7	3404.3	4234.7	1764.1	774.9
2006/07	15034.2	1019.7	5717.1	5234.4	2007.9	1054.9

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

Table 4.6

### Composition of Income Tax Revenue

In percentage

Fiscal Year	Total Income Tax Revenue	Public Enterprises *	Private corporate bodies	Individuals	Remuneration	Tax on interest
1991/92	100.0	20.2	0.7	70.6	6.3	2.2
1992/93	100.0	21.5	0.8	66.8	4.7	6.1
1993/94	100.0	27.9	1.0	61.7	4.4	5.0
1994/95	100.0	30.5	15.6	45.8	4.2	4.0
1995/96	100.0	33.4	16.4	42.8	3.9	3.5
1996/97	100.0	29.9	20.8	41.5	4.1	3.7
1997/98	100.0	26.9	18.9	43.3	6.6	4.3
1998/99	100.0	24.7	18.7	44.9	6.4	5.2
1999/00	100.0	29.6	18.1	40.6	6.1	5.6
2000/01	100.0	32.1	21.1	35.1	6.6	5.1
2001/02	100.0	19.9	15.9	49.6	9.4	5.3
2002/03	100.0	15.7	15.5	42.2	15.7	10.8
2003/04	100.0	22.2	16.6	38.2	15.0	7.9
2004/05	100.0	13.1	24.3	38.6	16.5	7.5
2005/06	100.0	1.9	32.8	40.8	17.0	5.5
2006/07	100	6.78	38.02	34.81	13.35	7.0
Average	100.0	22.2	17.2	46.08	8.76	5.66

Source: Table 4.5

Figure 4.5

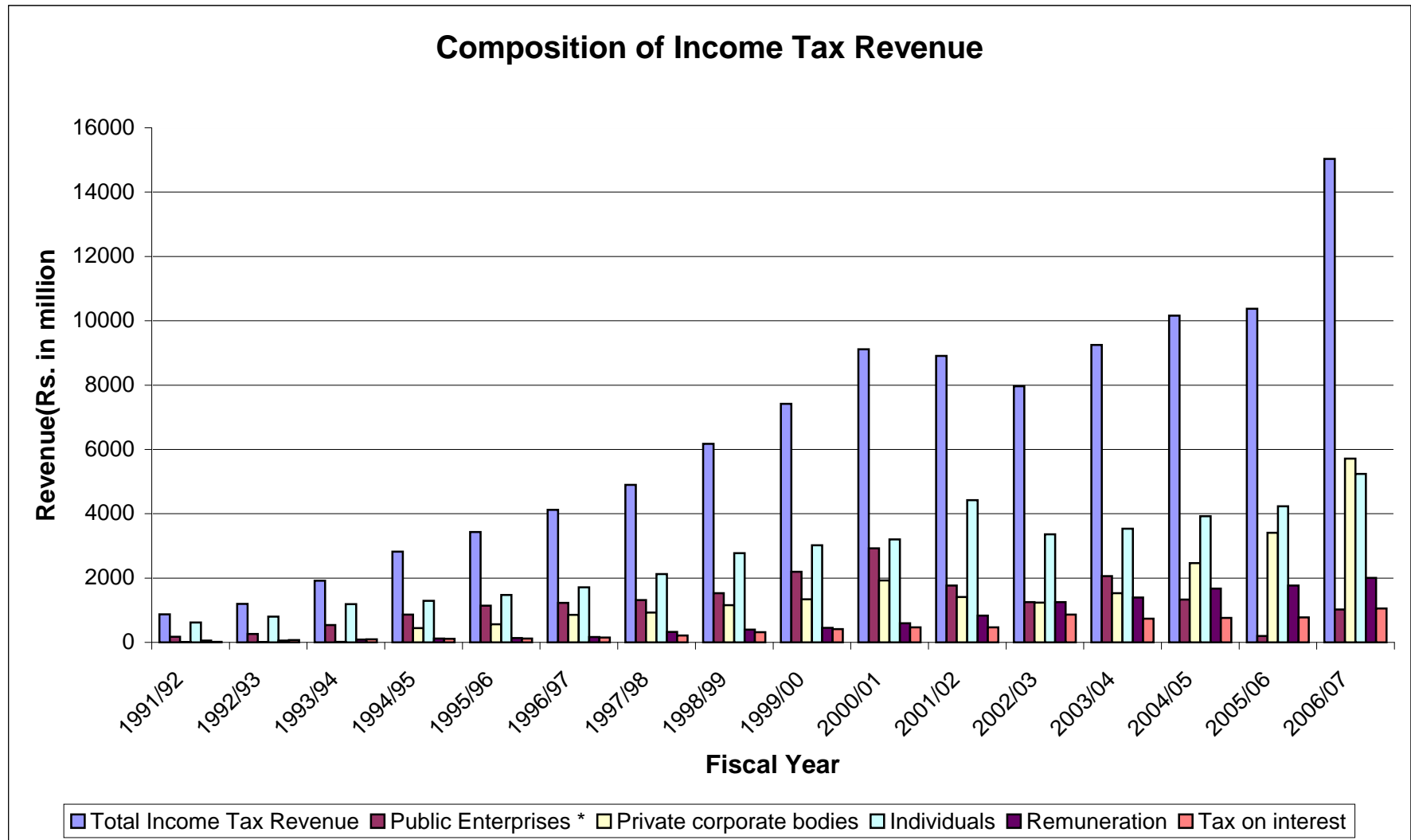
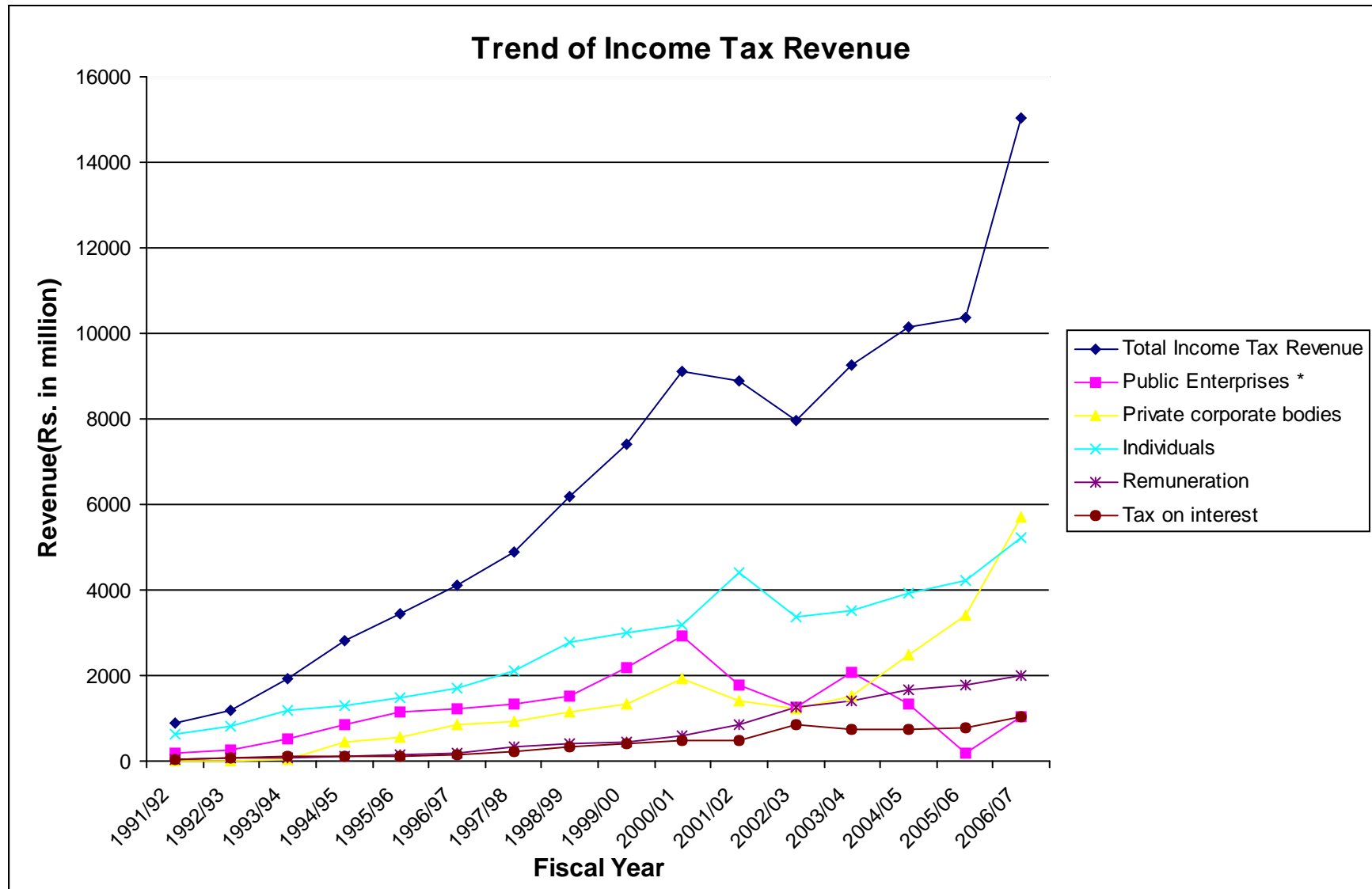


Figure 4.6



## 4.6. Performance of Income Tax before and after New Act

There are mainly three aspects of any kind of revenue collection by government. First thing is policy of government towards revenue, second laws, rules and regulations and third one is administration managed. For collection of tax from income there is income tax policy with mission, vision, objectives and goals; law and rules for guidance the way to achieve them and administration for implementation in specific field.

Nepal is in the way of economic liberalization as the demand of time and globalization and has made economic policy. For fulfill the requirement of the policy different economical laws have been amended and replaced. Among them existing Income Tax Act 2031 has also replaced by new Income Tax Act 2058. Change in existing system may affect the existing condition, performance and/or trend.

As shown in the tables above, it do not shows the significant change in trend of total revenue collection and total tax revenue collection due to general role of income tax with them. The notable effects appear in trend of direct tax and trend of income tax. The new income tax act is effective from fiscal year 2001/02 and according to table 4.4, (composition of direct tax revenue), the total amount of direct tax has increased in this year by very nominal rate i.e. 4.3 percent than previous year while the same rate is 13.5 percent in 2000/01. Further it has declined by 491.7 million with -4.8 percent for the second year of implementation of new act.

More visible effect of the act is in table 4.5. Total income tax has first time declined by 210.3 million and by -2.3 percent from former year. It further decreased by 937.5 million and -10.5 percent for next FY 2002/03 and has not covered the trend before new act up to 2005/06. In this year its growth rate with respect to former year is just 2.1 percent. The maximum increment in total income tax revenue is in F/Y 2006/07 (i.e. 15034.2 million), which is Rs 4660.5 higher than the previous fiscal year. The growth rate of this amount in comparison to F/Y 2005/06 is 44.92%. In 2000/01 growth rate was 22.8 percent and that was more than 20 percent for other preceding years.

The former income tax act has defined agriculture; industry, trade, profession, business; remuneration, house land rent; and others as sources of income while



new act has declared income from business, income from investment and income from employment as sources of income for the purpose of income tax. This provision has affected the structure of income tax. Income tax from public enterprises has mostly effected. Its contribution was 2928.0 million in 2000/01 and is unable to meet the record again. It declined to 1769.3 and 1251 for first two years of new act. It has positive symptom in 2003/04 when growth of 64 percent occurs but after this, its condition is poor. For the previous year of study its decline rate is 85.3 percent. By the bad condition of the country miss-management and lots or reason out there the public enterprises has very much suffered. So it is said that the condition of collection of revenue from public enterprises is very low which is nearer to year 1991/92 and 2005/06. In F/Y 2006/07 it has raised to 1019.7 million which is positive symbol because the growth rate from previous year is 421.05%.

The effect in income tax collection from private corporate bodies is declined for first two years of new act, slow growth for third year and rapid growth for last three years. The effects of act seem to be very positive as its contribution to total income tax has risen to 38.02 percent for FY 2006/07. An amazing trend has shown by income tax collection from individual. It has increased by 27.5 percent in 2001/02 with the amount of 4419.1 million. It decreased for 2002/03 to 3362.3 million and increasing gradually for the last four years. The largest amount of its share within study period is 5234.4 million, which has increased by 67.9%. It is the maximum amount collection from individuals within 16 years of study period.

Income tax from remuneration is the single source not declining after introduction of new act. It is continuously rising within study period from 54.7 million in 1991/92 to 2007.9 in 2006/07. It has increased 35 times within 16 years of study period. The contribution from tax on interest has not the fluctuating character but it was gradually increased before the implementation of new act. After the enactment of new act revenue collection from interest is slightly up down nature. The maximum amount collection from interest was in year 2006/07 i.e. 1054.9 million. The trend of income tax and different components of income tax is shown in figure 5.6.

Argued may be raised for the recession of income tax collection for the following year of new act introduction because this was the peak period of armed conflict in Nepal and all economic activities were affected by war. Logic may also

given that the sector generally unaffected by war such as remuneration and tax on interest has not shown the effect immediately. If it was so, the income tax collection from public enterprises should not decrease since public enterprises were in operation as in earlier within that period. In the other hand we see the revenue collection from other sources than income tax has not so irregular for the period of conflict. More clearly, data presentation and discuss about the share of income tax in different economical factors are presented in following tables and paragraphs. Opinion of experts on this topic has also collected and analyzed in empirical study.

## 4.7. Share of Income Tax in different Economical Factors before and after New Act

The contribution of Income tax to GDP, total revenue, total tax revenue and direct tax revenue before and after Income Tax Act 2058 has been presented below.

### 4.7.1. Contribution to GDP

Table 4.7  
Contribution of income tax to GDP

Fiscal Year	Total Income Tax Revenue	Percentage of income tax to GDP
1991/92	875.0	0.60
1992/93	1198.2	0.73
1993/94	1921.2	1.00
1994/95	2823.4	1.34
1995/96	3431.4	1.43
1996/97	4123.4	1.53
1997/98	4898.1	1.69
1998/99	6170.3	1.87
1999/00	7420.6	2.03
2000/01	9114.0	2.20
2001/02	8903.7	2.15
2002/03	7966.2	1.85
2003/04	9245.9	2.06
2004/05	10159.4	2.20
2005/06	10373.7	2.15
2006/07	15034.2	3.05

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

Figure 4.7

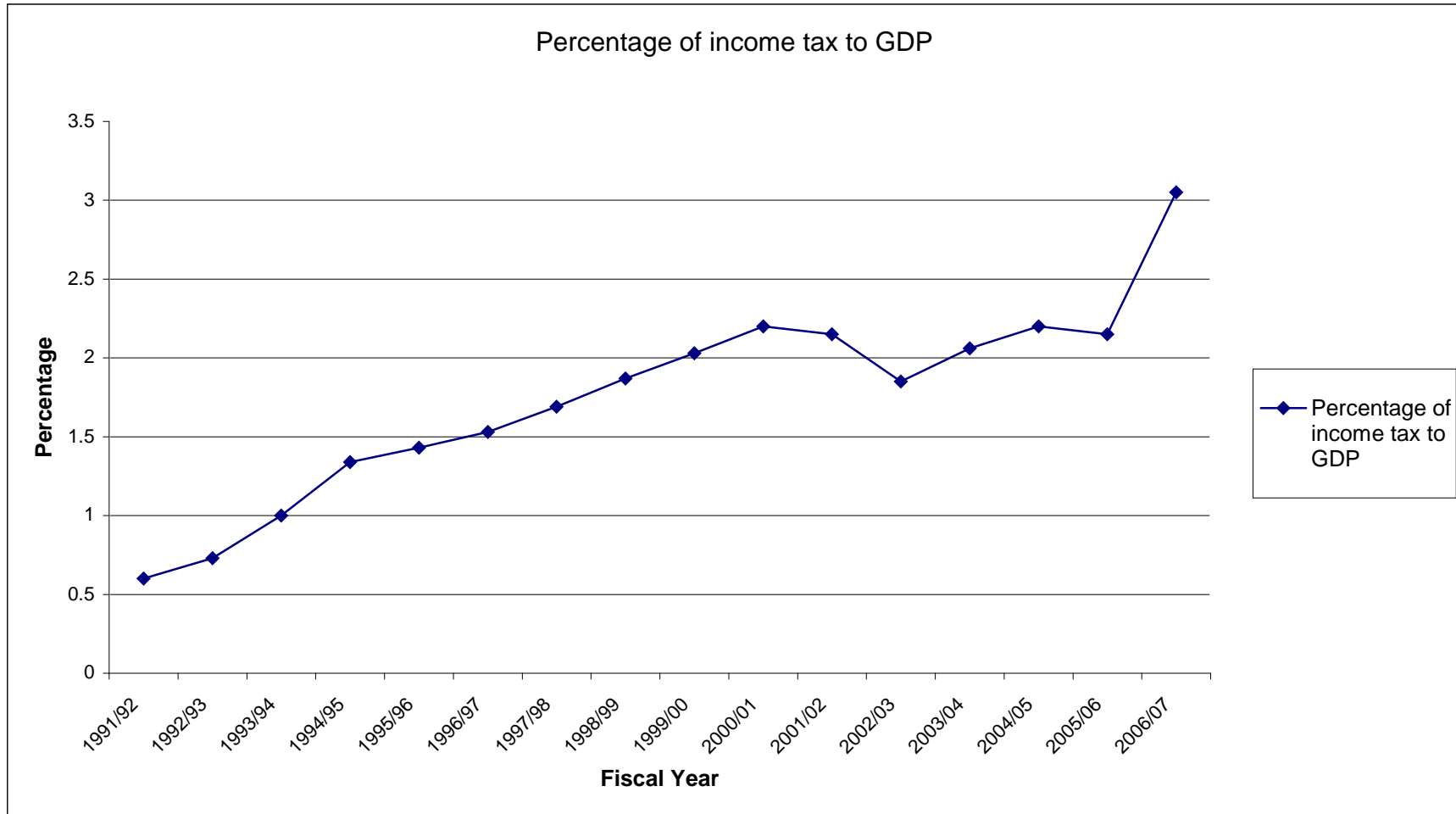


Table 4.7 shows the contribution of income tax to GDP. The contribution of income tax to GDP in FY 1991/92 was just 0.6 percent. It was continuously increasing rapidly up to 2000/01 and reached at 2.20 percent. It cannot be continued for the following period of new act and started declining. It declined to 2.15 percent in 2001/02 and again to 1.85 percent in 2002/03. It slowly increased to 2.06 percent and 2.20 percent for following two years and again declined to 2.15 percent in 2005/06. The maximum contribution of income tax to GDP was in year 2006/07 between the study period, which was 3.05%. The amount contribution of income tax to GDP at this year was 15034.2 million while the total amount of GDP of that year was 492812.3 million.

#### 4.7.2. Contribution to Total Revenue

The contribution of income tax to total revenue was 6.48 percent in FY 1991/92. It is positively correlated with time up to 2000/01. Its share in 2000/01 was

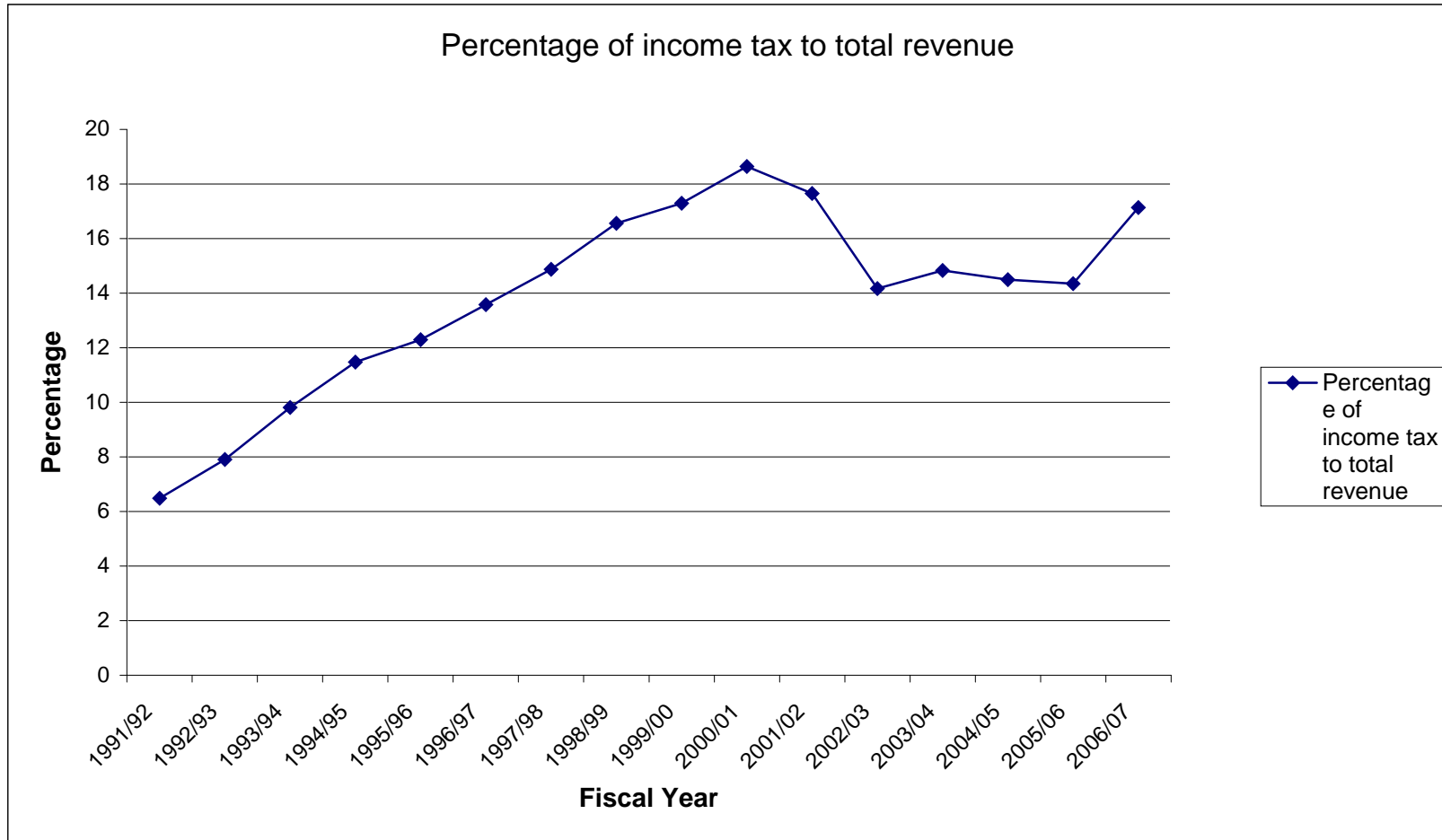
Table 4.8

##### Contribution of income tax to total revenue

Fiscal Year	Total Income Tax Revenue	Total Revenue	Percentage of income tax to total revenue
1991/92	875.0	13512.7	6.48
1992/93	1198.2	15148.4	7.91
1993/94	1921.2	19580.9	9.81
1994/95	2823.4	24605.1	11.47
1995/96	3431.4	27893.1	12.30
1996/97	4123.4	30373.5	13.58
1997/98	4898.1	32937.9	14.87
1998/99	6170.3	37251.0	16.56
1999/00	7420.6	42893.8	17.30
2000/01	9114.0	48893.6	18.64
2001/02	8903.7	50445.5	17.65
2002/03	7966.2	56229.8	14.17
2003/04	9245.9	62331.0	14.83
2004/05	10159.4	70122.7	14.49
2005/06	10373.7	72282.1	14.35
2006/07	15034.2	87712.7	17.14
Total	103658.7	692213.8	14.97

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

Figure 4.8



18.64 percent. It declines for next two years to 17.65 and 14.17 percent. It gradually increased for 2003/04 year to 14.83 percent and again decreased to 14.49 and 14.35 percent for last two years. In fiscal year 2006/07 the percentage of income tax to total revenue was 17.14%, which is 2.79% higher than the contribution of income tax to total revenue in year 2005/06. The contribution of income tax to total revenue is shown in table 4.8.

### 4.7.3. Contribution of Income Tax to Total Tax Revenue

The tax structure shows that indirect tax has major role in total tax revenue. So income tax has not so effective share in total tax. It was only 8.86 percent in 1991/92 and increased with slow growth rate to 23.45 percent in 2000/01. It decreased to 22.64 percent and 18.71 percent after FY 2001/02. It broke the decreasing trend in 2003/04 and continued to decrease in 2004/05 and 2005/06 and its contribution is 21.13 percent in last year of study. Table 4.9 shows the detail data and figure 4.9 shows the trend with time.

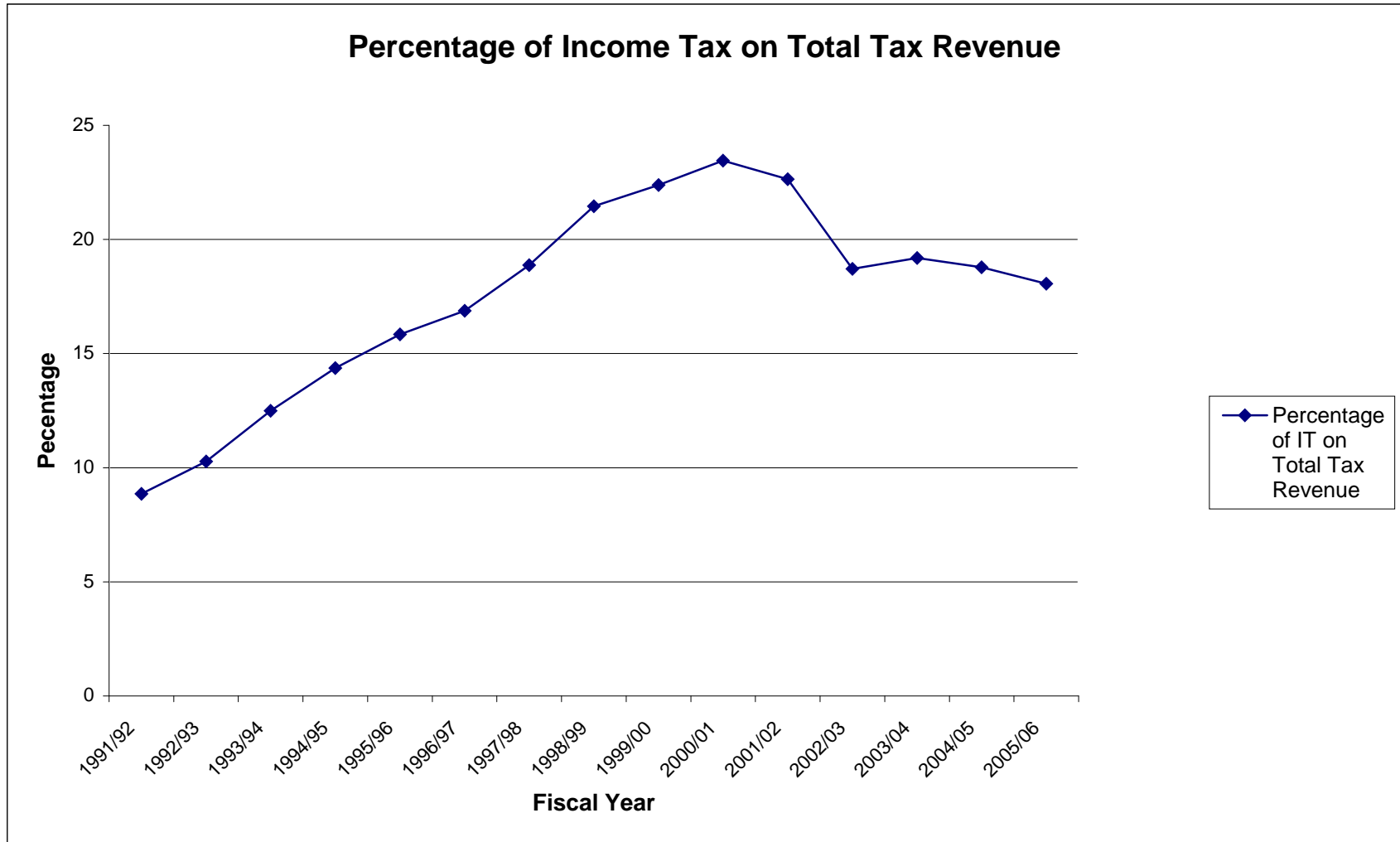
Table 4.9

#### Contribution of income tax to total tax revenue

Fiscal Year	Total Income Tax Revenue	Total Tax Revenue	Percentage of IT on Total Tax Revenue
1991/92	875.0	9875.6	8.86
1992/93	1198.2	11662.5	10.27
1993/94	1921.2	15371.5	12.50
1994/95	2823.4	19660.0	14.36
1995/96	3431.4	21668.0	15.84
1996/97	4123.4	24424.3	16.88
1997/98	4898.1	25939.8	18.88
1998/99	6170.3	28752.9	21.46
1999/00	7420.6	33152.1	22.38
2000/01	9114.0	38865.1	23.45
2001/02	8903.7	39330.6	22.64
2002/03	7966.2	42587.0	18.71
2003/04	9245.9	48173.0	19.19
2004/05	10159.4	54104.7	18.78
2005/06	10373.7	57430.4	18.06
2006/07	15034.2	71127.0	21.13
Total	103658.7	542124.5	19.12

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

Figure 4.9



#### 4.7.4. Contribution to Total Direct Tax Revenue

Income tax is the major source of direct tax. It has 78.65 percent contribution to direct tax within study period of 16 years. Its share was 54.85 percent in 1991/91. As its share to other economical factors, it was increasing up to 2000/01 and reached to peak of 89.71 percent. After this it could not adjust the share and also could not get the increasing trend but decreased to 84.02 percent, 78.83 percent and 77.61 percent in subsequent years. Little increase in 2004/05 to 77.72 percent and again decreased remarkably to 74.27 percent in 2005/06. The contribution of income tax to total direct tax revenue in F/Y 2006/07 was 79.20%. It shows the increasing trend of its contribution. The data of contribution of income tax to total direct tax is presented in table 4.10.

Table 4.10

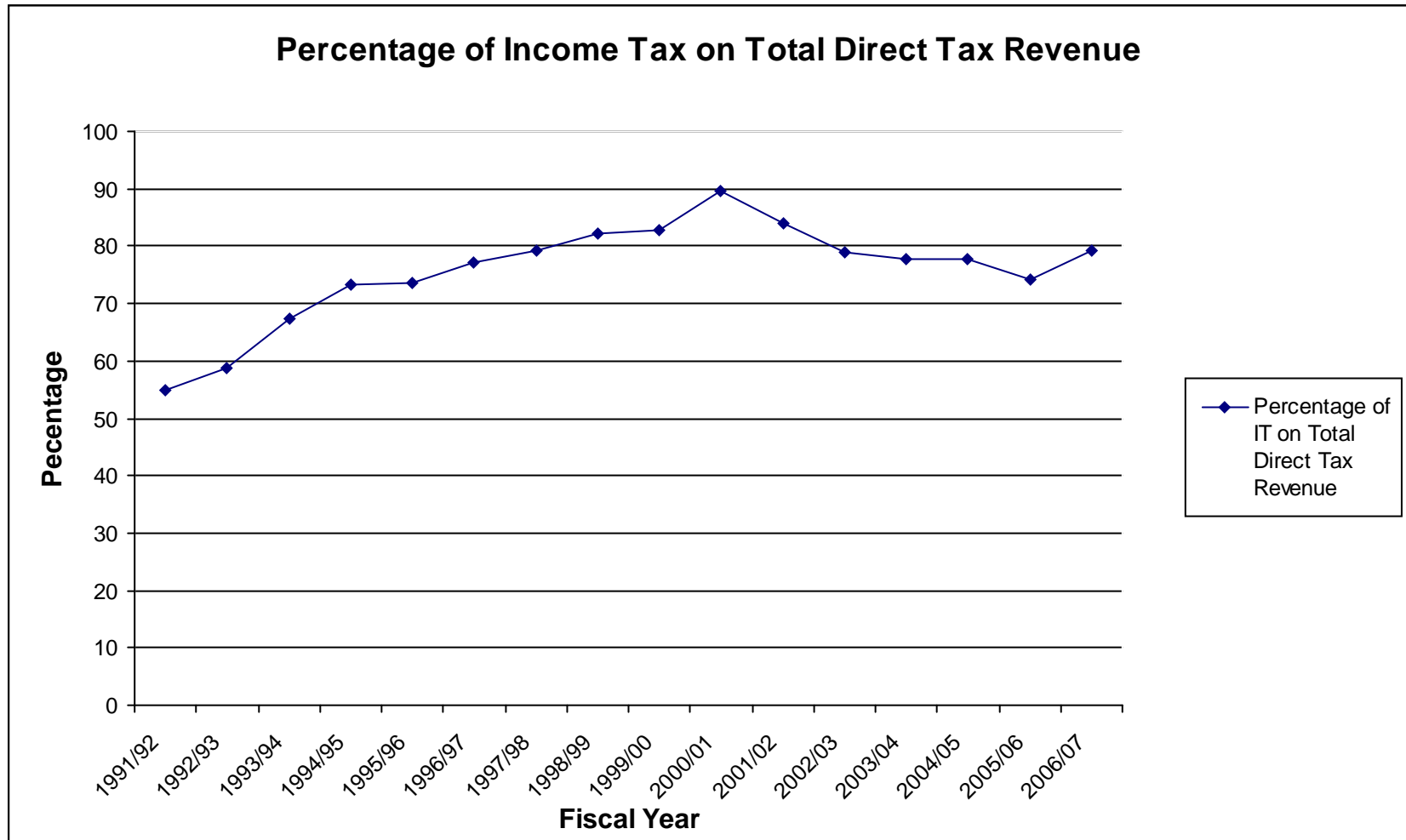
#### Contribution of income tax to total direct tax revenue

Fiscal Year	Total Income Tax Revenue	Total Direct Tax Revenue	Percentage of IT on Total Direct Tax Revenue
1991/92	875.0	1595.2	54.85
1992/93	1198.2	2036.2	58.84
1993/94	1921.2	2855.3	67.29
1994/95	2823.4	3849.3	73.35
1995/96	3431.4	4655.9	73.70
1996/97	4123.4	5340.0	77.22
1997/98	4898.1	6187.9	79.16
1998/99	6170.3	7516.1	82.09
1999/00	7420.6	8951.5	82.90
2000/01	9114.0	10159.4	89.71
2001/02	8903.7	10597.5	84.02
2002/03	7966.2	10105.8	78.83
2003/04	9245.9	11912.6	77.61
2004/05	10159.4	13071.8	77.72
2005/06	10373.7	13968.1	74.27
2006/07	15034.2	18980.3	79.2
Total	103658.7	131782.9	78.65

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



Figure 4.10



The among stated role of income tax and its trend verifies that overall economic activities were not declining and having rapid growth rate without income tax in the period after 2001/02. Even other sources of direct tax have not this type of zigzag trend. So as the amount of income tax is shown to be up and down is not due to other specific reason such as conflict and it is due to inefficiency to implement the new act for the first few years.

## 4.8. Empirical Study

### 4.8.1. Introduction

In order to enhance the study from the experience of real world scenario, an empirical study was conducted. This empirical survey was conducted to know the different aspects of income tax in Nepal. The structured questionnaire was prepared and distributed for this purpose to collect opinions of respondents. The questionnaire has covered role of income tax, features of new act, condition of income tax system and administration in Nepal and suggestion for betterment of income tax system in Nepal. (Appendix A). The respondents were personalities from different field categorized as tax administrator, tax expert and taxpayer. The numbers in each category was equal of twenty. The respondents were asked to tick the answer of their choice or to put the ranking numbers, as first choice was the most important and last choice was least important. The responses collected thus were tabulated and analyzed in proper way. The following table shows the groups and number of respondents.

Table 4.11  
Group of Respondents and No. from each category

S. No.	Groups of Respondents	No.
1.	Income Tax Experts	20
2.	Income Tax Administrators	20
3.	Income Tax Payers	20
Total		60

## 4.8.2. Result of Empirical Investigation

There were 12 questions in the questionnaire to collect opinions from respondents. Result of empirical study has been stated individually in coming paragraphs:

### 1. Role of income tax in government's revenue

To know what the role of income tax should be in government's revenue, a question was asked "What do you consider the role of income tax in government's revenue?" The responses are tabulated below.

**Table 4.12**  
**Role of Income tax in Government's revenue**

Responses Respondents	Significant		Moderate		Insignificant		Total	
	No.	Percentage	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	16	80.00	4	20.00	0	0.00	20	100.00
Tax Experts	14	70.00	6	30.00	0	0.00	20	100.00
Tax Payers	11	55.00	8	40.00	1	10.00	20	100.00
Total	41	68.33	18	30.00	1	1.67	60	100.00

Source: Opinion Survey, 2008

From the opinion Survey, it was found that 80 percent of tax administrators, 70 percent of tax experts and 55 percent of tax payers think that the role of income tax to be significant. 20 percent of tax administrators, 30 percent of tax experts and 40 percent of tax payers think it to be moderate and only 5 percent of tax payers thinks it to be insignificant. In total 68.33 percent of respondents consider the role of income tax to be significant, 30 percent respondents to be moderate and only 1.67 percent respondent consider the role insignificant. Thus it can be considered the role of income tax to be significant in government's revenue.

### 2. Contribution of income tax in revenue of Nepal

To know respondent's opinion towards current collection of income tax in Nepal a question was asked, "What do you think about the contribution of income tax in revenue of Nepal?" The responses are summarized below.

**Table 4.13**  
**Contribution of income tax in revenue of Nepal**

Responses Respondents	Satisfactory		Moderate		Unsatisfactory		Total	
	No.	Percentage	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	7	35.00	12	60.00	1	5.00	20	100
Tax Experts	3	15.00	10	50.00	7	35.00	20	100
Tax Payers	6	30.00	12	60.00	2	10.00	20	100
Total	16	26.67	34	56.66	10	16.67	60	100

Source: Opinion Survey, 2008

60 percent of each tax administrators and tax payers thinks the contribution of income tax in revenue of Nepal is moderate 50 percent of tax experts also thinks same. 5 percent of tax administrator, 35 percent of tax experts and 10 percent of tax payers declare this to be unsatisfactory and 35 percent of tax administrators, 15 percent of tax experts and 30 percent of tax payers are satisfied with current contribution of income tax to government's revenue of Nepal. In aggregate 16.67 percent of respondents are unsatisfied and 26.67 percent of respondents are satisfied with current condition. Majority of respondents i.e. 56.66 percent thinks it to be moderate. So it can conclude that the role of income tax in revenue of Nepal is neither so optimistic nor so hopeless. It is in moderate condition.

### 3. Evaluation of new Income Tax Act

As this study focused on effectiveness of new act, respondents were asked "How do you evaluate the income tax act 2002 with compare to former act for the purpose of effective collection of income tax?" The result is tabulated in table 6.4

**Table 4.14**  
**Evaluation of new Income Tax Act**

Responses Respondents	Better		Same		Worse		Total	
	No.	Percentage	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	17	85.00	3	15.00	0	0.00		
Tax Experts	20	100.00	0	0.00	0	0.00		
Tax Payers	18	90.00	2	10.00	0	0.00		
Total	55	91.67	5	8.33	0			

Source: Opinion Survey, 2008

No any respondent thinks the new act to be worse than former act. 91.67 percent of aggregate respondents evaluate the act better which includes cent percent of tax

experts, 90 percent of tax payers and 85 percent of tax administrators, of course a huge population. Only 15 percent of tax administrators and 10 percent of taxpayers evaluates the act as same as former act. So it can be said easily the new act to be better than former.

#### 4. Important provisions in new Income Tax Act

Income tax act 1972 was replaced by income tax act 2002 with some new

**Table 4.15**

#### **Important provisions in new Income Tax Act**

S.N.	Provision	Total Points Received				%	Rank
		Tax Administrators	Tax Experts	Tax Payers	Total		
1.	Classification of source of income	138	147	154	439	20.32	I
2.	Clarity on allowable expenses	157	136	126	419	19.40	II
3.	Method of assessment	125	130	134	389	18.01	III
4.	Provision of fines and penalties	78	70	56	204	9.44	V
5.	Provision of international taxation	52	63	75	190	8.80	VI
6.	Provision for tax on capital gain and dividend	70	57	49	176	8.15	VII
7.	Provision of resident and non resident person	71	70	72	213	9.86	IV
8.	Authorities and responsibilities of tax administrators and tax payers	29	47	54	130	6.02	VIII
	Total	720	720	720	2160	100.00	

Source: Opinion Survey, 2008

features for timely improvement in income tax system. These new features were presented and asked respondents to pick numbers as per importance to know their opinion. The choices of respondents are summarized and tabulated in table 4.15. From the opinion Survey, it was found that the provision of classification of source of income in new act is most important. Serially other provisions are important as listed below:

1. Classification of source of income
2. Clarity on allowable expenses
3. Method of assessment
4. Provision of resident and non resident person
5. Provision of fines and penalties
6. Provision of international taxation
7. Provision for tax on capital gain and dividend
8. Authorities and responsibilities of tax administrators and tax payers other important provisions not included in questionnaire, identified by respondents were:
9. Tax audit
10. Special provisions for banking and insurance business
11. Special provisions for retirement fund
12. Clarity in exemption, rebate and deductions.

To know the relation between views of taxpayers and tax administrators on different provisions of new act, we can test rank correlation coefficient. But the views of tax experts are kept constant.

**Hypothesis:**

There is no significant relationship between the views of tax administrators and taxpayers with respect to provisions of new act.

Calculation of Correlation by formula,

$$Pr = 6.6745 \times \frac{1 - r^2}{\sqrt{n}}$$

Let variable x and y denote views of tax administrators and taxpayers respectively.

**Table 4.16**  
**Correlation Test**

S.N.	Provisions	Total points (x)	Rank (R <sub>1</sub> )	Total points (y)	Rank (R <sub>2</sub> )	Difference of Rank (R <sub>1</sub> -R <sub>2</sub> )	Square of Difference (R <sub>1</sub> -R <sub>2</sub> ) <sup>2</sup>
1.	Classification of source of income	138	2	154	1	1	1
2.	Clarity on allowable expenses	157	1	126	3	-2	4
3.	Method of assessment	125	3	134	2	1	1
4.	Provision of fines and penalties	78	4	56	6	-2	4
5.	Provision of international taxation	52	7	75	4	3	9
6.	Provision for tax on capital gain and dividend	70	6	49	8	-2	4
7.	Provision of resident and non resident person	71	5	72	5	0	0
8.	Authorities and responsibilities of tax administrators and tax payers	29	8	54	7	1	1
Total							$\sum d^2 = 24$

Source: Table 4.15

$$R = 1 - \frac{6(24)}{8(8^2 - 1)} = 0.2857$$

$$Pr = 0.6745 \times \frac{1 - (0.2857)^2}{\sqrt{8}} = 0.219$$

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. That means the opinions of tax administrators and taxpayers' regarding the important provisions of act is significantly different. But there is some relationship between their views because the value of r is moderate.

### 5. Effective and efficient utilization of collected tax revenue

To know respondent's opinion towards the sound efficient and effective utilization of collected tax revenue in Nepal a question was asked, "What is your opinion about the effective and efficient utilization of collected tax revenue of Nepal?" The responses are summarized below.

**Table 4.17**

**Effective and efficient utilization of collected tax revenue of Nepal**

Responses	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	17	85.00	3	15.00	20	100.00
Tax Experts	14	70.00	6	30.00	20	100.00
Tax Payers	5	25.00	15	75.00	20	100.00
Total	36	60.00	24	40.00	60	100.00

Source: Opinion Survey, 2008

From the opinion survey, it was found that 15% of tax administrator, 30% of tax experts and 75% of tax payers did not agree with the Effective and efficient utilization of collected tax revenue of Nepal. In Total 60% of total respondents think that there was effective and efficient utilization of collected tax revenue of Nepal while 40% respondents did not agree. Those respondents who did not agree, another question was asked to know the priorities towards the main causes of disagree. Table 4.18 shows the responses of priorities.



**Table 4.18**

**Main causes of defective utilization of collected tax revenue in Nepal**

S.N.	Provision	Total Points Received				%	Rank
		Tax Administrators	Tax Experts	Tax Payers	Total		
1.	Too much corruption	5	13	60	78	21.67	I
2.	Wasteful government expenditure	4	8	51	63	17.5	V
3.	Problem in implementing program	13	18	43	74	20.55	III
4.	Defective administrative policies	11	25	33	69	19.17	IV
5.	Poor monitoring mechanism	12	26	38	76	21.11	II

Source: Opinion Survey, 2008

From the study of table 4.18 it can be concluded that the priorities of main causes of defective utilization of collected tax revenue in Nepal has been as under:

1. Too much corruption
2. Poor monitoring mechanism
3. Problem in implementing program
4. Defective administrative policies
5. Wasteful government expenditure

**6. Reason for Reduction of Income Tax just after New Act**

In the above chapter it was known that the trend of income tax just after implementation was reduced significantly for few years. To know the view of respondents on this matter one question was asked, "The trend of income tax collection before and after new act is not uniform. Why do you think to be so?" Opinions of respondents are presented below:

**Table 4.19****Reason for Reduction of Income Tax after New Act**

Responses Respondents	Provision of new act		Effect of change		Other reasons such as conflict	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	5	25.00	14	70.00	1	5.00
Tax Experts	7	35.00	13	65.00	0	0.00
Tax Payers	6	30.00	9	45.00	5	25.00
Total	18	30.00	36	60.00	6	10.00

Source: Opinion Survey, 2008

60 percent of total respondents have to say that the effect of change is main reason for reduction. Any kind of change may bring this type of situation. 70 percent of tax administrators, 65 percent of tax experts and 45 percent of taxpayers were of this opinion. Other 30 percent of respondents think it due to provision of new act while remaining 10 percent argued it to be affected by other reasons such as conflict then.

Some of the respondents have picked priority number, no tick mark in questionnaire. They want to tell that little more all of the reasons are responsible, degree of responsibility may only vary. According to result of opinion survey, effect of change is most responsible. Provision of new act and other reasons such as conflict are following factors respectively. This is the conclusion of this question.

### **7. Attitude towards Income Tax System**

There is more than five decades of introduction of income tax in Nepal. Tax system has been suffered from different paces. The objectives of income tax can be fulfilled or not during this period is a vital question. To know what the respondents thinks about development in income tax system they were asked "How is the income tax system in Nepal in your opinion?" Responses are tabulated below:

**Table 4.20**  
**Efficiency of Income Tax System**

Responses Respondents	Sound and effective		Satisfactory		Poor	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	3	15.00	15	75.00	2	10.00
Tax Experts	0	0.00	13	65.00	7	35.00
Tax Payers	0	0.00	10	50.00	10	50.00
Total	3	5.00	38	63.33	19	31.67

Source: Opinion Survey, 2008

Only 15 percent of tax administrator i.e. 5 percent of total respondents thinks the income tax system in Nepal to be sound and effective, while more than this i.e. 31.67 percent of total respondents think it to be poor. Majority group i.e. 63.33 percent of aggregate, which constitutes 75 percent of tax administrators, 65 percent of tax experts and 50 percent of taxpayers, are satisfied with income tax system in Nepal. Satisfactory itself means an average condition. In summary, study shows the system is neither so effective nor so poor.

#### **8. View towards Income Tax Administration**

Questions are always raised about entire government administration of Nepal. Tax system is not an exception. To know the respondents' view about the human resource working in tax administration, a question was asked, "How is the income tax administration in Nepal in your opinion?" The result was found as follows:

**Table 4.21**  
**Effectiveness of Tax Administration**

Responses Respondents	Effective		Satisfactory		Poor	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	2	10.00	17	85.00	1	5.00
Tax Experts	0	0.00	10	50.00	10	50.00
Tax Payers	0	0.00	5	25.00	15	75.00
Total	2	3.33	32	53.33	26	43.33

Source: Opinion Survey, 2008

The result is not in favor of current administration. 43.33 percent of respondents think the administration to be poor. It means some of the respondents

think administration to be poorer than entire income tax system. Among them, 75 percent of taxpayers and 50 percent of tax experts blame administration. Tax administrators themselves are just satisfied with current condition since 85 percent of them choose the answer as satisfactory. Only 10 percent of tax administrators are fully satisfied and thinks the administration is effective. In summary it can be said that the tax administrative system of Nepal is not so effective and needs some kind of treatments.

**9. Change Required in Rules and Regulation**

The existing act and regulation was replaced by new act and regulation recently. One of the objectives of this study was to analysis the change assessed due to this. To know what the respondents thinks about completeness of rules and regulation after change one question "What change should be made in rules and regulation in your opinion to make income system more effective?" Suggestions made by respondents are tabulate below:

**Table 4.22**  
**Degree of Change Required in Rules and Regulation**

Responses	No Change		Timely General changes in rate, amount and limit		Structural change in act and regulation	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	1	5.00	17	85.00	2	10.00
Tax Experts	0	0.00	3	15.00	17	85.00
Tax Payers	0	0.00	9	45.00	11	55.00
Total	1	1.67	29	48.33	30	50.00

Source: Opinion Survey, 2008

This was the question, which shows the vast contradiction between the view of tax administrators and tax experts. Rules and regulations require change or not is not the question of doubt because only 1.67 percent of total respondents think no change is required. Degree of change is the main subject of matter. 85 percent of tax administrators are in side of general change while same numbers of tax experts want the large-scale change i.e. structural change in rules and regulation. Taxpayers

are divided into these two groups about equally. So it is difficult to conclude and recommend the degree of change required in existing rules and regulations.

**10. Way of improving effectiveness of tax administration system:**

For the supplementation of question no 7, if improvement is required in tax administration of Nepal, what should be the degree of change was asked to respondents as "How can be improved the effectiveness of tax administration system?" The respondent response differently as shown in the table:

**Table 4.23**  
**Degree of Change Required in Tax Administration**

Responses  Respondents	No Change		General improvement such as decentralization and delegation		Evolutionary change	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	2	10.00	16	80.00	2	10.00
Tax Experts	0	0.00	8	40.00	12	60.00
Tax Payers	0	0.00	6	30.00	14	70.00
Total	2	3.33	30	50.00	28	46.67

Source: Opinion Survey, 2008

It is already identified that administrative system is not as effective as it requires. 50 percent of total population, which includes remarkable representation of tax administrators, i.e. 85 percent of them thinks general improvement such as decentralization and delegation will solve the problem. But 60 percent of tax experts and 70 percent of tax payers including 10 percent of tax administrators feels evolutionary change is lacking for betterment of income tax administration.

**11. Right treatment to administrative staffs to make them more responsible and energetic:**

Tax administration itself is a system, while organization of administrative staffs is most important part. Without changing attitude and perception of human resource working there, it is impossible to think about any kind of change. If tax system or administration requires change, obviously its initiation is to be taken by

human resource. To know the respondents' view administrative staffs are lacking incentives or they need penalties and punishments to make them more responsible and energetic or current condition is satisfactory, question was kept that "How tax administrative staffs can be made more responsible and energetic?" In contest of our country where government staffs are always criticized for their performance and behavior, what the respondents' answer, let's look at following table:

**Table 4.24**  
**Treatment to administrative staffs to make them more responsible and energetic**

Responses Respondents	Providing different incentives and trainings		Tight rules and regulation in service		Nothing is required	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	17	85.00	3	15.00	0	0.00
Tax Experts	11	55.00	9	45.00	0	0.00
Tax Payers	8	40.00	12	60.00	0	0.00
Total	36	60.00	24	40.00		

Source: Opinion Survey, 2008

Nobody is satisfied with current performance of administrative staffs, since no one thinks nothing is required. Obviously 85 percent of tax administrators want different incentives and trainings to improve performance of staffs, which is usual. 55 percent of tax experts and 40 percent of taxpayers support them. In the other hand 60 percent of tax payers demand tight rules and regulation in service to bind them and get support from 45 percent of tax experts and 15 percent of tax administrators. There is no exact choice since views of respondents have divided into 60:40 ratios. So it can be said that both kind of treatment is essential, incentives are to be provided firstly and if performance already not found to be satisfactory, provisions of penalties should be introduced.

**12. Way to make taxpayers more responsible**

Responsible taxpayers are the most important factor of effective and sound tax system. Our tax system cannot be exception. Whether the question is raised

about tax system, we must look at different factors related to taxpayers. These factors may be degree of awareness, feelings of responsibilities, attitude of taxpayers, economical environment etc. If our tax system is seems to be not efficient, we must consider the side of taxpayers. To know how the respondents think to improve attitude of taxpayers, question was asked "What is the most suitable way to make taxpayers more responsible?" Suggestions made by respondents are tabulated below:

**Table 4.25**  
**Way to make taxpayers more responsible**

Responses	Awareness through media		Harder provisions in rules		Incentives such as prize and respect		Nothing is required	
	No.	%	No.	%	No.	%	No.	%
Tax Administrator	9	45.00	5	25.00	6	30.00	0	0
Tax Experts	7	35.00	6	30.00	7	35.00	0	0
Tax Payers	8	40.00	2	10.00	10	50.00	0	0
Total	24	40.00	13	21.67	23	38.33	0	0

Source: Opinion Survey, 2008

From the opinion Survey, it was found that 45 percent tax administrator, 35 percent tax expert and 40 percent of taxpayers think taxpayers not to be aware. So they recommend for awareness through different media. 21.67 percent of respondents have opinion that taxpayers are aware but have intension to evasion so it requires harder provisions in rules. Fines, penalties, punishments etc. can bring them in track. Other 38.33 percent respondents including 50 percent of tax payers, 35 percent of tax expert and 30 percent of tax administrators identify the tax payers as responsible citizens and argued incentives such as prize and respect will motivate them. According to survey result, all provisions are to be implemented simultaneously.

## 4.9. Major Findings

Major findings of this study through different analysis are summarized below:

1. 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 reached to 45892.5 million in 2006/07. It is continuously increasing rapidly.
2. The basic sources of revenue are tax revenue and non-tax revenue but collection of these revenues is not sufficient to cover expenditure in Nepal. The tax revenue has very dominating role i.e. 73.08 percent of total revenue in 1991/92 and 81.09 percent in 2006/07. Share of non-tax revenue for the same period seems to be 26.92 percent and 18.90 percent respectively. The tax revenue contributed amount of 9875.6 million and 71127.00 million in 1991/92 and in 2006/07 respectively.
3. The tax revenue constitutes direct and indirect tax. Within indirect tax the VAT and costume are in first and second position by their share in total indirect tax in recent years. Indirect tax has a leading role in total tax revenue. Its share was 83.85 percent in FY 1991/92 and reduced to 73 percent in 1999/00 and gradually increased to 75.68 percent in 2005/06.and again reduced to 73.31% in year 2006/07.
4. Direct tax is levied by government for income generation and holding of wealth. In Nepal direct tax is the composition of land revenue and registration tax and tax on property, profit and income. The land revenue and registration is in increasing trend and has reached to 2253.5 million and occupies 11.87 percent of direct tax.
5. Income tax is the major source of direct tax revenue. The amount from income tax was 875.0 million in 1991/92 and was 15034.00 million in 2006/07. Income tax constitutes Income tax from public enterprises, semi public enterprises, private corporate bodies, individual, remuneration and tax on interest.
6. The role of income tax from public enterprises is significant. It has contributed 22.2 percent to total income tax in average. The share of income tax from



private corporate bodies is 17.2 percent in average. Income tax from public enterprises has mostly effected. Its contribution was 2928.0 million in 2000/01 and is unable to meet the record again. It declined to 1769.3 and 1251 for first two years of new act. It has positive symptom in 2003/04 when growth of 64 percent occurs but after this, its condition is poor. For year 2005/06 its decline rate is 85.3 percent. The effect in income tax collection from private corporate bodies is declined for first two years of new act, slow growth for third year and rapid growth for last two years. The effects of act seem to be very positive as its contribution to total income tax has risen to 32.8 percent for FY 2005/06 and 38.02% for F/Y 2006/07.

7. Income tax from individual has the major role in income tax and bears dominating role in period of the study. It has contributed up to 70.6 percent in 1991/92. Its lowest share is 34.81 percent in 2006/07 and average share is 46.08 percent. Income tax collection from individual has increased by 27.5 percent in 2001/02 with second largest amount of its share of 4419.1 million but it decreased for 2002/03 to 3362.3 million and increasing gradually for the last four years.
8. Income tax from remuneration was 54.7 million in 1991/92 and reached to 2007.9 million in 2006/07 with regular growth. Its share in total income tax is also positive and is highest year of 2005/06 i.e. 17.0 percent in. Average contribution is 8.76 percent within study period. Income tax from remuneration is not declining after introduction of new act. It is continuously rising within study period from 54.7 million in 1991/92 to 2007.9 in 2006/07.
9. Tax on interest is another source of income tax, which had slow increasing trend in amount and contributes 5.66 percent in total income tax revenue in average.
10. Performance of Income Tax before and after New Act seems not regular. The new income tax act is introduced on 2001/02 and total income tax has first time declined by 210.3 million and by -2.3 percent that year. It further decreased by 937.5 million and -10.5 percent for FY 2002/03. In 2000/01 growth rate was 22.8 percent and that was more than 20 percent for other preceding years but is just 2.1 percent in year 2005/06.

11. It was not due to other reasons because other economic activities did not show this type of fluctuating situation. Comparison of income tax with other economic factors such as GDP, total revenue, total tax revenue and total direct tax revenue shows the facts, which were also fluctuating.

An empirical study was conducted during the study to know the views of different sector of income tax about role of income tax, features of new act, condition of income tax system and administration in Nepal and suggestion for betterment of income tax system in Nepal. Major findings identified from empirical study are as follows:

1. Role of income tax should be significant in government's revenue.
2. Contribution of income tax in revenue of Nepal is neither so optimistic nor so hopeless. It is in moderate condition.
3. Income tax act 2002 has better provisions than former act.
4. Classification of source of income, clarity on allowable expenses, method of assessment, provision of resident and non-resident person etc is the major important factors of new act. Tax administrators and taxpayers have not same view towards importance of factors.
5. Parities of causes of defective utilization of collected tax revenue in Nepal are too much corruption, poor monitoring mechanism, problem in implementing program, defective administrative policies and wasteful government expenditure.
6. Effect of change is most responsible for not uniform contribution of income tax before and after enactment of new act. Provision of new act and other reasons such as conflict are following factors respectively.
7. Income tax system in Nepal is neither so effective nor so poor. It is just satisfactory which means average condition.
8. Tax administrative system of Nepal is not effective and needs some kind of treatments

# **CHAPTER FIVE**

## **SUMMARY, CONCLUSION AND RECOMMENDATION**

### **5.1. Summary**

The role of government is increasing as concept of welfare state is introducing. It requires fund to improve lifestyle of people, lunch public welfare program and maintain law and order. Fund is collected by government through external and internal sources. External sources such as foreign loan, grants, borrowing etc is not certain and not good for sustainable economic development of country so any government has to emphasis on internal sources such as tax and non tax revenue to collect necessary fund.

Nepal is one of the least developed countries of the world. Besides it is trying on planned development over five decades, already suffering from resource constraints, massive poverty, rapid growth of population, increasing frictional and seasonal unemployment, diseases, aggressive dependent on the agriculture, subsistence living standards and poor infrastructure. To overcome such serious problems government requires lots of fund but resource mobilization is still poor in Nepal. The resources gap i.e. the gap between government expenditure and internal source is widening continuously. There is no alternative to mobilize internal resources and collect funds internally through revenue for rapid and sustainable economic growth.

Revenue constitutes tax and non-tax revenue. Direct tax and indirect tax are branches of tax revenue and income tax is one of the major sources of direct tax. Income tax is imposed on net income of natural as well as legal person. It is called personal income tax if levied from natural person and called corporate income tax if levied from any corporation.

History of income tax starts from eighteenth century in world, initiated from Britain. In Nepal systematic provisions of income tax was introduced in 1959 through economical act. Business Profits and Remuneration Act 1960 and Nepal Income Tax Act 1962 made the provisions more systematic and effective. Income Tax Act 1974

was introduced after long consultations and homework according to economic policy of nation then. Different amendments were made in the act for timely corrections. To make timely improvement in Nepalese tax system according to modern economy and tax system of other countries and facilitate the system with concept of world trade, globalization, economic liberalization etc, Income Tax Act 2002 was passed through legislation and carried in practice.

This act has broadly divided the income into three categories: Employment income, Business income and Investment income. It has some new features such as concept of capital gain, pool system of depreciation, resident and non-resident person, international taxation etc and has made timely improvement in some other provisions.

## **5.2. Conclusions**

Nepal could not attain higher economic growth despite the five decades of planned development efforts. Though the country attained annual average economic growth of 5 percent in the Eighth and Ninth Plan periods, the growth rate remained 3.4 percent in the Tenth Plan period (2002/2003-2006/07). Amongst the projected average annual growth rate of 6.2 percent at the higher side and 4.3 percent at the lower side, Nepal's average annual growth was less than the lower limit. Political instability and armed conflict adversely affected the development efforts and worsened the internal and external investment environment. While neighboring India and China could attract huge level of foreign direct investment in the past couple of years, foreign investors did not choose Nepal as their investment destination on the face of surrounding instability and uncertainty due to the conflict. Also, the level of domestic saving mobilization remained low resulting in a saving-investment gap at a whopping 20.5 percent in FY 2007/08. This reinforces the need for higher level of domestic saving mobilization for the sustained increase in investment. At the same time, it is important to recall that Nepal could hardly remain aloof from the main stream of globalization whatsoever the gravity of the problems surrounding the domestic realm. Nepal has no alternative of developing an investment friendly environment and tapping the advantage of globalization that has eased the transfer

of capital, technology, and know-how. Only after this, the much-awaited economic transformation in the aftermath of the political regime shift is possible. The current challenge is to mobilize investment internally and externally by strengthening institutions. However, this requires guaranteeing rule of law, smoothening service delivery, and establishing a transparent and effective administrative mechanism.

Internal revenue collection is the most reliable alternative to bear expenditure of government and conduct development activities. Income tax is one of the important and relevant sources of revenue since it follows the basic principles of taxation such as equity and progressives.

State makes policies, rules and administration as per need of entire country to collect revenue through tax and non-tax sources. Nepal has made change in income tax act in 2002 as per need. The change has shown some effects on collection of income tax. It has broken the trend then and has got a new trend after the year. Although there are some difficulties in language, discretionary power etc., different provisions in new act are as per need of time and economic environment. A well implementation of this act will guide Nepalese income tax system to helpful direction.

Income tax system in Nepal is not fully satisfactory. Due to economic liberalization and globalization, very important sources of revenue i.e. custom duty is not in condition to bare its current share in coming days. So importance of internal sources such as income tax will increase in coming days. But there are many problems in Nepalese income tax system. Inefficient tax administrative system, widespread income tax evasion, complicated and frequent change in tax rate and lack of awareness and feelings of responsibility in tax payers are appearing as major factors of low contribution of income tax in national revenue. Internal conflict of nation and instability has affected the economic system indirectly but very seriously. It has damaged as well as destroyed the environment for generating more income, where income is limited; certainly the tax from income will not be so optimistic. In changing scenario, it seems to be necessary to give sufficient attention towards income tax system by all concerned parties for rapid and sustainable economic development.

### 5.3. Recommendations

Nepal has now entered into federal republican state. In addition to paving the way for economic development through high and sustainable economic growth, there is an urgent need to take immediate and long run measures to expand economic activities in order to fulfill peoples' heightening aspirations. On one hand, there is a need to promote inclusion by caste, sex, language and region into the process of economic development and opportunities and, on the other, there is a need to give special emphasis on development of quality human resource by balancing possible issues raised by different groups and sectors. If the State mechanism has to concentrate on the issues raised by one particular group or region, it will not only affect the quality service but could also affect the process of creating an investment friendly environment. To attain higher and sustainable economic growth, there is a need for maintaining balance between the equitable participation of all groups and sectors and quality services through the state mechanism. The following suggestions are made for betterment of income tax system in Nepal:

- 1) Overall revenue policy as well as tax policy should be revised through detail and critical analysis of situation.
- 2) Before making any kind of change in policy, rules and regulation, whole system is to be prepared to accept it.
- 3) All stakeholders are to be aware about the change in detail.
- 4) Organizational system to be established for broadens tax net. Special provisions for tax evaders and persons conducting business without registration should be introduced.
- 5) Provisions of act and regulations are to be improved or changed as per need. Following factors are to be considered while making change:
  - a) The language should be clear and simple.
  - b) Rules and regulations should not be changed for just change. It should fulfill the need of situation and time and should be based on ground of reality.
  - c) Provisions of fines and penalty amount and rate are to be revised each year.
  - d) Discretionary power of the tax officials should be curtailed by act.

- 6) Administration is the tool to implement all policies and rules. So, effectiveness of income tax system depends upon the income tax administration. It is clear that the effectiveness is lacking. Suggestions for improvement of income tax administration are as follows:
  - a) Administrative staffs should be well trained about system.
  - b) Monetary and non-monetary incentives are to be provided to administrative staffs as per need to motivation and to improve their performance.
  - c) Provisions of penalty and punishment should be realistic and logical. It should be well implemented for them who do not fulfill their responsibilities and expects unlawful returns.
- 7) Taxpayers are the most important factor of tax system. Suggestions regarding tax payers are as follows:
  - a) Awareness and brain storming of taxpayers should be emphasized. Workshops and media should be used to educate taxpayers and improve their attitude.
  - b) Regular and effective reward system should be started for responsible taxpayers to encourage paying tax voluntarily.
  - c) Harder provisions of fines, penalties and punishment should be well implemented to intentional tax evaders.
- 8) Tax offices should be decentralized for broad coverage of geographical region. Separate income tax department should be established for specialization of income tax.
- 9) Different recent technologies such as e-taxation should be introduced and promoted to avoid complexities and delay in income tax administrations. Tax audit system should be timely improved and equipped to work with modern technologies of account keeping.
- 10) The gap between the expenditure and revenue must be lowered for fiscal stability. Since there is a mismatch between the two, the gap has not been reduced. In this context, the effort must be given to increase revenue, increase the grant component in foreign aid, improve recurrent expenditure management and speed up the capital expenditure.

- 11) Long-term revenue policy should be formulated to tie up revenue with the economic growth, making revenue growth perfectly elastic to economic growth. This policy must help in fuller utilization of domestic resources, attracting foreign resources, adjusting the tax rates as per the commitment expressed in the international organizations, expanding the tax base so as to make the revenue growth suitable for a longer period, and ensuring effective implementation under the specified timeframe.
- 12) It has been seen that the firms registered in income tax are showing artificial losses to evade income tax and some persons are evading tax through transfer pricing in the same business group on the basis of involvement in various activities that attract different tax rates. Such tax leakages should be controlled.
- 13) Revenue mobilization remained satisfactory in the last two years. To give continuity to this, the challenge is to control tax leakages after identifying the possible leakage areas, especially in VAT and income tax, the two major contributors of tax revenue. Areas such as the expansion of tax base and change in tax rates should be reviewed revised and implemented them in addition to developing programs related to tax education and tax awareness so as to increase revenue mobilization. Similarly, the services delivery by the tax administration to the taxpayers needs to be improved as per the need of the time. Revenue leakages through the rampant and illegal use of the duty-free goods need to be controlled. Efforts should be made towards full atomization of tax administration, simplifying income tax procedures and reducing tax exemption limit. As the revenue mobilization is based on the efficiency of tax administration, effectiveness and professionalism, imparting the training for the human resources to effect structural changes in the tax administration seems inevitable.



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## **WEBSITES:**

[www.mof.gov.np.com](http://www.mof.gov.np.com)

# APPENDIX- 1

## QUESTIONNAIRE

Dear Sir/Madam

I have been writing a thesis on " **Impact of Income Tax in National Revenue (Before and after enactment of Income Tax Act 2058)** " in Partial fulfillment of the requirement of Master of Business Studies (MBS). This questionnaire has been developed and presented towards you as a part of study. The issues raised in this questionnaire are related to the study of researcher.

I humbly request you to fill it up at the best of your knowledge. Your kind cooperation in this regard will be great value for me. I shall be highly obliged for prompt responses as for as possible.

Thank you  
Laxmi Devi Bashyal  
Researcher  
Padmakanya Multiple Campus,  
Bagbazar, Kathmandu  
MBS final year

Name of Respondents: ... ..

Designation: ... ..

Category: Tax Administrator/ Tax Expert/ Tax Payer Office/Organization: ... ..

You are requested to tick the answer of your choice or specify numbers or texts as per question format.

- 1) What do you consider the role of income tax in government's revenue?  
a) Significant                      b) Moderate                      b) Insignificant
- 2) What do you think about the contribution of income tax in revenue of Nepal?  
a) Satisfactory                      b) Moderate                      c) Unsatisfactory
- 3) How do you evaluate the income tax act 2002 with compare to former act for the purpose of effective collection of income tax?  
a) Better                      b) Same                      c) Worse

4) What are the most important factors of Income Tax Act 2002 in your opinion?

(Prioritize):

- a) Classification of source of income. ( ... )
- b) Clarity on allowable expenses. ( ... )
- c) Method of assessment. ( .... )
- d) Provision of fines and penalties. (.... )
- e) Provision of international taxation. ( ..... )
- f) Provision for tax on capital gain and dividend. (.... )
- g) Provision of resident and non resident person. ( ... )
- h) Authorities and responsibilities of tax administrators and tax payers. ( .... )
  - i) Other: (Specify)

5) Is there effective and efficient utilization of collected tax revenue in Nepal?

- a.) Yes (.....)      b.) No (.....)

If no, what should be the main cause?

(Prioritize):

- a) Too much corruption. ( .....)
- b) Wasteful Government expenditure. ( .....)
- c) Problem in Implementing Programs. ( .....)
- d) Defective administrative policies. ( .....)
- e) Poor monitoring mechanism. ( .....)
- i) Other: (Specify)

6) The trend of income tax collection before and after new act is not uniform. Why do you think to be so?

- a) Provisions of new act
- b) Effect of Change
- c) Other reasons than act such as conflict.

7) How is the income tax system in Nepal in your opinion?

- a) Sound and efficient                      b) Satisfactory                      c) Poor

8) How is the income tax Administration in Nepal in your opinion?

- a) Effective                      b) Satisfactory                      c) Poor

9) What change should be made in rules and regulation in your opinion to make income tax system more effective?

- a) No change
- b) Timely general changes in rate, amount and limit.
- c) Structural change in act and regulation.

10) How can be improved the effectiveness of tax administration system?

- a) No change
- b) General improvement such as decentralization and delegation
- c) Evolutionary change

11) How tax administration staffs can be made more responsible and energetic?

- a) Providing different incentives and trainings
- b) Tight rules and regulation in service
- c) Nothing is required

12) What is the most suitable way to make taxpayers more responsible?

- a) Awareness through media
- b) Harder provisions in rules
- c) Incentives such as prize and respect.
- d) Nothing is required

13) You have any other comments and suggestions about income tax in Nepal?

Please specify ... ..  
 .....  
 .....  
 .....  
 .....  
 .....

 Thank you for your kind Co-operation 



## CURRICULAM-VITAE

NAME : BASHYAL , LAXMI DEVI  
 FATHER'S NAME : YAGYA PRASAD BASHYAL  
 DATE OF BIRTH : 2041/02/12 BS (25th May 1984)  
 MARITAL STATUS : MARRIED  
 SEX : FEMALE  
 HUSBAND'S NAME : KRISHNA PRASAD ADHIKARI  
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### ACADEMIC QUALIFICATION:-

SN	LEVEL	SCHOOL/CAMPUS	BOARD / UNIVERSITY	PASSED YEAR	DIVISION	%
1	MASTERS IN BUSINESS STUDIES	PADMAKANYA MULTIPLE CAMPUS, BAGBAZAAR, KATHMANDU	TRIBHUVAN UNIVERITY (TU)	1st Year	1st	65.33
				2nd Year	1st	65.33 Without thesis
2	BACHELOR'S DEGREE IN BUSINESS STUDIES (BBS)	PADMAKANYA MULTIPLE CAMPUS, BAGBAZAAR, KATHMANDU	TRIBHUVAN UNIVERITY (TU)	2062 BS 2005 AD	2nd	47.93
3	INTERMEDIATE LEVEL ON COMMERCE (10+2)	DARLAM DANDA HIGHER SECONDARY SCHOOL, DARLAMDANDA, PALPA	HSEB, NEPAL	2059 BS 2002 AD	PASS	42.10
4	SCHOOL LEAVING CERTIFICATE (SLC)	DARLAM DANDA HIGHER SECONDARY SCHOOL, DARLAMDANDA, PALPA	NEPAL (HMG)	2056 BS 2000 AD	2nd	54.29

### PROFESSIONAL SKILLS & EXPERTISE :-

I) Six month Computer course from St. Xavier Institute Pvt. Ltd. Bagbazaar , Kathmandu. (10<sup>th</sup> Feb.2005 to 10<sup>th</sup> Aug.2005).

### TRAINING: -

I) Nine days management training conducted by Management Student's Association of Nepal from (2<sup>nd</sup> Sept..2006 to 10<sup>th</sup> Sept.2006).

II) Ten days Banking Training on NRB hall organized by Management Student's Association of Nepal from (29<sup>th</sup> June 2007 to 8<sup>th</sup> July 2007).

**Member:-** Management Student's Association of Nepal (MSAN)

### **Others:-**

Lower Secondary Level Teaching Licence  
 Citizenship No :- 103052 (Palpa),

All the information stated in this CV is true & best of my knowledge.