CHAPTER - I

INTRODUCTION

1.1 Background of the Study

Economic development is the prime concern of every nation of the world. For the economic development, government has huge responsibilities towards the people. To fulfill the responsibilities, government needs revenue to operate different activities in a country. Such activities include general activities and developing activities. General activities incurred for the protection of common people and public administration. Development activities incurred for providing transportation, education, health and public utilities facilities to the community. Government collects revenue through two sources: (i) internal & and (ii) external sources. Developing countries like Nepal have limited sources of internal funds. So most of the development activities of the nation depend on the external sources. The external sources of financial are bilateral and unilateral grants, Loans from foreign countries and fund from donor agencies. These sources have been limited, inconvenient and not suitable to boost up the Nepalese economy due to the vested interest of the programs and policies of the donor countries and agencies and need to pay high interest accepting the inappropriate condition to take the loan. Government tries to finance resources through internal sources. It is very important for developing country like Nepal to mobilize internal resources where adequate natural resources and low cost labor force are available. Situation of Nepal is different. Nepal is not mobilizing its natural resources effectively, Small and stagnant industrial sector, partial Monetization of the economy, poor performance of public sector enterprises, poor rate of economic growth, inadequate tax *efforts,* deficiencies on tax policies, laws and administration etc.exist here. Internal sources of public fund are important not only for necessary financing funds, but also for proper utilization of external sources. Based on the nature of sources, public funds are also classified into revenue (public income) and borrowing (could be external and internal). The public income or revue includes: a) taxes (b) revenue from Government corporations and public enterprises (c) fees (d) special assessment (e) fines and penalties. Among them tax is the main sources of collecting the government revenues. In Nepal About *7'7%* of total revenues comes from tax revenues and the rest 23% from non-tax revenue (Amatya, Pokheral and Dahal, 2004).

According to Seligman (Kandel, 2005) "A tax is a compulsory contribution from the person to the government to defray the expenses incurred in the common interest of all without references to special benefit conformed." Kandel again, cited that the tax is levy paid or to be paid by the natural or an artificial person to the government without getting corresponding benefits of goods or services provided by government. Thus, taxes play vital role in the government revenue. Simply, tax is a compulsory contribution to the state from a person. The natural person or artificial person (entity or corporate body having tax liabilities pay taxes to the government. The taxpayer does not receive the equivalent benefit from the government. Tax is paid to government and the amount of tax is spent for common benefits and interest of the people. Taxes are classified into two major categories viz, direct tax and indirect tax. The tax directly paid by a person on whom it is legally imposed is known as a direct tax. Such tax is income tax, gift tax, interest tax, property tax, vehicle tax, house & Land tax, contract tax etc. Indirect taxation means a tax that is imposed to one person but partly or totally paid by another. Such tax may be custom duty, value added tax, entertainment tax., excise duty, sales tax, hotel tax, passenger tax etc. In Nepal. direct tax contributes about 21% and Indirect tax contributes about 79% in the tax revenue of government (Amatya, Pokharel and Dahal, 2004).

Income tax is one of the most popular direct taxes. It is charged on person income according to the law of nation. Income includes all the income, which are receiving from business, investment & employment. Income tax is superior to indirect tax because it is imposed on the basis of paving capacity of the taxpayer. People whose income is below the taxable income are free from the obligation of income tax. It may possible to reduce the gaps in income by imposing higher rate to those who are having high income and from that collected amount, providing necessary to the people with very poor economic condition. Hence it will help for the people with very poor economic condition. It may help to make equitable economic distribution in the society. Balanced regional economic development is also possible through the provision of income tax. The government should charge higher income tax on the income from urban area and less on the income from remote area. Income tax holiday and incentives would help to develop the priority sector of a national economy. "Income tax has become an effective investment to ensure balanced socio-economic growth" (Mathew (1975), Musgrave & Musgrave, (1998).

Income tax plays an important role in the Nepalese economy. It is the major source of government revenue. It is recognized as a good financial tool to narrow inequality of income. It helps to reduce regional economic imbalance by providing tax concession and holiday to business or industry, which are established in remote area. It is also helpful for generating the concept of social responsibility towards the nation and keeps the people vigilant to see the public money may not be misused.

The contribution of income taxes is much smaller to the total revenue for developing countries in comparison to developed countries and is likely to remain same for sometime despite the efforts over the years for the least developed countries to raise more revenue. There are mainly four reasons as why income tax yield is less in developing countries as compared to developed ones. They are problems of defining income, problems of assessing and measuring it, the choice of rates, allowance and deducting and difficulties of tax collection. Income tax is main source of government revenue. It is useful to balance economic development. Nobody can have doubt that the equal distribution of income is also possible through progressive income tax. It is being realized that contribution of income tax to the revenue of government must be increased in Nepal. Nepal has adopted the income tax system for last four and half decades. But Nepal's past experience shows that the government is unable to maximize the share of income tax to the public fund as per expectation. Being developing country, Nepal has been facing many problems in financial sectors. Merchant Bank plays a vital role in economic and financial development of the country. They work as a bridge which provides every kind of financial assistances to the industries and commerce. They play a highly significant role in mobilizing funds of savers to ingestible channels assuring of promising return on investments and thus can help in meeting the widening demand for ingestible funds for economic activity. The service of merchant banker could cover project counseling and pre-investment activities, feasible studies, project reports, design of capital stricture, issue management and underwriting loan, syndication, foreign currency finance, merger, amalgamations and takeover, venture capital and public deposits. Finance Company Act 2042 permits finance companies as a merchant banking Service. Although a few financial institutions (basically finance companies) are involved in different merchant banking activities, lots of financial systems are being slowed down due to insufficient capital technical a financial support. Merchant banks encourage them by its versatile service like project counseling, corporate counseling, portfolio management and venture capital and issue management.

Name list of (namely pointed out) merchant banking & finance companies, which are licensed by NRB up to mid-Jul. 2007 are as below:

Table 1.1

Name list of Merchant Banking & Finance Companies

S.N	Names	Operation Date (A.D)	Head Office
1	Nepal Merchant Banking & Finance Ltd.	1996/11/26	Durbarmarg. Ktm
2	Nepa1 Shreelanka Merchant Banking & Finance Ltd.	1996/02/04	Kamaladi. Ktm
3	Nepal Housing & Merchant Finance Ltd.	1995/04/11	Dillibazar, Ktm
4	Cosmic Merchant Banking & Finance Ltd.	2000/11/20	Durbarmarg, Ktm.
5	Capital Merchant-Banking &. Finance Ltd.	2002/02/01	Battisputali. Ktm
6	Royal Merchant Banking & Finance Ltd.	2002/02/14	Durbarmarg, Ktm.
7	Guheshwori Merchant Banking & Finance Ltd.	2002/06 13	Jawalakhel
8	World Merchant Banking & Finance Ltd.	200 1/08/10	M.Road, Hetauda
9	Kist Merchant Banking & Finance Ltd.	2003/02/21	Kamlpokani Ktm.
10	Prudential Merchant Banking & Finance Ltd.	2003/06/06	Dillibazar. Ktm.
11	Sagarmatha Merchant Banking & Finance Co.	2005/08/29	Manbhawan

Out of them only eight financial companies are operating more than five years up to mid-July, 2007. However this study contains only seven financial companies, they are;

1. Nepal Merchant Banking & Finance Ltd.
2. Nepal Shreelanka Merchant Banking & Finance Ltd.
3. Nepal Housing & Merchant Finance Ltd.
4. Cosmic Merchant Banking & Finance Ltd.
5. Capital Mrechant Banking & Finance Ltd.
6. Royal Merchant Banking & Finance Ltd.
7. Guheshwori Merchant Banking & Finance Ltd.

A good merchant banker would be consider being one who is expert, honest, have integrity and capacity to develop public relation. Whenever a business concern needs finds from the capital market it would usually approach the merchant banker rather than banks or financial institutions. By providing various services to public, business organization and government, merchant banking and finance companies earns profit because they are profit-oriented entities so they must pay income tax out of their net profits. It is therefore income tax of merchant banks and finance plays a role like a brick in government revenue.

1.2 Statement of Problem

Underdeveloped countries are facing various problems in the process of economic development. For the economic development sufficient resources is needed. One of the major sources of the public revenue is income tax in Nepal. It charged on person's income. With the increase in government expenditure, the source government revenue must be increased. But the expenditure of government of Nepal has been increasing in a faster rate than the increase revenue. Being developing country most of Nepalese people are below the poverty line nearly one third of the total population (about 31.8%) live below poverty line as per the Nepal Standards Survey 2003/04 and GDP per capita is $ 383 (According to MOF Report 2006/07). It shows that it needs huge amount of capital for economic development of Nepal. It is possible only when the volume of resource matches with the requirement.

Nepal is a developing country. Most of the developing countries of the world should make investment heavily on infrastructure and activities for balance social and economic development of the nation. That is why the government has been pressured to spend huge amount in education, health, physical construction and so many areas. There seem to be three reasons contributing to strong pressure to spend (Leaving aside general price changes): the growth of population, the emergence of strong local and the emergence of strong world options.

The development of the country will be possible when the government can mobilize its own internal revenue, which constitutes tax and non-tax revenue.

Tax revenue constitutes a significant position in government revenue. In the total tax revenue indirect tax has greater portion than direct tax. In Nepal only *0.5%* of the total population pays the income tax (Economic Survey 2005/06) Past experience shows that, there is poor tax paying habit in Nepalese people. There are various problems about income tax administration like, no proper record about the number of income tax payers, defective selection of personnel, lack of training and education to tax payers and tax officers, undue delay in making assessment, lack of responsibilities of officials on their work, existence of corruption and lack of motivation to concerned authorities etc. Because of the inefficiency of the administration and increasing corruption, people have to have faith in the working of government and its organizations.

The income tax is the vital source of the government revenue. Two types of income tax are applied i.e. personal income tax and corporate income tax. Most of the personal taxpayers do not reveal the income sources even they earn significant amount. They hardly keep the accounts. Similarly, some companies have been practicing to evade the tax liabilities by hiding incomes. As a result, the actual collection of income tax is very low and problem has been stable continuously due to corruption too. The laws of tax authorities also cause low revenue generation of the government. The discretionary power of the tax personnel and the tax assessment procedure or the income tax system of Nepal harass the taxpayer in the payment of tax and establish the cause for reduction in the income tax revenue.
Similarly the department cannot find out the actual number of income tax payers. In the context of developing countries like Nepal, government can not raise more income tax from corporation because high income tax may discourage the formulation of corporation. Government of Nepal is being unable to realize the

expected income tax from personal as well as corporation. There is no proper supervision over the staff member of tax collection department. Corruption is the main problem of tax administration. There is no reliable and sufficient data for tax purpose. However Merchant Banks and Finance companies assist government to collect its revenue though making profit from the financial transaction rendering service to the public and business organization and pay income tax from their taxable income.

1.3 Objectives of the Study

The main objective of the study is to analyze the income (corporate) tax collection from Merchant Banks and Finance companies by the government for the last five years. The other major objectives of this study are listed below.

- To analyses the role of income tax in Nepal.
- To introduce merchant banking and finance Service in Nepal and evaluate the contribution of income tax paid by selected merchant banks & finance companies to the government revenue.
- To assess the contribution of income tax paid by selected merchant banks & finance companies on total income tax and total tax revenue of the government.

  To forward the appropriate suggestions and recommendations for the identified issues.

1.4 Significance of the Study

For the economic development of the nation it is necessary to have huge amount outlay. But resources are limited. Government should identify the potential taxpayer and should give more emphasize to collect more revenue from them. For the economic development of the country contribution of direct tax is more essential rather than indirect tax. But the whole tax structure in Nepal is dominated by indirect tax. Among the direct tax income tax plays a significant role. It is one of the major resources that can be increased through proper correction in collection procedures and identification of potential taxpayers. So it becomes necessary to analysis the different taxpayers under each head and income tax collected from each group of taxpayers time to time.

To increase the portion of national revenue, research and analysis should be done in the field of income tax. But the studies and research work is lacking in the area of income tax. Merchant Banks & Finance are also income taxpayers. The problems they are facing in tax saving should be corrected so they may contribute more income tax the national receipt. Merchant Banks & Finance are such institutions, which are directly linked with most other business activities. The position of business trade and industries can be visualized through the analysis of activities of Merchant Banks & Finance Companies. This study is concerned with appropriate suggestions for the estimation, correction and provides comprehensive information about income tax. Besides, this analysis may be useful to make new policies for granting various facilities to the Merchant Banks & Finance for making more taxable income in the competitive environment and legal correction, vague section of income tax can be also rectified from such analytical study.

This study is concerned with these aspects and it tries to make appropriate recommendation for the correction of problems in paying income tax by Merchant Banks & Finance Companies. Besides, this study will also be useful to the tax planners, bankers, tax authorities and many others like teachers, students, researchers and people who are interested on it.

1.5 Limitation of the Study

As every research study is followed by some limitations, this study is also not free from limitations. The Major limitations are mentioned below:

1. The study will be concerned only on those selected financial institutions, which are (namely pointed out) Merchant Banks & Finance Companies.
2. This study concentrates on the income tax realization from selected seven Merchant Banks & Finance Companies. They are
   - Nepal Merchant Banking & Finance Ltd. (Bittiya Sanstha)
   - Royal Merchant Banking & Finance Ltd. (Bittiya Sanstha)
   - Cosmic Merchant Banking & Finance Ltd. (Bittiya Sanstha)
   - Capital Merchant Banking & Finance Ltd. (Bittiya Sanstha)
   - Guheshwori Merchant Banking & Finance Ltd. (Bittiya Sanstha)
   - Nepal ShreeLanka Merchant Banking & Finance Ltd. (Bittiya Sanstha
   - Nepal Housing & Merchant Finance Ltd. (Bittiya Sanstha)
3. The study has covered the data from fiscal year 2002/2003 to 2006/2007
4. Mainly secondary data have been used.

1.6 Design of the Study

The Study has been divided into major five chapters. They are as follows:

Chapter – I: Introduction

The first chapter has covered introduction, background of the study, Statement of the Problem, objective of the study, significance of the study, limitation of the study and design of the study.

Chapter – II: Review of Literature

The second chapters will focus on review of literature. It will be related on the survey of books, journals, thesis and dissertation and articles.

Chapter – III: Research Methodology

The third chapter deals with research methodology to be adopted for study consisting introduction, research design, population and sample nature and sources of data, data collection procedures variable and tools and technique employed.

Chapter – IV: Data Presentation and Analysis

The fourth chapter is related with the presentation & analysis of gathered data with figure and picture and major findings.

Similarly, **Chapter – V: Summary, Conclusion and Recommendations**

The fifth chapter deals with summary, conclusion, recommendations and suggestion.

CHAPTER - II

REVIEW OF LITERATURE

Government expenditure is increasing day by day because of demand of time, increase in population, social progress, increase in price, security etc. To meet the growing public expenditure the government has to manage its fund. It is received from different sources. To fulfillment the responsibility, the government collects revenue from public enterprises, specially assessment, fees, fines and assistance. Among them tax is main source of government revenue. In simple terminology tax is a liability to pay an amount to the government. It is compulsory contribution to the national revenue from the tax payers according to law.

According to Prof. Seligman "A compulsory from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefits concerned."

According to Plehn "Taxes are general contribution of wealth of wealth levied upon persons: natural or corporate to defray expenses incurred in conferring common benefits upon the residents of the states".

These definitions of tax clearly points out:

- Tax is a compulsory levy and taxpayer should not expect of particular return of goods or services by the government
- Tax is a liability imposed upon the tax assesses who may be an individual or groups of individuals, or other legal entities.
- Tax amount is spent for common interest of people.
- Tax is imposed as per government rules and regulations.

- Tax is a major head of internal revenue for government: the government utilizes the collected taxes for peace security day to day administration, economic development program and health and so on.

Taxes are broadly divided in two categories:

1. Direct tax
2. Indirect tax

Direct Tax:

If a person directly paid the tax liability to the government it is known as direct tax. It includes income tax, gift tax, and contract tax. The direct taxes have been used to bridge the gap of income and wealth inequality in the society.

Indirect Tax:

It is levied on the person who does not bear it from his or her income. Indirect taxes are imposed on the consumption of goods and services it includes export import duty, excise duty sales tax, value added tax, entertainment tax, hotel tax, passenger tax etc.

Taxation is a major instrument of social and economic policy.

- It reduces inequality of economic development by reallocation of resources.
- It transfers recourses from the private to public sector.
- It is also useful for resource mobilization through capital formation.
- It promotes economic growth, stability and efficiency.

2.1 Concept of Income Tax

After the great depression of the 1930’s the function of government has been increased considerably. Government has got various sources to collect revenue. Among various sources of revenue tax is a major source. Generally tax is defined as compulsory payment to the government. Every body upon whom it is imposed should pay tax.

Income tax is imposed on net income of individual and corporation must bear the burden of tax imposed on them. Generally, income means the inflow to person. Income tax is levied on the income derived from business, employment and investment. Income tax is levied on the net income i.e. total income less the allowable deduction. It is a best measure economic of a person as well as a nation. Higher income denotes the high living standard and lower income refers to the low living standard of people.

Economists define the term income in a broad sense it is an economic gain receipt to a person during a particular period by way of wages, interest, profits and rent. The money income of the people is used for two purposes. Part of income is spent on consumption and part is saved. This definition can be expressed in the formula as below:

$Y=C+S$

Where,

Y = Income

C = Consumption

S = Saving

According to income tax Act 1974 (2031) "Income means the income earned or received in cash or kind from the sources as besides employment and investment." In Income Tax Act 1974 (2031) there were five heads of income tax. They were

(i) Agriculture

(ii) Industry, Business. Profession or Vocation

(iii) Remuneration.

(iv) House and Land Rent

(v) Other sources

The new Tax Act 2002 (2058) was passed and implemented for 1st April 2002(Chaitra 19, 2058). This act defined the term as income of any person derived from emp1oyment business and investment and accumulated income calculated according to this act. This act, has classified the income into three different heads they are 1) Business 2) Employment 3) Investment.

Tax means income tax to be paid or would be payable according to income tax act or prevailing law of Nepal. According to this definition tax includes additional fees, deposits and fines. The constitution of Kingdom of Nepal 2047 has prescribed that “no tax shall be levied and collected except in accordance with the law.” Therefore only taxable income as calculated by the prevailing law is subject to tax so that the objective and principle of taxation will be fulfilled (Income Tax Act, 2058).

Income tax refers to the tax levied on the income of a person and profits the corporation for the specified time period, particularly one year. In a broad sense, income tax s a levy based upon the production or receipts or gain of the tax payers within a definite period of time.

2.2 Evolution of Taxation

The Great Britain is the first country in the world to introduce the income tax in 1799. It imposed income tax in order finance war with France. Similarly in USA the first federal income tax was imposed with the same objective. (To finance civil war) However in the beginning these countries imposed income tax on a temporary basis until 1860. There after since 1 91 3 it was accepted as permanent tax. Thus income tax was adopted by different countries gradually. Italy started it in 1864 and New Zealand adopted in 1891. Austria and Canada had followed the income tax in 1915 and 1917 respectively. After 1st world war the income tax became an important source of revenue in many developed countries. By 1939 it had become the most important source of revenue in most developed countries and had made appearance in number of dev eloping nations (Agrawal, 1980).

In India the income taxation was started in 1860 by the British government to have relief from economic burden created due to 1st democratic revolution. It was then regularly collected after the publication of Income Tax Act 1886 (Dhakal, 2057).
In this way income tax has became the regular source of national receipts for many developed and developing countries of the world. In the beginning income tax was generally levied at a flat rate. The principle of progressive rate had been adopted by the UK and New Zealand since 1909. Nowadays the progressive rate is commonly use rather than flat rate all over the word.

2.3 Evolution of Income Tax in Nepal

In the kingdom of Amsuverma, there was existence of irrigation tax and religious monuments preservation tax. There was tax for purification of caste by priest and even cremation tax, which was extracted in gold by the ruler of Bhajang in far western Nepal. In ancient Nepal, the taxes were levied in the form of cash, kind and labor. In the regime of the licchavi period the main source of government income was taxes. These were very much specific in nature. The taxes were known as “Bhaga”, “Bhoga”, and “Kara. The “Bhaga” tax was levied on agriculture. “Bhoga” was levied on animals and “Kara” was levied on business.

During the period 1768- 1816 (Unified Nepal) The main sources of Nepalese revenues were land and homestead taxes, monopolies customs, transit and market duties, mines, the export of forest products, birds, animals etc and various levies and fines. The taxes were usually collected at three levels:

1) Royal Palace (to finance occasional and ceremonial needs)
2) Government (to finance administrative work, military and other purposes assessed of official)
3) Local level (to finance local officials, functionaries and mendicants)

During the 104 years of rule of Rana family in Nepal, the taxation was imposed to fulfill the objectives, needs and whims of the then ruling prime ministers. At that time, the sources of revenues were land tax, customs and excise duties in the form of lump sum contracts, royalties on felling of trees, royalty on the supply of porters and soldiers, entertainment tax and few other minor taxes. After the downfall of the Ranas, in modern Nepal various types of direct and indirect taxes have been brought in use in order to finance the growing development expenditure.

2.3.1 Taxation in Ancient Nepal

Tax has been one of the major sources of national receipts since the ancient time in Nepal. In those days tax was collected in the form of cash, kind and labour from the merchants, travelers and the farmers. However, the nature of the tax levied by the government was temporary type in the old age, In the Lichhavi regime; taxes were the main source of revenue. During the period, taxes were known as Trikar which meant three kinds of taxes i.e Bhaga, Bhoga and Kara. The Bhaga tax was levied on agriculture, Bhoga was on animal and Kara was on business income. Direct taxes such as irrigation tax and religious monument preservation taxes existed in the time of king Amsuverma. The farmers had to pay tax on income from agriculture in 1/6 1/8 and 1/12 shares of production depending on the quality of land possessed by them. All artists had to donate compulsory labor as the tax payment (Adhikari, 2059).

2.3.2 Taxation in the Unified Nepal

After unification of Nepal, expenses for administration military and other operational activities were increased gradually. During that period the taxation had been taken as main source of revenue and different forms of tax like land tax, transit tax, market duties, forest product tax and mining tax was levied. The main objective of imposing those taxes was to maximize the national revenue,. In that period taxes were collected from three levels: royal palace, central government and local authorities. They collected cash or goods from tax payers as taxes. Royal palace had levied taxes like Walak, Gaddimubarak, Chumawan and Goddhuwa. Government had levied taxes like Darsan Bhet, Salami and local authorities had levied taxes on forest and water sources. Commercial taxes like customs, transits and market duties, mines and mints, export of forest products like herbs, wax, drugs, wild life and judicial fine. Taxes from land and business were type of direct tax among all the taxes during that period (Dhakal, 2001).

Walak was from each family in the period of national celebration or festivals. Similarly Gaddimubarak was collected in the time of coronation ceremony of new king, Chumawan and Goddhawa was collected in the time of investiture and marriage ceremonies of royal princes, princesses. Gadan was levied at the time of reigning king's funeral expenses. Darshan Bhet was collected from civil and military employees at the time of appointment. On the other hand Salami was collected by local authorities in the Terai region. After the unified period land tenure system was divided into five main

Forms: Raikar, Birta Guthi, Sera and Kipat. The main sources of revenue from land were birta and kipat (Dahal, 2001).

The founder of modern Nepal, King Prithvi Narayan Shah had introduced Pota Tax in 1772, which was regarded as revolutionary measure in the FY system of Nepal. It was based on flat rate system and was limited on small Birta owners. Though taxation was started there was no income taxation in the modern sense (Dahal, 2001).

2.3.3 Taxation in Rana Regime

During the Rana Regime there was no provision of effective revenue administration. The main source of revenues were land revenue, customs on export of wood which was collected in lump sum contract basis during that period and the salami was collected from government employees as income tax. Besides these, other taxes were also collected. In those days, taxes were collected at the time of requirement because there were no formal tax and finance acts (Thapa, 1993).

Rana prime minister levied taxes for meeting specified expenditure of the royal household or extra ordinary expenditures necessitated by war or other crisis rather than regular mobilization of the revenue in the nation. During Nepal Tibet war (1855-56), the first Rana Prime Minister Jung Bahadur Rana had imposed a tax on the income of selected groups. Similarly, Bir Sumser imposed a levy of 1% on the official value of jagir assignment of government employees to finance the transportation of water pipe supply in the capital. Another Rana Prime minister Ranodip Singh imposed a 50% tax on the income made by fishermen in Dhukuri from the sale of fish in 1892 (Thapa, 1993).

2.3.4 Income Tax in Modern Nepal

After the political revolution in February 1951 (2007 B.S Falgun) the role of the government had increased. The government of Nepal had presented its first budget in 1952 (2008 B.S Magh 21st). The first five year plan started in 1956 (2013-2018 B.S). Thus the changing role of the government also felt to levy tax on income as a permanent source of revenues. As a result, it issued the first Finance ordinance in 1959(2016 B.S) to impose tax on business profit and remuneration. In 1960(2017 B.S) the income tax act named “Business profits and remuneration Act 2017” was made with the provision of Finance ordinance 1959. It was the first income tax which had 22 sections. But this act was found to be narrow and vague. It was replaced by the income tax act 1962 (2019 B.S) This Act continued for twelve years and was replaced by the income tax act 1974 (2031 B.S) this act was amended for eight times in 1977, 79, 80, 84,85,86,89 and 1992 respectively. This tax act was replaced by new income tax act by 2002 (2058 B.S) which is the forth income tax act of Nepal.

2.4 Gradual Development of Income Tax Law in Nepal

The FY 1959- 60 was the beginning of income tax act in Nepal. The income tax act 1974 remained for 27 years with 8 amendments. According to the section 65 of income tax act 1974, his majesty's government had made the "Income Tax Rules 1982" to implement the objectives of income tax act. Each year the finance act is passed to translate the FY policies and programs in the budget speech into law. It generally prescribes the tax rate and exemption limit for tax purpose and it may abolish, add or modify the provisions contained in the income tax act. The decisions of the Supreme Court also act as precedent for income tax law purpose. The notification in Nepal Gazette and circular by Inland Revenue Department clarifies and complements the legal provisions. The income tax act therefore has relation with the constitution, finance act, income tax rules and decisions of the Supreme Court. This makes the provisions in income tax clear.

The development of income tax law in Nepal is presented below:

2.4.1 Business Profit and Remuneration Tax Act 1960 (2017 B.S)

The FY 1959-60 was the beginning year of income tax in Nepal. The first law relating to income tax was named Business Profit and Remuneration Act 1960 and rules made there under. This act had 22 sections. With the enactment of that act, the salary tax or the personal income tax was levied upon those individuals whose personal income exceeded Rs. 6000 per year. In the first three years the exemption was Rs. 7,000. An examination of tax files in Katmandu District Office disclosed

557 personal income tax files of individuals who had paid taxes in one or more years (Cooper, 1964: 4).

The following were the salient features of the Act:

1) The sources of income for tax purpose were limited to business profit and remuneration (i.e. the two heads of income were business profits and remuneration).
2) The basis of calculating tax liability for the remuneration was the income tax of the current year and for business profit it was the profit of previous year.
3) The deductions of expenses were not specified for calculating taxable income.
4) Tax and remuneration was deducted at sources (TDS)
5) The tax officer was empowered to assess tax on best judgment estimate.
6) Incase of default, fines up to Rs. 5,000 were prescribed.
7) Profits from industries were granted a rebate of 25% and profits from small industries were granted a rebate of 50%.

The business profit and remuneration tax act was too narrow and vague. It was limited to business profit and remuneration. High discretionary power in determination of taxes was granted to officers. Many loop holes for the income hiders and inadequate provisions had forced the act to become ineffective. As a result the income tax act 1962 (2019 B.S) was introduced.

2.4.2 Income Tax Act 1962 (2019 B.S)

This act was an extension of the Business Profit and Remuneration Act with 29 sections it was amended in 1972. It had a provision of imposition of income tax in agricultural income but this provision was abolished by the Finance Act 1966 (2023 B.S)

The main features of the act were as follows:

1) Income was defined as all kinds of income such as profit from business, income from profession, remuneration and occupation, house and land rent, income from agriculture, insurance business, agency and other sources.
2) The basis of tax assessment was specified on the best judgment estimate of the tax officers.
3) Provision of installment payment of the tax was made for the first time.
4) Provision of reassessment of as well as ratification of arithmetical error was made.
5) It had the provision regarding carry forward of the losses for the period of two years.
6) Provision of the exemption of the income tax for the new industry for the period not exceeding ten years was made.
7) The residential status of the tax payers for tax purpose was defined.
8) The act granted the power to constitute the income assessment committee.
9) Deductible expenses as well as methods of calculation of taxable income were specified.

This act also had some weakness. The changing socio-economic environment of the nation had forced the Income Tax Act to be change. As a result, the Income Tax Act 1974(2031 B.S) was introduced by abolishing the existing Act 1962.

2.4.3 Income Tax Act, 1974 (2031 B.S)

The Income Tax Act 1974 can be said as the refined form of Income Tax Act 1962 (Dhakal.2056:11). It had 66 sections. It contained many provisions of the old one and added certain new provisions. This act was amended eight times for making it more practical eliminating confusing words. Its basic framework had been derived from the Income Tax Act 1962. It retained or amended certain provisions of the old act and added certain new provisions. Some of the points of the act with amendment are as follows (Tiwari, 1991).

1) This act had clarified the definition of income tax, tax payers, year of income, personal status of tax payers, non resident tax payers, net income etc.
2) Five heads of sources of income were specified.
3) a)Agriculture b) Industry , Business, Profession or Vocation c) Remuneration d) House and Land Rent e) Other sources
4) Methods of computing the taxable income from each head had been specified with allowable deductions.
5) The act had made it obligatory for the tax payers to register their industries, business, profession, or vocation in the tax office and any changes should be notified.
6) Carry forward of the losses is allowable within subsequent three years.
7) Provision of self assessment of tax was made for the first time in Nepal.
8) Provision relating to deduction of life insurance premium and contribution made for philanthropic purpose was made.
9) Taxpayer was required to keep accounts and records of the income and those should be preserved for six years.
10) Provision of making agreement with foreign governments for the avoidance of double taxation was made.
11) Provision related to reassessment or additional assessment of tax was made.
12) Procedures for assessment, collection, payment and refund of tax were streamlined. Powers for search and seizure also was specified.
13) Provision relating to departmental action in case of negligence was made and the penalties were increased.

2.4.4 Income Tax Act, 2002 (2058 B.S)

The draft of Income Tax Act 2058 also proposed to bring all sources of income including capital gains into the tax net. This forth income tax act of Nepal has been made to minimize the weakness of previous act and for more collection of national receipt (revenue) for the economic development by improving collection procedure of the revenue. It is also necessary to amend and integrate according to modern age with international taxation system. It is essential to make new income tax act corresponding with extended income tax scope and changing form of tax administration thus the new Income Tax Act 2002(2058 B.S) was passed. It was issued and implemented from 1st April 2002(19 Chaitra 2058 B.S) with government seal. This act has been amended two times by the finance ordinance of 24th Ashad and 22nd Paush of 2059 B.S (Khadka, 2001).

The main objective of the Income Tax Act 2002 is pointed below.

1. To levy tax on all income sources and incoming earning transaction.
2. To impose uniform tax to all people and sources.
3. To make income tax revenue more productive and elastic.
4. To develop the tax system by means of extended scope, clear –cut transparent and simple.
5. To make accountable improvement on tax administration.
6. To reduce economic cost neutralizing income tax.
7. To emphasize statement based on accounting system.
8. To make responsible to income taxpayers by emphasizing procedures of self assessment system (Mallik, 2003).

This act is broad, scientific and meets the international standard level. The differences of this act with previous act are made clear by its salient features, given below.

1. This act has included all the provisions relating to income tax. It is a law of income tax code.
2. It has included all the financial transactions of the taxpayers considering present and future earnings.
3. Provision to impose tax to all income sources uniformly was made.

4. A provision of deduction of all expense relating to income earnings was made.
5. A provision of deduction of all expenses relating to each income in accumulation from taxpayers income was made.
6. Carry forward of losses is allowed for the period of four subsequent years. This limit is extended up to five years for banking and insurance business
7. Provision of tax incentives for infrastructure, electricity projects and special industries has continued.
8. It has accepted self assessment system absolutely. Provision to accept the statement submitted by tax payer as tax assessment was made and incase of non-submission of statement, the advance tax payment made by tax payer is taken as assessed tax amount.
9. It has clearly defined the rights and duties of tax payers
10. It defines general anti- avoidance rule, control of transfer pricing, thin capitalization and control of dividing stripping as a tax evasion measure.
11. Provisions to claim for deduction of installation expenses of pollution control device and research and development expenses was made.
12. It has classified the tax payers into natural person and entity. Entity includes company, partnership, and trust and so on.

Special Provisions for banking and business:

Income Tax Act 2002 has made special provisions for banking business (Section59)

According to this section, provisions given to that sector are as follows

1) Prime introduction: Banking business refers to the banking transaction of affiliated bank and financial institution in accordance with prevailing law (Income Tax Act 2003).

2) Banking transaction refers to accepting deposits and for providing loan and investment, paying back it at the time of demand by saver (Commercial Bank Act 1974 and Finance Company Act 1983).
3) Provisions of risk bearing Fund: Any provision debited in the profit and loss account is not deductible(Income tax Act 2002) However the Financial Ordinance 2059 B.S has amended it and provision has been made to claim for deduction of risk bearing fund up to 5% of outstanding loans that was only 3% (Income Tax Act 1974).
4) Written of loss: Loan loss of banks can be written off in compliance with NRB guidelines and it can be treated in the debit side of profit and loss account as expenditure for carry back of losses but it is not allowed if this amount has already been deducted from income as risk bearing fund.
5) Carry Back of Loss: Loss of any year from banking business can be carried back to the past five year for deduction of it from income of those years.
6) Interest Suspense: As per the directions of NRB to the Banking Institutions, no interest can be treated as income on the accrual basis. Interest suspense account should be opened if the interest earned but not received each within one month. This type of income is given tax exemption by the Income Tax Act 1974 and it is continued by this act, issuing the finance ordinance 2059 B.S

2.5 Concept of Corporate Tax

A company or a corporate body is a voluntary association of persons formed to run business activities for fulfilling the objectives of earning profit by collecting capital and selling shares. A person or some persons interested to carry on any business or mercantile activity or other lawful trade with the motivation of earning profit by contributing money or money’s worth incorporate corporations.

Corporate bodies conduct business and generate profit. Corporate tax is a tax levied on the corporate bodies contrast to unincorporated enterprises. So corporate tax comes from the profit, which made by corporate bodies in a particular time period. The history of corporate tax is not long. It was started in 1909 in USA when 1% excise was levied on the corporation i.e. companies on the ground of the privilege enjoyed. After this all the developing countries followed the corporate tax. Now it is contributing a substantial amount of revenue to the state treasury of countries. Corporate tax rate is being increased and decreased at short intervals of time. Corporate tax was initially very low. It was increased rapidly after the First World War and has started to decline after the 1980s.

American chief Justice Marshal defines company or a corporate body as a person, artificial, invisible, intangible and existing only in the eyes of the law. Being a mere creation of the law, it possess only those properties which the charter of its creator confers upon it, either expressly or identical to its very existence. The above definition clearly states that a company or a corporate body can be defined into transferable shares with limited liability. It has own property. It can execute contract, raise debt and generate profit.

2.5.1 Development of Corporate Tax in Nepal

Nepal has started informal taxation already from the beginning of the Licchhavi period. Although Nepal has a long history of taxation, the history of corporate tax is not so far long, corporate tax was first introduced only in 1960. During the early days, corporate tax was not differentiated form the personal income tax. The same personal tax rate was imposed to the entire tax payer in progressive manner and exemption given to companies was withdrawn.

Nepal originally combined corporate income tax and individual income tax, the same rate structure was designed for the corporate income and other incomes for many years. In 1986/87 a flat rate of corporate income was introduced for the Government Corporation and public Limited Corporation listing with the security exchange centre. Corporate tax was extended to private limited companies in 1993/94 and the partnership firms in 1995/96.

Income Tax Act 1974 was introduced with new provisions. The finance act under this act introduced a separate provision for the companies. Similarly, the finance act 1985 made provisions of giving 5% tax rebate from higher marginal rate of 55% to listed public companies and the government enterprises. The FY 1986/87 changes the nature of tax rate to the corporate bodies (companies) from the progressive tax rate to flat tax rate. In this time the tax rate was 40% flat rate for all listed companies. The same finance act imposed tax on the divided also to be deducted at the source rate of 20%. But the divided tax system was changed exempting dividend to a level of 85% in 1987/88 and the cent percent in 1990/91. Compulsory self-tact assessment system for public and private limited companies was introduced in the Finance act 1992. The additional change was made that taxing corporate income at flat rate to the private limited company and enacted from the financial year 1994/95. This change abolished the discrimination between private companies and public companies. Another major change carried out by FY 1998/99 was the inclusion of dividend of the non- industrial companies within the tax net. The initial corporate income tax amount in 1960/61 was 255. It was increased to 60% in the FY 1975/76. It was dropped to 50% in 1979/80 and continues to 1981/82. Once again, the rate was increased up to 55% in 1982/83 and was stable for 3 years i.e. up to 1986. And declined thereafter to 40% and 30% for up to 1991/92 and now this rate is 20% for special industry and 25% for the general industry and 30% for the bank and finance companies.

2.5.2 Corporate Tax Rate Structure in Nepal

Developing countries like Nepal need to boost their economic condition by developing industries and trade within the country. Tax ate is the base of measurement of tax liability. It should not be high only for the maximum revenue but should be activator of private investment. Imposing of tax on corporate profit was started with the enactment of the Business profit and Remuneration Acct 1960. The starting corporate tax rate was 25% and it was levied on progressive way. The tax amount was calculated on different slabs before FY 1985/86. The corporate Tax rate structure was combined with individual tax rate structure. The reason was the number of companies was limited and the family generally managed private companies. In the year 1985/86 the progress tax rate structure was abolished in case of government enterprises and public limited companies listed in the Nepal Stock exchange because enterprises used to split into different units to the private companies also was abolished in the FY 1995/96. Thus the flat rate system was been continues for all corporate bodies since the FY 1995/96.

In the FY 1975/76 the corporate tax rate was increased up to 60% the maximum rate from the 25%. During 1960/61 to 1975/76, increment of rates was made three times. After FY 1975/76, the tax rate was again decreased to 51 and 50%. This rate was again increased to 55% and remains continued from 1982/83, to 1987/88. In the year 1987/88, the listed public companies were levied 10% less than others. This concession was given to such companies by only 5% in the year 1985/86. After the FY 1987/88, the tax rate was continuously decreased. Now it is 20% to industry (except cigarette and alcohol), 25% to general companies and 30 %bank and finance companies. Special fee 3% of taxable income was levied to all corporate bodies. Now it is decreased to 1.5% as surcharge (additional income tax since FY 2062/63).

Table 2.1

Corporate Tax Structure of Nepal

Year	Marginal Tax Rate		Nature of Tax Rate
	Pvt. Company	Public Company	
1960/61-1962/63	25	25	Progressive
1963/64-1964/65	30	30	“
1965/66-1966/67	40	40	“
1967/68	55	55	“
1968/69-1974/75	55	55	“
1975/1976	60	60	“
1976/77-1978/79	51	51	“
1979/80	50	50	“
1980/81-1981/82	50	50	“
1982-1983	55	55	“
1983/84-1984/85	55	55	“
1985/86	55p	55f	Progressive and Flat
1986/87-1987/88	55p	50f	“
1988/89-1989/90	50p	50f	“
1990/91-1991/92	40p	40f	“
1992/93-1994/95	35p	35f	“
1995/1996	33	33	Flat
1996/1997	30	33	“
1998/99-2002/03	20-25&30	20-25 & 30	Flat rate

Sources: 1. Kandel, P.R (200) corporate Tax system and Investment Behavior in Nepal and Budget Speech 2002/03

Note:

20% tax rate for special industries

25% tax rate for general industries producing Liquor and Tobacco

30% tax rate for non-industries for banking, Finance and insurance business.

2.5.3 Tax Incentive

Tax incentives are facilities or concessions given to the corporate bodies. It is a phenomenon developed specially to accelerate the slow rate of investment. The main objective of tax incentive is to increase saving and encourage investment in desired sector. It encourages investment in selected manufacturing activities and helps in utilization of domestic resources.

The tax incentives are becoming important and getting wide support in short period. Specially, in developing countries like Nepal increase in corporate investment is the sign of socio- economic development of the nation. Development of the industry is necessary to utilize the natural resources. Investors' desire can be fulfilled by providing them incentives as they are interested to invest only in such cases where the after tax probability is higher.

A variety of incentive laws prevail in various countries and are influenced by their economic and political nature. Among different varieties of tax incentives, the most popular incentives in different countries of the world are:

- Tax holiday (Investment incentive)
- Set off and carry forward of losses
- Depreciation allowances
- Tax rate deductions

Incentive tax holiday is the exemption of tax for a certain period of time. It is one of the most popular of tax incentives. This incentive is mainly concerned with newly established companies and short term project in the industry sector. Such a relief on tax is applicable on profit earned from new investment and it will automatically terminate after the holiday period. The aims of these incentives are:

- Job Creation
- Technology Transfer
- Industrialization
- Promoting Industry

- Regional Development
- Research and development etc

After the expiry of tax holiday period, these corporate bodies will be subjected to the rate of taxation according to the prevailing tax act.

Set Off and carry forward of losses is another technique of tax incentive. If there is losses under one source and profit under other sources, the losses can be set off against the profit. The net loss of this year can be carry forwarded in further years to set off against the income of subsequent year.

Different countries are providing such incentives in terms of scope, condition and time. Most of the countries allow to deduct losses or carry forward of losses for successive five years. In Nepal, as per the Income Tax Act 1974, losses were allowed to be carried forward and set off in the following three years compare to two years in Income Tax Act 1962. Now new Income Tax Act has increased this period for four years for general business and five years for bank and insurance companies.

The next incentive system Depreciation allowance means that depreciation is calculated in higher rate in initial year and gradual decrement in the following years. It also included allowing the cost of fixed assets to be depreciated within a shorter period than its service life. Written down value method and double declining method, depreciation do this work in a better way.

The last method of providing incentive is deduction of tax rate. This method mainly focuses on deduction of statutory rate of tax. It is very simple and economic method, however reducing tax rate reduces the government revenue. It treats all the firms equally whether large or small, new or old, short term or long term, capital intensive or labor intensive and located in urban or rural areas. This incentive system is a phenomenon. Almost all the countries in the world are following this system and cutting their corporate tax rate vehemently.

Among these types of incentives investment allowance is mostly used by British Common Wealth nations like coast and central Africa, Srilanka, Canada, Australia etc. Besides these, Belgium, Germany, Japan, UK, Brazil, Malaysia, China, Singapore, Taiwan, South Korea and Egypt are also using this method to encourage investment (Kandel, 2001).

In some developing countries like Philippines, Mexico etc. the incentive is mainly in the form of tax holiday. A combination of tax holiday with investment allowances and other rebate is also common in many countries. Aforesaid tax incentives have always been the important part of corporate tax system because they are important instruments in accelerating the pace of economic growth through mobilizing saving and investment. The type, size and magnitude vary according to the needs and aspirations of the people of different countries (Poudyal, 1993: 40).

2.5.4 Tax Incentive in Nepal

The corporate sector is in its initial stage of development in Nepal .The performance of corporate sector; especially the industry is very poor. To develop the corporate sector in Nepal, there are many incentives provided by different laws. They are:

- Industrial Enterprise Act 1992
- Nepal Petroleum Act 1993
- Electricity Act 1992
- Foreign Investment and Technology Transfer Act 1992

Nepal Petroleum Act 1992 has provided certain relief on tax rate to petroleum industries. Similarly, Electricity Act 1992 has given certain facilities to the Hydro Electricity Power in Nepal and Foreign Investment and Technology Transfer Act 1992 has made the provisions regarding tax relief to the foreign investors.

Most important law regarding the corporate bodies in Nepal is the Industrial Enterprises Act. The main agenda of this act is to provide FY Incentives to the industries. Till now, Nepal had experienced four industrial enterprises acts, they are:

- Industrial Enterprises Act 1962
- Industrial Enterprises Act 1074
- Industrial Enterprises Act 1981
- Industrial Enterprises Act 1982

In relation to tax incentives provided, the first Industrial Act 1962 made the provision of ten years tax holiday for new industries, Tax rebate up to 25% of the tax liability on the discretion of HMG Nepal to existing industries, Full or partial rebate to the tariff for exporting goods and importing machinery, parts and raw materials. The main type of incentives provided by the Industrial Enterprises Act 1974 were up to eighteen years tax holiday to different Industries established in different parts of the country, investment allowances and depreciation facility to extension and modernization, relief of import and export duty. Accordingly, the main types of tax relief provisions appended in Industrial Provisions Act 1981 also were not so much different from that of its predecessors. It also included up to twelve years tax holiday to industries. Income Tax rebate of up to 50% for export, 15% investment allowances to additional investments, only 1% levy for imports of machinery spare parts and raw materials, excise exemption to different types of industries, exemption of sales tax to cottage industries on the import of machineries, spare parts etc and domestically produced goods. Apart from these, there was also the provision relating to tax life of the assets, containing twenty years for building, and ten years for machinery, five years for furniture and vehicles and ten years for other remaining assets.

Industrial Enterprises Act 1992 avengement 1997 has given various tax related facilities to the industrial communities. They are as follows:

- Complete exemption of any type of income tax, sales tax, etc. for cottage industries.
- Specifying as maximum rate of tax to industries except those related to tobacco and alcohol.
- Ten years 50% tax holiday to the national priority industries related to the construction of roads, bridges, tunnels, ropeways, flying bridges, trolley buses, and trains.
- Income tax rebate of 60%, 50%, 25%, and 10% and excise rebate of 35%, 25%, 15% and 10% to the industries established in remote, underdeveloped, partially developed and developed area respectively except the industries based on tobacco and alcohol.
- 25% tax exemption for ten years to those industries which are not related to tobacco and alcohol and are established in underdeveloped area stated in Appendix III of the act.
- Five plus three years sales and excise rebate to the fruit processing based wine producing industries located in remote areas.
- Investment allowances of 40% extended fixed assets investments if the firms increased its capacity of line production by more than 25% of original level.
- Deduction of 50% and 10% of gross income for promotion and development of technology respectively from net income.

- 30% tax exemption for industries, which are not related to tobacco and alcohol and are established in most underdeveloped district stated in Appendix-III of the Act.
- 20% tax holidays for those industries which are not related to tobacco and alcohol and are established in under underdeveloped district stated in Appendix- III of the act.

2.6 Tax Evasion and Avoidance

Tax evasion and avoidance both are major causes for low income tax collection. Income tax checks the inequality between high and low income earners. It helps the government in the movement of resources from the private sector to the public sector. Income tax collection can only be effective if the tax evasion and avoidance is controlled.

2.6.1 Tax Evasion

Tax evasion eliminates the tax burden and liability by dishonest manner. It means fraudulent, illegal acts of the tax payers culminating in the violation of the provisions of the tax law. It implies maneuvers involving an element of concealment, deceit misinterpretation of facts, falsification of accounts and downright fraud resulting from conscious effects of the tax payers to evade payment of tax legally. Tax evasion may arise from weak enforcement, inadequate tools or resources of administration and tax payer’s low integrity and moral. Tax evasion may involve:

- Omission of taxable income.
- Less receipt
- Artificial expenses.
- Concealment of a source of income.
- Incorrect claim for allowances and deductions

- Fictitious transactions
- Over and under invoicing
- Maintenance of multiple sets of accounts.
- Artificial contracts.
- Misinterpretation of facts and information.

Tax evasion can be of several types:

1. Unilateral: It is an evasion of tax by taxpayer himself
2. Bilateral: It is an evasion of tax with the assistance of tax officials.
3. Trilateral: It is evasion of tax from the collusion of tax auditors and tax payers.
4. Multilateral: It is evasion of tax from all parties involved from government to tax payers.

Tax evasion is an illegal work so it has to be penalized by court. Failure to submit income statement to tax office and failure to make payment of taxes because of negligence are also called tax evasion.

2.6.2 Tax Avoidance

Tax avoidance refers to reduction of tax liability through legal means. It means making good use of legal loopholes shortcutting and weakness of tax law. It is not illegal but unethical. It has become a science and arts with its own inventors and practitioners." A taxpayer is entitled to arrange his financial affairs so as to take the maximum advantages of the law and its weakness to reduce or prevent its liability".

Some methods of tax avoidance mentioned by Dr. G.R. Agrawal in his book "Resource Mobilization for Development "are as follows:

- Registering firms, which are not genuine, composed mainly of family members, to reduce incidence of tax.
- Diversion of income or assets to different taxable entities so that lower tax rate may be applied.
- Transfer of income to wife or minor child without adequate consideration.
- Transfer of assets and /or income to non taxpayers.
- Transferring business to tax havens.
- Payment of salaries, interests and other benefits to family members.
- Expenses camouflage.
- Purchase of such firms, which have huge amount to be carried forward as losses.
- Formation of rules and other philanthropic type institutions, which are exempt form tax but whose benefits do the family members derive.
- Use of nominees in Nepal or in other countries by non-residence through collective agreements when undertaking business transactions.
- Factitious contracts in the name of international enterprises, such contracts stipulate that delivery will be made at Indian railhead points. This income there by is not received in Nepal.
- Representing international forms in Nepal for supply and other purpose and getting commission for such representation.
- Sales cum dividend deals.
- Transitions in fictitious names etc

Tax avoidance can be defined as any planning of tax done strictly according to the legal requirements but defeats the basic intension of the legislature behind the tax law. It is legally permissible but unethical.

2.7 Tax Administration

Tax administration implies the management of affairs related to tax. A sound system of tax administration is pre-requisite to assess the taxation policies of the government. For the success of tax administration of any government executive, legislative, reporting, auditing etc.

2.7.1 Income Tax Authorities

Income tax is administrated directly by the Inland Revenue Department. It is responsible for the implementation and administration of the Act. Government of Nepal has the highest authority of the tax offices of the department and prescribed their jurisdiction by notification in the Nepal Gazette to facilitate the department in fulfilling its responsibilities. The following officers and the other staff may be deputed in the department.

- A Director General
- Deputy Director General in the numbers as may be required
- Chief Tax administrators
- Directors
- Chief Tax Officers
- Tax Officers
- Other Officers
- Other Staff

The Ministry Of Finance is at the apex administration. The Ministry carries out the functions related to taxation on behalf of Government of Nepal. The Revenue Department of the ministry is responsible for formulating tax related policies and coordinating the activities of all Revenue Departments. Similarly Custom Department, Revenue Investigation Department and Revenue Administration Training Center are also involved in the administration of income tax.

2.7.2 Rights of Government of Nepal

Income tax Act, 2058 has empowered government of Nepal as regards to the implementation of the tax law. The rights of government of Nepal with respect to ITA 2058 are as follows.

1. Rights to make double tax avoidance treaty with other countries to avoid the situation of double taxation.
2. Right to establish or remove tax office for the purpose of collecting tax.
3. Right to establish or remove of donation given to tax exempt organization by publishing notice in Nepal Gazette.
4. Right to make rules regarding tax for fulfilling the objectives of the Act.
5. Right to make changes as required in schedules other than schedule 1
6. Right to remit in whole or in part any tax payable by a person if bthe tax amount cannot be collected.
7. Right to give order or direction to Inland Revenue Department for the purpose of making tax administration effective.

2.7.3 Power of Department

Inland Revenue Department (IRD) can exercise the following power given in ITA. 2058 and Income Tax Rule 2059:

- To take an official against its employees.
- To exercise power of the court for the purpose of this Act.
- To develop and issue directives as required.
- To make order for payment of penalty amount.
- To decide an exempt amount.
- To specify accounting methods.
- To specify about long term contracts.
- To characterize the amount in advance on the basis of arm’s length. Principle.

- To approve retirement fund.
- To give Permanent Account Number (PAN) and amend it as per request.
- To provide tax clearance and tax exemption certificate.
- To specify taxpayers who are not required to submit returns.
- To specify the place of auction.

2.7.4 Right of Direct General (DG)

Director General subject to direction by government of Nepal can:

- Exercise any power granted to the Department under the Act.
- Delegate the exercise of any of the power to another officer.
- Where there is no tax officers assign any of the officers in the civil service to exercise all or any of the powers other than the power
    1. To issue public circular
    2. To prescribe documents.
    3. To stay or otherwise affect a reviewable decisions.
    4. To allow or disallow the objectives by any person in whole or part.
    5. To compound an offence
    6. To authorize any officer.

2.7.5 Right of Deputy General (DDG), Chief Tax Administrator, Director, Chief Tax Officer or Officer appointed as the Chief of a Tax Office

The above officials ma exercise any power granted to the Department under this Act other than the power:

- To issue public circular under section 75
- To prescribe documents under section 77
- To stay or otherwise affects a revisable decision under section 11.5(5)
- To allow or disallow the objection by any person in whole or part under section115(7)

- To compound an offence under section 129.

  Also the above officials can delegate the exercise of any such power to other tax officers.

2.7.6 Rights of Other Officers

An officer of the Department other than Direct General, a Deputy Director General, Chief Tax Administrator, Director, Chief Tax Officer appointed as the chief of tax officer may:

1. Exercise any power granted to the Department than has been delegated to the officer other than.
   - To issue public circulars under section 75.
   - To prescribe documents under section 77.
   - To say or otherwise affect a reviewable decision under section 115(5)
   - To allow or disallow the objection by person in whole or part under section 115(7)
   - To compound an officer under section 129
   - To authorize an officer under section 82 or issue a notice under section 109.

2.7.7 Right of Taxpayer(Assesses)

A taxpayer means a person (an individual or entity) whom the tax imposed as on and realized from as per Income Tax Act 2058. As per section 74 of the Act the taxpayer with respect of paying tax is entitled to enjoy the following rights.

- Right to get respectful behavior
- Right to receive tax related information as per prevailing law.
- Right to get opportunity of submitting proof in own favor in respect of tax matter
- Right to appoint lawyers or auditors for self defense

- Right of secrecy in respect of tax matters and keeps it inviolable

Besides these a taxpayer can enjoy the following rights:

- Right to obtain clarification on personal (advance) ruling.
- Right to get refund of excess tax paid
- Right to appeal to review the decision
- Right to receive public circulars.
- Right to extend time to file return.

2.8 Problem Associated With Tax Administration in Nepal

The government needs huge amounts for the expenses to be made in development activities. Each year the estimated expenditures exceed over expected revenue that arises revenue gap and it needs to borrow foreign loans. The income tax is only justifiable to increase the resource mobilization in the nation internally. However due to poor earning capacity of people it is difficult to raise the contribution ratio of income tax in the total revenue. On the other hand most of people who are earning significant amount are beyond the income tax net. The income tax system in Nepal has been facing many problems. Inefficiency of income tax administration is one of the reasons. Tax administration is a complex and difficult technical matter. There are explained some problems including passed period.

2.8.1 Failure to Locate New Tax Payers

Mr. G R Agrawal has pointed out that arguments related to the location of new tax payers in his book "Resource Mobilization in Nepal." Tax administration in Nepal lacks and up to date role of existing as well as potential tax payers (Agrawal, 1980: 109). Tax administration set targets to collect income tax in certain percentage of GDP each year, and makes policy to extend the scope of taxation. But the target has not been fulfilled. The major problem is the location of new taxpayers in case of non resident and non citizen persons who are really outside the income tax net. This is due to open boarder with India. Similarly, self employed persons as professionals and skilled persons have also remained outside the effective reaction of income tax net.Brokers,speculators, dealers, suppliers in big hotels, tourist guides, insurance agents and persons remaining outside the income tax net. Administration deficiency, poor tax payers, morality and compliance about the income tax payment are the major responsible factors for problem of failure to locate the new tax payers.

2.8.2 Failure to Maintain Proper Account and Records

Most of tax payers in Nepal do not maintain account in proper way for the income tax purpose. They show hesitation in submission of accounts and tax returns in the Inland Revenue Department. On the other hand, large numbers of private business entities submit false income statements for tax purpose even though they maintain accounts of their business transactions; they make two sets of accounts and hide the real statement. That is why the income tax officers fail to find out the true and fair view of the financial state of affairs for the tax purpose. Some reasons are stated below.

2.9 Review of Related Studies

Since the period of introduction of income tax system in Nepal, many individuals as well as some institutions have made efforts on study of taxation the ways for the improvement of income tax system in Nepal in every aspect of income taxation. Many books research reports and articles have been published in this respect. While doing researches and preparing the thesis some books, thesis and some articles concerning with income taxation have been consulted. Some of them are presented below in brief.

Govinda Ram Agrawal presented the research report entitled “resource Mobilization for Development: The reform of income tax in Nepal” which was published by the CEDA Katmandu in July 1978. This research work was the first comprehensive study on the income tax in Nepal. In the research work, he analyzed various aspect of income tax system of Nepal such as role of income tax and administration in Nepal. In this report he showed the cause of problems facing by tax authorities in the tax administration. As per his study , the main cause of administrative problems are undue delay in tax assessment, failure to maintain proper account by tax payers, failure to maintain proper records by tax offices, failure to locate new taxpayers, unfriendly behavior of tax officials to the tax payers, assessment under the best judgment etc. He also showed the main reasons of assessment delays. As mentioned by him delays in filing of returns of income, delays in settlement o0f appeals , defective assessment procedure, lack of proper taxpayer information and failure to maintain the proper accounts and records by taxpayers/tax offices. He also found the buoyancy of income tax with respect to GDP for the period 1967/68 to 1975/76 and elasticity of income tax. He also showed that about 2.18 buoyancy and 2.01 elasticity of income.

The other book named “Income Tax system in Nepal” written by Narayan Raj Tiwari (1978) described the income tax in general. The book has discussed about the historical background of income tax in Nepal. This book therefore is important to understand the theoretical aspect of income tax law only as it failed to give the fact about the role and numerical information regarding income tax system in Nepal.

Surendra Keshar Amatya, Dr. Bihari Binod Pokhrel and Rewanta Kumar Dahal (2004) have written a book entitled “Taxation in Nepal”. Amatya, Pokhrel, and Dahal have described about income tax and its development in Nepal. They have also discussed about tax accounting, quantification, allocation and characterization of amount, exemption, concessions, facilities, and tax rates, expenditure expressly disallowed for deduction, capital or revenue income, and expenditures, of tax payers, special provision for natural person and entity, income heads and sources, income from employment, income from business, set-off long back and carry forward of losses, income from investment, net gain from disposal of assets, and liabilities, and capital gain taxation, form of documentation, PAN and maintenance of documents, income return and tax assessment payment, collection and refund of tax, tax administration , rights and duties of tax payers etc. this book has been written to fulfill the course requirement of Tribhuvan University. It is based on the syllabus of Bachelor level of management, law and CA and also for master level of management and law. This boo0k is informative rather than analytical. They have also included numerical problems in regard to income tax assessment but failed to analyze the importance of income tax problem and defects in Nepalese income tax system.

Puspa Raj Kandel also presented the Ph.D thesis entitled “Corporate Tax System and Investment Behavior in Nepal” in 2000. He undertook the research work to find out the problems relating to corporate tax which have blocked the development of private investments. The main objectives of the study were to evaluate the corporate tax system in general, to examine the sensitivity of certain policy like inflation, capital gain tax, dividend tax and interest tax etc. based on their impact on tax burden. He has shown the relationship of private investments with average effective tax rate. (AETR), marginal effective tax rate.(METR) and tax incentive in Nepal.. He has found that the METR for debt –financed project are almost negative (i.e. -1.7%) and positive for equity financed project and debt-equity ratio project by 27% and 19% respectively. He has also found that the impact of inflation to the METR. According to him the statutory tax rate deduction had impact private investments by 60% to 20%. In this regard he has shown the adjusted R^2 value 0.87at 5% level of significance. He has concluded that the statutory tax rate was in modern level under all financial options: debt, mix and equity i.e. it was not much distort.

Above studies shows that Income Tax is the main source of government revenue. It is useful to balance economic development. Nobody can doubt that, the equal distribution of income is possible through progressive income tax system. Nepal has adopted the income tax system for the last four decades. But the past experiences show that the government is unable to maximize the share of income tax to public fund as per expectation. Merchant banks play a vital role in economic and financial development of the country as they are profit oriented entities so they must pay income tax out of their net profits.

"The term Merchant Banking was originated in the 18^{th} and early 19^{th} century in the United Kingdom when trade between countries was financed by bills of exchange drawn on the principal merchant houses with the increase in international trade. The established merchants started the practice of lending their names to the new comers and accepting the bills of exchange on their behalf. They would receive commission for the purpose and thus accepting the business became the hallmark of Merchant Bankers. Once these banks have gained the confidence of the government, they also involved with the job of issuing bonds in the London Market".

Merchant Banking Service was introduced in different period of time in different countries. It was emerged in the early 19^{th} century in USA with the introduction of Blue Sky Laws to protect investors from the promoters and security salesman. In India merchant6 banking activities was originated only after the restoration of independence. After the Banking Commission in 1972, Indian banks started merchant banking service as part of their multiple services. State Bank of India in 1972 with its Merchant Banking Division was the first bank to offer the merchant banking services.

About Nepalese concept it does not have so long background about financial system. Before the establishment of “Tejarath Adda” during the period of Rana regime, the unauthorized sectors like money lenders, goldsmiths, and landlords have their universal domination on the financial matter. They used to charge very high interest rates. “Tejarath Adda” may be regarded as the father of the modern banking institutions in Nepal. in the context of Nepal Merchant Banking exits from the establishment of Nepal Bank Ltd in 1994 B.S existence was in crude form. After the restoration of democracy in 2046 B.B and an announcement of government’s economic liberalization policy, private sector investors are attracted to invest in different organized commercial ventures. As a result lots of public and private limited companies were established in a very short span of time to reap benefit of economic liberalization policy of the nation.

According to Mr. Ramesh Kumar Pokhrel, in his article “Merchant Banking Service in Nepal” in banking Prabadhan.2057 vol11 has mentioned on regulatory Aspect of Merchant Banking in Nepal, Merchant Banking is a new concept for Nepal. its role as an important financial intermediary cannot be challenged anywhere in the growing financial system of Nepal. Although a few financial institutions (basically finance companies) are involved in different merchant banking activities, there is no clear definition of merchant banking in Finance Company Act 1986, and no specific legal provision to be complied by merchant banker. However section(e) of Finance Company Act 1986, permits finance companies to sell and purchase the bonds issued by Nepal Government , by other companies or institutions, to underwrite them and to dorm syndicate for such purpose or to participate in such syndicate and to act as broker under the Security Exchange Act 1983. and section 3(g) of the same act permits them to perform functions of merchant banking with prior approval of NRB.

Since there is no separate entity to carry out the merchant banking activities in Nepal, these activities are associated with other transaction of finance companies.

2.10 Research Gap

To increase the portion of national revenue, research and analysis should be done in the field of income tax. But the studies and research work is lacking in the area of income tax. Merchant Banks & Finance Companies are also income taxpayers. The problems they are facing in tax saving should be corrected so they may contribute more income tax to the national receipt. Merchant Banks & Finance Companies are such institutions, which are directly linked with most other business activities. The position of business trade and industries can be visualized through the analysis of activities of Merchant Banks & Finance Companies. This study is concerned with appropriate suggestions for the estimation, correction and provides comprehensive information about income tax. Besides, this analysis may be useful to make new policies for granting various facilities to the Merchant Banks & Finance Companies for making more taxable income in the competitive environment and legal correction, vague section of income tax can be also rectified from such analytical study.

This study is concerned with these aspects and it tries to make appropriate recommendation for the correction of problems in paying income tax by Merchant Banks & Finance Companies. Besides, this study will also be useful to the tax planners, bankers, tax authorities and many others like teachers, students, researchers and people who are interested on it.

CHAPTER - III

RESEARCH METHODOLOGY

Methodology is the research method used to complete the study systematically and test the hypothesis. This study has been carried out to analyze the tax contribution of merchant banks and finance companies in the national receipts and problems relating to income tax payment. To achieve these stated objectives, the research method has been designed accordingly. The research method contained research design, sources of data collection, procedure of data collection, using tools and procedures of data presentation and analysis.

3.1 Research Design

This thesis is a type of descriptive design as the research entitled "A Study on Income tax collection from Merchant Banking and Finance Companies of Nepal has concerned with past phenomena both numerical as well as opinion. Thus the study had followed the descriptive research design.

3.2 Data Collection Procedure

The data and information in this report were both from primary and secondary sources. All the numerical data have been collected from the secondary sources while other required information has been collected from primary sources.

(a) Primary Sources: Primary Data were collected through, questionnaire circulation to the bankers as well as tax authorities. Interviews have been taken to get more information.

(b) Secondary Sources : Secondary Data were obtained from the various sources, specified as below:

1) Annual Report and Published Documents of NRB
2) Reports and records of Department of Taxation, MOF Nepal

3) Budget Speech and Economic Surveys of Various Years, MOF Nepal
4) Books related to income tax and public finance
5) Annual reports of merchant banking and financial institutions FY 2002/2003-2006/2007

Seven Merchant Banks & Finance Companies have been selected as samples in this report. They are:

1. Nepal Merchant Banking & Finance Ltd.
2. Nepal Shreelanka Merchant Banking & Finance Ltd.
3. Nepal Housing & Merchant Finance Ltd.
4. Cosmic Merchant Banking & Finance Ltd.
5. Capital Mrechant Banking & Finance Ltd.
6. Royal Merchant Banking & Finance Ltd.
7. Guheshwori Merchant Banking & Finance Ltd.

3.3 Data Presentation

The data collected were arranged in tables, graphs and charts to make the analysis easier.

3.4 Statistical Tools Used

For analyzing and interpreting collected data, the tabulation charts and diagrams were used along with simple presentation as demanded by the subject matter. From these tabulating data interpretations were made by simple arithmetic mean and ratios wherever necessary. Similarly Standard deviation and coefficient of variation were used to show dispersion of tax payment from Merchant Banks and Financial institutions.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with presentation and analysis of data related with income tax collection from merchant banking and finances. Under this selected merchant banking and financial institutions has been analyzed with tables, graphs and line charts.

4.1 Structure of Nepalese Government Revenue

Government needs adequate budget for the development activities, operation of administration, maintaining peace and security and security and for other welfare activities. The required budget is collected from various sources. Generally the revenue collected by the government from various sources is known as public revenue/ public receipt/ National Exchequer. The structure of the government revenue in Nepal is the composition of tax revenue and non tax revenue. Tax revenue includes various direct taxes as well as indirect taxes. Direct tax includes income tax, property tax, house and building registration, Vehicle tax and others. An indirect tax includes customs, excise, and value added tax and others.

On the other hand, non tax revenue is the composition of various receipts from different government entities. The government revenue is therefore the mixture of tax revenue and non tax revenue of various sources. Mostly, income of the government is generated through indirect tax in Nepal. They are: custom duty, excise duty and sales tax or VAT. Custom duties consists of export, import, Indian Excise refund and miscellaneous. The excise duty is the imposition of tax on liquor production, tobacco production and other industrial productions. The other indirect taxes, which are also important as the government revenue, comprise of contract tax, hotel tax, entertainment tax and air flight tax.

Direct tax revenue includes income tax, house and building registration, property tax, vehicle tax etc. The income tax is directly imposed upon the individuals' income or profits. Income tax is the tax composition of income or profit of public enterprises, semi public enterprises, private corporate bodies, individuals and remuneration. The house and land registration, property tax and vehicle tax is also the pert of indirect tax.

Non tax revenue of the government includes various registration fees, income from sale of government services and products. Dividend received royalties, principal and interest received and miscellaneous. The registration fees also include the firm registration, vehicle registration, license registration and such. Water supply charge, electricity charge, telephone charge, post service, income from education, income from food, agriculture and income from transportation are the major sources of the government service and products. Government receives dividends from financial institutions, trading companies, industrial enterprises and service oriented organizations. Similarly, royalty from mine is also the non tax revenue of the government.

The government revenue includes different items. They are indirect taxes, direct taxes and non taxes. As shown in table 4.1, more than 75% has been collected from tax revenue in every year by the government. Government had collected revenue from total taxes in FY. (in A.D.) 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 was 57.77%, 58.2%, 58.53%, 60.13% and 59.5% respectively. Though in FY. 2006/07 the amount decreased, it showed the increasing rate of collection in all other years. In individual, value added tax showed increasing trend than others. It was collected in FY. 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 was 23.95%, 23.26%, 26.95%, 29.90% and 29.81% respectively.

Government had collected revenue from direct taxes in FY. 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 was 17.975, 19.09%, 18.63%, 19.32% and 21.64% respectively. It showed slight increase from FY. 2002/03 to 2003/04 and decrease in FY. 2004/05, again it increased regularly till FY 2006/07. In individual, Income Tax showed increasing trend than others. The collection in FY 20002/03, 2003/04, 2004/05, 2005/06 and 2006/07 was 14.46%, 15.25%, 14.91%, 15.13% and 17.93% respectively.

Government had collected revenue from Non- taxes in FY. 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 was 24.26%, 22.71%, 22.84%, 20.55% and18.86% respectively. It showed the highest revenue in FY 2002/03 and the lowest in FY 2006/07. Hence non-tax revenue collection showed no consistent trend of increase or decrease in each year. In individual, duties and fees showed increasing trend than others. It was collected as 3.91%, 5.21%, 5.38%, 5.75% and 5.84% respectively in the FY 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07.

Thus the tax revenue is the highest contributing source of total government revenue. But non tax revenue has been also contributing a considerable rate among the other individual revenue items. It has captured second and third position in the different FY. When comparison is made among all revenue items individually. In conclusion, the composition of government revenue has different types of tax and non-tax revenue items. The income tax is in increasing order from the beginning of analysis and it to be progressive in future items. The income tax is in increasing order4 from the beginning and found to be progressive. This is supported by the higher growth rate of this revenue item.

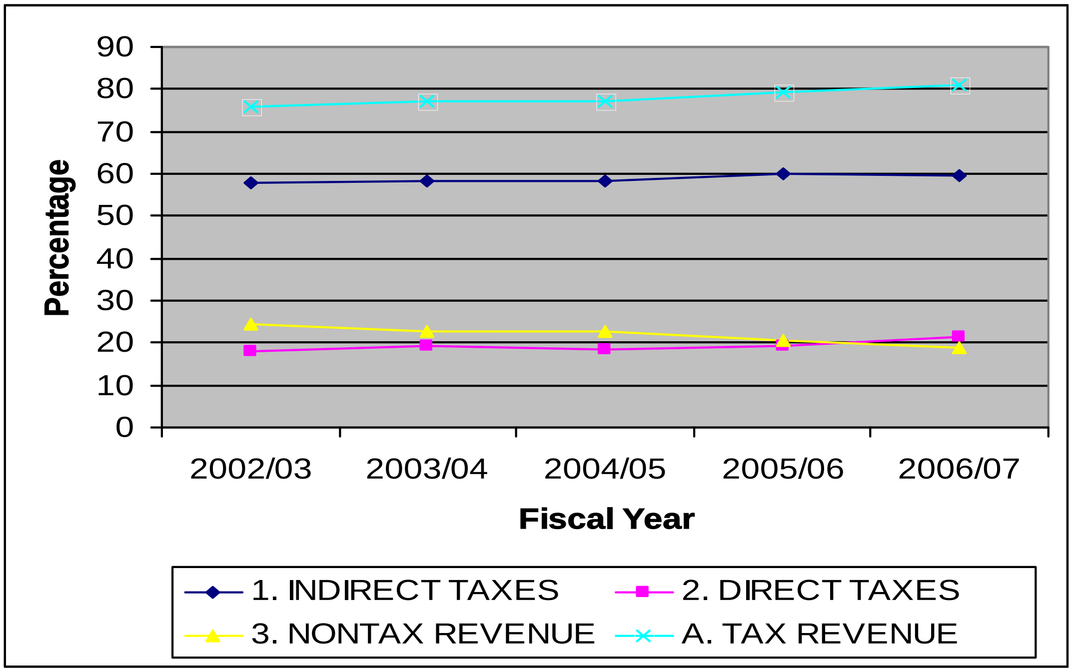
Table 4.1
Composition of Government Revenue in Nepal under Various Heads

(Rs. In Million)

FY	**2002/03**		**2003/04**		**2004/05**		**2005/06**		**2006/07**	
Revenues	Rs.	%	Rs	%	Rs	%	Rs	%	Rs	%
1. Indirect Taxes	32481.2	57.8	36274	58.2	41043	58.5	43466	60.1	52188	59.5
a. Customs	14236.4	25.32	15554	24.95	15702	22.39	15344	21.23	16699	19.04
b. Value Added tax	13467.3	23.95	14498	23.26	18896	26.95	21615	29.9	26145	29.81
c. Excise	4777.5	8.5	6221.4	9.98	6446	9.19	6506.5	9	9343.6	10.65
2. Direct Taxes	10105.8	18	11902	19.09	13061	18.63	13961	19.3	18980	21.64
a. Income Tax	8132.2	14.46	9504	15.25	10456	14.91	10934	15.13	15730	17.93
b. House and building Registration	1414.2	2.52	1697.5	2.72	1799	2.57	2180.3	3.02	2238.7	2.55
c. Property Tax	0.1	0	0	0	0	0	0	0	0	0
d. Vehicle Tax	559.3	0.99	700.4	1.12	806.1	1.15	847.6	1.17	1011	1.15
3. Nontax Revenue	13642.8	24.3	14155	22.71	16018	22.84	14855	20.6	16544	18.86
a. Duties and Fees	2200.8	3.91	3245	5.21	3771	5.38	4153.8	5.75	5216.4	5.84
b. Fines and Forfeiture	166.9	0.3	133.2	0.21	173.5	0.25	551.6	0.76	251.3	0.29
c. Public Utilities	1274.3	2.27	1321.3	2.12	1266	1.81	1150.7	1.59	1310.4	1.49
d. Dividends	2497.6	4.44	2661.1	4.27	4590	6.55	3394.8	4.7	4937.7	5.63
e. Interests	924.6	1.64	1656.5	2.66	1467	2.09	1734.6	2.4	1049.8	1.2
f. Royalty and sales of government property	1945.4	3.46	1465	2.35	1932	2.75	1195.6	1.65	1095.7	1.25
g. Principle repayments	1539.7	2.74	1850.5	2.97	1248	1.78	1513.6	2.09	1025.6	1.17
h. Miscellaneous income	3093.5	5.5	1822.7	2.92	1571	2.24	1160.4	1.61	1747.2	1.99
A. Tax Revenue (1+2)	42587	75.7	48176	77.3	54105	77.2	57427	79.5	71168	81.14
B. Non Tax Revenue (3)	13642.8	24.3	14155	22.7	16018	22.8	14855	20.6	16544	18.86
Total Revenue (A+B)	56229.8	100	62331	100	70123	100	72282	100	87712	100

Figure 4.1

Composition of Government Revenue in Nepal



4.2 Contribution of Tax Revenue to the Total Revenue

National Exchequer is the composition of tax and non- tax revenue. Tax revenue has also direct and indirect taxes. Customs, excise duty, sales tax, VAT and other miscellaneous are the main revenue items of the indirect tax revenue. Direct tax however is the composition of income tax, land tax, property tax and other direct taxes. Non- tax revenue of the government is an also important revenue source that includes different types of fees, charges, dividends, royalty and principle with interests from companies and corporations. Sale of fixed assets and minerals are also components of non-tax revenue. Table 4.2 shows the comparison between tax revenue and non tax revenue collection.

Table 4.2

Contribution of Tax Revenue/ Non Tax Revenue to the Total Revenue

(Rs. in Million)

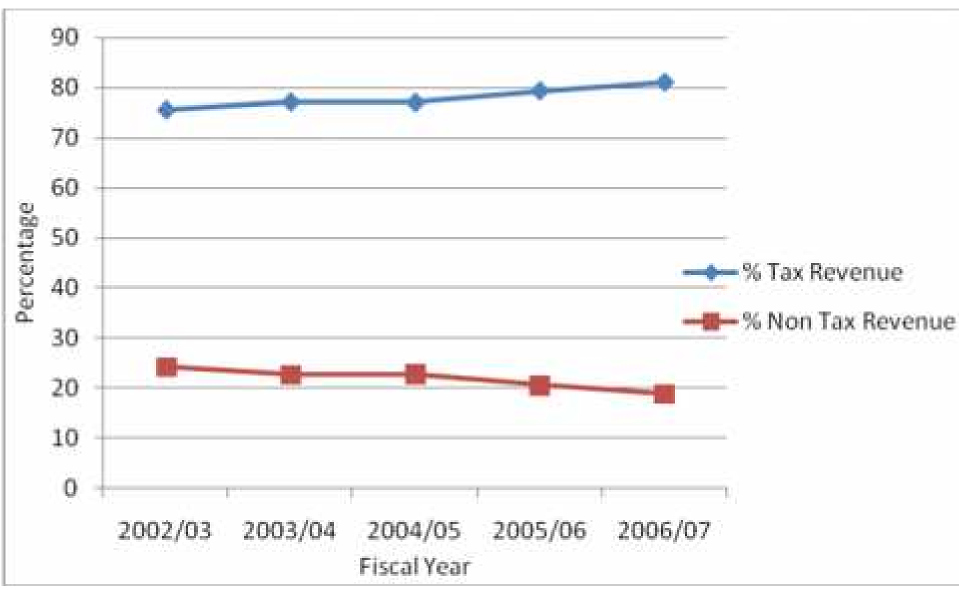
FY	Total Revenue	Tax Revenue	%	Non Tax Revenue	%
2002/03	56229.8	42587	75.74	13642.8	24.26
2003/04	62331	48175.7	77.29	14155.3	22.71
2004/05	70122.6	54104.7	77.16	16017.9	22.84
2005/06	72282.1	57427	79.45	14855.1	20.55
2006/07	87712.1	71168	81.14	16544	18.86
Average collection			78.15		21.85

Sources: 1 Quarterly Economic Bulletin (2007)No. 3 NRB

2. *Economic Survey(MOF)*

Figure 4.2

Contribution of Tax Revenue and Non Tax Revenue to the Total Revenue



As shown in the table 4.2, tax revenue contributed more than 75% in the total revenue realization. In FY. 2002/03, tax revenue contributed 75.74%, FY. 2006/07 showed the highest realization of tax revenue i.e. 81.14%. It shows regular increase till FY. 2006/07. In the FY. 2002/03, non tax revenue contributed highest revenue 24.26% and FY.2006/07 showed the lowest realization of tax revenue i.e. 18.86%. Non tax revenue contribution showed slight up and down each year. The above analytical company thus shows that the tax revenue was contributing more than non tax revenues. Tax revenue decreased to 75.74%, the lowest in the FY. 2002/03. Non tax revenue was realized 24.26% the highest in the same FY. This analysis also showed the average revenue collection through tax revenue and non tax revenue (average of last 5 years). As shown by table, the average contribution of tax revenue was 78.15% where as the contribution made by non tax revenue was 21.85%. This interpretation is also understood through the given figure no. 4.2 which visualizes the same.

4.3 Share of Direct Tax on Total Tax Revenue and Total Revenue

Tax Revenue is divided into two classes; direct and indirect. A direct tax is such type of tax which is imposed upon the person out of his income or property. A direct tax is really paid by the person or whom it is legally imposed. The taxpayer from other can not shift the burden of paying tax to the other person. He/she must pay it from his/her own pocket. Like income tax, property tax, expenditure tax, gift tax, contract tax, vehicle tax and others are the best examples of direct tax. On the other hand, an indirect tax is such type of tax which is imposed upon any person but without direct collection from him. An indirect tax is imposed on one person but paid partially or wholly by the others. Sales taxes, VAT, entertainment tax, customs, excise duty are the good examples of this sort of tax. Thus direct tax is any tax which is imposed to a person who bears its direct economic burden by him and indirect tax is any sort of tax in which economic burden is shifted to the other person. For instance, government imposes VAT on goods sold, but the amount of Vat is collected from the buyers or the customers. Here tax is imposed upon the sellers but buyer bears the responsibility of tax payment in an indirect manner by paying VAT additionally to the price of the goods or service.

Table 4.3 shows the contribution ratio of the direct tax on tax revenue and total revenue of the government. This relationship is also presented in the figure no. 4.3. The initial share of the direct tax on total revenue was 17.97% which was 23.73% on total revenue in the FY. 2002/03. In t5hat year Rs. 10105.8 million was collected from the direct tax. In FY. 2003/04 the share of direct tax on total revenue was 19.09% and 24.71% on total tax revenue. In FY. 2004/05 it decreased to 18.63% and 24.14% respectively. Then after it started to increase till 2006/07 as in FY. 2005/06 it was 21.64% and 26.67% in the FY. 2006/07.

Table 4.3

Ration of Direct Tax in Total Tax Revenue and Total Revenue

(Rs. in Million)

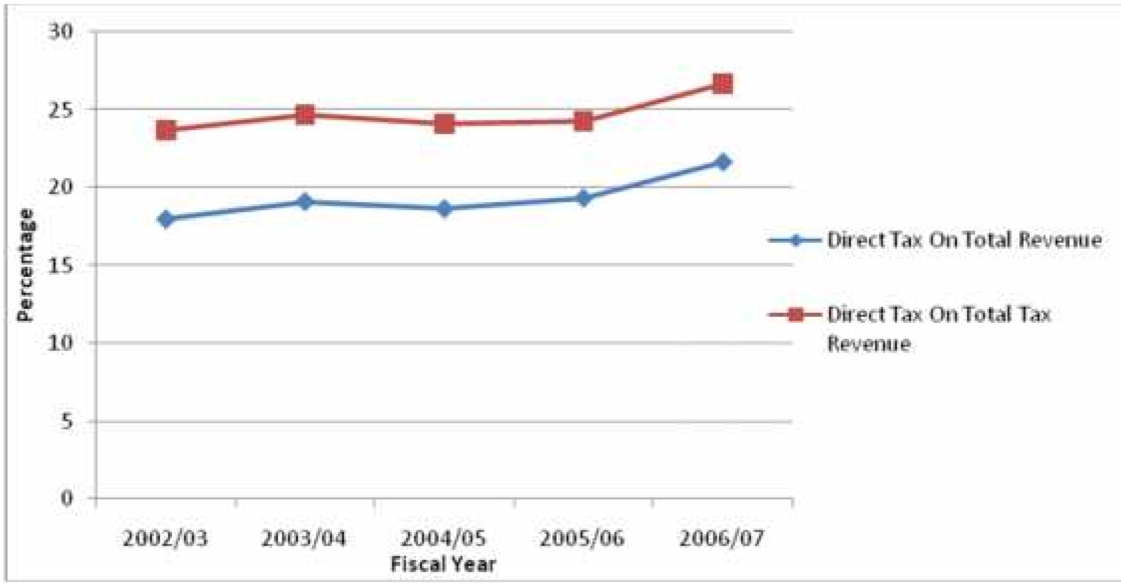
FY	Total Revenue	Total Tax Revenue	Direct Tax	Direct Tax On Total Revenue	Direct Tax On Total Tax Revenue
2002/03	56229.8	42587	10105.8	17.97	23.73
2003/04	62331	48175.7	11901.9	19.09	24.71
2004/05	70122.6	54104.7	13061.3	18.63	24.14
2005/06	72282.1	57427	13961.4	19.32	24.31
2006/07	87712.1	71168	18979.7	21.64	26.67

Sources: 1. Quarterly Economic No.3, Bulletin (2007) No. NRB

2. Economic Survey(MOF)

Figure 4.3

Ratio of Direct Tax in Total Tax Revenue and Total Revenue



Direct Tax on Total Revenue is more fluctuating than Direct Tax on Total Tax revenue. The reason behind fluctuation was the highest collection from direct tax. The income tax collection has been increasing due to increase in number of the taxpayers and their taxable amount and profits. In conclusion, it can be said that the positive trend of direct tax denoted economic improvement of the nation, even though the nation is in deep trouble being in the transition phase.

4.4 Structure of Income Tax in Nepal

Income tax is levied on net taxable income. This means that not all incomes accrued from all sources brought into the payment of income tax. The Income Tax Act, 2002 has mentioned about income tax as personal income tax levied upon individual where as Corporate tax levied upon organizations. The government therefore imposes income tax upon the person (individuals, firms and companies) earning taxable incomes without direct benefit to them. Paying income tax is the duty of a person to the state.

Income Tax Act 2002 has clearly defined the related terms. It has defined tax head for computation of tax liabilities. According to this law, three income headings including various receipts are mentioned as follows:

1. Income form Business: It includes income and profit from industry, business, profession and other business transaction, professional fees, service fees, sales proceeds of business stocks, amounts received from disposal of business assets and liabilities, proceeds from disposal of depreciable assts, business gifts, receipts from business restriction and receipts of amount from deeds directly related to business.
2. Income from employment: It includes various receipts. They are wages, salaries, allowances, fees, commissions, awards, gifts, bonus and other facilities. The other facilities include additional payment for Dashain, housing facility, vehicle facility and telephone facility and so on. Similarly dearness allowance, house rent, entertainment, transportation costs and costs of living expenses are also the remuneration of employees. Besides, receipts made in agreement of doing job and many other receipts in retirement such as retirement contribution and other amount prescribed by Income Tax Act are subjected to tax.
3. Income from investment: The third head of income is investment income, which includes various incomes received by investing assets in any business sector. They are dividend, interest, rent receipts, receipts from investment, insurance, gain from unrecognized retirement fund. It also includes proceeds from the sale of non-business assets. Capital gains from disposal of depreciable assets, gifts received in relation with investment, amount received in the acceptance of restriction of investment and others. Thus, taxable income is a composition of above mentioned various income sources. Income tax is divided into two types in broad sense viz. personal income tax and corporate income tax. Both have different income sources. Corporate tax

is a composition of three tax payers. They are government enterprises, public limited company and private limited company.

Individual income tax includes income tax from remuneration, industries, trade and profession of individual. Besides, rent and interest taxes are also included in income tax. This is shown in the table on. 4.4 For the last 5 years. According to the table the total income tax realized in FY. 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 was Rs. 8132.2, Rs. 9504, Rs. 10456, Rs. 10933.6 and Rs. 15730 millions respectively. In table 4.4 there are mainly four components as sources of income tax. They are as follows: A) Corporate Income Tax B) Remuneration Income C) Investment Income D) other taxes. Sources of corporate income tax are mixed with Government Corporations, public Ltd. Corporation, Private Ltd.Corporation, and Individual and sole trading firm and income from other institutions. The highest income tax collection in FY. 2002/03 by individual and sole trading firm in FY.2003/04 by Government Corporation, in FY 2004/05 to FY.2006/07 by public Ltd Corporation was 22.16%, 21.64%, 23.60%, 31.15% and 36.64%. These all incomes are the sources of corporate income tax.

The contribution of corporate tax in FY 2002/03 was 68.30% where the contribution of remuneration income tax, investment income tax and other taxes were 15.36%, 16.25%. 0.09% respectively. In FY 2003/04, the contribution of corporate income tax was 71.6% while that from remuneration income tax, investment income tax and other taxes were 14.66%, 13.59% and 0.15% respectively. In FY 2004/05 the contribution of corporate income tax was 70.12% where as from remuneration income tax, investment income tax and other taxes were 16.05%, 13.64%, 0.20% respectively. In the same way, In the FY 2005/06, the contribution of corporate income tax was 69.30% while the contribution from remuneration income tax, investment income tax and other taxes were 16.20%, 14.15% and 0.36% respectively. In FY 2006/07 the contribution of corporate income tax was 73.78% while the contribution from remuneration income tax, investment income tax and other taxes were 12.76%, 13.22% and 0.24% respectively. The data shows that corporate income tax has always been the highest contributor to total income tax revenue.

Table 4.4

Structure of Income Tax Revenue in Nepal

(Rs in Million)

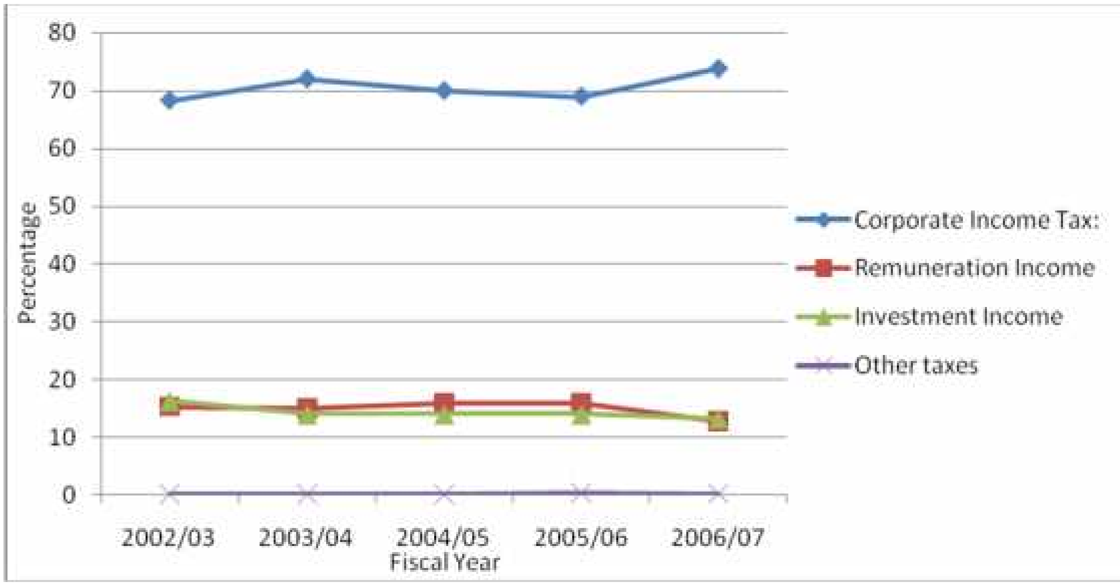
FY	2002/03		2003/04		2004/05		2005/06		2006/07	
Particulars	Rs	%	Rs	%	Rs	%	Rs	%	Rs	%
A. Corporate Income Tax:	**5554**	**68.3**	**6805**	**72**	**7331**	**70**	**7577**	**69**	**11605**	**73.78**
1. Government Corporation	1251	15.38	2057	22	1332	13	195.8	1.8	1020	6.48
2.Public Ltd. Corporation	1235.1	15.19	1531	16	2468	24	3406	31	5716	36.34
3.Private Ltd. Corporation	1166.7	14.35	1240	13	1527	15	1703	16	2310	14.69
4.Individual & Sole Trading Firm	1801.7	22.16	1870	20	1877	18	1959	18	2303	14.64
5.Income From Other Institutions	99.5	1.22	107.6	1.1	128.1	1.2	313.4	2.9	255.6	1.62
B.Remuneration Income	**1249**	**15.36**	**1393**	**15**	**1678**	**16**	**1771**	**16**	**2007**	**12.76**
C.Investment Income	**1321.5**	**16.25**	**1292**	**14**	**1426**	**14**	**1547**	**14**	**2080**	**13.22**
D.Other taxes	**7.7**	**0.09**	**14.2**	**0.2**	**20.6**	**0.2**	**39.3**	**0.4**	**38.2**	**0.24**
INCOME TAX (A+B+C+D)	**8132.2**	**100**	**9504**	**100**	**10456**	**100**	**10934**	**100**	**15730**	**100**
Growth Rate	**-9.49**		**14.43**		**9.1**		**4.37**		**30.49**	

Source: Economic Bulletin, (2007) NRB.

$$\text{Growth Rate} = \frac{\text{Current Years Collection} - \text{Previous Years Collection}}{\text{Current Years Collection}} \times 100$$

Figure 4.4

Income Tax Structure



4.5 Role of Corporate Tax in Nepal

Corporate tax has a very important role in the developing countries. Nepal, being an impoverished and land locked country, has always had budget deficits since the inception of the budgeting practice. Unfortunately, the whole economic sector of Nepal has been badly affected due to various reasons such as poor education system, least development of infrastructure, poor trade relation with third countries, lack of strong commitment of the government, instability of government, and so on. Income tax is one of the best and vital resources of national revenue that can be mobilized in the country to attain development. The increment in income tax is justifiable for the development of infrastructure as increasing other indirect taxes will give a tremendous burden to the already poor people. Increase in other taxes will also have a serious effect in other sectors of economy. The income tax can be increased as it is levied to the income generator without affecting others. It gives incentives to the people to work hard and increase economic transaction. The number of tax payers can also be increased by investigating potential tax payers who are not contributing. The income tax has a positive effect on the people's ability to work. The individual deficit will be compensated by the government's expenditure on the poor and middle class to raise their level of income, providing them better housing and education. Thus, it is levied not only for raising national revenue but also to bridge the gap between the rich and the poor. A highly progressive income tax if administered properly should be able to reduce inequalities in the short run. Progressive income tax levies taxes at a low rate for low income earners and high tax rate for the high income earners. Therefore most countries have been using this policy not only for the revenue to the state but also to solve the problem of inequality in income. Moreover, the government itself will be one of the main sources of capital formation as it will invest part of the tax proceeds in industries, transport and communication. Thus if the revenue from income taxes is devoted to national building, it stabilizes and promotes business activity and increase the volume of national income.

Most of the people in developing countries do not have to pay individual income tax because they are least income earners. In this situation, income tax from corporate bodies, play vital role in resource mobilization in the nation. The other points of corporate tax are that it is easily identifiable and accounts can be maintained in a proper way. They can not escape from tax liability and evade taxes as the individual tax payers can. Unfortunately, Industrial sector has not been able to develop in Nepal. Some government enterprises have been privatized, most of which are not in operation. Even the private limited companies have been practicing tax evasion. This decreases the revenue from corporate income tax. As said earlier, there are only a limited number of corporate bodies in the country. Though their economic performance is very low and not much satisfactory, their contribution is still higher in total government revenue.

Table 4.5 shows the contribution of corporate income tax on total income tax with its growth rate during the FY 2002/03 to 2006/07. About Rs. 5,554 has been raised in the FY 2002/2003 which was 68.30% of total income tax collection. It was continuously increased to 6,805 million in the FY 2003/2004 with contribution of 71.60% of the total income. It was decreased and reached 71.12% and 69.30% of the total income tax revenue in the FY 2004/2005 and 2005/2006 respectively. Thereafter it again increased to reach 73.78% of the total income tax revenue in the FY 2006/2007. During the FY 2002/2003 to 2006/2007 the growth rate of contribution of income tax to the total income tax revenue showed (30.58%), 18.38%, 7.18%, 3.24% and 34.71%. In the FY 2002/2003 the growth rate was negative hence the growth rate has very fluctuating trend within five years

Table 4.5

Contribution of Corporate Tax in Total Income Tax Revenue

(Rs in Million)

FY	Total Income tax	Corporate Tax	% on Total Income Tax	Growth Rate
2002/03	8132.2	5554	68.3	-30.58
2003/04	9504	6805	71.6	18.38
2004/05	10456	7331.3	70.12	7.18
2005/06	10933.6	7576.6	69.3	3.24
2006/07	15730	11605	73.8	34.71

Source: 1. Quarterly Economic Bulletin 2007

2. Economic Survey 2003/04 and 2006/07

3. Annual Report of IRD 2006/07

Figure 4.5

Contribution of Corporate Tax in Total Income Tax Revenue with Growth Rate

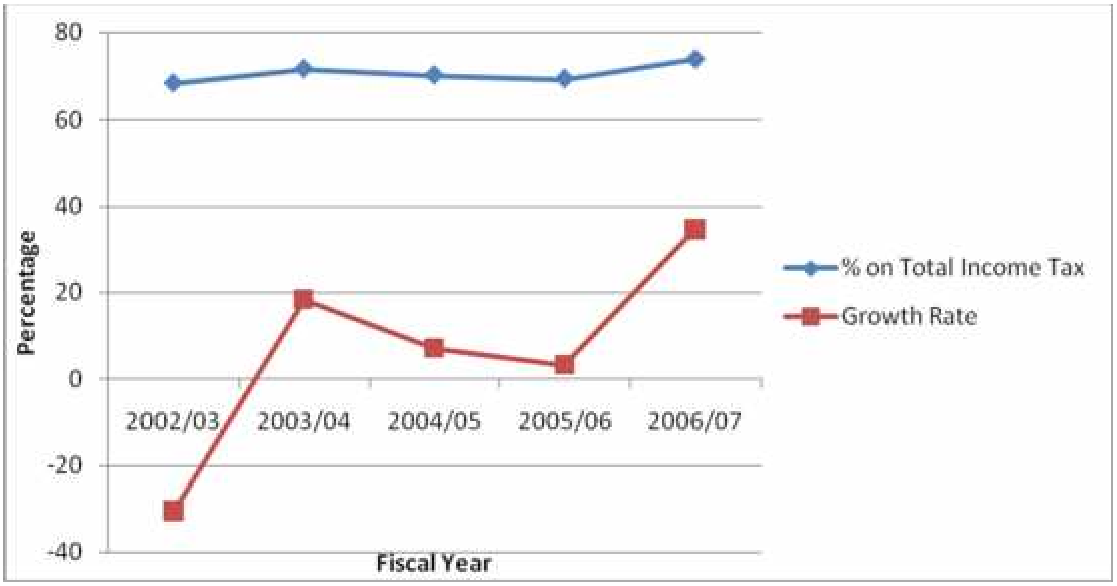


Table 4.6

Contribution of Corporate Tax on Government Revenue

(Rs in Million)

FY	Government Revenue (GR)	Corporate Tax	Corporate Tax % on GR
2002/03	56229.8	5554	9.9
2003/04	62331	6805	10.9
2004/05	70122.6	7331.3	10.5
2005/06	72282.1	7576.6	10.5
2006/07	87712.1	11605	13.23

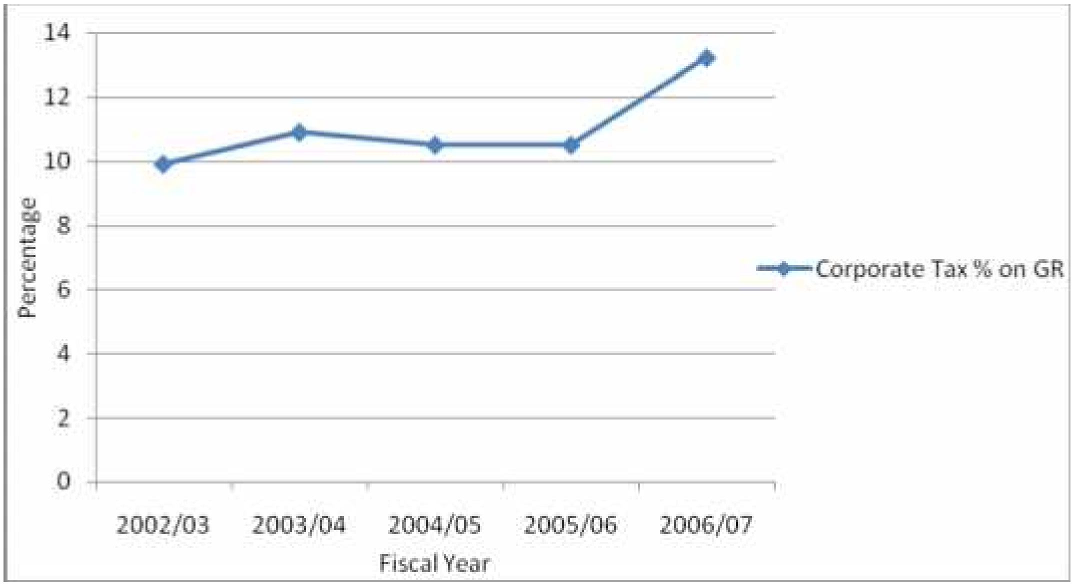
Source: 1. Quarterly Economic Bulletin 2007

2. Economic Survey 2003/04 and 2006/07

3. Annual Report of IRD 2006/07

Figure 4.6

Contribution of Corporate Tax As Percentage of Government Revenue



Corporate income tax is the direct tax which is the main source of government revenue. Table 4.6 shows the contribution of corporate tax on government revenue. In FY 2002/03 the contribution of corporate tax in government revenue was 9.9%. Similarly the contribution in FY 2003/04 was 10.9% and in FY 2004/05 and FY 2005/06 it was 10.5%. After that it has increased to 13.23% in FY 2006/07.

Table 4.7

Corporate Tax/Income Tax Collection From Listed Merchant Banking & Finance Companies

(Rs in Million)

S.N.	Particular	2002/03	2003/04	2004/05	2005/06	2006/07	Total
1	Nepal Merchant Banking & Finance Ltd.	4.11	6.74	15.18	15.18	15.33	53.55
2	Nepal Shreelanka Merchant Banking &Finance Ltd.	0.48	1.02	0	0	0	1.5
3	Nepal Housing &Merchant Finance Ltd.	4.93	3.56	2.84	6.02	6.78	24.14
4	Cosmic Merchant Banking &Finance Ltd.	4.32	1.65	2.92	0	8.81	17.71
5	Capital Merchant Banking & Finance Ltd.	0	0	1.54	1.25	3.94	6.73
6	Royal Merchant Banking & Finance Ltd	0	0.13	2.82	3.72	7.02	13.7
7	Guheshwori Merchant Banking & Finance Ltd.	1.78	1.95	1.97	2.57	5.34	13.6
	Total	15.63	15.05	24.09	28.74	47.41	130.92

Source: Annual Report of Relevant Merchant Banking & Finance Companies. (2002/03to 2006/07)

Note: Tax Amount, Tax Provision from P/L Account, Tax adjustment of Last Year.

Table 4.8

Averages Corporate Tax Collection from Listed Merchant Banking & Finance Companies

(Rs in Million)

Particulars	Mean payment of Corporate Tax	Standard Deviation of Payment	Coefficient of Variation
Nepal Merchant Banking & Finance Ltd.	10.71	4.56	0.4
Nepal Shreelanka Merchant Banking & Finance Ltd.	0.3	0.33	1.1
Nepal Housing &Merchant Finance Ltd.	4.83	1.47	0.3
Cosmic Merchant Banking &Finance Ltd.	3.54	2.99	0.8
Capital Merchant Banking & Finance Ltd.	1.35	1.44	1
Royal Merchant Banking & Finance Ltd	2.74	2.59	0.9
Guheshwori Merchant Banking & Finance Ltd.	2.72	1.33	0.5

Source: Appendix –II of this Report

Table 4.8 shows the average corporate tax payment made by Merchant banking and finance companies with standard deviation and coefficient of variation of the tax payment. As shown in the table Nepal Merchant Banking and Finance Ltd., Nepal Housing and Merchant Finance Ltd, and Cosmic Merchant Banking and Finance Ltd. are the top three corporate tax payers out of these seven merchant banking and finance companies. The coefficient of variation (C.V) demonstrates the variation of payment of corporate tax from the central tendency i.e. mean payment. As shown in the same table Nepal Housing and Merchant Finance Ltd. Has less C.V.i.e.0.3%. It means its corporate tax payment was very close to the average payment than others. Nepal Shrilanka Merchant Banking and Finance Ltd.

has the highest C.V. that is why it has high volatile in income tax payment .It has not contributed any tax amount in FY 2004/05 to FY2006/07 as the bank is suffering loss.

Table 4.9

Contribution Ratio of Income Tax Paid by Merchant Banking & Finance Companies to Total Government Revenue & Total Tax Revenue

(Rs in Million)

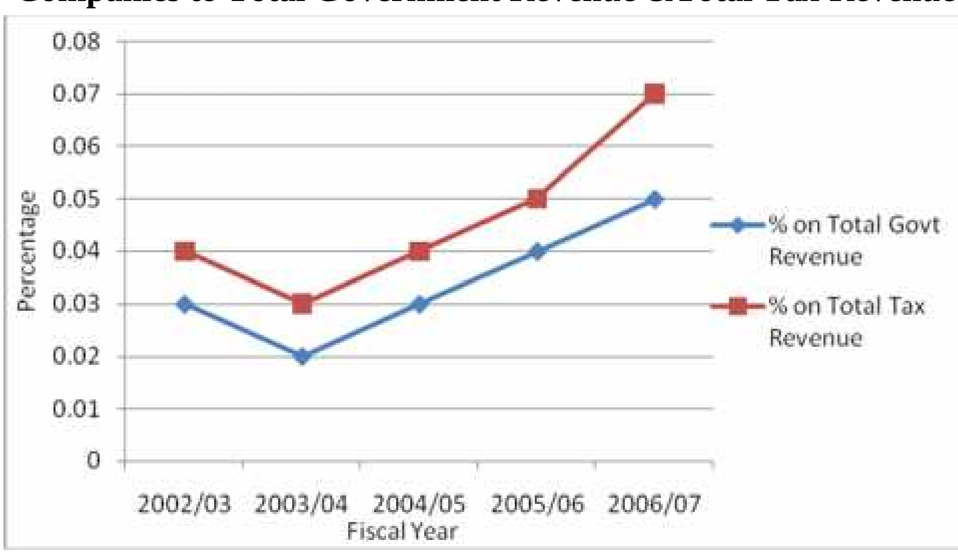
FY	Total Govt Revenue	% on Total Govt Revenue	Corporate Tax collected From M.B.F	Total Tax revenue	% on Total Tax Revenue
2002/03	56229.8	0.03	15.63	42587	0.04
2003/04	62331	0.02	15.05	48175.7	0.03
2004/05	70122.6	0.03	24.09	54104.7	0.04
2005/06	72282.1	0.04	28.74	57427	0.05
2006/07	87712.1	0.05	47.41	71168	0.07

Source: Economic Survey 2003/04 and 2006/07

Annual Report of Merchant Banking & Finance Ltd.2002/03 to 2006/07

Figure 4.7

Contribution Ratio of Income Tax Paid By Merchant Banking & Finance Companies to Total Government Revenue &Total Tax Revenue



The table 4.9 and figure 4.7 have presented the contribution ratio of corporate tax collected from listed merchant banking and finance companies in total tax revenue and in total government revenue for the last five years. As shown in the table the contribution of corporate tax of the merchant banking and finance companies in the FY 2002/03 was about Rs. 15.63 million which was 0.3% in total government revenue. In the same year its contribution total tax revenue was 0.04%. In the FY 2006/2007 the realization of the tax amount from the listed merchant banking and finance companies was Rs 47.41 million, which was 0.05% of the total government revenue and 0.07% of total tax revenue. The contribution of tax payment made by the listed merchant banking and finance companies has been slightly increasing, though it decreased in FY 2003/04. The situation is not satisfactory. The instable political situation and some other conflicts can be described as the reason for this.

Table 4.10

Contribution of Ratio of Income Tax Collection From M.B.F to Total Income Tax and Corporate Tax

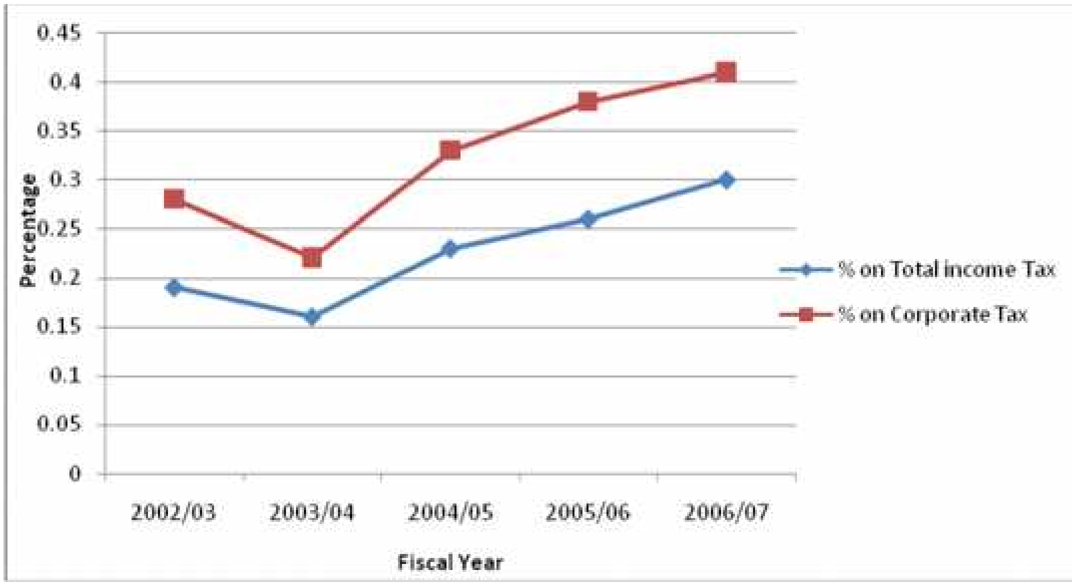
(Rs. in Million)

FY	Total Income Tax Revenue	% on Total Income Tax	Corporate Tax Collection From Listed M.B.F	Corporate Tax	% on Corporate Tax
2002/03	8132.2	0.19	15.63	5554	0.28
2003/04	9504	0.16	15.05	6805	0.22
2004/05	10456	0.23	24.09	7331.3	0.33
2005/06	10933.6	0.26	28.74	7576.6	0.38
2006/07	15730	0.3	47.41	11605	0.41

Source: Annual Report of IRD, 2006/07and Annual Report of Merchant Banking & Finance Ltd. 2002/03 to-2006/07

Figure 4.8

Contribution Ratio Of Income Tax Collection From M.B.F To Total Income Tax and Corporate Tax



This part of analysis has been represented by the table 4.10 and figure 4.8. According to these figures the contribution of corporate tax collected from listed merchant banking and finance companies was 0.19% and 0.28% FY 2002/03 in total income tax and total corporate tax realized by the government respectively. In that year about Rs. 15.63 million was collected as corporate tax from listed merchant banking and finance companies. In FY 2003/04 corporate tax collected from listed merchant banking and finance companies was decreased to 0.16% and 0.22% in total income tax and total corporate tax realized by the government respectively. After FY 2003/04 the contribution ratio of the corporate tax collected from listed merchant banking and finance companies in total income tax and total corporate tax has increased till FY 2006/07. During the five years corporate tax collection from the listed Merchant Banking and finance companies in total income tax and total corporate tax increased to 0.30% and 0.41% in the F.Y. 2006/07.

Table 4.11

Relationship of Corporate Tax and Tax Collected from Listed M.B.F with Gross Domestic Product

(Rs. in million)

FY	Gross Domestic Product (GDP)	Growth Rate	Corporate Tax	Corporate Tax Collection From Listed M.B.F	Corporate Tax as % Of GDP	Corporate Tax from Listed M.B.F as % of GDP
2002/03	438920	7.85	5554	15.63	1.27	0.004
2003/04	474242	7.45	6805	15.05	1.43	0.003
2004/05	589412	19.54	7331.3	24.09	1.24	0.004
2005/06	646471	8.83	7576.6	28.74	1.17	0.004
2006/07	719477	10.15	11605	47.41	1.61	0.007

Sources: 1. Economic Survey, 2003/04 and 2006/07

2. Annual Reports of IRD, 2006/07

3 Annual Reports of Merchant Banking & Finance Ltd. 2001/02 to 2006/07

The Corporate Tax and tax collection from listed merchant banking 7 finance companies to GDP are shown in table 4.11. Gross Domestic Product (GDP) means the value goods and services produced within the nation. If it is represented in the income of the factors of production, it is known as GDP at factor cost where as it is known as GDP at market price if goods and services are charged at ruling prices. Prices include all taxes on expenditure subsidies being regarded as negative taxes. For the analysis GDP at current market price is taken as base. As shown by the table 4.11 the contribution ratio of these two taxes has been very low in GDP even though both have been increasing.

In FY 2002/03 the GDP growth rate was 7.85% i.e Rs 438920 million. The share of corporate tax and corporate tax collection from listed merchant banking and finance companies in the GDP was 1.27% and 0.004% respectively in the same year. The GDP growth rate decreased to 7.45% in FY 2003/04 and the share of corporate tax in the GDP has increased to 1.43% whereas the corporate tax collection from listed merchant banking and finance companies decreased to 0.003%. In the same year. In FY 2004/05 to FY 2005/06 the share of corporate tax collection in GDP from listed merchant banking and finance companies was 0.004% as in the previous year and the share of corporate tax in the GDP were 1.24%and 1.17% respectively. In FY 2006/07 the GDP growth rate was 10.15%, and Rs 719477 million in amount. In the same year the share of corporate tax in GDP was 1.61% and the share of corporate tax collection from listed merchant banking and finance companies in the GDP was 0.007% which was the highest ration during the five years period.

4.6 Empirical Investigation

An empirical investigation has been conducted to find out different aspect of Nepalese income tax and public enterprises income tax imposition in Nepal. The major tool used in survey research was through questionnaire. An opinion questionnaire was distributed to 70 people. The questionnaire included the various aspect of income tax concerning with selected merchant banking and finance finance companies and IRD. A total of 50(71.43%) filled questionnaire were collected. Among them 15(30%) were tax administrator, 15(30%) were tax exoperts, 15(30%) were tax payers, and 5(10%) were bank officials.

The respondent were asked either to response yes/no or tick best answer one or to write their opinion. Some of the respondents have chosen more than one answer and ranked them. Information received from all respondents was tabulated in to the separate table format and they were presented in percentage of total numbers or points then analyzed in to descriptive way. The respondents were selected four denominations and code was used to represent each denomination in order to make the analysis easy. The following table shows denomination of respondents and code used to represent them.

Table 4.12

Denominations of Respondents and Code

SN	Denomination Of Respondents	Code Used
1	Income Tax Administrators	A
2	Income Tax Experts	E
3	Income Tax Payers	P
4	Bank Officials	O

4.6.1 Income Tax as Suitable Means of Raising Domestic Resources

In order to know whether income tax is suitable means of raising domestic resources, a question was asked “In your opinion, is the income tax suitable means of raising domestic resources in Nepal”. The response received from respondents is tabulated as follows.

Table 4.13

Income Taxes as a Suitable Means of Raising Domestic Resources

Respondents	A	E	P	O	Total	Percentage
Yes	17	17	7	7	48	96
No	0	0	2	0	2	4
Total	17	17	9	7	50	100

Source: Opinion Survey

The question was responded by all respondents. 96% of total respondents accept the income tax as a suitable means of domestic resource and only 4% of total respondents don’t recognize income tax a suitable means of domestic resources mobilization. Thus the conclusion can be drawn that the income tax is a suitable means of raising government revenue.

As the corollary to the earlier question another Question was asked “If yes, why it is a suitable means for raising domestic resources”. The opinions of respondents are presented in the following table.

Table 4.14

Reasons for Income Tax to be a Suitable Means for Raising Domestic Resources

S.N.	Problems	Points	%	Rank
1	It is harmful to depend fully on external sources	170	36	1
2	Among the internal sources taxation seems to be the most viable method	140	30	2
3	It is not possible to cut the consumption level of people, as it is already too low	65	14	3
4	Several limitations of public borrowings.	57	12	4
5	Others	35	8	5
	Total	467	100	

Source: Opinion Survey

From the above table it is shown that it is harmful to depend fully on external sources are the main causes for income tax to be a suitable means for raising domestic resources of Nepal. The reason for income tax to be a suitable means for raising domestic resources are ranked below in order of preference.

- It is harmful to depend fully on external sources.
- Among the internal sources, taxation seems to be the most viable method.
- It is not possible to cut the consumption level of people as it is already too low.
- Several limitations of Public Borrowings.
- Others.

4.6.2 Soundness and Effectiveness of Income Tax System of Nepal

The most effective part of income tax system is its effectiveness and soundness. The question "Do you think the income tax system of Nepal is sound and Efficient" was asked. The responses are presented below.

Table 4.15

Soundness and Effectiveness Of Income Tax System of Nepal

Reponses	A	E	P	Total	Percentage
YES	10	4	3	17	34
No	6	11	16	33	66
TOTAL	16	15	19	50	100

Source: Opinion Survey

There was 100% responses received from respondents. Majority of the respondents disagree with sound and effective income tax system in Nepal. 66% of the total respondents are unsatisfied. Only 34% are satisfied with the soundness and effectiveness of income tax system of Nepal.

As the corollary to the earlier question another question was asked. That was "If No, what is the major problem in income tax system of Nepal". The opinions of the respondents are presented on the table below.

Table 4.16

Major Problems in Soundness and Effectiveness of Income Tax System of Nepal

S.N.	Problems	Points	%	Rank
1	Complexity in Income tax policy, rules and regulations	115	24	2
2	Inadequate government economic policy	125	26	1
3	Lack of appropriate assessment procedures	100	21	3
4	Lack of honest, trained and competent personnel	77	16	4
5	Others	60	13	5
	Total	477	100	

Source: Opinion Survey

From the above table it is shown that inadequate government economic policy is the main cause for dissatisfaction of soundness and effectiveness of income tax system of nepal. The reasons for dissatisfaction are ranked below in order of preference.

- Inadequate government economic policy
- Complexity in income tax policy, rules and regulations.
- Lack of appropriate assessment procedure
- Lack of honest, trained and competent tax personnel
- Others.

4.6.3 Corporate Tax Rate in Nepal

Corporate tax rate plays vital role in income tax. It is clear that the corporate tax rate should be such which enables the government to collect more amounts for its revenue and provide incentives to invest corporate sector. Exciting corporate tax rate in Nepal is 25% whereas in the financial corporate sector it is 30%. The table below shows the level of satisfaction of corporate tax rate.

Table 4.17

Corporate Tax in Nepal

Responses	A	E	P	O	Total	Percentage
YES	15	15	15	5	50	
NO	0	0	0	0	0	
TOTAL	15	15	15	5	50	100

Source: opinion Survey

100% responses were received from the respondents. The responses from the respondents it is clear that the existing corporate tax rate of 25% is satisfactory and do not need to change it. Thus the conclusion can be drawn out that the corporate tax rate that is 25% is appropriate.

4.6.4 Specific Goal of Income Tax

Income tax is imposed on person's income in order to achieve some specific goal. Regarding the specific goal of income tax in Nepal, respondents were requested to rank their response on 1 (most important) to 4 (least important). The question was "what should be the specific goal of income tax in Nepal". The table below has presented the responses.

Table 4.18

Specific Goal of Income Tax in Nepal

S.N.	Goals of Income Tax	Group			Total Points	%	Rank
		A	E	P			
1	Increase the revenue of government	70	75	79	224	40	1
2	Reduce the gap between poor and rich	50	45	55	150	27	2
3	Promote private sector investment	42	37	35	114	21	3
4	Reduce unemployment	15	27	27	69	12	4
	Total				557	100	

Source: Opinion Survey

The specific goals of income tax in Nepal are ranked in order of the preferences of the respondents are as follows.

- Increase the revenue of government.
- Reduce the gap between poor and rich.
- Promote private sector investment.
- Reduce unemployment.

Minimize tax avoidance and tax evasion; attract foreign business group and increase the feelings of social justice are some of other goals as stated by the respondents.

From the above analysis it is clear that increase in revenue of government is the most important goal of income tax in Nepal. It is also an important factor to reduce the gap between poor and rich.

4.6.5 Delay in Tax Assessment

A question was asked," Do you accept that there exists delay in tax assessment". The responses received from the respondents are tabulated as below.

Table 4.19

Delay in Tax Assessment

Responses/Respondents	**A**	**E**	**P**	**O**	**Total**	**Percentage**
YES	17	17	7	4	45	90
NO	0	0	5	0	5	10
TOTAL	17	17	12	4	50	100

Source: Opinion Survey

The question was answered by all the respondents. 90% of the total respondents accept the existence of delay in tax assessment and only 10% of total respondents do not feel that there exists delay in tax assessment.

As the corollary to the earlier question another question was asked “If Yes, what may be the reasons”. The Responses given by the respondents are presented below.

Table 4.20

Reasons for Delay in Tax Assessment

S.N	Problems	Points	%	Rank
1	Delay in filing returns	17	36	1
2	The assessment procedure itself takes longer time	115	25	2
3	Inefficiency of tax authorities	90	19	3
4	Negligence of tax personnel	57	12	4
5	Others	36	8	5
	Total	465	100	

Source: Opinion Survey

From the above table it is shown that delays in filing returns is the main cause for delay in income tax assessment. The reasons for delays in tax assessment are ranked below in order of preference.

- Delay in filing returns.
- The assessment procedure itself takes longer time.
- Inefficiency of tax authorities
- Negligence of tax personnel
- Others

4.6.6 Types of Complain that Merchant Banking & Finance Companies Make

A question was asked,” what type of complains do Merchant Banking & Finance Companies make”. The responses of the respondents are tabulated below.

Table 4.21

Types of complain That Merchant Banking & Finance Companies

S.N	Problems	Points	%	Rank
1	About Tax Assessment	217	40	1
2	About Behavior	113	21	2
3	About Tax Incentives	95	18	3
4	About provisions included income tax law	64	12	4
5	About Fines & Penalties	40	7	5
6	Others	9	2	6
	Total	538	100	

Source: Opinion Survey

The types of complain that the Merchant Banking & Finance Companies make are ranked in order of the percentage of the respondents are as follows.

- About tax assessment
- About behaviors of tax personnel.
- About tax incentives.
- About provisions included in income tax law.
- About fines and penalties.
- Others.

4.6.7 Filing appeals by Merchant Banking & Finance Companies to Revenue Tribunal

A question was asked “What may be the reasons of filing appeals by Merchant Banking & Finance Companies to Revenue Tribunal”. The responses received from the respondents are presented below.

Table 4.22

Filling Appeals by Merchant Banking & Finance Companies to Revenue Tribunal

S.N.	Reasons	Points	%	Rank
1	Order of tax assessment by tax authorities	171	36	1
2	Tax evasion	115	24	2
3	Vague provision of tax law	99	21	3
4	Use of discretion by tax authorities	50	11	4
5	Others	35	8	5
	Total	470	100	

Source: Opinion Survey

The reasons for filing appeals by Merchant Banking & Finance Companies to Revenue Tribunal are ranked in order of the percentage of the respondents are as follows.

- Order of tax assessment by tax authorities.
- Tax evasion.
- Vague provision of tax law.
- Use of discretion by tax authorities.
- Others.

4.6.8 The Concession Facilities and Incentives to be given to the Merchant Banking & Finance Companies

A question was asked “What types of tax concession facilities and incentives to be given to the Merchant Banking & Finance Companies,” the responses receive from the respondents are presented below.

Table 4.23

Tax Concession Facilities and Incentives to be given to the Merchant Banking & Finance Companies

S.N	Concessions, Facilities, Incentives	Points	%	Rank
1	Tax holiday	209	38	1
2	Investment Credit	107	19	2
3	Carry forward of losses	95	17	3
4	Tax rate deduction	71	13	4
5	Accelerated depreciation	45	8	5
6	Others	25	5	6
	Total	552	100	

Source: Opinion Survey

The types of tax concession facilities and incentives to be given to Merchant Banking & Finance Companies are ranked in order of percentage of the respondents are as follows.

- Tax holiday
- Investment Credit
- Carry forward of losses
- Tax rate deduction
- Accelerated depreciation
- Others

4.6.9 Effectiveness of Tax Administration to Impose Fines and Penalties

In order to know the effectiveness of tax administration to impose fines and penalties in Nepal, a question was asked, “DO you think that the tax administration of Nepal is effective to impose fines and penalties as per necessity.” The responses of the respondents are presented below.

Table 4.24

Effectiveness of Tax Administration to Impose Fines and Penalties

Responses/Respondents	A	E	P	Total	Percentage
YES	5	12	5	17	38
NO	10	3	15	28	62
TOTAL	15	15	15	45	100

Source: Opinion Survey

From the above table it has been clear that most of the respondent's i.e 62% thought that tax administration in Nepal is not effective to impose fines and penalties. Only 38% of the respondents thought that tax administration in Nepal is effective to impose fines and penalties. Most of the tax administrators were in favors of effective tax administration to impose fines and penalties as they didn't want to show their weakness. Thus it can be concluded that the tax administration system of Nepal is not effective in imposing fines and penalties.

In order to know the cause of ineffective tax administration the next question was asked. "if No what are the reasons ." The respondents were requested to rank their answer, which is presented in the following table.

Table 4.25

Reasons of Ineffective Tax Administration to Impose Fines and Penalties

S.N	Reasons	Group			Total Points	%	Rank
		A	**E**	**P**			
1	Corruptions	90	13	137	240	23	1
2	Lack of information	75	15	94	184	17	3
3	Lack of competent staff	83	17	107	207	19	2
4	Complicated tax law	47	20	75	142	13	4
5	Unnecessary outside pressure	35	15	67	117	11	5
6	Lack of Co-operation in tax administration	45	14	40	99	9	6
7	Lack of logistic support.	25	19	35	79	8	7
	Total				1068	100	

Source: Opinion Survey

The causes of ineffectiveness of Nepalese Income tax administration system to impose fines and penalties in order of the preference of the respondents are as follows.

- Corruption
- Lack of competent staff
- Lack of information
- Complicated tax law
- Unnecessary outside pressure
- Lack of Co-operation in tax administration
- Lack of logistic support

It can be concluded that corruption, lack of competent staff, complicated tax law and lack of information is the most important causes of ineffectiveness of tax administration system in Nepal to impose fines and penalties.

4.7 Major Findings

On the basis of the data presented and analyzed some important findings of this report are summarized below.

- The study has shown that the contribution of tax revenue in total revenue was from 75.74% to 81.14% and that of non tax revenue was from 18.86% to 24.26% during the period of five years. It has clarified that tax is a major source of revenue mobilization.
- The tax revenue is the composition of direct tax and indirect tax. The contribution of tax revenue in total revenue was 75.74%, 77.29%, 77.16%, 79.45% and 81.14% in FY 2002/03 to FY 2006/07 respectively. It shows the increasing trend of contribution of tax revenue in total revenue. The contribution of indirect tax in total tax revenue in FY 2002/03 to FY 2006/07

was 57.77%, 58.2%, 58.53%, 60.13%, and 59.50%. Similarly the contribution of direct tax in total tax revenue in FY 2002/03 to FY 2006/04 was 17.97%, 19.09%, 18.63%, 19.32%, and 21.64% respectively. It shows that the contribution of indirect tax is higher that the contribution of direct tax in total tax revenue.

- Non tax revenue is the composition of various components i.e. duties &fees, fines & forfeiture, public utilities, dividends, interests, royalty and sales of government property, principal repayments and miscellaneous income. The contribution of non tax revenue in total tax revenue in FY 2002/03 to FY 2006/07 was 24.26%, 22.71%, 22.84%, 20.55% and 18.86% respectively. It shows that the contribution of tax revenue is in decreasing trend. In comparison between tax revenue and non tax revenue, the tax revenue is the main sources of government revenue.
- Ratio of direct tax in total revenue was 17.97%, 19.09%, 18.63%, 19.32% and 21.64% in FY 2002/03 to FY2006/07 respectively. It shows the increasing trend though it has decreased in FY 2004/05.The direct tax to total tax revenue was 23.73%, 24.71%, 24.14%, 24.31%, and 26.67% respectively in FY 2002/03 to FY 2006/07. it shows constant trend till FY 2005/06 then after it has increased in FY 2006/07. Even though the ratio of direct tax to total tax revenue is higher than ratio of direct tax on total revenue.
- Income tax revenue is the composition of corporate tax and other income tax, remuneration tax, investment income tax and other taxes. The growth rate of income tax was (9.49)%,14.43%, 9.10%, 4.37% and 30.49% respectively in FY 2002/03 to FY 2006/07. it shows that the growth rate of income tax is positive though it was negative in FY 2002/03.
- The contribution of corporate tax to total income tax was 68.30%, 71.60%, 70.12%,69.30%,and 73.78% in FY 2002/03 to FY 2006/07 respectively.. the growth rate of corporate tax was (3058)%, 18.38%, 7.18%, 3.24%, and 34.71% respectively in above fiscal years. It shows that the total income

depends mostly on corporate tax. Thus corporate tax plays vital role in the contribution to national revenue.

- Corporate tax is the part of income tax revenue. It is a direct tax and it is a main source of income tax revenue. The contribution of corporate tax in government revenue was 9.9%, 10.9%, 10.5%, 10.5% and 13.23% respectively in FY 2002/03 to FY 2006/07.
- The contribution of listed merchant banking and finance companies in total tax revenue and in total government revenue was 0.04%, and 0.03% in FY 2002/03, 0.07% and 0.05% in FY 2006/07 which was the highest contribution percentage of total tax revenue and total revenue. The lowest contribution percentage of total tax revenue and total revenue was 0.02% and 0.03% in FY 2003/04.
- The contribution of listed merchant banking and finance companies in income tax and in corporate tax was 0.19%, and 0.28% in FY 2002/03 and 0.30%, and 0.14% in FY 2006/07 which was the highest contribution percentage of income tax and corporate tax revenue and the lowest contribution percentage of income tax and corporate tax was 0.16% and 0.22% in FY 2003/04.
- The contribution of listed merchant banking and finance companies in GDP was 0.004% in FY 2002/03 and 0.007% in FY 2006/07 which was the highest contribution percentage. The lowest contribution percentage was 0.003% in FY 2003/04.

From the opinion survey of various respondents i.e. tax experts, tax administrators, tax payers, and bank officials, the following findings have been drawn.

- The main goal of income tax revenue in Nepal is to increase the revenue of the government.

- Income tax is a suitable source of mobilizing domestic resources. Main reason behind this is that it is harmful to depend fully on external sources.
- Lack of clear, transparent and progressive economic policy is the main reasons for dissatisfaction with soundness and effectiveness of income tax system in Nepal.
- Existing corporate tax rate has been found suitable and single rate for all types of corporation is preferred.
- Delays in tax assessment is exists in Nepal. The main reason for this is delay in filing returns.
- The major complains of merchant banking and finance companies are regarding tax assessment system. The main reason for filing appeals by merchant banking and finance companies to revenue tribunal is regarding the order of tax assessment by tax authorities.
- Tax holiday is main means of tax concession facilities and incentives to be given to the merchant banking and finance companies.
- Tax administration is not effective to impose fines and penalties as per necessity. Main reasons for the ineffective tax administration system are corruption, lack of competent staff, complicated tax law and lack of ho

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This Chapter shows the final report of the study. The chapter is divided into three parts.

The first part deals with the Summary, the second with the Conclusions of the study and the third deals with the Recommendations. The details of the Chapter are presented below:

5.1 Summary

Merchant bank plays a vital role in economic and financial development of the country being a working bridge which provides every kind of financial assistance to the industries and commerce. Merchant bankers are one of the pioneer instruments for business organization development. Basically objective of the study of Income Tax collection from the Merchant Banking and Finance Companies of Nepal is to evaluate contribution of Income Tax as Government Revenue and to analyze the problem of the Merchant Banking and Finance Companies in Nepal. They play highly significant role in mobilizing funds of savers to ingestible channels with assurance of returns on the investments and thus can help in meeting widening demand for ingestible funds for economic activity. The service of Merchant banker could cover project counseling and pre investment activities, feasibility reports, project reports, design of capital structure, issue management and underwriting, loan syndication, foreign currency finance, merger, amalgamations and takeover, venture capital and public deposits.

For the analysis of the "A Study on Income Tax Collection from Merchant Banking and Finance Companies in Nepal", primary and secondary methods of data collection are used to obtain the relevant statistics. Annual Reports of the concerned institutions, informal interviews, questionnaire, and frequent visits to the Security Exchange Board of Nepal, old reports, thesis and magazines are major sources of the data collection.

The information are tabulated and presented in graph and table. Obtained data are analyzed through different elements and different headings like as corporate tax, tax revenue, non tax revenue, government revenue, gross domestic product and in other topics. Various types of statistical tools like mean, standard deviation and coefficient of variation are also used in data analysis. Data presentation analysis chapter represents the presentation of the whole data collected. Basically the data is taken from the fiscal year, 2059/060 to 2063/064 B.S.

For the study of Income Tax Collection from Merchant Banking and Finance Companies in Nepal, especially I have chosen the seven institutions which are Nepal Merchant Banking and Finance Limited, Nepal Shrilanka Merchant Banking and Finance Limited, Nepal Housing and Merchant Finance Limited, Cosmic Merchant Banking and Finance Limited, Capital Merchant Banking and Finance Limited Royal Merchant Banking and Finance Limited, Guheshwori Merchant Banking and Finance Limited. During Fiscal year2059/060 to 2063/064 income tax collection from Nepal Merchant Banking and Finance Limited, Nepal Shrilanka Merchant Banking and Finance Limited, Nepal Housing and Merchant Finance Limited, Cosmic Merchant Banking and Finance Limited, Capital Merchant Banking and Finance Limited Royal Merchant Banking and Finance Limited, Guheshwori Merchant Banking and Finance Limited were Rs. 53.55 million. Rs. 1.5 million, Rs. 24.14 million, Rs. 17.71 million, Rs. 6.73 million, Rs. 13.70 million and Rs. 13.60 million respectively. In comparison within five years income tax collection from Nepal Merchant Banking and Finance Limited was highest and that of Nepal Shrilanka Merchant Banking and Finance Limited was the lowest. Corporate tax collection from above mentioned seven merchant banks in Fiscal Year 2059/060 was Rs. 15.63 million which was 0.03%on total government revenue and 0.04% on total tax revenue. F.Y. 2060/061 was Rs.15.05 million which was 0.02% on total government revenue and 0.03% on total tax revenue. F.Y. 2061/062 was Rs. 24.09 million which was 0.03% on total government revenue and 0.04% on total tax revenue, F.Y. 2062/063 was Rs. 28.74 million which was 0.04% on total government revenue and 0.05% on total tax revenue and F.Y. 2063/064 was Rs. 47.41 million which was 0.05% on total government revenue and 0.07% on total tax revenue.

In the context of Income Tax collection from Merchant Banking and Finance Companies, I found that the Finance Companies are actively participating in merchant banking and the most of public issues are also related with Finance Companies however most of the responses are related with weak regulatory provisions. They focused on lack of specified governing power. There are various problems about income tax administration like proper record about the number of the income tax payers, defective selection of personnel, lack of training and education to tax payers and tax officers, undue delay in making assessment, lack of responsibilities of officials on their work, existence of corruption, and lack of motivation to concerned authorities etc. Because of the inefficiency of the administration and increasing corruption, people have to faith in the working of government and its organization.

Income Tax is the vital source of the government revenue. In the context of developing countries like Nepal, the government can not raise more income tax from corporations because high Income Tax may discourage the formulation of corporation. There is no proper supervision over the staffs of Tax Collection Department. Corruption is the main problem of tax administration. There is no reliable and sufficient data for tax purpose. However Merchant Banking and Finance Companies assist government to collect its revenue though making profit from the financial transaction by rendering service to the public and business organization and pay income tax from their taxable income.

5.2 Conclusion

Lack of sufficient financial resources is the main constraints for economic development of Nepal. Nepal has been suffering from capital shortage to acquire the goal of Economic Growth. Nepal is not being able to collect necessary fund. The expenditure of Nepalese government is increasing year by year. Therefore, it has been heavily relying on the external and internal debt to meet the budget deficit because of the low revenue collection compared to the total expenditure. Internal resources are preferable for suitable economic development. But Nepal has been found itself unable for proper mobilization of internal resources. Thus, fiscal deficit of Nepal is increasing. To meet the expenditure, Nepalese government is trying to extract money or valuable contribution from its people through taxation. To solve the problem of fiscal deficit, income tax should play an important role. It has been considered as a good remedy to cure the growing resource gap problem in Nepal. But, it has not been mobilized efficiently and properly.

Income Tax System of Nepal encompasses four taxes. They are: Corporate income tax, individual tax, house and land tax and interest tax. Among them contribution of the corporate sector is the highest. The Nepalese income tax system has introduced in the F.Y.2059/060. The first elected government levied the first income tax and no specific act was made to define and to treat income tax. Since then four Income Tax Acts have been implemented.

Finance Company Act, 1986 permits finance companies to sell and purchase the bonds issued by His Majesty's Government of securities issued by other companies or institution, to underwrite them and to form syndicate for such purpose or to participate in such syndicate and to act as broker under the Security

Exchange Act 1983 and Section 3(g) of the same Act permits them to perform function of Merchant Banking with prior approval of NRB. Merchant Banking and Finance Companies are all profit oriented organizations. They make profit from above mentioned financial transactions. Because of profit making corporate bodies they must pay corporate tax out of the profit they make after deduction of allowable expenses provided by Income Tax Law.

Nepal has trade deficits from the very beginning of budgeting practice. Consequently, it has been taking loans from various friendly countries and international organizations. But this is not permanent solution of the national budget deficit. For the permanent solution of this problem, the country is required to mobilize internal resources as far as possible.

Government revenue is the composition of various items of tax revenue and non-tax revenue. Each of them play role in national operation and development but due to insufficiency of these revenues, it is being unable to operate socio economic development as expected. There are interrelationship between resources mobilization and developed economy. Maximum revenue realization through internal sources is only possible when its economy is developed or boomed. Income tax is one of the sources that are potential and justifiable to increase. Education of taxation and morality in tax paying of taxpayer also help in maximizing realization of income tax. Corporate bodies also play important role in revenue collection to the government. Developing countries like Nepal also hope that the corporate bodies are the taxpayers from whom considerable amount can be collected. Analytical studies regarding financial performance and tax paying trends of different corporate sector should be undertaken time to time recognize the probable increment of collectible tax from these sectors and tax problems that causes low tax collection so that correction of the problems could be done in time. This study has taken into consideration of these issues.

5.3 Recommendations

On the basis of findings of the study, the following recommendations have been made for the sound and effective income tax imposition. Success of income tax system is highly depended upon the simplicity of income tax law. The following amendments have to be made in Income Tax Law:

- The collection and tax assessment provision should be made clear and simple so these taxpayers would be encouraged to pay income tax.
- Income Tax Act, Rules and Regulations should be clear and simple for all the taxpayers as well as tax administration. It should be more effective.
- The language should be simple and clear. In spite of using the vague meaningful words, clear cut provisions should be made.
- The effective implementation of provision of reward, prize and incentive should be granted to the taxpayers who pay tax voluntarily.
- The provision of fines, penalties and punishments should be imposed to the tax evaders and executed effectively.
- Timely revision should be made in the matter of income tax policy. The system of changing income tax policy with the change in government should better be avoided.
- There should be effective implementation of provision of auditing.

Income tax administration in Nepal suffers a number of interacting and interrelated problems, which have badly affected its productivity and image. Thus the following step should be taken by Nepal Government to improve tax administration.

- There should be establishment of a monitoring unit of the implementation of income tax law, policies and programs.
- There should be separate corporate Income Tax Act, Rules and Regulations.

- Coordination between tax policy, tax personnel and other department must be established.
- Effective system of reward and punishment to the employee should be established.
- The administration should try to increase effective public participation to minimize the income tax evasion.
- All the tax personnel should be given comprehensive training on various aspects of taxation on regular basis. Such training to the employees should be provided within and outside the country. Besides, seminars, meetings, conference should be held on regular basis.
- A single corporate tax rate should be imposed for all types of corporations.
- The tax assessment system should be scientific. The self- assessment tax system should be promoted and developed as per the interest of taxpayers.
- The income tax needs to be strengthened both for revenue and socio economic purpose. It is to be raised through broadening the base, an effective enforcement and better tax compliance.
- Broadening its coverage must widen the tax base and institutions which are philanthropic and non profit oriented by name but profit earner and without service attitude.
- Formally 15% to 18% Tax GDP ratio is regarded as moderate standard but Nepalese tax GDP ratio does not maintain it. The highest ration of it is not exceeding 10% during the study period and the increment of this ratio or percentage is regarded as better than direct tax proportion.
- Contribution percentage of direct tax revenue on total tax revenue on total tax revenue is very low. Corporate sector's income tax is the main source of direct tax revenue and Merchant Banking and Finance Companies income taxes are included in the corporate sector income tax. So, government should

increase the income tax from Merchant Banking and Finance Companies in order to increase the direct tax revenue.

- Income Tax from Merchant Banking and Finance Companies as percentage of GDP is very fluctuating. It indicates the poor performance, M.B.F. So M.B.F. should avoid such high fluctuation by improving performance.
- The study reflects the decreasing trend of income tax from Merchant Banking and Finance Companies. Some M.B.F is in loss regularly because of their high expenditure. Due to the loss they are not successful to contribute to the national revenue. There should be cut down of unnecessary expenses and development of effective management system for Merchant Banking and Finance Companies to meet the economic objective of the government.