

# **CHAPTRE I**

## **INTRODUCTION**

### **1.1 General Background**

Every nation requires sufficient funds to carry out development plans, handle day-to-day administration, maintain peace and security and launch other public welfare activities. The funds required by the government are normally collected from two sources: debt and revenues. The debt can be collected either from internal sources or from external sources. The debt collected from within the country is known as internal debt while the debt collected from outside the country is called external debt. The debt financing of the government is also known as deficit financing. The revenue of the government comes basically from two sources tax and non-tax. Non-tax includes different revenue like gifts, grants, revenue from public enterprises, administrative revenue such as registration fees, fines and penalties. Tax sources include customs, excise duty, VAT, income tax. In Nepal around eighty percent of the government revenues come from taxation. Hence, tax is the major source of the government revenue. (Koirala & Bhattarai 2007)

Taxation is the most effective and powerful tool reserved in the hands of the government of a country. It is taxation, which invest permanent power in the government to hold over the economy of the country. The major objective of taxation is to make fund available for the economic development and economic stability. A major part of the government revenue comes from taxation is much better than external resource mobilization. It is better for developing countries to maximize revenue through domestic source, which is much safer and fruitful as well. Taxation not only contributes in economic development and stability but also helps equal distribution of the national income of a country.

As “Kautily” says the launching of all programmes depends first and foremost on the treasury so every state needs resources. Whether to pay salary to the government employs or to do the development works it needs huge amount of money called revenue.

The government of a country requires sufficient revenue to carry out development plans handle day to day administration to maintain peace and security and to launch various public welfare activities. The government revenue comes from different sources like tax revenue from public enterprises special assessment fees, fines, grants etc. Among them, tax is the main source of government revenue. Custom, excise duty, sales tax, value added tax, income tax are the examples of the tax source of tax revenue. Government passes the acts for getting tax revenue and collects the taxes as per the act. Nepal collects around 80 percent of the revenue form these sources.

Nepal has a predominantly agriculture base economy. The major portion of population of Nepal is in village area and most of them live blow the poverty line. Wide spread population poverty rapid population growth, low income level, extreme disparity in the distribution of wealth and income, heavy dependence on agriculture, lack of industrialization, lack of needed saving capital. Dependence on foreign aid, unemployment, unexploited resource, lack of infrastructure, adverse balance are the main characteristics of Nepalese economy and it show poor performance of economy.

Now days, the prime concern of every country is repaid economic development and Nepal is not exception to this ever counting process, aimed at the betterment of its people. Capital plays vital role in the rapid economic development programme to solve the various socio-economic problems.

The constitution of Nepal has clearly directed Nepalese government for a self reliant economic system, encouragement to national enterprises prevention of economic exploitation as well as upgrading the standard of the people. For self reliant economic system and sound infrastructure for the development, the government should generate sufficient government revenue. Government revenue is the most important source of financing of government expenditure. To achieve the national objectives, the government is required to make and implement various policies and planning, acts and procedure. Besides these functions revenue mobilization is one of the most important functions of the government. (Bhattarai, 1977:23)

The income of the government is called public or government revenue. Government revenue constitutes internal and external sources. Internal sources constitute tax and non-tax revenue. Taxation is regarded as an effective instrument to monitor various economic activities in a country. The major objectives of the taxation are to make fund available for the economic development and economic stability. For the economic development of the country internal resources mobilization is much better than external resource mobilization because internal sources are safer than external. It is better for developing countries to maximize the mobilization of domestic resources. Heavy dependence on foreign assistance and loan to strengthen the revenue structure is not favorable sign for the developing countries (Panta & Panta, 1999:12)

The dependency on foreign assistance or loan can be minimized if the country can maximize the mobilization of the domestic resources. There are lots of ways to strengthen the economy of the country by properly mobilizing the internal resources. Taxation may be very useful and major internal sources for government revenue as it is considered as safe means of capital formation.

The effectiveness of any government depends on the willing of the people govern to surrender or exchange a measure of control over their person and property in return for protection and other services. Taxation is one of this exchange. (Encyclopedia, 1971:54 )

In the context of developing countries like Nepal, the prospect of mobilizing resources other than taxation had not been so encouraging. Taxation not only contributes in capital formation but also in equal distribution of national income of country. It helps to reduce extreme disparity in the distribution of wealth and income.

Tax is the major source of government revenue of Nepal. Taxes are compulsory payments to government without expectation of direct return in benefits to the tax payers. Although the degree of coercion varies in different taxes, tax is coercive. According to Richard Musgrave and Peggy Musgrave-“taxes are compulsory imposts. Taxes are withdrawn from the private sector without leaving the government with a liability to payee.” Hence, tax is compulsory and it may or may not benefit the tax payer. As for example the tax payers or vehicle owners benefit from custom and

excise duty. But the tax payers do not get direct benefit from custom and excise duty.  
(Dr Shyam Joshi 2007)

Tax is, in simple terminology. A liability to pay an amount to the government. It is a compulsory contribution to the national revenue from the tax payers according to law.

Prof. Seligman defined tax as a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefits conferred.

From the definition given above, it can be said that firstly, a tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government.

Basically, Tax can be classified into two categories which are as follows:

- **Direct tax**
- **Indirect tax**

A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is the same. Examples of direct tax are income tax, property tax, vehicle tax, interest tax etc.

An indirect tax is a tax imposed on one person but partly or wholly paid by another in the indirect tax, the person paying and bearing the tax is different. Examples of indirect tax are value added tax, excise duty, import and export duty etc.

Revenue collection from income tax is one of the major parts of the taxation. Income tax is a direct tax. Which enjoys a major place in the revenue of the government all over the world. It is a tax levied by the government on the income of individuals and business firms. (Prasad 1999:33)

## **1.2. Statement of Problem**

Nepal is one of the least developed countries among the developing countries in the world. It is facing serious financial problem from the beginning of its development process.

Despite the various measures adopted by the government to boost revenue collection, there is still a substantial resource gap between expenditure and revenue. Resources constraint is appearing as a limiting factor from the beginning of the development phase to present time due to increasing gap. Even if foreign aids also taken into consideration the resource gap is not negligible.

There is improper internal resources mobilization, heavy foreign aid dependence, low aid absorptive capacity and misutilization of available resources in Nepal. There are not adequate internal financial resources to spend and invest on economic development activities of the country. Even after the introduction of various taxes after the advent of the democracy in Nepal in 1951 to create internal resources for economic development, the first five year economic plan (1956-1961) was implemented under cent percent foreign assistance. Considering this background, the main problem of Nepal is lack of creation and mobilization of internal financial resources. ( Guru Gharana, 1995:164 )

The development of the country will be possible only when the government can collect its own internal revenue which constitutes tax and non tax revenue. Tax revenue constitutes a significant portion in the government revenue. Of the total revenue collected in fiscal year 2008/09, tax revenue and non tax revenue account for 80.85 percent and 19.14 percent respectively. In fiscal year 2001/02, their contribution on total government revenue was 77.97 percent and 22.1 percent respectively. (economic survey 2009)

Government has adopted various policies to strengthen the revenue structure of Nepal. Broad tax base is necessary to enhance the government revenue and for this purpose income tax revenue is most reliable among the different sources of revenue.

There is low collection of income tax even after the implementation of self assessment system, and higher tendency of income tax evasion. The revenue administration is not effective in Nepal. There is no willingness to pay tax on the part of the taxpayers of the country. Frequent changes in tax rates and policies would not be favorable to strengthen the revenue mobilization and economic development and this fact is to be taken into consideration by the government of Nepal. (Auditor General' Report 2053/54 Nepal, p.12)

In developed countries income tax revenue is very important and it contributes more than 40 to 50 percent of total revenue of the government but in developing countries income tax contributes only low per capita. In Nepal, the contribution of income tax to total revenue is only 16.96 Percent in fiscal year 2008/09.

Although the trend of income tax revenue has displayed a healthy growth rate in the more recent years it still does not constitute a significant percentage of the country's gross domestic product (GDP). In fiscal year 2008/09 total contribution of government revenue to GDP is 14.80 percent; however the contribution of income tax to total government revenue is only 16.96 percent in the same fiscal year. Above figure clarifies a very little contribution of income tax to GDP. There are many problems in Nepalese income tax collection system. The causes of low coverage of income tax in government revenue are low per capita income of Nepalese people, inefficient income tax administrative system, lack of consciousness about income tax in part of public, widespread income tax evasion etc.( Economic Survey, July 2009 )

As the investment and expenditure of the country on economic activities are increasing yearly, the internal resources mobilization is not increasing at the same ratio which is not a good sign for the national economy and it causes heavy burden of foreign loans and assistance and country is suffering from mass poverty.

A good tax system should be structured so that it can be administer effectively and economically. Taxes that are costly or difficult to administer divert resources to non productive uses and diminish confidence in both levy and the government.( Encyclopedia,p.153 )

If the government had been effective in its revenue collection by income tax and other internal resources, the amount of foreign loan would have been increased less rapidly. So, in order to create the huge internal resources, the revenue administration of the country must be systematic and the people of the county must have knowledge of income tax rules and regulation and willingness to pay tax. Only after that, the prospect of revenue collection from income tax will be higher for internal resources mobilization.

Therefore, for the government of Nepal it is better to depend on its own revenue than foreign assistance. Among the various sources of government revenue, income tax revenue can play a significant role if the problems of Nepalese income tax collection system can be improved.

### **1.3. Importance of the Study**

Nepal is one of the lowest taxed economies in the world as its tax/ GDP as well as tax/GNP ratio are the lowest among SAARC countries and among the rest of the world as well. This indicates the poor performance of the income tax management of Nepal. For the economic development of the country, contribution of direct tax is more important rather than indirect tax but the whole tax structure of Nepal is dominated by indirect tax. (Nepal, 1998:44)

In developing countries like Nepal, income tax is very crucial for reducing economic inequalities in the society and to increase the domestic resource mobilization. It may be a useful instrument to measure the economic standard of the people. But the tax management of Nepal is suffering from various problems. The major problems are inappropriate tax policies, administrative bottlenecks of the direct tax structure and existence of mass poverty. So, to identify the problems and to overcome them to improve income tax system, study in the field of income is essential.

## **1.4 Objective of the Study**

The major objectives of the present study are as follows:

1. To analyze the effectiveness of income tax system and income tax administration of Nepal.
2. To evaluate the contribution of income tax in national revenue.
3. To examine the problems and challenges of revenue collection from income tax.
4. To suggest and recommend on the basis of major findings.

## **1.5. Scope of the Study**

Present study will attempt to cover the major constituents of income tax collection system in Nepal as a major source of direct tax revenue. It aims to find out the major problems in revenue collection system of income tax in Nepal and prospect for its effectiveness. The major areas of the study are as follows:

1. Structure of government revenue in Nepal.
2. Contribution of income tax to government revenue and GDP.
3. Administrative aspects of income tax in Nepal.
4. Income tax assessment procedures in Nepal.
5. Existing position of income tax in Nepal.
6. Tax laws and procedures, income tax rate, exemption limit in income tax etc.

## **1.6 Limitation of the Study**

There are some limitations in this study which are as follows:

1. The extent of the study is based on the availability of reliable data and sufficient literature.
2. Major data used in this study is secondary data, while primary information is collected from tax administrator, tax experts and tax payers.
3. For the purpose of this thesis a field survey was done in Katmandu valley only due to the time constraint and other difficulties.
4. This study is confined to Nepalese laws, acts, rules and regulations to the income tax.



## **1.7. Organization of the Study**

The organization of the study has followed five separate chapters which are as follows:

**Chapter I:** This chapter includes general background, statement of problem, importance of study, objectives of study, scope of study, limitation of study and organization of the study.

**Chapter II:** The second chapter is about conceptual framework and review of literature. Conceptual framework deals with concept of tax, gradual development of income tax act and laws, legal provision of income tax in Nepal, sources of income, appeal, interest and fines, methods of income tax assessment, concept of corporate tax, development of corporate tax in Nepal etc. in literature review, review of thesis, books, research reports and articles are done which are used as guideline for preparing this thesis.

**Chapter III:** The third chapter is on research methodology which includes research design, population and sample, nature and sources of data, data and data information collection procedure, data processing and analysis procedure.

**Chapter IV:** The fourth chapter is presentation and analysis of data. It deals with tax structure of Nepal, composition of total revenue, contribution of income tax in Nepal, structure of income tax in Nepal, problems of resource gap in Nepal, contribution of corporate tax on income tax revenue etc.

Empirical investigation regarding public awareness towards income tax system, contribution of income tax revenue, reasons for tax payer wise low collection from income tax, appropriateness of income tax rates, weakness of income tax act 2058, situation of present income tax administration, problems of tax payers, motivating factor for income tax payers, appropriate method of income tax assessment in Nepal, suggestion for achieving effectiveness of income tax in Nepal etc.

**Chapter V:** The fifth chapter is the major findings, conclusion and recommendation which summarizes the thesis, draws the conclusion and provides the recommendation measures for the improvement of the existing situation.

## **Chapter II**

### **Review of Literature**

#### **2.1 Theoretical Concept**

Different person have defined taxation in different ways. In this respect, it would be better to take the definition given by Seligman, in his works taxation is the “compulsory contribution form a person to the government defray expenses incurred in the common interest of all without references to special benefit conferred.”

Form the definition given above, it can be said that firstly, tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefits of services or goods from the government. The tax payer does not have any right to receive direct benefits form the tax paid. Due to this compulsory nature, people have expressed different views in satirical ways about the taxation. Some say: “nothing is in certain in this world but death and taxes,” some say: “death and tax are both certain.....but death is no annual” while others say, “death means stopping the to pay tax.” Here it should be noted that all compulsory payments are not tax. For examples, fines and fees are also compulsory payments without having direct benefits to tax payer but it is not tax because its objective is not to collect revenue but to curb certain types of offences. Secondly, taxpayer cannot receive any quid pro quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. A tax is not a price paid by one, for which he can claim goods and services. The charge of price for goods and services by public authority is not a tax. Thirdly, the tax is paid to the government for running it , fourthly, in case of tax the amount is spent for common interest of the people. The tax is collected from haves and basically, spent for the interest of have-nots in the society. Fifthly, a natural as an artificial person pays the tax.

Generally, income means the inflow of cash to the person or firm. Most of the people do not take the kind as an income. It is a best measure of the economic well being of a person as well as of nation. Higher income denotes the high living standard and lower income from rendering various types of services, selling goods and producing crops for their own use, income may be cash or kind that is receive by a person for livelihood.

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

$$Y=C+S$$

Where,

Y= income

C= consumption

S= saving

But the purpose of taxation, the definition of income tax is some how different from the aforesaid definition. According to income tax act, 1974 (2031) “income means the income earned or receive in cash or kind from the sources mentioned in sec. 5.” In this section five different heads of income were mentioned. They were as follows:  
[ITA, 1974]

- ) Agriculture
- ) Industry, business, profession or vocation.
- ) Remuneration
- ) House and land rent
- ) Other sources.

The existing income tax Act/ 2002 (2058), which has been enacted since 2058, chaitra 19 (1st April 2002) has defined income in section 2/a “person’s” income from any employment, business as calculated in accordance with this act (ITA, 2002 ). It includes all sorts of income received for the provision of labor or capital or both of whatever form or nature in the taxable income.

Income tax refers to the tax to the tax levied on the income of a person and profit of cooperation for the specific time period, particularly one year .income tax is levied on the taxable income of a person or a company after deducting allowable expenses.

Accounting profits may differ from taxable profits. For the computation of taxable income, generally incomes are added and expenses are subtracted and losses, which are allowed to deduct under the provision of income tax Act. Then, tax free incomes, allowances and common expenses are also deducted to get taxable income. After giving the exemption limit as per law, the amount at tax to be levied on this computed income is the income tax.

In conclusion, it can be said that a tax is a liability to pay an amount to the government. The basis for the payment is that the assessee have income of a minimum amount form certain specified sources or that they own certain tangible or intangible property or that carry on certain economic activities which have been chosen for taxation

The research study based on effectiveness of income tax system in Nepal is not an easy task to perform as a hole. Because, time to time, the concept and rules are changing rapidly. Income tax is directly affected by national and international environment. In Nepal there is no long history of income tax. But it does not mean that the history of it is very short. It is not easy to task to collect all the information about effectiveness of income tax system in Nepal. Reviews of available materials, based on the income tax, are helpful regarding to the actual subject matter in the tax system and its actual condition in Nepal. For this study, various books, articles, thesis, dissertations etc have been reviewed as for as possible which are as follows.

## **2.2 Review of books**

The review of various books are as follows:

**Dr. Agrawal (1980)** had written a book entitled “resource mobilization in Nepal” published by CEDA. The books had been divided into eight chapters; the first chapter deals with special reference to Nepal. The second chapter deals with fiscal policies in developing nation and Nepal and third chapter looks at income tax in Nepal from the historical perspective, the fourth chapter deals with structure of Nepalese taxation. In this chapter, writer had concluded the predominant role of indirect taxes in Nepalese tax structure. More than 60% tax revenue was derived from foreign trade alone. However, the role of income tax had been increasing since 1974/75.

**Dr. Khadka (1994)** had written a book entitled, “Nepalese taxation: a path for reform”. The book deals with both national and international taxes. The writer had described the scenario of Nepalese tax system from origin of income tax, adoption of quasi-global or a limited scheduler system, segregation of corporate income tax from individual income tax, increasing dependence on the presumptive basis, basic allowance and progressive rate structure, move from joint taxation to individual taxation and shift from itemized to flat system of standard expenses, experiment with an advance tax on impacts and the existing structure, commodity taxes and poverty taxes. He had evaluated the Nepalese tax system based on conventional, theoretical concepts and suggested measures for its improvement. The book had not been directly focused on corporate tax only but explains the whole Nepalese taxation system and structure for its reform.

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

**Bhattarai and Koirala (2003)** published two books named ‘Taxation in Nepal and ‘Tax Laws and Tax Planning’. First book has been designed in conformity with the syllabus of BBS 3<sup>rd</sup> Year and the second one has been designed based on the syllabus of MBS 2<sup>nd</sup> Year. Relevant theoretical and practical aspects have been discussed in the books. Both books have shown how taxable incomes are computed under employment, business and investment sources.

**Mr. Malik (2003)** had written a book entitled “Nepal KO Adhunik Aayakor Pranali”. This book especially deals with the thorough analysis of income tax act, 2058 with examples. Every section of income tax act has been clarified with suitable examples. He had written about the development of existing income tax and need and importance of income tax system in Nepal. The new provision made by income tax act 2058, about tax base, computation of income, tax exempt amount, allowable

deduction, accounting of tax, capital gain, retirement saving and tax, dividend tax, intonation tax auditing have been clarified precisely in his book. Similarly, the book had also explained about tax administration, documentation, information collection, payment of tax, installment tax, income statements, tax collection, review and appeal, fees and interest, fine and penalties, tax rate and determination of provision of depreciation etc.

**Adhikari (2003)**, has written a book entitled to “Value Added Tax in Nepal: Theory and Practice” he has analyzed that in both theoretical and practical proceeds. In his words, VAT is an indirect tax that is imposed on different goods and services on the basis of value added amount in different stages. In this tax, the government may (by making provisions in laws) taxes for certain goods, services and purchasing of specific consumers. this is a reformed sales tax that avoids cascading effects and provides tax credit facility as well as facility of refund .He has further mentioned that Vat’s main characteristics and objectives in point wise as follows:

#### Characteristics

Based on value added principle.

- ) An indirect tax nature and avoids cascading effects.
- ) Contains catch –up effect and self –assessment system.
- ) Based on factors costs and input costs.
- ) Facility of tax credit and tax refund system.
- ) Timely tax realization and income tax mobilization.
- ) Provisions of tax exempt and zero-rates.

#### Objectives

- ) To produce more revenue and mobilization capacity or buoyant o the tax system in the county.
- ) To transparent tax system, effective and efficient.
- ) To make VAT main stream of tax system.
- ) To remove the cascading effects of traditional sales tax etc.

Prof. Adhikari has concluded, however, in the VAT system less chance to tax evasion, easy for administration and less burden to consumers too, because of simple and single stage tax. It is very neutrality and effective tax. That's Why VAT encourage to investment and export too.

**Mr. Aryal and Mr. Poudel (2004)** had written a book entitled “taxation in Nepal”. They had explained about the income tax system in Nepal along with house and land tax and value added tax. This book has been designed on the basis of the curriculum of B.B.S. It had been divided into three parts. In the first part of the book introduction and development of income tax, capital and revenue nature expenses and incomes items, entity and retirements saving, dividend tax, computation of income from business, remuneration and investment have been explained in the second and third part respectively. The book also included proper bibliography and adequate appendix where various income tax, house and land rent and VAT related forms, schedules and format had been described. Lastly, he had recommended mobilizing additional domestic resources through taxation, rendering the tax structure in order to increase the role of direct tax and reformation of income tax in Nepal.

**Khadka (2005)** wrote a book entitled 'Modernizing Tax Administration in Nepal'. This book is very much useful to anyone who is interested in Nepalese income Taxation. This book gives almost complete information about the tax system of Nepal from its ancient time to current situation of income tax system. He has shared his expertise in his book. Basically author focuses on the Administrative aspects of the tax system in Nepal.

### **2.3 Review of Some Articles, Reports**

Some articles, reports were reviewed for this study which are as follows:

**United nation (1977)** published a journal on public finance entitled “guidelines for improving tax administration in developing countries”. The study was divided into four separates parts. Among them reforming the structural organization of the tax administration are explained in two separate sub topic i.e. guidelines for appropriate initiative and underlying consideration and explanatory commentary. Function of tax

administration are identification and registration of taxpayer, taxpayer's education, information provider and assistance etc. The study had detailed explained there functions and recommended some valuable suggestions to the developing countries.

**Dahal (2001)**, in his article "A Few Words About VAT" writes VAT is a most scientific, innovative and powerful tax with built-in quality of universal application for both developed and developing economics. The biggest virtue of Vat is that it is revenue buoyant and highly instrumental for resource mobilization especially in an economy with an acute shortage of resources. Nepal has entered into a major global tax system with the introduction of VAT. VAT is an account-based tax that leads to transparency and accountability both on the part of taxpayers and collector.

Open boarder, non-monetized economy, non-issuance of invoices etc are major problems that would marginalize the prospects for resource mobilization in Nepal. This calls for introduction stringent regulations to deal with delinquency of tax, maintaining records properly and improving efficiency of VAT administration. The success of VAT will have significant bearing on the economy of Nepal.

**Mr Pant (2004)** had written an article entitled "problems in tax administration and their remedies" published in journal of finance and development 'Rajaswa' 2004. April vol.1.

He had comprehensively explained about the problems and their remedies related with tax revenue and major types of practical problems and challenges, in tax administration. He had highlighted on the major problems like showing limited amount of transactions at low selling price low practice of issuing and taking bills. Hiding the real factory costs, commercial fraud, lack of corporation in tax auditing, legal ambiguity and complexity in implementation and lack of corporation between Inland Revenue investigation unit.

Meanwhile, he had recommended some valuable suggestion to solve the problems and to overcome the challenges. Such as managing statistical and information system. Using of fixed norms and standard for assessing selling price and factory costs,



compulsory use of billing system, proper co-corporation of inland revenue office with various entities of HMG, revenue investigation department and its related units.

**Dr. Kandel (2004)** had written an article entitled “are tax incentives useful? If so, which one?” published in the journal of finance and development, ‘Rajaswa’, volume. 1, 2004, April. In that article, he had tried to seek the answer from the survey of various empirical studies done in Nepal, India, Pakistan and other western countries. He found that the tax incentives are still the controversial matter whether they promote the investments or not but he argued that most of the developing countries need tax incentives. The empirical study concluded that among different types of tax incentives, investment allowances or investment tax credit and accelerated depreciation is superior to other types of tax incentives. Tax holiday is most inferior type of tax incentive which causes revenue loss without enhancing the investment environment. Meanwhile, most of the researchers have opposed the tax holiday system both within Nepal and outside Nepal.

He further added that the survey of the studies indicate that accelerated depreciation system had positive impact on investment. Reducing tax rate, especially followed after 1990s to the lowest rate was not a proper decision. That is why, if Nepal wants to go to tax incentives again, it should adopt investment allowance or investment tax credit, not the full tax holiday in future.

The institute of charter accountants of Nepal (ICAN) published a monthly journal on December 2005. Sinha presented an article named “taxation-legal illegally?”. He had described the taxpayer have been encouraged by the tax officials themselves to go courts over the complaints of their wrong doing because the authority is totally convinced that no immediately solution can be expected from the court of tribunal on short-span of time as long as they are in position. The tribunal court reviews the decision of Inland Revenue department’s director.

**In 2005, the Kantipur daily** published news about income tax and VAT. The news presented the terms used in income tax and VAT which is not clear. There is not friendly business environment between taxpayers and the government. Similarly, the vocabularies used in tax act are very ambiguous and difficult.

**Marashini (2006)**, written an article entitled to “Value Added Tax: The Road Ahead” director at the advocates for increasing publicity campaigns based on radio, television, FM programs that are popular in the cities where most of the taxpayers reside. He also advises for sudden inspection of goods and services on the road to check tax evasion. Nepal has adopted destination based consumption type VAT with tax credit mechanism extending through the retail level. The rate of tax was 10 percent now changed to 13 percent combined with zero rates on exports. The exemption list is quite long and registration threshold is Rs 2 million (2000000 for imports).

Taxpayers required issuing invoices of their supplies and maintaining purchase and sales books. The tax period is trimester for voluntarily registrant, and one month for others. The VAT Act makes provisions for the additional charges as the late payment penalties. The rate of such penalties is 10% of the VAT payable in the first month, an additional 10% in the second month, and no further action. Late payment penalties are based on based on one calendar month from the due date. There is also a provision for the interest on non-payment. The current rate of interest is 15% VAT is based on the principle of self assessment .Tax officials, however can assess VAT when a tax payer doesn't submit the return; or submits an incorrect or fraudulently return: tax officers are authorized to recover tax dues by various means, including retention of tax credit, deduction from the debtors, closing the business, and seizing and selling the property of the VAT debtor.

**In 2007, Mr. Neupane** had published an article in economic bulletin ‘Rajaswa’, which shows the contribution of income tax to total tax revenue, had decreased from 23.93% to 20.83% in the FY056/057 to 061/62. it may be due to the collection of property tax by municipalities. But it was not only the cause; emphasis should be given to the income tax collection. To facilitate tax collection, Inland Revenue department had implemented e-tds, e-pan, and e-filing for better tax compliance. There was provision of tax plate also. But the frequent change in the act decreased tax complaint which was a major setback of instable political condition.

**In 2007, the Kantipur daily** had published news about tax paying behaviors in Nepal and European countries. The news presented that 95% of tax payer in European

countries were willing to pay tax but in Nepal 95% taxpayer want to hide the income and they did not pay tax as per rules and regulation.

**In 2010 July**, Kantipur daily presented news entitled “Collection of Target Revenue on Fourth Year Too” despite the lower level of economic activities due to the political instability in the country, the government able to collect revenue more than target. According to revenue secretary Ram Hari Baskota government collects revenue of Rs.180000 million which was more than 25.5% more than last years. In budget speech it was declared that the government targeted to collect 1760000 million. The government able to collect almost Rs 3500 millions more revenue than the target.

But the government unable to collect the revenue of mid-year revised target due to the high increment of revenue collects the ministry of finance target to collect almost Rs 130000 million more than revised target in the mid-year.

After that the government unable to collect the mid-way revised target due to the decrease in the transaction of house and land and also decreased in the collection of vehicle tax.

But the government able to collect targeted revenue on fourth year too. In 2065/66 the government targeted to collect Rs 1434700 millions which actual collection was Rs 176200 millions. In FY 2063/64 government targeted to collect 88700 millions which the ministry of finance able to collect 94100 millions. In preliminary projection the collection of revenue from different heads were VAT Rs 63500 million, income tax Rs 40500 millions, import and export Rs 35000 million, custom duty Rs 26500 millions, Registration fee Rs 4500 millions and Non-Revenue tax Rs 23000 millions respectively.

#### **2.4 Review of Related Studies**

Some dissertations and thesis were reviewed for this study which are as follows:

**Acharya (1994)** did a research on "income Tax in Nepal" A study of its structure, productivity and problem" T.U. Acharya described the structure of income tax,

productivity of income tax and problems of income tax system. He presented some numerical and diagrams of structure and productivity of income tax. His study about income tax was not so detailed because he did not explain the provisions relating to income tax and his study was more concentrated on the problems of income tax system. Although, his findings about the problems of exemption limit and allowances were considerable and accountable. Acharya showed the problems of exemption limit as follows:

- Exemption limit being equal to remuneration taxpayers and business individual does not seem reasonable. The exemption limit for remuneration taxpayers should be comparatively higher than the business individual.
- The exemption limit in the Nepalese context neither shown any definite relationship with per capita GDP nor with the rate of inflation nor with poverty line so it seems to be unscientific. His findings about the problems with allowances were as follows:
  - Fifteen percent depreciation allowances for corporate taxpayers seem to be inadequate.
  - Private boarding schools running now days are basically inclined with profit. They are excluded from income tax, which is not reasonable.
  - One and two percent deduction of the total income from trade, industry, profession and vocational for advertisement and guest hospitality, respectively seem to be low.
  - Allowances for remuneration taxpayers are not scientific in specifying the figure in obsolete term also. Only the proportional figure is recommended, otherwise these should be frequent adjustment in income tax act, which is not so practical.
  - Additional allowances are lacking for specific industries provided that they are feasible in the Nepalese economy. Tourism industries, cooperative organizations in rural sectors etc. are in this category and should been encouraged. On the other hand, the special allowances for export income of industry does not seem essential such as for carpet of garment industry. It is because that small business investors are unable to export their products.

**Mr. Shakya (1995)** had presented his thesis entitled “income tax in tax structure of Nepal” and had tried to give origin and meaning of income tax with its historical review, structure of the government revenue in Nepal, importance of income tax, contribution of income tax to total tax revenue and total revenue.

In his study, he stated that the structure of the government revenue in Nepal is a composition of the tax and non-tax revenue. The tax revenue is the most important sources of the government revenue which occupies 80% share in the total government revenue in the year 1993/94. the ratios of income tax to GDP, total tax revenue and direct tax revenue had an increasing trend. But the increasing rate was low in comparison to other countries. He further added that the change in tax rate and exemption limit had made the assessment of income tax more complicated which had given plenty of opportunities to evade income tax which exist as a major problem.

Lastly, he had recommended many suggestions for the sound and effective income tax such as honest and effective tax administration, scientific method in the collection and encouragement to self-assessment of tax.

**Mr. Tripathee (1995)** had presented a thesis entitled “income tax system in Nepal and some potential areas for reform”. Deficit annual budget and deficit financing of the nation were his main concern of the study where he had tried to show the tax structure in Nepal, rule of income tax in Nepalese economy, income tax administration and tax evasion in Nepal along with reform.

Mr.Tripathee concluded his research using the fifteen years data since 1974/75 to 1989/90. Primary data were also used which were collected through opinion survey within Katmandu valley. Simple statistical tool such as mean and time series were used to analyze the data, graphs, charts and diagrams were also used as necessary.

Form that research, he had concluded that tax from individual sector had provided maximum contribution in income tax structure and above 80% of total revenue was collected through taxation. Tax evasion had increased due to poor tax administration and delay in the process of tax assessment. Lastly, he had recommended levying tax

on agriculture income. Tax holiday should be given to the firm and administration should be sound and efficient.

**Mr. Shah (1995)** had conducted a research on the topic, “contribution of income tax in National revenue of Nepal “. His research problems were increasing resources gap and how income tax can be the means for resource mobilization. The main objective of this research were to show the contribution of income tax in the government revenue, to show the resource gap in Nepalese finance, to highlight the importance of income tax as a source to avoid financial deficit, to find out the rate and per capital burden of income tax and trend and structure of income tax in Nepal.

His research design was historical and descriptive. He had used only secondary data of 21 years from 1974/75 to 1994/95. Data collection and analysis procedure were, consulting the required government and non-government offices and simple arithmetic rule, chart and diagrams were applied to analyze data. From that research he had found out and concluded that income tax can be the vital source for internal resource mobilization to fulfill resource gap. Only 0.35% of the population came under the categories of tax payers in Nepal during his research period. He found that collection of income tax was gradually growing and the contribution of income tax in total tax revenue and total national revenue were 9.95% and 7.47% respectively. Similarly, he also concluded that individual tax payer had higher contribution in income tax than salaried tax payer.

**Mr. Panta (1996)** had presented a thesis entitled “a study on income tax management in Nepal” the main objective of his research were to find out the share of income tax to the government revenue, to review the income tax system and to identify the problems of income tax management. His research was based upon secondary data as well as primary data. The primary data were collected within Kathmandu valley through interview, questionnaire etc.

Lastly, he had recommended that income tax net should be widened, assessment procedure must be improved and income from agriculture and capital gain should be taxed.

**Mr. Poudyal “Kshetry” (1998)** had submitted a Ph.D. thesis entitled, “corporate tax planning in Nepal”. This thesis report was aimed to examine the implication of tax factors in strategic planning, project planning and operational planning in Nepalese companies. He had found that the majority (90%) of the companies (sample size of the study) considered tax factor while selecting the business. He also found the positive correlation (+0.8) between tax rate and the debt equity ratio because of interest paid on debt is a tax deductible item. Similarly, the correlation coefficient between average fixed assets and corporate tax was (0.75) in large companies and (+0.12 in medium size companies. As against this, in large companies, there was a negative correlation (-2), which showed that increase in fixed assets in the large companies resulted in decrease in the corporate tax. He addressed that the tax planning should be considered while making corporate planning and companies should set up separate tax section to get maximum benefit of provision, provided by the law. However, tax assessment under the best judgment blocked the application of tax planning in corporate planning. He had recommended that tax incentives should be given to non-industrial companies too, and tax rate should be differentiated for resident and non-resident companies.

**Shrestha (2001)** had covered the historical background, legal provisions, structure of income tax, income tax administration in Nepal and empirical investigation. Her findings about tax structure were: there was dominant share of tax revenue in Nepalese government revenue. But the contribution of tax revenue showed the decreasing trend. The tax/GDP ratio was not found satisfactory with compare to other SAARC countries. It was 6.81 percent for the period of 1984/85 and 9.36 percent in 1998/99. There was serious and growing financial resource gap problem in Nepal seems to be never ending problem for Nepalese economy. There was dominant role of indirect tax revenue in Nepalese tax revenue. The contribution of direct and indirect on tax revenue were 17.76 percent and 82.24 percent respectively in 1984/85 which become 26.14 and 73.86 percent in 1998/99. The contribution from individuals to income tax revenue was greatest in every fiscal year and it was in increasing trend. Income tax revenue was playing a significant role in direct tax revenue because the share of income tax in direct tax was increasing rapidly.

She had found various problems of income tax system in Nepal. They were-narrow tax coverage, mass poverty of Nepalese people, lack of conscious of taxpayer,

widespread evasion and avoidance of income tax, unscientific tax assessment procedure, inefficient tax administration, complicated tax laws and procedures, instability in government policy. She had also identified the major weak points of income tax administration in Nepal. They were failure to locate new taxpayers, failure to maintain proper accounts and records, defective selection of personnel, undue delay in making assessment, lack of motivation in tax personnel, existence of corruption. She had suggested broadening the Nepalese income tax base by bringing agricultural income and capital gain under income tax net. She had suggested making consciousness to people, reform of income tax assessment, reform the tax administration and minimizing the tax evasion. For the improvement of income tax administration, she had suggested computerization and effective exchange of information, tax education to tax payers, tax inspectors and officials, effective personnel management. Her suggestion for minimizing tax evasion were control illegal business activities, enforce proper auditing and investigation.

**Mr. Lamsal (2001)** had presented a thesis entitled “a study on contribution of income tax on government revenue”. His research had mainly focused on the removing and controlling income tax evasion for better resource mobilization. As his main objectives was to analyze the impact of income tax evasion in government revenue of Nepal, he set further objectives which were to identify the ways and causes of income tax evasion, to estimate the volume and tendency of income tax evasion in small trade sectors and to examine the role of income tax in utilizing the resources in Nepal.

Mr. Lamsal had concluded the research following analytical as well as descriptive research design. Most of the data were from secondary sources and some were primary sources. Primary data were collected through opinion survey, field visit and interview, simple statistical analysis such as average and percentage were used for data analyzing tool, graphs, charts and tables were used to interpret visually the findings of the research.

From the research, he had concluded that there was widespread evasion of income tax in Nepal and income tax is a suitable for raising the government revenue. He had recommended measures for controlling tax evasion by controlling illegal business



activities, increasing penalties and fines to tax evader, compulsory maintenance of accounts etc.

**Poudyal (2002)** presented a dissertation entitled 'Income Taxation in Nepal: A study of its structure and Productivity. The objectives of her study were to analyze the structure of income tax in Nepal, to estimate the elasticity and buoyancy of income tax in Nepal, to assess the role of income tax administration in Nepal, to evaluate the success of Voluntary Disclosure of Income Scheme (VDIS) program in brief and to provide the suitable recommendation for improving the scenario of income tax. She has found that overall revenue of Nepal showed an annual growth of 16%, indirect taxation has more significant contribution in total tax revenue, income tax occupied the first rank among the direct taxes, personal income tax slabs has been changed radically from seven slabs in 1975/76 to two slabs in 1999/2000, VDIS could not attract more potential taxpayers into tax net due to lack of good planning and adequate homework of the government, working procedures of the tax administrators are still traditional and cost of administration has not been brought to the satisfactory level.

**Mr. Kandel (2002)** presented the P.h.D. thesis entitled “corporation tax system and investment behavior in Nepal” he undertook the research work to find out the problems relating to corporate tax, which blocks the development of the private investments. The main objectives of his 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 showed the relationship of private investment with average effective tax rate, marginal effective tax rate and tax incentives in Nepal. He found that debt-financed project are almost negative i.e. -17% and positive for equity financed project and debt-equity project by 27% and 19% respectively. He had also found the impact of inflation on the marginal effective tax rate. According to him, the statutory tax rate deduction had impact on private investments by 60% to 20%. In this regard, he had shown the adjusted value 0.87 at 5% level of significance. He had concluded that statutory tax rate was in moderate level under the financing options, debt, mix and equity i.e. it was not much destructive. The relationship between inflation and effective tax burden in Nepal was negative.

**Sharma (2003)**, had presented a thesis entitled “Value added tax: issues and prospects in Nepal” he undertook the research to find out the problem relating to the issue and prospects of VAT. The main objectives of his study were to review the tax structure of the Nepal, to explore and identify the performance of VAT, to access the existing issues in the implementation of VAT and to recommended possible way for making VAT effective and efficient.

Sharma concluded that the Value added tax, theoretically, is best form of sales tax because of its neutrality and generation of more revenue. The existing import/ manufacturing level, sales tax as well as other taxes seems to be inefficient and less productive that have created cascading and pyramiding effects. So, the rationalization of such taxes is the need of time for the better resource mobilization of the Nepal.

He also concluded that in Nepalese tax structure, sales tax has suffered from very low tax base, cascading/ pyramiding effects and distortion effects. But, VAT is considered as the best form of sales tax having much merits like self-policing, catch up effects, broad base of tax, neutral etc. so, there is the need of VAT in place of sales tax to mobilize internal resources through effective tax structure, which is also considered as the optimal solution of resources GAP and high dependency of foreign loan.

He recommended that the VAT should be made broader tax base through effective steps taken for implementing the threshold or replacing the nominal threshold. VAT should be adopted in Nepal as important measures of reforming tax system. For its proper implementation, the various issues pertaining to VAT should be considered seriously and be resolved. He also recommended that to avoided the problems of fraud transaction custom duties and any other similar types of duties must be gradually reduced along with the establishment of accurate invoicing.

**Mr. Serchan (2003)** had covered tax structure, role of income tax and legal provision of income tax in thesis. He had specially focused on provision of fines and penalties of income tax act. He had found the dominating role of tax revenue to the total government revenue. Income tax had occupied third position during his study period and it was in increasing trend. The tax to GPP ratio was not found satisfactory. There

was dominating role of corporate income tax but it was in decreasing trend and contribution of individual income tax was in second position with increasing trend. He had recommended measures for revising the provision of fees and penalties, introduction of reward, prize to the tax payer, clear act, rules and regulation regarding income tax, timely revision of income tax policy, and computerized system for payment of income tax. This study was done with the objectives of analyzing tax structure of Nepal, analyzing the provision of fines and penalties under the law, awareness of taxpayer towards fines and penalties etc.

**Palli Magar (2003)**, submitted a thesis entitled, "Income Tax in Nepal. A study of Exemptions and Deductions". This thesis was aimed to analyze the exemption of income which is produced by income tax. Act, study the provisions of exemption limit. Provided to individual and family, analyze the deduction of expenses which are provided by the income Tax Act, find out the contribution of income tax in public revenue of Nepal and to provide suggestive and recommendations about income tax administration and income tax law.

Palli magar found that there was dominant tax revenue in Nepalese government revenue. Contribution of tax revenue and non-tax revenue, direct tax revenue and indirect revenue to total revenue were 77.97%, 22.03%, 25.50% and 74.44% respectively in FY 2001/02. He also found that the contribution custom duty, sales tax (VAT), income tax and excise duty were 25.09 %, 23.60%, 17.60% and 7.54% of total revenue respectively in FY 2001/02. He also found that the contribution of income tax to total revenue was in increasing trend.

Palli magar also found that the some exemptions granted to achieve certain objectives are not effective. Tax incentives is one the examples of this. Tax concessions encourage the establishment of industries in certain areas but they vanish are change names, ownership or place the business when the tax concessions facilities expires. He found that the income tax system of Nepal had not efficient.

He recommended that the tax base must widen including the incomes from agricultural sector, retirement amount received by Nepalese people retired from the services by army or police of foreign country and currently exempted other sources of

income. He also recommended that tax exemption for an individual and family for Rs.100000 and Rs 150000 respectively. The provision relating to income tax system of Nepal was not effective and efficient so it should be made effective and efficient by making clear provisions and law. It was also to made income tax system effective computerized system should be installed in every IRD office of the country.

**Adhikari (2004)**, presented the MBS thesis entitled, “ Value-Added Tax in Nepal: Theory and Practice” He Undertook the research work to find out the problem relating to value added tax in Nepal and he present the problem as how can Nepal generate adequate revenue to lower the present resource GAP? How to solve the problem of unequal distribution of wealth and regional in balanced ? How to improve the tax system as per the national requirement? And how can value added tax be made the back bone of Nepalese tax System? And his main objectives of the study were to review the theoretical aspects of VAT, to have a general survey on the standard practice of VAT in the international arena, to explore the current practice of VAT in Nepal, to project the probable collection of VAT for coming ten years and to suggest the ways to better implementation of VAT in Nepal.

He concluded that the introduction of VAT has increased the level of VAT compliance and discouraged the practices on the part of the business community could not readily accept the new tax system. That was a great hue and cry about the government’s decisions to implement VAT. They had a misconception of VAT. The compliance cost of the new tax system was perceived to be little bit higher than that of the existing tax system.

He also concluded that the biggest virtue of VAT is that it is revenue buoyant and highly instrument for resource mobilization especially in an economy with acute shortage of resources. Despite preliminary resistance, VAT is currently well received by the consumers as well as business and industrial communities. The tax payers’ education campaign and the lucky draw scheme run by the Inland Revenue department with the objectives of uplifting the level of awareness among the concerned stakeholders of the society is indeed praiseworthy.

He recommended that the government should reach out the customers through the extensive use of media available at it's disposal and increase publicity by means of increased numbers of ads, commercials radio jingles, hoarding boards, pamphlets, leafless, branches and other similar means. The inland revenue department should import more education to the tax officials and timely organize programs to enhance their level of competency the tax administration should have state-of -the-art easily available to the tax officials to make the VAT system more effective and efficient.

**Kakshapati (2005)** submitted the thesis entitled "Revenue collection from VAT with its problems prospects."

The major objectives of the study were;

- To revise about theoretical aspect of VAT.
- To examine the importance of VAT in revenue collection.
- To identify current problems & analyze future prospect of VAT.
- To recommend for making VAT effective & efficient in coming days.

Kakshapati mentioned the following findings;

- Tax leakages have badly eroded Nepalese tax base.
- Majority of the tax payers are not conscious about VAT system of Nepal.
- Due to weak administration system, the smuggling business activities have increased.
- Billing system is one of the major aspects of effective implementation of VAT.

**Khatiwada (2005)**, presented the MBS thesis entitled, “ contribution of income tax in the government revenue of Nepal” he undertook the research work to find out the problem relating to income tax, which blocks collection of the government revenue. The main objectives of the study was to study the historical development of income tax in Nepal, in general to analyze the contribution of direct and indirect tax to total revenue of the government, measure the ability of the income tax to meet the

government current requirement, to examine the effectiveness of income tax revenue collection, to analyze the problem of revenue collection from income tax and give suggestion to make income tax effective and efficient.

Khatiwada found that the contribution of tax and non-tax revenue to total revenue of the government was 77.9 percent and 22.1 percent respectively during his study period. He presents the GDP growth rate, tax revenue as percent of GDP were 2.24 percent and 9.88 percent respectively. He found that the direct tax was in decreasing trend and indirect tax was in increasing trend. He found that the income tax was in increasing trend and the amount of income tax in fiscal year 1988/99 was Rs 879.6 million and it increased to 7966.2 million in fiscal year 2002/03. The share of total income tax from public enterprises was 25.50 percent of total income tax. The exemption limit was allowed separately from fiscal year 1979/80 to individual, couple and family before that the exemption limit was same for all categories.

Khatiwada has identified the problems in collection of income tax. Which were lack of effective income tax system, lack of responsible tax administration, lack of proper tax education and training to the tax payer, lack of effective punishment to tax evader, lack of tax paying capacity of the people and consciousness among the tax payer and lack of scientific method of tax collection etc.

Khatiwada suggested to over come from these various problems. He suggested that the terms and procedure under the income tax should be made simple and understandable among the common people, rules and regulation of income tax should be simplified, income tax act should be liberal with broad sense, the government should be launched nationwide campaign to inform people, the government should introduced provision relating to reward, prize, incentives, to encourage the tax payer, the fine and penalties punishment should be made at higher rate to discourage the tax evasion and also to minimize tax evasion public participation should be increased and all the items related to deduction and exemption should be defined clearly in the Act.

**Mr. Paudel (2006)**, conducted a research entitled “role of income tax in Nepal revenue of Nepal” in order to fulfill partial requirement of masters of public administration (MPA). The main objective of his study were to study the role of

income tax revenue of Nepal, evaluate prevailing income tax system, and examine issues relating to income tax. The major findings of study were as follows:

- There was dominant contribution of tax revenue over non-tax revenue to the total revenue of Nepal. Contribution of tax revenue was in increasing trend.
- The tax – GDP ratio of Nepal was not found satisfactory compare to other developing countries.
- Nepalese income tax system is facing problems during tax collection such as: lengthy assessment process, lack of sufficient incentives to employees, inadequate power to income tax administrators, and lack of experts in the tax management, more tax evasion etc.
- Tax payer were facing problems while paying tax because misconduct of tax personnel, administrative harassment and complex tax laws and rules.
- Reforming and controlling present taxation system, controlling open boarder with India, preventing illegal business, making effective administration, increasing tax coverage can contribute positively to the present tax system of Nepal.

**Regmi (2006)** has presented a dissertation entitled “Income Tax Administration and its Effectiveness in Nepal”. He has analysis contributions of indirect tax and direct tax in total tax revenue and find out the share of income tax in total tax revenue. He has examined the effectiveness of income tax revenue collection and administrative aspect of income tax in Nepal. He has described that the effectiveness of income tax system depends upon the income tax administration. According to him in Nepal, one of the most important reasons for unsound income tax system is ineffective and unscientific income tax administration he has suggested that delays in assessment should be reduced as possible, computerized information system is necessary to keep up to data records of income tax, proper tax education should be provided to tax officials as well as taxpayers regularly, cost of income tax collection is one of the determinants of efficiency of administration. Therefore the concerned authority should pay due attention to it should be reduced, unnecessary outside pressure should be avoided and income tax experts/ Professional should be increased in tax administration. He pointed out that two administrations should pay great attention to bring the income from

house and land rent; doctor's clinic, consultancy service, tuition, research works into income tax net. In these sectors, income tax has been highly evades.

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

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

**Mr. Pokhrel (2007)** had presented a thesis entitled to “contribution of income tax on tax structure of Nepal” had conducted an empirical investigation. According to his investigation, income tax is a suitable means of raising the government revenue and tax education is necessary in Nepal for which 91.67% and 98.33% respondents have supported respectively. He found that inefficient tax administration, tax evasion and inappropriate objectives of income tax were the main causes of low collection of income tax in Nepal. Self assessment method of assessing income tax is most appropriate in Nepal. 70% of the respondents were favor of fees, fines and penalties whereas remaining 30% were against it. The recommended measures of the respondents are effective tax management, training and development programs to the personnel, development of check and balance system can bring efficiency in income tax system in Nepal.

**Dotel (2007)** presented a dissertation named “Income Tax Act 2058; Expectations and Realities” in 2007. The objectives of the study was to measure the effectiveness of



Income Tax Act 2058 both in theory and practice, to review the views of taxpayers, tax experts and tax administrators to ITA 2058. He found that Income Tax Act 2058 seems effective because it has the features of provisions of international taxation, taxing capital gains and dividends income, abolition of various tax related concession, rebate and exemption etc. He also found that the most of taxpayers, tax administrators and tax experts are acquaintance to present Income Tax Act. However they suggest that some of the words in the act needed to be further simplified.

**Chalise (2007)** has presented a thesis entitled “A study on Contribution of Income Tax to Government Revenue”. The objective of the study was to analyze the structure of government revenue, identify the ways and cause of income tax evasion and to make suggestion and recommendation for the elimination of income tax evasion. In his study he found that the average contribution of custom, VAT (Sales Tax), income tax and excise duty were 25.03%, 24.63%, 15.48% and 8.46% of total revenue respectively for the period of 10 years i.e. from fiscal year 1996/97 to 2005/06. Inefficient income tax administration, reluctance of taxpayer to maintain account, poor tax morality and taxpayer's compliance are the major causes of income tax evasion in Nepal. Controlling illegal business activities, fine and penalties to tax evaders, incentives to regular taxpayers are the major ways of controlling income tax evasion in Nepal.

**Oli (2008)** presented a dissertation entitled “Contribution of Individual Taxpayers to Income Tax Revenue of Nepal”. The objective the study was to examine the structure of government revenue, analyze the volume of direct and indirect tax to total revenue, analyze the contribution of individual tax payer to income tax revenue as well as total public revenue of Nepal etc. He has found that the tax revenue is 79.45% of the total revenue of Nepal in FY 2005/06. There is dominant role of indirect tax revenue in Nepalese tax revenue. It was major contribution by indirect tax revenue, which was 75.68% in FY 2005/06, but the direct tax was 24.32%. The major contribution in the income Tax was from individual. It was Rs. 5998.80 million in FY 2005/06, But from the public enterprises was only Rs.195.70 million.

**Sapkota (2008)** presented a dissertation entitled “Contribution of Income Tax to National Revenue; before and after enactment of Income Tax Act 2058.” The main objective of the study was to analyze the contribution of income tax in national

revenue before and after enactment of Income Tax Act 2058, to provide suitable suggestion for the betterment of income tax system in Nepal. During his study, he found that performance of income tax before and after new act seems not regular. The new income tax act is introduced on 2001/2002 and total income tax has first time declined by 210.3 million and by -2.3% that year. It further decreased by 937.5 million and -10.5% for FY 2002/03. In FY 2000/01 growth rate was 22.8% and that was more than 20% for other preceding year but is just 2.1% in the year FY 2005/06. He suggested that overall revenue policy as well as tax policy should be revised. Tax offices should be decentralized for broad coverage of geographical region. Different recent technologies such as e-taxation should be introduced and promoted to avoid complexities and delay in income tax administration.

**Subedi (2009)**, presented the MBS thesis entitled, “Tax Payer Attitude Towards Exemptions and Deductions under income tax Act 2058” he undertook the research work to find out the problems relating to exemption of incomes and deduction of expenses. The main objectives of the study were to analyze the contribution of income tax to national revenue of Nepal, to examine and evaluate the exemption and deduction facilities provided by income tax act 2002, to examine the view of respondents about the exemption and deduction facilities provided in the present tax Act and provide suggestion and recommendation to the income tax administration and income tax law.

Subedi found that there was highly resource gap in Nepal, income tax is the major source of the government revenue, contribution of income tax to total revenue is in increasing trend, tax GDP ratio is not satisfactory as compare to other developing countries, the exemption limit for all tax payer was equal from fiscal year 1965/66 to 1966/67 which was Rs 5000, which was divided into three categories in fiscal year 1978/79. He found that the exemption limit was increased according to time and situation which was Rs 125000 and Rs 140000 during his study period which he found that not sufficient and also the provision of deduction facilities provided by income tax Act was not sufficient.

Subedi found that the main causes for the creation of ineffective tax administration were weakness in government’s policy, less public participation, defective income tax

Act, lack of trained employee, faulty organization structure of tax administration, shortage of tax experts/ professional in tax administration etc.

Subedi also found that the exempted items mention in the income tax Act 2002 insufficient and inappropriate for all categories. Current additional tax exemption limit (30,000, 24,000, 18,000, 12,000 and 6,000 to A, B, C, D and E areas respectively) to the individual working in remote areas is proper or suitable. The medical facilities provided to the individual is not proper or appropriate. And lastly he found that as a whole the provision of exemptions and deductions made under the income tax act 2002 are insufficient in all respects.

Subedi suggested to increase the exemption limit to Rs 150000 to individual and Rs 200000 to family or couple. He suggests to replace the additional exemption given for some period to encourage establishing industries in different remote areas by introducing separate special package. He also suggested to be brought into tax net to non- transparent tax exempted organization by making separate law and rules.

Subedi also suggested on deduction of expenses which were as follows:

- ) Clear provision should be made regarding deductions of expenses.
- ) Items of deduction should be defined clearly.
- ) Due to unclear provision gives double meaning and which creates loopholes, it should be reduced from Act,
- ) Donation up to Rs 50 lakh given before six month until election to the political parties registered in the election commission should be eliminate from tax Act.
- ) Actual medical expenses made by tax payer should be allowed for deduction.
- ) Whole interest expenses should be allowed for deduction within fiscal year.

**Acharya (2009)**, presented MBS thesis entitled, “a study on VAT: trend analysis and projection”. He undertook the research work to find out the problem relating to collection of VAT and income tax, which blocks the reform of income tax system in Nepal. The main objective of his study were to review the theoretical aspects of VAT, analyze the trend of total government revenue, analyze the trend of total tax revenue,

analyze and evaluate the trend of VAT and give suggestion for the improvement of VAT and income tax system in Nepal.

Acharya found that the VAT was implemented to the purpose of rectifying the problems within the existing tax system. He found that the VAT was the replacement of sales tax, contract tax, entertainment tax and hotel tax. He found that the VAT was implemented after excising the various programs such as publicity, campaigns, workshop training, publication of articles, discussion on radio and television etc. he found that for implementing the VAT only the positive aspects of VAT were discussed and published but the negative aspects were not consideration. Therefore, there was problem to implement the VAT successfully.

Acharya also found that the revenue collection from VAT is less then tax collected from tax which was replaced by VAT in earlier years i.e. collection from four taxes that have been replaced by VAT were maximum of 35 percent and minimum of 33.2 percent in fiscal year 1990/91 and 1996/97 respectively of the total tax revenue. As compare to this after the implementation of VAT 30 percent of total tax revenue. He found that the contribution of total government revenue, total tax revenue and non-tax revenue were in increasing trend and also in future the contribution from VAT to the total revenue seems to be increasing.

Acharya has identified the reason for low collection of revenue from VAT and income tax. Which were lack of sound VAT and tax administration, lack of motivated tax administration, lack of honest tax payer and supportive tax administration, lack of awareness, improper billing system, under valuation of bills, smuggling in boarder side and lack of proper preparation work of the government.

Acharya suggested that the government should make tax administration effective, supportive and honest. He suggest that the government should bring strong programmed to tackled with the smuggling in the border side. He suggested that the existing exemption has board coverage and it should be minimized successfully. He also suggested that due to too many tax shelters with series of tax exemption and deduction must be eliminated that have not only disturbed the tax structure but also led to massive corruption.

## CHAPTER - III

### RESEARCH METHODOLOGY

#### 3.1 Research Design

The research study focused on role of income tax, indirect tax and direct tax in total tax revenue; effectiveness of income tax revenue collection in Nepal. To achieve the stated objective of the study, the opinion of the 60 respondents associated with distinct denomination i.e. tax experts; tax administrations and taxpayers were collected through the structured questionnaires. The questionnaire included the role of income tax to national revenue, provisions of fines and penalty, soundness and effectiveness of income tax system, the most important factors for the effectiveness of income tax system including necessary suggestions for achieving effectiveness of income tax in Nepal, etc. In this way, the research design of this research is descriptive, analytical and empirical.

#### 3.2 Population and Sample

In order to fulfill the objectives of the study, 60-sample size from Katmandu valley is selected. Persons included in the sample are carefully selected by consultation with lectures and best judgment of the researcher. The respondents have been divided into three groups. The following table shows the groups of respondents and the size of samples.

**Table No.3.1 Group of Respondents and Size of Samples**

S. N.	Groups of Respondents	Sample size
1	Income Tax Administrators	20
2	Income Tax Experts	20
3	Income Tax Payers	20
Total		60

Source: As Designed By Researcher

#### 3.3 Nature and Source of Data

Necessary data and information for this study has been collected from primary as well as secondary sources. The major sources of data are as follows:

### **a. Primary Data**

Primary data and information have been collected through administering structured questionnaire to sample of population. The same questionnaire was distributed to all respondents. Tax administrators are selected from tax department and various sectors of tax offices. Tax experts are the lecturers, auditors, chartered accountants etc. Tax payers are selected representing various sectors i.e. manufacturing company, trading company, private banks, insurance company, finance company, departmental store etc. Total 75 questionnaires were distributed to the respondents among which 60 of them can be received in time. That is only 80% of the distributed questionnaire was collected.

### **b. Secondary Data**

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

1. Budget speech and Economic survey of various years, Ministry of finance, GON.
2. Reports and records of department of Taxation, Ministry of finance, GON.
3. Dissertations related to income tax.
4. Books related to income tax and public finance.
5. National and international newspapers, journals, souvenir, and news magazines.
6. Various Internet websites.
7. Other relevant records and data.

Secondary data from fiscal year 1998/99 to fiscal year 2007/08 is used in this study.

### **3.4 Data Collection Procedure**

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

### **3.5 Data Processing and Analysis Procedure**

For the analysis, the collected data and information of various aspects of Income tax were organized and processed. Then, the descriptive tools and statistical tools such as simple percentage, simple average, graphs, charts and diagrams etc have been applied

in the way of analysis so that the findings could be presented and interpreted properly in order.

## **CHAPTER-IV**

### **PRESENTATION AND ANALYSIS OF DATA**

#### **4.1 Tax structure of Nepal**

Modern economic planning of Nepal has started with initiation of first economic planning in 1956. Since then, taxes have been used for the achievement of national economic goals. So, taxes play vital role to the economic development of Nepal. Tax structure of any country comprises both direct and indirect taxes.

##### **4.1.1 Composition of Total Revenue**

Total revenue of Nepal is composed of both tax and non-tax revenue since the presentation of first national budget in 1951/52 by HMG.

Table 4.1 shows the composition of total revenue of government, which includes tax and non-tax revenue from FY 2001/02 to 2007/08. it seems that the share of Tax Revenue has always been greater than the share of non-tax revenue. In FY 2001/02 share of tax and non-tax revenue is 77.96% and 22.03% respectively. However it is 80.85and19.14% in FY 2008/09. It indicates tax revenue plays the significant role in financing government expenditure. Tax revenue has been placed as a major source of government revenue in Nepal.

The composition of total revenue from fiscal Yr. 2001/02 to 2008/09 is given below.

**Table 4.1 Composition of total revenue**

F.Y.	Total Revenue	Tax Revenue	% of Tax Revenue	Non-tax Revenue	% of Non-tax Revenue on TR
2001/02	50445.54	39330.67	77.96	11114.90	22.03
2002.03	56229.78	42586.00	75.74	13642.86	24.26
2003/04	62331.00	48173.00	77.29	14158	22.71
2004/05	70122.70	54104.70	77.16	16018.00	22.84
2005/06	72281.00	57430.40	79.45	14851.60	20.55
2006/07	87712.20	71126.70	81.09	16585.50	18.90
2007/08	107622.58	85155.54	79.12	22467.04	20.87

2008/09	126304.80	102120.30	80.85	24184.50	19.14
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Sources: Economic Survey 2009

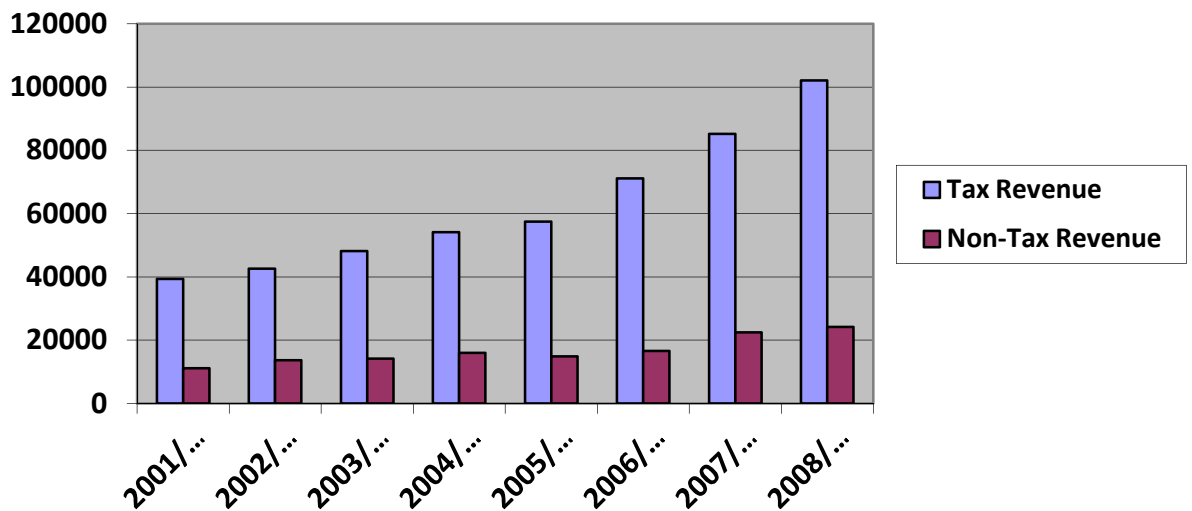
The above Table reflects the increasing trend of tax revenue from the FY 2001/02 to 2008/09. It was 39330.64 million in FY 2001/02 and increased to Rs.102120.30 million in FY 2008/09.

But the percentage contribution of tax revenue seems to be fluctuating in different years. The contribution of tax revenue on total revenue was maximum 81.09% in FY 2006/07 and minimum 75.74% in FY 2002/03 during the study period. The non-tax revenue is also in increasing trend for first 4 years, later it is also increased from 22467.04 million to Rs. 24184.50 in last year i.e. FY 2008/09.

The percentage contribution of non-tax revenue to total revenue is also fluctuating among the study period it was increased to 24.26% in FY 2002/03 and decreased to 22.71% in FY 2003/04. During the FY 2008/09 the contribution of non-tax revenue to total revenue is only 19.14% however the contribution of tax revenue is 80.85% in the same year. From the above figure it is clear that the tax revenue has covered the major portion of government revenue.

The contribution of tax and non-tax revenue on total revenue is shown the following bar diagram.

**Figure 4.1 Composition of total revenue**



#### 4.1.2 Composition of tax revenue

Tax revenue is composed of direct tax and indirect tax, income tax, property tax, interest are included indirect tax. Indirect tax includes customs, excised duty, VAT



etc. The composition of Nepalese tax revenue is presented in table 4.2 in terms of direct and indirect tax revenue from FY 2001/02 to 2008/09.

**Table No. 4.2 Contribution of direct and indirect tax on total tax revenue.**

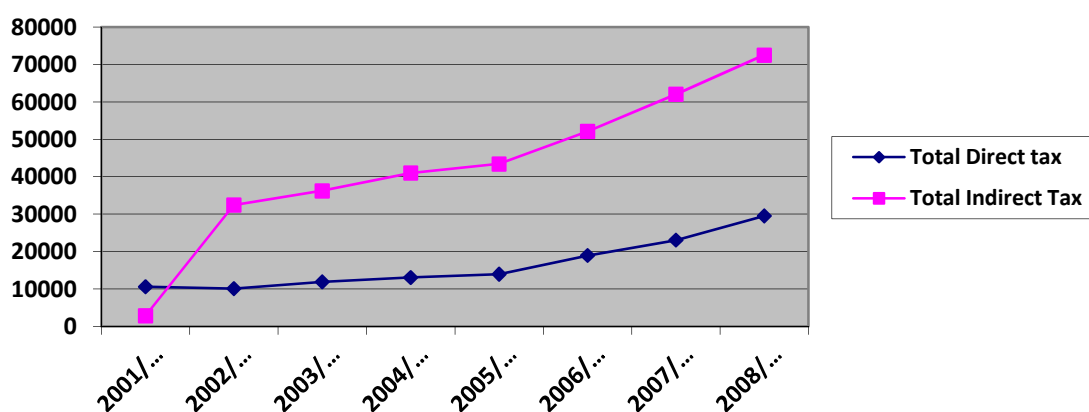
F.Y.	Total Tax Revenue	Total Direct Tax	% Share of Direct Tax	Total Indirect Tax	% Share of Indirect Tax
2001/02	39330.64	10597.55	26.94	2873.10	73.06
2002.03	42586.92	10105.66	23.73	32481.20	76.27
2003/04	48173.00	11912.60	24.74	36260.40	75.27
2004/05	54104.70	13071.80	24.16	41032.90	75.84
2005/06	57430.40	13968.10	24.32	43462.30	75.68
2006/07	71126.70	18980.30	26.68	52146.40	73.31
2007/08	85155.67	23087.76	27.12	62067.82	72.88
2008/09	102120.30	29571.30	28.95	72549.00	71.04

Sources: Economic Survey 2009

Above Table 4.2 makes us clear that major portion of tax revenue is covered by indirect tax and it was also increasing trend till the FY 2004/05, and then it was in decreasing trend till last year.

The share of indirect tax has increased from 73.06% in FY 2001/02 to 75.84% in FY 2004/05 and decreased to 71.04% in FY 2008/09. But direct tax is 26.94% in FY 2001/02 and decrease to 24.16% in FY 2004/05 and then increased in FY 2008/09 up to 28.95%. It indicates that the income level of people is in decreasing trend in on hand and promotion of importing goods from other countries. on other hand till the FY 2004/05 and it also indicates that the income level of people from last 2 years is in increasing trend which is good news for the government of Nepal. To direct the economy in the channel of development it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax. Therefore attention should be paid on the sufficient resource mobilization through internal sources.

**Figure 4.2 Contribution of direct and indirect tax on total tax revenue**



#### 4.1.3 Composition of indirect tax

Nepalese tax structure is heavily dependent on indirect taxes which constitutes the major portion of total tax revenue. Nepalese tax revenues is dependent mainly on international trade and VAT on goods and services supplemented by taxes on income and property to some extent. The major components of indirect tax in Nepalese tax structure constitutes custom duty, excise duty, VAT etc. Custom duty has been classified mainly into import duty and expert duty. Following tale shows the composition of indirect tax.

**Table 4.3 Major sources of indirect tax and their relative percentage to indirect tax**

(Rs. in million)

F.Y.	Indirect Tax Revenue	Customs Duties	As % of IDT	Excise Duties	AS% of IDT	VAT	AS% of IDT
2001/02	2833.10	12658.75	44.06	3807.05	13.25	12267.30	-
2002.03	32481.20	14236.43	43.83	4785.12	14.73	13459.70	42.44
2003/04	36260.40	15554.80	42.90	6226.70	17.17	14478.90	39.93
2004/05	41032.90	15701.60	38.27	6445.90	15.71	1885.40	46.02
2005/06	43462.30	15344.00	35.30	6507.60	14.97	21610.70	49.72
2006/07	52146.40	16707.60	32.03	9343.20	17.91	26095.60	50.04
2007/08	62067.80	21062.50	33.93	11189.58	18.02	29815.70	48.03
2008/09	72549.00	23105.85	31.84	13831.95	19.06	35611.20	49.08

Sources: Economic Survey 2009

The Table reflects that the custom duty and VAT occupies major portion in indirect tax. The total direct tax revenue collected in FY 2001/02 is Rs.28733.10 million of

which Rs.12658.75 million i.e. 44.06% is contributed by customs, 42.70% i.e. 12267.30 is covered by excise duty. The share of customs is continuously increasing from FY 2001/02 to 2008/09. The collection of VAT seems to be fluctuating in different years. The amount of VAT in FY 2001/02 is 12267.30 which is increased up to 35611.20 in FY 2008/09 i.e. 49.08%. Similarly, the share of excise duty is also increasing from 2001/02 to 2008/09. However, its percentage of share in indirect tax is in fluctuating trend during the study period. In FY 2001/02 its percentage contribution is 13.25 and increased to 17.17% in FY 2003/04. The highest contribution of excise duty is 19.06% in FY 2008/09 representing Rs.13831.95 million. From the above table it can clearly seen that percentage contribution of excise duty to indirect tax revenue is not significantly changed although total collection from excise duty is increased.

#### 4.1.4 Composition of direct tax

The major components of direct tax are income tax, land revenue and registration, urban house and land tax, vehicle tax and others.

**Table 4.4 Components of direct tax and their percent to direct tax**

FY	Direct Tax	Income Tax	I.T as% CF D.T	Land revenue Reg. Tax	AS % of D.T	Vehicle Tax	As % of D.T	Others	As % of D.T
2001/02	10597.55	8903.70	84.01	1131.82	10.68	559.74	5.28		
2002/03	10105.66	7966.20	78.84	1414.30	14.00	559.50	5.54	165.77	1.64
2003/04	11912.60	9245.90	77.62	1697.50	14.25	700.60	5.88	268.60	2.25
2004/05	13071.81	10159.40	77.72	1799.20	13.76	806.50	6.17	306.70	2.35
2005/06	13968.10	10373.70	74.22	2181.10	15.61	847.60	6.07	565.70	4.05
2006/07	18980.03	15034.00	79.20	2253.50	11.87	995.00	5.24	697.80	3.67
2007/08	23087.76	17311.22	74.98	2940.74	12.73	1069.21	4.63	1766.59	7.65

2008/09	29571.30	21418.05	72.42	4084.05	13.81	1884.6	6.37	2184.6	7.38
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Sources: Economic Survey 2009

Above Table 4.4 shows the contribution of income tax to direct tax is higher than other tax and it occupies the largest share in direct tax. The percent share of income tax to direct tax in FY 2001/02 is 84.01 percent amounting Rs.8903.70 million. The percent contribution of income tax is continuously decreased in FY 2003/04 its contribution to direct tax is 77.62% and in FY 2008/09 it is decreased to 72.42% amounting Rs.29571.30 million. So, this regular decrease in contribution percent of income tax to direct tax is not satisfactory. It needs to increase by widening the tax rate.

The land revenue and registration has covered 10.68% of direct tax in FY 2001/02 amounting Rs.1131.82 million. In FY 2006/07 it decreases to 11.87%. Afterwards it started to increased. Another major component of direct tax is vehicle tax which has covered 5.28 of direct tax is continuously increasing till FY 2004/05 and decrease in FY 2007/08 up to 4.63%. Its maximum share is 6.37 i.e. 1884.60 million in FY 2008/09, which is maximum percent during the study period.

The contribution of other sources to direct tax is also increasing trend from FY 2007/08 and 2008/09.

#### **4.1.5 Contribution of Direct Tax as Percent to GDP Total Revenue and Total Tax Revenue**

The contribution of direct tax as percent of GDP total revenue and total tax revenue is shown below.

**Table 4.5 Contribution of direct tax as percent to gdp total revenue and total tax revenue**

FY	Direct Tax	Direct Tax % of Total Tax	Direct Tax as % of Total of GDP	Direct Tax as % of Total Revenue
2001/02	10597.55	26.94	2.61	21.00
2002.03	10105.66	23.73	2.31	17.97
2003/04	11912.60	24.73	2.51	19.11
2004/05	13071.80	24.16	2.38	18.64
2005/06	13968.10	24.32	2.31	19.32

2006/07	18980.30	26.68	2.61	21.63
2007/08	23087.76	27.12	2.82	21.45
2008/09	29571.30	28.95	3.53	23.41

Source: Economic Survey 2009

From the Table 4.5, it is clear the percentage share of direct tax to total tax revenue is 26.94 percent in FY 2001/02 then it has decreased to 23.73% in FY 2002/03 which is minimum contribution during the study period and then it started to increase in every years.

The share of direct to GDP seems to be very low. It is only 2.61% in FY 2001/02, which is decreased to 2.31% in FY 2005/06. But the share of direct tax to GDP in FY 2008/09 is 3.53% which is maximum during the study period. From the above figures, we can conclude that there is not any significant improvement in contribution of direct tax to GDP in the last years. In the other hand the share of direct tax on total revenue was fluctuated. Its contribution is 21% FY 2001/02 and its share is decrease to 17.97% in FY 2002/03 which is minimum during the study period. In FY 2008/09 its share is only 23.41% which is 1.96% higher than FY 2007/08.

#### 4.1.6 Contribution of Various Taxes as % to GDP

The contribution of various taxes as % to GDP is given in the following table.

**Table 4.6 Contribution of various taxes as % to GDP**

FY	TR as% of GDP	Total T.R. as % of GDP	D.T. as % of GDP	I.T. as % of GDP	I.T. as % of GDP	Custom Duty as % of GDP	Excise of % if GDP	L.R & Regis. of % of GDP	Vat as % of GDP
2001/02	11.00	8.60	2.61	6.28	1.94	2.76	0.83	0.24	2.68
2002/03	11.40	8.70	2.31	6.63	1.62	2.90	0.97	0.28	2.74
2003/04	11.60	9.00	2.51	6.77	1.72	2.90	0.89	0.31	2.70
2004/05	11.90	9.20	2.38	6.97	1.73	2.66	1.09	0.30	3.21
2005/06	11.10	8.80	2.31	6.65	1.58	2.35	0.98	0.33	3.31
2006/07	12.10	9.80	2.61	7.18	2.07	2.21	1.28	0.31	3.59
2007/08	13.20	10.40	2.82	7.58	2.11	2.57	1.36	0.35	3.64
2008/09	14.80	12.20	3.53	8.67	2.55	2.76	1.65	0.48	4.25

Source: Economic Survey 2009

From the above Table 4.6 it seems that the contribution of total revenue on GDP is in increasing trend. In FY 2001/02 it is 11% which is gradually increased and reached to 14.8% in FY 2008/09. The contribution of total tax revenue on GDP is fluctuating in

last 8 years. It is 8.6% in FY 2001/02 and increased to 9.2% in FY 2004/05. In FY 2005/06 its share to GDP is decreased to 8.8% and started to increase from 2006/07 and reached to 12.2% in FY 2008/09. There is significant role of indirect tax in the tax structure of Nepal, which has contributed almost three times more than direct tax. In FY 2001/02 the contribution of indirect tax and direct tax on GDP are 6.28 and 2061% respectively. This is increased to 8.67% and 3.53% in FY 2008/09. The contribution of income tax on GDP is fluctuating in past 8 years. Its contribution is 1.94 in FY 2001/02 which is decreased to 1.62% in FY 2002/03 at minimum level during the period of 8 years. Then after, it is increased and reached up to 2.55% in FY 2008/09. The contribution of land revenue and registration tax is 0.24 in FY 2001/02 and it is slightly increased to 0.48 in FY 2008/09. Within the direct tax, the contribution from income tax on GDP is higher than other tax.

The custom duty, which is composed of import and export duty, has contributed the largest part in GDP with in the indirect tax. It has contributed 2.76% of GDP in FY 2001/02. After that it is gradually increased and covered the share of 2.90 in FY 2003/04. But it is again decreased to 2.66 and 2.21 in FY 2004/05 and 2006/07 respectively. The contribution of VAT in GDP is also higher. It has contributed 2.86% on GDP in FY 2001/02 and increased to 4.25% in 2008/09.

The contribution of excise duty in FY 2001/02 is 0.83 it is increased to 1.65% in FY 2008/09. The government has target to increase the VAT at 4% of GDP which is fulfill in the FY 2008/09.

#### **4.1.7 Contribution of income tax in Nepal**

Nepal has late, started the practice of income tax. Tax idea of introducing income tax in Nepal was originated along with the first budget in 1951. Finally, in 1959, business profit and remuneration Tax Act 1960 was introduced. At that time income tax was levied only on business profits and salaries. After about three year of experiencing income tax. The government replaced the prevailing tax by income Tax Act 1962. In 1974, income Tax Act 1974 (2031) was enacted, however, this act is replaced by Income Tax Act, 2002 (2058). The contribution of income tax on various revenues is given in the following table.

**Table 4.7 Contributions of income tax to gdp, total revenue, total tax revenue and direct tax revenue**

Fiscal Year	GDP	Total Revenue	Total Tax Revenue	Direct Tax Revenue	Income Tax	% of IT on GDP	% of IT on TTR	% of IT on TR	% of IT on Direct tax
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2000/01	330018	37251	28752.90	7516.10	6170.2	1.87	21.46	16.56	82.09
2001/02	366251	42893.70	33152.10	8951.5	7420.6	2.02	22.38	17.30	82.89
2002/03	394052	48893.90	38865.10	10159.4	9114	2.31	23.45	18.64	89.71
2003/04	406138	50445.60	39330.60	10597.5	8903.7	2.19	22.64	17.65	84.02
2004/05	437546	56229.70	42587	10105.8	7966.2	1.82	18.70	14.17	78.83
2005/06	474919	62331	48173	11912.6	9245.9	1.95	19.19	14.83	77.61
2006/07	548485	70122.70	54104.70	13071.8	10159.4	1.85	18.77	14.19	77.72
2007/08	603673	72282.10	57430.40	13968.10	10373.7	1.72	18.06	14.35	74.27
2008/09	837051.65	1263048	102120.30	29571.30	21418.05	2.55	20.97	16.97	72.42

Source: Economic Survey 2009

The above Table 4.7 reflects that income tax is increased in 2008/09 as compared with 2001/02. Total income tax is Rs. 8903.70 million for the FY 2001/02 and it is increased to Rs.21418.05 million for the FY 2008/09. The share of income tax on GDP Nepal is very low. It lies between 1.92 and 2.55% during the study period. It is 1.94 in 2001/02 and increased to 2.55% in FY 2008/09. In FY 2008/09 it is maximum.

The share of income tax to total tax revenue is fluctuated in between 18% to 24%. It is 22.64% in FY 2001/02, decreased to 18.70 in FY 2002/03 therefore increased to 20.97 in FY 2008/09. Sincerely, contribution of income tax to total revenue is 17.65 in FY 2001/02 and it is decreased to 14.17 in FY 2004/05, again started to increased and reached to 16.97% in FY 2008/09.

The contribution of income tax on direct tax is maximum, it is 84.02% in FY 2001/02, its contribution is sharply decreased to 72.42% in FY2008/09. Such decreasing and increasing trend of contribution of income tax to direct tax structure is not fruitful for the tax structure of developing country like Nepal.

#### **4.1.8 Structure of income tax in Nepal**

Income tax revenue is divided into corporate tax, individual tax and remuneration tax until 1993/94. After that, the income tax revenue is divided into four group i.e. corporate income tax, individual income tax, house and land tax and interest tax. Corporate tax is collected from government, public and private limited companies and partnership firms and individual industries income tax is collected from remuneration and industry, business profession of vocation, interest tax is paid from banks and financial institution that pay interest for all types of deposits and the house rent tax is levied on income obtained from renting house and land in urban areas. The structural composition of income tax is presented below.





**Table 4.8 Composition of income tax****(Rs. in million)**

FY	Total Income Tax	Corporate Income Tax	% of corporate Tax on IT	Individual Income Tax	% of Individual Income on IT	Remuneration Tax	% of Rem. Tax on IT	Interest Tax	Interest % of Tax on IT
2001/02	8903.70	3181.30	35.73	4419.09	49.63	835.56	9.38	467.70	5.25
2002/03	7966.20	2487.30	31.22	3362.20	42.20	1252.60	15.72	864.00	10.84
2003/04	9245.90	3587.90	38.80	3533.40	38.22	1391.20	15.03	733.40	7.93
2004/05	10159.40	3800.20	37.40	3926.30	38.65	1675.90	16.49	757.00	7.95
2005/06	10373.70	3600.00	34.70	4234.70	40.82	1764.10	17.00	774.90	7.47
2006/07	15034.00	6736.80	44.81	5235.70	34.18	2007.90	13.35	1054.90	7.01
2007/08	17311.22	7391.04	42.69	6381.21	36.86	2451.04	14.15	1087.91	6.28
2008/09	21418.05	8316.45	38.82	8608.65	40.19	2709.60	12.65	1783.35	8.32

Source: Economic Survey 2009

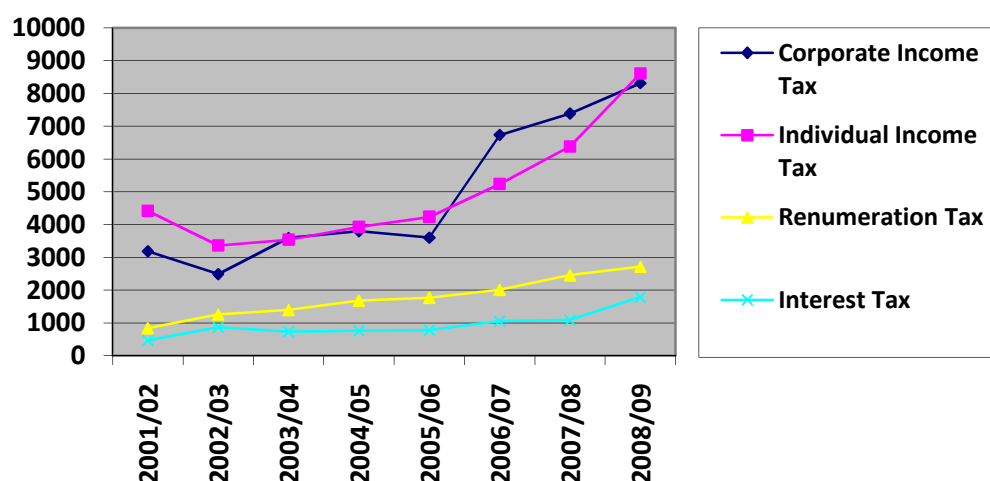
The Table 4.8 shows that the share of corporate income tax on income tax was 35.73% in FY 2001/02 which was decreased to 31.22% in FY 2002/03 and it gradually increased to 38.08% in FY 2003/04. But it sharply decreased to 34.7% in FY 2005/06 and increased 44.81% in FY 2006/07. Among these ups and downs the share of corporate income tax to total income tax is decreased to 38.82% in FY 2008/09. Tax collection from corporate sector is found to be highly fluctuated during the study period, which is the red signal for the corporate sector.

Contribution of individual income tax seems to be gradually increasing from 4419.09 million 8608.65 million in FY 2001/02 and 2008/09 respectively. Individual income tax collection is highest in FY 2008/09 which is 40.19% of total income tax.

Contribution from remuneration tax and interest tax is Rs.835.56 million and 467.70 million which is 9.38 and 5.28% of total income tax respectively in FY 2001/02. The share of remuneration tax is continuously increasing during the study period. Its share

is 9.38% in 2000/01 and reached to 12.65% in FY 2008/09 amounting Rs. 2709.6 million. An interest tax is fluctuating trend during last 8 year, it is Rs.864 million in FY 2002/03 but decreased to Rs. 733.4, 757 and 774.90 million in FY 2003/04, 2004/05 and 2005/06 respectively. Then it is in increasing trend i.e. 1054.90, 1087.93 and 1783.35 in FY 2006/07, 2007/08 and 2008/09 respectively.

**Figure No. 4.3 Composition of income tax**



#### **4.2 Problems of resource gap in Nepal**

The resource mobilization is the main challenge in the economic development of the country. The internal resource plays vital role in economic development of the country. Government collects the resources from different ways. The tax structure is major source of revenue for the government. Government has imposed two types of tax like direct and indirect tax. In the present tax structure, the government collects higher revenue from indirect taxes rather than direct tax. The policy has to be made a part of the instrument of the development goals.

The resource mobilization has been a major problem in financing of growing government expenditure. Since the beginning of planned development of Nepal there has been tremendous increment in the size of government expenditure. The development works have to be carried out by the government in the initial stage. An increase in government expenditure creates additional demand in the economy through multiplier effects and there by induces arise in aggregate output. The government resources have been concentrated more on expanding economic overhead in the form of transport, power and communication, which will stimulate agriculture, industry and transport in the private sectors.

The government expenditure is the main source of gross national investment and capital formation. Many studies have been attempted to examine the problem of resource gap and prospect of internal resource gap. Domestic resource gap is the amount of excluding net foreign grants and loans. But the overall resources gap includes the contributions made by foreign grants loan in financing public expenditure.

The problem of resource gap has increased from one year to another which has been recovered through inflow of external capital. Regular expenditure is fulfilled by internal resources where as development expenditure is mostly in external resources.

The dependence on foreign aid and deficit finance has not shown any declining trend. If the resource gap is minimized through the over dependence of foreign loans, it can further create the resource problem in the near future.

The problem of resource mobilization and resource gap is related to the saving and investment. The level of income and the rate of interest influence the saving structure. The low rate of saving is prevailing in the country as a result of low level of income of the people. The low level of income creates the problem of resource mobilization for undertaking investment programmes in a large scale by both government and private sector.

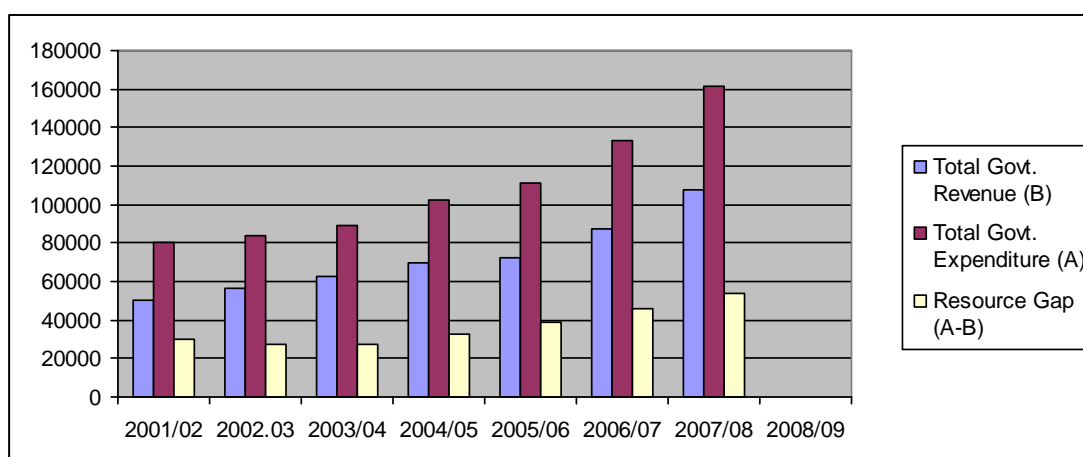
**Table No. 4.9 Domestic resource gap pattern in Nepal**

Fiscal Year	Total Govt. Expenditure (A)	Total Govt. Revenue (B)	Resource Gap (A-B)	Resources gap as % of Total Expenditure
2001/02	80072.20	50445.52	29626.66	36.99
2002.03	84006.10	56229.78	27776.32	33.06
2003/04	89442.60	62331.00	27111.60	30.31
2004/05	102560.40	70122.70	32437.70	31.62
2005/06	110889.20	72287.00	38607.20	34.12
2006/07	133604.60	87712.20	45892.20	34.35
2007/08	161349.90	107622.58	53727.32	33.29
2008/09				

Source: Economic Survey 2009

From the Table 4.9, it seems that the resource gap is Rs. 29626.66 in FY 2001/02 and it decreased to 27111.60 in FY 2003/04 and then it is started to increase from FY 2004/05 i.e. 32437.70 million and reached to Rs.53727.32 million in FY 2008/09. The percentage of resource gap to total expenditure is maximum 36.99% in FY 2001/02 amounting to Rs.29626.66 million. The Government revenue and expenditure is increasing every year. But the rate of increase in expenditure is higher than increasing revenue which is leads to the rising resource gap.

**Figure 4.4 Bar diagram showing resource gap**



#### 4.2.1 Revenue Expenditure

Revenue expenditure gap is known as resource gap. In the context, three types of gaps are measured and used in the analysis of resource gap.

**Table 4.10 Overall resource gap pattern of Nepal**

FY	Total Govt. Expenditure (A)	Total Govt. Revenue (B)	Resource Gap (A-B)	Foreign Grants (C)	Resource Gap 2 (A-B+C)	Foreign Loan (D)	Resource Gap 3 (A-B+C+D)
2001/02	80072.20	50445.52	29626.66	6686.10	22940.56	7698.70	15241.86
2002/03	84006.10	56229.78	27776.32	113319.10	16437.22	4546.40	11890.82
2003/04	89442.60	62331.00	27111.60	11283.40	15828.20	7629.00	8199.20
2004/05	102560.40	70122.70	32437.70	14391.20	18046.50	9266.00	8780.50
2005/06	110889.20	72287.00	38607.20	13827.50	24779.70	8214.30	16565.40
2006/07	133604.60	87712.20	45892.20	15800.80	30091.60	10053.50	20038.10
2007/08	161349.90	107622.58	53727.32	20320.70	33406.62	8979.90	24426.20
2008/09							

- Resource Gap<sup>1</sup> (A-B)

The gap between government revenue and expenditure has risen from 29626.66 million to 53727.32 million in FY 2001/02 and 2007/08 respectively. This figure shows the poor performance of domestic resource mobilization.

- Resource Gap<sup>2</sup> (A-B+C)

This type of resource gap is Rs.22940.56 million in FY 2001/02, which is decrease to 16437.22 million and 15828.2 million in FY 2002/03 and 2003/04 respectively and

increased up to Rs.33406.62 million in FY 2007/08. The above data suggests that foreign grants should be encouraged to minimize the resource gap.

- Resource Gap<sup>3</sup> [A-(B+C+D)]

This resource gap is taken as the difference between total expenditure and total revenue plus foreign grants plus foreign loan. In FY 2001/02 the gap was 15241.86 million which is decreased to Rs.11890.82 million and 8199.2 million in FY 2002/03 and 2003/04 respectively and it was further decreased to 8780.5 in FY 2004/05 then it was rapidly increased and reached to Rs.24426.22 million in FY 2007/08 which is Rs. 4388.12 million higher than previous year. It measures the internal indebtedness of the government. The above data reflects the decreasing resource gap when foreign loan is decreased and vice versa. As the loan taken amount will decrease simultaneously, the resource gap will increase consequently. Moreover, foreign loan largely depends on the fiscal policy adopted by the nation.

Fiscal deficit (resource gap) is continuously increasing due to lack of proper income management to meet the increasing trend of the government expenditure (Economic Survey). Thus this increasing resource gap indicates that it is necessary to mobilize additional domestic resources. Ultimate and best measure to fill up the resource gap is to increase public revenue through effective tax system. If any government has a resource gap, it has to resort a deficit budget. There was a large portion of foreign grants to meet the budget deficit in the early year's budgets in Nepal. But in recent years, the percentage of foreign loans is rising and percentage of grants is decreasing. It is not a desirable direction for our economy. Moreover, foreign loan creates extra burden to the economy because debt servicing charge increases every year. The foreign loan should be taken as a complementary resource to mobilize internal resource properly.

#### **4.2.2 Problems in Public Expenditure**

Government expenditure is increasing along with its expanding activities in development and social activities. The increasing trend of government expenditure can be fulfilled either by internal resources or through inflow of foreign aid. The increasing rate of growth in government expenditure creates many problems in public expenditure management. As a result, deficit financing takes place in the economy. On the one hand, the resource gap problem is increasing and on the other hand it has grown the inflation and price unstabilization in the economy. There is two way

relationships between resource mobilization and expansion in budgetary size in developing country. Government policy should be reformed for maximum resource mobilization in accordance with the expansion in economy that has taken place through the investment of public sector in development activities.

Development expenditure is mostly prepared in accordance with commitment of the donor agencies. But the disbursement of foreign aid has not been as per the commitment. The lack of funding compiles to delay the completion of the projects. In the same way the donor agencies are too much involved in the decision making which creates many problems in implementation and for the completed project by the funding agencies the problem stands to the government on the operation and maintenance of the project.

**Table 4.11 Share of government revenue, foreign aid and citr in public expenditure.**

(Rs. million)

FY	Total Govt. Expenditure	Total Govt. Revenue	TR as% of TE	Foreign Aid	Foreign Aid as% of TE	CITR	CITR as% of TE
2001/02	80072.20	50445.50	63.00	14384.80	17.96	8181.30	3.97
2002.03	84006.10	56229.78	66.93	155885.50	18.91	2487.30	2.96
2003/04	89442.60	62331.00	69.69	18912.40	21.14	3587.90	4.01
2004/05	102560.20	70122.70	68.37	23657.30	23.07	3800.20	3.70
2005/06	110889.20	72282.00	65.18	22041.80	19.88	3600.00	3.25
2006/07	136604.60	87712.20	65.65	25854.37	19.35	6736.80	5.04
2007/08	161349.90	107622.58	66.70	29300.60	18.35	7391.04	4.58
2008/09							

The above Table 4.41 shows the total government expenditure, government revenue, foreign aid and CITR. The contribution of government revenue is only 63% of government expenditure in FY 2001/02. This share has increased to 69.69% in FY 2003/04 amounting Rs.62331 million, which is maximum contribution on Govt. expenditure. The contribution of Government revenue in FY 2007/08 is 60.70% amounting to Rs.107622.58.

The share of CITR is 3.97% in FY 2001/02. This share is maximum in FY 2006/07 which is 5.04% of total government expenditure. The share of CITR is only 2.96% in FY 2002/03 which is lowest percentage during the study period. However it is increased to 4.01% in FY 2003/04 and decreased to 3.255 in FY 2005/06 amounting to Rs.3600 million.

Similarly, the contribution made by foreign aid comprising both foreign grants and loans is 17.96% in FY 2001/02 amounting Rs.14384 million after this year, its share is in increasing trend up to 2004/05. Its contribution is maximum in FY 2004/05 i.e. 13.07% amounting Rs. 23657.30 million. In FY 2007/08 it has contribution 18.15% of Govt. expenditure amounting to Rs. 29300.60 million.

In conclusion from the above analysis is that the government dissaving is increasing every year. Government expenditure is increasing at a high rate than the growth rate of domestic saving has not increased substantially even the external capital inflow has been increasing with higher rate. As a consequence of which the resource gap is highly increasing instead of diminishing. In this context, the certain percentage increase in the share of CITR will play a significant role to fulfill resource gap from the internal sources. So more emphasis should be given on raising revenue through corporate sector.

### **4.3 Corporate Tax Structure**

This deals with the corporate tax rate and tax base. It has divided into two section first section presents structure of corporate income tax while the second reveals the present corporate tax based followed by corporate sector.

#### **4.3.1 Corporate Tax Rate Structure in Nepal**

Tax rate is the base of measurement of tax liability. Tax should not be so high only for minimum revenue realization but should be activator for the private investment Developing countries like Nepal, needs to boost up their economic conditions by developing industries and trade within the country. For this, corporate tax rate also plays a crucial role. Imposition of tax on corporate profit was started with the enactment of business profit and remuneration tax act 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 numbers of companies where limited and private companies were generally managed by family. in the year 1985/86 the progressive tax rate structure was abolished in case of government enterprise and used to split into different units to take advantage of lower rates. The progressive rate of tax to private companies was



abolished in the fiscal year 1995/96. This, flat rate system has been continued for all corporate bodies since the FY 1995/96.

The corporate tax rate structure was increased up to 60% the maximum rate in the FY 1995/96 from 25% during 1960/61 to 1975/76; the tax rate again decreased up to 51% and 50%, this rate was again increased to 55% and remains continued from FY 1982/83 till 1987/88. in the year 1987/88 the listed public limited 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 decreasing, now tax is 20% to industry, 25% to general companies and 30% to banks and finance companies. The corporate tax structure of different years is presented as below.

**Table 4.12 Corporate tax rate structure in Nepal**

FY	Maximum Marginal Tax Rate		Natural of Tax Rate
	Private Co.	Public Co.	
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	"
1975/76	60	60	"
1976/77-1978/79	51	51	"
1979/80	50	50	"
1980/81-1981/82	50	50	"
1982/83	55	55	"
1983/84-1984/85	55	55	"
1985/86	55	55	Progressive (P)& Flat (F)
1986/87-1987/88	55	50	"
1988/89-1989/90	50	50	"
1990/91-1991/92	40	40	"
1992/93-1994/95	35	35	"
1995/96	33	33	Flat
1996/97	30	33	"
1997/98-2008/09	20, 25, 30	20, 25, 30	"

Source: 1. Kandel P.R. (2000), corporate tax system & Investment Behavior in Nepal.

2. Budget speech 2006/07, 2007/08

3. Finance Acts

### **4.3.2 Corporate Tax Base in Nepal**

Under the Income Tax Act 2058 of Nepal, corporate tax is levied on the total taxable income of the previous year. It has assumed the global or total as well as scheduler income tax. This act has divided the source of income into three major heads they are: income from business, income from investment and income from employment. The third amendment of income tax act 2058 has further clarified about calculating the adjusted taxable income and net taxable income from business, investment and employment. All the taxable income are added as per law and deduction allowable expenses such as general deduction, cost of trading stock, interest expenses, repair & maintenance expenses, depreciation, reserve and rise bearing fund and expenses related with business and investment were deducted as per the law, which occurs adjusted taxable income, then in case of business income, pollution control and R&D expenses should be deducted taking the adjusted taxable income as base, after that we get assessable income from business before loss adjustment. Then, loss from business in current year and previous year are deducted to get the net assessable income from business. Likewise, loss in Business and investment of current year and business loss of previous year are deducted to get the net assessable income investment. Total assessable income is calculated by adding the net income from business and investment from where common expenses and donation expenses can be deducted as per law to get total taxable income. No exemption limit is provided to the companies.

### **4.3.3 Contribution of Corporate Income Tax**

Contribution of corporate income tax on income tax revenue, total government revenue, its composition and trend line for 8 years has been drawn in this sub-chapter. The relationship of CITR with other taxes and total revenue and its coverage portion has been examined.

#### **4.3.3.2 Contribution of Corporate Income Tax Revenue on Income Tax Revenue**

Income tax revenue comprises of corporate income tax, individual income tax, remuneration tax and interest tax. The size of income tax revenue largely depends upon the size of corporate sector. Greater the size of corporate sector, higher will be the CITR and total tax revenue and vice versa. So, CITR in Nepal has played a crucial role in income tax revenue which has been presented in the following table.

**Table 4.13 Contribution of CITR on income tax revenue****(Rs. in million)**

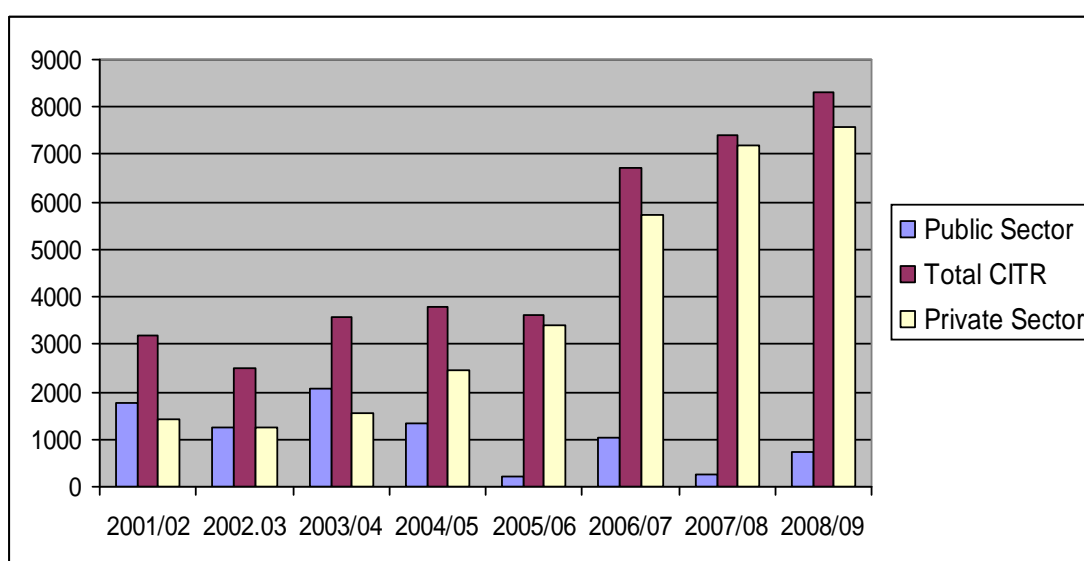
FY	Income Tax	Corporate Income Tax				Total CITR	%
		Public Sector	%	Private Sector	%		
2001/02	8903.70	1769.33	19.87	1412.00	15.86	3181.30	35.73
2002/03	7966.20	1251.02	15.70	1236.27	15.52	2487.30	31.22
2003/04	9245.90	2056.60	22.24	1531.30	15.56	3587.90	37.40
2004/05	10159.40	1332.40	13.11	2467.80	24.29	3800.20	37.40
2005/06	10373.70	195.70	1.88	3404.30	32.81	3600.00	34.69
2006/07	15034.00	1019.70	6.78	5717.10	38.00	6736.80	44.81
2007/08	17311.22	240.58	1.39	7186.46	41.51	7391.04	42.69
2008/09	21418.05	722.10	3.37	7594.35	35.45	8316.45	38.82

Source: Economic Survey

Above Table 4.13 reflects that the contribution of CTIR to income tax seems to be in decreasing trend during the study period it is 43.35% amounting Rs. 2681.50 million in the FY 2001/02, which is increased to 47.67% amounting Rs.3538.3million in FY2002/03. It is increased to 53.24% amounting 4852.3million in FY 2003/04. But its contribution is started to decrease and reached to 31.22% in FY 2005/06. After that it is increased to 37.80% and decreased to 37.40% in FY 2006/07 and 2007/08 respectively. In FY 2008/09 the contribution of CITR is only 34.69% amounting Rs.3600million. The Sectoral composition of corporate sector seems to be changed during the study period. In FY 2001/02, 24.73% and 18.72% contribution is made by public and private sectors. This figure is 15.70% and 15.52% respectively 2005/06 and this figure is changed to 1.88% and 32.81% in FY 2008/09.

The above figure clarifies that the contribution of public sector is decreasing and private sector is in increasing trend. The CITR and income tax revenue position has been shown in the following bar diagram and chart.

**Figure no. 4.5 CITER on income tax revenue**



**Table 4.14 Contribution of corporate income tax on total revenue**

(Rs. in million)

FY	Total Revenue	Corporate Income Tax				Total CITER	%
		Public Sector	%	Private Sector	%		
2001/02	50445.54	1769.33	3.51	1412.00	2.80	3181.30	6.31
2002/03	56229.78	1251.02	2.22	1236.27	2.20	2487.30	4.42
2003/04	62331.00	2056.60	3.33	1531.30	2.46	3587.90	5.76
2004/05	70122.70	1332.40	1.90	2467.80	3.52	3800.20	5.42
2005/06	72282.00	195.70	0.27	3404.30	4.71	3600.00	4.98
2006/07	87712.20	1019.70	1.16	1757.60	6.52	6736.80	7.08
2007/08	107622.58	240.58	0.22	7186.46	6.67	7391.04	6.86
2008/09	1263048.00	722.10	0.85	7594.35	9.15	8316.45	9.87
Total	1769793.8	8587.943	13.46	148980.81	38.03	39100.99	50.7

Above Table reflects the contribution percentage of corporate income tax, to total government revenue during the study period is fluctuating from 4% to 7%. The share of corporate income tax revenue is 6.31% amounting to Rs. 31.81% million in FY 2001/02. In which 3.51% is covered by public sector and rest by private sector. In FY 2002/03 it is decreased to 4.42% in which 2.22% is covered by public sector and rest by private sector. Later on the share of CITER on total revenue has increased up to 9.87% in FY 2008/09 which is the maximum contribution during the study period,

where intra-structural composition of corporate sector is dominated by private sector contributing 9.01% of maximum percentage amounting to Rs. 8316.45 million. Total revenue is also in increasing trend which is not only the cause of better implementation of fiscal policy and positive macro economic indicator but it was also due to the expansion of taxation and revenue net. This table also shows that the private sector's tax collection is fluctuating but it is around 2% to 9% since last 8 years although Nepal has liberalized the economy and privatized about 30 public enterprises and companies during the last decade. Likewise, tax collection from public enterprises seems to be increasing trend up to FY 2003/04 but later it was decreased and reached 0.85% in FY 2008/09. From the above table we can find that the contribution from public sector is decreasing gradually and from private sector is in increasing trend.

Nevertheless, Nepalese corporate sector is contributing to total revenue only about 7% on average which seems to be very small portion comparing to other developing countries. The contribution pattern of corporate income tax to total revenue has been shown in the following bar diagram.

## **4.4 Empirical Investigation**

### **4.4.1 Introduction**

The survey result has been conducted to find out the various aspects of income tax in Nepal. The structured questionnaire was prepared and distributed for this purpose. The opinion of the various 60 respondents associated with distinct denominations i.e. tax administration; tax expert and taxpayers were collected. The questionnaire has covered role of income tax, major problem of income tax system problems facing by taxpayer, the most important factors for the effectiveness of income tax system in Nepal. (See the format of questionnaire in a appendix B). The respondents were asked either to response yes/no or for ranking of choices according to no of alternative where first choice was the most important and last choice was least important. No of respondents in each denomination is equal i.e.20. Information received from the respondents are tabulated and analyzed in the proper way. Following table shows the groups and no. of respondents.

**Table 4.15 Group of respondents and no. from each group**

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

Source: As Designed by Researcher, 2010

Total 75 questionnaires were distributed to the respondents among which 60 of them can be received in time. That is only 80% of the distributed questionnaire was collected.

## Result of Empirical Investigation

### 4.4.2 View towards Income Tax System in Nepal

To know the respondents view regarding soundness and efficient of income tax system in Nepal, a question, "In your opinion is income tax system of Nepal sound and efficient?" (Q.No.1, Appendix). Was asked. The responses are tabulated as follows.

**Table 4.16 Soundness and effectiveness of income tax system in Nepal**

Response	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	2	10	18	90	20	100
Tax Expert	1	5	19	95	20	100
Tax Payer	-	-	20	100	20	100
Total	3	5	57	95	60	100

Source: Opinion Survey, 2010

98.2 percent respondent approve income tax system of Nepal is not sound and efficient. Only 1.8 percent respondents approve soundness and efficient tax system of Nepal.

### 4.4.3 Income Tax as Suitable Means of Raising Government Revenue

To know whether income tax as a suitable means of raising government revenue in Nepal, a question was asked "Do you consider that income tax is the suitable means

of raising government revenue in Nepal?"(Q.No.2, Appendix). The respondent's responses are tabulated as follows.

**Table No.4.17 Income tax as a suitable means of raising revenue**

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	19	95	1	5	20	100
Tax Expert	20	100	-	-	20	100
Tax Payer	18	90	2	10	20	100
Total	57	95	3	5	60	100

Source: Opinion Survey, 2010

From the opinion survey, it is found that 95 percent tax administrators, cent percent tax experts and 90 percent tax payers recognize income tax as a suitable means of raising government revenue. Only 5 percent tax administrator and 10 percent tax payer does not recognize. In aggregate, 95 percent respondent recognized and 5 percent does not recognized income tax as a suitable means of raising government revenue in Nepal. Thus, it is concluded that income tax is a suitable means of raising government revenue in Nepal.

#### 4.4.4 Need of Public Awareness Program

To know the respondents' view towards public awareness program the questions was put "Do you think that public awareness program is necessary in Nepal for raising the government revenue?" (Q.No.3, Appendix).Opinion result is summarized in the table 6.3 below.

**Table 4.18 Need of public awareness program**

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	20	100	-	-	20	100
Tax Expert	20	100	-	-	20	100
Tax Payer	19	95	1	5	20	100
Total	59	98.33	1	1.67	60	100

Source: Opinion Survey, 2010

All of the samples of tax administrator and tax experts approved public awareness program is necessary in Nepal for raising government revenue. Only 5 percent of the tax payer does not approved public awareness program is necessary in Nepal. Thus, it can be concluded that public awareness program is necessary for raising Nepalese government revenue.

#### 4.4.5 Contribution of Income Tax Revenue

Income tax has contributed about 20 percent to public revenue in Nepal. It is blamed that contribution of income tax to national revenue is not satisfactory. To know the fact, the question was asked to respondent "In your opinion, is contribution of income tax to national revenue of Nepal satisfactory?" (Q.No.4, Appendix ). Opinion result is presented in the table 4.20 as below.

**Table 4.19. Satisfactory contribution of income tax revenue**

Response	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	19	95	1	5	20	100
Tax Expert	20	100	-	-	20	100
Tax Payer	19	95	1	5	20	100
Total	58	96.67	2	3.33	60	100

Source: Opinion Survey, 2010

Cent percent tax expert argue that contribution of income tax to national revenue in Nepal is satisfactory. But 5 percent of tax administrator and tax payer approve that income tax contribution to public revenue is satisfactory. In aggregate, 96.67 percent respondents argue that Nepalese income tax contribution is satisfactory.

In order to know the major reasons for lower contribution of income tax, next question was asked, "If no, what are the major reasons." The respondents were requested to rank their choice from 1 to 5 according to preference.



**Table 4.20 Reasons for low contribution of income tax to national revenue**

S. N.	Method	Total Points Received				Percent	Rank
		Tax Administrator	Tax Expert	Tax Payer	Total		
1	Defective of income tax act	39	52	44	135	16.28	4
2	Mass Poverty and low income level	98	85	89	272	32.81	1
3	Increasing habit of tax evasion	68	63	48	179	21.59	2
4	Inefficient income tax administrator	44	60	52	156	18.81	3
5	Inappropriate rate and exemption limit	41	36	50	87	10.49	5
Total					829		

Source: Opinion Survey, 2010

From the above Table, the major reasons for low contribution of income tax to national revenue ranked in order of preference of the respondents are as follows.

- a. Mass poverty and low income level.
- b. Increasing habit of tax evasion.
- c. Inefficient income tax administration.
- d. Defective income tax act.
- e. Inappropriate rate and exemption limit

### **Contribution of Direct Tax**

Direct tax includes tax on property, tax on income, tax in interest and other taxes. The contribution of direct tax to nation revenue is about 21 percent in average.

To know whether the contribution of direct tax to national revenue is effective or not, a question was asked, “Do you think that contribution of direct tax to total revenue is effective?” (Q.No.6, Appendix). The responses are tabulated as follows:

**Table 4.21 Effective contribution of direct tax**

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	1	5	19	95	20	100
Tax Expert	-	-	20	100	20	100
Tax Payer	1	5	19	95	20	100
Total	2	3.33	58	96.67	60	100

Source: Opinion Survey, 2010

Only 5 percent of each tax administrator and tax payer recognized the contribution of direct tax to total revenue is effective. Cent percent tax expert did not recognize the contribution of direct tax to total revenue is effective. 96.67 percent respondent did not approve that contribution of direct tax to total revenue is effective. From this opinion, it can be concluded that the contribution of direct tax to total revenue is not effective.

#### 4.4.7 Attitude towards Exemption and Deduction

Adequate exemption and deduction is necessary to promote the business enterprises. Many exemption and deduction provided by 'Industrial Enterprises Act 2049' and 'Income Tax Act 2031' has curtailed by new 'Income Tax Act 2058'. The question "Are exemption and deduction provided by act appropriate"(Q.No.7, Appendix). Was asked to find out the opinion of the respondent regarding the exemption and deduction. Opinion result is summarized in the table as below.

**Table 4.22 Attitude towards appropriateness of exemption and deduction**

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	13	65	7	35	20	100
Tax Expert	16	80	4	20	20	100
Tax Payer	9	45	11	55	20	100
Total	38	63	22	37	60	100

Source: Opinion Survey, 2010

Most of respondent i.e.63 percent agree with present exemption and deduction. Only 37 percent respondents disagree with the present exemption and deduction. Majority of the respondent, who disagree with present provision of exemption and deduction, was view of increase the deduction and exemption limit to promote special industry.

#### 4.4.8 Income Tax Assessment Method

Revenue collection from income tax also depends on the income tax assessment procedures. Therefore, assessment procedure should be appropriate and effective. A question, "Which income tax assessment method is appropriate in Nepal"(Q.No.8, Appendix). Was asked to know the respondents' opinion about appropriate method of income tax assessment. The response is presented in the table 6.8 as below.

**Table 4.23 Appropriate method of income tax assessment**

S.N.	Method	Tax Administrator	Tax Expert	Tax Payer	Total	Percentage
1	Self Assessment	12	10	11	33	55
2	Best Judgment	2	4	6	12	20
3	Tax Settlement commission	-	1	1	2	3
4	Lump sum(15% rate)	6	5	2	13	22
Total		20	20	20	60	

Source: Opinion Survey, 2010

55 percent respondents approved self-tax assessment method is more appropriate to assess income tax. 20 percent respondents are in favor of best judgment, 22 percent in favor of lump sum and 3 percent in the favor of assessment by tax settlement commission. From the above opinion, it can be concluded that self-tax assessment method is more appropriate while assessing income tax to collect large amount of revenue through income tax.

#### 4.4.9 Attitude toward Problems in Paying Income Tax

To know the problems facing by the taxpayers while paying income tax, the respondents were requested to rank their choice from 1 to 5 according to their

preference. The question was, "In your thinking, what types of problems are facing by the tax payer while paying income tax." (Q.No.9, Appendix ). Responses received from respondents are tabulated as below.

**Table 4.24 Problems in tax paying**

S.N.	Problems	Points Received				Percent	Rank
		Tax administrator	Tax Expert	Taxpayer	Total		
1	Consuming unnecessary time	57	58	41	156	19.23	3
2	Expectation illegal incentives by tax personnel	39	46	64	149	18.37	4
3	Vague provision in income tax laws	74	69	59	202	24.91	1
4	Lengthy process	68	61	69	199	24.53	2
5	Lack of cooperation by tax administrator	35	38	32	105	12.94	5
Total					811	100	

Source: Opinion Survey, 2010

From the above Table 4.24, the major problems facing by the taxpayer while paying income tax ranked in order of preference of the respondents are as follows.

- a. Vague provision in income tax laws
- b. Lengthy process
- c. Consuming unnecessary time
- d. Expectations illegal incentives to the personnel
- e. Lack of co-operation by tax administrator

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

## Hypothesis

There is not significant relationship between the views of tax administrator and taxpayers with respects to problems facing by the taxpayers while paying tax.

Calculating Correlation by formula,

$$R=1 Z \frac{6 d^2}{n(n^2 Z1)}$$

$$Pr= 0.6745 \times \frac{1 Z r^2}{\sqrt{n}}$$

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

**Table 4.25 Correlation coefficient calculation**

S.N.	Problems	Total Points (x)	Rank (R <sub>1</sub> )	Total Points (y)	Rank (R <sub>2</sub> )	Difference of Rank (R <sub>1</sub> -R <sub>2</sub> )	Square of Difference (R <sub>1</sub> -R <sub>2</sub> ) <sup>2</sup>
1	Consuming unnecessary time	57	3	41	4	1	1
2	Expectation of illegal incentives	39	4	64	2	2	4
3	Vague provisions in income tax laws	74	1	59	3	-2	4
4	Lengthy process	68	2	73	1	1	1
5	lack of cooperation by tax administrator	35	5	32	5	0	0
Total							∑d <sup>2</sup> =10

Source: Table 5.23

$$R=1 Z \frac{6(10)}{5(5^2 Z1)}=0.5$$

$$Pr=0.6745 \mid \frac{1 Z(0.40)^2}{\sqrt{5}}=0.22$$

Here, r is greater than Pr. The relation is not significant because to be significant r should be 6 times greater than Pr. However, the value of r is moderate, therefore is some relationship between views of tax administrator and tax payer. So, null hypothesis is rejected. Then, we can conclude that the opinion of tax payer and tax

administrator regarding the problems facing by taxpayer while paying tax is not significantly difference.

#### 4.4.10 Attitude towards Fines and Penalty

Fines and penalty also play significant role to reduce the tax evasion and illegal activities and make morality to the tax payer. To know the views of respondents about the fine and penalty, the respondents were requested to tick yes/ no option. The question was, "Are the provisions of fines and penalty under the Nepalese tax system reasonable?" (Q.No.10, Appendix). The opinion of respondents is as follows.

**Table 4.26 Attitude towards reasonableness of existing fines and penalty**

Response Respondent	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	14	70	6	30	20	100
Tax Expert	12	60	8	40	20	100
Tax Payer	11	55	9	45	20	100
Total	37	61.67	23	38.33	60	100

Source: Opinion Survey, 2010

61.67 percent respondents are in the favor of present provision of fines and penalty but 38.33 percent respondent are against the present provision of fines and penalty. Out of total taxpayer respondent, the highest 45 percent are against the present fine and penalty.

In order to know reasons of unreasonable fine and penalty provisions, the next question was asked, "If no, how it be made reasonable?" (Q.No.10, Appendix). Views of respondents are tabulated as below.

**Table No. 4.27 Reasonable rate of fine and penalty**

Respondent	Increasing		Decreasing		Total	
Tax Administrator	4	66.67	2	33.33	6	100
Tax Expert	7	87.50	1	12.5	8	100
Tax payer	3	33.33	6	66.67	9	100
Total	14	60.87	9	39.13	23	100

Source: Opinion Survey, 2010

60.87 of the respondents, who were against present fines and penalty, gave their view for increasing fine and penalty and 39.13 percent gave view in the favor of decreasing rate.

#### 4.4.11 Attitude towards Income Tax Administration

To know the respondents view regarding effectiveness of income tax administration in Nepal, a question, "Do you agree that Nepalese income tax administration is effective?" (Q.No.11, Appendix) was asked. The responses are tabulated as follows.

**Table 4.28 Attitude towards effectiveness of income tax administration in Nepal**

Response	Yes		No		Total	
	No.	Percentage	No.	Percentage	No.	Percentage
Tax Administrator	3	15	17	85	20	100
Tax Expert	2	10	18	90	20	100
Tax Payer	-	-	20	100	20	100
Total	5	8	55	92	60	100

Source: Opinion Survey, 2010

From the above Table it has been clear that Nepalese income tax administration is not effective. Most of the respondents i.e. 92 percent of respondents recognize it ineffective.

#### 4.4.12 Most Important Factors for Effectiveness of Income Tax

The respondents were requested to rank their choice from 1 to 5 according to their preference to know the opinion of the respondents' view regarding to important factors for effectiveness of income tax in Nepal. A question was, "In your opinion, what is the most important factor for effectiveness of income tax in Nepal to raise government revenue?" (Q.No.12, Appendix) was asked. Responses are summarized in the table 4.30 as below.

**Table 4.29 Most important factors for effectiveness of income tax**

S.N.	Method	Points Received				Percent	Rank
		Tax Administrator	Tax Expert	Tax Payer	Total		
1	Clear Act, rules and regulation	70	78	75	223	25.25	1
2	Conscious and honest tax payers	81	59	50	190	21.25	3
3	Honest tax officers	57	53	65	175	19.82	4
4	Effective tax administration	60	81	74	215	24.35	2
5	Political non interruption	32	20	28	80	9.06	5
Total					883	100	

Source: Opinion Survey, 2010

The important factors for effectiveness of income tax in Nepal according to the preference of the respondents were as follows:

- a. Clear act, rules and regulation
- b. Effective tax administration
- c. Conscious and honest tax payers
- d. Honest tax officers
- e. Political non interruption

To know how much the opinion of tax administrator and tax payers are related, we can test rank correlation coefficient.

### **Hypothesis**

There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax.

Symbolically;

Ho = There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax.



H1 = There is significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax.

**Correlation**

There is no significant relationship between the opinion of tax administrator and taxpayers with respect to the factors for effectiveness of Nepalese income tax.

Calculating Correlation by formula,

$$R = 1 - \frac{6\phi d^2}{n(n^2-1)}$$

$$Pr = 0.6745 \times \frac{1-r^2}{n}$$

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

**Table 4.30 Calculation of correlation coefficient**

S.N.	Factors	Total Points (x)	Rank (R <sub>1</sub> )	Total Points (y)	Rank (R <sub>2</sub> )	Difference of Rank (R <sub>1</sub> -R <sub>2</sub> )	Square of Difference
1	Clear Act, rules and regulation	70	2	75	1	1	1
2	Conscious and honest tax payers	81	1	50	4	-3	9
3	moral and honest tax officers	57	4	65	3	1	1
4	Effective tax administrator	60	3	74	2	1	1
5	Political non interruption	32	5	28	5	0	0
Total						$\phi d = 0$	$\phi d^2 = 12$

Source: Table No.4.30

$$R = 1 - \frac{6(12)}{5(5^2-1)}$$

$$= 0.40$$

$$Pr = 0.6745 \times \frac{1-(0.40)^2}{5} = 0.25$$

Here, r is greater than Pr. The relation is not significant because to be significant r should be 6 times greater than Pr. So, null hypothesis is rejected. It means that the

opinion of tax payer and tax administrator regarding most important factors for effectiveness of income tax in Nepal is significantly difference. However, the value of r is moderate; therefore, there is some relationship between views of tax administrator and taxpayer.

#### **4.4.13 Other suggestions from respondent for achieving effectiveness of income tax in Nepal**

To know the respondents other suggestions for achieving effectiveness of income tax in Nepal, a question, "Do you have any other suggestions for achieving effectiveness of income tax in Nepal? If yes, please specify."(Q.No. 13, appendix) was asked. Various mix responses are found from the correspondents

## Chapter-V

### Major Findings, Conclusion and Recommendations

#### 5.1 Major Findings

On the basis of data presentation and analysis in above mention sub-chapter some important findings of the study are summarized below.

1. The study shows that the contribution of tax revenue to total revenue is 80.85 percent and non-tax revenue to total revenue is 19.14 percent in FY 2008/09 amounting to Rs 102120.30 millions and Rs 24184.50 millions respectively. The contribution of total tax revenue to total revenue is in increasing trend but the percentage contribution of non- tax revenue to total revenue is in fluctuating trend during the study period of eight years.
2. Nepalese tax revenue is composed of both from direct and indirect tax revenue there is a dominant role of indirect tax revenue in Nepalese tax structure the contribution of direct tax and indirect tax to total tax revenue was 26.94 percent and 73.06 percent in FY 2001/02 which become 28.95 percent and 71.04 percent in FY 2008/09. Although the total amount of both taxes is increasing, there is not satisfactory growth in collection of both taxes.
3. The contribution of customs duty, excise duty and VAT on indirect tax revenue were 44.06 percent, 13.25 percent and 42.70 percent respectively in FY 2001/02 and contribution of each taxes were reached to 31.84 percent, 19.06 percent and 49.08 percent respectively in FY 2008/09. It shows that the custom duties are in decreasing trend where as excise duties and VAT is in increasing trend.
4. The contribution of income tax, land revenue and registration, urban house and land tax and vehicle tax on direct tax revenue were 84.01 percent, 10.68 percent, 0.02 percent and 5.28 percent respectively in FY 2001/02. The contribution from other taxes was nil during that period. This was reached to 72.42 percent, 13.81 percent, 00 percent and 6.37 percent in FY 2008/09. The contribution from other taxes was 7.38 percent during this year. In the composition of direct tax income tax was the giant one which contribution seems to be fluctuating every year. The percentage contribution from land revenue and registration is in fluctuating trend and from urban house and land tax come to nil in the proceeding years.

5. Income tax has been considered as suitable source for mobilizing internal resources. It can be used as positive instruments to boost up government revenue collection, to develop the economic condition of Nepalese people, to promote distributive justice and eliminate the resource GAP problem.
6. Total tax revenue covered only 8.60 percent of GDP in FY 2001/02. This increased to 9.20 percent in FY 2004/05. In FY 2005/06 this ratio was only 8.80 percent and in FY 2008/09 which is increased to 12.20 percent but there is no significant increment in total tax revenue/GDP ratio in last eight fiscal years.
7. The indirect tax/GDP ratio, custom duty/GDP ratio, excise duty/GDP ratio and VAT/GDP ratio were 6.28 percent, 2.76 percent, 0.83 percent and 2.68 percent respectively in FY 2001/02. These were reached to 8.67 percent, 2.76 percent, 1.65 percent and 4.25 percent respectively in FY 2008/09. It shows that the contribution of indirect tax to GDP is not satisfactory in last eight years however the ratio is in increasing trend.
8. The direct tax/GDP ratio, contribution of direct tax to total tax revenue and total revenue in FY 2001/02 were 2.61 percent, 26.94 percent and 21 percent respectively, which were 3.53 percent, 28.95 percent and 23.41 percent respectively in FY 2008/09. It means there is not sustainable growth in the collection of direct tax.
9. The income tax/ GDP, income tax/ total revenue, income tax/ total tax revenue and income tax/ direct tax revenue ratio were 1.94 percent, 17.65 percent, 22.64 percent and 84.01 percent respectively in FY 2001/02. Which had been changed to 2.55 percent, 16.97 percent, 20.97 percent and 72.42 percent respectively in FY 2008/09. It shows that there is increased in ratio of income tax/GDP but the ratio of income tax to total revenue, total tax revenue and direct tax revenue were decreased for the last eight years.
10. The income is the composition of corporate income tax, individual income tax, remuneration tax and tax on interest. Corporate tax and individual income tax which are the major components of income tax. The overall contribution of corporate income tax, remuneration tax and interest tax is in increasing trend but the contribution of individual income tax is in decreasing trend. The contribution of remuneration tax has become more than doubled in last eight years.

11. The resource gap is increasing every year. It was Rs 29626.66 millions in FY 2001/02 and increased to Rs 53727.32 million in FY 2007/08. It shows the poor performance of domestic resource mobilization the amount of foreign grants is slightly increasing and amount of foreign loan is in decreasing trend. The resource gap as percent of total expenditure was 36.99 percent in FY 2001/02 and 33 percent in FY 2007/08.
12. Total government revenue has contributed 63 percent in financing government. Expenditure in FY 2001/02. Similarly, foreign aid and CITR had contributed 17.96 percent and 3.97 percent respectively. In FY 2007/08 the contribution of government revenue, foreign aid and CITR to total government Expenditure is 66.70 percent, 18.15 percent and 4.58 percent respectively. There is increment in the contribution made by foreign aid and CITR. Foreign aid is increased due to increased in the funding made by donor agencies. Similarly, the contribution percentage of corporate sector is increased mainly because of the friendly business environment created by the government, political parties and economic situation of the country.
13. The corporate tax rates have been revised for several times. Now a day, special industries, general industries and non industries banking and insurance business are taxed at a flat rate of 20 percent, 25 percent and 30 percent respectively in spite of the progressive, progressive and flat tax rate in previous years.
14. The contribution of CITR on income tax revenue was 35.73 percent in FY 2001/02, of which public sector and private sector contributed 19.87 percent and 15.86 percent respectively. In FY 2008/09 CITR has contributed 38.82 percent of which public and private sector share were 3.37 percent and 35.45 percent respectively. The contribution of public sector has decreased due to the corruption and irregularity in public sector's enterprises. The CITR from public sector has drastically decreased in last eight years. This may be due to the inefficiency of the public enterprises. Most of the public enterprises are suffering from heavy losses due to their inefficient operation. But private sector is flourishing day by day so their share in CITR is also increasing, this may be due to the globalization and economic liberalization in the country.
15. Contribution of CITR on total government revenue was 6.31 percent in FY 2001/02. In which public and private sector contributed 3.51 percent and 2.80

percent respectively. The share of CITR to total revenue was maximum i.e. 7.68 percent in FY 2006/07. The contribution of CITR on total revenue is in fluctuating trend during the study period of eight years. In FY 2008/09, the contribution of CITR is only 6.58 percent of the total government revenue in which the share of public and private sector is only 0.57 percent and 6.01 percent respectively.

16. In the structural composition of corporate income tax, public sector had played a dominating role in the initial years. In FY 2001/02 share of public sector and private sector was 55.61 percent and 44.38 percent respectively but in FY 2008/09 the share of public sector has decreased to 8.68 percent and that of private sector has increased to 91.31 percent. It shows the flourishing trend of private sector in the economy.

An opinion survey has been conducted in order to find out the role of income tax in Nepal and some other aspects of income tax. From the opinion survey with tax administrators, tax experts and tax payers, the following findings have been drawn.

- Income tax is the suitable means of raising government revenue.
- Public awareness program is necessary to increase tax consciousness and raising the government revenue.
- Tax Administration of Nepal is having lack of organizational and individual incentives.
- Mass poverty and low income level, increasing habit of tax evasion, inefficient income tax administrations, etc. are the major reasons for the low contribution of income tax to the national revenue.
- Exemption and deduction should be increased to promote the special industry and export.
- To increase the voluntary compliance by the taxpayer, self-assessment method is the appropriate method while assessing the income tax.

- Lengthy process, vague provision in income tax laws, consuming unnecessary time etc are the major problems facing by the taxpayer while paying the tax.
- The fines and penalty under the Nepalese tax system are not reasonable and it should be increased to discourage tax evades and illegal activities.
- Clear act, rules and regulation, effective tax administration are the most important instruments for effectiveness of income taxation in Nepal.

## 5.2 Conclusion

Nepal being one of the least developed nations in the world has always suffering from the social and economic problems. Nepal cannot successfully and properly tear a curtain built from massive poverty, hunger, diseases, unemployment, heavy dependence on agriculture, lack of adequate industries, low income level and social-political and geographical constraints over 50 years of planned development. Yet, Nepalese economy is suffering from ineffective and effortless plan, program and policy of development and is also fighting against whatever bottlenecks identified before the starting of planned period.

The government need huge amount to achieve the maximum objectives of nation. In developing countries like Nepal, lack of sufficient financial resource is the main constraint for the national economic development. Nepal has facing serious problem of resource gap and high dependency on foreign loan. Resource gap has been increasing at a faster rate than the increase in revenue. The resource gap is widening continuously with the increment of total expenditure in respect to total revenue collection. To solve such serious problem of deficit fiscal, income tax should play important role. But, resource mobilization in Nepal is still poor.

The government of Nepal introduced a formal tax for the first time in Nepal in 1960 (2017 B.S.) in the form of "Business Profits and Remuneration Tax." The "Business Profits and Remuneration Act 1960" governed it. According to this act only Business profits and remuneration on income were subjected to tax but the revenue for these taxes should not be collected properly according to originals estimates. At present, Income Tax Act 2002 is effective which was introduced in 2002. In the new 'Income Tax Act 2002', sources of Nepalese income are classified into Business income,

investment income and employment income for the tax purpose. The percentage share of income tax to government is not satisfactory in comparison to other developing country like India, Pakistan, Bangladesh, Sri Lanka, etc. There are three major income tax assessment methods in the Nepal.

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

The success or effectiveness of income tax system entirely depends upon implementation of provisions, which is the major responsibility of income tax administration. Income tax system of Nepal has blamed as not efficient enough. Various problems existed in the income tax such as increasing habit of tax evasion, inefficient income tax administration, defective income tax law are the reasons of lower contribution of income tax. But if we analyze the data relating to it then we can find out that revenue collection from income tax is increasing continuously. Provisions in act and language have to be made clear. Some reforms in income tax administration are needed to raising the income tax revenue.

### **5.3 Recommendations**

Income tax is an important source of government revenue of Nepal. For the development of nation and Nepalese economy, maximum income tax revenue should be needed. The contribution of income tax revenue is likely to be significant in the future but there are many problems. As findings of the present study, the following recommendations are made for the sound and effective income tax system and improvement of tax collection for government revenue. Which are as below.

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



- Income tax policy should be formulated according to the economic policy of the country. Income tax policy should be revised timely.
- The members involved in formulating income tax policies must have deep knowledge about income tax.
- The term objectives of income taxation should be growth redistribution and stabilization. The income tax policy should be properly formulated on the basis of critical analysis of existing situation.
- Income tax, rules and regulation should be clear and simple for all the taxpayers as well as for tax administrators. Following recommendations are made in income tax law.
  - The language of act should be simple and clear.
  - The assessment and tax collection provisions should be made clear and simple so that taxpayers would be encourage paying income tax.
  - Discretionary power of the tax officials should be curtailed in the act.
  - The assessment of time limit after the submission of income assessment should be reduced.
  - The definition made in income tax act should be further clarified and well defined.
- The provisions of rewards, prize, incentives should be introduced in the act to encourage the taxpayers to pay tax voluntarily rather through coercive measures.
- The rate of fine and penalties should be increased. The provisions of fines, penalties and punishments should be made at higher rate for income tax evaders.
- A research and intelligence center should be established in each tax office for proper planning and to collect the information in regard to income tax evaders,

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

- Tax personnel should be encouraged, punished and transferred on the basis of their work and experience. Regular and effective training system; reward, prize and punishment system should be established for the effective personnel management.
- Effective public participation is necessary to minimize the income tax evasion. Tax authority should do continuous effort in order to develop the taxpayers' positive attitude towards taxation.
- Clear provisions should be made in case of deduction. All the items of deductions should be clearly defined in the act.
- To promote export, more deduction should be provided.
- The provision of tax deduction at source and advance payment of tax should be extended to different source of income as far possible.
- Separate income tax Department should be established so that the specialization could be achieved in matter of income tax.
- Income tax administration implements the tax laws. Therefore, effectiveness of income tax system depends upon the income tax administration. In Nepal, one of the most important reasons for unsound income tax system is inefficient and unscientific income tax administration. Following recommendations are made for improvement of income tax administration.
  - Delays in assessment should be reduced as possible.
  - Computerized information system is necessary to keep up to date records of income tax.
  - Proper tax education should be provided to tax officials as well as tax taxpayers regularly.

- Cost of income tax collection is one of the determinants of efficiency of administration. Therefore, the concerned authority should pay due attention to it should be reduced.
  - Unnecessary outside pressure should be avoided.
  - Income tax experts/profession should be increased in tax administration.
- The administration should pay great attention to bring the income from house and land rent; doctors' clinic; consultancy service; tuition; research works into income tax net. In these sectors, income tax has been highly evaded.

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## Questionnaire

Name (optional) :..... Designation: .....  
Office orgn: ..... Occupation: .....

Please you are requested to tick()the suitable answer of your choice from the following questions or wherever appropriate. Please rank them on order to preference from 1 to last number. Number 1 stands for the most important and the for least.

Q.No.1

Do you think that people are well informed about the income tax system in Nepal?

Yes

No

Q.No.2

In ur Opinion, is Contribution of income tax to national revenue is satisfactory?

Yes

No

If no, what are the main causes of the tax payers wise law collection from income tax in Nepal?(please rank)

Inconsistant Tax Act, Rules and Regulation :

Loopholes in Income Tax Act :

Existence of Smuggling :

Improrer Billing System :

Lack of Tax Education :

Income Tax returns not filling on time :

Instable Political Condition :

Increasing Tendency of Tax Evasion :

Mass Provery and Low Income Level :

Q.No.3

Is present Income Tax Rates in Nepal high?

Yes

No

If yes, what should be the maximum rate of income tax?

i. 20%

ii. 18%

iii.15%

iv.10%

v. others

Q.No.4

Do u believe that the contribution of income tax is not satisfactory because of income tax act 2058?

Yes

No

If yes, what is the main reason?

- i. Difficulty in management due to the large no.of taxpayers.
- ii. Inefficient tax officials.
- iii. Composition due to disharmony between income tax and VAT.
- iv. Increasing habit of tax evasion by tax payers after registering in VAT.
- v. Others, if any .....

Q.No.5

What do u feel about the present income tax administration of Nepal?

- i. Efficient
- ii. Inefficient
- iii. Satisfactory

If, inefficient what are the Major Causes?(Please tick)

- i. Lack of trained and competent tax officials.
- ii. Lack of delegation of authority among tax personnel.
- iii. Lack of proper direction.
- iv. Lack of effective communication.
- v. Unnecessary outside pressure.
- vi. Lack of co-ordination among Tax department.
- vii. Complicated tax laws.
- viii. Others, if any .....

Q.No.6

In Your opinion, What types of problems are facing by the tax payers while paying income tax?

- i. Time consuming process.
- ii. Expectation of illegal incentives by tax personnel.
- iii. Vague provisions in income tax laws.
- iv. Lack of co-operation by tax administrator.
- v. Other, if any please specify.....

Q.No.7

Each year only 60 percent of the total payers submit income tax return to the revenue office .do you believe that it is the maim reason of decreasing income tax?



Yes

No

If yes, what should be done to increase the submission of income tax return?

- i. Heavy fines and penalties should be levied.
- ii. Awareness should be given through newspaper and mass media.
- iii. Certain exemption should be given for timely submission of income tax returns.
- iv. Provisions of award.
- v. If others please specify .....

Q.No.8

What do you think is the main loopholes in income tax act 2058?(please tick)

- i. High rate of depreciation.
- ii. Complicated income tax act, rules and regulations.
- iii. Based on Self-Assessment.
- iv. Inappropriate rate and exemption limit.
- v. Lack of accuracy in submitted bills and vouchers.
- vi. High rate of Depreciation.
- vii. Less provision of fines and penalties.

Q.No.9

What should government do for the tax payers who pay more tax in order to motivate them?

- i. They should be honored as CIP (Commercially important person)
- ii. Government should provide facilities like free medical service, free education etc.
- iii. Certain percent tax refund in up coming year.

Q.No.10

What method is more appropriate in Nepal for assessing income tax?

- i. Assessment on the basis of accounts submitted by the tax payers.
- ii. Self assessment.
- iii. Assessment on the best judgment.
- iv. Assessment by the committee.
- v. Others, please specify.

Q.No.11

What is the most important factor for effectiveness of income tax in Nepal?

- i. Honest tax officers.
- ii. Honest tax payers.
- iii. Clear act, rules and regulations.
- iv. Effectiveness income tax administration.
- v. If others, please specify .....

Q.No.12

Do you have any others suggestions for achieving effectiveness of income tax in Nepal?  
(if yes please specify)

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