

**INCOME TAX IN NEPAL:
EXEMPTIONS AND DEDUCTIONS**

By:

YADAB BANIYA

Faculty of Management

Patan Multiple Campus

T.U. Registration No: 7-1-224-179-2001

Campus Roll No: 29/063

Exam Roll No:4300/2065

A Thesis Submitted to:

Office of the Dean

Faculty of Management

Tribhuvan University

**In partial fulfillment of requirements for the
Master's Degree of Business Studies (MBS)**

Kathmandu Nepal

September, 2010

RECOMMENDATION

This is to certify that the thesis

Submitted by:

Yadab Baniya

Entitled:

Income Tax In Nepal : “Exemptions and Deductions”

has been approved by this campus in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

Dinesh Man Malego
(Thesis Supervisor)

Bishnu Gopal Khimbaja
(Chairman, Research Committee)

Krishna Badan Nakarmi
(Campus Chief)

VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis
submitted by:

Yadab Baniya

Entitled:

Income Tax in Nepal: Exemptions and Deductions

and found the thesis to be the original work of the student and written according to the prescribed format. We recommend this thesis to be accepted as partial fulfillment of the requirements for the Degree of Master of Business Studies (MBS)

Viva-Voce Committee

Member (Thesis Supervisor)

Chairman (Research Committee)

Member (External Expert)

Date :

DECLARATION

I hereby declare that the work reported in this thesis entitled “**Income Tax in Nepal: Exemptions and Deductions**” submitted to Patan Multiple Campus, Tribhuvan University, is my original work done in the form of partial fulfillment of requirement of Master Degree in Business Studies (MBS) under the supervision of Mr. Dinesh Man Malego.

Date: September, 2010.

Yadab Baniya
Roll No: 29/063
Patan Multiple Campus
Patandhoka, Lalitpur.

ACKNOWLEDGEMENTS

This study is mainly concerned with an analysis of exemptions and deductions of income tax provided by Income Tax Act 2002 and with the contribution of income taxes to overall revenue generation of Nepal.

First of all, I like to express my sincere gratitude to my thesis supervisor Mr. Dinesh Man Malego, asst. campus chief, faculty of management, Patan Multiple Campus Tribhuvan University for his generous encouragement, proper guidance, timely comments and suggestions and undertaking of the supervision of my entire research work. I would like to extend my sincere gratitude to Mr Bishnu Gopal Khimbaja, coordinator of MBS program of Patan Multiple Campus and my other respected lecturer of Patan Multiple Campus, for providing me valuable suggestions, comments and continuous support.

Similarly, I wish to express my sincere thanks to all staffs of central library national library Hariharbhawan who provided me necessary information required for this study.

Lastly, my thanks goes to my family members, relatives, friends and all well-wishers for their continuous help in computer works, checking errors and mistake and other suggestion.

Efforts have been made to avoid all type of errors and mistake. I am sorry for the unknown mistake that I made in this research work.

Yadab Baniya

TABLE OF CONTENTS

Recommendation	ii
Viva- voce sheet	iii
Declaration	iv
Acknowledgement	v
Table of contents	
List of tables	ix
List of figures	x
List of abbreviations	xi
CHAPTER	
1. Introduction	
1.1 Background of the study	1
1.2 Statement of the problems	5
1.3 Objectives of the study	9
1.4 Scope of the study	10
1.5 Significance of the study	10
1.6 Limitation of the study	11
1.7 Organization of the study	11
CHAPTER	
2. Review of the literature	
2.1 Theoretical concept	13
2.2 Review of books	13
2.3 Review of some article, reports	15
2.4 Review of related studies	20
2.5 Summing up	33
CHAPTRE	
3. Research methodology	
3.1 Research design	34
3.2 Population and sample	34
3.3 Nature and source of data	35
3.4 Data gathering procedure	35
3.5 Data processing procedure and analysis of data	36
3.6 Weight of choice	36

CHAPTER

4. Presentation and analysis of data

4.1 Tax Structure of Nepal	37
4.1.1 Composition of total revenue	37
4.1.2 Composition of total tax revenue	38
4.1.3 Contribution of various taxes as GDP	40
4.1.4 Composition of total indirect tax	42
4.1.5 Composition of total direct tax	45
4.1.6 Contribution of direct tax	46
4.1.7 Contribution of income tax in Nepal	48
4.1.8 Composition and trend of income tax	49
4.1.9 Composition of income tax	51
4.1.10 Exemption limit in Nepalese income tax Act	52
4.1.11 Income tax rate	53
4.2 An empirical analysis	56
4.2.1 Introduction	56
4.2.2 Contribution of income tax to national revenue of Nepal	56
4.2.3 Soundness and effectiveness of income tax administration of Nepal	57
4.2.4 Major causes, which are responsible for unsound and ineffective income tax administration of Nepal	58
4.2.5 Opinion on current income tax rate	59
4.2.6 Sufficiency of exempted items of income tax	60
4.2.7 Adequateness of current income tax exemption limit	61
4.2.8 Family exemption limit according to the number of dependents	63
4.2.9 Opinion on providing exemption limit on agricultural income	65
4.2.10 Sufficiency about the itemized deductions	66
4.2.11 Opinion on providing additional exemption to an individual working in different remote areas	67
4.2.12 Additional exemption facility to the special industries established in different area	68
4.2.13 Problems and weakness of Nepalese income tax system	69
4.2.14 Sufficiency of provisions relating to exemption and deductions	70
4.2.15 Suggestions about income tax in Nepal	72

4.3	Heads of income exemption and deductions provided by income tax Act 2002	73
4.3.1	Income from an employment	73
4.3.2	Income from business	75
4.3.3	Income from an investment	75
4.3.4	Exemption from income tax	77
4.3.5	Allowable deductions	80
4.3.6	Expenses not allowed for deduction	84

CHAPTER

5. Major findings, conclusions and recommendations

5.1	Major findings	86
5.2	Conclusions	90
5.3	Recommendations	92

Bibliography

Appendices

LIST OF TABLE

3.1 Group of respondents and size of sample	35
4.1 Composition of total revenue	37
4.2 Contribution of direct tax and indirect tax to total revenue	39
4.3 Contribution of various taxes as GDP	41
4.4 Major components of indirect tax and their relative percent the indirect tax	43
4.5 Components of direct tax and their relative percent to total direct tax	45
4.6 Contribution of total direct tax to total tax revenue, GDP and total revenue	47
4.7 Contribution of income tax to different revenue heads	48
4.8 Components of income tax and trends in different years	50
4.9 Composition of income tax	51
4.10 Exemption limit in the Nepalese income tax	53
4.11 Rate of personal income tax in Nepal	54
4.12 Income tax rate for partnership firms, corporations and non-residents	55
4.13 Groups of respondents and code used	56
4.14 Contribution of income tax to national revenue of Nepal	57
4.15 Soundness and effectiveness of income tax administration of Nepal	57
4.16 Major causes, which are responsible for the unsound and ineffective income tax administration of Nepal	58
4.17 Opinions on the current income tax rate	59
4.18 Sufficiency of exempted items of income	60
4.19 Adequateness of current income tax exemption limit	62
4.20 Suggestion of exemption limit for an individual	62
4.21 Suggestion of exemption limit for a couple or a family	63
4.22 Family exemption limit on the basis of number of dependents	63
4.23 Exemption limit according to the inflationary situation of the country	64
4.24 Exemption on agricultural income	65
4.25 Sufficiency about the itemized deductions	66
4.26 Opinion on providing additional exemption to an individual working in different remote areas	67
4.27 Additional tax exemption facilities to special industries established in different areas	68
4.28 Problems and weakness of Nepalese income tax system	69
4.29 Sufficiency of provisions relating to exemptions and deductions under the Nepalese income tax Act	70

LIST OF FIGURES

4.1 The contribution of tax and non-tax revenue to total revenue	38
4.2 Percentage contribution of total direct and indirect tax to total tax revenue	40
4.3 Contribution of various taxes as percent to GDP	42
4.4 Major components of indirect tax and their contribution to total indirect tax	44
4.5 The components of direct tax and their contribution to total direct tax	46
4.6 Composition of income tax	52

Abbreviations

A.D.	: Anno Domini
CEDA	: Center for Economic Development and Administration
Dr.	: Doctor
DT	: Direct Tax
e.g.	: For Example
ed.	: Edition
Eds.	: Editors
etc.	: and others
FDB	: Forest Development Board
FNCCI	: Federation of Nepalese Chamber of Commerce and Industry
FY	: Fiscal year
GON	: Government of Nepal
GDP	: Gross Domestic Product
HRLRT	: House Rent and Land Revenue Tax
I.D.	: the same
i.e.	: that is
I.T.	: Income Tax
IDT.	: Indirect Tax
IRD	: Inland Revenue Department
KTM.	: Katmandu
Ltd.	: Limited
LRRF	: Land Revenue and Registration Fees
MBA	: Master in Business Administration
MBS	: Master of Business Studies
MOF	: Ministry of Finance

Mr.	: Mister
Mrs.	: Mistress
No.	: Number
PP	: Page(s)
Pvt.	: Private
Rs.	: Rupees
S.N.	: Serial Number
T.U.	: Tribhuvan University
TR.	: Total Revenue
TTR.	: Total Tax Revenue
VAT	: Value Added Tax
viz.	: Namely
Vol./Vols.	: Volume(s)
vs.	: Versus, against