

# CHAPTER-I

## INTRODUCTION

### 1.1 General Background

Every government has to spend a lot of money to fulfil its responsibilities towards the people. The responsibilities may be either for security, health or education or other development activities in each country, a lot of fund is spent by the public authority for the protection of common people and for the creation of various socio-economic infrastructures. Protection expenditure includes the purchases of arms and ammunitions, army and police expenses and administration of jail. The government for operating transportation and public enterprises, which are undertaken by the public interest, also incurs commercial expenditure. The other type of public expenditure is development expenditure. This is the expenditure incurred for providing education, health and public utility facilities to the community. So the government expenditures are increasing day by day because of demand of time, increase in population, social progress and so on. The government needs more money to run it successfully. The money that is so much important to the government is called public revenue or receipt. It is received from different sources. These are external and internal sources.

External sources of fund are foreign grants and loans. This kind of fund is received from foreign countries and international organizations. External source of fund is more important for underdeveloped countries. It is used for economic development, reconstruction and foreign exchange. But external sources are uncertain inconvenient and not good for healthy development of nation because they have to be paid after a certain period. So it is better to mobilize internal sources rather than looking within beggars' eyes to the donors like developed countries, developing country try to mobilized their internal sources for regular and developmental activities Nepal's experience is that she has mobilized internal resources fewer than expected.

Internal sources of fund are own sources within the nation. Internal sources of fund include both tax and non-tax revenue. Continuous use of external sources of fund

is not good because it reduces the liquidity position of the government increases the inflation. So internal sources are more important not only for financing necessary funds but also for proper mobilization of external sources.

In the other hand, sources of public –revenue can be classified into two types:

- a) Tax revenue and
- b) Non tax revenue

Tax revenue includes the amounts, which are compulsory contribution by taxpayers to the government.

Non-tax revenue includes fees, special assistant, gifts, grants and penalties etc. Non –tax sources are uncertain and inconvenient because they are imposed according to the necessary of the government. So taxes are the better sources of public revenue. The use of taxes is safer for financing public revenue in developing countries. So taxation has been taken as the best effective tool for raising the public fund. Tax is any compulsory levy from individuals, households and firms to central or local government. It is simply a liability to pay an amount to the government. It is a compulsory contribution from the taxpayers. Tax is computed and paid as prescribed enacted laws (Bhattarai and Koirala, 2007).

According to Prof. Seligman. “Tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without references to special benefit conferred. “So, a tax is a compulsory levy paid or to be paid by an individual or an artificial person to the government without getting corresponding benefit of goods or services provided by the government. The person who pays tax does not get any equivalent benefit from the government. It is compulsory liability of the person who has to pay tax.

Generally taxes are classified in to two types on the basis of form. One is direct and other is indirect. If some one pays tax to the government from his/her own income it is called direct tax. Income tax, property tax, interest tax, etc. are direct taxes. Indirect tax is that tax which is imposed one person but paid partly or wholly by another. Customs duty, value added tax, entertainment tax, etc. are indirect taxes.

Income tax is the most popular tax. It is considered as one of the major elements of tax revenue. Income tax is charge on persons' income according to the law of nation. It covers all the fees, additional fees, fines and income includes all the incomes, which are received from employment, business and investment. Income tax is superior to other taxes because it is imposed on the basis of paying capacity of taxpayer. People having taxable income have to bear the incidences of income tax.

Within the income tax system, deduction, exemption and concession are more important for knowing about income tax because they are used continuously and treated differently year to year. To make up to date knowledge about income tax system, it should be known. By knowing it, we can compute net income and tax liability. Income tax law of every nation must clearly mention about the inclusion of incomes and deduction of expenses.

Income tax plays a very important role in the economic development of Nepal. It is a tool of achieving maximum social and economic objectives as lay down by the constitution of Nepal. It is also recognized as a good financial tool to make narrow the inequality in income. It reduces the regional economic imbalance by providing tax concession and holidays to the business or industries. Which are established in remote and backward areas? Income tax is essential not only for collecting government revenue but also to control over consumption, to reduce inequality of income and wealth, to promote saving and investment and to accelerate development process. It is no doubt that income tax is the main sources of government revenue. It is also useable in the balanced economic development. Nobody can doubt that the distribution of income is also possible through progressive income tax. It is being realized that contribution of income tax to the government revenue must be increased in Nepal. Nepal has been adopting the income tax system since the last four decades it is assessed on yearly basis.

Although the legal provision has been made and updated timely, there are many problems about income tax practices in Nepal such as, leakage in tax feeling a people about tax as penalty, lack of consciousness of people, mobility of tax

administration to cover new tax payer, delays in computation and collection, lack of accuracy and unity in accounting system, etc. In the other hand raising more revenue is the main objectives of taxation but it also affects the pattern of consumption, production and distribution in the economy. Because all these things deduction exemption and concession of income tax system most be reviewed and immediate correction should be made.

## **1.2 Focus of the Study**

The study tries to cover the major constituents of income tax system in Nepal. Its aims to find out the deductions exemptions and concession provided by Income Tax Act, problems and weakness in income tax system, contribution of income tax to the government revenue. It also tries to suggest some possible areas for confirm about tax. Especially, income tax deductions, exemptions and concessions are discussed in detailed. The study has covered the following aspects of income tax system of Nepal:

- I. Exemption and concession of income tax,
- II. Deduction of income tax,
- III. Structure of income tax revenue,
- IV. Contribution of income tax to the government revenue and GDP,
- V. Administrative aspect of income tax in Nepal,

### **1.3 Statement of the Problems**

Economic development is the prime concern of every nation of the world. To achieve this objective, every nation of the world is accomplishing various activities nevertheless, under developed countries are facing serious problem in the process of economic development. Nepal is not an exemption to this condition.

The poverty line of the people and the GDP per capita show the economic condition of Nepal. It needed huge amount of capital for the economic development of Nepal. Despite the various measures adopted by the government to boost revenue collection, there is still a substantial resources gap between expenditure and revenue collection. The rate of government expenditure is exceeding the rate of growth revenue almost every from the beginning of its development phase, the resource gap in 2063/64 was Rs. 3495 millions. The source of filling up to the resources gap is internal and external borrowings. The use of external borrowing has been playing a dominant role to fulfil the resource gap. In 2063\064; the external borrowing was Rs. 11856.8millions. The use of borrowing to fulfil the growing government expenditure brings various problems. The development of countries will be possible only when the government can collect its own internal revenue that constitutes tax and non-tax revenue. Tax revenue constitutes a significant portion on government revenue of the total revenue in fiscal year 2064\064, tax and non-tax revenues account for 81.14 percent and 18.86 percent respectively (Annual Report of IRD, 2008). It is thus event that the major portion of government revenue is covered by taxation. Although the tax composition of Nepal shows that the government of Nepal is highly dependent on direct tax. In 2063\064, the indirect tax had contributed 73.33 percent of tax revenue (Annual report of IDR, 2008).

As the mean of economic growth and social justice, income tax has not succeed to play significant role in Nepalese tax structure. The direct tax had contributed only 27percent and the income tax had contributed 30.30 percent of total revenue in 2063\064 (annual Report of IDR, p31). It shows that the government is largely depending upon indirect tax.

People in developing nations tend to have greater propensity to evade taxes. This is because, they have lesser knowledge about income tax and they have to maintain their livelihood from their limited income. Rich people are avoiding taxes by using legal loopholes and taking advantages of an inefficient tax administration. Recent notice of authority misuse investigation composition has proved that there is a corrupt bureaucracy in revenue office or tax office.

In Nepal the coverage of income tax is very low. Only 0.5 percent of the total population pays the income tax. There is poor income tax paying habit of Nepalese people. The tax authorities are inefficient and ineffective in enforcement. There are no integrating programmes for taxpayer's education assistance, guidance and counselling. Tax offices are looked upon as heaven for corruption harassment and incompetent personnel. The assessment procedure of income tax is not effective, undue delay in tax assessment not only reduces the total revenue, but also brings harassment to the taxpayers.

So the coverage of income tax is very narrow in Nepal. Agricultural income is exempt from income tax. Labour tax is taxed more heavily than the capital income. Retirement amount received by Nepalese people being retired from the service by army or police of foreign country is also exempted from income tax. Exemption of these sources provided loopholes for tax evasion and complicated to the tax administration. In the other hand exclusion of agricultural income from the tax net alone cuts out about half of the gap.

Some exemptions granted to achieve certain objectives are not effective. Tax incentive is one of the examples of these tax incentives or concessions encourage the establishment of industries in certain area but they vanish or change names ownership or place the Business when the tax concession period expires.

At present the exemption limit to an individual has been provided into two distinct categories in Nepal. The present act and rules classify persons into an individual and the family according to the personal status. Thus classification does not recognize the various sizes of the dependent family members. There is no

discrimination between taxpayers having only spouse and taxpayer with a spouse, parents and children. Therefore this limit is the Nepalese context neither shows any specific or definite relationship with per capita income GDP nor with the rate of inflection nor with poverty norm.

Income Tax Act, 2002 has clearly mentioned about the expenses, which are allowed for deduction and not allowed for deduction. But they are not sufficient and systematic. In Nepal, 10 percent of the gross profit is allowed as deduction against net income on account of expenses related with technology or product development and efficiency improvement. This is not enough. In the other hand there is no special provision of deduction that keeps proper records and book of an account and files accurate returns. There is no any provision for deduction of necessary expenses like newspapers made by the taxpayers or his dependent etc.

There are various problems of income tax and deduction, exemptions and concessions. Specifically, this study has been carried out to answer the following research questions:

- a) Are the exemption and concession items of income sufficient?
- b) Are the current deductions of expenses sufficient?
- c) Are the provisions made under the Nepalese income tax Act, 2002 sufficient in all respect?

#### **1.4 Objectives of the Study**

The main objectives of the study is to gain an insight into the deductions, exemption and concessions of present income tax and give appropriate suggestions to improve the tax system so that the government can collect more revenues and use then in the process of national development. The study does not only help the government to collect more revenues but also make the concerned people aware about the exemption and concession of income and deduction of expenses. Being an opinion survey, it analysis the exempted income, which are provided by the Income Tax Act 2002, and it also analysis the deduction of expenses, which are provided by income tax. So the specific objectives of the study will be as follows:

- I. To examine the exemptions and concessions of income which are provided by the Income Tax Act, 2002.
- II. To identify the deductions of expenses which are allowed by the Income Tax Act, 2002.
- III. To analyse the effectiveness of provisions made under the Income Tax Act, 2002, in all respect.

### **1.5 Importance of the Study**

Developing countries like Nepal require higher magnitude of financial resources for the development program. Domestic resources have more significant role than the external resources for the development programs. Among the domestic resources, income tax plays a significant role. But it is a matter of great un-pleasures to quote that the contribution of income tax to the national revenue is very low in Nepal. To increase the contribution of income tax in the national revenue, problems faced by the income tax system should be researched and analysed objectively. But it is pity to say that the study and research works in the areas of income tax have been lacking in Nepal. Within income tax, the intensive study on tax exemptions, concessions and Deductions has not been done in Nepal. Even though several scholars doing research on income tax has studied tax exemption, concessions and deductions as a minor topic. In this context, need and significance of this study can be known easily.

Various studies have been conducted regarding tax system in Nepal and different reports about the taxation system are also available. But very few studies have been done in income tax. In recent years no studies have been conducted about deductions, Exemptions and concessions so, this is the main reason to undertake this study.

This study is helpful for the following groups and individual:

- ) Further researcher
- ) University students
- ) Major parties who are interested in income tax
- ) NGO and INGO

- ) Researchers, individual firm, public enterprise, public limited company, finance Companies
- ) Others

## **1.6 Limitations of the Study**

The study is based on exemptions and concessions of income and deduction of expenses in Nepalese income tax. It is not a complete study of income tax system in Nepal. So the limitations of this study are as follows:

- I. It is based on exemption and concession of in income and deduction of expenses but not as the complete study of income tax system.
- II. The views of respondent are collected only in the Kathmandu valley,
- III. Samples are selected only from opinion survey due to time constraint.
- IV. The limit time available with the research and the resource constraints will also limit the work.
- V. The study has been done on the primary data and secondary data.

## **1.7 Organization of the Study**

The whole study has organized into five chapters, which are:

- I. Introduction
- II. Review of Literature
- III. Research Methodology
- IV. Data Presentation and Analysis
- V. Summary, Conclusion and Recommendation

The first chapter is about the introduction of the research study. It includes background information, statement of problem, objective of the study, focus of the study, importance of the study and organization of the study

The second chapter is about the Review of the literature. Some books, dissertations reports and articles have been reviewed for this study.

The third chapter is about research methodology. In this chapter, research design population and sample of data, data gathering procedure, data processing procedure and analysis of data, weight of choice and weight of respondent have been described. The fourth chapter is about presentation and data analysis. This is major part of this study. This chapter aims to make the critical analysis of income tax system of Nepal with the assistance of authoritative data and opinion survey. In it, tax structure of Nepal, exemption, deduction and concession of income tax system and opinion survey has been analysed. On the basis of an analysis, it has tried to find out whether the income tax system in Nepal is satisfactory or not. It describes the problems and weakness of tax administration also.

The last chapter five is mainly concerned with finding, summary, conclusion and recommendation. In the beginning of the chapter, the major findings have been presented about the exemption, concession and deduction of income tax systems, tax structure and administration aspects of revenue administration. Some possible areas for reform the defects in income tax system have been recommended.

Bibliography and Appendix have been presented in the last part of the study.

## **CHAPTER-II**

### **REVIEW OF LITERATURE**

#### **2.1 Theoretical Framework**

##### **2.1.1 Concept of Tax and Income Tax**

###### **Concept of Tax**

Tax is a compulsory payment to the government. Taxpayers do not get any direct benefit from the state by paying tax. Tax is not a fines government collects tax with the permission of the state. Tax is a compulsory payment to government for the compensation of public expenditures. Tax fulfils the needs of country or local government to spend for philanthropic work. The main objective of tax is to distribute wealth and income equally. Mainly tax is classified in two groups. They are direct tax and indirect tax ( Adhikari, 2003 :2).

Taxes are compulsory levies on individuals, firms, companies, and other units for general government purposes. Government with the authority assigned in different laws generates with compulsion, some funds from individuals, firms, companies and other units, which generally termed as taxes. So taxes are compulsory payment to government to support the public services. According to economist Prof. E.R.A. Seligman “A tax is compulsory contribution from the person to the government to defray the expenses incurred in the common interest of all, without reference to special benefits conferred.

According to classical economist Dalton “A tax is a compulsory contribution imposed by a public authority irrespective of the exact amount of services rendered to the taxpayer in return and not imposed a penalty for any legal offence.”

According to economist Plehn, “Tax are generally contribution of wealth to levied upon persons, nature or corporate to defray expenses incurred in conferring common benefits upon the resident of states.”

According to classical economist Adam Smith, “A tax is a contribution from citizen for the support of the states.”

To Bastable, “A tax is compulsory contribution of Wealth of a person or body of persons for the service of public powers.”

According to Frindlay Shirras, “tax is a compulsory contribution to public authorities to meet the general expenses of government which have been incurred for the expenses of government which have been incurred for the public good and without reference to special benefit.”

In classical economics, tax was taken as an extra burden to the people and the economists were in the favour of small government, which only had to maintain law and order in the state. But now time has changed public welfare to the people. Thus the maximum public welfare to the people. Thus the government has to burden its revenue.

### **Concept of Income Tax**

The concept of income tax in different countries is found differently because of diverse economic structure, nature of the government and status of people. In United States, income tax is viewed as a matter of practice, recurrent is not relevant to the tax status. In United Kingdom, the original concept of the tax was that of a levy on recurrent income and the tax was applied to five schedules, any item not falling within one of the five schedules not being subjected to tax. In India, the personal income tax is levied on the net income of all individuals, joint Hindu families, unregistered firm and other association of person (Chillian, 1959:11).

Income tax is a personal tax imposed on the net income of individuals and corporation. In most of the countries especially the United States of America, Canada and other countries; the income tax is defined in money or goods from the tax payer during the period. In flow of wealth method taxation is imposed on a realisation rather

than as an accrual basic, and the applies only when a transaction accurse between other persons and taxpayers (Due; 1959:125.126).

According to tax economist “An income tax is a levy imposed upon the income of individuals after the exemption limit. Income tax is direct tax based on the total income of the payer from all sources and it graduation on a special system of exemption ( Siwakoti, 1887:21)

“An income tax is also levied on the capital gains of income of individuals. All income above tax exemption level are subject to income is dependent upon the income tax act if the country” (Due, 1959:181).

Income tax is levied according to the ability to pay as the principle of taxation. Here, the person who is liable to pay tax or who may be deemed to be liable to pay tax on income is called ‘assesses’. In this case, a person implies individual, firm company, corporation etc. which have liability of paying income tax. The taxpayer whom the tax is imposed must bear the burden of tax.

In Nepal, income tax is defined as the levied on the net income derived after deducting allowable deductions and relieves from the total income. Income tax is levied on the income derived from business employment and investment. Income tax is always levied on the net income i.e. total income less the allowable deductions.

Income tax can be classified into two types: personal\individual income tax and corporate income tax. Individual income tax is modern tax, which is a measure of ability to pay of any individual. It is based on the progressive rates. Corporate income tax is levied on business enterprises having a legal personality, distinct from their owners. Taxes on corporate ultimately come from the income or wealth of individuals. Generally, flat rate is applied to corporate income tax.

### **2.1.2 Historical Perspective of Income Tax on International Context**

Tax collection by the state was started parallel to the origin of state. The ancient Hindu philosopher and writer Kautilya, Manu and Yagyankalkya argued “ as the ripe fruit is picked from the garden leaving out the unripe ones, tax also should be taken only from those who are able to pay” (Bhandari,1994:33).

Income tax was first introduced in 1799 in Great Britain in order to finance wars with France. The supporting document was not found about the presence of income tax before that period. The main reason for the introduction of this tax was that it was preferable as a substitute for customs and excise duties in raising revenue. It remained more or less a temporary tax until 1860 when it got accepted as a permanent tax (Siwakoti, 1987:26).

In USA, the first federal income tax was imposed in 1862 to finance civil war expenditure. However, it became a permanent feature only in 1913 after 16<sup>th</sup> amendments to US constitution. Income tax of a sort was established in Italy in 1864, in India in 1860. New Zealand adopted income tax in 1891, Australia in 1915, Switzerland in 1840 and Canada in 1917. After World War I, the income tax became an important source of tax revenue in many developed countries and had made appearance in a number of developing nations (Agrawal, 1980:8).

Income tax reached to its developed stage during and after the world war. Today, the personal income tax raises substantial amount of revenue in all industrial countries of the free world and is employed although to a lesser extent in most developing countries. Today, the income tax has become the “sheet-anchor” of the revenue system in the most advanced countries. In the beginning, income tax was levied at a flat rate. The principle of taxing the income by progression of income was introduced in the United Kingdom and New Zealand in 1909.

Nowadays, every country of world has income. Income tax was introduced due to the cause of war and national emergencies. Thus, the second name of income tax as

war tax. After the end of the war, the tax was named as income tax. Nowadays it has been the important instrument against poverty and inequality (Agrawal 1978: 6).

### **2.1.3 Income Tax in Modern Nepal**

After the independence of the country in 1951, the role of government has drastically changed. Government was enforced to perform development activities besides regular functions. So it was realised to impose tax on Business Profit and Remuneration. Consequently, finance act 1959 was passed. In 1960 (2017), a formal income tax act was enacted in accordance with the provision in finance Act, 1959 for the first time in Nepal. In three years experience, the business profit and remuneration Act, 1960 was found very narrow and vague, and it was replaced by the Nepal Income Tax Act 1962 (2019). The income tax Act 1962 remained till 1974 and Income Tax Act, 1974, also replaced it. Income Tax Act 2002 also replaced the Income tax Act 2019.

“No Tax shall be levied and collected except in accordance with law” (Constitution of Kingdom of Nepal, 2047, sec 73-1). The income tax law at present in force in Nepal is Income Tax Act, 2002(2058) and Income Tax Rule 2002(2059) made there under finance Act is passed every year to translate the economic policy contained in the budget speech into law. It generally prescribes the rates and exemption limit for tax purposes and may delete, add or modify the prohibitions contained in the income tax act. Decision of Supreme Court in Nepal also acts as precedents for income tax law purposes. The notification in Nepal Gazette or circular by inland Revenue Department classifies and complements the legal. The legal aspect of income tax, therefore consist of provisions in the constitution, income Tax Act, finance Act, Income Tax Rules and decisions of the Supreme Court. Together they make up income tax law in Nepal. Historical development of income tax law in Nepal is given below:

### **2.1.3.1 Business Profit and Remuneration Tax Act 1960(2017)**

Income tax in Nepal was first introduced in the fiscal year 1959-60. It was then known as “Business Profit and Remuneration Tax.” The imposition of the tax was governed by the Business profit and Remuneration tax Act 1960 and rules made there under this act consisted 22 sections. The silent features of this act were as follows:

- a) The basis for calculating tax liability for remuneration was the income of the current year, and for business profits it was the profit of the preceding fiscal year.
- b) Tax on remuneration was to be deducted at source but the specified deduction was not provided.
- c) Only remuneration and Business profit were subject to tax. Deductions were not specified for the purposes of calculated the taxable income.
- d) Salary of any diplomatic representative, foreign citizen; dividend of shareholders; profits to be spend on religious or public welfare activity; profit of local autonomous origination allowances granted by NG to ministers assistant, ministers, speakers, deputy speakers , chairman, government chief whip and leaders of opposition crop from own land; money drawn from provident or shaving fund where exempted from tax
- e) The tax officer was empowered to assess tax a best judgment estimation where tax return was not filed or a false return was filed.
- f) The taxpayer had a right to appeal against the tax officers assessment to the local ‘Bada Hakim’ or ‘magistrate’. If he had not satisfied with the decision, he could appeal to the ‘revenue and tax court’ after depositing fixed amount.
- g) In cash of defaults, the fines ranged from Rs.500 to Rs.5000 and for informants; there was a provision of 20% of total tax realized if the information had been proved.
- h) Profits from large industries where granted a rebate of 20% and profit from small industries were granted at a rebate of 20% (Business Profit and Remuneration Act 1960)

Aforesaid features of business profit and remuneration tax act indicate that this act was very narrow and vague. High discretionary power was granted to the tax officer in the matter of assessment many loopholes and inadequate provisions were the main weakness of business profit and remuneration act. Those were the basic reasons why this act was replaced by Income Tax Act 1962 (2019).

### **2.1.3.2 Income Tax Act 1962 (2019)**

This act was an extension of the Business Profit and Remuneration Tax Act 1960 (2017). It had 29 sections. It was amended in 1972. The additional features of this amended act were as follows.

- a) Income was defined as all kinds of income including income derived from business, profession, remuneration and occupation and house and land rent, investment in cash or kind, agriculture, insurance business, agency and other source.
- b) The basis was specified for assessment tax on the best judgment estimate of the tax officer.
- c) The personal as well as residential status of taxpayer for purposes was defined.
- d) The procedures for assessment and collection of income tax were classified. Specific prohibitions were made for allowable deductions. Methods were also specified calculation of net income.
- e) Tax payment could be instalment as well as advanced payment.
- f) The provision was made to constitute the net income assessment committee with five members.
- g) Provision was made for re-assessment of tax as well as rectification of arithmetical errors.
- h) Carry forward of losses was allowed for a period of two years.
- i) Provision was made for the exemption of tax for new industries for a period not exceeding ten years.
- j) Agricultural income was brought under the scope of income tax for the first time.

- k) In agricultural income, only 1/4 of the total income was taken net earnings and remaining 3/4 of the total income as expenditure while in case of net earning from rent of house and land, from investments and from professions 90 percent to total income was taken as net earning and 10 percent was expenditure.
- l) There was additional provision of exemption for income of Nagar Panchyat public origination; income of Nepal Rastrya Bank, deposits of employees in the employees saving from salaries; any income notified in the Nepal Gazette.
- m) There was special provision of newly opened industry in which the NG might wholly exempt exemption after 10 year (income tax Act; 1962).

The finance Act 1966 (2023B.S.) exempted the agriculture income fully from income tax. The finance Act 1973 (2030B.S.) restored agriculture income tax. Ten bighas of land were exempted and presumptive value of income based on the classified. The finance Act 1977 (2034B.S.) again exempted the agriculture income from income tax.

This act was also not far from weakness. In order to keep the law on tune with the changes in the socio-economic environment of the country; the need was felt for consolidating and amending the existing income tax law. Hence, income tax Act 1974 was introduced.

### **2.1.3.3 Income Tax Act 1974 (2031 B.S.)**

Income Tax Act 1974 (2031 B.S.) had been implemented in place of Income Tax Act 1962 (2019 B.S.). Its basic framework had been derived from previous act and it had 66 sections with clear cut provisions of assessment carry forward of losses for three years and précis definitions of related terms like tax assessment of tax, year of income, income of non residence taxpayers etc. This act was amended in 1977, 1979, 1980, 1984, 1985, 1986, 1989 and 1992 to make it more practical and to eliminate confusing terms. In this act, certain provisions were added and some provisions were amended. From time to time so the Income Tax Act 1974 had become more scientific and better organized with the progress of time. GON enacted the income tax rules 1982(2039) in accordance with the authority given under section 65

of income Tax Act, 2039. Besides this act and the rules, the current finance act was also equally applicable for the proper administration of income in Nepal.

Some of the silent features of this Act, 1974 as amended are as follows:

- a) There were additional provisions of exemption from income tax then the former act such as income of Guthis, compensation for life insurance policy
- b) It had made provision for self assessment of tax for the first time in Nepal.
- c) Carry forward of loss was allowed for subsequent three years.
- d) It had classified certain definitions specially relating to taxpayer, taxable income, gross income, net income, personal status of the taxpayers, assessment of tax, philanthropic work, non-resident etc.
- e) Five sources of income had been specified. They were:
  - a) Agriculture b) industry, trade profession or occupation
  - c) Remuneration d) house and compound rents and) others.
- f) Method of computing net income from each source including the deductions allowable had been specified.
- g) The act had made its obligatory for taxpayers to register their industry, business, profession or vocation in the tax office. Any changes had also to be notified.
- h) Deduction was allowed for life insurance premium.
- i) Taxpayers were required to keep accounts and records for their source of income and preserve these records for a period of six years.
- j) Procedure for assessment, collection, payment and refund of tax has been streamlined. Powers for search and seizure had been specified. Penalties had been increased. Various forms related to income tax had also been specified.
- k) Provision had been made for tax exemption either full or partial, to the industrial enterprises (Income Tax Act, 1974).

Although, income Tax Act, 1974(20310 was far ahead then the previous act, yet it had many deficiencies and weakness. It had used many vague or unclear words like 'reasonable', 'appropriateness' etc. it had also provided high discretionary powers to the tax officer in the matter of tax assessment.

### **2.1.3.4 Income Tax Act 2002 (2058 B.S.)**

Income Tax Act, 2002 has been implemented from 19\12\2058 B.S. This act has replaced the Income. Tax Act 1974 (2031) and other acts replaced to Income Tax. GON enacted Income Tax rules 2059 B.S. In accordance with the authority given under section 138 of Income Tax Act 2002. Income Tax Act 2002 has 143 sections. Finance ordinance 2059 and 2060 has amended Income Tax Act 2002 first time. Amended Income Tax Act 2002 has dismissed the section 66. There is various additional provisions in this Act. Some of the silent features of the income tax act 2002 as amended are as follows:

a) Income Tax Act, 2058 B.S. has classified income into three headings:

(i) Business (ii) Employment and (iii) Investment.

b) The government allowances to widows, elder citizens or disabled individuals; gift; bequest; inheritance; scholarship; income of foreign officials; government bodies and non profit organizations have been exempted from the income tax net. Amount of a person Privileged under bilateral or multilateral treaty, an agricultural income, income of corporate societies based on agricultural products and dividend of such society etc. also exempted from income tax.

c) This act has defined the income as “a person’s income from any employment, business or in accordance with this act.” It includes all kind of income received for the provision of labour or capital or both in whatever form or nature in the taxable income.

d) When Income Tax Act 1974 (2031) was in practice, there were several exemptions and deductions provided by the act and other related acts. But now, there are no more exemptions and deductions except the ones provided for by the Act.

e) This act has given the option for husband and wife as a separate natural individual unit they don’t accept as a couple.

f) These act focuses on the self assessment system, and every assessment is treated as a self- assessment. The tax offices can determine tax assessment within four years. The Jeopardy assessment is essential when a person becomes bankrupt, is wound

up, or goes into liquidation; a person is about to leave Nepal forever or to close down activity in any department or in Nepal.

- g) Presumptive tax is limited to the small taxpayers whose annual net income is up to Rs. 120000 and are subject to flat annulling taxes.
- h) The Inland Revenue Department is responsible for the implementation and administration of this of this act.
- i) This act has introduced the concept of administrative review to correct the administrative mistakes. The Inland Revenue department should give its decision within 90 days of the submission of objections and if the department doesn't gives its decision within the given time limit the taxpayers may appear to the revenue tribunal.
- j) This act has introduced the concept of medical tax credit under which resident individuals may claim a medical credit of 15 percent of the amount of approved medical costs.
- k) A resident person may claim a foreign tax credit for any income year for any foreign income tax paid by the person to the extent to which it is paid with respect to person's assessable income for that year.
- l) There is a provision of functional division of work among tax officer. The division is to be made under the direction of GON and Director General.
- m) This act has guaranteed the rights and secrecy of taxpayers through the act and the strict punishment for not maintaining the secrecy is provided.
- n) The penalties are divided into two parts. The tax officer can lively only fines and interest and the court can levy penalties and imprisonment.
- o) This act has determined the rate of income tax itself for the first time, which used to be determined by the finance acts in the previous years.
- p) For the purpose of calculating a person's income from any business or investment there are provisions of deduction related to overhead costs.
- q) The act has based on global income tax principle and has brought all sources of income into the tax net and has treated in an equal manner. This act has abandoned the itemized system of deduction and expenses are taken into amount on a global manner not on a live by line basis.

- r) A pooled system of depreciation has been adopted in this act, in which assets are broadly classified into five categories. The depreciation rates are 5 percent, 25 percent, 20 percent, 15percent for classes A,B,C and D respectively which are based on diminishing balanced method of depreciation for. Class E, the rate is based on straight line method.
- s) Capital gains are taxed explicitly under this act after four decades of the introduction of income tax. In case of business capital gains, gains on the disposition of business properly are taxed as an ordinary income and in case of non business capital gain only the gains from the casual sales of real property (land and buildings) and securities are subject to capital gains tax at a flat are of 10 percent. There is also a clear provision for adjusting net loss during the fiscal year.
- t) A person has been defined as a resident whose place of avocet is in Nepal and who lives in Nepal at any time or who lives in Nepal for 183 days or more with in the income year or who is an employee of NG posted abroad during the income year.
- u) Resident individuals and demotic companies are taxes on their world wide income while non resident individuals and foreign companies are taxed only on their income sourced in Nepal.
- v) The income of an approval retirement fund is free from tax. But retirement payments in the hands of employees are taxable
- w) Company is liable from its shareholders. The bonus share, loans and advances to directors and shareholders, distribution made on liquidation etc. are also brought under the tax net in order to plug loopholes for evidence.
- x) Investment insurance premium can be deducted as 7 percent insurance policy amount or Rs. 1000 which ever is less.
- y) A person can deduct population control expenses and research and development expenses up to maximum 50 percent of adjusted taxable income of total business run by him.
- z) Donation amount can be deducted as a 5 percent of adjusted income or Rs.100000 which ever is less.
  - aa) 7 percent of depreciation base amount of end of the year can be deducted as a repair and maintenance expenses and unreduced amount can be capitalized or

excess repair and maintenance expenses can be added to depreciation base amount of coming income year (Income Tax Act, 2002).

## **2.2. Review of Related Literature**

There is no long history of income tax in Nepal. Since 1959/060. income tax was started in Nepal. After its establishment, many individuals and institutions have studied in this subject regarding legal aspect, administrative problem, historical aspect, trend of income tax, income tax system, income tax structure etc. they have made appreciable efforts in the field of income tax.

Many books, dissertations, articles and reports had been reviewed for performing this research study. while reviewing the books, it was found that most of the books were syllabus oriented and some of them had described the problems and prospects of income tax system and a path for reform of income tax .similarly many dissertations, articles and reports had described the income tax and a path for reform of income tax, there were no detail studies made on the topic of income tax deduction, exemptions and concessions. All the researcher who made research were concise study on the deductions and exemptions.

### **BOOKS:**

Some books are more important and relevant for this studies which are as follows:

- ❖ Santosh Raj Paudel and Prem Prasad Timilsina (2047) had presented a book of Income Tax named “Income Tax in Nepal” They described the theoretical as well as particle aspects of income tax. The book has fully based on TU syllabus prescribed for B.Com They had not described the problems of income tax system and structure of Nepal. The book was descriptive rather than analytical.
- ❖ Rup Bahadur Khadka (2051) had published a book named “Nepalese Taxation: path for reform.” In this book, he had described the economic policy of Nepal, vat as a long term tax for Nepal, income tax from a rough to a refined system, property taxes as the main source of local revenue, improving tax

administration, tax reform strategy. He has shown the composition of tax revenue from 2008\2009to 2048\2049.

About the Income Tax, he had described the introduction, development, existing structure main problems, and possible direction of reform. His book was based on analytical study of income tax. He had identified the major problems of income tax as narrow coverage, unscientific tax assessment, deviation from basic principle of income taxation, defective system from the perspective of international taxation. He had not only identified the major problems of income but also had identified the major problems of income but also had identified the possible direction for reform; they were

- I. Extension of coverage,
- II. Improvement in tax assessment,
- III. Use presumptive method,
- IV. Extension of withholding tax,
- V. Inflation adjustment,
- VI. Introduction of current year payment basis,
- VII. Tax treaties with the major trading partners of Nepal etc.

Similarly he had identified the major problems of tax administration, they were

- i) Weak tax administration,
- ii) Inadequate tax training,
- iii) Imbalance and inadequate origination patterning
- iv) Predominance of low level non- technical posts,
- v) Inadequate physical and other facilities,
- vi) Debatable scope of Revenue Investigation department,
- vii) Lack of adequate information system,
- viii) Lack of coherent tax policy etc.

He had also suggested some suggestions for administrative reforms. They were

- i. Strengthen the revenue service provision of existing tax training.

- ii. Reorganization and expansion,
- iii. Developing an integrated information system,
- iv. Research on taxation, etc.

His book is very useful to know the various aspects of income tax. Although, he had not shown any numerical illustration and had not mentioned the legal provisions relating to the income tax. So his book was analytical rather than descriptive.

- ❖ Bishowdeep adhikari (2059) had published a book named “Income Tax Law: then and now”. He had described the legal provisions of new Income Tax Act, 2058. He also had described the decisions made by Supreme Court about the income tax. He had described the legal provisions with critical analysis. His book was very useful to know the new Income Tax Act 2058 but had not analyzed the role of income tax and income tax structure.
- ❖ Narayan Raj Tiwari (2050) had published a book named “Income Tax System in Nepal”. He had described the legal provisions relating top income tax. He had described the process, provisions and methods to assess the income tax with numerical examples. The book was fully based on campus level syllabus. He had not shown the role of income tax in economic development of Nepal. He also had not identified the problems of income tax system. His book was descriptive of legal provisions rather than analytical.
- ❖ Pavan Kumar Ojha (2050) had published book entitled “Taxation Law”. He had described the different acts and law of income tax. He had taken many tax cases into consideration to describe legal terms. His book may be beneficial to understand income tax laws. But he had not analysed the role of income tax.
- ❖ Kamal Deep Dhakal (2056) published a book named “Income tax and House compound Tax Law Practice with VAT”. He had described the legal provisions relating to income tax with numerical examples. This book is very useful to know about the legal provisions of income tax Act 2031. The book was fully based on the syllabus of BBC and MBS prescribed by TU. This book was informative or descriptive rather than analytical. He had not analyzed the role of income tax and the structure of income tax.

- ❖ Nagendra Bahadur Pradhanangahas (1993) written a book entitled, “Income Tax Law and Accounting” objectives of this book was to providing the facilities to the students of taxation. In 20 chapters, he has described the legal provision relating to income tax. He has also included example to derive the income tax payable from the various income sources, which is very much useful to the B.com students. He has also described the development of income tax in Nepal, finance Act, industrial enterprises Act, income from remuneration, Agricultural income from house and land rent, income from industry, business profession, vocation income from other sources etc. the provision related to fine and penalties, appeal, admissible and mentioned in this book (Pradananga 1993).
- ❖ Bidhyadhur Manlik (2003) has written a book entitled, “Nepalko AAdhunik Kar Pranali.” He has explained the various difficult languages of ITA 2058 in simple language with suitable examples. The main objective of this book to make clear about the provisions of the new Act to the taxpayers. This book is some how analytical in nature with the description of the legal provisions of the income tax Act 2058. he has clarified how the new income tax Act has broadened its tax base and more amounts of income are brought into tax net (Mallik.2003).
- ❖ Puspa Raj Kandel (2003) has written a book entitled, “Tax Laws and Tax Planning”. This book’s main objectives are to meet in conforming to the MBS level syllabus of T.U. He has presented the numerical examples to derive the taxable income and tax liability. Another book entitled “Nepal Ko Bartaman Kar Byabastha” by the same writer in the same year has been published. This book is based on the course of BBS level. He has includes the chapter deduction Exemption and Concession in this boo. He has clearly explained about exemptions, Tax exempt organization, Tax exempted income, Business exemption and organization in system tic way. Similarly, he has explained about deduction, expenditure allowed for deduction in his boo. (Andel, 2003).

## Dissertations

Some dissertations were reviewed for this study. They are as follows:-

- ❖ Ram Bahadur Thapa (2050) had presented a dissertation entitled “Income Tax Assessment Procedure in Nepal, an analytical study.” This study was basically concentrated on income tax assessment procedure. His findings about the problems of income tax assessment are lack of adequate accounting skills, which are considerable at present. He had conducted an opinion survey of income tax assessment procedure. He had taken 23 people as a simple. About the exemption limit, 8 were negative attitude and 9 were indifference about the exemption limit. Out of them, two gave the negative response, had suggested increasing the exemption limit according to the inflection of the country. He also had suggested giving tax holding to new industrials as investment allowance. He also had suggested taxing the agriculture income. His topic was about income tax assessment procedure but he had described only about the income tax assessment method and fine, fee and penalties. He had not mentioned the assessment procedure, legal provision relating to income tax and items of exemption and deduction.
- ❖ Manidev Bhattari (2050) has made a draft entitled, “Income Tax Facilities Provided by Industrial Enterprises Act 2049.” His opinion is that the facilities provided by the industrial enterprises act 2049 are not beneficial to the small industries. The deduction Allowed to the modernization of industries such as pollution control device, technology and product development sales promotion expenses etc. have produced the large industries only. The expenses such as advertisement, entertainment, hospitality etc. have created rude in income tax. Since, these facilities are given in the same manner to all kinds of industries .according to him, the industries are to be advertised highly where as other not so, the equal treatment to industries as trading business is not favourable. The provision related to the tax exemption facilities to the reinvestment income of the industries was favourable to the industries related to alcohol, tobacco, etc. because

they have reinvested their income and got the tax exemption facilities. (Bhattarai, 2050)

- ❖ Dhan Bahadur Pallimager (2003) has presented a dissertation entitled, “Income Tax in Nepal, A Study of Exemption and Deduction”. His finding is that the deduction facilities provided by the ITA 2059 have myopic vision. The government is not liberal enough to give the sufficient deduction facilities which are important for the well being of the nation such as pollution control cost, research and development cost, repair and maintenance cost etc. and some cost like depreciation allowance are far from the realities. The loss adjustment procedure is not sufficient enough to attract the industries. He has further found that the incentives and facilities given to encourage the establishment of industries in certain areas are not effective.

They have vanished or changed names. Ownership or place of the business when the tax concern facilities expired. In case of income tax administration, his findings are that the problems regarding the tax administration are lack of trained employees, storage of income tax, lack of public participation, defective income tax, fully organization etc. His suggestions regarding the industries are that the incentives should have been increased because they are not sufficient to attract incentives in the remote areas. The incentives may be in the form of investment allowance of 20% per annum on the depreciable assets on straight line basis or accelerated depreciation and a special package for the remote areas should be introduced.

Research and development expenses should be wholly exempted because research is the backbone of industrial development. Interest of the tax exempt control entity should be wholly allowed to deduction (Pallimager, 2003).

- ❖ Binita Shrestha (2058) had presented a Dissertation Named, “Revenue Collection from Income Tax in Nepal, Problems and Prospect”. She had described the conceptual frameworks and legal provisions, structure of income tax in Nepal, income tax administration in Nepal an empirical investigation and problems and prospects of income tax in Nepal. Her findings about the structure were, there was the domination share of tax revenue in

Nepalese government revenue. But the contribution of tax revenue showed the decreasing trend as it had contributed by 80% in 2055\2056. The tax and GDP ratio of Nepal had fluctuate Cicely between 6.83 percent to 9.36 percent for the period of 2050/2051 to 2055/2056. There was the dominant role of indirect tax revenue such as 17.76 percent and 82.24 percent. Her finding about the problems of Nepalese income tax system was narrow coverage, mass poverty of Nepalese people, lack of conscious of taxpayer, wide speared evasion and avoidance of income tax. Unscientific tax assessment procedure, inefficient tax administration, instability in government policy. She had also found the various weak point of Nepalese tax administrations major weak points were:

- i. Failure to locate new taxpayers,
- ii. Failure to maintain proper accounts and records
- iii. Defective selection of personal,
- iv. Venue delay in making assessment,
- v. Lack of motivation to tax personnel,
- vi. Existence of corruption which are more relevant and considerable at present.

He had conducted an empirical investigation about the different aspects of income tax system. She had taken 60 persons as a sample. About the soundness of Nepalese income tax system, most of the respondent it unsound and unscientific. She had conducted an opinion survey of influence of agriculture and capital gain as a taxable income. About the agriculture income 57 percent of the respondents were positive to tax. On the capital gain, 80 percent of respondents were positive to tax. She had used the correlation coefficient to prove the hypothesis on the problems income tax system. Her suggestion about the income tax system was ad follows:

- I. Extension of tax coverage,
- II. Tax consciousness to people,
- III. Minimize the problems and weakness of tax administration,
- IV. Reform in tax assessment,
- V. Reform income tax administration.

Although, she had not mentioned the future prospects of income tax. She had taken an empirical investigation but she had not taken any investigation about the exemptions and deduction.

- ❖ Jayenti Upaudyal (2059) had presented a dissertation entitled “Income Tax in Nepal a study of its structure and productivity”

TU she had described the income tax in its historical perspectives, income tax structure, elasticity and buoyancy of income tax, voluntary disclosure of income scheme, role of income tax administration in Nepal.

She had more emphasized on income tax structure of Nepal. She had described the contribution of income tax. She had mentioned the contribution of indirect tax is about twice than direct tax. Similarly, within the direct tax income tax is the largest source of revenue. About the tax administration of Nepal, she had found that the working procedure s was traditional and the cost of administration had not been brought to the satisfactory level.

She had suggested to board income tax base, reform of tax administration, successful implementation of vat, establishment of standardized accounting system. But she had not mentioned the problems of income tax system and exemptions and deductions. She had not clarified the role of income tax administration

- ❖ Puspa Kandel (2058) had published a draft of "Income Tax Act 2058, as a Critical Analysis". He had criticized the ITA2058 on several grounds. They were exemption of agricultural income from income tax export duties levied on export, inequality between different capital earned income, withdrawal of exemption provision and an adjustment for inflectional. He further criticized the act for the provision of income tax for export as 0.5 percent of total export because it is not good choice of income tax base.
- ❖ Govinda Bahadur Thapa (2058) had published a draft of tax system and its reform in Nepal as a descriptive way. He had described the tax system features of tax, causes of characterized the tax system as too many and too high rates, myriad of tax incentives and tax holdings, multiple objectives of taxes

schedular rather global approach to income taxation, too many income brackets and high progressively complicated and ambiguous tax laws. He further added. “Taxes were levied at manufacturing rather than retail stage which added to the production cost. Too many tax incentives and tax holdings narrowed the tax base and revenue collection had to be increased from that rising of tax rates encouraged tax avoidance and evasion and gave birth it the unaccounted economy.

He identified the areas for reform the tax system in Nepal. They were:

- i. Low tax rates on broad base,
  - ii. Simplicity and neutrality,
  - iii. Gradual abolition of exemptions, deductions and tax holdings to broad tax base,
  - iv. Few rates for single rate,
  - v. Few axes with high revenue productivity,
  - vi. Emphasis on tax compliance rather than corrective enforcement,
  - vii. Incentives saving and investment,
  - viii. Conversation of sales and service taxes into VAT.
  - ix. Exercise duty only on cigarette, Tobacco, alcohol, automobiles, petroleum’s and automatic spare parts,
  - x. Abolition of surcharge and additional duty system to make the tax system simple,
  - xi. Making the tax system internationally compatible at attract foreign investment,
- ❖ Naina Nepal (2059) has presented a dissertation named “A Study on the Problem and Prospects of Income Tax in Nepal”. She has described the fiscal system of Nepal, tax structure in of Nepal and an opinion survey of the problem and prospectus income tax in Nepal. Her finding about the problem of incoming tax were as follows:

- i. Lack of account keeping by the taxpayers,
- ii. Narrow tax coverage,

- iii. Lack of co-operation between taxpayers and department,
- iv. Lack of tax education assessment deficiency etc. which are considerable at now,

She had maintained that the feature of income tax is good because it is growing year to year. She had taken an opinion survey of ten tax officer and 25tax payers about the difference aspect of income tax about the exemption and deductions; she had taken an opinion survey of exemption limit. She had conducted an opinion survey of the appropriateness of exemption limit. Out of 10 tax officer 9 were in positive response and 1 was in negative response about the appropriateness and exceptive limit. Similarly out of the 25 taxpayer's 9 were positive response and remaining 10 were negative response she had also taken an opinion survey of adjustment of exemption limit according to a inflation. Out of 10 tax officer 8 were agreed to adjust and 2 were disagreed. About taxpayers 25 taxpayer were agreed to adjust and 2 were disagreed on the widening the percent income tax coverage all total 10 tax officer were agreed and all total 25 taxpayers were agreed.

Her suggestions about the tax rate and exemption limit were:

- i. It should be elastic, scientific and progressive.
- ii. The exemption lime should be separated to the couple and family. But only the increases in exemption limit will not create benefit.
- iii. If exemption income is speeded in luxurious consumption, it will hamper saving and investment. She had not do maintained the legal provision relating to income tax exempted incomes and deduction of expenses.

### **2.3. Summing Up**

There is the gap between this research and previous researches, most of the previous research studies where based on laws, system, Administrative aspect and structure of tax. Most of them have indicated the inefficiency of tax administration. But majority were based on theoretical facts of tax administration. They have not

reasonably shown the inefficiency of tax administration, weakness of provisions like Deduction, Exemption and concession. They have identified the problems of income tax evasion at high level and suggested for its control. The finding of the previous researchers was mostly based on secondary data. This research focus on primary data' in recent years no studies have been conducted about deductions, Exemptions and concessions. So this research will be very beneficiary for all parties, who like to know about exemption deduction and concessions provided by ITA 2058 and getting optimum benefits within the frame of ITA by exempting of incomes and deducting of expenses to the tax payers.

## **CHAPTER-III**

### **RESEARCH METHODOLOGY**

This chapter is devoted to research methodology applied in the study for the achievement of desired objectives. Primary as well as secondary data were used for the study. Opinion survey technique is adopted to collect the primary about the different aspects of income tax. While conducting opinion survey, questionnaires were distributed to different groups who were related to income tax. They were income tax payer's income tax policy makers, income tax administrators, income tax experts, accountant, auditors, lawyers, officers, etc.

The collected data were tabulated in to the separate format and tables. Some statistical tools such as simple average and percentage were used where necessary. The results were expressed in the forms of descriptive and analytical.

#### **3.1 Research Design**

This study attempted to analyze the percent deduction, exemption and concession of income tax, opinion of 64 respondents associated with the income tax via income tax policy makers, administrators, experts and payers, are collected through questionnaires. The questionnaires included the problem of income tax administration, soundness of income tax administration, exempted income concession of income, exempted level, deduction of expenses origination sufficiency of provision etc. Similarly, various publications of income tax of different privatization were used for this study. Hence the research methodology followed in this study can be termed as survey cum descriptive research design.

#### **3.2 Population and Sample**

The population for this study comprised all the persons belonging to income tax of Nepal. Among distributed 85 samples 64 samples from Kathmandu valley have

been taken to fulfil the objectives of the study. This is the 75% sample of the population. The respondent had been derived into 3 groups. The following table shows the groups of respondents and size of sample.

**Table 3.1**  
**Groups of respondents and size of samples from each group**

S.N	Groups of respondents	Sample size
1	Income tax exports	14
2	Income tax administrator	25
3	Income tax payers	25
	Total	64

Source: - Opinion Survey

### **3.3 Nature and Sources of Data**

Collected data from primary and secondary sources were firstly tabulated and then converted into separated formatted in systematic manner. The data were tabulated according to the subject in order. Then simple statistical analysis such as percentage and rank were calculated where necessary and they were presented and analyzed in descriptive way. Graphs and charts were also presented to interpret if necessary.

### **3.4 Data Collection Procedures**

The data of the study were collected from two sources. Primary data were collected by using Questionnaire method. A set of questionnaire was developed and distributed to the selected respondents in order to get actual and accurate information. Some of the information is also collected from interview with the respondents. The secondary data were collected according to the organization of different publication books.

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

Collected data from primary and secondary sources were firstly tabulated into separate format in systematic manner the data was tabulated into various tables according to the subject in order. Then simple statistical analysis such as percentage and rank were calculated where necessary and they were presented and analyzed in description way. Graphs and charts were also presented to interpret.

## **CHAPTER-IV**

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

#### **4.1 Tax Structure of Nepal**

Modern economic development of Nepal had started with the initiation of first economic planning in 2013. Since then, taxes have been raised for the achievement of national economic goals. So taxes play vital role to the economic development of Nepal. To know about the taxes, the tax structure should be known. The tax structure refers to the level as well as relative importance of various taxes in the composition of total tax revenue of a country is composed of both direct and indirect taxes.

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

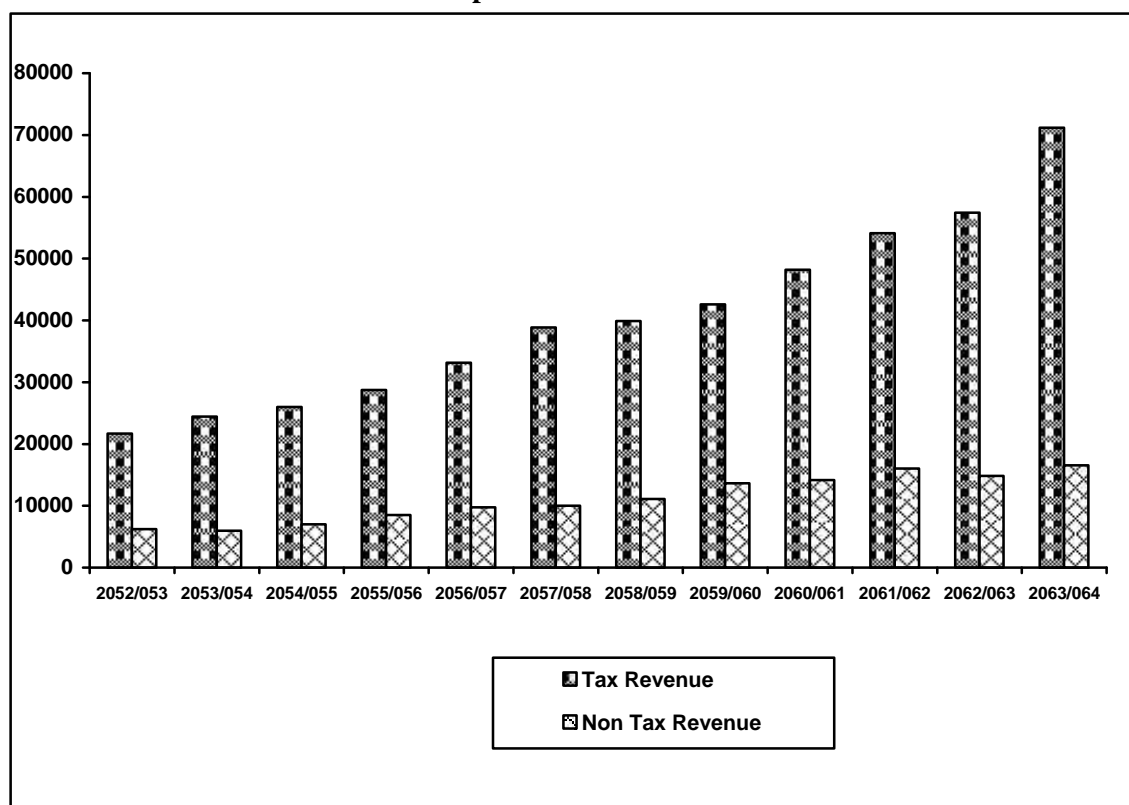
In Nepal the total revenue is composed of tax revenue and non –tax revenue when the first national budget was presented in 2008/2009, the revenue structure was typically that of tradition economy with 73%of government receipts coming from non – tax sources and land tax, out of 73% the share of non tax- revenue was 43%(Budget speech 2008/2009,MOF).In 1960's the share of non – tax revenue was declined drastically because of the increasing contribution of indirect tax on foreign trade. In 2063/2064, the share of non – tax revenue was 18.86 percent of total revenue as compared to 20.49 percent in 2052/2053. On the other hand , the share of tax revenue of the initial period of the study 2052/2053 was 71.34 percent of the total revenue and has been increment to 81;14 percent in fiscal year 2063/2064, as shown in the following table,4.1.

**Table 4.1**  
**Composition of Total Revenue** **Rs. In Million**

Fiscal year	Total revenue	Total Tax Revenue	Tax revenue as % of Total Revenue	Total Non Tax Revenue	non Tax revenue as % of total revenue
1	2	3	4	5	6
2052/053	27893.00	21668.00	71.34	6225.00	20.49
2053/054	30374.90	24425.20	74.16	5949.70	18.06
2054/055	32938.20	25970.00	78.75	6998.20	21.25
2055/056	37247.10	28753.00	77.19	8494.10	22.81
2056/057	42903.60	33162.00	77.29	9741.60	22.71
2057/058	48889.60	38860.80	79.48	10028.80	20.52
2058/059	50990.60	39875.60	78.20	11115.00	21.80
2059/060	56229.70	42587.00	75.74	13642.70	24.26
2060/061	62331.00	48175.70	77.29	14155.30	22.71
2061/062	70123.10	54105.10	77.15	16018.00	22.85
2062/063	72282.10	57427.00	79.45	14855.10	20.55
2063/064	87712.10	71168.00	81.14	16544.10	18.86
Total	619915.00	486177.40	927.18	133767.60	256.87
Average	51659.58	40514.78	77.27	11147.30	21.41

Source: Appendix I

**Figure 4.1**  
**Composition of Total Revenue**



From the above table 4.1, it can be concluded that the source of tax revenue on total revenue is fluctuating 71.34 percent to 81.14 percent. The total tax revenue ,non

tax revenue and total revenue were Rs. 486147.4 million, Rs. 133767.6 million and Rs. 619915 million respectively, where as average percentage collected tax revenue and non tax revenue were 78.42 % and 21.58 % respectively during the study period. This indicates the signification role of tax revenue in total revenue. The composition of tax revenue is shown graphically in above figure 4.1

#### 4.1.2 Composition of Total Tax Revenue

Tax revenue is composed of total direct tax and total indirect tax. There has been simultaneous increased in total direct tax, total indirect tax and the total tax revenue in absolute term. In 2052/2053, their amount was Rs 4550 million, Rs. 17083 million and Rs. 21668 million respectively and during the period of 12year; these amounts become rs.18979.70 million, Rs. 52188.30 million and Rs. 71168.00 million. The basis reasons for the increment were due to the expansion of the tax bases and tax rates both wide and deep.

Despite the absolute increment of direct tax during the study period, its share in total tax revenue is shrinking continuously from 21 percent amounting to Rs.4550 million in 2052/2053 to 26.67percent amounting to Rs. 18979.70 million in 2063/2064. The contribution of total indirect tax in 2052/2053 was 79 percent amounting to 17083 million and decreased to 73.33 percent amounting to Rs. 52188.30 million in 2063/2064. This implies the significant role in tax revenue. As indirect tax is considered regressive in nature, the tax structure of Nepal is not justified on equity ground and progressiveness from the following table, we can see that there is greatest reliance on indirect tax making our tax system regressive in nature and it needs to shift towards direct tax. The composition of total revenue has been shown in Table 4. 2 and also shown graphically in figure 4. 2

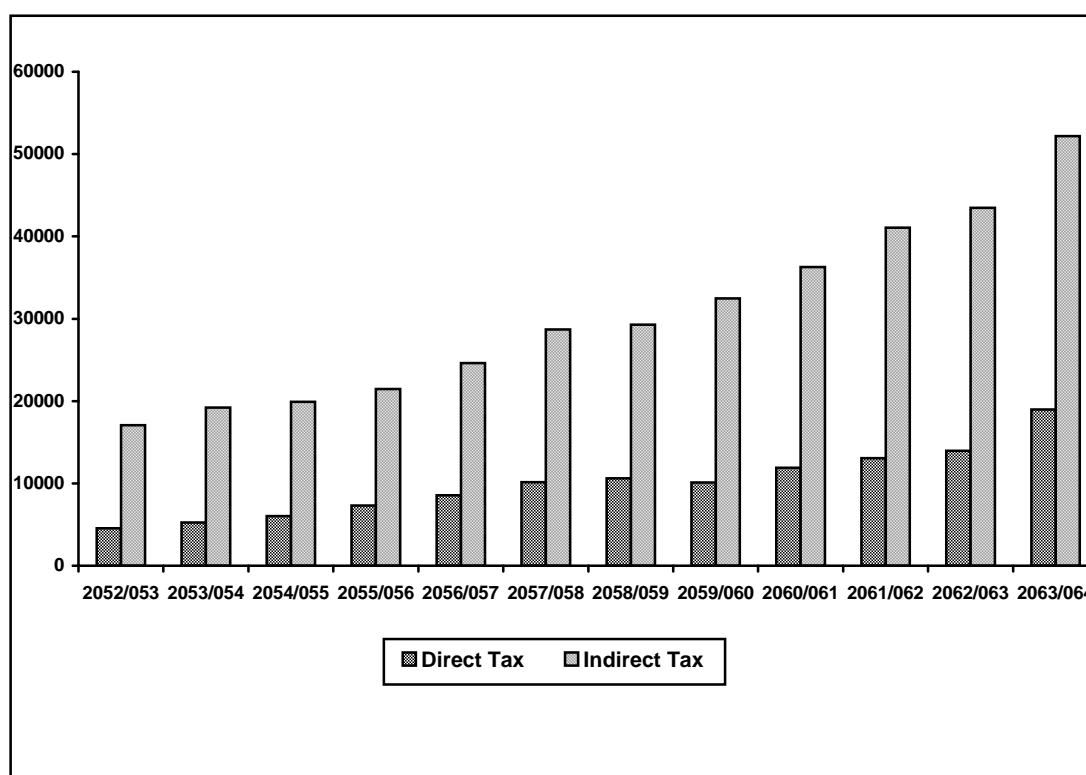
**Table 4.2**  
**Contribution of Total Direct and Total Indirect Tax to Total Tax Revenue Rs. In Million**

Fiscal Year	Total Tax Revenue	Total Direct Tax	%of Direct Tax to Total	Total Indirect Tax	% of Indirect Tax Revenue
-------------	-------------------	------------------	-------------------------	--------------------	---------------------------

			Revenue		
2052/053	21668	4550.00	21	17083	79
2053/054	24425.2	5234.00	21.43	19191.2	78.58
2054/055	25940	6013.00	23.18	19927	76.82
2055/056	28753	7297.00	25.38	21456	74.62
2056/057	33162	8555.00	25.8	24607	74.2
2057/058	38860.8	10159.00	26.14	28701.4	73.86
2058/069	39875.6	10599.00	26.58	29276.6	73.42
2069/060	42587	10105.80	23.73	32481.2	76.27
2060/061	48175.7	11901.00	24.71	36273.8	75.29
2061/062	54105.1	13061.30	24.14	41043.8	75.86
2062/063	57427	13961.50	24.31	43465.5	75.69
2063/064	71168	18979.70	26.67	52188.3	73.33
Total	486147.4	120416.30	293.07	365694.8	906.94
Average	40512.28333	10034.69167	24.4225	30474.56667	75.57833333

Source: Appendix-I

**Figure 4.2**  
**Contribution of total Direct and Total Indirect Tax to Total Tax Revenue**



### 4.1.3 Composition of Total Indirect Tax

Nepalese tax revenue is dependent mainly on tax on international trade and sales tax / vat on goods and services supplemented by taxes on income and property to

some extent, Nepalese tax structure is heavily dependent on total indirect taxes. This contributed 73.33 percent of total tax revenue in 2063/2064.

The major components of indirect tax in Nepalese tax structure constitutes custom duty, exercise duty, sales tax/ vat and contrast tax. Custom duty and export duty. Other components of indirect tax like entertainment tax, hotel tax, air flight tax and other tax, contribute nominal share even zero because they are included in vat in 2054. The others of indirect tax include remission of Indian excise duties, road bridge repair tax and other taxes. The compositions of indirect taxes are given the following table.

**Table 4.3**

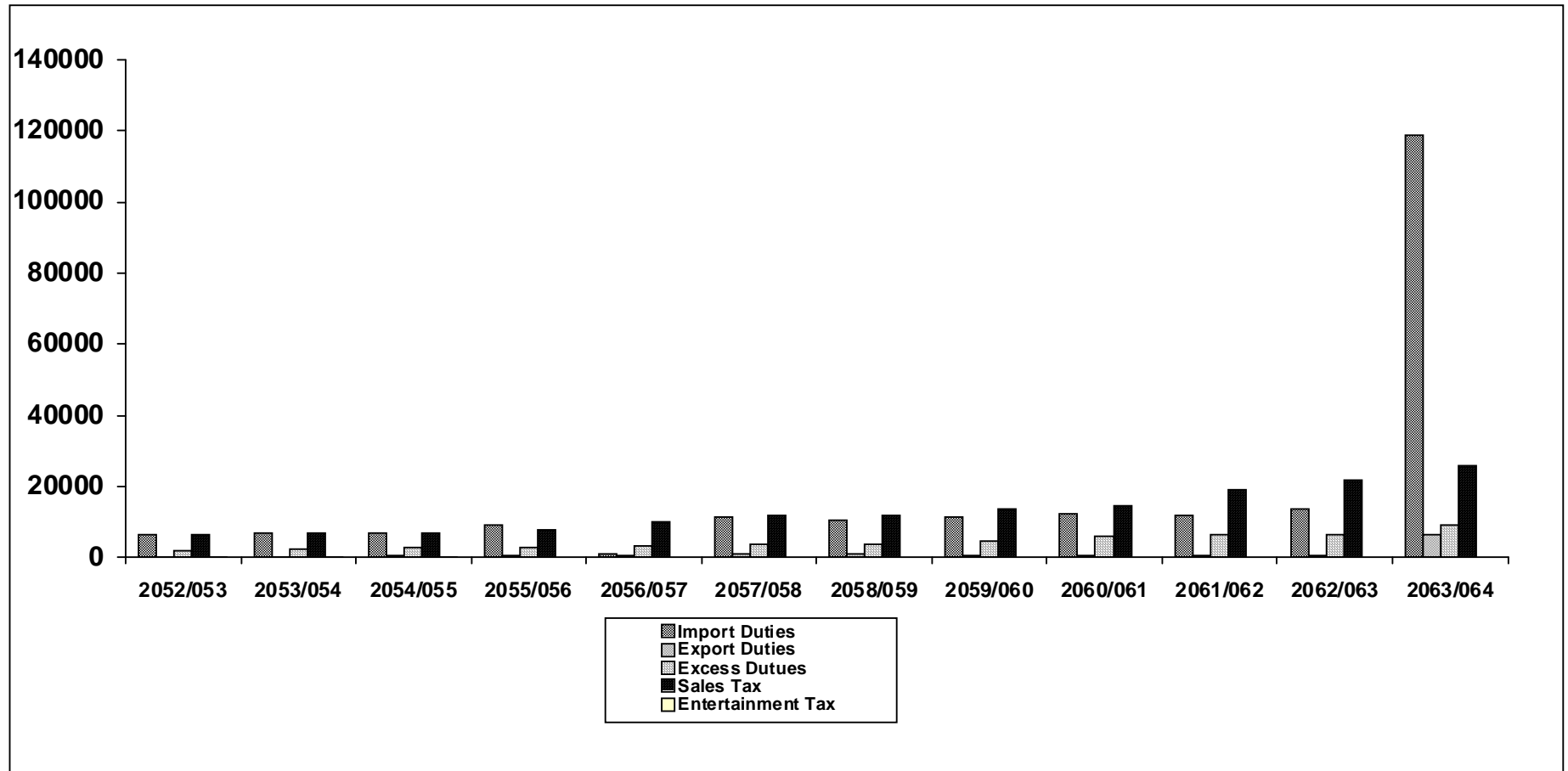
**Major sources of indirect Tax and their percentage to Indirect Tax (Rs in Million)**

Fiscal year	Total indirect Tax	Import duties	%	Export Duties	%	Excise duties	%	Sales Tax/vat	%	Entertainment Tax	%	Hotel Tax	%	Contract Tax	%	Air Tax	%	Other	%
2052/053	17083.0	6247.0	36.57	149.9	0.88	1944.3	11.38	6431	37.65	100.4	0.58	284.2	1.66	613.1	3.59	311.1	1.82	1002	5.8
2053/054	19191.2	7093.0	36.96	167.8	0.87	2298.1	11.97	7127	37.14	114	0.59	301.1	1.57	621.3	3.23	314.4	1.64	1154.4	6
2054/055	19927.0	7019.0	35.22	217.1	1.09	2885.8	14.48	7123	35.74	90.6	0.45	45.8	0.23	761.6	3.82	343.4	1.72	1440.7	7.23
2055/056	21456.0	7698.0	35.88	378.0	1.76	2953.2	13.76	7882	36.73	23.5	0.11	1.5		618.7	2.88	210.7	0.98	1690.4	7.8
2056/057	24607.0	8960.0	36.43	432.5	1.76	3137.6	12.75	9882	40.15	11.5	0.04	1.8		374.5	1.52	0.5		1806.6	7.34
2057/058	28701.4	1039.1	36.21	492.6	1.72	3770	13.13	12042.8	41.95	30.4	0.11	0.1		304	1.1	0.8		1668.8	5.8
2058/059	29276.6	11508.04	39.31	1150.5	3.93	3807.7	13	11947.9	40.81	2		5		300.5	1.03			559.8	1.92
2059/060	32481.2	10567.7	32.53	855.2	2.63	4777.5	14.7	13467.3	41.46									2813.5	8.66
2060/061	36273.8	11439.1	31.54	527.4	1.45	6221.4	17.15	14498.2	40									3587.7	9.89
2061/062	41043.8	12302.9	29.98	736.3	1.79	6446.3	15.7	18896	46.03									2662.1	6.48
2062/063	43465.5	11744.5	27.02	625.3	1.44	6506.4	14.96	21615.4	49.73									2973.9	6.84
2063/064	52188.3	13623.9	26.11	708.6	1.36	9343.2	17.9	26095.6	50									2417	4.64
Total	365694.8	118595.4	-	6441	-	57341	19.43	167733.2	573.97	575.7	3.37	1087.7	6.7	4355.6	22.45	1676.8	9.69	24965.6	86.6
Average	25581.52	9883	32.43	537	1.76	3822.733333	12.962	11182.21333	38.26467	38.38	0.224667	72.513333	0.44667	290.373333	1.49667	111.78667	0.646	1664.3733	5.774

Source: Appendix-I

Figure 4.3

Major sources of indirect Tax and their percentage to Indirect Tax (Rs in Million)



The share of export duty in custom duty is very low as compared to the import duty. It was 0.88 percent in 2052/053. It was increased a little bit in 2058/2059 as 3.93 percent. In the other hand, the share of import duty in 2052/2053 was 36.57 percent of Indirect Tax and rest of the years till 2063/2064 remained below 36.96. The sale tax / VAT has become an important source of overall tax revenue with relatively increasing trend, which contributed 50.00 percent to indirect tax in 2063/2064 compared to 37.65 percent in 2052/2053. Excise duty is levied only on the domestically manufactured goods and the imported goods are kept outside the excise net in the recent year. Its contribution to indirect tax had marginally increased from 11.38 percent in 2052/2053 to 17.90 percent on 2063/2064. The contribution of entertainment tax in hotel tax, contract tax and air tax are seen zero, since 2052/2053, 2059/2060 because these items were added in VAT.

#### **4.1.4. Composition of Total Direct Tax**

In Nepalese tax structure, the major components of direct tax are Income tax, land tax and house and land registration tax unit. Until the fiscal year 2050/2051 vehicle tax was considered as a direct tax and since 2051/2052 budget speech.

It has been classified under the indirect tax. On the other hand, interest tax and urban house and land rent tax were included under the income tax since 2051/2052. Thus the contribution of income tax has become larger than the other direct taxes. The share of the major component of the direct taxes is given the following table 4.1.4 and figure 4. 4

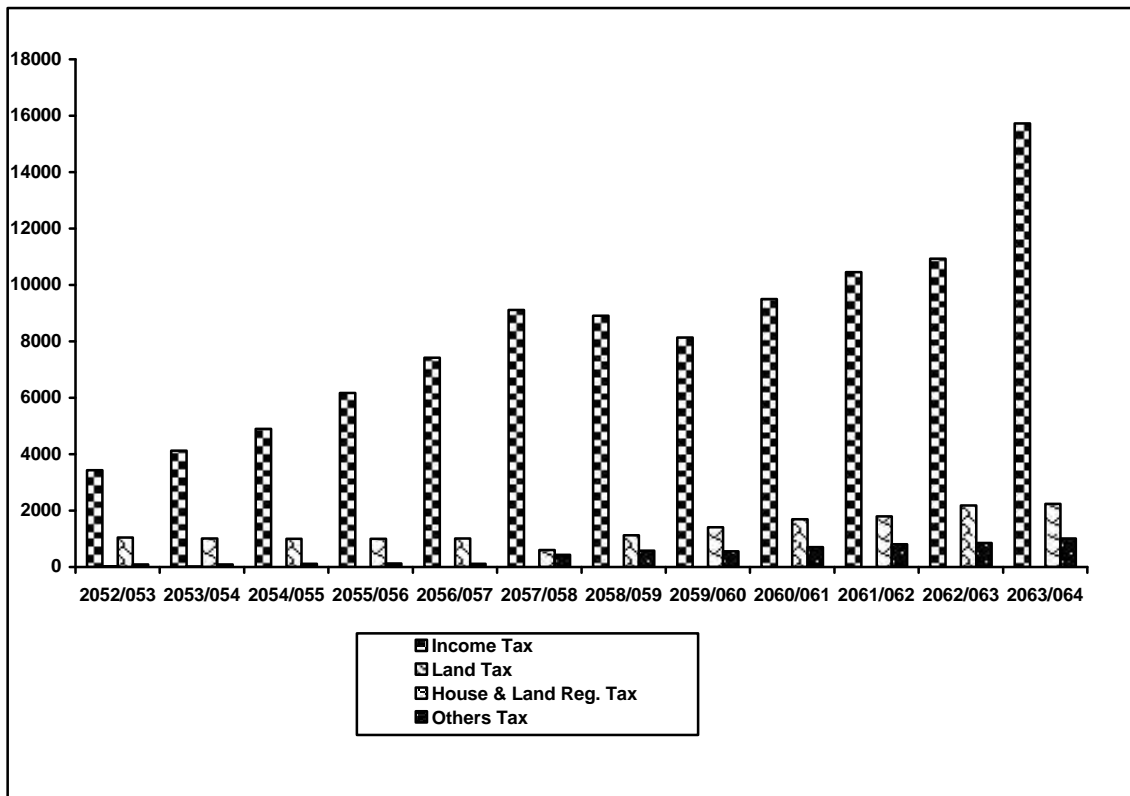
**Table 4.4**  
**Components of Direct Tax**

**Rs. In Million**

Fiscal Year	Direct Tax	Income Tax	%Share to Direct Tax	Land Tax	%Share to Direct Tax	House and Land Registration Tax	% Share to Direct Tax	Other Tax	% Share To Direct Tax
2052/053	4550	3431.4	75.41	18.2	0.4	1048.4	23.04	87	1.15
2053/054	5234	4123.3	78.78	5.9	0.11	1009.5	19.29	95.3	1.82
2054/055	6013	4898.1	81.46	3.6	0.06	1000.6	16.64	110.7	1.84
2055/056	7297	6170	84.55	1.4	0.02	1001.8	13.73	123.8	1.7
2056/057	8555	7420.6	86.74	4.6	0.05	1011.3	11.82	118.5	1.39
2057/058	10159.4	9110	89.67	5.1	0.05	607.8	5.98	436.5	4.3
2058/059	10599	8903.6	84			1121.3	10.58	574.1	5.42
2059/060	10105.8	8132.2	80			1414.2	14	559.4	5.53
2060/061	11901.9	9504	79.85			1697.5	14.26	700.4	5.89
2061/062	13061.3	10456	80.05			1799.2	13.78	806.1	6.17
2062/063	13961.5	10933.6	78.31			2180.3	15.62	847.6	6.07
2063/064	18979.7	15730	82.88			2238.7	11.8	1011	5.32
Total	120417.6	98812.8	981.7	38.8	0.69	16130.6	170.54	5470.4	46.6
Average	10034.8	8234.4	81.80833333	3.23333333	0	1344.216667	0	455.866667	3.88333333

Source: appendix I

**Figure 4.4**  
**Components of Direct Tax**



Income tax occupies largest share in the direct tax and the percentage share of this component in the fiscal year 2052/2053 was 75.41 percent amounting to Rs.3431.4 million after the inclusions of interest and urban houses and land rent tax in income tax, it started to increase and reached 82.88 percent in 2063/2064.

Land tax, which composed 0.40 percent of direct tax, even in 2052/2053, contributed only 0.05 percent in 2057 /2058 and zero in 2063/2064. The share of land tax was decreased sharply in the mid 1970's due to the rise in the relative importance of indirect taxes and income tax and large exemptions granted under the land revenue collection authority has been transferred to the government and has ceased to become revenue sources of control government. Thus, land tax has been a negligible contribution to the revenue structure of Nepal. The total collection of income tax, land tax, house and land registration during the study period were Rs. 98812.8, Rs. 38.8 Rs. 16130.6 and Rs. 5470.4

million respectively, in which average collection on direct tax were 82, 0.11, 13.39, 4.5 percent respectively.

#### **4.1.5 Income Tax Rate**

Rate structure of income tax has been changing continuously. Since its introduction in 2016/2017. Since 2016/2017 to till now there are national records of highest and lowest income tax rate. In 2020/2021 the highest income tax rate was 60 percent, which are not repeated till now. From the introduction of income tax, tax rate is changed slabs. In 2032/2033, the income tax rate for personal income was 10 percent to 60 percent for 7 different slabs. From 2055/2056 to till now, the income tax rate for personal income is 15 and 25 percent for 2 different slabs. It shows that there is a trend of reducing the number of slabs and tax rates.

Under new Income Tax Act 2058: individual income tax is levied with two rates of 15 percent and 25 percent. For individuals, who have Rs .1 lack incomes or Rs. 10 lakes turnover from any kind of business in metropolitan or sub–metropolitan cities, municipalities and other area in Nepal are subject to pay Rs. 2000, Rs 1500 and Rs. 1000 as an annual flat rate respectively. The income tax rate for partnership firms, corporation and non- residence was 15 to 60 percent for 5 different slabs in 2032/2033 which decreased to 30and 25 percent for total taxable income.

For every, finance acts prescribe the exemption limit for individual, family and couple. Above the exemption limit, different income tax rate have been levied. The exemption limits in different years are shown in the following table:

**Table 4.5**  
**Exemption limit in Nepal (2016/2017 to 2063/2064)**

Fiscal Year	Individual	Couple	Family	All Taxpayers
2016/017 to 2019/020				7000.00
2020/021 to 2021/022				6000.00
2022/023 to 2024/025				5000.00
2024/025 to 2030/031	3000.00	4500.00	6000.00	
2031/032	4500.00	6000.00	6000.00	
2032/033	5500.00	6500.00	7500.00	
2033/034 to 2035/036	6500.00	7500.00	8500.00	
2036/037 to 2037/038	7500.00	10000.00	10000.00	
2038/039 to 2039/040	10000.00	15000.00	15000.00	
2040/041 to 2046/047	15000.00	20000.00	20000.00	
2047/048 to 2048/49	20000.00	30000.00	30000.0	
2049/050 to 2053/054	25000.00	35000.00	35000.00	
2054/055	30000.00	40000.00	40000.00	
2055/056	40000.00	50000.00	50000.00	
2056/057	50000.00	60000.00	60000.00	
2057/058	55000.00	75000.00	75000.00	
2058/059	55000.00	75000.00	75000.00	
2059/060	65000.00	85000.00	85000.00	
2060/061	80000.00	100000.00	100000.00	
2061/062	85000.00	115000.00	115000.00	
2062/063	100000.00	125000.00	125000.00	
2063/064	115000.00	140000.00	140000.00	

Sources: Finance Acts of Various Years, Nepal Government Budget Speech

The above table shows that there was only one exemption limit for all individual taxpayers from 2016/2017 to 2023/2024. After 2024/2025 individual taxpayers were categorized into 3 hands i.e. individual, couple and family. From fiscal year 2024/2025 to 2035/2036, exemption limit was different for each category. But after 2036/2037 to till now, the exemption limit of couple and family is same. This shows that the exemption is given only for 2 categories i.e. individual and family or couple. Above the exemption limit of individual income, different sets of tax rates are charged for different slabs. The following table shows the rates for personal income tax in Nepal.

**Table 4.6**  
**Rates of personal Income Tax in Nepal**  
**(2032/2033 to 2063/2064)**

Fiscal	slabs (over exemption limit)							
	1	2	3	4	5	6	7	8
2032/033	5000.00,7%	5000.00,10%	10000.00,.20%	10000.00, 30%	10000.00, 40%	50000.00, 55%	Balance 60%	
2037/2038	5000.00,5%	5000.00,10%	10000.00,15%	20000.00,20%	20000.00,30%	30000.00,40%	Balance,50%	
2042/043	5000.00, 10%	5000.00, 15%	10000.00, 20%	15000.00,25%	15000.00,30%	30000.00,40%	200000.00,50%	Balance,55%
2047/048	10000.00,5%	15000.00,20%	20000.00,35%	25000.00,40%	30000.00,45%	Balance ,50%		
2052/053	40000.00,10%	25000.00,20%	Balance , 30%					
2057/058	75000.00,15%	Balance ,25%						
2058/059	75000.00,15%	Balance,25%						
2059/060	75000.00,15%	Balance, 25%						
2060/061	75000.00,15%	Balance ,25%						
2061/062	75000.00, 15%	Balance, 25%						
2062/063	75000.00,15%	Balance ,25%						
2063/064	75000.00,15%	Balance ,25%						

Source: Finance Act of Various Year

From the above table, it is clear that the rates for personal income tax in Nepal are different for slabs. In 2032/2033, the tax rate for personal income was 7 to 60 percent for different slabs. After 2032/2033, the slabs were increases to 8 in 2042/2043. But after 2042/2043, the number of slabs and rate of personal income tax decreasing till now. In 2063/2064, there was 15 percent rate of 75000 and 25 for balance.

Similarly, income tax is charged for partnership firms, corporation and non residents In the case of these, exemption limit is not given. Tax is charged on the income after deducting expenses. The rate and slabs approved for different years are given below:

**Table 4.7**  
**Tax Rates for partnership firm, corporation and non-residents**  
**(2032/2033 to 2063/2064)** **In rupees**

Fiscal year	slabs (over Exemption limit )							
	1	2	3	4	5	6	7	8
2032/033	10000.00 7%	10000.00 25%	10000.00 40%	50000.00 55%	Balance 60%			
2037/038	5000.00 5%	5000.00 10%	10000.00 15%	20000.00 20%	20000.0 0 30%	30000.0 0 40%	Balance 50%	
2042/043	5000.00 10%	5000.00 15%	10000.00 20%	15000.00 25%	15000.0 0 30%	30000.0 0 40%	200000.0 0 50%	Balance 55%
2047/048	10000.00 15%	15000.00 20%	20000.00 35%	25000.00 40%	30000.0 0 45%	Balance 50%		
2052/053	33% In total							
2057/058	a)30% b) 25%							

2058/059	a)30% b) 25%							
2059/060	a)30% b) 25%							
2060/061	a)30% b) 25%							
2061/062	a)30% b) 25%							
2062/063	a)30% b) 25% c) 20%							

Sources: Finance Act of Various Year, MOF, GON

\* a = bank finance, companies, financial

\* b= other partnership firms

\*c=special industry

The above table 4.7 shows that the income tax rates for partnership firms, corporation and non- resident were different for different slabs in the earlier year. But after 2052/2053, the rate and slabs is only one. There is shows the progressive tax in earlier year and flat in recent year. The income tax rate for 2032/2033 was 15 percent to 60 percent for 5 slabs. But in 2063/2064, the tax rate was only 30 percent for bank, finance companies and financial firms and 25 percent for other partnership firm s at a flat rate on taxable income.

## 4.2 Analyses of Exemption and Concessions

Income Tax Act 2031has been replaced by classified the income into three following heads:

- I. Business
- II. Employment and
- III. Investment

The act has defined the income heads as bellow:

**Business:** - Business means any industries, a trade, a profession, or the like isolated transaction with the business character and includes a past, present or prospective business.

**Employment:** - Employment includes a as, a present or prospective employment.

**Investment:** - investment means an act of holding or investing one or more assets of a similar nature that are used in an integrated fashion but excludes;

- I. Act of the holding of assets, other then non business chargeable assets, primarily for personal use by the person owning the assets or investing amount on such assets
- II. Employment or business:

For the calculation of net income of these three income heads, act has clearly mentioned the income or amount which is taxable and non-taxable and expenses, which are allowed for deduction and not allowed for deduction and not allowed for deduction. For the computation of incomes, act has made the following provisions:

#### **4.2.1 Income from Business**

Income Tax Act 2058, section 7, has clearly mentioned the income or amounts which are includable in computing the income form business they are

- I. A person's income from business for an income year is the person's profit and gains from conducting the business for the year.
- II. There should be included in calculating a person's profit and gains from conducting a business for an income year, the following amounts derived by the person during the year:
  - i. Service fee,
  - ii. Net gain from the disposal of the person's business assets or liabilities of the business,
  - iii. Amount derived from the disposal of trading stock,
  - iv. Amount of excess depreciation on the disposal of the person's depreciable assets of the business,
  - v. Gifts received by the person in respect of business.
  - vi. Amount derived as consideration for accepting a restriction an business operation,
  - vii. Amount derived that are effectively connected with the business and that would otherwise be included in calculating the persons income from an investment
  - viii. Other amount required to be included on tax accounting or qualification , allocation and characterization of amount or dealings between an entity and a beneficiary or general insurance business,

Non-includable amounts a profit of business. The following amount\ are excluded in calculating a persons profit and gain from conducting a business.

- a. Exempt amount under section 10,
- b. Taxation of dividends under section 54,
- c. Dividend distributed by a controlled foreign entity at the end of the year under section 69 and,

d. Final withholding payments

#### **4.2.2 Income from Employment**

Income Tax Act 2058, section 8, has clearly mentioned the incomes or amounts, which are includable upcoming income from employment. An individual's income from an employment for an income year is the individual's remuneration from the employment of the individual for the year. For the purpose of computing income from an employment, the following amounts reservedly he/she in respect of him/her any year of income shall be included

- I. Any ways, salary, leave pay, overtime pay. Fees, commission, prizes, gifts, bonuses, and other facilities.
- II. Any personal allowance, including any cost of living dearness, subsistence, rent, entertainment and transportation allowance.
- III. Any payment for reimbursement of cost incurred by the individual or an associate of the individual.
- IV. Any payment for the individual agreement to any conditions of the employment.
- V. Any payment for redundancy or loss or termination of the employment.
- VI. Retirement contributions, including those paid by the employer to a retirement fund in respect of the employee and retirement payments.
- VII. Other payment \s made ion respect of employment and,
- VIII. Other amounts includable on tax accounting or qualification, allocation and characterization of amount.

Non- includable amounts on employment income. The followings amounts are not includable in computing the not income from employment.

- i. Amount exempt under section 10 and final withholding payment,
- ii. Meal or deferments provided in premises operated by or on behalf of employers, employee that are available to all the employees or similar terms.
- iii. Any discharges or reimbursement costs incurred by the individual,
- iv. That services the proper business purposes of employer or
- v. That is\ would otherwise be deductible in calculating the individual's income from any business or investment.
- vi. Payment of prescribed small amounts, which are so small and thus unreasonable or administratively impractical to make accounting of them.

#### **4.2.3 Income from Investment**

Section 9 of Income Tax Act 2058, has defined the income from an investment for income tax purpose. For the purpose of computing income of any person from an investment for an income year is the person's profits and gains from conducting the investment for the year and there shall included:

- I. Any dividend, interest, natural resources payment, rent, royalty, gain from investment, insurance gain from an unapproved retirement fund, interest or retirement payment made by an approved retirement fund, gain received from non- approved retirement fund or retirement payment from approved retirement fund.
- II. Net gains from disposal of the person's non- business chargeable assists of investment,
- III. Excess amount of incoming over the deprecation basis including outgoings on the disposal of depreciable assets of the investment of the person.
- IV. Gifts received by the person in respect of investment,

- V. Retirement contributions, including those paid to a retirement fund in respect of the person and retirement payments in respect of investment,
- VI. Amount derived as consideration for accepting restriction on the capacity to conduct the investment,
- VII. Other amounts required to be included on tax accounting or qualification, allocation and characterizations of amounts or transaction between any entity and beneficiary or general insurance business.

In the above provision, act has included the amounts derived as consideration for accepting a restriction on the capacity to conduct the investment it is full to the investors who rest rived the compensation against the restriction. But it will not nr possible to implement , if the tax doesn't clarify the nature of restriction , cause of imposing restrictions, process of compensation computing any entity , which give compensation.

Non- includable amount in investment income:

- i. Exempt amount under section 10,
- ii. Taxation of dividend by under section 54,
- iii. Dividend distributed by controlled foreign entity at the end of the year under section 69 and final withholding payments and
- iv. Amounts those are included in calculating the person's income from any employment or business.

#### **4.2.4 Exemption from Income Tax**

Income Tax Act 2058, has mentioned the amount, which are exempt and under concessions. They are described in the following section,

- I. Exempt Amount:-  
The following amount is exempted from tax under section 10, Income Tax Act 2058:  
:-Amount derived by a person entitled to privileges under a bilateral or a multilateral treaty concluded between Nepal government and a foreign country or an international organization.
- II. Amount derived by an individual from employment in the public service of the government of foreign country provided that:
  - a. The individual's a resident person solely by reason of performing the employment or is non resident person and
  - b. The amounts are the payable from the public funds of the country.
- III. Amount derived from public fund of the foreign country by an individual who is not a citizen of Nepal as referred to in paragraph or by a member of the immediate family of the individual.
- IV. Amounts derived an individual who is not a resident of Nepal from employment by Nepal government on terms of the exemption,
- V. Allowance paid by Nepal government to widows, elder citizens or disable individuals.
- VI. Amount derived by the way of gift, request, inheritance, scholarship.
- VII. Amount derived by an exempt organization by way of:
  - a. Gift, donation,
  - b. Other contributions that directly related to the organization's function to in paragraph of the definition of exempt organization in section 2, whether or not the contribution provided by the organization.
  - c. Amount earned by Nepal Rastra Bank as its objectives.

## **I. Pension Received by Nepali Citizen Related from the Army or Police**

Service of a foreign country provided the amounts are payable from the public fund of the country.

In the above section, pension's amount received by Nepalese p-people being retired from the service by an army or police of foreign country is exempted from income tax; it restricts the objectives of raising more revenue of government because some of them receive more amount than exemption limit approved by the government.

Exempt organization means the following entities:

- i. A social religious, educational or charitable origination of public character registers without having profit motive
- ii. An amateur sporting association formed for the purpose of neither promoting social or neither sporting amenities nor involving the acquisition of gain.
- iii. A political party registered with the Election Commission.
- iv. A village development committee, municipality or district development committee.
- v. Nepal Rastra Bank.
- vi. Nepal government.
- vii. The prescribed entity that has been issued with a personal ruling under section 76 stating that it is an exempt organization.

Income Tax Act has mentioned the organizations which is tax free exempt organization. Act has exempted a social, religious , educational or charitable organization of a public character registered without having profit motive, in the case of

non-transparent private business like boarding schools ,NGO's or other entitles, where profit are earned, but for the sake of tax planning is called retained earning or something else . So they are tax free. It is not good symptom of tax administration.

## **II. Business Exemption and Concessions**

The following business exemption and concessions are mentioned is section 11 of income tax Act 2058.

- i. An agricultural income derived from sources in Nepal during an income year by a person other than the income from an agriculture business derived by a registered firm or partnership or a corporate body or through the land about holding ceiling as prescribed in the land Act 2021, is exempted from income tax.
- ii. Income derived by corporative societies, registered under corporate Act 2058, from business mainly based on agricultural and forest products such as sericulture and silk production, horticulture and fruit processing animal husbandry, tea gardening and processing, coffee farming and processing, herb culture processing , vegetable seeds processing , bee keeping, honey production rubber farming, floricultures and production forestry related business such as lease-hold forestry, agro forestry, cold storage of established for the store of vegetable and business of agriculture seeds, insecticide such as fertilizer and agriculture tools and rural community based saving and credit cooperatives are exempt from tax. Dividends distributed by such societies are also exempted from tax.
- iii. Income derived from sources in Nepal during an income year by a person from a special industry is taxed as follows:
  - a. In case, the industry provides direct employment to six hundred or more Nepalese citizens during the year, at 90 percent of rate are applicable to that income.

- b. In case, the industry is operated in a remote undeveloped or underdeveloped area at 70, 75 or 80percent respectively, of the rate is applicable for the period of 10 years commencing from and the year in which the operation commences.
- iv. A person who is entitled to concession under subsections I, ii, iii, shall calculated the income referred to in those subsections as though the income was the only derived by a separable person.
- v. Where a person qualifies for more than 1 concession under sub-section (b) I or II with respect to the same income, the person shall only be entitled to one concession with respect to that income but shall be entitled to select which concession applies.
- vi. Notwithstanding subsection (iii), where a person uses assets to conduct an activity of the type referred to in paragraph II of the subsection, then for the purpose of calculating the time limit under that subsection the time during which any other person pervious conducted a similar activity using substantially the same assets shall be counted.

Clarification for the purpose of this section

- i. Agriculture business means the business of producing crops from public or private land or deriving rent from a tenant using land.
- ii. Remote area, underdeveloped areas have the meaning in annex 3 of Industrial Enterprises Act 2049.
- iii. Special industry means a manufacturing industry as categorized in section III of the industrial Enterprises Act 2049.

Other than an industry producing cigarettes, bidi ,cigar, chewing tobacco, khaini or other goods of a similar using tobacco as the basic raw material or alcohol, beer or other goods of a similar nature.

In the above section, there is a provision of exemption of tax from any agricultural income other than income from an agriculture business derived by a firm, or company or partnership or corporate body or through the land above the holding ceiling as prescribed in land Act 2021. But the provision of taxing on agriculture business is not clear on itself. In the other hand, exclusion of agricultural income from the tax net alone cuts out about half of the GDP.

There are various provisions about exemption and concession some concessions granted to achieve certain objectives are not effective. Tax concessions encourage the establishment of industries in certain areas but they vanish or change names, ownership or place the business when the tax concessions period expires. In the other hand, the concessions or incentives period to special industries are non energetic. For this kind of concession, nobody will be encouraged to open the industry in remote area. For the purpose of industrial development of remote area a separate incentive should be provided. But the new act is also unable to do so.

### **III. Donation, Gifts to Exempt Organizations**

Section 12 of Income Tax Act 2058 has mentioned the provision of donation, gift to exemption. The provisions are:

- i. A person may claim to have their taxable income for an income year reduced by donation, gifts made by the person during the year to an exempt organization that are approved for the purpose of this section by the department.
- ii. Notwithstanding section (a), reduction allowed to a person under subsection (I) for an income year shall not exceed Rs. 100000 or 5 percent of the person's taxable income for the year calculated without a deduction for gifts referred to in subsection (a) and ignoring the limitation in 17 (2) and 18 (2) whichever is less.

- iii. Notwithstanding subsection (a) and (b), Nepal Government may prescribe, by a notification in the Nepal Gazette, as to allow full or partial deduction at the time of assessing a person's income of the expenses of gifts given by the person.

From the above provision (i) it is clear that the donation given to political parties is allowed for deduction. But it is not able to solve the voice of people of "Transparency of donation amount given by businessmen to political parties." Similarly in the above provision (iii), there is a provision of special purpose. But the act has not defined 'what is the special purpose.

#### **4.2.5. Deductions Allowed**

Chapter five of Income Tax Act, 2058 has provided the provisions relating to expenses which are allowed for deduction. Expenses which are allowed for deduction are discussed from 13 to 20 sections under chapter five. They are discusses or analyzed in the following section:

#### **I. General Deductions**

For the purpose of calculating a person's income from an income year from business or investment, there shall be deducted all actual costs to the extent incurred during the year, by the person and in the production of income from the business or investment.

## **II. Interest:-**

For the purpose of calculating the income of a person from an income year from a business or investment, there shall be deducted all interest incurred during the year by the person under a debt obligation was incurred in borrowing money, used during the year or was used to purchase an assets that is used during the year or in any other case the debt obligation was incurred.

But the total amount of interest that an exempt- controlled resident entity may deduct under the above case for an income year shall not exceed the sum of all the interest derived by the entity during the year that is to be include in calculating the entity's taxable income for the year, and 50 percent of the entity's taxable income for the year calculated without including any interest derived by the entity or deducting any interest by the entity. Any interest for which a deduction is denied as a result of above cause may be carried forward and treated as incurred during the next income year.

It is a wonderful step to businessman not to get the deduction of full amount of interest. It doesn't fulfil objective if industrial\ economy development. There is controversial condition between the law of banking and law of banking – interest must be paid to bank but according to the law of income tax there is a provision of not to get to deduction of full amount of interest for an income year.

## **I. Cost of Trading Stock**

For the purpose of calculating a person's income for an income year From any business, no deduction is otherwise allowed for the cost of trading stock except the allowance determined by subtracting the amount of closing value of trading stock of business from the opening value of trading stock plus the cost of trading stock of the business acquired by the person during the year.

The opening value of trading of business, no deduction of otherwise allowed for the cost of reading stock except the allowance determined by subtracting the amount if closing value of trading stock of the business from the opening value of trading stock of he business from the opening value of trading plus the cost of trading stock of the business acquired by the person during the year.

The opening value of trading stock of business for an income year is the closing value of trading stock of at the end of the previous income year. The closing value of trading stock of business is the lower value of the cost trading stock of the business at the end of the year or the business at the end of the year or the market value of trading stock of the business at the end of the year.

The cost of trading stock of the business at the end of the person is determined by using the prime–cost of absorption cost or ascription cost method in the case of a person accounting for tax purpose on a cash basis in calculating income of business and using the absorption cost method in the case of a person accounting for tax purpose on an accrual basis in calculating income of the business.

In the case where absorption – cost method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which the cost of trading stock is equal to the sum of direct material cost, direct labour cost and variable factory costs. In the case where the prime – cost method is followed as per the generally accepted accounting principle under which the cost of trading stock is equal to the sum of direct material costs and variable factory overhead costs.

Where trading stock of a person’s business is not readily identifiable, the person may elect that the cost of trading stock be determined according to the first – in – first out method and average cost method. Once chosen the method may only be changed with the written permission of the Department. In the case where average cost method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which the cost a particular type of trading stock is determined as the weighted average cost of all trading stock of that type and held by the business. In the case where first –In – First out method is followed, the cost of trading stock is determined as per the generally accepted accounting principle under which trading stock is disposed of in the order of its acquisition.

For the purpose of this section, “Direct labour costs” means labour costs directly related to the production of trading stock, “Direct material costs” means the cost of materials that are or become an integral part of the trading stock, “factory overhead costs” means the total cost incurred by the person in manufacturing trading stock except direct material costs and “variable manufacturing overhead costs” means these factory overhead costs that vary directly with volume of trading stock manufacture.

## **II. Repair and Important Costs**

For the purpose of calculating a persons income for an income year From any business or investment, there shall be deduction all costs to the extent incurred during the year in respect of the repair or improvement of depreciable assets owned and used by the person during the year in the production of the person income from the investment or business.

But the deduction allowed under the above case with respect to all depreciable aspects in a particular pool of depreciable assets of the person shall not exceed 5 percent of the depreciation basis of the pool at the end of the income – year and the deduction shall be allowed with respect to costs in the order in which they are incurred. Any excess cost, or part thereof, for which deduction is not allowed as a result of this limitation, shall be added to the depreciation basis of the pool to which it relates. The provision of adding any excess costs or part thereof to the depreciation basis amount is not contextual and lawful provision because it shows that the repair or improvement cost of depreciable assets has not got full approval. In the other hand the tendency of caring forward of this cost will in case the income tax revenue of government in some content but it will not bring the cordial relationship between the taxpayer and government.

## **III. Population Control Costs**

For the purpose of calculating a persons income for an income year from any business there shall be deducted population control costs to the extent incurred by the person during the year in conducting the business. But the deduction allowed to a person for an income year with respect to all business conducted by the person shall not excess 50 percent of the person's taxable income calculated without a deduction for population control costs. Any excess costs or part thereof, which deduction is not allowed shall be capitalized and may be depreciated.

For the purpose of this section, “population control costs” means costs incurred by a person with respect to a process or assets that seeks to control population or otherwise protect or sustain the environment. Government has a will of controlling population and then protection of environment but has not spent a little bit money on it. In the other hand, all the expenses made by the businessman to control population are not allowed for deduction and has made a standard limit for it so, it is not a good symptom of population control.

#### **IV. Research and Development Costs**

For the purpose of calculating a person’s income for an income Year from any business there shall be deducted research and developed costs to the extent incurred by the person during the business. But the deduction allowed to a person for an income year with respect to all business conducted by the person shall not exceed 50 percent of the person’s taxable income calculated without a deduction of research and development cost. Any excess, or part thereof, for which deduction is not allowed shall be capitalized and may be depreciated.

Research is an infrastructure of development. For successful industrial development, research and development is more important and must be extended on it. Expenses made on it must be approved and should be allowed for deduction for tax purpose. But the provision of income tax has not given full deduction on it. It is a myopic vision of government.

## V. Depreciation Allowance

For the purpose of calculating a person's income for an income year from any business or investment, there shall be deducted in respect of depreciation of depreciable assets owned and used by the person during the year in the production of the person's income from the business or investment.

But the following provisions shall be applied in respect of depreciation of the machine, equipment and other machinery installed in the electricity project \s that are involving in building power station, generating and transmitting electricity and in the project conducted by any entity as to build public infrastructure own operate and transfer to the Nepal government.

- I. In case where the old machine, equipment and other machinery that are already installed require replacement in any income year as they are out of order due to belong too old, the balancing value of the old machines, equipment and other machinery remained after cost shall be allowed as expenses for the year.
- II. At the time of transfer of other assets to Nepal Government expect of old assets replace in accordance with above paragraph, the balancing value if remained, after subtracting the depreciation up the year of the transfer from their cost shall be allowed as expenses.

Rates of depreciation are from reality because there is no specific estimation provision of real age of assets and depreciation rate in Nepal. In the other hand, there is no any specific provision of depreciation of assets which are taken in lease and instalment payment basis. It shows a weak point of new Income Tax Act.

## **VI. Losses from a Business or Investment**

For the purpose of calculating a person's income from an income year from any business or investment, there shall be deducted any unrelieved loss of the year incurred by the person from any other business and any unrelieved loss of the previous four income year incurred by the person from any business. In the case of electricity projects involving in building power station generating and transmitting electricity and the projects conducted by any entity so as to build public infrastructure, own, operate and transfer to Nepal government any unrelieved loss of the previous seven years shall be deducted.

For the purpose of calculating the income of a person for an income year from an investment, there shall be deducted any unrelieved loss of the year incurred by the person from any other investment. But a person may deduct an unrelieved loss with a foreign source only in calculating the person's foreign source income and an unrelieved loss incurred in deriving non-taxable income only in calculating the person's non – taxable income. Where a person incurs a loss or has an unrelieved loss available for carry forward under the above case during the income year in which a long term contract of a person's business is completed or otherwise disposed of by the person, that is attributable to the long term contract, the Department may, by notice in writing, allow to be carried back to a proceeding income year or years and treated as an unrelieved loss that year or year in an amount not exceeding the amount by which inclusion in calculating the income from the business to which the long term contract relates for that the business to which the long term contract relates for that year or year exceed deductions relating to the contract.

The following loss incurred by a person during an income year is attributable to long term contract or contracts of the person loss incurred from the long term contract or contracts relate to the business, and loss for each such contract that is incurred due to the deductions in calculating the income from the business for the year that relates to the contract exceed inclusion that relates to the contract exceed inclusion that relates to the contract. Where a person may deduct an unrelieved loss a calculating the person's income for an income year from more than on business or investment, the person may priorities in which calculations the loss or past of the loss is deducted.

Loss of an income year incurred by a person from deny business or investment is calculated as the excess of amount deducted in calculating the persons income from the business or investment over amount included in calculating such income ignoring the operation of this section.

Carry forward of losses for four years is not sufficient as compared to other countries. It is not sufficient to encourage there business for taking risk. The provision of carry forward is also thoughtful because the amounting system of Nepal is not so standard to apply this provision.

#### **4.2.6 Expenses not allowed for Deductions**

For the purpose of calculating the income of a person for an income Year from any business, employment; the following expenses are not allowed for deduction under section 21 of Income Tax Act 2058.

- i. Expenses of domestic or personal nature.
- ii. Income Tax

- iii. Expenses to a person in deriving amounts exempt under section 10 or final withholding payments,
- iv. Expenses for payment made by a person whose annual turnover for an income year exceeds Rs. 2000000 is not allowed a deduction for a cash payment in excess of Rs. 50000 incurred at once other than in specified conditions.
- v. Distribution of profit by an entity,
- vi. Expenses of a capital nature and
- vii. Foreign income tax, etc.

A person whose annual turnover for an income year exceeds Rs. 2000000 is not allowed for deduction for a case payment in excess of Rs. 50000 incurred at once other than in the following condition by the person during the year:-

- i. Payment is made to Nepal Government a contribution body, a corporation owned by Nepal government or a bank or financial institution,
- ii. Payment is made to a former or producer for producing primary agricultural products even in the case where the product is primarily processes by the former himself,
- iii. Payment is a retirement contribution or retirement payment
- iv. Payment is made in an area where booking services are not quail able,
- v. Payment is and must necessary be made in cash or on a day when banking cash or on a day when banking service are closed or.
- vi. Payment is made into a bank account of the payee, etc.

It means that the payment made with ignorance will not get full approval as expenses for the purpose of tax calculation these amounts should be added back.

Any other amount, to the extent to which deduction is not denied by the section 21, (i); (f) has not defined and clarified the amounts. These kinds of provision will provide a loophole for both tax administration and taxpayers.

#### Clarification

For the purpose of this section:

1. “expenses of a domestic or personal nature” means the following expenses:
  - a) expenses incurred for an individuals and the following expenses including interest incurred with respect to money borrowed to the extent to which is used for personal purpose:
    - ❖ expenses incurred in maintaining the individual, including in providing shelter as well as means, refreshment, entertainment or other leisure activities,
    - ❖ Expenses incurred with respect to the individual travelling, other than travelling in the course of conducting a business between the individual’s have or investment is conducted ,
    - ❖ Expenses incurred in acquiring clothing for the individual, other than clothing that is not suitable for wearing of work and
    - ❖ Expenses incurred in education and training provided that the deduction of the expenses incurred for education that is directly relevant to a business or investment conducted by the individual ad which doesn’t lead to a degree or diploma is allowed.
  - b) Where a person make a payment to an individual, expenses incurred in making the payment, including expenses incurred in favour of a third person except in and to the extent of the following conditions:
    - ❖ The payment is included in calculating the income of the individual,

- ❖ The individual makes a return payments of an equal market value to the person as consideration for the first mentioned payment or,
  - ❖ The payment of the prescribed small amounts, which are so small and thus unreasonable or administratively impracticable to make accounting for them
- I. “An area having banking services” means the area where there are no banking area facilities within the surrounding of 10 Kilometres.
  - II. “Cash Payment means a payment other than made through a bank or financial institution by way of letter of credit, cheque, draft money order, telegraph transfer, money transfer hundi, and other from of transfer made between two banks or financial institutions.
  - III. “expenses of a capital nature” means the following expenses:
    - a. Expenses incurred in respect of natural resource prospecting expiation and development,
    - b. Expenses incurred in the acquisition of an assets with a useful life exceeding 12 months or Expenses incurred on the disposal of a liability.

## **4.3 An Empirical Analysis**

### **4.3.1 Introduction**

An empirical investigation has been conducted in order to find out various aspects of income tax from the expense of the real world. The major tool used for this purpose is an opinion questionnaire, which was dispatched to 78 persons representing tax administration, tax experts were received. The questionnaire included the various aspect of income tax

concerning with provisions of exemption, deductions concessions and tax administration. The questionnaire either asked for a yes/no response or asked for ranking of choice according to number of alternatives where a first choice was most important and last choice was least important. Information received from respondents was tabulated into the separate format and they were expressed in percent of total number or points they analysed into descriptive way. The following table shows the group of respondents and code used to represent them.

**Table 4.8**  
**Group of Respondents and code used**

S.N.	Groups of Respondents and code used	Sample size	Code used
1	Tax experts	14	A
2	Tax administrative	25	B
3	Tax payers	25	C
	Total	64	

Sources: Opinion Survey

### 4.3.2 Soundness of Income Tax Administration of Nepal

In order to know the respondents opinion about the soundness of income tax administration of Nepal, a question was asked, “Do you consider that the income tax administration Nepal is sounded?” The responses received from the respondents are tabulated as follows:

**Table- 4.9**  
**Soundness Income tax Administration of Nepal**

Response Respondent	Yes		No		Total	
	No	%	No	%	NO	%
A	5	33.33	10	66.67	15	100

B	15	62.5	9	37.5	24	100
C	5	20	20	80	25	100
Total	25	39.06	39	60.94	64	100

Sources: Opinion Survey

The question received 100 percent response AS 39.06 percent of total respondents agree that the income tax administration of Nepal is sounds and 60.94 percent of total respondents do not agree about the soundness of income tax administration of Nepal. Most of the respondents of code A and C were disagreed about the soundness of income tax administration of Nepal. 37.5 percent of the administrations were the soundness of tax administration. From this, it can be concluded that the income tax administration of Nepal is unsound.

In order to know the causes of unsound income tax administration, the next question was asked, “If no, what are the causes, which are responsible for the creation of unsound tax administration?” The respondents were requested to rank their answer from 1 to 6. But most of the responses were received as a tick mark. For ranking purpose, the alternative, which got many more tick mark, was arranged as the most important

**Table.4.10**  
**Causes for the creation of unsound Income**

S. N.	Causes	Group			Total frequency	Percent	Rank
		A	B	C			
1	Defective Income Tax Act	1	2	2	5	8	6

2	Lack of public participation	3	5	5	13	20	3
3	Lack of trained employ	5	5	6	16	25	1
4	Faulty organization structure of Tax administration	2	3	3	8	13	4
5	Shortage of Income Tax expert / professional in Tax administration	2	5	8	15	23	2
6	Weakness in government's economic policy	2	4	1	7	11	5
	Total				64	100	

Sources: Opinion Survey

In the above table, percentage was calculated according to the total frequency obtained by each causes, for ranking purpose percentage of each causes was matched with each other and assigned first rank to the highest percentage. According to respondent's point of view, the main cause for the creation of unsound of unsound income tax administration of Nepal was ranked as follows:

- I. Lack of trained employees.
- II. Shortage of income tax exports/ professionals in tax administration.
- III. Lack of public participation.
- IV. Faculty organization structure of tax administration.
- V. Weakness in government's economic policy.
- VI. Defective Income tax Act.

Lack of public awareness, public tendency not to pay tax but get something from the state and difficulties of payment system of tax were some of the cause stated by the respondents. From the above in overall, it can be concluded that the main cause for the creation of unsound tax administration of Nepal is lack of trained employees in tax administration.

In separate view of each group of respondents, Group-A (tax experts) and group C (tax payers) was prioritized the lack of trained employee as the main cause of unsound income tax administration. Group C (tax payers) were prioritized the shortage of income tax experts/ professional in tax administration also. In the other hand, group B (tax administrator) was prioritized the lack of public participation as the main cause of unsound tax administration. In overall, most of the respondents of each class were agreed that the main causes of unsound tax administration are lack of trained employees, shortage of income tax expert/ professionals in tax administration and lack of public participation

### **4.3.3 Opinion on current Income Tax Rates**

In order to know the opinion on current income tax rates, respondents were requested to tick one among the three alternatives (High, medium, and low). The question was asked, “What is your opinion about the current income tax rate. The responses received are tabulated below:

**Table 4.11**

**Opinion on current Income Tax Rates**

S.N.	Tax Rate	Group			Total no	Percentage
		A	B	C		
1	High	3	2	14	19	29.69
2	Medium	7	15	6	28	43.75
3	Low	5	8	4	17	26.56
	Total				64	100

Source: opinion survey

Out of the cent percent response, 43.75 percent of the respondents were agreed that the current income tax rate is medium, 29.69 percentages of the respondents agreed on high and remaining respondents agreed on low tax rate. From the above tables, it can be concluded that the current income tax rate is medium. Some respondents feel that the rate is not higher in absolute terms but it is higher as compared to tax paying capacity of Nepali people.

**4.3.4 Sufficiency of Exempted Items of Income Tax**

Income Tax Act has provided exemptions to the various incomes. The exemption had provided to different items of income Act has pointed the exempt origination, which are tax free organization. To know the sufficiency of exempted items of

income, a question was asked, “Do you think that the exempted items of income is sufficient?” The responses were as follows:

**Table 4.12**  
**Sufficiency of Exempted Items of Income**

Respondent Response	Group			Total No	Percentage
	A	B	C		
Yes	4	20	10	34	53
No	10	5	15	30	47
Total				64	100

Sources: Opinion Survey

There was hundred percents response received from responses respondents. Out of sixty five respondents, 34 respondents (53 percent) were agreed that the exempted items of income are sufficient. But this was the causes of tax administrations because majority of tax administrator feel that they do not want to make bias against government.

As who gave negative response about the sufficiency of exempted items of income were asked a question, “if no, what kind of income should be exempted? The respondents were requested to write in the blank numbers. Most of the respondents

did not response about it. Only four responses of tax experts, ten responses of taxpayers and one response of tax administrator were received.

The responses were classified according to the code used in number wise.

A. Tax Experts

- I. Provident fund.
- II. Life insurance premium.
- III. Experts earning.
- IV. Remote area allowance.
- V. Interest received from government bank.
- VI. Scholarship.

B. Tax Administrators

- I. Life Insurance premium
- II. Citizenship Investment fund contribution.

C. Tax payers

- I. Overtime Allowance
- II. Retirement Benefit
- III. Income of foreign Employee.
- IV. Medical Allowance.

- V. Provident fund.
- VI. Employee's gratuity.
- VII. Life Insurance premium.

#### 4.3.5 Appropriateness of current Income Tax exemption limit.

Finance Act of Nepal nearly prescribes the tax rate and exemption limit of Income. From the very beginning of income tax, tax rate and exemption limit are changing year to year. To know the respondent's view about the current exemption limit, a question was asked, "Do you think that the current income tax exemption limit is appropriate?" The responses are as follow:

**Table 4.13**

**Appropriateness of current Income Tax Exemption Limit**

Respondent Response	Group			Total No	Percentage (approximately)
	A	B	C		
Yes	5	10		15	23
No	10	14	25	49	77
Total				64	100

Sources: Opinion Survey

From the above table it is clear that the current income tax exemption limit is not appropriate. 77 percent of the respondents were against the appropriateness of current exemption limit whereas only 23 percent of the respondents were for

the appropriateness of current exemption limit. Respondents who were against the appropriateness of the current exemption limit were asked. “If no, how much be the exemption limit should be for an individual unit?” The responses were as follows:

**Table 4.14**  
**Exemption limit for an Individual**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Rs 100000	5	10	7	22	38
Rs 150000	4	6	8	18	31
Rs 200000		5	2	7	12
Rs 250000	2		6	8	14
Other if any	1		2	3	5
Total				58	100

Sources: opinion survey

On the responses about the exemption limit of an Individual, it was found that the 38 percent of the respondents in favour of Rs. 100000. 31 percent of the respondents suggested that the exemption limit should be Rs. 1500000. 12 percent of the respondents suggested that the exemption limit should be Rs. 200,000. 14 percent of the respondents suggested that the exemption. Limit should be Rs. 2, 50,000. 5 percent who specified on other, if any was Rs. 300000. From the above table, it is clear that the exemption limit for an individual should be Rs. 100000. Similarly a question was raised on the topic of

exemption limit for a family as, “How much exemption limit should be for a family?” The responses were given in the following table 4.15.

**Table 4.15**  
**Exemption Limit for a Family**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Rs 100000	1	2	7	3	5
Rs 150000	6	10	5	21	34
Rs 200000	4	5	10	19	31
Rs 250000	3	5	7	15	25
Other if any			3	3	5
Total				61	100

Sources: Opinion Survey

From the above table it is clear that the most of the respondent, i.e. 34 percent suggested for Rs. 150000 as exemption limit for a family. 31 percent of the respondents were suggested for 200000. Similarly, 5 percent were for Rs. 100000. 3 respondents

who were specified as other (if any) was Rs. 300000. On the personal discussion with respondents, the researcher found that more people were in support to provide income tax exemption limit equivalent to annual remuneration income of a government employee section officer.

**4.3.6 Family Exemption Limit that must be provided according to the number of Dependents**

Income Tax Act has provided exemption limit to a family. But it is not mentioned the number of dependents about a family. So, to know the opinion about the exemption limit of a family according to the number of dependents, a question was asked” do you agree that family exemption must be provided according to the number of dependent?” The responses were.

**Table 4.16**  
**Family exemption limit on the basis of the number of Dependents**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Yes	5	9	17	31	48
No	10	16	7	33	52
Total				64	100

Source: Opinion Survey

The above table shows the response of respondents about the family exemption limit that must be provided according to the number of dependents. Out of the 100 percent responses, 48 percent of t respondents agreed that number of dependents. Majority of respondents of group A and B were disagreed but group C was agreed on providing the family exemption; limit according to the number of dependents. On the personal discussion with the respondents, the researcher found that respondents

were in support to provide exemption limit to a family according to the number of dependents but it is difficult to execute because it is impossible practically.

Similarly, one question was asked, “Do you feel that exemption limit sound be adjusted according to the inflationary situation of the country?” The responses were:

**Table 4.17**  
**Situation limit according to the inflationary situation of the country**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Yes	15	29	25	59	92
No		5		5	8
Total				64	100

Source: Opinion Survey

The above table shows that 92 percent of the respondents were agreed to adjust the exemption limit according to the inflationary situation of the country. So, it can be conducted that the exemption limit of a family or an individual should be adjusted according to the inflationary situation of the country.

#### 4.3.7. Opinion on providing Exemption on Agricultural Income.

From the commencement of Income Tax Act agricultural income has been treated as taxable income in sometime and exempted income in sometime. The new Income Tax Act has exempted agricultural income tax other than the income from, or through the land above the holding ceiling a prescribed in land Act 2058. To know the opinion on it one question was asked, “What is your opinion on providing exemption on agricultural income?” The responses were:

**Table 4.18**  
**Exemption on agriculture Income**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Yes it should be exempted	7	6	14	27	42
No.	3	10	3	16	25
No it should be treated as their income Other specify	1	5	2	8	13
	4	4	5	13	20
Total				64	100

Source: Opinion Survey

On the question asked, 42 percent of the respondents were in support to exempt the agricultural income where as 25 percent of the respondents were against the exemption of agricultural income. Only 13 percent of the respondents were in

support to treat it as other income. The respondents who specified their responses as other were give the following suggestions:

- ❖ Based on subsistence farmer and commercial farming, for the first, it should be exempted.
- ❖ A practical arrangement for taxing agriculture should be formulated, for example, based on he size of land holding
- ❖ Commercial agricultural income should be taxed as other income.
- ❖ It should be added on their income.

On the personal discussion either the respondents some of the dependent s said that it is impossible or difficult on taxing agricultural income because there is a condition of not collecting land tax or revenue. On the condition, how can collect the agricultural income tax?

#### **4.3.8 Attitude Towards the Itemized Deduction**

Income tax Act 2058 has provided different kinds of expenses as deduction as standard deduction. In order to know the attitude towards the item-wise deduction of expenses, the following two questions were asked.

- i. Do you suggest for itemized deduction in income tax?
- ii. So you think that itemized deductions are sufficient?

The responses to these above questions are tabulated

**Table 4.19**  
**Suggest for Itemized Deduction**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Yes	10	11	15	36	56
No	4	14	10	28	44
Total				64	100

Sources: Opinion Survey

**Table 4.20**  
**Sufficiency for Itemized Deduction**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Yes	5	18	8	31	48
No	9	7	17	33	52
Total				64	100

Sources: Opinion survey

There was cent percent response received on first question from the respondent. Majority of the respondents were suggested for item- wise deduction of expenses. Expert tax administrators., majority of tax experts and tax payers were in favour of item –wise deduction of expenses from the above table, it an be concluded that the expenses should be deducted in item- wise from the point of view of respondents. Similarly; there was cent percent response received of second question from the respondents. The above second table shows that 44 percent of the total respondents were agreed on insufficiency of

itemized deduction or there was not sufficient deduction of item- wise deduction. Majority of the respondents of group A (tax experts) and group C (tax payers) were against the sufficiency of itemized deduction of expenses were as majority of the respondents of group B (tax administrations) were in favour of sufficiency of itemized deduction of expenses. From the above table, it can conclude that there was insufficiency of itemized deduction.

#### **4.3.9 Prioritization of Expenses for Deduction**

To know the respondents view about the priority of expenses for deduction, a question was asked “In your opinion what kind of expenses should be prioritized for deduction? The responders were requested to response in blank area. Most of the respondents did not response on this question, only 12 respondents of Group A. 21 respondents of Group B and 20 respondents of Group C were responded on it. The responses of each Group have been shown in the following table.

**Table-4.21**  
**Prioritization of Expenses for Deduction**  
**Group-A (Tax Experts)**

S.N	Response	No of respondents
1.	All expenses Relating income earning	5
2.	Cost of Trading stock life insurance premium Interest on loan Deprecation Repair & maintenance	4
3.	Medical Expenses donation	1
4.	Purchasing of Newspaper Paying of life insurance premium fixed percentage of salary for Travelling Expenses paying of fees of students	2

**Group-B (Administrator)**

S.N	Response	No of respondents
1.	All Expenses Relating to taxable income	10
2.	Cost of good sold Rent ,Salary Depreciation	7
3.	Cost of trading stock Repairs, maintenance & improvement	2

	Interest on loan Research & development deprecation	
4.	Life insurance premium Expenses Interest on Retirement Payment	1
5.	Deprecation Staff overhead Maintenance Advertisement Transportation	1

**Group-C (Tax Payers)**

S.N	Response	No of respondents
1.	All Expenses Relating to taxable income	3
2.	Medical Expenses Travelling Expenses	4
3.	Expenses of fund Expenses of Health Expenses of house Rent Expenses of clothes	2
4.	Insurance premium Expenses of education upto +2 Expenses of Entertainment	2
5.	Machinery Expenses Salary	1
6.	Tax on Bank Interest	1
7.	Capital losses entertainment Donation	2

8.	Staff expenses Business Premium Expenses Subsidy Production losses	3
9.	Insurance premium Medical Expenses	1
10.	Tax on life Insurance premium	1

Source: - Opinion Survey

From the above listing, most of the respondents responded to priorities the expenses, which are related with taxable income that may be business expenses or employment expenses. Majority of the respondents were employee, so they were suggested to priorities the expenses, which are related to employment income. Businessmen or investor were suggested to prioritise their in come earning expenses. The respondents who did not gave the response, were agreed to priorities the expenses which are expended on income earning that may be business or investment or employment. It was the response of personal discussion with respondents. So it can be concluded that the expenses, which are related to taxable income, should be prioritized for deduction. Related with the above question, one more question was asked as, “What is the need for deduction these expenses?” Respondents given full options for writing the responses in their own words only 1 tax expert, 6 tax administrators and 4 taxpayers give the responses. These responses are listed in the following section.

**Table- 4.22**  
**Need of Deduction Expenses**  
**Group-A (Tax Experts)**

S.N.	Response	No. of Respondents.
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1.	To calculate the Taxable Income To verify the position of the entity	1
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**Group B (Tax Administration)**

S.N.	Response	No. of Respondents.
1.	To calculate the real Net income	1
2.	To calculate the Taxable income	2
3.	To verify the position of the entity To analyse various matters.	2
4.	For Invoices & Document	1

**Group C (Tax payers)**

S.N.	Response	No. of Respondents.
1.	To calculate the Tax liabilities Income	1
2.	To maintain relating with the supplies & Government To take the Actual Expenses To maintain & good relation between government & supplies.	1
3.	Because per capita income of	1
4.	Because of wear & Tear of machinery & tools. Because of brand of Debt	1

Source: - Opinion Survey

From the above listing, it can be concluded that the need for deduct the expenses were: to calculate tax liabilities s, evidence & accuracy, to identify profit & loss, being very low capita income of Nepalese people. One respondent of Group C (in S.N.4) has given the deducting depreciation, bad debt and entertainment expenses.

**4.3.10 Knowledge about the Present Depreciation System**

Income Tax Act 2058 has classified the assets into five classes and approved different rates to each class for depreciation purpose. The whole legal provisions relating to depreciation is given in the section of legal provisions relating to deduction allowed in former chapter. To know the opinion or knowledge of respondents, a question was asked, “Do you know about the present Depreciation system on Income Tax Act?” the responses about it were given in the following table:

**Table 4.23  
Knowledge about the Present Depreciation System**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Yes	10	20	14	44	69
No	5	5	10	20	31
Total				64	100

Source: - Opinion Survey

Out of the total respondents, 69 percent of the total respondent were familiar with present depreciation system of income tax whereas only 31 percent depreciation system. So it can be concluded that majority of the respondent were familiar

with present depreciation system. On personal discussion, one respondent had criticized the classification of assets. He said that. There is no specific and scientific pool of assets. He had favoured the former deprecation system rather than present deprecation system.

#### **4.3.11 Problems and Weakness of Nepalese Income Tax system**

In Income tax system of Nepal has been blamed that it is not efficient enough.

To know the cause of problems and weakness of Nepalese Income tax system, a question was asked, “What are the major problems and weakness in Nepalese income tax system?” The respondents were requested to rank their answer from 1 to 9. But most of the respondents were ticked tick mark. For ranking purpose, the alternative, which got many more tick mark, was arranged most important and ranked as first.

**Table 4.24**  
**Problems and Weakness of Nepalese Income Tax system**

S.N	Problems and weakness	Group			Total No	Percentage Approx	Rank
		A	B	C			
1.	Voluntary compliance	6	15	9	30	13	4
2.	Relatively high tax rate	4	5	7	16	7	8
3.	Difficult to maintain the account for Tax purpose	5	8	7	20	9	7
4.	Limited tax base	7	14	1	22	10	6
5.	Ambiguous provisions under the Nepalese income tax law	7	9	7	23	10	5
6.	Lack of cooperation in tax Administration	9	10	15	34	15	2
7.	Lack of trained Employees	9	16	12	37	16	1
8.	Lack of Timely adjustment	5	9	13	30	13	3
	Total			225	100		

Sources: Opinion Survey

The major problems and weakness of the Nepalese income tax system of Nepal were ranked in order of reference of the respondents as follows;

- i. Lack of trained employee
- ii. Lack of cooperation in tax administration
- iii. Limited tax base
- iv. Difficult to maintain the account for tax purpose
- v. Relatively high tax rate
- vi. Increased corruption
- vii. Voluntary compliance
- viii. Lack of timely adjustment of tax laws

The other problems stated by the respondents were as follows;

- i. Lack of motivation
- ii. lack of motivation
- iii. Tax evasion which comes into voluntary compliance.

From the view of respondents of each group, Group A, (tax experts) and Group C (Tax payers) had ranked first rank to lack of cooperation in tax administration as the major problems and the lack of trained employees as the major problems and weakness of Nepalese income tax system. In overall all the respondents were agreed on the tax administration as the cause of problems weakness of Nepalese income tax system. After the unsound tax administration, they were agreed on voluntary compliance and increased corruption as the problems and weakness of income tax system.

In the personal discussion with respondents, most of the taxpayer said that increased corruption is the major problems and weakness of Nepalese income tax system, one respondent gave the example of increased corruption of his industry. From the above ranking in overall, it can be concluded that the major problems and weakness of Nepalese income tax system are lack of trained employees, lack of cooperation in tax administration, voluntary compliance and increased corruption.

#### **4.3.12 Sufficient of Provisions made under the Nepalese Income Tax Act.**

In order to know the sufficiency of provision made under the Nepalese income Tax Act, respondents were requesting to tick between two (yes\No) alternatives. The question was, “in your opinion, are the provisions made under the Nepalese Income Tax Act sufficient in all aspect? The responses were received are as follows:

**Table 4.25**  
**Sufficient of Provisions made Under the Nepalese Income Tax Act.**

Respondent Response	Group			Total No	Percentage Approx
	A	B	C		
Yes	6	16	5	27	42
No	9	8	20	37	58
Total				64	100

Sources: -Opinion Survey

Since 42 percent of the respondents were agreed the sufficient of provisions made under the Nepalese Income Tax Act, but 58 percent of the total respondents were against the sufficiency of provisions from the above table 4.25, it can be concluded that majority of the respondents were against the sufficiency.

**Finding of Empirical Investigation:**

- i. Income tax administration of Nepal is considered as unsound main causes of unsound income tax administration are lack of trained employees, shortage of income tax expert/ professionals in tax administration and lack of public participation.
- ii. Income tax rates of Nepal are considered as medium. Most of the tax experts and tax administration were agreed that the income tax rates are medium whereas most of the taxpayers were agreed on high income rate.

- iii. Exempted items income in Nepal is sufficient.
- iv. Current exemption limit is not appropriate according to the income most of the respondents were suggested to provide Rs. 10,000 and Rs. 150,000 as exemption limit for individual and a family respectively.
- v. Family exemption limit must be provided according to the number of dependents.
- vi. Agriculture income should be exemption from income tax.
- vii. Exemption limit should be adjusted according to the inflationary situation of the country
- viii. Average respondents were suggested for itemized deduction and average respondents were agreed on that there is sufficiency of itemized deduction.
- ix. All expenses, which are related to earning income, must be prioritized for deduction.
- x. Most of the respondents were familiar with the present depreciation system.
- xi. Main problems and weakness of Nepal income tax system are lack of trained employees lack of cooperation in tax administration,
- xii. Are not sufficient in all respects. Improvement is needed in language, law tax administration exemption limit, depreciation etc.

## **CHAPTER -V**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

On the basis of preceding chapters some important finding are drown. The Major findings of this research are summarized below:

- i. Government revenue is the compotation of external revenue and internal revenue. Internal revenue includes both tax and non tax revenue. There is dominant share of total tax revenue in Nepalese government revenue. But the contribution of total tax revenue shows the decreasing trend as it had contributed 81.73 percent in 2032/2033 on total revenue but it was decreased to 81.14 percent in 2063/2064.
- ii. Nepalese total tax revenue is the composition of total direct and total indirect tax revenue. There is dominant role of total indirect tax revenue in Nepalese total indirect tax revenue were 19.01 percent and 80.99 percent respectively in 2050/2051, which become 27.67 percent and 73.33 percent in 2063/2064
- iii. Income tax has been considered as major sources for the collection of government revenue and mobilizing internal resources. It may enhance the revenue of government, permute distributive justice and encourage private sector investment.
- iv. Within the income tax, there is the dominant role of corporate income tax, there is the dominant role of corporate income tax but it is in decreasing trend, which was 59.96 percent of income tax revenue in 2054/2055 and increased to

68.98 of income tax revenue in 2060/2061. The contribution of individual income tax is second position and it is in increasing trend.

- v. In Nepal, the coverage of income tax is very low agricultural income is exempted from income tax. Exclusion of agricultural income from the tax net alone cuts out about half of the GDP. In other hand, labour tax is taxed more having than the capital income. Retirement amount received by army or police of foreign country is also exempted from income tax. Exemption of these sources provided loopholes for tax evasion.
- vi. Some exemptions granted to achieve certain objectives are not effective. Tax incentives are one of the examples of this. Tax concessions encourage the establishment of industries in certain area but they vanish or change names, ownership or place the business when the tax concession facility expires.
- vii. For the purpose of calculating the income of person for an income year from a business or investment all the interest are allowed for deduction. But in the cash of an exempt controlled resident entity, it may deduct the amount of interest but not exceeding the sum of the interest derived by the entity during the year that is to be included in calculating the entity's taxable income for the year, and 50 percent of the entity's taxable income for the year calculated without including any interest derived by the entity or deducting any interest by the entity. It is an unlawful step to business not to get the deduction of full amount of interest. Here a controversial condition exists between the law of banking and law of income tax does not given the deduction of full amount of interest for an income year.
- viii. For the purpose of calculating a person's income for an income year from any business, no deduction is otherwise allowed for the cost of trading stock of the business from the opening value of trading stock plus the cost of trading of the business acquired by the person during the year.

ix. For the purpose of calculating the income of a person for an income year from any business, employment or investment, the following expenses are not allowed for deduction:

- ❖ Expenses of domestic or personal nature,
- ❖ Income tax,
- ❖ Expenses made on deriving amount exempt under section 10 or final withholding payments.
- ❖ Distribution of profit by an entity,
- ❖ Expenses of capital nature,
- ❖ Foreign income tax and any other amount,
- ❖ Any other amount to the extent to which a deduction is not denied by the above paragraph, has not defined and clarified the amounts.

This kind of provisions will provided loopholes for tax administration and tax payers. A person whose annual turnover for an income year. Exceeds Rs. 20, 00,000 is not allowed a deduction for a cash payment is excess of Rs. 50000 incurred at once other than in the following condition by the person during the year:

- ❖ Payment made to Nepal government,
- ❖ A contribution owned by Nepal government
- ❖ A bank or financial institution,
- ❖ A farmer or a producer producing primary agricultural products even in the cash where the product is primarily process by the farmer himself,
- ❖ A retirement contribution or retirement payment,
- ❖ In an area where banking services are not available,

- ❖ In cash or a day when banking services are closed of into a bank account of the payee. It means that the payment made with ignorance will not get full approval as expenses
  - ❖ For the purpose of tax calculation these amount should be added back.
- x. Income tax administration of Nepal is not sufficient enough due to various causes. Major causes are:
- ❖ Lack of trained employees
  - ❖ Shortage of income tax experts/ professional in tax administration,
  - ❖ Lack of participants,
  - ❖ Fully organizational structure of tax administration,
  - ❖ Weakness in government economic policy,
  - ❖ Defective income tax act. Etc
- .
- xi. Income tax system of Nepal is suffering from various problems and weakness such as:
- ❖ Lack of trained employee,
  - ❖ Lack of cooperation in tax administration,
  - ❖ Increased corruption,
  - ❖ Voluntary compliance,
  - ❖ Ambiguous provisions under the Nepalese income Tax Laws,
  - ❖ Limited tax base,
  - ❖ Different to maintain the account for tax purpose,
  - ❖ Relatively high tax rate,

- ❖ Lack of timely adjustment of tax laws etc.
- xii. An opinion survey has been conducted in order to find out the various aspects of income order to find out the various aspects of income tax. From the opinion survey of various respondents, the following conclusions have been drawn;
- ❖ Income tax administration of Nepal is considered as unsound. Main causes of unsound income tax administration are:
    - a) Lack of trained employees,
    - b) Shortage of income tax expert/professional in income tax administration and
    - c) Lack of public participation.
  - ❖ Income tax rates of Nepal are considered a medium,
  - ❖ Exempted items of income are sufficient,
  - ❖ Current exemption limits of an individual and family are not sufficient and appropriate,
  - ❖ Family exemption limit must be provided according to the inflationary situation of the country.
  - ❖ Agricultural income should be exempted from income tax,
  - ❖ Half of the respondents were suggested for itemized deduction and were agreed for sufficiency of itemized deduction.
  - ❖ All the expenses, which are related to earn income, must be prioritized for deduction.
  - ❖ Most of the respondents were familiar with present depreciation system.
  - ❖ Lack of trained employees, lack of cooperation in tax administration, voluntary compliance and increase corruption are the major problems and weakness of Nepalese income tax system.

- ❖ Provisions made under the Nepalese income tax are not sufficient in all respects. Improvement is needed in language, laws, tax administration, exemption limit etc.

## **5.2. Conclusions**

Developing countries like Nepal are facing serious problems in the process of economic development lack of sufficient financial resources is the main constraint for economic development of Nepal. A list of funds is required to meet the objectives of economic development. But Nepal is not being able to collect necessary fund. Due to poor performance on internal revenue (fund) collection and mobilization, Nepal has been heavily relying on foreign loans and grants. The dependence is increasing which is not desirable for only economy. Thus, it is more essential to mobilize the internal fund to the optimum level.

To increase the government revenue, Nepalese is trying to extract money from people through taxation. Within tax, income tax is the most important sources of government revenue. It is considered as good remedy to cure growing resources gap problem in Nepal. In Nepal the history of income tax is not so long, it is started only on late fifties. The income tax was introduced as a trial on business profit and the remuneration income. The first elected government levied the first income tax act was made only in 2016/2017 since than four income tax act has been implemented. From the very beginning the concepts of exemptions, deductions and other forms of the relief in income tax have changed in Nepal. All incomes of an individual can not be taxable because the minimum cost required for subsistence can not be trained. The exemptions, deductions and other forms of tax relief are essential to encourage an individual to work more. The tax relief works as an incentive to an individual. So the concept of deductions, exemption concession and tax reliefs were emerged in Nepal from the very beginning of Income tax. Currently, income tax system of Nepal encompasses four taxes, i.e. corporate income tax, individual income

tax, house rent tax and interest tax. Among them, contribution of corporate sector is highest. Exemptions limit and the rate of the income tax is determined according to the income level and sector wise but it is not adjusted according to the inflationary situation of the country and number of dependents.

Income tax system of Nepal has been blamed as not efficient enough. Being various problems relating to income tax, revenue collection from income tax is low as compared to other developing countries like India, Sri Lanka, Pakistan etc. nevertheless, if we analyzed the data relating to it we can find out that it is neither bad nor worse but it is continuously improving. However, income tax law and administration in Nepal are to be deeply scrutinized and properly implemented. The provisions made on act have to be maintained clearly and language has to be made clear. Some reforms in tax administration are needed. If the problems relating to income tax system in Nepal can be solved and resources are effectively utilized then only the prospects of revenue collection from income tax will be bright and the economic development of Nepal will be achieved.

### **5.3 Recommendation**

There are various problems regarding to income tax of Nepal. The major problems of Nepalese income tax system consists problems relating to income tax policies, income tax laws and income tax administration. The major problems observed in present days are the problems of efficient tax administration. In the opinion survey it was noticed that all

respondents were dissatisfied with the tax administration. The study did not look heavily into the problems that are not related to exemption, deduction and concession. So, the recommendation made for other than the deductions exemptions and concessions may be considered as the general recommendations. Here, research of this study has made the following recommendations on tax deductions, exemptions and concessions:

### **Exemptions and Concessions:**

- I. To increase the income tax revenue, the present tax base must be widened by including the income from agriculture sector; retirement amount received by Nepalese people being retired from the services by army or exempted other sources of Income.
- II. In the agricultural income, there must be some exemption limit and the income above this limit must be taxed.
- III. The present level of income tax exemption is a minimum of Rs. 100000 against Rs. 85000 for an individual. The recommendation is based on the assumption that the remuneration income institution must not be taxed.
- IV. The present provision of family exemption is not appropriate and fair. The government has to provide the family tax exemption in such a way that would consider the number of family members. It should be raised to a minimum of two dependents children and the dependent parents.
- V. The exemption limit must be adjusted according to the inflationary situation of the country on yearly basis.
- VI. There are many provisions relating tax exemptions and concessions. Some concessions granted to achieve certain objectives are not effective. Tax concessions encourage the establishment of industries in certain area but they vanish or change names, ownership or place the business when the concession facilities expire. The incentives provided to special industries are not emergent for this kind of concession, nobody will be encouraged to open the

industries in remote area. So, the provisions of investments allowances in the form of accelerated depreciation should be introduced, the investment allowances should be introduced be 25 percent per annum of the depreciable capital assets on straight line basis. Similarly, for the purpose of industrial development of remote area, a separate special package should be introduced.

- VII. 10 percent of tax rebate should be provided to the taxpayer s who submits true income statement within the specified period of time.
- VIII. Income tax on total export amount is not appropriate because income tax must be based in income not the total amount is not appropriate because income tax must be based in income not the total amount. So, the provision of taxing on export income should be introduced. Similarly, expert fee on expert transaction must be eliminated or exempted
- IX. Double taxation on divided must be eliminated Income Tax Act has mentioned the origination, which ate tax free. Act has exempted a social, religious educational or charitable organization of a public character registered without having profit motive. In the case of non transparent private business like boarding school, NGO's or other entities, where profits are earned but for ht sake of tax planning, is called retained or something else,. So, they should be taken into tax net.
- X. Retirement contribution are nothing else than the product of sacrifice of present earning. They are the base for living standard of oldness of employees. So, they should be excluded from income tax.
- XI. Dearness allowance is given to meet the living standard of employees, it is not lawful to include in taxable income. So, it should be fully exempted from income tax.
- XII. The provision of special fee must be eliminated.

## **Deduction**

- I. Donation given to political parties registered with the election commission is allowed for deduction. But it is not able to solve to voice of people of “transparency of donation amount given by businessmen to political parties” so , donation amount given to political parties must be transparent
- II. Deductions allowed from an employee income are not sufficient. So, the following deductions should be provided to the taxpayer whose sources of incomes is only the remuneration
  - a) Expense for better education of their children
  - b) Medical expenses made by taxpayer
  - c) Expenses made for house rent
  - d) Educational expenses for taxpayers himself if he is still studying in an educational institution
  - e) Life insurance premium of taxpayer
- III. Clear provisions should be made in the case of education. All the items of deductions should be clearly defined in the act
- IV. Deduction allowed from business or investment income is not sufficient. So, the following deduction should be provided to the taxpayer whose source of income is business or investment.
  - a. In the case of exempt controlled resident entity, full deduction of interest expenses is not allowed. It is not lawful step to the businessmen who operate the business with loan/debt amount. So, it should be fully allowed for deduction within an income year.

- b. The provision of adding any excess cost or part these of repair and improvement costs to the depreciation basis amount is not contextual and ;awful provision because it shows that the repair or improvement cost of a depreciable assets has not get full approval of deduction. So it should be fully allowed for deduction within an income year.
- c. To control pollution and then protection of environment research and development is more essential and development is more essential and most be expended on it, expenses made on it must be approval and should be fully allowed for deduction within an income year. Government should not make standard limit on it
- d. There should be specific provisions of depreciation of assets, which are taken a lease and instalment basis, Act should not silent on it provisions made on depreciation allowances must be generally understandable by all people.
- e. Carry forward of loss for four year is not sufficient as compared to other countries. So, it must be extended up to five or six years. The provision of carry forward of losses should be considered because the accounting system of Nepal is not so standard to apply his provision.

Besides these suggestions, the following suggestions are made to compensate the loss of revenue due to the provision of additional exemptions and deductions suggested by the researchers.

- a. The income tax policy should be formulated so as to match with the economic policy of the country.
- b. The members involved in formulating income tax policies must have deep knowledge about income tax.
- c. Timely revision and adjustment should be mad e in the matter of income tax policy.
- d. Income tax policy should be formulated so as to satisfy the following criteria
  - It should be progressive ensure social justices
  - It most be consistence with tax administration capacity,
  - It should not militate against natural properties and efficient resource use.

- e The success of effectiveness of any system entirely depends upon Implementation provisions, which is the major responsibility of administration in Nepal; one of the most important reasons unsound income tax system is efficient and unscientific income tax administration. Following suggestions are made for the improvement of income tax administration in Nepal:
- All the tax personal should be given comprehensive training on various aspects of taxation on regular base, for this, a separate training section within tax department should be established.
  - The performance, responsibilities, authorities and duties should be clearly defined.
  - Financial benefited and extra incentives should be provided to the personal to decrease corruption.
  - Effective forward and punishment system should be established.
  - Working environment of ht tax offices should be improved; vehicle and necessary machinery should be provided.
  - The administration should try to increase effective public participation to minimize the income tax evasion.
  - Income tax experts/ profession should be increase in tax administration.
  - Coordination between staff and departments must be established.
  - Delays in assessment should be reduced as soon as possible.
  - Fair and scientific provision of promotion and career development should be introduced.
  - The cost of collection is one of the departments of administrative efficiency. So, the concerned authority should pay the attention on it.
  - An integrated information system should be developed to prepare the list of potential taxpayers and gather information of various aspects relating to income tax.
  - The system of recording by computer should be developed in income tax administration.
  - Tax deduction should be provided to tax payers on regular basis.

- f. Laws relating to income tax should be clear, simple and comprehensive. It should not contain any loopholes and ambiguity; therefore it should be reviewed frequently and reformed. The following suggestions made for the reformation of existing tax laws in Nepal.
- The language should be simple and clear. In spite of using of vague meaningful words, clear cut provision should be made.
  - The definition made in Income Tax Act should be further clarified and well defined.
  - The assessment and tax collection provisions should be made clear and simple.
  - The provision of fines, penalties and punishment should be made at higher rate for income tax evaders.
  - The assessment of time limit after the submission of income statement should be reduced.
  - Discretion power of the tax officers must be curtailed and their rights and duties should be clarified in Income tax Act.
- i. The reward, prizes, incentives provisions should be introduced in the act to encourage the taxpayer to pay the tax voluntary rather than coercive measures.
  - ii. Clear provisions should be made in the case of deduction. All the items of deductions should be clearly defined in the act.
  - iii. Special provisions should be made in the act for research and development.

**APPENDIX I**  
**Master Table**  
**Total Revenue, Revenue from Direct and Indirect Taxes and Individual Taxes**

**Rs. in million**

Year	Total GDP	Total Revenue	Tax Revenue	Non Tax Revenue	Direct Tax					Indirect Tax									
					Income Tax	Land Tax	House & Land Reg.	Others	Total	Import Duties	Export Duties	Excise Duties	Sales Tax/ Vat	Entertainment Tax	Hotel Tax	Contract Tax	Air Flight Tax	Other	Total
052/053	239388.0	27893.0	21668.0	6225.0	3431.4	18.2	1048.4	87.0	4550.0	6247.0	149.9	1944.3	6431.0	100.4	284.2	613.1	311.1	1002.0	17083.0
053/054	269570.0	30374.9	24425.2	5949.7	4123.3	5.9	1009.5	95.3	5234.0	7093.0	167.8	2298.1	7127.0	114.0	301.1	621.3	314.4	1154.5	19191.2
054/055	289798.0	32938.2	25940.0	6998.2	4898.1	3.6	1000.6	110.7	6013.0	7019.0	217.1	2885.8	7123.0	90.6	45.8	761.6	343.4	1440.7	19927.0
055/056	330918.0	37247.1	28753.0	8494.1	6170.0	1.4	1001.8	123.8	7297.0	7698.0	378.0	2953.2	7882.0	23.5	1.5	618.7	210.7	1690.4	21456.0
056/057	366251.0	42903.6	33162.0	9741.6	7420.6	4.6	1011.3	118.5	8555.0	8960.0	432.5	3137.6	9882.0	11.5	1.8	374.5	0.5	1806.6	24607.0
057/058	394052.0	48889.6	38860.8	10028.8	9110.0	4.6	607.8	436.5	10159.4	10391.9	492.6	3770.0	12042.8	30.4	0.1	304.0	0.8	1668.8	28701.4
058/059	406138.0	50990.6	39875.6	11115.0	8903.6	5.1	1121.3	574.1	101599.6	11508.4	1150.5	3807.7	11947.9	2.0	0.005	300.5	-	559.6	29276.6
059/060	437545.8	56229.7	42587.0	13642.7	8132.2	-	1414.2	559.4	10105.8	10567.70	855.2	4777.5	13467.3	-	-	-	-	2813.5	32481.2
060/061	474918.5	62331.0	48175.7	14155.3	9504.0	-	1697.5	700.4	11901.9	11439.1	527.4	6221.4	14498.2	-	-	-	-	3587.7	36273.8
061/062	508651.0	70123.1	54105.1	16018.0	16456.0	-	1799.2	806.1	13061.3	12302.9	736.3	6446.3	18896.0	-	-	-	-	2662.1	41043.8
062/063	557869.6	72282.1	57427.0	14855.1	10933.6	-	2180.3	847.6	13961.5	11744.5	625.3	6506.4	21615.4	-	-	-	-	2973.9	43465.5
063/064	670588.7	87712.1	71168.0	16544.1	15730.0	-	2238.7	1011.0	18979.7	13623.9	708.6	9343.2	26095.6	-	-	-	-	2417.0	52188.3
Total	4944789	619915	48147.4	133767.6	98812.8	38.8	16130.6	5470.14	120452.6	118595.4	6441	54092.1	157008.2	372.4	634.5	3593.7	1180.9	23776.8	365694.6
Average	412066	51660	40512	11147	8234	6.47	1344	456	10038	9883	537	4508	13084	53.2	90.6	513	197	1981	30475

Sources: - Budget Speech, Economic Survey of Various Years, Ministry of Finance, Annual Report of Inland Revenue Department.

## APPENDIX II Questionnaire

Name of the Respondent:- .....

Position:- .....

Department:-.....

**Please tick ( ) the suitable answers of your choice from the following questions and wherever appropriate please rank them on the basis of numbers of alternatives and important**

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

a). Yes [ ] b). No [ ]

If no, what are the causes, which are responsible for the creation of unsound tax administration?

i. defective Income Tax Act [ ]

ii. Lack of public participation [ ]

iii. Lack of trained employee [ ]

iv. Faulty organizational structure of tax administration [ ]

v. Weaknesses in governments economic policy [ ]

vi. Others (if any, specify) .....

2. What is your opinion about the current income tax rate? The current income tax rate is:

a). High [ ] b). Medium [ ] c). Low [ ]

3. Do you think that the exempted items of income are sufficient?

If no what kind of income should be exempted?

Please write in the following numbers

a. ....

b. ....

c. ....

d. ....

e. ....

4. Do you think that the current income tax exemption limit appropriate?

- a). Yes [ ] b). No [ ]

If no how much the exemption limit should be for an individual unit?

- a. Rs. 100000 [ ]  
b. Rs. 1500000 [ ]  
c. Rs. 200000 [ ]  
d. Rs. 2500000 [ ]  
e. Rs. Others (if any, specify).....

5. Similarly, how much exemption limit should be for a family?

- a. Rs. 100000 [ ]  
b. Rs. 1500000 [ ]  
c. Rs. 200000 [ ]  
d. Rs. 2500000 [ ]  
e. Rs. Others (if any, specify).....

6. Do you agree that family exemption must be provided according to the number of dependent?

- a). Yes [ ] b). No [ ]

7. Do you feel that exemption limit should be adjusted according to the inflationary situation of the country?

- a). Yes [ ] b). No [ ]

8. What is your opinion on providing exemption on agricultural income?

- a. yes, it should be exempted [ ]  
b. No [ ]  
c. It should be treated as other income [ ]  
d. other, (if any, specify) .....

9. Do you think that itemized deductions are sufficient?

- a). Yes [ ] b). No [ ]

10. Do you suggest for itemized deduction in income tax?

- a). Yes [ ] b). No [ ]

11. In your opinion, what kind of expenses should be prioritized for deduction?

Please write in the following numbers.

- a. ....
- b. ....
- c. ....
- d. ....

12 What are the need for deduct the expenses?

Please specify in the following numbers.

- a. ....
- b. ....
- c. ....
- d. ....

13. Do you know about the present depreciation system of income tax act?

- a). Yes [ ]
- b). No [ ]

14. What are the major problems and weakness in Nepalese income tax system?

- a. ....
- b. ....
- c. ....
- d. ....
- e. ....
- F. ....

15. In your opinion, are the provisions made under the Nepalese Income tax act sufficient in all respect?

- a). Yes [ ]
- b). No [ ]

**“Thank You for your kind co-operation”**

## APPENDIX III

### A. Tax Experts

S.N.	Name of the Respondents	Position	Department & office
1.	Dr. Bhubanesh Panta	Deputy Director	Nepal Rastra Bank
2.	Umesh Bhandari	Deputy Director	Nepal Rastra Bank
3.	Tula Raj Basyal	Senior Economic Advisor	GON, Ministry of finance
4.	Govinda sharma	Tax specialist	Inland Revenue Department Lazimpat
5.	Suraswati Adhakari	Charter Account	Rastriya Banijya Bank, Singhadarbar.
6.	Sushil Ram Mathema	Executive Director	Nepal Rastra Bank
7.	Badri Karki	Auditor	Overall service & Consultancy, Kalimati
8.	Dr. D. P. Paudyal	Senior Economist	Ministry of finance
9.	Dr. Rup Bahadur khadka	National Economist	RAS Project, lazimpat
10.	Janak Raj Pokheral	Charter Accountant	Agricultural Development Bank. Singhadarbar
11.	Kabiraj Adhakari	Deept. Head Finance	Rastriya Banijya Bank, Singhadarbar
12.	Rasta Jha	Head of Treasury	Standard Chatard Bank, Kathmandu
13.	Asit Bhattari	Manager	Kumari Bank , Kathmandu
14.	Dharma Raj Shrestha	Auditor	Dharma and Company

## APPENDIX IV

### B. Income Tax Administrators

S.N.	Name of the Respondents	Position	Department & Office
1.	B.N.Sharma	Director	Inland Revenue Department, Lazimpat
2.	Mani Dev Bhattarai	Director	Inland Revenue Department, Lazimpat
3.	Govinda Bahadur Baniya	Director	Inland Revenue Department, Babarnahal
4.	Bishnu Parsad Nepal	Director	Inland Revenue Department, Lazimpat
5.	Badari Parsad Gautam	Director	Inland Revenue Department, Lazimpat
6.	Gopal Koirala	Tax Officer	Inland Revenue Department, Babarmahal
7.	Sarad Niraula	Tax officer	Inland Revenue Department, Lazimpat
8.	Shadananda Gurung	Tax officer	Inland Revenue Department, Lazimpat
9.	Parkash Paudel	Tax officer	Inland Revenue Department, Lazimpat
10.	Ram Prasad Sharma	Tax officer	Inland Revenue Department, Lazimpat
11.	Durganath Bhandari	Tax officer	Inland Revenue Department, Babarmahal
12.	Janardhan Tripathi	Chief Officer	Inland Revenue Department, Lazimpat
13.	Prakash Prasad Timilsina	Tax Officer	Inland Revenue Department, Lazimpat
14.	Keshav Rai Acharya	Tax Officer	Inland Revenue Department, Lazimpat
15.	Parkesh Paudel	Tax Officer	Inland Revenue Department, Lazimpat
16.	Hem Raj Subedi	Tax Officer	Inland Revenue Department, Lazimpat
17.	Surya Prasad Pokheral	Tax Officer	Inland Revenue Department, Lazimpat
18.	Chandra Bahaduar Khadka	Tax Officer	Inland Revenue Department, Lazimpat
19.	Binod Lamichani	Tax Officer	Inland Revenue Department, Babarmahal
20.	Narayan Prasaf Sharma	Tax Officer	Inland Revenue Department, Babarmahal
21.	Dilip Karki	Tax Officer	Inland Revenue Department, Babarmahal
22.	Shyam Bahadur Thapaliya	Tax Officer	Inland Revenue Department, Babarmahal
23.	Nita Shrestha	Tax Officer	Inland Revenue Department, Babarmahal
24.	Ram Prasad Acharya	Tax officer	Inland Revenue Department, Lazimpat
25.	Shiva Prasad Bhattari	Tax officer	Inland Revenue Department, Lazimpat

## APPENDIX V

### C. Income Taxpayers

S. N.	Name of the Respondents	Position	Department & Office
1.	Hari Bahdur Darlami	Section Officer	Ministry Of Education
2.	Ganga Ram bhandari	Account Officer	Forest products Development Boars, Babarmahal
3.	Deepak Kumar Shrestha	Deputy Finabce Manager	Bottlers Nepal Ltd.
4.	Labraj Dahal	Account officer	Nepal Bank Ltd. Jamal
5.	Narayan Bhandari	Section Officer	Ministry of Education & sports Thamel
6.	Nirajan Bashnet	Dye. Finance Manager	Nepal level Ltd. Kamaladi
7.	Bhakta Bahadur Shakya	Account officer	Nepal polipipe, industries Balaju
8.	Minkaji Karki	Account officer	D D C Balaju
9.	Rajan Jung Thapa	Account officer	Diary Development Corporation Balaju.
10.	R.K. Thapa	Account officer	Nepal Gas Udhyog Pvt. Ltd. Balaju
11.	Bhuwan Kumar Shrestha	Proprieter	Bhuaneshwor Traders, Kalimati
12.	Bhushan Sherestha	Manager Dye. Finance	Nepal Tele Communication Singhadarbur
13.	Rabindra Shrestha	Director	Nebico Biscuits Pvt. Ltd.
14.	Uttom Dhungana	Account Officer	Rastriya Banijya Bank Singhadarbur
15.	Sukadev Pathak	Dye. Finance Manager	Rastriya Banijya Bank Singhadarbur
16.	Sachet Thapa	Account Officer	Laxmi Bank, Hattisar
17.	Sundar Lal Manander	Section officer	Agricultural Development Bank. Singhadarbar
18.	Jit Govinda Maharjan	Account officer	Kathmandu floor Mill Pvt. Ltd.
19.	Ganesh Man Seratha	Deputy Head (HRM)	Rastriya Banijya Bank. Singhadarbar
20.	Labroj Dahal	Account officer	Nepal Bank Ltd. Jamal
21.	Gopal Karki	Finance Manager	Nepal Bank Ltd. Jamal
22.	Susan Sherstha	Secretary	Foret products Development Boards, Babarmahal.
23.	Hem Narayan Shrestha	Proprieter	S. Hem Enterprises, Kalimati
24.	Ram Prasad Sharma	Section Officer	Ministry of Security Singhadirbur
25.	Sarbendra Mishra	Head Treasury	Sunrise Bank Ltd.

## APPENDIX VI

Date:-.....

To .....

Dear Sir/ Madam,

I would like to introduce myself as a student of Shankar Dev College of Management, MBS final year. In order to fulfil the partial requirement of masters Degree in Business studies of Tribhuvan University of Nepal, I am going to prepare a dissertation titled, “Income Tax in Nepal, A Study of Deductions, Exemptions and concessions”.

I would very much appreciate if you kindly spare a few minute of your valuable time in filling this Questionnaire enclosing with your valuable suggestion.

Looking forward to your co-operation and support with many thanks.

**Yours Sincerely**

Puspa Man Shrestha