CHAPTER ONE

INTRODUCTION

1.1 General Background

Nepal is one of the least developed countries. It is a landlocked mountainous country, located in the central part of Asia. Here total area is 147,181 square kilometers, about 0.03% of the world and 0.3% of Asia. Nepal is an economical paradox in the sense that it is a rich country where poor people live. She has the riches of natural and cultural beauties but the economic condition is far behind. Her economy is mainly based on agriculture. Large portions of population who live under the line of poverty are in rural area.

In Nepal, development planning was started with the implementation of the First Five Year Plan in 1956. Despite experiencing with improvements, Nepal still remains one of the poorest countries in the world with a Human Development Index of 0.530, which gives the country a rank of 145th out of 179 counties. Population growth is high at 2.1 percent per year. Life expectancy is at 60.94 years 2009 but there are considerable regional disparities. The population is diverse comprising of more than 75 ethnic, caste and linguistic groups (UNDP 2009/10).

Nepal is one of the poorest countries in the world with per capita income of U.S. $1597 per year. Currently about 31 percent of the population live on less than U.S. $1 a day (absolute poverty). Human Poverty Index value of 33.3% for Nepal ranks 99th among 135 developing countries for which the index has been calculated. (The Human Poverty Index for developing countries focuses on the proportion of people below a threshold level in the same dimensions of human development as the human development index-living a long and healthy life, having access to education, and a decent standard of living). Adult literacy rate of the population in age bracket 15 years and above is 52.42 percent with 3.21 as the mean year of schooling (UNDP, 2009).

Following are the main features of Nepalese economy

- A poor country in the world.
- Agro based economy.
- Developing country.
- Landlocked and mountainous country.
- Mixed economy.
- High rate of population growth.
- Dependence on foreign aid.
- Unequal distribution of national income.
- Low rate of capital investment.
- Rich in water resource and natural scenery.

Every nation in the world is engaged in fulfilling the pressing need of its population. In economics terminology, they are aspiring at a rapid economic growth. For this Nepal has completed more than half-a-decade of planned economic growth. But results have been far below than expected. the economic growth rate for the year 2007, 2008 and 2009 have just been 3.3%, 5.3% and 4.7% respectively, and for the year 20010 and 2011 are 3.0% and 4.0%, respectively have been estimated. (I.M.F, 2010).

A country spends a lot of money to fulfill its responsibility towards people. The responsibility may be either for security or for 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 social-economic infrastructures. Protection expenditure includes the purchase of arms and ammunition, maintenance of army or police and administration of justice and jail. The government for the public interest also incurs commercial expenditure. The third type of public expenditure is development expenditure. This is the expenditure made on providing education, health and utility facilities of the community. A nation will be able to achieve maximum social welfare if it has sufficient funds can mobilize sufficient resources.

Government expenditure is increasing because of demand of time, increase in population, increasing challenges in security, increase in price and national income etc. A lot of money has been spent to achieve national objectives either to pay regular expenditure or to do development works. Government collects revenue which can be classified into external and internal. External revenue includes foreign loans, grants, external borrowing, etc., whereas internal revenue includes tax and non-tax revenue. The example of non-tax revenue is fees, fines, royalty, administrative and business income, etc. Administrative income denotes the amount charged by government for providing administrative service. Business income means the return received by government for providing various goods and services to the people. Tax revenue is one of the main sources of government revenue. Customs, excise, Value Added Tax, corporate and personnel income tax are the example of the source of tax revenue. Government collects revenue through taxation with major objectives of economic development and economic stability. Taxation is the main source of government since it occupies the most important place in the government treasury.

The Income Tax Act, 2058 of Nepal comes to enhance the revenue mobilization through effective revenue collection (by replacing the Income Tax Act 2031). The basic objective of the Act (IT 2058) is to promote the economic development of the nation. It has integrated all the laws relating the income tax in Nepal. The Income Tax Act 2058 has broadened and clarified the base of tax. There is also a provision on installment payment. Another feature of the Act is that it focuses on self-assessment. It has treated every assessment as self-assessment. Even if a person fails to file a return by the due date, the person is treated to have made an assessment on the due date for filing the return, and his assessed tax for the year will be equal to the sum of tax withheld and tax paid in installment. The department may then proceed for an amended assessment.

1.2 Statement of problem

The recent burning problem of income tax system in Nepal is aphorism and undue delay in tax assessment procedure. It reduces not only the total revenue but also harasses the taxpayers in the payment of tax. The paying habit is not developed, and there is a general lack of tax consciousness in the Nepalese public and voluntary compliance. Tax authorities are inefficient and ineffective in enforcement. There is no better program for taxpayer's education, assistance, guidance and counseling, etc., and also the question of morality of tax officers and taxpayers.

Although government has introduced some policies and rules but tax collection hasn't become cost effective. According to the revised estimate, revenue collection will stand at just above Rs 142 billion an increase by 32.14% as compared to actual of the FY 2008/09 (Budget Speech for the fiscal year 2066/67).

It has always been alleged in Nepal that collection of tax has not been effective. It hasn't even been successful to collect tax from taxpayers who lie in the taxable boundary. In such a situation, it is very difficult to bring them into tax net. The process of payment of taxes is long, and taxpayers feel various problems. It gives mental pinch to the taxpayers, as they have to curtail their income to pay the government. Taxpayers feel unconvinced as the government imposes tax progressively. Tendency to evade tax may increase to avoid tax burden. It is expensive for the government to collect tax individually. Due to defective tax administration, taxpayers are ready to provide illegal benefit to the administrators but they are not ready to pay small amount as tax. Government can increase income tax revenue through efficient tax administrative system. Widespread income tax evasion and complicated and frequent change in tax rate and in policies are appearing major factors for low contribution of income tax revenue to national revenue. This problem is largely related to income tax assessment procedure.

Nepal depends on the external sources more than on the internal sources because the available resources do not meet the estimated budget fulfilling the aspiration of the people and constructing the social welfare state. Nepalese tax system needs to mobilize the internal resource to the maximum extent possible. But in the current situation presents a very poor and inefficient picture.

New tax laws are vague and monotonous, and there are ever changing provisions on the fiscal acts. There are a few competent personnel in the Inland Revenue Office having knowledge of tax assessment procedure while many tax officers have come from different disciplines, who have no knowledge about assessment of tax. In a situation, it is imperative to make a study of income tax assessment procedure system and suggest ways to improve it.

1.3 Objectives of the Study

The main objective of the present study is to examine the self-assessment system of income tax in Nepal. Other objectives are:

1. To study the existing provisions of income tax assessment under Income Tax Act, 2058.
2. To explore the need of self-assessment.
3. To analysis the contribution of Income Tax to National Revenue of Nepal.
4. To analyze the view of taxpayers, tax experts and tax officers about self-assessment.

1.4 Scope of the Study

Present study aims at finding out the problem faced by assesses while undertaking the tax assessment of their income. The major areas covered by this study are as follows:

1. Role of income tax in Nepal.
2. Brief introduction of income tax assessment procedure.
3. Government revenue from direct and indirect tax.
4. Existing position of income tax in Nepal.
5. Provision of income tax assessment under Income tax Act 2058.
6. Tax laws and provisions, income tax rate, exemption limit in income tax etc.

1.5 Research Methodology

The data and information used in this study "Effectiveness of Self-Assessment of Income Tax in Nepal" are both from primary and secondary sources. Primary data has been collected by administrating questionnaire to sample population in Kathmandu that includes tax experts, tax officers, businessmen, politicians and consumers.

For the purpose of illustrating facts, secondary data are collected. The secondary data used are obtained from various sources. These sources are: Central Bureau of Statistics, Ministry of Finance, Inland Revenue Department, Institute of Chartered Accountants of Nepal (ICAN), World Bank Report, UNDP Report, Nepal Rastra Bank's publications, Research papers, Articles etc.

For the analysis, collected data on various aspects of income tax are arranged in order and processed. The statistical tools and analytical tools have been applied in the way of analysis so that the finding could be presented and interpreted properly and clearly.

1.6 Limitation of the Study

The limitations of this study are as follows:

1. The study is mainly based on secondary data.
2. This study is confined to Nepalese law, act, rules and regulation.
3. Sample size is quite small
4. The researcher focused time and source constraints.

1.7 Scheme of Study

This study has been organized in seven chapters. The first chapter is introduction chapter, which includes general background, statement of problem, objectives of study, scope and limitation of study.

Review of literature regarding the conceptual framework, the self assessment system in Nepal and other related matters have been presented in the second chapter. This chapter also deals with the legal provision regarding income tax, conceptual framework of incomes from different sources and tax assessment and provisions of self-assessment in Incomes Tax Act, 2031 and Income Tax Act, 2058.

Research design, population and sample data collection procedure, data analysis and data processing used in the study have been spelt out in the third chapter.

Secondary and Primary data has been presented and analyzed in the fourth chapter. Mainly tax structure and composition, resource gap, contribution of income tax to revenue, estimation and collection of income tax, tax rates and exemption limits in Nepal have been presented and analyzed. Respondent's views towards methods of income tax assessment, effectiveness and problems of self-tax assessment system, attitudes towards penalty and time limit for the file return have been analyzed.

Findings, conclusion and recommendation are presented in the last chapter of the study.

Bibliography and appendixes have been also included in the end of this study.

CHAPTER TWO

2. CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1.1 Concept of Tax

The government of a country requires sufficient revenues to carry out development works, to handle day to day administration, to maintain peace and security and to launch other public welfare activities. In order to carry out such activities, the government collects revenues from various sources such as tax, revenues from public enterprises, special assessment, fees, fines, grants and assistance etc. Among them, tax is the main source of government revenue. The source of government revenue can be divided into two parts tax and non-tax.

Income tax is a tax levied on the earning of the person or legal entity. Generally, income tax is imposed on net income. Net income comes after deducting the cost of production from gross income. In practice, the expenses incurred in earning the income and appropriate exemptions and deductions are deducted to find out taxable income. Net income may be real income or money income. Real income is more comprehensive and includes not only money income but also other incidental advantages. Real income should, therefore, be the true index of ability to pay. So, income tax should be charged on real net income of an individual and not on his net money income.

Tax is a compulsory levy imposed by government. Tax is levied on a person as per the prevailing laws. Tax is paid to the state to perform the function of the government. The taxpayer does not have any right to demand direct benefit from the tax paid. The taxpayer does not receive the equivalent benefit from the government. Amount of tax is spent for common interest of the people, and collected from haves and spent for the interest of have-nots in the society. Thus tax is a compulsory contribution made by the taxpayer to the government without having any direct quid pro quo.

Economists have classified taxes into several categories. Basically, tax can be classified in to two broad categories: direct and indirect tax.

A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is the same. It is the tax on income and property such as income tax, property tax, vehicle tax, interest tax, gift tax etc. Direct tax is equitable as it is imposed on person as per the property or income. Time, procedure and amount of tax to be paid is known with certainty. It is elastic (the government can change tax rate with the change in the level of property or income). Taxpayer can easily estimate his tax liability. The government can easily increase tax according to economic situation of the country. It has also some demerits. Direct tax is expensive for the government to collect individually. Tendency to evade tax may increase in order to avoid tax burden. Direct tax gives mental pinch to the taxpayers as they have to curtail their income to pay the government.

An indirect tax is a tax imposed on one person but partly or wholly paid by another. In indirect tax, the person paying and bearing the tax is different. It is the tax on consumption or expenditures. Examples of indirect taxes are VAT, sales tax, entertainment tax, hotel tax, excise duty, import and export duty etc. Indirect tax is transferable. People pay tax when they receive or consume goods or services. Therefore, they do not feel burden to pay lump sum. There is mass participation because every person who receives goods and services pay tax. The government encourages domestic products and discourages foreign goods through higher rates of indirect tax but it is regretful as the tax burden to the rich and the poor is the same.

2.1.2 Concept, Meaning and Definition of Income Tax

The term income may be defined as the best measure of ability in the sense of economic well being. Income is the primary determinant of level of living which a family enjoys. Income refers to the economic gain to a particular person during a particular period of time. Income consists of total increase in net wealth and consumption. These definitions can be stated as follows:

$$Y = C+W$$

Where,

Y = *Income*

C = *Value of Consumption*

W = *Income in Wealth*

Income is exemplified rather than defined in income tax laws of various countries.

The most widely accepted definition of income was developed by R.N. Haig and Henry Simon who are renowned for defining the term income in most acceptable view that income consists of the total of increase in net wealth and consumption.

$$Y = C + |\zeta W$$

Where,

Y = *Income*

C = *Value of Consumption*

a*W* = *Net Increase of Personal Wealth Respectively*

According to sec. 2 of the Indian Income Tax Act, 1961, profits and gains, dividends, voluntary contributions received by charitable trust, value of any perquisite of profit in lieu of salary, any capital gain and winning from lotteries and cross word puzzles.

Section 2 of Income Tax Act 2058 defines "Income" as the total amount received (receivable in case of the accrued method of accounting) from business, employment and investment. Income denotes the total receipts, which are included in calculation of taxable income.

Income tax, as the word itself, is a tax on income. In a broad sense, income tax is a levy based upon the production or receipts or gain of the taxpayers within a definite period of time.

Income Tax Act, 2058 is as well recognizes that income encompasses both revenue and gains. Revenue is treated as gross receipt from the disposal of goods. Gain is treated as gross receipt of the property less the total outflows to acquire it.

Income tax is charged on the taxable income. Taxable income is derived by deducting the allowed expenditures from the revenues and gains. So the formula may be framed like this:

Revenue + Gains – Allowable Expenses = Income

Income is derived for a certain period. In Nepal the period for twelve months commencing from 1st of Shrawan to end of Ashad is treated as one income year. Income Tax Act, 2058 has classified the taxable income into three classes: income from business, income from employment and income from investment. The totals of the incomes of a person is said to be an income of the person.

Income from business is derived by deducting allowed expenses of the business from the revenues of business. In the same way the income from employment and investment are derived. Income as shown by financial statements may differ from the taxable income.

Income tax is payable on the income. Thus, income tax is defined as tax chargeable on income of a person as per the relevant income tax Act.

The income tax law enforced at present in Nepal is the Income Tax Act 2058 (2002), and income tax rules are made under finance act passed every year to translate the economic policy contained in the budget speech into law. It generally possesses the rate and exemption limit for tax purposes, and government may delete, add or modify the provision contained in the Income Tax Act. Decision of Supreme Court in Nepal also acts as procedures for income tax laws. The notification of Nepal Gazette or circular by Inland Revenue department classifies and compliments the legal provisions.

Income tax can easily be modified to give elasticity in raising revenue and it is highly productive in a developing country like Nepal. Income tax is the major contributor towards government treasury among direct taxes.

2.1.3 Historical Perspective of Income Tax

Great Britain is the first country in the world to introduce the modern income tax. It introduced income tax in 1799 to finance the war fought with France. USA introduced income tax in 1862 to generate revenue to finance civil war. In India, while income tax in its modern form was adopted in 1860, several experiments were made from 1860 to 1866 and finally the systematic income tax legislation was enacted in 1866.

Although the taxes were collected in various forms in ancient era, the history of modern income tax is not very old in Nepal. The idea of introducing income tax in Nepal originated only in the 1950s. When multi-partly democratic political system was introduced in 1951, the finance minister in his budget speech declared the intention of the government to levy an income tax.

Kautiya's "Arthasastra" of the Fourth century B.C. has classified the tax receipt into three types.

1. Income earned through taxes on goods produced within the country.
2. Income earned through taxes on goods produced in the capital.
3. Income earned through taxes on imports and exports.

Land revenue was an important source of taxation in ancient India. Kautilya mentioned, "The tax system should be such as not to prove a great burden on the public (praja). The king should act like the bee which collects honey without inconveniencing the plant" (Gorola: Koutilya's Arthasastra). His economic thought was guided by social welfare concept. He suggested heavy taxation for luxuries and other articles, which weren't in favor of public welfare. Kautilya classified the main items of public expenditure as:

1. National defense.
2. Salaries of ministers and expenditures on government departments.
3. Public administration.
4. Expenditure incurred on maintenance of armies.

2.1.4 History of Income Tax in Nepal:

It will be better to classify the tax era into four with regard to the progress of income tax act in Nepal: a. prior of 2019 B.S., b. after 2019 to 2031 B.S., C. after 2031 to 2058 B.S. and d. after 2058 B.S.

a. Period before 2019 B.S.

During the period, the formal income tax act was non-existent to charge income tax on income from any source. But the progress of income tax was as follows during the period:

Finance Act, 2016:

- Provision was made to charge income tax on income from employment and business, dividing the total taxable incomes in 10 slabs and income tax was charged on each slab at the rated ranging 5% to 25%.
- Some relaxations of income tax were given to small scale, middle and big industries.

Business Income and Employment Act, 2017:

This Act was enforced from Jestha 2, 2017. The following were the basic features of this Act:

- Some basic terms with regard to income, business, employment, etc were defined.
- Procedures of tax assessment and collections were provided.
- Some tax exempted persons are defined.
- Provision for tax deducted at source was introduced.
- Filing of tax returns was made compulsory for some of the taxpayers.
- Provisions of charging penalties and procedures off appeal against an assessment were provided, and
- Rates for charging income tax were left on the Finance Act of the relevant year.

b. Period after 2019 and up to 2031B.S.

Nepal Income Tax Act, 2019 was enforced from Shrawan 9, 2019. This was the first income tax Act enforced to charge income tax on incomes from various sources. The following were the major features of the Act:

- Sources of income were classified into: business, employment, profession, house and land rent, investment, agriculture, insurance business, agency, and other sources.
- Some more terms like-person, couple, family, partnership firms, non-resident persons, etc were defined.
- Provision was made for appointment of assessment committees in each area.
- Methods of calculation of taxable income under different heads were set.
- Provision was made to enter into an agreement with a foreign country with regard to income tax.
- Provision was made to make a revised return.
- Provisions with regard to set off and carry forward of losses were incorporated, and
- Provided to establish an Income Tax Department.

Finance Act, 2020:

- A provision to charge income tax on a resident taxpayer on an income earned and accrued in Nepal and also on an income accrued in outside Nepal but received in Nepal, was introduced;
- An exemption limit of Rs. 6,000 was prescribed for all the taxpayers.
- Provision was made to charge income tax on income earned by a person exceeding the exemption limit, dividing the total taxable incomes in 12 slabs and income tax was charged on each slab at the rates ranging 4% to 30%.

Finance Act, 2021:

- A flat rate of income tax @8% was charged on an amount received by a foreign film distributor from Nepal.

Finance Act, 2022:

- The initial exemption limit was withdrawn for corporate taxpayers.
- A tax exemption was allowed on interest from government bounds.
- Different rates of income tax were imposed on house and land rent.

Finance Act, 2024:

- The initial tax exemption limits were at Rs. 3,000 for an individual, Rs. 4,500 for a couple and Rs. 6,000 for a family.
- Provision was made to charge income tax on income earned by a person exceeding the exemption limit, dividing the total taxable incomes in 11 slabs and income tax was charged on each slab at the rates ranging 5% to 55%.
- A flat rate of income tax at 45% was fixed for corporate taxpayers.

Finance Act, 2025:

- The initial exemption limit was withdrawn for non-resident taxpayers.
- The slabs of taxable income were reduced to 5 and the rates of tax were charged ranging 15% to 55%.

Finance Act, 2026:

- A Provision was made regarding clubbing of incomes from a partnership firm, land and house rent and from foreign investment with other income of the individual for calculation of tax.

Finance Act, 2027:

- Industries are compelled to file a tax return.
- Tax exemption available to an industry was limited to income from industrial activities only.

Finance Act, 2029:

- Foreign investors in Nepal were required to make certain deposits at the tax office for registration.
- Partnership firms were treated as separate persons for tax purpose.

Finance Act, 2030:

- Additional tax exemption was allowed on allowances received by a member of Rastriya Panchayat and also on an agricultural income of a person having not more than 10 bighas of land.

c. Period after 2031and up to 2058

During the year 2031, Income Tax Act, 2019 was completely replaced by Income Tax Act, 2031with effect from Kartik 5, 2031. The new Act was divided in to 66 Sections. The various amendments in the Act along with the notable changes are given hereunder:

Income Tax (1st amendment) Act, 2034; effective from 2034.05.22:

- The provision that the expenses incurred with regard to tax-exempted income is not available for deduction was incorporated.
- Conditions were provided for extension of time for filing tax returns.

Income Tax (2nd amendment) Act, 2036; effective from 2036.08.05:

- Method of tax assessment of small taxpayers was determined.

Income Tax (3rd amendment) Act, 2037; effective from 2037.6.0:

- A post of Director General was created.
- The allowable repair expenses were limited to 10% of the rent amount.

Income Tax (4th amendment) Act, 2041, effective from 2041.07.27:

- The provisions regarding registration with income tax office were amended.
- Income received was defined as either it actually received or an entry passed in the book of accounts.
- Limitation was imposed on advertisement and guest entertainment expenses up to 2% and 1% respectively of gross income.
- The method of calculation of taxable profit of a petroleum industry and a cooperative society was determined.
- HMG was authorized to waive tax amount payable by any taxpayer.

Income Tax (5th amendment) Act, 2042; effective from 2042.06.23:

- Provision was made for awarding and individual providing any information of tax evasion to government.

Income Tax (6th amendment) Act, 2043; effective from 2043.06.22:

- Provision was introduced to inter into written agreement for rent in case the monthly rent amount exceeds Rs. 25,000.
- Responsibility of management of a private limited to pay tax was imposed.

Income Tax (7th amendment) Act, 2046; effective from 2046.06.11:

- Definition of net income was added.
- Restriction was imposed on deductible interest expenses for an amount of more than Rs. 20,000 in a year to a person in case the interest is payable to other than a corporate body without registration of the loan deed.
- The pre-production or pre-operation expenses are allowed to be deducted in five equal annual installments.

Income Tax (8th amendment) Act, 2049; effective from 2050.03.10:

- Definitions of agricultural income and gross income were added.
- Income earned in foreign country regarding activities conducted in Nepal is made taxable in Nepal.
- Certain allowances were excluded from taxable income from employment.
- The concept of deemed rent for particular area was introduced.
- Salary to an individual more than Rs. 25,000 per month can be allowed for deduction only in case permission is taken from HMG.
- The provision regarding self-tax assessment was introduced.
- Banks and finance companies were allowed to deduct loan loss provision as expenses up to 3% of the total loan outstanding.
- Provisions regarding tax audit and registration of tax auditor were introduced.
- Provided to make payment more than Rs. 20,000 at a time through bank only.

d. Period after 2058 B.S.

Income Tax Act, 2058

The age old Act having eight amendments and several transitional provisions through Financial Acts have created a thrust for a new and quite revised Act for income tax. Globalization of the trade, establishment of new kinds of foreign entities in Nepal, emerging complications in business relationships, establishment of joint venture enterprises in which more than one foreign country is associated, etc are the new features, which are felt to be incorporated in Income Tax Act.

Lecturer Dr. Peter A. Harris, technical advisor to IMF, Prepared the draft of this Act. The International Monetary Fund had financed the entire project. Harvard Institute for International Development, which is a branch of Harvard University, Had fully cooperated with Nepal in reforming tax laws. The VAT Act, 2052 is based on the draft given by the institute. The institute's contribution to reforming income tax also is notable.

HMG/N had worked hard and taken the help of FNCCI to give the final shape to the Act. It had conducted several rounds of talks with advocates, chartered accountants, foreign tax consultants, business houses, and all other concerned personalities.

Difficulty was faced mainly due to translation of the draft in Nepali language. Each and every word was translated in Nepali language; however, the words are very difficult to understand even by the tax consultants and chartered accountants. It had created misunderstandings in the businessmen.

Inland revenue Department came up with several publications of booklets and established a special office named by 'Customers Service Center' for easy understanding of the Act.

Main Features of Income Tax Act, 2058

Tax system is the subsystem of total economy. Tax policy is changed with the change in the economic policy of a country, change in world economic policy, and advancement in information technology. “Income Tax Act 2058” has been enacted to avoid the deficits of Income Tax Act 2031. This act has made a broad classification of income. This act imposes tax on all those activities contributing towards the creation of wealth. This act contains 143 sections. As compared to Income Tax Act 2031, very new concepts are introduced in this act. This act has silent features which are as follows:

- All income tax related matters are confined within the act.
- Tax rates are spelled out.
- Specification of stock valuation methods.
- Abolition of various tax related concessions, rebates and exemptions.
- Simplification of depreciation related provision.
- Taxing capital gains and dividends.
- Generous losses set-off and carry forward provision.
- Provision of international taxation.
- Stringent fine and penalty provision.
- Incentives are provided to infrastructure constructor, hydropower projects and special

industries.

- This act has classified all incomes into three headings under section 3 as business, employment, and investment.
- There is special provision for deduction, pollution control, and research and improvement expenses.
- The income of an approved retirement fund is free from tax but retirement payments in hands of employees are taxable.
- Resident persons are taxed on their worldwide income while non-resident persons are taxed only in their income sourced in Nepal.
- If a person submits an income return for and income year on the due date indicating the amount of total tax liability for the year and the amount of tax still payable by a person, it is treated as a self tax assessment.

2.2 LEGAL PROVISION ON INCOME TAXATION

The function of revenue collection has remained one of the key activities of the government from ancient time in Nepal. At that time, taxes were levied on the merchant, travelers and farmers in the form of cash or labor. On some occasions, gold and agricultural products were also paid as taxes but the nature of these taxes were temporary, and were raised for special purposes. In the content of Nepal the prevailing act, Income Tax Act, 2058 is under implementation since 19/12/2058 B.S. This act replaces the Income Tax Act, 2031 and other acts related to income tax. Some related provisions of the Act have been discussed in the succeeding sections.

2.2.1 Sources of Income

Income Tax Act, 2058 has classified the sources of income for the purpose of assessment under the following three heads:

a. Income from business.
b. Income from employment.
c. Income from investment.

2.2.1.1 Income from Business

Business means use of capital and labor to earn income. It is the mix of capital and labor. It is equivalent to the business profession or vocation defined by Income Tax Act, 2031. Income Tax Act, 2058 defines business as the business transactions related to industry, trade, profession or any other similar type of activities. According to the Act, it encompasses above-stated types of activities conducted in past, present or future. The term business does not include employment.

The following amount derived by a person during the year should be included:

a. Service charges, disposal of trading stock, net gain from disposal of business assets or liability, gain from disposal of pool of depreciable assets, prizes or gifts in connection with business, amounts received in lieu of accepting any restriction on the capacity to conduct the business and amounts received from any investment directly related to business. (sec 7.2)
b. Incomes to be included due to exchange in accounting methods. (sec 22.6)
c. Excess amounts received due to exchange rate variation. (sec 24.4)
d. Bad debts recovered.
e. Proportionate amounts received under long term contracts. (sec 26.1)
f. Under payment of interest according to market rate. (sec 27.1)
g. Receivable amounts paid to others. (sec 29)
h. Amounts received for compensation. (sec 31)
i. Other amounts received under the head of business income.

While computing income from business, the following amounts are excluded on profit and income from business for tax purpose.

a. Exemption amount under section 10.
b. Dividends under section 54 and 69.
c. Final withholding payment under section 92.

2.2.1.2 Income from Investment

Investment income means income generated from the use of capital. Investment means use of capital for the purpose of getting income. According to Income Tax Act, 2058 (sec. 2) investment means an act of holding or investing one or more assets of a similar nature that in an integrated fashion; however, it excludes the following:

- The act of holding assets other than non-business taxable assets for personal use by the person owing the assets or investing amount on such assets, or
- Employment or business.

For the purpose of calculating the profits or gains from the investment, the following are included:

a. Any dividend, interest, natural resource payment, rent, royalty, gain from insurance, gain from an unapproved retirement fund and from approved retirement fund. (sec 9.2)
b. Net gains from the disposal of the person's non-business chargeable assets of investment. (sec 9.2)
c. Excess amount of incomes over the depreciation of the depreciable assets of the investment of the person. (sec 9.2)
d. Gifts or prizes received in connection with investment. (sec 9.2)
e. Retirement contribution including those paid to a retirement of the person and retirement payments in respect of investment. (sec 9.2)
f. Amount received instead of acceptance of any restriction regarding investment. (sec 9.2)
g. Amount included under change of accounting method. (sec 24)
h. Excess amount received due to exchange rate of currency. (sec 28)
i. Bad debt recovered allowed previously. (sec 25)
j. Proportionate amount under long-term contract. (sec 28)
k. Under paid interest amount according to market price and amount received as compensation. (sec 31)

l. Other amounts being included on tax accounting or quantification, allocation and characterization of amounts or transaction between entity and beneficiary or general insurance business. (sec 9.2)

The following amounts are excluded income from investment for tax purpose:

a. Exemption amount under section 10.
b. Taxation of dividends under section 54.
c. Final withholding payment under section 92.
d. Amount that is included in calculating the person's income from any employment or business.

Following amounts are not allowed for deduction for deriving taxable income from business/investment.

a. Cost to the intent to which they are domestic or personal nature.
b. Income tax, bribe, fine and penalty paid to government or political subdivision of country by breach of any law. (sec 21)
c. Cost incurred by a person in driving exempt amount as per set 10 or final withholding payment. (sec 21)
d. Distribution of profit by entity. (sec 21)
e. Capital nature expenditure and foreign income tax. (sec 21)
f. Payment of cash exceeding Rs. 50,000 is not allowed for deduction in case where banking service is available and if annual turnover is more than Rs. 2 million.
g. Any other amount that is denied by other provision of the law. (sec 21)

2.2.1.3 Income from Employment

An individual's remuneration income from an employment, termed as income from employment, are included in employment income. All payments or benefits received in respect of employment, including past or future employment are taxable. The remuneration received by a person from the employment is following payments made by the employer: (sec 8)

a. Payments of wages, salary, leave pay, overtime pay, fees, commission, prizes, gifts, bonuses and other facilities.
b. Payments of allowances including any cost of living, rent, entertainment and transportation cost.

c. Payment for the termination or loss or compulsory retirement.
d. Payments for the agreement to any conditions of the employment.
e. Payment of reimbursement of cost incurred by the individual or an associate of the individual.
f. Retirement contributions including those paid by the employer to the retirement fund in respect of the employee and retirement payments.
g. Other payments in respects of the employment.
h. Other amount as given in chapter 4 of the act requisites and gains due to change in tax accounting required to be included.

In addition to above stated items of remuneration, the following types of perquisites are included in remuneration of a person.

a. Price and gifts.
b. The amount of difference of the interest on loan paid by employer lower than the market rate.
c. Market value of assets in case of the transfer of the assets.
d. For the payment other than stated above, the value of benefit of the payment to a third person.

The following are excluded in calculating an individual's remuneration from an employment.

a. Amounts exemption under section 10 and final withholding payments.
b. Meals or refreshment provided in premises operated by or on behalf of an employer to the employer's employees that are available to all the employees in similar terms.
c. Payments of prescribed small amounts, which are so small and thus unreasonable or administratively impractical to make accounting for them.
d. Any discharge or reimbursement of cost incurred by the individual cost that serves the proper business purpose of the employer and that would otherwise be deducted in calculating the individual income from any business or investment.

2.2.2 Meaning and Concept of Tax Assessment

Assessment means “to determine” or “to compute.” Income tax assessment means the determination of the amount of income tax imposed on the taxpayer for a specified period. “The word assessment comes from the Latin words “ad seeders assess ere” meaning ‘to sit through, to fix a rate’ or impose a tax. In the most common sense, the imposition of a tax on person and property to be taxed and evaluation of the property of each person on the basis of apportionment and levy such acts usually being performed by administrative officers and sometimes by legislature. Thus, income tax liability on a person is determined on the basis of state act. Assessment of income tax denotes supplementary assessment, provisional assessment, advance assessment, reassessment, self tax assessment, the order issued by tax officer after amending self-assessment and any order made requiring security deposit. This definition has widened the scope of assessment of tax. Assessment of income tax means the computing of total income tax liability and procedures for imposing tax liability as well. The word assessment means computation of total income, determination of the amount of tax payable and whole procedure laid down in the act for imposing liability upon the taxpayer. Assessment has to be understood with reference to the context in which it has been used. The word assessment is used in number of provisions in a comprehensive sense and it can comprehend the whole procedure for ascertaining and imposing the tax liability upon the taxpayer and the machinery for enforcement thereof. (Sanprappa V. ITO, 1968:68)

Hence, income tax assessment is the process of determining policy, rules, provisions and procedures to levy the tax and computing the income tax liability in accordance with the rules. The process of assessment consists of various stages such as filing of return, amendment of return before assessment, self-assessment enquiry before assessment, assessment of income escaping, rectification of mistakes, final assessment of income tax and collection or recovery of income tax. These terms will be dealt later in concerned heads.

Income tax is levied on total income calculated in accordance with the provisions under income tax act. Income tax will be levied on income earned in Nepal and foreign country as well from the business conducted in Nepal. Income will be calculated under different heads mentioned in the act. Tax liability is computed on this net income.

In case of a non-resident person income tax shall be charged on his net income acquired or earned in Nepal and other net income may be acquired from Nepal while residing in any other foreign country (Income Tax Act, 2031, section 6). This provision may prove disincentive to a non-resident bringing his taxable income in Nepal. He may opt to keep such earning in foreign country and escape from the tax liability in Nepal.

Income Tax Act, 2058 has defined the term "assessment" as an assessment of tax to be paid under this act and it includes an assessment of interest and penalty made under this act. However, the term does not include an assessment that has been replaced with an amended assessment.

2.2.2.1 Tax Assessment Procedure

The revenue collection from income tax is also based upon the income tax assessment procedure followed. An efficient and effective assessment procedure reduces the corruption and evasion and increase the morality which assists to generate additional financial resources through income taxes. (Routh: 119)

The income tax assessment procedure generally proceeds through four stages:

a. Return of income statement.
b. Assessment of taxable income.
c. Determination of tax liability.
d. Collection of net proceeds after deducting his advance tax payment.

2.2.2.1.1 Return of Income (sec 96)

According to sec 96 of ITA 2058, every taxpayer should file at the place prescribed by the department a return of income not later than 3 months after the end of each income year. The return of income should be in the following:

a. The person's assessable income for the year from each employment, business and investment and the source of income.
b. The person's taxable income for the year and the tax payable with respect to that income for the year.

c. In the case of a foreign permanent establishment of a non-resident person situated in Nepal, the foreign permanent establishment's repatriated income for the year and the tax payable with respect to that income.
d. Any other information that the department prescribes.

The return of income should be signed by the person or manager. It should be accompanied by necessary disclosures along with a declaration that the return is complete, true and accurate.

2.2.2.1.2 Returns of Income not Required (sec 97)

Unless requested by the department by notice in writing or by publishing a public notice, the following person is not required to file a return of income.

a. A person who has no tax payable for the year under section 3 (a)
b. A resident individual who has only one employer at a time during the year and all of whom are resident employers and who claims only a medical tax credit with respect to medical costs borne by the employer and reduction for retirement contribution made by the employer but does not claim a reduction for donation.
c. A person who receives final withholding payment.
d. If a vehicle owner paying flat taxes is an individual.

2.2.2.1.3 Extension of Time to File Return of Income (sec 98)

A person who is required to file a return of income may make a written request to the department by the due date for filling the return. The department may, on such terms and conditions as prescribed by the department and where reasonable cause is shown, may grant multiple extensions not exceeding three months in total by which the return is to be filed. The department will inform the person in writing of its decision on the application.

2.2.2.2 Types of Assessment of Income Tax in Income Tax Act, 2031

The Income Tax Act, 2031 has mentioned eight different types of assessments which are explained as below:

2.2.2.2.1 Advance Tax Assessment

If the tax is assessed before the end of the income year, it is advance tax assessment. The act has made provisions of assessment and collection of tax in advance. It states, “if the tax officer is satisfied that any taxpayer being a non-Nepalese citizen or non-resident who is obliged to pay income tax by the Nepal Income Tax Act, 1963, this act or any other existing Nepal law is likely to abscond to evade payments of tax, or any person who is obliged to pay tax has changed the name and place of firm or business with the purpose of evading the income tax, he may order that the amount likely to be taxed from him to be deposited, or immediately after the receipt of tax assessment notice, as security or that the amount of tax finally assessed be deposited notwithstanding the fact that this year of income is not over or that time for submission of statement has not expired or that the final assessment has not been made or that time for payment of the assessed tax has not expired.” (Income Tax Rules 29)

In respect of taxpayers other than above where statement of income is not submitted, the tax officer may required, without prejudice to other proceeding or the assessment of tax under this act, to make order for advance payment, within such a period not exceeding 35 days, of a deposit equal to the amount of tax to be chargeable on the net income of the last year for which assessment has already be made or tax due on the last income of the statement so submitted. [Section 35(2)]

Thus, tax officer may order for advance tax in the following conditions:

a. Before the completion of income year.
b. Though the period for the submission of statement has not expired.
c. Before the assessment of tax.
d. Though the period for payment of tax has not expired.
e. Immediately after receiving the tax assessment order.
f. In case the immediate assessment is not possible.

2.2.2.2.2 Provisional Tax Assessment

Income tax officer makes provisional tax assessment in some cases; such assessment is not final assessment. Following are grounds for provisional tax assessment.

a. Where the profit and loss account and balance sheet of any company has not been audited or approved by annual general meeting of such company with in three months after the end of the year of income, a provisional statement of such account and balance sheet shall be submitted with in such limit [section 27(2)]

b. If the profit and loss account and balance sheet concerned with statement submitted under sub-section (2) is not approved by the general meeting and submitted in tax office within six months from the submission of provisional statement the tax officer may not act accordingly with section (28) of the act. [section 27 (2)A]
c. Engaged in any profitable activity for less than a year shall submit provisional statement of his income to the tax officer before cessation of such activity. [section27(3]
d. The company obliged to submit its statement of income pursuant to sub-section(2) of section 27 if submits a provisional statement of his transaction the tax officer shall, without prejudice to the provisions of other sections of this act, make a provisional assessment of tax on the basis of such statement. [section 33(5)]

2.2.2.2.3 Re-assessment and Supplementary Assessment of Tax

If government is satisfied that any person filed or caused to file false statement and reduced the tax liability, it may order re-assessment or supplementary assessment of his tax within five years from the date of said assessment. Further, if government is satisfied that the tax liability has been reduced in case of a taxpayer due to dishonesty, negligence or irregularity, it may order reassessment or supplementary assessment. [section 56(3)]

Notwithstanding the fact that an appeal is pending against an assessment order made pursuant to the provisions of Nepal Income Tax Act 1963, this Act or a decision which regard to such appeal has been made, supplementary assessment pursuant to sub-sections (1) or (3) of section 56 may be made in respect of the income falling outside the purview of the earlier assessment order. [Section 56 (b)]

The reassessment or supplementary tax assessment is made by the government on the following conditions:

a. In case of amendment of income statement. [section 29(1)]
b. In case of rectification of tax assessment order. [section 55(1)]

c. Non-fulfillment or irregularity or negligence in tax assessment. [section 34(2)]

The reassessment order of the government will be final. There are no legal remedies through writ (Bhatta, Lava Dev, and Collection of Summary of Decisions Made by Supreme Court, 2035: 647) but the act has granted authority to tax officers to issue tax re-assessment order in the case of taxpayers who submit particulars of income for the purpose of self-tax assessment. [Income Tax Act, 2034 section 56(1)]

2.2.2.2.4 Self-Tax Assessment

The first amendment of Income Tax Act, 1974 in 1977 had made the provision of self-tax assessment for the first time. This provision aims to increase awareness in taxpayers about their tax liability and to facilitate the collection of tax. The eighth amendment of income tax act has mentioned many provisions in this regard and has given high priority to self-tax assessment.

A taxpayer having obligation of maintaining books of accounts shall determine his net income, submits particulars thereof in the self-tax assessment from and assesses his tax himself [section 33(A) (1)]. But tax assessment made by the taxpayer may not be a final one. The tax officer will check the assessment; and if finds during his investigation that the incidence of tax has been lowered, the tax officer will make the final assessment [section 33(A) (2)] and also prescribes the specimen of the form to be submitted along with particulars of self-tax assessment, the categories of taxpayers who must make self tax assessment on a compulsory basis and the criteria for determining whether self-tax assessment is appropriate or not. [section 33(B)] Such self assessment form must be certified by a recognized auditor. [Section 33 (c)]

2.2.2.2.5 Best Judgment Assessment

In the event where assesses do not submit income tax return (ITR) or the submitted income tax return is not reliable or not acceptable to the assessing officer (AO), the income tax assessment is made on the basis of certain prescribed information. This method of assessment though not specifically mentioned in the income tax act as such but is called best judgment assessment.

2.2.2.2.6 Assessment by Income Assessment Committee

Income Tax Act, 1974 has provided authority to government to form assessment committee. The act states “notwithstanding anything contained in this act, government if thinks necessary may, from time to time by notification published in the Nepal Gazette, constitute an assessment committee consisting of a chairman and other members not exceeding four for the purpose of computing the net income of any taxpayer or class of taxpayer. [Section 40 (1)]. The government has power to constitute the income tax assessment committee to assess the income of any taxpayers of particular class. (Shrestha, Narayan, VC Tax Office Kathmandu writ no. 2314 of 2042).

For this purpose, the government has made provision of constituting district assessment committee. This Committee shall assess the income of those taxpayers that are unable to maintain their business account and income is below Rs. 100,000. (Nepal Gazette 2033/6/11)

2.2.2.2.7 Assessment by Income Tax Assessment Committee for Small Taxpayer:

Income Tax Act, 2031 section 17(A) has made provision for the assessment of small taxpayer. It states “notwithstanding anything contained in other section of this act, the method and procedure of assessing the tax of small taxpayer having income of a prescribed limit shall be prescribed. [Income Tax Act, 1974 Section 17(A)]
The small taxpayers who can’t maintain their account and whose income is below Rs. 100,000 shall have assessed their income tax by small taxpayer income tax assessment committee.

The income taxpayer whose income tax has been already assessed by the committee if pay 15 percent additional taxes more than the previous year will be assumed as assessed.

The committee will be constituted as follows: [Income Tax Rules, 2039 No.26 (1)]

a. Chief of tax office or a person specified by him - chairman.
b. Custom office, or if not, officer of treasury and account’s controller office - member.
c. Excise duty officer, or if he is absent, land revenue officer – member.

d. Representative of concerned village development committee or municipality – member.
e. Representative of local trade and commerce union, or if not, highly recognized businessman specified by chief district officer - member.

2.2.2.2.8 Assessment on the Basis of Agreement

In special cases, the act has made provisions to compute net income by agreement. The act states, "if Director General doesn't deem it equitable to compute the net income of any taxpayer in accordance with the provisions of this act in relation to the income acquired or earned in any particular manner from business conducted at the international level, it may make special arrangements for computing such net income by entering into agreement with such taxpayer. (ITA 2031 sec 18) Thus, the act has widened the provisions for the exceptional cases other than stated in the act.

2.2.3 Types of Assessment in Income Tax Act, 2058 B.S. (2002)

Income Tax Act, 2058 provides the following major methods of assessing income tax:

2.2.3.1 Self-Tax Assessment

Self-tax assessment is the system in which the taxpayer pays himself his income tax by calculating his tax to pay on the preparation of his income and showing his every detail. (Joshi, 2044:61)

The first amendment in 1977 of Income Tax Act, 1974 had made the provision of self-tax assessment for the first time. This provision aims to increase awareness in taxpayers about their tax liability and to facilitate the collection of tax. The eighth amendment of income tax act has mentioned many provisions in this regard have given high priority to self-tax assessment, but it was not properly implemented in practice before the enforcement of Income Tax Act, 2058.

According to the act, if a person submits an income return for an income year on the due date indicating the amount of total income, tax liability and tax still payable for the year; it is treated as an assessment has been made. Such assessment is known as self-tax assessment. The tax official validates self-assessment only when the person submits the income return in prescribed format on the due date along with the tax payable in a proper way without any error and motive of fraud.

Since the current tax laws have fully adopted self-tax assessment system, it is supposed to be assessed tax on due date until such time as the income return is to be filed although a person fails to file the return. So in case of failure to submit the income return in the due date, the total sum of any tax withheld for payment derived by the person during the years and any tax paid by the person in installments for the year is treated as paid on the due date. It means only the remaining tax is treated as tax arrears until such time as the return is filed and the tax arrears is recovered along with penalty, interest and fine. (Amatya, Pokharel and Dahal, 2004:261)

For the self-tax assessment, three procedures are to be followed by the taxpayers:

a. Preparation of income and expenditure as prescribed format.
b. Declaration of net income of each source of income.
c. Showing the taxable income.

In such assessment the taxpayer also should show:

a. Tax payable by the person.
b. Amount of tax still to be paid by the person for the year being shown in the return.

2.2.3.2 Jeopardy Assessment

In some doubtful situations, the tax officials may make jeopardy assessment. The assessment is initiated prior to the date of filling an income return. The assessment is actually made according to the best judgment basis under the special circumstances as when: (Sec 100 of ITA, 2058)

a. The person becomes bankrupt, wound-up, or goes into liquidation.
b. The person is about to leave Nepal indefinitely.
c. The person is otherwise about to cease activity in Nepal.

d. The department otherwise considers it appropriate.

Jeopardy assessment can be made either for the whole year or for the part of the year. If the assessment is made for the whole year the taxpayer is not required to file the return for the year; but if the assessment is made for the part of the year then taxpayer is required to file the return of income for the year on due date.

The department may give seven days of time to the taxpayer to produce profit, if any, in own favor with respect of the jeopardy assessment. Moreover, if the tax official makes a jeopardy assessment, the tax official is required to provide written notice of the assessment to the taxpayer mentioning the total tax liability, tax payable along with the date of payment and the manner and reason of the assessment. The notice should include the time, place and manner of objecting to the assessment.

2.2.3.3 Amended Assessments

The department may amend an assessment made by the taxpayer to adjust the assessed person's tax liability. It is done according to the intension of the act. The tax officials may amend both the self-assessment and jeopardy assessment so as to adjust the tax liability. Amended assessment is carried out after filling return or after the expiry of due date for filling income return. The tax officials may amend an assessment according to the best judgment for as many times as the tax officials think appropriate. The department may amend an assessment within four years at any time where the assessment is inaccurate by the reason of fraud or any willful neglect by or on the behalf of the assessed person.

The tax official may not amend an assessment if the assessment has been amended or reduced assessed tax by the revenue tribunal or a court of competent jurisdiction except where the order is reopened. This provision should not be a barrier to amend in the case where an order for reinvestigation is issued.

Where the department makes amended assessment, the department shall be required to serve a notice of the assessment to the person stating the following: (sec 101)

a. Tax payable by the person, tax still to be paid for the income year or the period to which assessment is made.
b. The manner in which the assessment is calculated.
c. The reason why the department has made assessment.
d. The date on which the assessment is payable.
e. Time, place and manner of objecting to the assessment.

The department may give the 15days of time to the taxpayer to produce proof, if any, in own favor with respect of the assessment.

2.2.4 Payment, Collection and Refund of Tax

Income Tax Act, 2058 has established two major methods of collecting tax. One is voluntary payment of tax and another is collection of tax. If a taxpayer voluntarily pays tax within specified time limit, it is known as voluntary payment of tax. If a taxpayer does not pay tax voluntarily within the specified time limit, the tax official collects tax through special effort and it is known as collection of tax.

According to the act, the tax is to be paid in the form and at the place prescribed by the tax authority. In case a person is required to pay tax at a place as per a notice issued by IRD or IRO, the person has to pay the tax at the same place as mentioned in the notice. In general cases, each person has to submit the tax payable to the Inland Revenue Office or recognized bank. Generally in practice, the Inland Revenue Office accepts the amount of tax in cash only up to Rs. 10,000 but the person is required to pay the tax with cheque or draft in the case above such limit.

2.2.4.1 Methods of Tax Payment:

Payment of tax is one of the important functions of tax administration. Income Tax Act, 2058 has adopted following three methods collecting tax from the taxpayers. (Sec 94)

a. Installment Method

An individual or an entity having assessable income during an income year from a business or investment is required to pay tax in three installments:

Date Payable	*Amount Payable*
By the end of Poush	40% of estimated tax
By the end of Chaitra	70% of estimated tax
By the end of Ashadh	100% of estimated tax

While paying tax in installment, the taxpayer should pay remaining amount after deducting the amount of tax paid earlier.

b. Withholding Method

Withholding tax is the tax deducted from employment income, investment return, service fees, contract or other incomes by the payer of the income and paid to tax authorities wholly on behalf of the recipient (i.e., withholder). Withholding tax is also called as tax deducted at source (TDS). It is imposed on receivers but collected through payers.

Any person who makes disbursement of income subject to withholding tax is required to withhold income tax at the time of disbursement, to remit all taxes thus withheld to the government account within 15 days and to submit particulars thereof to the tax office concerned.

c. Collection along with self-assessment

Each person is required to file a return within three months after the end of each income year. While filing the final return, taxpayers are required to pay outstanding tax, if any.

2.2.4.2 Collection of Tax

If a taxpayer doesn't pay tax voluntarily within the due date, the tax official collects the tax arrears through special efforts. According to the present laws, collection of tax refers to the

recovery or realization of tax arrears through such special effort made by the tax official.
The act has stated the following measures for the recovery of the due amounts:

Recovery of Tax from Person Owing Money to Tax Debtor (sec 109)

Tax administration may recover due amount from the following persons on account of and to the tax payable by the tax debtor:

a. Person owing money to the tax debtor.
b. Person holding money on account of a third person for payment to the tax debtor.
c. Person having authority from a third person to pay money to the tax debtor.

A person making a payment to the government will be treated as making the payment to the tax debtor. The tax debtor or any other person mayn't make a claim against the persons with respect to such amount.

Departure Prohibition Order (Sec. 106)

If a person didn't pay tax within payable time, the department can serve notice to the immigration office to prevent the person from leaving country for a period of 72 hours from the time of notice served. If the person pays the tax or makes an arrangement for payment, tax administration may be noticed in writing served on the office and withdraw the order.

Recovery of Tax from Agent of Non-Resident (sec. 110)

The department may by service of a notice in writing require a person who is in possession of assets owned by the tax debtor to pay the tax on the behalf of the tax debtor up to the market value of the assets. In case of such payment, the person may recover the payment from tax debtor an amount not exceeding the payment. The tax debtor may not make claim against the person with respect to the retention.

Recovery of Tax from Receiver (Sec 108)

Tax administration also can recover amount from a receiver such as a liquidator, a mortgagee in possession, an executor, administrator or direct heir of a deceased individual's estate, or any person conducting the affairs of an incapacitated individual.

Charge Over Assets and Sales of Charged Assets (sec 104)

If the tax payer is not able to pay tax on or before the due date, the government can create charge over the assets of the taxpayers by severing notice to him stating:

- Detail of the assets auction.
- The extent of charge. (Tax payable, interest occurred etc.)
- Any cost of charge on auction

Suit for Unpaid Tax/Legal Action against Unpaid Tax

The administration may file a suit against the person who has not paid tax on time with the concerned district court for recovery of the tax. (sec. 111)

2.2.4.3 Remission of Tax

Government may remit in whole or in part any tax that is payable of a person where the tax cannot be collected. The government also remits in whole or in part any interest of penalty chargeable under the act. (sec. 112)

2.2.4.4 Refund and Set-off (sec 113)

If a person has paid the tax in excess of the tax liability, the department will first recover the tax payable by the person. After recovering that amount if there is still the tax excess of the liability, the remaining amount will be refunded to the taxpayer.

2.2.5 Appeal

Income Tax Act, 2058 has made provision for two types of appeal system: First to the Inland Revenue Department for an administrative review and second is to Revenue Tribunal.

2.2.5.1 Administrative Review

Income Tax Act, 2058 has introduced the concept of administrative review that will allow the tax administration to correct mistakes made by the tax administration internally.

For the purpose of Income Tax Act 2058, administrative review may be conducted on the following decisions:

a. A personal ruling issued by the department.

b. An estimate by the department or the decision to make an estimate on person's estimated tax payable.
c. A decision by department on an application by a person to extend the due date by which the person must file a return.
d. A decision by the department to require a person to file a return of income.
e. An assessment of income tax payable by a person or determination of the costs of auction of charge assets or interest and penalties payable by a person.
f. Notification by the department of an amount to be set aside by a person as a receiver.
g. A decision by the department to require a person to pay monies owing to a tax debtor to the department.
h. A decision by the department to require a person to pay tax on behalf of a non-resident person.
i. A decision by the department on as application by a person for a refund of tax.
j. A decision by the department on an application by a person for an extension of time.

A taxpayer who doesn't agree with review-able decision made by a tax officer may file in writing an objection to the decision with the department. It is noted that in case of application filed for administrative review against on assessment of income tax payable by a person under jeopardy or amended assessment, the person has to deposit 50% of debatable tax and full amount of un-debatable tax.

After consideration of a person's objection filed, the department may allow or disallow the objection in whole or part. The department is required to notify the person in writing of the decision on an objection. If the department fails to notify the person in writing of the decision on an objection within 90 days of an objection being filed the person may treat the department as having made a decision to disallow the objection.

2.2.5.2 Appeal to the Revenue Tribunal:

As per sec. 116, a person who is aggrieved by a decision on an objection may appeal to the Revenue Tribunal in accordance with the Revenue Tribunal Act 2031. The appellant should file a copy of the notice of appeal with the department within 15 days of doing so. However, the operation and enforcement of an objection decision is not stayed or otherwise affected by an appeal. If director general of the department has made the decision relating to administrative review, the appeal to Revenue Tribunal would be effective.

2.2.6 Tax Accounting

2.2.6.1 Methods of Tax Accounting

On the basis of this act, the financial transactions of a firm are recorded either on a cash basis or in an accrual basis. Income Tax Act 2058 has specified the method of tax accounting in section 22 when a person derives an income or incurs an expense is made according to the generally accepted accounting principles. In calculating the individual's income from an employment or investment for tax purpose, the accounting should be done on cash basis.

Table 2.1: Use of Tax Accounting

Person	Income Head	Accounting Method
Individual	Employment, Investment	Cash Basis
Sole Trader/Proprietor	Business	Cash or Accrual Basis
Company	Business, Investment	Accrual Basis
Other entity	Business, Investment	Cash or Accrual basis

Source: Income Tax Act, 2058

2.2.6.1.1 Cash Basis of Accounting

A person who keeps tax account on a cash basis in calculating the person's income from employment, business or investment should:

- Treat an amount as derived and include in income only when the payment is received or made available to the person.
- Treat an expose as incurred and deduct in that calculation only when the payment is made.

2.2.6.1.2 Accrual Basis of Accounting

A person who keeps tax account or an accrual basis in calculating the person's income from business or investment should treat an amount as derived and include in income when the person becomes entitled to the payment for the purpose of deductions, the following expenses is treated as incurred:

- When the person is obliged to make the payment
- The value of obligation can be determined with reasonable accuracy
- The other payment has been received.

In case of accrual basis accounting, an appropriate adjustment should be made at the time the payment is received or made so as to account for the in accuracy that may happen in both income and expenditure including by reason of a change in currency valuations.

2.3 Self-Tax Assessment

Self-tax assessment is the system in which a taxpayer pays himself his income tax by calculating his tax to pay on the preparation of his income and showing his/her every detail. In general self-tax assessment is done by the assesses himself. The first amendment 1977 of Income Tax Act 1974 had made the provision of self-tax assessment for the first time. This provision aims to increase awareness in taxpayers about their tax liability and to facilitate the collection of tax, but it was not properly implemented in practice before the enforcement of Income Tax Act, 2058.

Income Tax Act, 2058 focuses on the self-assessment system. Under this Act, every assessment will be treated as self-assessment. Where a person files a return of income for an income year, an assessment is treated as made on the due date for filing the return of:

- the tax payable by the person for the year and in the amount shown in the return, and
- the amount of the tax still to be paid for the year being the amount shown in the return.

Where a person fails to file a return of income for an income year then, until such time as return is filed, an assessment is treated as made o the due date for filing the return that:

- The amount of tax payable bye the person for the year is equal to the sum of any tax withheld from payments derived by the person during the year and any tax paid by the person by installment for the year, and
- There is no tax payable on the assessment.

The tax official validate self-assessment only when the person submits the income return in format on the due date along with the tax payable in a proper way without any error and motive of fraud.

Advantage of self-assessment:

- Minimize undue delay in tax assessment procedure.
- Upgrade the taxpaying habits.
- Proper maintenance of the bookkeeping.

In order to cope with the several problems the government has declared the following objectives of the current revenue policy.

- To improve tax flexibility and effectiveness.
- To facilitate stakeholders.
- To encourage investment and saving by providing friendly environment to taxpayers.

2.4 Review of Related Studies

A number of books, dissertations, articles and reports have been published on the tax system of Nepal, some individuals and institutions have also conducted studies on income tax. They have studied about the various aspects relating to administrative problem, legal aspects and trends of income tax, etc. These studies are useful in the field of income tax.
Some of the books, articles and dissertations that are reviewed during this study are as follows:

2.4.1 Review of Books

Nagendra Bahadur Prandhanga (1993) wrote a book entitled “Income Tax Laws and Accounting”. Mr. Pradhananga has described the provisions made under income tax laws. This book is divided into 20 chapters. In this book, Mr. Pradhananga has described about the income tax and its development in Nepal. He has also described about fines and penalties, appeal, contribution of income tax for the development of nation, income tax administration and official, collection and return of income tax and admissible and inadmissible expenses etc. He also included some numerical problems in regard to income tax assessment, but this book has not analyzed the importance of income tax, problems and defects in Nepalese income tax act and importance of exemptions and deductions in income tax system of Nepal. This book has been written to fulfill the M. Com and B.Com course of T.U, especially this book is based on the syllabus of B.Com of T.U.

Khadka (1994) has described national and local taxes and tax administration in Nepal. The study mainly focuses on the process by which the Nepalese tax system was adopted and developed. He examined the structure & operation of the Nepalese tax system of that period in more detail. He has covered existing major problem of income tax and possible direction for reform. The major problems are as follows: unscientific tax assessment and collection, narrow tax coverage, weak tax administration, imbalance and inadequate organizational structure, inadequate tax training programme, lack of information on tax system. His possible direction for reform was extension of tax coverage, improvement in tax assessment, extension withholding tax, inflation adjustment etc. He has also identified some possible directions for administration reform. They were reorganization and expansion, research unit on taxation. His book is very useful to know about various aspects of income tax in Nepal, although he has not any numerical illustration and has not mentioned the legal provision relating to income tax.

Tiwari (1999) has presented a book about income tax system in Nepal. Basically this book is written for the students of Tribhuvan University and it is equally useful to the taxpayers, tax administrators, and the person who want to get theoretical as well as practical knowledge about income tax. He has described the provisions under Income Tax Act 2031, income tax rules, provision under Finance Act, 2055, other provisions, information and acts related income etc. He has not analyzed the major problems of income tax system.

Adhikari (2002) has presented a book on income tax. He has discussed the legal provisions relating to Income Tax Act, 2058 with critical analysis. He has also included the decision made by Supreme Court on different cases relating to income tax. This book has only focused on the legal aspects of income tax. Agreement and protocol relating to avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income between different countries are also included in his book. His book is informative rather than analytical.

Aryal & Poudyal (2004) have published a book named “Taxation in Nepal.” They have described the theoretical and practical aspects of income tax & VAT. This book is extremely based on B.B.S. third year syllabus as prescribed by Tribhuvan University. This is very useful to get knowledge about Income Tax Act 2058, although it is unable to describe the tax structure of Nepal and the problem of income tax system.

Amatya, Pokhrel and Dahal (2004) wrote a book entitled “Taxation in Nepal”. This book is also designed to meet the requirement of B.B.S. third year syllabus. Theoretical as well as practical aspects of taxation have been included in the book. This book is a descriptive one, not analytical.

Khadka (2007) wrote a book entitled “Modern Tax Administration in Nepal”. This book is very much useful to anyone who is interested in Nepalese income taxation. This book gives almost complete information about the tax system of Nepal from its ancient time to current situation of income tax system. He has shared his expertise in his book. Basically, author focuses on the administrative aspects of the tax system in Nepal.

Adhikari (2006) has presented a book on modern income tax. He has discussed the provision under Income Tax Act 2058. His book is analytical rather than informative. He has introduced different aspects of tax planning needs and base for successful tax planning. He has also presented historical background, income tax laws and its implements, assessment of tax and tax authorities and duties.

Bhattarai and Koirala (2008) wrote a book entitled “Tax Laws and Tax Planning”. This book has been written to fulfill the master’s course of T.U. This book has been organized in 20 chapters. In this book, writers have described the process related to the income tax assessment and tax planning. They have also presented an overview of relevant tax laws, Income Tax Act, 2058 and Value Added Tax, 2052. They have also included numerical problems in regard to income tax assessment. This book is informative and descriptive rather than analytical. It has not analyzed the importance of income tax, problems and defects of income tax system, importance of exemptions and deductions and calculation income tax from various sources.

2.4.2 Review of Dissertations

Pandey (1978) has described a brief review of Nepalese economy resource mobilization, structure of income tax and legal aspect, role and problem of income tax in Nepal. He has given more emphasis on tax structure on Nepal. He has identified two main things: one is that indirect taxes are more significant than direct taxes because of various problems to impose direct taxes and the other is role of income tax to control the inflationary trend within the country. He has identified that the problems of income tax are lack of recordkeeping, lack of maintaining account by taxpayer, lack of responsibility and honestly of tax officers, lack of co-ordination between various tax departments and revenue departments and leakage in personal income tax collection. He has suggested that capital gain should be included on income tax, income from bank interest should be subjected to income tax, the system of granting income tax holiday to industries should be scrapped, and income tax account assessment and collection method be scientific. Although he had explained various aspect of income tax in Nepal, he had not described it with numerical examples and empirical investigation.

Pant (1996) presented his master's level dissertation entitled 'A Study on Income Tax Management in Nepal'. He has identified various problems of income tax management in Nepal and among them lack of managerial efficiency is the main problem. Lack of effective personnel management, poor reward and punishment system, weak income tax assessment procedure, poor tax information and narrow coverage of income tax are the other problems of income tax management in Nepal identified by him.

Bhattarai (1997) has prepared a dissertation with objectives to examine the effectiveness of corporate income tax imposition in Nepal and to recommend an optimum model of corporate income tax system for Nepal. In this study, he has found out that there is lack of balance between rights and duties of tax officer and taxpayer. There is also frequent change in income tax act and finance act. There is lack of balanced delegation of authority, responsibility and accountability. Poor rewards and punishment system, lack of systematic evaluation and control mechanism are the drawbacks of the tax system.

Shrestha (2001) has described the historical background, conceptual framework and legal provisions, structure of income tax in Nepal, income tax administration in Nepal and empirical investigation and problem of income tax in Nepal. Her findings are that there is dominant share of tax revenue in Nepalese government, but the contribution of tax revenue shows the decreasing trends. The tax/GDP ratio is not finding satisfactory in comparison to other SAARC countries. There is serious and growing financial resource gap problem in Nepal and it seems to be never ending problems for Nepalese economy. There is dominant role of indirect tax revenue in Nepalese tax revenue. The estimation and collection of income tax seems to be satisfactory as the collection has been 79.32% of estimation in 1984/85 and it is 106.75% of estimation in 1998/99. She has also found various problem of income tax system in Nepal. They are narrow tax coverage, mass poverty of Nepalese people, lack of taxpayer awareness, widespread evasion and avoidance of income tax, unscientific tax assessment procedure, inefficient tax administration, complicated tax laws and procedures, instability in government policy. Her recommendations are to broaden the Nepalese income tax base by bringing agricultural income, capital gain and other sources of income under the income tax net.

Poudel (2002) presented a dissertation entitled "Income Taxation in Nepal; A Study of its Structure and Productivity." The objectives of her study were to analyze the structure of income tax in Nepal, to estimate the elasticity and buoyancy of income tax in Nepal, to assess the role of income tax administration in Nepal, to evaluate the success of voluntary disclosure income scheme (VDIS) program in brief and to provide the suitable recommendation for improving the scenario of income tax. She has found that overall revenue of Nepal showed and annual growth of 16%. Indirect taxation has more significant contribution in total tax revenue. Income tax occupied the first rank among the direct taxes. Personal income tax slabs have been changed radically from seven slabs in 1975/76 to two slabs in 1999/2000. VDIS couldn't attract more potential taxpayers into tax net due to lack of good planning and adequate homework of the government. Working procedure of the tax administrators is still traditional and cost of administration has not been brought to the satisfactory level.

Kafle (2004) has described the contribution of income tax from public enterprises to public

Revenue of Nepal with special reference to Nepal Electricity Corporation. He has mainly focused about conceptual framework, legal provision and structure of income tax, conceptual framework of PEs and the Nepal Electricity Corporation, contribution of income tax to the public revenue and contributed portion of income tax of Nepal Electricity Corporation to the total income tax. He has conducted an empirical investigation about various aspects of PEs income tax impositions in Nepal. He has taken 65 persons as a sample. Tax experts, taxpayers, tax administrators and Nepal Electricity Corporation's officers are the sample of his study. His findings about the tax structure were in total tax revenue, indirect tax constituted 78%. The share of income tax to direct tax revenue has been fluctuating significantly. The contribution of income tax revenue from Nepal Electricity Corporation in total tax revenue and total government revenue was 0.26% and 0.21% respectively in the fiscal year 2001/02. Contribution of income tax from PEs in Nepal was not sufficient. He suggested that income tax system will succeed if the system has widening tax coverage, tax consciousness to people, minimize the evasions and avoidance problem, enhance the self assessment system and reform in income tax assessment and administration system.

Uttam Gautam (2005) conducted a study entitled "Personal Income Taxation in Nepal; A study on Exemptions and Deduction." His study is confined with exemption and deductions provision under ITA 2058. He has described that to increase the government revenue, the present tax base must be widened by including the income from foreign sector such as amount received by Nepalese people after their retirement from the services of army or police of the foreign government. In agricultural income, there must be some exemption limit and the income above this limit must be taxed. The present level of income tax exemption is not appropriate. It must be raised to minimum of Rs. 100,000 against Rs. 85,000 for an individual. Similarly, the limit provided to family and couple should be adjusted on the basis of inflationary situation of the country on yearly basis. He had made the empirical analysis by making survey of 50 samples in Kathmandu valley.

Ghimire (2007) presented his master's level dissertation entitled, 'Effectiveness of Self-Assessment of Income Tax in Nepal'. He has identified that there was dominant share of tax structure in Nepalese government revenue. Income tax has occupied third position in his study period and it has increasing trend. The tax GDP/ratio was not found satisfactory with the income tax. There was the dominant role of corporate income tax but it was in decreasing trend, and contribution of individual income tax was in second position and it was in increasing trend. He has also found that lack of trained employees, shortage of income tax experts/professionals in tax administration, lack of public participation, weakness in government policy and defective income tax act were the major causes for inefficient tax administration. He has suggested that public awareness program should be conducted to raise government revenue. A Proper and effective audit system is necessary in order to make self-assessment system successful.

Bastola (2007) presented her master's level dissertation entitled 'The Role of Income Tax in National Economy and Income Tax Management in Nepal'. She has briefly presented about resource mobilization, structure of income tax and legal aspect, role and problem of income tax in Nepal. She has identified two main things: first, indirect taxes are more significant than direct taxes because of various problems to impose direct taxes and the other is role of income tax to control the inflationary trend within the country. She has identified that the problems of income tax are lack of recordkeeping, lack of maintaining account by taxpayer, lack of responsibility and honesty of tax officers, lack of co-ordination between various tax departments and revenue departments and leakage in personal income tax collection. She has identified various problems of income tax management in Nepal. Among them lack of managerial efficiency is the main problem. Lack of effective personnel management, poor reward and punishment system, weak income tax assessment procedure, poor tax information and narrow coverage of income tax are the other problems of income tax management in Nepal identified by her.

2.4.3 Review of Reports and Articles

Revenue Consultation Committee (2001) report has studied the overall taxation situation in depth. It highly emphasized to simplify the tax policy to increase voluntary compliance. This report recommended for written communication between taxpayer and tax administration rather than the informal relation. This report suggested to wide the income tax base by including all kinds of taxpayers and income and to find out the taxpayers of new sector. For this, the report suggested to make the actions more transparent and clear in order to attract foreign and domestic investors. It was further suggested to increase income tax exemption limit considering purchasing power and inflation rate.

Pant (2004) has described the problems in tax administration and reform in Nepal. He has identified the following problems on tax administration.

- Low amount record in transaction.
- Low amount record in sales.
- Lack of the mobilization of experienced personnel.
- Ineffective reward and punishment system.
- Lack of effective co-ordination between Inland Revenue Office and Revenue Research Unit.
- License revenue without tax clearance.

Toyanath Tripathi (2005) in his research study entitled "Contribution of Income Tax from Public Enterprise to Government Revenue in Nepal." The main objective of this study was to analyze the structure of income tax in Nepal, to analyze the contribution of income tax in Nepal and to analyze the contribution of tax from public enterprises to government revenue of Nepal. In this study, he suggests that the income tax rules and regulations should be clear and simple for all taxpayers.

Binod Rijal (2006) conducted a research entitled "A Study on Contribution of Corporate Tax in Government Revenue" in 2006. The main objective of this thesis was to analyze the role of income tax in Nepal, to examine the corporate tax structures in Nepal etc. The study analyzed only the period of 10 years. In his study, he made recommendations that private investment should be increased, revenue leakage should be controlled, corruption should be controlled etc. but he didn't make any recommendations about exemptions and deductions.

Conclusion

Various books, dissertations, reports and articles published in journals and newspapers are reviewed while preparing this dissertation. Some of them are concentrated on the legal and administrative aspects of income tax system and structure of tax and some are related to income tax provision and laws, but most of them are related on the syllabus of Master and Bachelor levels. Most of the research studies have identified major problems of Nepalese income tax system as tax evasion, high level of ineffective tax administration and lack of clear provision of law. There are very few research studies about self-assessment of income tax under present income tax act in Nepal which plays an important role to collect tax revenue.

2.5 Research Gap

Studies mentioned above are concerned with laws, provisions, administrative aspects, structure of tax and types of tax. Most of them, in general, have identified inefficiency of tax administration and widespread tax evasion as major problems. No attention has been paid on a particular problem in detail. Thus a thorough study on a particular problem like self- tax assessment system is utterly felt.

Income Tax Act, 2058 has fully adopted self-tax assessment system. Self-assessment of income tax is a system in which a taxpayer assesses himself his income tax by maintaining proper accounts. Self-assessment of tax from corporate sector plays vital role in Nepalese economy. It is supposed to assess tax on due date until such time as the income return is to be filed although a person fails to file the return. Self-assessment of tax is mentioned as efficient all over the world. Thus, the topic "Effectiveness of Self Assessment of Income tax in Nepal" has been selected for the purpose of the study. The Study is directed towards analyzing the various aspects analytically.

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter deals with the research methods used by us in conducting the present study in line with the objections spelt out in 1.3.

3.1 Research Design

The research study first focuses on the role of income tax, indirect tax and direct tax in total tax revenue and effectiveness of income tax revenue collection in Nepal. To achieve the stated objective of the study, the opinion of 122 Persons associated directly with tax, i.e., tax expert, tax administrators and taxpayers will be collected through structured questionnaire (See: Appendix - 1). The questionnaire inquires about the role of income tax to national revenue, provisions of fines and penalty, soundness and effectiveness of income tax system, the most important factors for the effectiveness of income tax system including necessary suggestions for achieving effectiveness of income tax in Nepal etc. In this way, the research design of this research is a combination of descriptive, analytical as well as empirical.

3.2 Population and Sample Sources of Data

Out of 122 questions only 100 sets of questions were collected. For all purposes of the study 100 respondents concerned with tax system of Nepal from Kathmandu valley were selected to fulfill the objectives of this study. Persons included in the sample are carefully selected on the basis of fundamental sampling. The respondents have been divided into three groups. The following table shows the group of respondent's size of the sample.

3.2.1 Group of Respondent and Size of the Sample

S. No.	Group of Respondents	Distributed Sample Size	Received Sample Size
1	Tax Administrators	30	25
2	Tax Experts	32	25
3	Taxpayers	60	50
Total		122	100

3.3 Nature and Source of Data:

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

A. Primary Data

Primary information has been collected through administrating structured questionnaire to sample population. The same questionnaire was distributed to all respondents. Tax administrators are selected from tax department and various tax offices. Lecturers, auditors, chartered accountants etc has been considered as tax experts. Taxpayers are selected representing various sectors like manufacturing, trading, banks, insurance, finance, departmental store etc.

B. Secondary Data

Secondary information was collected from various published report of different organizations. The sources of information have been collected through the following sources:

- Books on public finance, and taxation in Nepal.
- Dissertation.
- Internet websites.
- National and international newspapers, journals, souvenir and magazines.
- Reports and records of Department of Taxation and Ministry of Finance, Government of Nepal, UNDP.
- Budget speech and economic survey for various years, Ministry of Finance, Government of Nepal
- Other relevant records and data.

3.4 Data Collection Procedure

The data for this study are collected from two sources. Primary data are collected by using questionnaire. Questionnaire was developed, distributed, and collected personally through field visits. Secondary data are collected from published reports of different organizations.

3.5 Data Processing and Analysis Procedure

For the analysis, all collected data and information of various aspects of income tax was arranged in order and processed. Then the descriptive tools and statistical tools such as simple percentage; simple average; graphs, charts and diagrams; correlation and other statistical and financial tools etc. have been applied in the way of analysis so that the findings could be presented and interpreted properly in order and clearly.

CHAPTER FOUR

DATA PRESENTATION AND EMPIRICAL ANALYSIS

4.1 PRESENTATION AND ANALYSIS OF DATA

4.1.1 Tax Structure of Nepal

The history of modern income tax in Nepal originated in the early 1950s when the multiparty democratic political system was introduced. In 1951, the finance minister in his budget speech declared the intention of the government to levy an income tax. The first elected government in 1959 finally introduced Business Profit and Salaries Tax Act, 1960 in Nepal. After about three years experience of income tax, the government replaced the prevailing tax act by another Income tax act in 1962. In 1974, Income Tax Act, 1974 (2031) was enacted, and in 2058 the Income Tax Act was enacted and coverage extended. Since the initiation of first in 1956, taxes have been raised for the achievement of the national economic goals. The tax structure of the nation composed of direct as well as indirect taxes. The total tax structure of the Nepal from the fiscal year 1999/00 to 2008/2009 is presented in this chapter.

4.1.2 Resource Gap in Nepal

Every government is responsible to perform numerous functions for the betterment of the people in the country. A government needs huge volume of income to meet various types of expenditure for this purpose. Government collects revenue from different sources. Government income is generated through various sources like taxes, borrowing, fees, donation etc.

Nepal has been facing a serious resource gap problem from the beginning of the planned economic development. A large amount of external aid, loan and internal loan is borrowed to fulfill this growing resource gap. But scarcity of resource seems to be never ending problem for Nepal.

Resource mobilization is still poor, and that does not cover the total expenditure in Nepal. Fiscal deficit is due to the continuously growing expenditure of the government on the other hand low revenue performance on the other. Due to this almost twenty five percent of the government revenue is being utilized in debt servicing. It is also often said that Nepal is being encircled into debt trap. The position of resource gap in Nepal is presented in Table 5.1.

The resource deficit of Rs.17667.00 million in 1999/00 reached to Rs.50804.60 million in the fiscal year 2008/09. It clearly shows that Nepal is facing a serious problem, and the problem will further be aggravated in the future days to come.

The government takes foreign and domestic loans to meet resource deficit. Foreign loan was Rs. 5272.2 million in the fiscal year 1999/00 and Rs. 9968.90 million in 2008/09. Similarly, domestic loan was Rs. 6540.00 million in the fiscal year 1999/00 and Rs. 18417.10 million in 2008/09. Foreign and domestic loan are not enough to fulfill the resource gap, still there exist gap termed as net resource gap in the table. After foreign and domestic loan financing, net resource gap stood at Rs 5854.80 million in the fiscal year 1999/00 and increased to Rs 22418.60 million in the fiscal year 2008/09. Only in the fiscal year 2004/05 there was surplus finance by Rs 157.7 million. Thus, the increasing resource gap indicates that it is necessary to mobilize additional domestic resource. Ultimate and best measure to fill up the resource gap is to increase public revenue through effective tax system.

Table 4.1: Resource Gap in Nepal

Rs. in Million

Financial Year	Expenditures (A)	Receipts (B)			Resource Deficit (C) {A-B}	Source of Deficit Financing (D)			Net Resource Gap (E) {C - D}
		Revenue	Foreign Grants	Total		Foreign Loan (A)	Domestic Loan	Total	
1999/00	66272.50	42893.80	5711.70	48605.50	17667.00	5272.20	6540.00	11812.20	5854.80
2000/01	79835.10	48893.60	6753.40	55647.00	24188.10	4114.00	7930.00	12044.00	12144.10
2001/02	80072.20	50445.50	6686.10	57131.60	22940.60	7698.70	8000.00	15698.70	7241.90
2002/03	84006.10	56229.80	11339.10	67568.90	16437.20	4546.40	8880.00	13426.40	3010.80
2003/04	89442.60	61815.70	11283.40	73099.10	16343.50	7629.00	5607.80	13236.80	3106.70
2004/05	102560.40	70122.70	14391.20	84513.90	18046.50	9266.10	8938.10	18204.20	-157.70
2005/06	110889.20	72282.10	13827.50	86109.60	24779.60	8214.30	11843.20	20057.50	4722.10
2006/07	133604.60	87712.10	15800.80	103512.90	30091.70	10053.50	17892.30	27945.80	2145.90
2007/08	161349.90	107622.50	20320.70	127943.20	33406.70	8979.90	20496.40	29476.30	3930.40
2008/09	219661.90	143474.50	26382.80	169857.30	50804.60	9968.90	18417.10	28386.00	22418.60

Source: Economic Survey, 2009/10, Ministry of Finance, Kathmandu

4.1.3 Composition of Total Tax and Non-Tax Revenue to Total Revenue

The income of the government through all sources like custom duty, value added tax, income tax, land revenue and registration charge, fines and penalty, royalty etc. is called public revenue. Public revenue may be broadly classified into two categories.

a. Tax Revenue
b. Non-Tax Revenue

In Nepal, the total revenue of the government is composed of tax and non-tax revenue. Tax revenue includes the amounts which are compulsory contribution by the taxpayers to the government. Non-tax revenue includes fees, special assessment, gifts, grants and penalties etc. Non-tax revenue sources are uncertain and inconvenient. The composition of total tax and non-tax revenue is presented in following table 4.2.

Table 4.2: Composition of Total Tax and Non-Tax Revenue

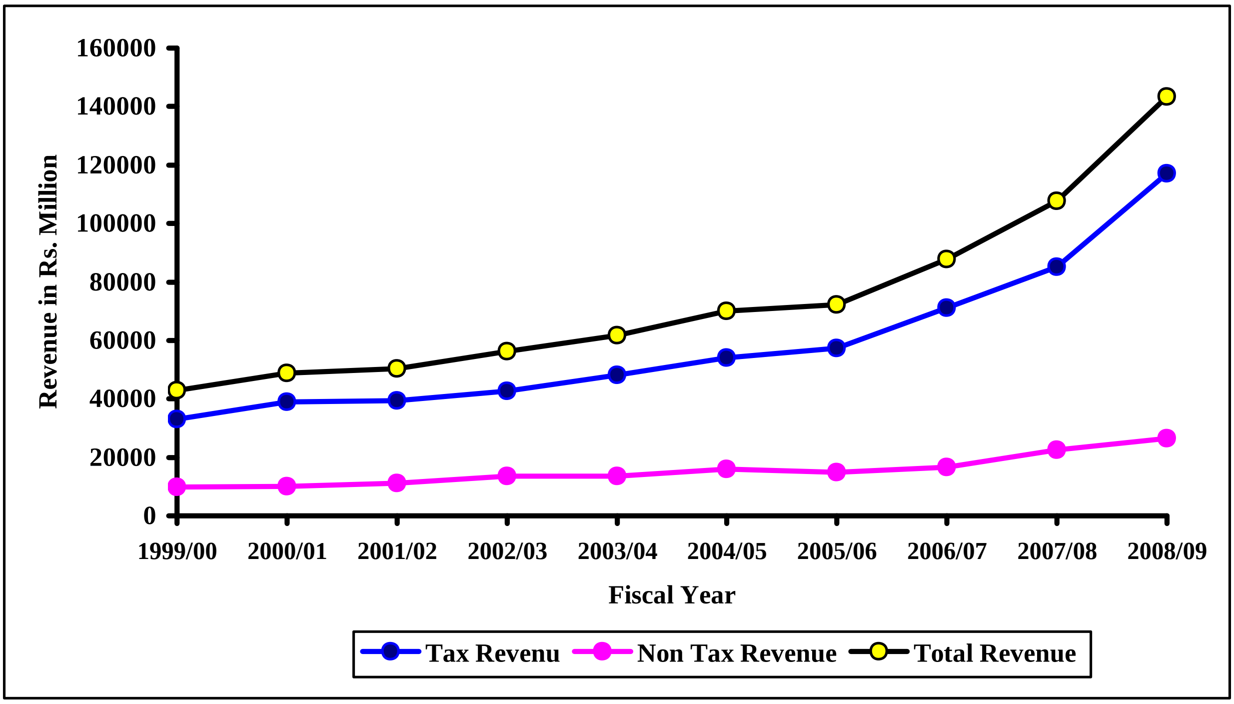
Rs. in Million

Financial Year	Revenue			Percentage on Total Revenue	
	Tax	Non-Tax	Total	Tax	Non-Tax
1999/00	33152.10	9741.70	42893.80	77.29	22.71
2000/01	38865.10	10028.50	48893.60	79.49	20.51
2001/02	39330.60	11114.90	50445.50	77.97	22.03
2002/03	42586.92	13642.88	56229.80	75.74	24.26
2003/04	48173.00	13642.70	61815.70	77.93	22.07
2004/05	54104.70	16018.00	70122.70	77.16	22.84
2005/06	57430.40	14851.70	72282.10	79.45	20.55
2006/07	71126.70	16585.40	87712.10	81.09	18.91
2007/08	85155.54	22466.96	107622.50	79.12	20.88
2008/09	117051.9	26422.6	143474.5	81.58	18.42

Source: Economic Survey, 2009/10, Ministry of Finance, Kathmandu

The total revenue for the fiscal years 1999/00 to 2008/2009 is presented in the above table. It shows the contribution of tax revenue to the total revenue of the nation. In the fiscal year 1999/00 the tax revenue 77.29 percent and non-tax revenue was 22.71percent of total revenue. Likewise in the fiscal year 2008/2009 the percentage was 81.58 and 18.42 respectively. The above table shows that the composition of total revenue is almost in the same trend. Tax revenue has ranged between 76 and 81 percent.

Figure 4.1: Composition of Total Tax and Non-tax Revenue of Total Revenue



Tax revenue is the most important source of the government revenue since it contributes more than 75 percent share in the total government revenue. The importance of non-tax revenue can not be less prioritized. The trend of non-tax revenue collection has also increased during the period selected for the study (Fiscal Year 1999/00 to 2008/2009).

4.1.4 Composition of Total Direct and Total Indirect Tax to Total Tax Revenue

Tax is a compulsory contribution imposed by a public authority. Tax revenue is the principal source of the government revenue; however, its contribution differs significantly in different countries. In the context of Nepalese economy, tax revenue composes of total direct tax revenue and total indirect tax revenue. If someone pays taxes to the government from his/her own income, it is called direct tax. Indirect taxes are that taxes which are imposed on one person but paid partly or wholly by others. Custom duty, VAT, entertainment tax etc. are indirect taxes. There has been simultaneous increase in total tax, total indirect tax and total direct tax revenue in absolute form. The trend and composition on of tax revenue for 1999/00 to 2008/2009 is presented in the table as below:

Table 4.3: Composition of Direct Tax and Indirect Tax Revenue on Total Tax Revenue

Rs. in Million

Financial Year	Tax Revenue			Percentage on Tax Revenue	
	Direct	Indirect	Total	Direct	Indirect
1999/00	8951.50	24200.60	33152.10	27.00	73.00
2000/01	10159.40	28705.70	38865.10	26.14	73.86
2001/02	10596.50	28734.10	39330.60	26.94	73.06
2002/03	10105.80	32481.12	42586.92	23.73	76.27
2003/04	11912.10	36260.90	48173.00	24.73	75.27
2004/05	13071.80	41032.90	54104.70	24.16	75.84
2005/06	13968.10	43462.30	57430.40	24.32	75.68
2006/07	18980.30	52146.40	71126.70	26.69	73.31
2007/08	23087.76	62067.78	85155.54	27.11	72.89
2008/09	34320.70	82731.20	117051.90	29.32	70.68

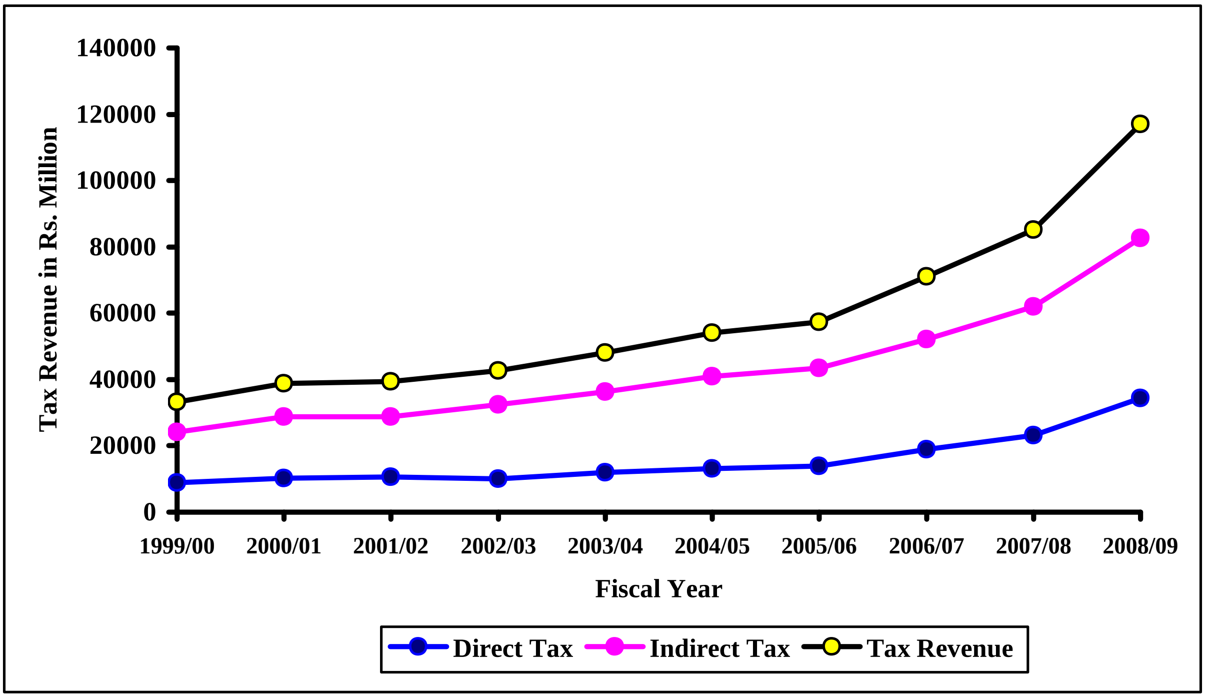
Source: Economic Survey, 2009/10, Ministry of Finance, Kathmandu

In Nepalese tax revenue; share of indirect tax is larger than the direct taxes. Its share lies between 73 to 76 percent during the period under study. It shows that there has not been fluctuation. However, the share of direct tax is quite low. In absolute terms, the amount is increasing for both the direct and indirect taxes. The basic reason for increase in these taxes is due to expansion of tax bases and tax rates. The trend in absolute value, total tax revenue, direct tax and indirect tax is also increasing.

In comparison to the other developed country like USA, UK, Japan etc., contribution of direct taxes in Nepal is very low. Being an undeveloped country, most of the Nepalese people live at subsistence level and all of their income is being spent out on consumption. This could be a reason that direct tax is not producing more revenue than indirect tax.

The amount of indirect tax in the fiscal year 1999/00 was Rs. 24200.60 million and 73.00 percent of total tax revenue; but even after 10 years in the year 2008/09, share of tax is 70.68 percent at Rs. 82731.20 million. The picture of both the direct and indirect taxes will be clear from figure 4.2.

Figure 4.2: Composition of Direct Tax and Indirect Tax Revenue on Total Tax Revenue



We have shown the trend of total tax revenue, direct tax and indirect tax is shown in table 4.3 and figure 4.2. Bothe these have made it clear that although almost the same share in percentage term has been maintained, the share of direct tax is quite low. It needs to be raised by raising people's income so that they would be able to pay higher taxes.

4.1.5 Contribution of Income Tax and Personal Income Tax to Total Tax Revenue

In the following table, the percentage share of income tax and personal income tax in the total tax revenue is given. The income tax and personal income tax's share are increasing every year. The income tax from the individuals and income tax from the remuneration are included in the personal income tax revenue. For the purpose of calculating income tax, the income tax from property, profit and the income is taken. So, income tax includes income tax from public enterprises, income tax from semi-public enterprises, income tax from private corporate bodies, income tax from urban house and land rent tax, tax on interest and other taxes.

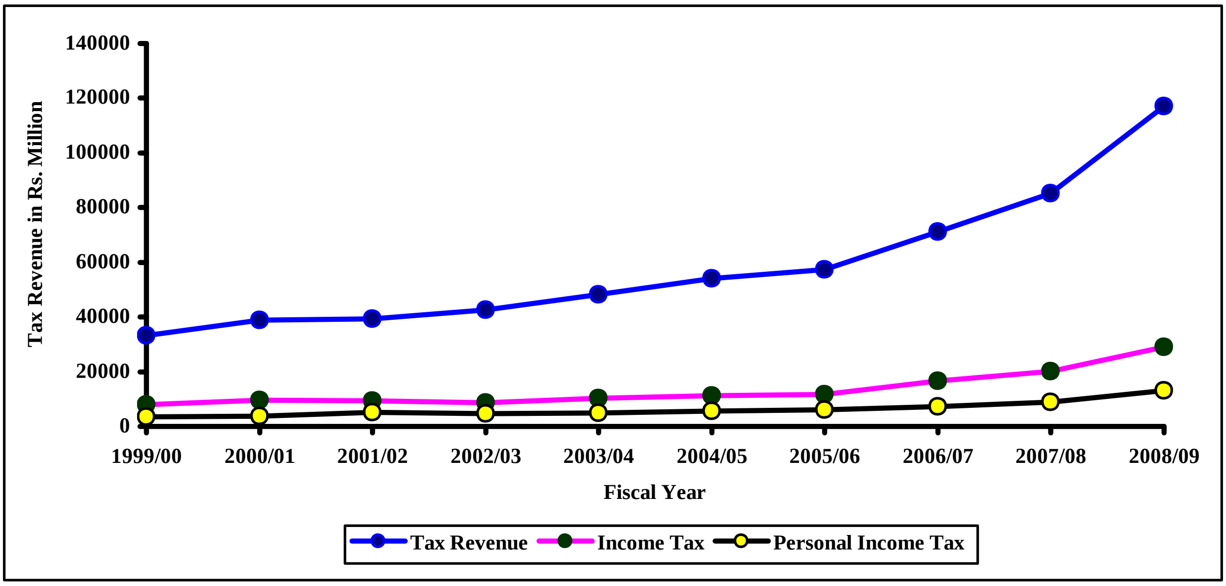
Table 4.4: Contribution of the Income Tax and Personal Income Tax to Total Tax Revenue

Financial Year	Total Tax Revenue	Income Tax Revenue	Personal Income Tax Revenue	Percentage on Tax Revenue	
				Income Tax	Personal Income Tax
1999/00	33152.10	7935.60	3467.90	23.94	10.46
2000/01	38865.10	9546.50	3797.80	24.56	9.77
2001/02	39330.60	9465.73	5254.65	24.07	13.36
2002/03	42586.92	8691.36	4614.80	20.41	10.84
2003/04	48173.00	10215.10	4924.60	21.21	10.22
2004/05	54104.70	11272.60	5602.20	20.83	10.35
2005/06	57430.40	11787.00	5998.80	20.52	10.45
2006/07	71126.70	16726.80	7242.30	23.52	10.18
2007/08	85155.54	20147.20	8832.25	23.66	10.37
2008/09	117051.9	29097.4	13073.1	24.86	11.17

Source: Economic Survey 2009/10, Ministry of Finance 2010 Kathmandu

Information presented in the above table has also been depicted in the following figure, and then discussed.

Figure 4.3: Contribution of the Total Income Tax and Personal Income Tax to Total Tax Revenue



From the above table and figure, it is clear that in the fiscal year 1999/00 the contribution of the total income tax revenue and personal income tax revenue to the total revenue was 23.94 and 10.46 percentage respectively; but in the fiscal year 2008/09, this ratio went up and dropped to 24.86 percent and 11.17 percent respectively. Above information clearly tells that the percentage of both the income tax as well as personal income tax revenue has almost remained the same with very little fluctuations. For example, Share of income tax revenue varies between 20.4 to 24.6 percent, and personal income tax from 10 to 13 percent. However, both of them have tremendously increased in absolute term over this study period, income tax revenue by three times and personal income tax revenue also by almost three times. This is an implication of the fact that in absolute term the amounts of different types of taxes have increased, but the percentage of each almost remaining at the same with very little fluctuations.

4.1.6 Composition of Direct Tax Revenue

Direct tax is actually paid by the person on whom it is imposed legally. Direct tax is levy by the government on the income and wealth received by households and business enterprises in order to raise revenue as an instrument of fiscal policy. It is progressive so far as the amount paid varies significantly according to the income and wealth of the taxpayer. In Nepalese tax structure, the major component of direct taxes are income tax, land tax, property tax, land registration tax. The contribution of direct tax and other tax component are shown in table 4.5.

Table 4.5: Composition of Direct Tax Revenue

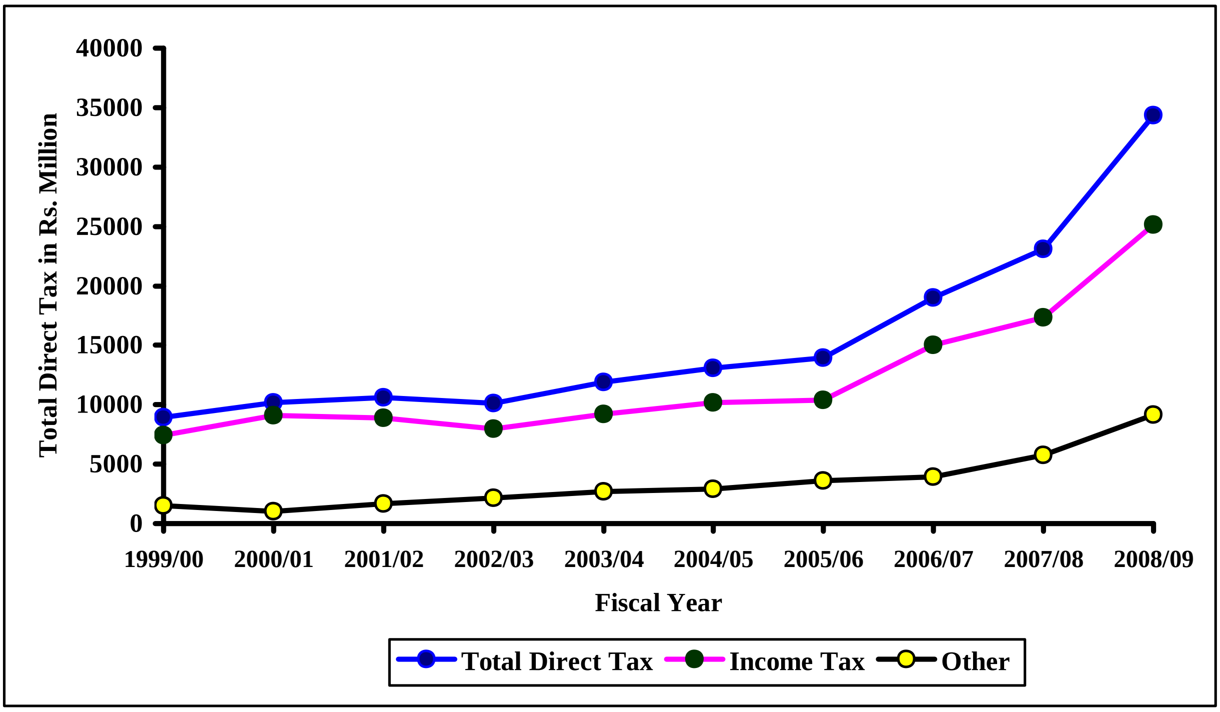
Rs. in Million

Financial Year	Total Direct Tax	Direct Tax		Percentage on Direct Tax	
		Income Tax	Other	Income Tax	Other
1999/00	8951.50	7420.60	1530.90	82.90	17.10
2000/01	10159.40	9114.00	1045.40	89.71	10.29
2001/02	10596.50	8903.70	1692.80	84.02	15.98
2002/03	10105.80	7966.20	2139.60	78.83	21.17
2003/04	11912.10	9205.90	2706.20	77.28	22.72
2004/05	13071.80	10159.40	2912.40	77.72	22.28
2005/06	13968.10	10373.70	3594.40	74.27	25.73
2006/07	18980.30	15034.00	3946.30	79.21	20.79
2007/08	23087.76	17311.22	5776.54	74.98	25.02
2008/09	34320.7	25142.4	9178.3	73.26	26.74

Source: Economic Survey 2009/10, Ministry of Finance 2010 Kathmandu

Major portion of direct tax is the income tax. The amount of contribution from income tax to the total direct tax has fluctuated between 73 to 90 percent. Initially in the year 1999/00 it stood at 82.90 percent and then reached the highest percentage of 90 in 2000/01. Finally it has remained at a low figure of 73 percent in 2008/09. It means that share of the rest other than income tax has increase. Diagram also makes it clear (Figure 4.4).

Figure 4.4: Composition of Direct Tax Revenue



4.1.7 Composition of Income Tax Revenue:

Income tax is an important source of the direct tax. In the present situation, Nepal is levying three different types of income taxes. They are individual income tax, corporate income tax and tax on interest. Individual income tax covers all natural person and sole traders and partnership etc. having income of taxable capacity. Corporate covers public enterprises and semi-public enterprises and private corporate bodies. Remuneration refers to salaries earned from government or non-government sectors.

The composition of income tax revenue for the recent past 10 years is presented in table 4.6 and figure 4.5.

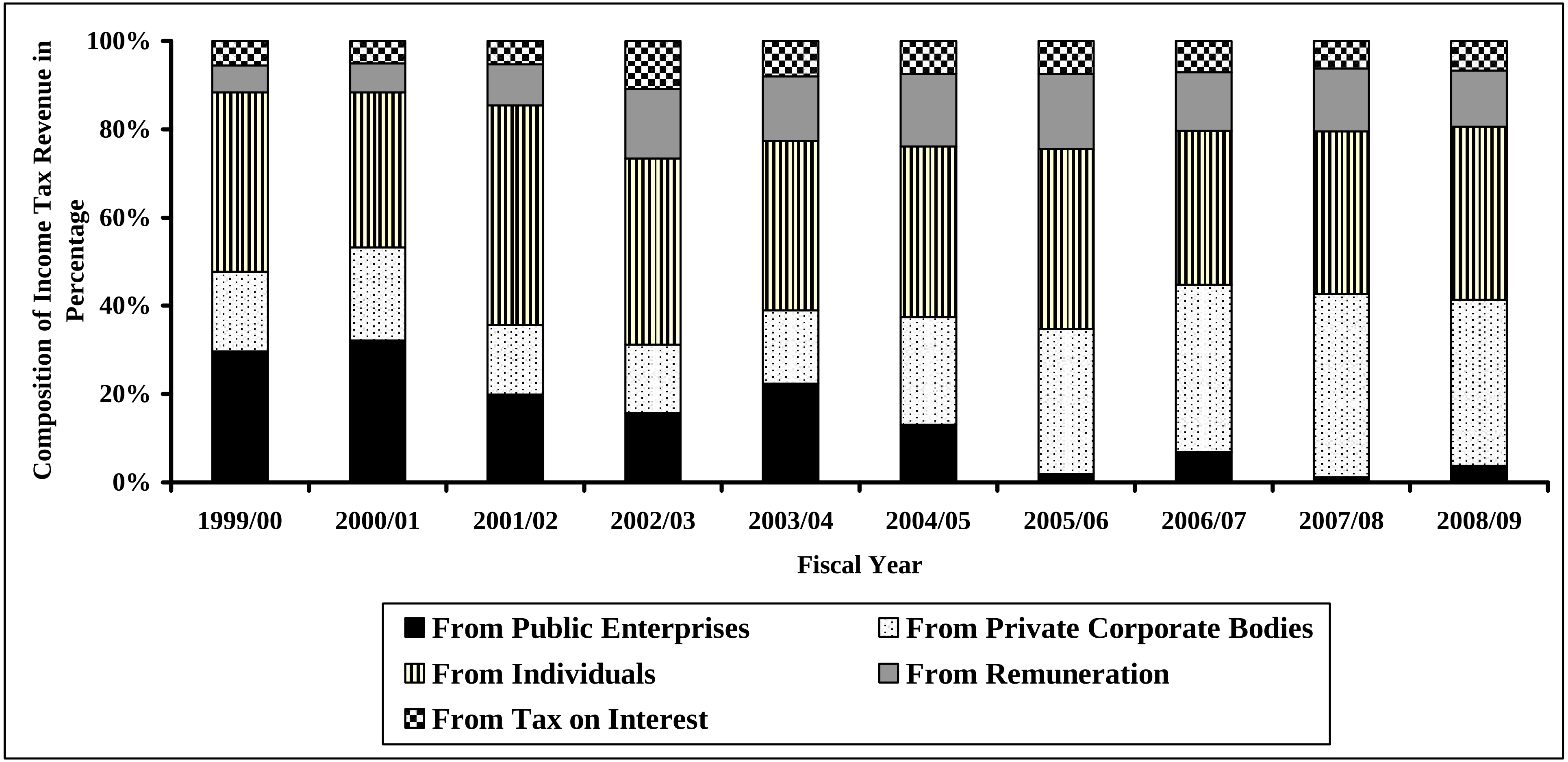
Table 4.6: Composition of Income Tax Revenue

Rs. in Million

Financial Year	Income Tax											
	Total		From Public Enterprises		From Private Corporate Bodies		From Individuals		From Remuneration		From Tax on Interest	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%	Rs.	%	Rs.	%
1999/00	7420.60	100	2198.80	29.63	1339.50	18.05	3016.40	40.65	451.50	6.28	414.40	5.58
2000/01	9114.00	100	2928.00	32.13	1924.30	21.11	3200.50	35.12	597.30	6.55	463.90	5.09
2001/02	8903.70	100	1769.30	19.87	1412.00	15.86	4419.10	49.63	835.60	9.38	467.70	5.25
2002/03	7966.20	100	1251.00	15.70	1236.30	15.52	3362.30	42.21	1252.60	15.72	864.00	10.85
2003/04	9205.90	100	2056.60	22.34	1531.30	16.63	3533.40	38.38	1351.20	14.68	733.40	7.97
2004/05	10159.40	100	1332.40	13.11	2467.80	24.29	3926.30	38.65	1675.90	16.50	757.00	7.45
2005/06	10373.70	100	195.70	1.89	3404.30	32.82	4234.70	40.82	1764.10	17.01	774.90	7.47
2006/07	15034.00	100	1019.70	6.78	5717.10	38.03	5234.40	34.82	2007.90	13.36	1054.90	7.02
2007/08	17311.22	100	204.58	1.18	7186.46	41.51	6381.21	36.86	2451.04	14.16	1087.93	6.28
2008/09	25142.40	100	959.10	3.81	9425.10	37.49	9877.50	39.29	3195.60	12.71	1685.10	6.70

Source: Economic Survey 2009/10, Ministry of Finance 2010, Kathmandu

Figure 4.5: Composition of Income Tax Revenue



The amount of income tax is gradually increasing except for 2001/02 and 2002/03. In the fiscal year 1999/00, the amount of income tax stood at Rs 7420.60 million which increased to Rs 25142.40 million in 2008/09. This amount is the total income tax from public enterprises, semi-public enterprises, private corporate bodies, individuals, remuneration and interest tax.

From table 4.6 it is seen that the amount of contribution from public enterprises has fluctuated from a maximum of Rs. 2928.0 million in 2000/01 to a minimum of Rs. 195.7 million in 2005/06. The contribution ratio of this tax is quite low during the last three years under study. At the end it has stood at 3.81 percent of total income tax. This is clearly an indication of the fact that public enterprises in Nepal are not performing well.

Private corporate bodies are the prime revenue generating sector for income tax. From fiscal year 2002/03 the ratio of contribution is increasing each year. In the fiscal year 2002/03 the contribution is 15.52 percent which is the lowest contribution and reached to 37.49 percent in fiscal year 2008/09 which is the average increasing contribution. This shows private sector activities are to some extent growing.

Individual income tax is the largest revenue generating sector of income tax. During the first three fiscal years it slowly decreased and finally reached to Rs. 3200.5 million in the 2000/2001. In the fiscal year 2001/2002 contribution of individual income tax revenue is the highest, i.e. 49.63 percent. Then again it started decreasing. It shows that the contribution of individual income tax is not consistent. In the fiscal year 2008/09 the individual income tax is Rs. 9877.50 million, which is the 39.29 percent of total income tax.

The remuneration tax is also the major source of income tax. The tax revenue from remuneration is increasing each year except fiscal year 2003/04 and 2006/07. The highest contribution to income tax is 17.01 percent in fiscal year 2005/06. It was Rs 451.50 million in the fiscal year 1999/00 and reached to Rs. 3195.60 million in fiscal year 2008/09.

Tax on interest is the lowest revenue generating sector of income tax. During the first four fiscal years the rate of contribution is almost consistent at 5 percent. In the fiscal year 2002/2003 contribution of interest tax is the highest, i.e. 10.85 percent and again it decreases. It shows that the contribution of tax on interest is not consistent. In the fiscal year 2008/09 the tax on interest is Rs. 1685.10 million, which is the 6.70 percent of total income tax.

4.1.8 Estimation and Collection of Income Tax in Nepal

Nowadays, the revenue from income tax has the increasing trend. The collection was little bit higher than the estimates in the fiscal year 1999/00, i.e. 100.55 percent of estimate. It was also collected in excess than the target during the fiscal years 1999/00, 2003/04 and 2006/07. In the fiscal year 2006/07 the tax collection rate was 122.9 percent, which is the highest. But in the fiscal year 2008/09 the tax collection rate declined to 107.37 percent. In that fiscal year tax was collected by Rs. 1872.10 million more than estimates. Table and diagram also makes it clear. (See table 4.7 and Figure 4.6).

Table 4.7: Estimate and Collection of Income Tax in Nepal

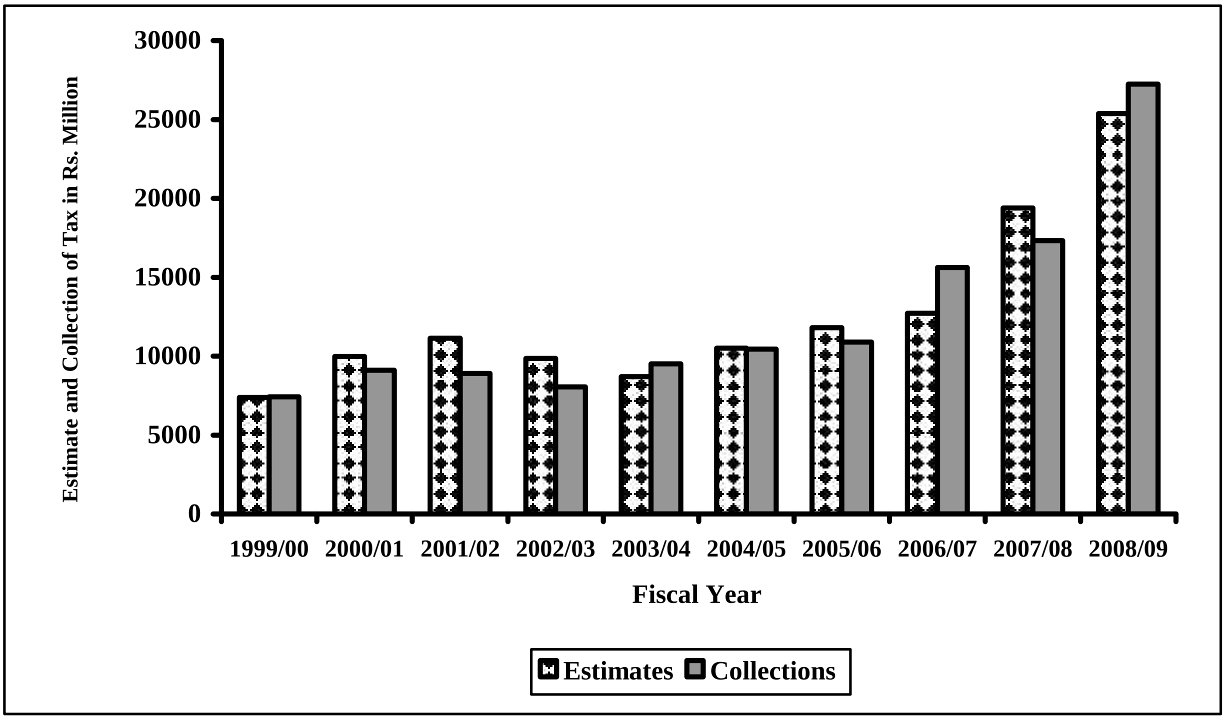
Rs. in Million

Fiscal Year	Estimates	Collections	Difference	Percentage of Collection on Estimates
1999/00	7380.00	7420.60	40.60	100.55
2000/01	9980.00	9114.60	(865.40)	91.33
2001/02	11140.00	8903.70	(2236.30)	79.93
2002/03	9862.50	8059.57	(1802.93)	81.72
2003/04	8697.50	9514.78	817.28	109.40
2004/05	10500.00	10452.64	(47.36)	99.55
2005/06	11800.00	10896.45	(903.55)	92.34
2006/07	12710.50	15621.43	2910.93	122.90
2007/08	19387.50	17327.92	(2059.58)	89.38
2008/09	25374.30	27246.40	1872.10	107.37

Note: Figure in bracket indicates negative.

Source: Annual Reports of I.R.D 2010

Figure 4.6: Estimate and Collection of Income Tax



Both the table and figure make the situation of tax estimation and collection clear.

4.1.9 Income Tax Rates in Nepal for the Fiscal Year 2009/10 *(Based on Finance Act 2066)*

An income tax rate in Nepal for the fiscal year 2009/10 has been presented in the following section 4.1.9.

4.1.9.1 Tax Calculation of Natural Persons

A. Tax Rates for Natural Persons

For Resident Individual Taxpayers

Taxable Income Bands	*Tax Rate*
Rs 1 to Rs 160,000	1% for employees, 0% for others
Rs 160,001 to Rs 260,000	1% up to Rs.160,000 & 15% for balance
Above Rs 260,000	Rs.16,600 up to Rs.260,000 & 25% for balance

For Resident Individual couples

Taxable Income ***Bands Tax Rate***

Rs 1 to Rs 200,000	1% for employees, 0% for others
Rs 200,001 to Rs 300,000	1% up to Rs.200,000 & 15% for balance
Above Rs 300,000	Rs.17,000 up to Rs.300,000 & 25% for balance

Tax Rate for Non Resident Natural Person

Taxable income of a non resident natural person shall be taxed at 25%.

Rebate on Tax Liability for Resident Female with only employment income

A female resident natural person having only remuneration income from employment shall be provided with a rebate of 10% on the tax liability.

Tax on Non Business Chargeable Assets

Gain from disposal of Non Business Chargeable Assets are taxed at 10% after taking into consideration exemption limit (i.e. Rs.1, 60,000 for individual and Rs.2, 00,000 for couples). In case of land and buildings, if the disposed land & buildings has been owned for more than 5 years, tax rate of 5% shall apply.

Gain from Non Business Chargeable Assets includes

- Gain from sale of shares of companies,
- Gain from sale of land and building owned and resided for less than 10 years and disposed for more than Rs.50 lakhs.

Special Tax Rates for Natural Persons

Particulars	Applicable tax rate
For incomes earned from operating special industries	20% where 25% tax rate applies
For incomes earned from export business	20% where 25% tax rate applies

B. Deductions and Facilities for Resident Persons

Life Insurance Premium

While calculating taxable income, life Insurance premium paid by a resident natural person is deductible up to the limit of Rs 20,000.

Employees working in Diplomatic Agencies

75% of foreign allowance is deducted from taxable income in case of an employee employed at diplomatic agencies of Nepal situated at foreign countries.

Incapacitated natural persons

In case of incapacitated natural persons, the minimum exemption limit (Rs.1,60,000 for individual and Rs.2,00,000 for couples) is increased by additional 50%.

Remote Area Benefit

In case the income is generated from an activity at a remote area of Nepal, an additional exemption limit has been prescribed.

Classification	Limit in Rs.
A	30,000
B	24,000
C	18,000
D	12,000
E	6,000

Additional limit for pension income

If income of a resident natural persons includes pension income, the minimum exemption limit (Rs.1, 60,000 for individual and Rs.2, 00,000 for couples) is increased by additional 25% or pension amount included in income whichever is lower..

C. Tax Credits for Resident Persons

Medical Tax Credit

In case of approved medical expenses, medical tax credit is available to resident natural persons as deduction from tax liabilities. The limit prescribed is Rs.750 or 15% of Approved medical expense or actual approved medical expense incurred whichever is lower. Any unutilized expenses can be carried forward to next year.

Foreign Tax Credit

If foreign income is included in taxable income of a resident person, foreign tax credit for tax paid in foreign country in respect of that income. The foreign tax paid can either be deducted as expense or tax liability in Nepal can be reduced by such tax paid up to average rate of tax applicable in Nepal, depending on the option of tax payer.

4.1.9.2 Tax Calculation of Entities

A. Normal Tax Rates

S. No.	Entities	Applicable tax rate
1.	General companies/firms/industries	25%
2.	Special Industries	20%
3.	Banks and Financial Institutions	30%
4.	General Insurance Companies	30%
5.	Entities engaged in the business of petroleum products	30%
6.	Industries producing products with tobacco as basic raw material and industries producing liquors, beers and similar other products	30%
7.	Entities involved in construction of roads, bridges, tunnels, rope-ways suspension bridges etc.	30%

B. Reduced Rates

S. No.	Corporate Groups	Applicable tax rate
1.	Information Technology industries	22.5%
2.	Special Industries and Information Technology Industries providing direct employment to 300 or more Nepalese citizens during a period	90% of applicable rate
3.	Special Industries providing direct employment to 1200 or more Nepalese citizens during a period	80% of applicable rate
4.	Special Industries providing direct employment to more than 100 Nepalese citizens during a period 33% of which are women, incapacitated and dalits	80% of applicable rate
5.	Special Industries operating in very undeveloped area	50% of applicable rate

6.	Special Industries operating in undeveloped area	70% of applicable rate
7.	Special Industries operating in underdeveloped area	75% of applicable rate
8.	Industries established in Special Economic Zone of mountain district as specified by the government and hilly district	0% for 10 years & 50% thereafter
9.	Industries established in Special Economic Zone of other areas	0% for 5 years and 50% thereafter
10.	Income from foreign technology, management fee and royalty earned by foreign investor from industries established in special economic zone	50% of applicable rate
11.	Industries established in remote areas	0% for 10 years
12.	Information Technology based industries established at prescribed Information Technology park	75% of Normal Rate
13.	Licensed Industries engaged in production and distribution of electricity, if the production and distribution is completed by the end of Chaitra 2075	100% exemption for first 7 years, 50% for next 3

C. Tax Rates for Non Residents

Particulars	Applicable tax rate
For incomes earned from operation of water transport, charter service or air transport or by operating a cable, radio, optical fiber or earth-satellite communication business from the transmission of news or information through the equipments installed in Nepal	5%
For incomes earned from providing air transport, water transport or telecommunication services within the territory of Nepal	2%
On repatriation of income by Foreign Permanent Establishment	5%

D. Presumptive Taxation

a. Income Tax on Owners of public vehicles

Types of Vehicle	Tax (Per Vehicle p.a.)
Minibus, Minitruck, Truck and Bus	Rs. 1,500.00
Car, Jeep, Van, Micro bus	Rs. 1,200.00
Three Wheeler, Auto Rikshaw and Tempo	Rs. 850.00
Tractor and Power Tiller	Rs. 750.00

b. Income Tax for Small Tax Payers

Resident Natural Persons who only have business incomes with annual business turnover of Rs. 20,00,000 and net income below Rs 2,00,000 may chose to pay tax as below subject to that the person cannot claim medical tax credit or advance tax for TDS deposited.

Location of Business	Tax (p.a.)
Operating business in Metropolitan and Sub-Metropolitan areas	Rs. 5,000.00
Operating business in Municipality areas	Rs. 2,500.00
Operating business in other areas	Rs. 1,500.00

4.2 EMPIRICAL ANALYSIS

4.2.1 Introduction

An empirical investigation was conducted to find out the various aspects of income tax from the experience of the real world. The major tool used for this study is an opinion questionnaire (appended in Appendix B). It was distributed to 122 persons from taxpayers, tax experts and tax administrators and only 100 sets of questionnaire having completely responded were received. The views of the respondents were collected from Kathmandu valley. Questions were provided with two or more alternatives or asked for ranking of choice according to the number of alternatives where first choice was the most important and last choice was the least one.

Information collected from the respondents was tabulated into the separate format, and they were expressed in terms of percentage of total number and have been analyzed in descriptive ways.

Out of total samples collected, opinions were mainly taken from the income taxpayers, as they represent all types of taxpayers. The numbers of respondents by different groups are presented as below:

Table 4.8: Reponses by Groups

S.N.	Groups in Respondents	Sample Size	
		No.	%
1	Income tax Administration	25	25
2	Income tax payers	50	50
3	Income Tax Experts	25	25
Total		100	100

4.2.2 Result of Empirical Investigation

4.2.2.1 Income Tax as a Suitable Means of Raising Government Revenue

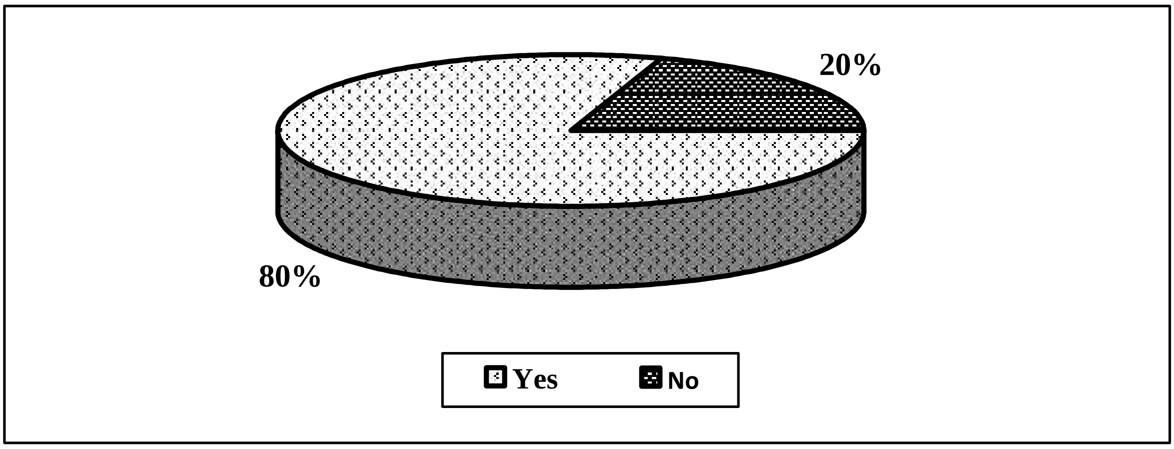
In order to know whether income tax should be practiced as a suitable mean of raising government revenue in Nepal, a query has raised "Do you consider that income tax is the suitable mean of raising government revenue in Nepal?" The respondents were just requested to provide their answer either in affirmative or negative. The respondents' responses are tabulated below in Table 4.9 and then diagrammatically presented:

Table 4.9: Income Tax as a Suitable Mean of Raising Government Revenue

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	25	100	-	-	25	100
Income Taxpayers	30	60	20	40	50	100
Income Tax Experts	25	100	-	-	25	100
Total	80	80	20	20	100	100

Source: Opinion Survey, 2010

Figure 4.7: Income Tax as a Suitable Mean of Raising Government Revenue



From the opinion survey, it is found that cent percent of tax administrators, 60 percent of tax payers and cent percent of tax experts recognize income tax as a suitable means of raising government revenue. Only 40 percent among the taxpayers do not recognize it as a suitable means of raising government revenue in Nepal. Thus, it can be concluded that income tax is a suitable mean of raising government revenue in Nepal. Government of Nepal needs to launch more effective programs to collect more revenue.

4.2.2.2 Necessity of Public Awareness Program

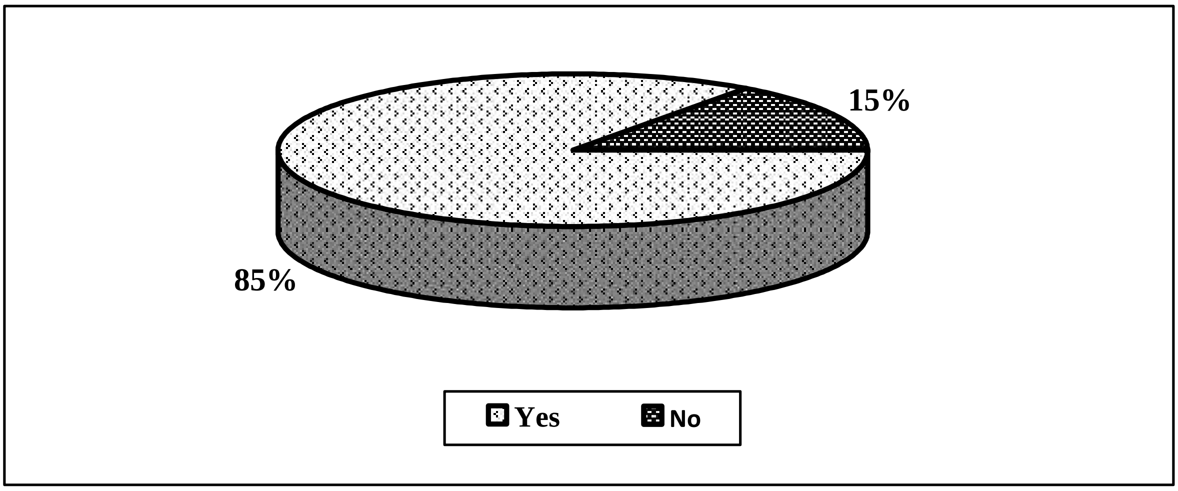
After knowing that income tax is a suitable means of raising government revenue the researcher felt that there exists a need of creating public awareness. It was thus necessary to know the opinion of respondents in this regard. Then a question was asked "Do you think that public awareness program is necessary for raising government revenue?" The responses of the respondents will be clear from Table 4.10 and also the diagram following it.

Table 4.10: Necessity of Public Awareness Program

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	20	80	5	20	25	100
Income Taxpayers	40	80	10	20	50	100
Income Tax Experts	25	100	-	-	25	100
Total	85	85	15	15	100	100

Source: Opinion Survey, 2010

Figure 4.8: Necessity of Public Awareness Program



Cent percent of tax experts, 80 percent of tax administrators and tax payers have positive attitude that public awareness program is necessary for raising government revenue. Only 20% percent tax administrators and tax taxpayers do not recognize public awareness program is necessary for raising government revenue from the survey. In aggregate, 85 percent respondents approved the need of public awareness program. Thus, it can be concluded that public awareness program is necessary for raising Nepalese government revenue.

4.2.2.3 Methods of Income Tax Assessment

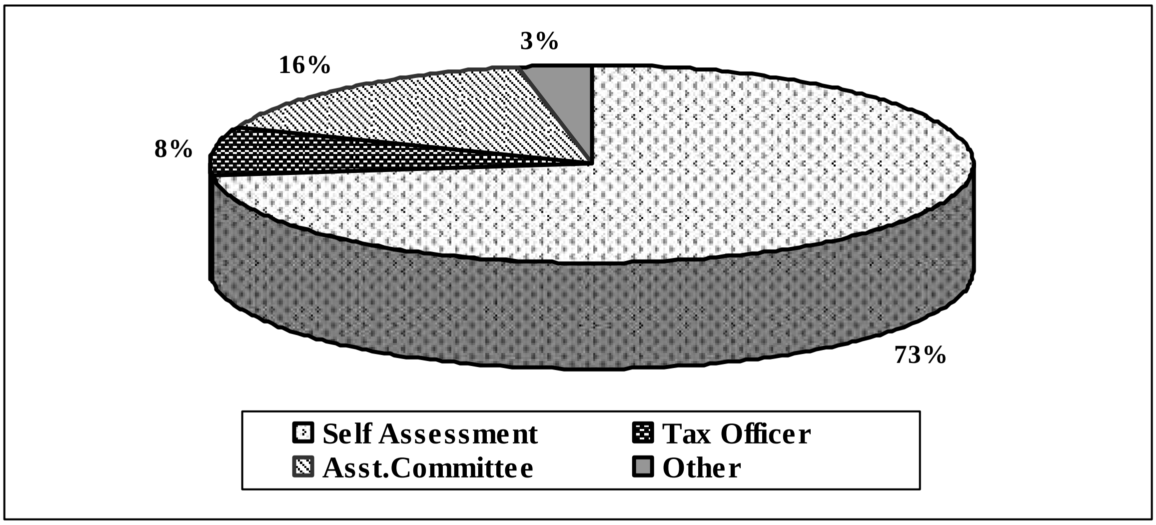
Revenue collection from income tax also depends on the income tax assessment procedure. Assessment procedure should be appropriate and effective. Thus, a related query was interviewed in the questionnaire as to “Which income tax assessment method is appropriate in Nepal” was asked to know the respondents’ they respondent in the following way**:**

Table 4.11: Appropriate Method of Income Tax Assessment

Method	Income Tax Administrators	Income Tax Payer	Income Tax Expert	Total	%
Self-assessment	18	40	15	73	73
By Tax Officer	4	-	4	8	8
By Asst. Committee	3	8	5	16	16
Other	-	2	1	3	3

Source: Opinion Survey, 2010

Figure 4.9: Appropriate Method of Income Tax Assessment



Above tabulation and diagram make it clear that 73 percent respondents prefer self-tax assessment method as more appropriate to assess income tax, which 8 percent in favor of tax officer, and 16 percent in favor of assessment committee, only 3 percent are in the favor of other type assessment. From this, it can be concluded that self-assessment of income tax method is more proffered and appropriate in the eyes of respondents while assessing income tax. In this context it would be necessary to explore whether the self-assessment system is effective.

4.2.2.4 Effectiveness of Self-Assessment of Tax in Nepal

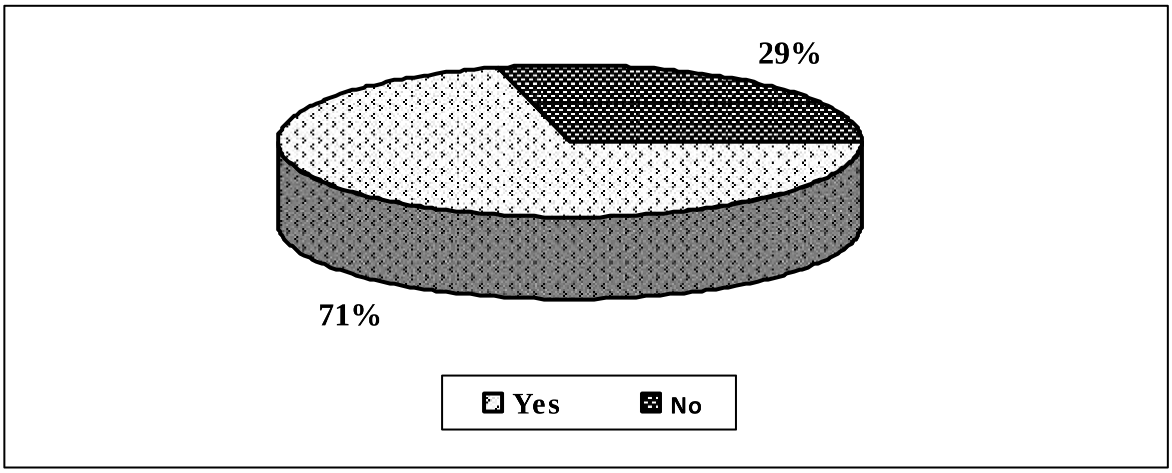
Current income tax act has fully adopted self-tax assessment system. It is supposed to assess tax on the due date until such time that the income return is to be filed although a person fails to file the return. To know the view about the effectiveness of self-assessment of tax in Nepal, the question, “Do you think that self-tax assessment system is effective in Nepal?” was asked to the respondents. The responses were:

Table 4.12: Effectiveness of Self-Tax Assessment in Nepal

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	15	60	10	40	25	100
Income Taxpayers	38	76	12	24	50	100
Income Tax Experts	18	72	7	28	25	100
Total	71	71	29	29	100	100

Source: Opinion Survey, 2010

Figure 4.10: Effectiveness of Self –Tax Assessment in Nepal



Sixty percent of tax administrators, 76 percent of taxpayers and 72 percent of tax experts have accepted the self-assessment of tax as an effective system in Nepal. In aggregate, 71 percent respondent approved self-tax assessment is effective in Nepal. It can be concluded that self-tax assessment is effective in the context of Nepal. But it is also to be noted at this point 29 percent respondents do not prefer this system. Thus, an additional question was asked to those respondents who had replied self-tax assessment is not effective in Nepal. The purpose was to know the reasons for ineffectiveness. The question was "If no, what are the reasons." The responses were:

Table 4.13: Reasons for Ineffectiveness of Self-Assessment of Tax in Nepal

S. No.	Reasons	Rank wise responses				Total
		1	2	3	4	

1	Lack of Knowledge about Self-Assessment Procedure	10	6	7	6	29
2	Lack of Correct Auditing Practices	6	9	4	10	29
3	Lack of Proper Accounting System	9	8	10	2	29
4	Lack of Belief Upon Government	5	7	11	6	29

Source: Opinion Survey, 2010

Ten respondents out of 29 viewed that lack of knowledge about self-assessment procedure is the major reason for ineffectiveness of self-assessment of tax in Nepal and they ranked first for this reason. Same as lack of current auditing practice ranked fourth by 10 respondents, lack of proper accounting system ranked third by 10 respondents and lack of belief upon Government ranked third by 11 respondents.

Meanwhile we thought it would be appropriate to rank the reasons in overall. Thus, weighted mean was formulated and tabulated.

Weighted Mean:

Mean in which each item being averaged is multiplied by a number (weight) based on the item's relative importance. The result is summed and the total is divided by the sum of the weights. Weighted averages are used extensively in descriptive statistical analysis. In short weighted mean is an average that takes into account the proportional relevance of each component, rather than treating each component equally. In the case of ranking analysis the lowest weighted mean stands for first ranking and the highest one standing for last rank.

The weighted Arithmetic Mean is given by:

$$\overline{X} \ \mathrm{X} \ \frac{WX}{W}$$

Weighted mean ($\overline{X}$) calculated by Dividing the total value (∑WX) by the total weight (∑W). Further we used the information tabulated in Table 4.13 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses.

S. No.	Reasons	Rank × No. of Responses (W× X)				∑WX	Weighted Mean	Rank
1	Lack of Knowledge about Self-Assessment Procedure	10	12	21	24	67	2.31	2
2	Lack of Correct Auditing Practices	6	20	12	36	74	2.55	3
3	Lack of Proper Accounting System	9	16	30	8	63	2.17	1
4	Lack of Belief Upon Government	5	14	33	24	76	2.62	4

Weighted mean for the reason lack of proper accounting system is the lowest (i.e. 2.17) so ranked first and lack of belief upon Government is the highest (i.e. 2.62) so it ranked fourth.

In general reasons for ineffectiveness of self-assessment of tax in Nepal according to preference are found as:

- Lack of proper accounting system.
- Lack of knowledge about self-tax assessment procedure.
- Lack of correct auditing practices.
- Lack of belief upon government.

4.2.2.5 Self-Tax Assessment as a Suitable Means of Raising Domestic Resources

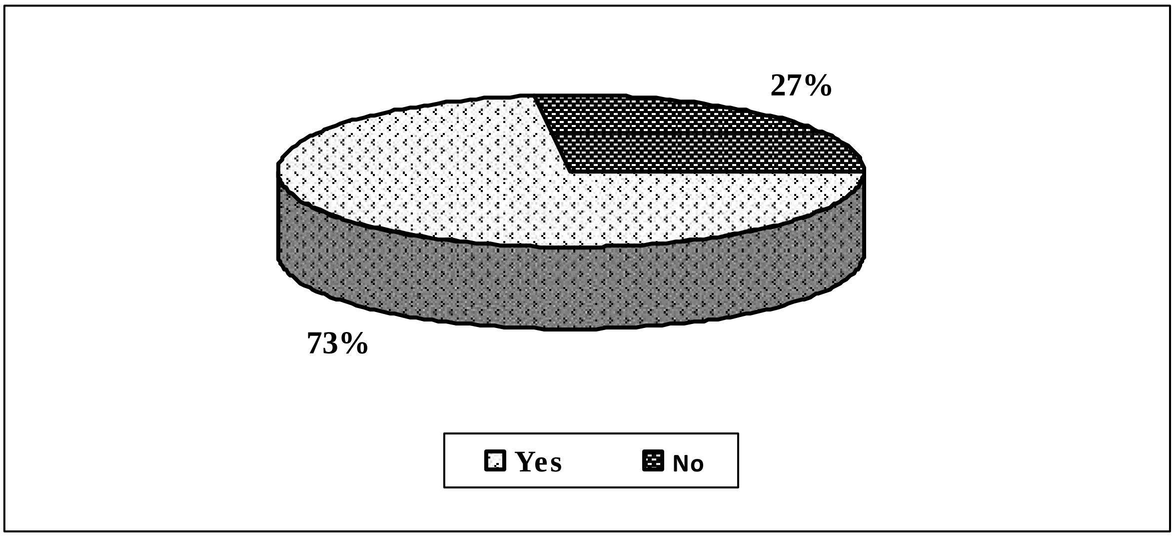
The respondents were asked to respond on question "In your opinion, is the self-tax assessment as a suitable means of raising domestic resources?" The responses received from the respondents are tabulated as follows:

Table 4.14: Self-Tax Assessment a Suitable Mean of Raising Domestic Resources

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	20	80	5	20	25	100
Income Taxpayers	28	56	22	44	50	100
Income Tax Experts	25	100	-	-	25	100
Total	73	73	27	27	100	100

Source: Opinion Survey, 2010

Figure 4.11: Self-Tax Assessment a Suitable Mean of Raising Domestic Resources



Eighty percent of tax administrators, 56 percent of taxpayers and cent percent of tax experts have accepted self-assessment as a suitable mean of raising domestic resources. It is observed that out of total 100 sample collected 73 percent of the respondents felt that self-tax assessment as a suitable means of arising domestic resources appropriate whereas 27 percent of the respondents felt that self-tax assessment as a suitable means raising domestic resources is not appropriate.

Among the respondents who were satisfied with the self-tax assessment a suitable mean raising domestic resources were asked another question "If yes, why it is suitable measure of raising domestic resource?" The responses have been tabulated as follows:

Table 4.15: Reasons for Suitable Measure of Raising Domestic Resources

S. No.	Reasons	Rank wise responses				Total
		1	2	3	4	
1	Helps to know their own liability of taxpayers	26	24	12	11	73
2	Helps to maintain their books of account	9	15	25	24	73
3	Simple and short procedure of assessment	8	14	26	25	73
4	Encourage taxpayer's motive about payment of tax	27	28	11	7	73

Source: Opinion Survey, 2010

Twenty six respondents out of 73 viewed that 'helps to know their own liability of taxpayers' is the major reason for suitable measure of raising domestic resources and they ranked first for this reason. Same as 'helps to maintain their books of account' ranked third by 25 respondents, 'simple and short procedure of assessment' ranked third by 26 respondents and ’encourage taxpayer’s motive about payment of tax’ ranked second by 28 respondents.

Meanwhile we thought it would be appropriate to rank the reasons in overall. Thus, weighted mean was formulated and tabulated.

Weighted Mean:

Mean in which each item being averaged is multiplied by a number (weight) based on the item's relative importance. The result is summed and the total is divided by the sum of the weights. Weighted averages are used extensively in descriptive statistical analysis. In short weighted mean is an average that takes into account the proportional relevance of each component, rather than treating each component equally. In the case of ranking analysis the lowest weighted mean stands for first ranking and the highest one standing for last rank.

The weighted Arithmetic Mean is given by:

$$\overline{X} \text{ X } \frac{WX}{W}$$

Weighted mean ($\overline{X}$) calculated by Dividing the total value (∑WX) by the total weight (∑W).

Further we used the information tabulated in Table 4.15 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses.

S. No.	Reasons	Rank × No. of Responses (W × X)				∑WX	Weighted Mean	Rank
1	Helps to know their own liability of taxpayers	26	48	36	44	154	2.11	2
2	Helps to maintain their books of account	9	30	75	96	210	2.88	3
3	Simple and short procedure of assessment	8	28	78	100	214	2.93	4
4	Encourage taxpayer’s motive about payment of tax	27	56	33	28	144	1.97	1

Weighted mean for the reason ' Encourage taxpayer's motive about payment of tax' is the lowest (i.e. 1.97) so ranked first. So as, ' Simple and short procedure of assessment' is the highest (i.e. 2.93) so it ranked fourth. In general reasons for self-tax assessment are suitable measures of rising domestic resources according to preferences are found as:

- Encourage taxpayer's motive about payment of tax
- Helps to know their own liability of taxpayers
- Helps to maintain their books of account
- Simple and short procedure of assessment

4.2.2.6 Self-Tax Assessment Provision in the Income Tax Act, 2058

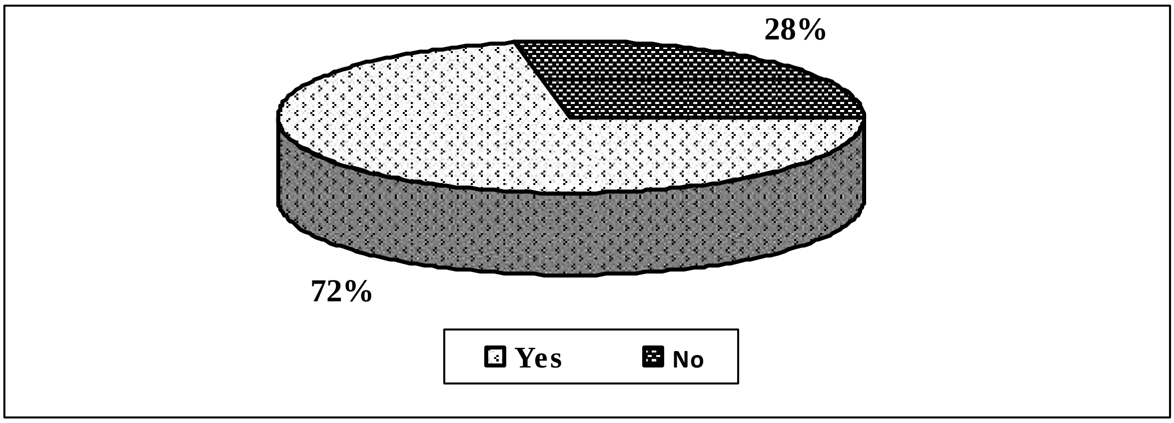
In 1977, the method of self-tax assessment provision was introduced for the first time in Nepal. At present, act has fully adopted self-tax assessment method. Various provisions for self-tax assessment have also been introduced. To know about sufficiency of provisions regarding self-tax assessment method a question, "Do you think that provisions given for self-tax assessment in the new Income Tax Act, 2058 are sufficient?" was asked. The responses as provided by respondents are as follows:

Table 4.16: Sufficiency of Self-Tax Assessment Provision in Income Tax Act

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	20	80	5	20	25	100
Income Taxpayers	30	60	20	40	50	100
Income Tax Experts	22	88	3	12	25	100
Total	72	72	28	28	100	100

Source: Opinion Survey, 2010

Figure 4.12: Sufficiency of Self-Tax Assessment Provision in Income Tax Act



Seventy two percent respondents imply that the self- assessment provision in the income tax act is sufficient while 28 disagree to it. Thus, it can be concluded that the Government of Nepal needs to give concentration in this matter. The provision for self-tax assessment should be made simple. Clear-cut rules need to communicate to the taxpayers easily. Furthermore, incentives should be provided to those taxpayers who submit return on time.

4.2.2.7 Adoption of Self-Assessment System by the Taxpayers

Self -assessment of tax in Nepal is an important feature of income tax system in Nepal. The eighth amendment of Income Tax Act, 2031 has made some mentioned many provisions in this regard giving priority to it. However, but it was not properly implemented in practice before the enforcement of Income Tax Act, 2058. Now most of the persons follow the self-

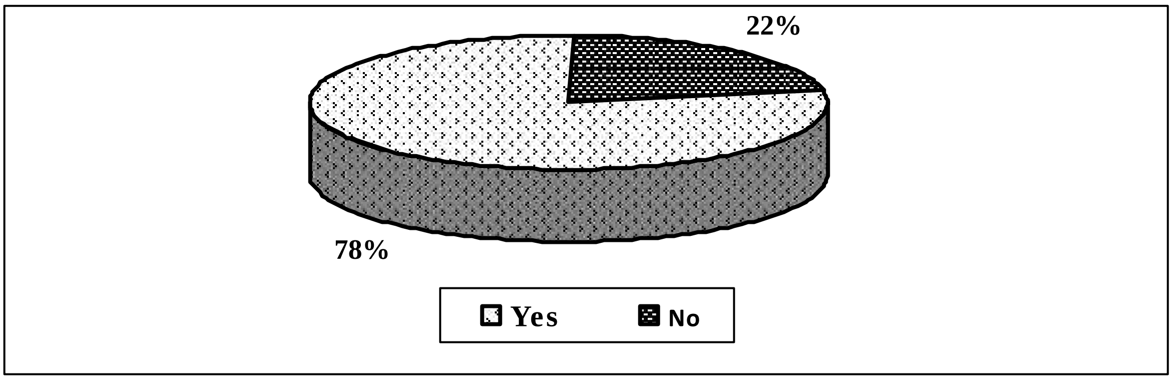
assessment. To know if all the taxpayers adopt the self-assessment a question, "Do you think that all taxpayers follow the self-assessment?" was asked. The responses as provided by respondents are as follows:

Table 4.17: Adoption of Self-Assessment System by the Taxpayers

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	35	70	15	30	50	100
Income Taxpayers	43	86	7	14	50	100
Total	78	78	22	22	100	100

Source: Opinion Survey, 2010

Figure 4.13: Adoption of Self-Assessment System by the Taxpayers



From the opinion survey, it is found that among the respondents 78 percent think that all tax payers follow the self-assessment system, while 22 percent disagree to it. Thus, it can be concluded that most of the taxpayers follow the self-assessment system.

4.2.2.8 Problems in Income Tax Assessment Procedure in Nepal

In order to know the existing problem in self-assessment of income tax procedure in Nepal, the respondents were requested to rank various problems from 1 to 4 according to priority. A question was asked, “What are the major problems of income tax on self-assessment procedure in Nepal?” Responses have been tabulated and analyzed in four groups: 1. tax administrator's view, 2. tax payer's view, 3. tax expert's view, and 4. overall view.

In order to find out the ranks we used weighted mean separately for every group.

Weighted Mean:

Mean in which each item being averaged is multiplied by a number (weight) based on the item's relative importance. The result is summed and the total is divided by the sum of the weights. Weighted averages are used extensively in descriptive statistical analysis. In short weighted mean is an average that takes into account the proportional relevance of each component, rather than treating each component equally. In the case of ranking analysis the lowest weighted mean stands for first ranking and the highest one standing for last rank.

The weighted Arithmetic Mean is given by:

$$\overline{X} \text{ X } \frac{WX}{W}$$

Weighted mean ($\overline{X}$) calculated by Dividing the total value (∑WX) by the total weight (∑W).

Table 4.18: Problems in Tax Assessment Procedure in Nepal *(Tax Administrator's View)*

S. No.	Reasons	Rank wise responses				Total
		1	2	3	4	
1	Lack of relevant tax information	4	5	8	8	25
2	Assesses does not maintain books of account	13	8	4	0	25
3	Lack of proper recording system in tax offices	3	6	7	9	25
4	Assesses wants to escape from tax liability	9	8	5	3	25

Source: Opinion Survey, 2010

Further we used the information tabulated in Table 4.18 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses. Weighted mean was formulated and tabulated as below:

S. No.	Reasons	Rank × No. of Responses (W × X)				∑WX	Weighted Mean	Rank
1	Lack of relevant tax information	4	10	24	32	70	2.80	3
2	Assesses does not maintain books of account	13	16	12	0	41	1.64	1
3	Lack of proper recording system in tax offices	3	12	21	36	72	2.88	4

4	Assesses wants to escape from tax liability	9	12	15	12	48	1.92	2

Weighted mean for the reason ' Assesses does not maintain books of account' is the lowest (i.e. 1.64) so ranked first. So as, ' Lack of proper recording system in tax offices' is the highest (i.e. 2.88) so it ranked fourth. In general the problems in income tax assessment procedure in Nepal according to the scale of preference of the tax experts are as follows:

- Assesses does not maintain books of account.
- Assesses wants to escape from tax liability.
- Lack of relevant tax information.
- Lack of proper recording system in tax offices.

Table 4.19: Problems in Tax Assessment Procedure in Nepal *(Tax Payers' View)*

S. No.	Reasons	Rank wise responses				Total
		1	2	3	4	
1	Lack of relevant tax information	20	10	11	9	50
2	Assesses do not maintain books of account	19	13	9	9	50
3	Lack of proper recording system in tax offices	23	20	5	2	50
4	Assesses wants to escape from tax liability	9	8	8	25	50

Source: Opinion Survey, 2010

Further we used the information tabulated in Table 4.19 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses. Weighted mean was formulated and tabulated as below:

S. No.	Reasons	Rank × No. of Responses (W × X)				∑WX	Weighted Mean	Rank
1	Lack of relevant tax information	20	20	33	36	109	2.18	3

2	Assesses do not maintain books of account	19	26	27	36	108	2.16	2
3	Lack of proper recording system in tax offices	23	40	15	8	86	1.72	1
4	Assesses wants to escape from tax liability	9	16	24	100	149	2.98	4

Weighted mean for the reason 'Lack of proper recording system in tax offices' is the lowest (i.e. 1.72) so ranked first. So as, 'Assesses wants to escape from tax liability' is the highest (i.e. 2.98) so it ranked fourth. In general the problems in income tax assessment procedure in Nepal according to tax payer's preference are as follows:

- Lack of proper recording system in tax offices.
- Assesses does not maintain books of account.
- Lack of relevant tax information.
- Assesses wants to escape from tax liability.

Table 4.20: Problems in Tax Assessment Procedure in Nepal *(Tax Expert's View)*

S. No.	Reasons	Rank wise responses				Total
		1	2	3	4	
1	Lack of relevant tax information	4	3	12	6	25
2	Assesses do not maintain books of account	15	5	3	2	25
3	Lack of proper recording system in tax offices	3	15	5	2	25
4	Assesses wants to escape from tax liability	10	10	5	0	25

Source: Opinion Survey, 2010

Further we used the information tabulated in Table 4.20 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses.Weighted mean was formulated and tabulated as below:

S. No.	Reasons	Rank × No. of Responses (W × X)	∑WX	Weighted Mean	Rank

1	Lack of relevant tax information	4	6	36	24	70	2.80	4
2	Assesses do not maintain books of account	15	10	9	8	42	1.68	1
3	Lack of proper recording system in tax offices	3	30	15	8	56	2.24	3
4	Assesses wants to escape from tax liability	10	20	15	0	45	1.80	2

Weighted mean for the reason 'Assesses do not maintain books of account' is the lowest (i.e. 1.68) so ranked first. So as, Lack of relevant tax information' is the highest (i.e. 2.80) so it ranked fourth. In general the problems in income tax assessment procedure in Nepal according to tax expert's preference are as follows:

- Assesses does not maintain books of account.
- Assesses wants to escape from tax liability.
- Lack of proper recording system in tax offices.
- Lack of relevant tax information.

Table 4.21: Problems in Tax Assessment Procedure in Nepal *(Overall View)*

S. No.	Reasons	Rank wise responses				Total
		1	2	3	4	
1	Lack of relevant tax information	28	18	32	22	100
2	Assesses do not maintain books of account	46	26	16	12	100
3	Lack of proper recording system in tax offices	29	41	17	13	100
4	Assesses wants to escape from tax liability	28	26	18	28	100

Source: Opinion Survey, 2010

Further we used the information tabulated in Table 4.21 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses.Weighted mean was formulated and tabulated as below:

S. No.	Reasons	Rank × No. of Responses (W × X)				∑WX	Weighted Mean	Rank
1	Lack of relevant tax information	28	36	96	88	248	2.48	4
2	Assesses do not maintain books of account	46	52	48	48	194	1.94	1
3	Lack of proper recording system in tax offices	29	82	51	52	214	2.14	2
4	Assesses wants to escape from tax liability	28	52	54	112	246	2.46	3

Weighted mean for the reason 'Assesses does not maintain books of account' is the lowest (i.e. 1.94) so ranked first. So as, Lack of relevant tax information' is the highest (i.e. 2.48) so it ranked fourth. In general the problems in income tax assessment procedure in Nepal according to preferences are as follows:

- Assesses does not maintain books of account.
- Lack of proper recording system in tax offices.
- Assesses wants to escape from tax liability.
- Lack of relevant tax information.

4.2.2.9 Effectiveness of Tax Administration in Tax Assessment

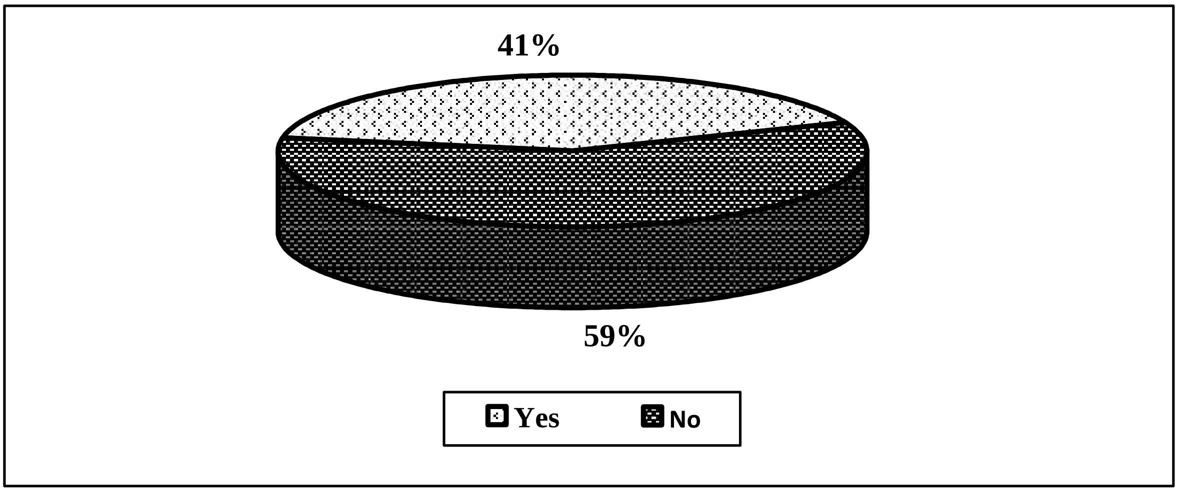
In order to know effectiveness of tax administration in Nepal, a question, “Do you think that tax administration in Nepal is effective?” was asked. The responses are tabulated as below:

Table 4.22: Effectiveness of Tax Administration in Tax Assessment

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	20	80	5	20	25	100
Income Taxpayers	8	16	42	84	50	100
Income Tax Experts	13	52	12	48	25	100
Total	41	41	59	59	100	100

Source: Opinion Survey, 2010

Figure 4.14: Effectiveness of Tax Administration in Tax Assessment



Eighty percent of tax administrators, 16 percent of taxpayers and 52 percent of tax experts have accepted that Nepalese income tax administration is effective and rest disagrees to it. It is observed that 41 percent of the respondents felt that income tax administration is effective and rest 59 percent felt that income tax administration is not effective. Government of Nepal needs to initiate corrective actions.

In order to know the opinion of the respondents regarding the important factors for ineffectiveness of income tax in Nepal, a question, "If no, what are the reasons" was asked. Responses are summarized in the Table 4.23.

Table 4.23: Reasons for Ineffectiveness of Tax Administration in Tax Assessment

S. No.	Reasons	Rank wise responses					Total
		1	2	3	4	5	
1	Lack of proper incentives to tax personnel.	11	14	13	11	10	59
2	Unnecessary outside pressure	17	18	9	7	8	59
3	Lack of knowledge about tax assessment procedure.	22	14	8	5	10	59
4	Lack of meaningful taxpayers' information.	8	11	19	12	9	59
5	Lack of co-ordination within department	6	9	11	9	24	59

Source: Opinion Survey, 2010

Meanwhile we thought it would be appropriate to rank the reasons in overall. Thus, weighted mean was formulated and tabulated.

Weighted Mean:

Mean in which each item being averaged is multiplied by a number (weight) based on the item's relative importance. The result is summed and the total is divided by the sum of the weights. Weighted averages are used extensively in descriptive statistical analysis. In short weighted mean is an average that takes into account the proportional relevance of each component, rather than treating each component equally. In the case of ranking analysis the lowest weighted mean stands for first ranking and the highest one standing for last rank.

The weighted Arithmetic Mean is given by:

$$\overline{X} \text{ X } \frac{WX}{W}$$

Weighted mean ($\overline{X}$) calculated by Dividing the total value (∑WX) by the total weight (∑W).

Further we used the information tabulated in Table 4.23 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses.

Weighted mean was formulated and tabulated as below:

S. No.	Reasons	Rank × No. of Responses (W × X)					∑WX	Weighted Mean	Rank
1	Lack of proper incentives to tax personnel.	11	28	39	44	50	172	2.92	3
2	Unnecessary outside pressure	17	36	27	28	40	148	2.51	2
3	Lack of knowledge about tax assessment procedure.	22	28	24	20	50	144	2.44	1
4	Lack of meaningful taxpayers' information.	8	22	57	48	45	180	3.05	4
4	Lack of co-ordination within department	6	18	33	36	120	213	3.61	5

The most possible reasons for ineffectiveness of tax administration in case of tax assessment stated by the respondents according to preference are:

- Lack of knowledge about tax assessment procedure.
- Unnecessary outside pressure.
- Lack of proper incentives to tax personnel.
- Lack of meaningful taxpayers' information.
- Lack of co-ordination within department.

The main cause indicated by the respondents about ineffective tax administrators in case of tax assessment is lack of knowledge about tax assessment procedure, and other reasons are lack of meaningful taxpayers' information, lack of proper incentives to tax personnel, lack of co-ordination within department and unnecessary outside pressure. Because of the above reasons, the tax administration in Nepal is ineffective.

To know the opinion of the respondents regarding important factors for effectiveness of income tax in Nepal, a question "How can it be improved?" asked. The Responses were:

Table 4.24: Suggestions for Improving Tax Administration

S. No.	Suggestions	Rank wise responses					Total
		1	2	3	4	5	
2	Establishment and implementation of effective rewards and punishment system	21	14	9	5	10	59
1	Controlling the negligence of taxpayers	23	13	8	9	6	59
5	Providing more salary and incentives	4	9	12	11	23	59
3	Conducting seminars, training and conference	8	11	19	12	9	59
4	Timely information and check by government	6	9	11	9	24	59

Source: Opinion Survey, 2010

It would be appropriate to rank the reasons in overall. Thus, weighted mean was formulated and tabulated.

Weighted Mean:

Mean in which each item being averaged is multiplied by a number (weight) based on the item's relative importance. The result is summed and the total is divided by the sum of the weights. Weighted averages are used extensively in descriptive statistical analysis. In short weighted mean is an average that takes into account the proportional relevance of each component, rather than treating each component equally. In the case of ranking analysis the lowest weighted mean stands for first ranking and the highest one standing for last rank.

The weighted Arithmetic Mean is given by:

$$\overline{X} \text{ X } \frac{WX}{W}$$

Weighted mean ($\overline{X}$) calculated by Dividing the total value (∑WX) by the total weight (∑W).

Further we used the information tabulated in Table 4.24 to calculate the weighted mean and ranking analysis. Where, X denotes for no. of rank, W denotes for no. of individual responses.

Weighted mean was formulated and tabulated as below:

S. No.	Suggestions	Rank × No. of Responses (W × X)					∑WX	Weighted Mean	Rank
1	Establishment and implementation of effective rewards and punishment system	21	28	27	20	50	146	2.47	2
2	Controlling the negligence of taxpayers	23	26	24	36	30	139	2.36	1
3	Providing more salary and incentives	4	18	36	44	115	217	3.68	5
4	Conducting seminars, training and conference	8	22	57	48	45	180	3.05	3
4	Timely information and check by government	6	18	33	36	120	213	3.61	4

The most important factors for effectiveness of tax administrators in Nepal according to preference by respondents are as follows:

- Controlling the negligence of taxpayers.
- Establishment and implementation of effective rewards and punishment system.
- Conducting seminars, training and conference.
- Timely information and check by government.
- Providing more salary and incentives.

Another open question was asked to get suggestions for improving income tax assessment procedure. The question was, “Do you have any other suggestions for improving income tax assessment procedure under Income Tax Act, 2058. If yes, please specify ……………” Some respondents have given some suggestions, which are listed as below:

- Tax officers should be well trained.
- Clarity and wide interpretation are required on disputed expenses head.
- Effective implementation of tax rules and laws.
- Format should be simplified, and monitoring and supervision are needed.
- Procedure should be made more simple and short.

It can be concluded that clear act, rules and regulation and simple procedure is most important factor for the improvement of tax assessment procedure in Nepal.

4.2.2.10 Attitude towards Heavy Penalty for False Statement

Submission of false income statement is an offence. It is blamed that taxpayers do not keep record and statements in proper and correct way. To know the respondent’s opinion to impose penalty to those taxpayers who submit false statement for self-tax assessment purpose, a question “Do you suggest heavy penalty on those taxpayers who submit false statement of self-tax assessment?” was asked. The respondent’s responses are presented as below.

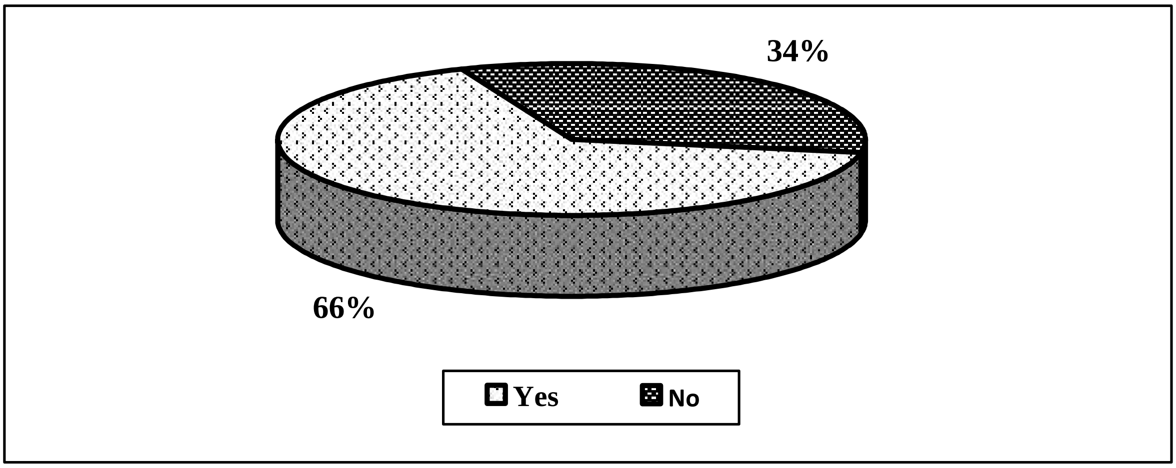
Table 4.25: Attitude towards Heavy Penalty for False Statement

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Income Tax Administrators	22	88	3	12	25	100
Income Taxpayers	20	40	30	60	50	100

Income Tax Experts	24	96	1	4	25	100
Total	66	66	34	34	100	100

Source: Opinion Survey, 2010

Figure 4.15: Attitude towards Heavy Penalty for False Statement



From the above table 4.25 and diagram 4.15, it is observed that 88 percent tax administrators, 40 percent taxpayers and 96 percent tax experts are in favor of imposing heavy penalty on those taxpayers who submit false statement of self-tax assessment. In total sample of 100, 66 percent respondents were in favor of heavy penalty on those taxpayers who submit false statement of self-tax assessment. Only 34 percent respondents were not in the favor. It can be concluded that heavy penalty should be charged on those taxpayers who submit false statement.

4.2.2.11 Attitude towards the Time Limit for the File Return

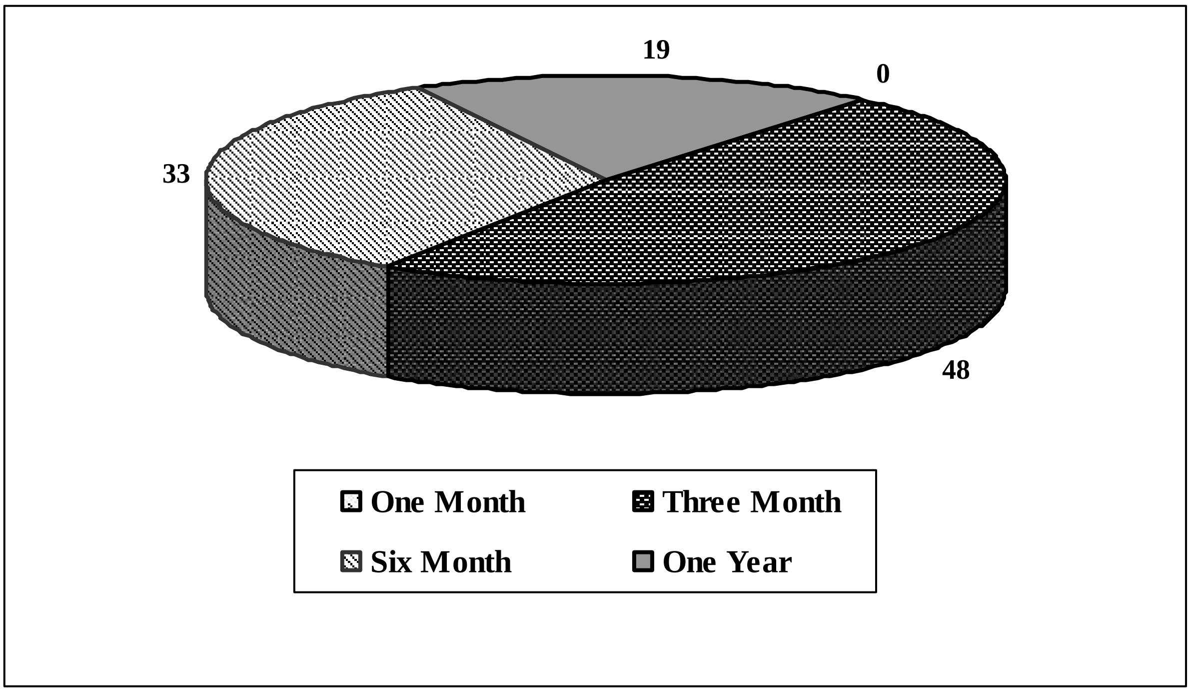
According to Income Tax Act, 2058, every taxpayer should file at the place prescribed by the department a return of income not later than 3 months after the end of each income year. To know the respondent's opinion about the time limit to be given for the file return after passing the income year, a question, "In your opinion what should be the time limit be given for the assessment of tax after passing the income year?" was asked. The respondents will be clear from Table 4.26 and also the diagram following it.

Table 4.26: Time Limit for the File Return

Time Duration	Respondent				
	Tax Administrator	Tax Payer	Tax Expert	Total	%
One Month	-	-	-	-	-
Three Months	15	15	18	48	48
Six Months	8	20	5	33	33
One Year	2	15	2	19	19
Total	25	50	25	100	100

Source: Opinion Survey, 2010

Figure 4.16: Time Limit for the File Return



From the Table 4.26 and the diagram 4.16, 48 percent respondents approved that 3 month time limit be given for file return after passing the income year. 33 percent respondent approved that 6 month time limit and 19 percent respondents approved that one year time limit should be given for the file return after passing the income year. It can be concluded that 3 months for file return is appropriate for file return.

CHAPTER FIVE

5. MAJOR FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Major findings

The major findings of this study are summarized as below:

Income tax has been considered as a suitable mean of raising government revenue and mobilizing internal resources. It may enhance the revenue of government to meet the development expenditure of the government. To develop the economic condition of Nepalese people, promote distributive justice, minimize regional disparity and to cure resource gap problem; income tax is a crucial factor. To meet the government expenditure, achieve the goal of national development, not only that to decrease poverty and illiteracy, there is equally important role of income tax.

Government revenue is the composition of external revenue and internal revenue. There is dominant share of tax revenue in Nepalese government revenue, the contribution of tax revenue shows the undersized increasing trend as it had contributed 77.29 percent in fiscal year 1999/00 on the total and was increased to 81.58 percent in 2008/09.

There is serious growing financial gap which creates problem in Nepal. It seems to be never ending problem in Nepalese economy. The resource deficit in fiscal year 2008/09 was Rs. 50804.60 million, and it extended from Rs. 17667.00 million in fiscal year 1999/00. The main cause of resource deficit is lack of mobilization of other domestic resources. Government expenditure is increasing at a faster rate than the increase in revenue, raising inflation rate, increase in the burden of debt serving defective government expenditure program and other political ill performance, less commitment, and weak management function.

Nepalese tax revenue is the composition of direct and indirect tax. There is dominant role of indirect tax revenue in Nepal. The contribution of direct tax and indirect tax on total tax revenue were 73.00 percent and 27.00 percent respectively in 1999/00 which became 70.68 percent and 29.32 percent in 2008/09. The trend shows that the share of direct tax is increasing but still the indirect tax has dominant role.

Income tax is an effective tool to reduce the gap between rich and poor. Widespread evasion of tax, small number of taxpayers, defective government expenditure programs, poor tax paying capacity and lack of tax consciousness are the main causes of ineffectiveness of income tax in reducing the gap between rich and poor.

Nepalese income tax revenue is the composition of business tax (from public enterprises, semi-public enterprises, and private corporate bodies' individuals), remuneration and tax on interest. Income tax was Rs. 25142.40 million in 2008/09. Individual income tax is the largest revenue generating sector of income tax. In first three fiscal years it slowly decreases and reached to Rs. 3200.50 million in the 2000/2001. In the fiscal year 2001/2002 contribution of individual income tax revenue is the highest, i.e. 49.63 percent. Again it decreases. It shows that the contribution of Individual income tax is flexible. In the fiscal year 2008/09 the individual income tax is Rs. 9877.50 million, which is the 39.29 percent of total income tax.

Income tax exemption limit in Nepal has been changed on the basis of time and income condition. The current exemption limit is Rs. 1, 60,000.00 for single individuals and the current exemption limit is Rs. 2, 00,000.00 for couple. The exemption limit is not provided to partnership firms, corporations and non-residents.

The collection and estimates of tax has analyzed in the chapter four. Tax was collected in excess than the target only in the fiscal year 1999/00, 2003/04 and 2006/07. In the fiscal year 2006/07 the tax collection rate was 122.9 percent, which is the highest rate. But in the fiscal year 2008/09 the tax collection rate increased to 107.37 percent. In that fiscal year tax was collected by Rs.1872.10 million more than estimates. It shows that collection performance is increased, so that income tax in Nepal is going on satisfactory.

An opinion survey has been conducted in order to find out the role of income tax assessment system and provision and some other aspects of income tax. Tax experts, tax administrators, and taxpayers have given their opinions.

Following can be summarized from the opinion survey:

- Income tax system of Nepal has been blamed as not efficient enough.
- Income tax is a suitable means of raising government revenue.
- Tax revenue collection of the government is not satisfactory. Mass poverty and low income level, increasing habit of tax evasion, defective income tax administration and inappropriate rate and exemption limit are the major reasons for the low contribution of income tax to national revenue.
- The provision of fee, fine and penalties under income tax act of Nepal are considered as reasonable.
- Self-tax assessment is suitable method while assessing the income tax in Nepal. Lack of proper accounting system, lack of knowledge about self-tax assessment procedure and lack of correct auditing system are the weakness of self-tax assessment system. So, it doesn't seem possible to apply it in full extent. According to Income Tax Act 2058, all the returns filed are treated as self-assessment. The system of self- assessment may also reduce the workload of the tax personnel and help taxpayers to understand their duties.
- The provisions given for self-tax assessment in new tax act are complex. The provision of income tax act and rules with regards to self-assessment should be made simple that encourages the taxpayers for self-tax assessment by providing incentives.
- Taxpaying habit and taxpayers' compliance in Nepalese people is poor basically due to lack of simplification of tax rules, lengthy process of tax assessment, lack of incentives to regular taxpayers and due to lack of heavy fine and penalties to defective taxpayers. Some of the respondents advised that sound government economic policy, effective tax management, training and seminar to the tax personnel and development of check and balance systems can lead income tax towards its efficiency.
- Public awareness program is necessary to increase tax consciousness and raise the government revenue.
- The income tax assessment procedure also seems ineffective. Lack of adequate information about income assessment, trend of evading tax by the taxpayers, lack of proper recording system in tax administration and non-maintenance of books of account by the taxpayers are considered

as the major problems in income tax assessment procedure.

5.2 Conclusion

Nepal is one of the least developed countries among of the world. Nepal is facing serious financial problem in its economic development process. Nepal could not successfully and properly tear a curtain built from massive poverty, hunger, diseases, unemployment, heavy dependence on agriculture, lack of adequate industries, low income level and social political and geographical constraint over 53 years of planned development. Nepalese economy is suffering from ineffective and effortless plan, program and policy of development. The foremost concentration of every nation of the world is rapid economic growth which indicates prosperity. A lot of funds are required to meet the additional financial requirement for the development activities of the country. Government revenues are collected through foreign loans, grants and internal sources i.e. excise duty, value added tax, penalty tax, interest tax, direct and indirect tax internal resources are preferable for sustainable economic development.

Income tax assessment plays a vital role in the collection of income tax. Proper, fair and reasonable system and method of income tax assessment do not help only to increase the revenue but certainly help to minimize the economic gap between different levels of people in the society. The new Income Tax Act 2058 has given the format for method of taxing system and focuses on self-tax assessment.

Presently income tax revenue is collected in accordance to the Income Tax Act 2058. Due to various problems related to income tax, revenue collection from income tax is low in Nepal from different sectors. It is blamed that Nepalese income tax law is inappropriate and the administration is not efficient; but if we analyze the data relating to, then we can find out that it is not so bad. However, income tax laws and administration in Nepal are to be deeply scrutinized and properly implemented. Some provisions should be mentioned clearly.

According to the study, income tax is a suitable mean of raising government revenue as well as the tax education is necessary in Nepal which 80% respondents have supported. It is found that inefficient tax administration, tax evasion and inappropriate objectives of income tax were the main causes of improper collection of income tax in Nepal. Self- assessment methods of assessing income tax is more appropriate in Nepal. 73% of respondents were in the support of Self-assessment system. Some of respondents advised sound economic policy, effective tax management, training and seminar to the tax personnel and development of check and balance system can lead income tax towards its efficiency.

Resource gap in Nepal has been increasing every year. The internal revenue is sometimes insufficient even to meet regular expenditure, and most to the development activities depends on foreign aid where Nepal has been compelled to harmonize the door. The major problems of domestic resource mobilization are poor utilization of the nature resources, small and stagnant industrial sector, poor economic growth and inadequate tax effort etc. So, in this context, revenue generation from internal source is very important in which income tax is one of the major sources.

5.3 Recommendations

On the basis of the findings mentioned above the major areas of recommendations are as follows:

1. Efficiency of Nepalese income tax system mainly depends on income tax and policies. Income tax laws and policy should be made such that main objectives of imposing income tax can be achieved.
2. Income tax policy should be formulated according to the economic policy of the country. Income tax policy should be revised timely.
3. The exemption limit must be adjusted according to inflationary situation of the country on the year basis.
4. To solve the problems existing in Nepalese income tax system, following recommendations are made:
    - Income tax act, rules and regulation should be clear and simple for all taxpayers, tax officers and tax inspectors.
    - Training and sufficient incentive should be given to the employee, and there should be provision of better incentives for regular taxpayers and heavy penalties and fine to those who evade tax.

- õ The assessment and collection provision should be made clear and simple.
- õ There should be compulsory provision of auditing.

5. The Government of Nepal must launch more effective programs to collect more revenue from income tax.
6. Tax assessment system should be scientific. The tax is largely assessed under the assumption, and the income of many taxpayers is not associated on a regular basis. Tax officers make tax assessments on the presumptive income, and the result is that income tax system is less revenue productive, inefficient and has become less effective. Thus, it should be replaced by current year's basis, and self-assessment system should be developed gradually in place of the official assessment system.
7. The following recommendations are made to increase tax paying habit and increase taxpayers' compliance:
    - õ Simplification of tax law and rules.
    - õ Simplification of tax assessment procedure.
    - õ Tax education to taxpayers.
    - õ Incentive to regular taxpayers.
    - õ Better public relation by tax officers.
    - õ Heavy fine and penalties to defaulter.
8. The following recommendations are made to make satisfactory contribution of income tax from public enterprises sector:
    - õ Weakness of government economic policy should be avoided.
    - õ The internal conflict and political pressure should be solved for better performance of public enterprises sector.
9. The following recommendations are made for the improvement of income tax administration in case of income tax assessment:
    - õ Improving tax assessment procedure
    - õ Computerized information system is necessary to keep up-to -date record of income tax.
    - õ Controlling taxpayers' negligence while preparing

and submitting income statement.

- Proper tax education should be provided to tax officials as well as tax inspector, and taxpayers regularly.
- Proper co-ordination within the tax department.
- Avoidance of unnecessary outside pressure.

10. The efficient and competent tax administration is the basic requirement of self-assessment of tax. Therefore, income tax administration should be recruited with efficient honest, trained and qualified tax personnel.
11. There should be compulsory provision of submitting income statement within the due date. If someone fails to submit income statement without reasonable notification, he should be punished with 100% penalty. The tax officers, who fail to assess the tax within that period without appropriate reason, should be punished.
12. Public awareness program should be conducted to raise government revenue.
13. A Proper and effective audit system is necessary in order to make self-assessment system successful. The performance of audit is poor in Nepal, both quantitatively and qualitatively. The taxpayers consider that they are being harassed by tax audits whereas the government does not get much revenue as a result of audits. Audit has always been controversial in Nepal. Scientific systems of audit such as on the basis of computer generated intelligence may be relevant in Nepal.

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APPENDIX – A

Cover Letter

Dear Madam\Sir,

First of all, I would like to introduce myself as a student of Shanker Dev Campus, Tribhuwan University, Master's in Business Studies (MBS), Final year. I am going to prepare a dissertation entitled "Effectiveness of Self-Assessment of Income Tax in Nepal" to fulfill partial requirement of Master's Degree of Business Studies of Tribhuvan University.

I have sent a questionnaire to spare some of your valuable time to provide your suggestions and opinions concerning income tax system in Nepal, which will be very useful and guide me for completing my research work. I would be very much appreciated if you could provide your important time for filling this questionnaire.

I assure to keep every detail you provided to me confidential.

I am looking forward to your co-operation and support with many thanks as soon as possible.

Yours Sincerely

Binod Pandey
MBS Final Year

APPENDIX – B

Questionnaire

"Effectiveness of self-assessment of Tax in Nepal"

Name.. Designation..............................

Office organization.............................. Occupation...............................

Please Tick (□) the answer of your choice or where ever appropriate put in order of preference from one to last number of alternative. Number one is the most important and the last number for the least.

1. Do you consider that the income tax is suitable means of raising government revenue?

   Yes [ ] No [ ] I don't know [ ]

2. Do you think that public awareness programmer is necessary in Nepal for raising government revenue?

   Yes [ ] No [ ] I don't know [ ]

3. To generate more additional resource from income tax what factor do you approve to mobilize? (Please rank according to the priority)

   i) Widening tax base and tax coverage. [ ]
   ii) Granting investment allowance instead of tax incentive to new industries. [ ]
   iii) Increasing Tax paying habit of tax payers [ ]
   iv) Increment of administration efficiency. [ ]
   v) Discouraging corruption practice. [ ]

vi) Other if any (please specify).....................................

4. To assess income tax, which method do you prefer?

   I Self………… II Tax officer……… III Asst. committee…….. IV Other……….

5. Do you think that self Tax Assessment system is effective in Nepal?

   Yes [ ] No [ ] I don't Know [ ]

6. If No, what are the reasons? (Please rank according to priority 1 to 4.)

i) Lack of proper accounting system. [ ]
ii) Lack of knowledge about self-Tax assessment procedure. [ ]
iii) Lack of correct auditing system. [ ]
iv) Lack of believe upon government. [ ]
v) Other if any (please specify)...

7. In your opinion, is the Self-Tax Assessment a suitable means of rising Domestic resource?
   Yes [ ] No [ ] I don't know [ ]
8. If Yes, Why is it suitable measure of rising domestic resource?
   i) Encourage Tax Payer to motive about payments of Tax. [ ]
   ii) Helps to know their own liability of the tax payers. [ ]
   iii) Helps to maintain their books of accountant. [ ]

iv) Simple and short procedure of assessment. [ ]

v) Other if any (please specify)..

9. Do you think that provisions given for self tax assessment in the new Income Tax Act 2058 are sufficient?

Yes [ ] No [ ] I don't know [ ]

10. If No, how it can be improved?
i) Provisions of law regarding to self assessment should be made simple. [ ]
ii) Encourage the assesses for self assessment by providing incentives. [ ]
iii) Assessment of tax should be made in time. [ ]

iv) Other if any (please specify)...

11. Do you think that all tax payers follow the self assessment?

Yes [ ] No [ ] I don't know [ ]

12. Do you suggest heavy penalty on those tax payers who submit false statement of self tax assessment?

Yes [ ] No [ ] I don't know [ ]

13. Do you feel any problem in paying income tax?

Yes [ ] No [ ] I don't know [ ]

14. If yes, what are the major problems?
i) Complicated procedure due to complex tax laws. [ ]
ii) Administrative harassment. [ ]
iii) Lack of relevant tax information. [ ]

iv) Other if any (please specify)..............................

15. In your opinion what should be the time limit be given for the assessment of tax after passing the income year?
i) One months. [ ]
ii) Three months. [ ]
iii) Six months. [ ]
iv) One year. [ ]

v) Other if any (please specify)..

16. Do think that, Tax administration in Nepal is effective?

Yes [ ] No [ ] I don't know [ ]

17. If No, what are the reasons? (Please rank according to the priority)
i) Lack of knowledge about tax assessment procedure. [ ]
ii) Lack of meaningful taxpayers information. [ ]
iii) Lack of proper incentives to tax personnel. [ ]
iv) Lack of co-ordination with in department. [ ]

v) Unnecessary outside pressure. [ ]
vi) Other if any (please specify).....................................

18. How can it be improved? (Please rank according to the priority)
i) Providing more salary and incentives. [ ]
ii) Timely information and check by government. [ ]
iii) Conducting seminars training & conference. [ ]
iv) Establishment and implementation of effective rewards & punishment system. [ ]
v) Controlling the negligence of taxpayers. [ ]

v) Other if any (please specify)......................................

Thanks for your co-operation.

What Does *Weighted Average* Mean?
An average in which each quantity to be averaged is assigned a weight. These weightings determine the relative importance of each quantity on the average. Weightings are the equivalent of having that many like items with the same value involved in the average.

Investopedia explains *Weighted Average*
To demonstrate, let's take the value of letter tiles in the popular game Scrabble.

Value:	10	8	5	4	3	2	1	0
Occurrences:	2	2	1	10	8	7	68	2

To average these values, do a weighted average using the number of occurrences of each value as the weight. To calculate a weighted average:

1. Multiply each value by its weight. *(Ans: 20, 16, 5, 40, 24, 14, 68, and 0)*
2. Add up the products of value times weight to get the total value. *(Ans: Sum=187)*
3. Add the weight themselves to get the total weight. (*Ans: Sum=100*)
4. Divide the total value by the total weight. **(Ans: 187/100 = *1.87 = average value of a Scrabble tile)***

Definition

An average that takes into account the proportional relevance of each component, rather than treating each component equally.

Weighted Average differs from a regular average because calculation of the average is affected by volume. Some common applications are:

- Calculating product costs or revenue from assorted groups of products
- Determining the yield across a portfolio of mixed investments
- Infinite applications for scientific data

The use of weighted averages is common in many different applications, especially in the fields of accounting and various tasks that involve analysis and mathematical evaluations. Essentially a weighted average involves the assignment of different levels of importance or weights to various components that are used to arrive at a final answer or solution to a question or problem. This is in contrast to the practice of assigning a common mean value to each component that is relevant to the task at hand.

One of the easiest ways to understand the concept of a weighted average is to look at a common grading model used in many schools and colleges.

At the discretion of the instructor, different types of work performed by the student will be assigned a value that will help determine the final grade earned for the course. Successful completion of homework assignments may account for a smaller percentage of the total grade, while one or two major tests may carry additional weight in the final grade earned. This concept of proportional relevance means that in the greater scheme of things, the tests carry more importance in making a good grade for the course, although the successful completion of both components will ensure earning the highest grade.

This same principle of a weighted average can be applied in other venues as well. Marketing strategists may develop a campaign that is aimed at primary and secondary consumer markets. While the main thrust of the campaign is directly relevant to the primary market, the same techniques are anticipated to be relevant to lesser degree to other markets. The result is a projection of revenue earned primarily from one sector of the consumer market, but still accounting for smaller percentages of revenue from one or more smaller sectors.

A weighted average is somewhat subjective, in that the individual or entity who sets the values for each component involved in the average usually does so with some preconceived ideas about those values. However, it is possible to adjust the criteria used for calculating a weighted average as more facts emerge that could impact the relative value of each component.

Mean in which each item being averaged is multiplied by a number (weight) based on the item's relative importance. The result is summed and the total is divided by the sum of the weights. Weighted averages are used extensively in descriptive statistical analysis such as index numbers. Also called weighted mean.